NEW FEDERALISM: IMPACT ON STATE AND LOCAL GOVERNMENTS

Kathleen K. Anders and Curtis A. Shook*

ABSTRACT. This paper explores the changing nature of federalism in the United States. While the paper highlights different phases of federalism and its impact on sub-national governance, the focus is on “New Federalism” a reform initiative begun in the 1970s that emphasizes decentralization from the national to state and local governments. Today, federal programs and funding are transferred to the states; however, these program responsibilities are then devolved from state to local governments. This creates tension across governments in a good economy; however, it can be a formula for disaster in times of severe budget shortfalls. The argument is made that, though devolution is largely a positive development, collaboration among interdependent national and sub-national governments needs to be advanced.

INTRODUCTION

This paper explores the changing nature of federalism in the United States by tracing its evolution from its roots in the Constitutional Convention to its current stage. While the paper highlights different phases of federalism and its impact on sub-national governance, the focus is on “New Federalism” a reform initiative that describes federalism since the 1970s and emphasizes decentralization from the national to state and local governments.

New Federalism was introduced by President Richard Nixon as a reform of the “old” federal system represented in the Great Society.

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programs of the 1960s. His prescription for federalism reform was to decentralize national programs and restructure the roles and responsibilities of governments at all levels. Nixon sought to simplify intergovernmental relations by providing funds to general levels of government through block grants and general revenue sharing. Spending now would be funded by the federal government but controlled at lower levels.

In the 1980s, the Reagan administration viewed New Federalism as part of a broader strategy to reduce the role of government at all levels. Like Nixon, Reagan wanted to reverse the centralization of power in Washington and to bring government closer to the people. Yet, he also wanted to minimize government’s interference in people’s lives and roll back the modern welfare state.

In the 1990s, the size of the national government with its burgeoning deficit brought about renewed promises to streamline the federal bureaucracy and devolve power and decision making to state and local governments. Federal spending was to be cut and capped and New Federalism, as outlined by a Republican Congress in its *Contract with America*, would include concomitant reductions in federal spending and taxes. President Clinton agreed in principle to a balanced federal budget as well as devolution even though he disagreed in degree and tactics. His administration would emphasize “reinvention” as a means to improve government performance and intergovernmental relations.

Newly elected President George W. Bush felt that “the [budget] surplus is not the government’s money” but “the people’s money” and had as a first order of business for his administration legislation to cut taxes (Bush, 2000). Now facing a return of federal deficits, the President maintains that that tax cuts are again needed to strengthen the economy (Bush, 2003). Although winning passage of only $330 billion in tax reductions, or half of the amount requested, such tax relief, coupled with the shift in balance toward self-funded state and local spending, may exacerbate spending pressures and budget gaps facing state and local governments.

Currently, federalism is advancing toward decentralization, characterized as a “second order devolution.” Under second order
devolution, federal programs and funding are transferred to the states; however, these program responsibilities are then devolved from state to local governments. Further complicating this new federal design is decreasing public confidence in government coupled with a decade long economic expansion that has prompted not only the federal government but also state governments to cut taxes and increase unfunded mandates. This creates tension across governments in a good economy; however, it can be a formula for disaster in times of deficits and severe budget shortfalls. The argument is made that, though devolution from national to sub-national governments is largely a positive development, collaboration should now guide intergovernmental relations in the United States.

ORIGINS OF THE FEDERAL DESIGN

One of the foremost obstacles to the framers of the United States Constitution was the proper division of power between the new central government and the existing states (Farrand, 1912). While anti-federalists feared that a strong central government would threaten the states new found liberty, federalists believed only a powerful central government could provide the new nation with the economic, political and military might it would need to maintain its independence. They did however agree on some basic principles: that government power is a potential threat to individual freedom and therefore must be limited and that power divided is power restrained. Their solution produced American federalism, an innovative sharing of authority between the central government and the states. This sharing of power would prove to be a dynamic concept that has served governance well by protecting “the existence and authority of both national and sub-national political systems” (Elazar, 1966, p. 2).

Unlike nations such as Britain with a unitary form of government, where states are subordinate to the national government, American federalism would operated with a division of power between independent governments. That is, the states retained the right to function as separate constitutional (not merely administrative) entities. At the time of the founding, federalism was not a formal theory of government structure. The concept of federalism, the way it is understood today, was not in use until much later (Farrand, 1912, p. 69). Nevertheless, the framers agreed that they would establish a system of two sovereigns—the state and the
nation—and that the competition between the two would be an effective limitation on the power of both.

The framers of the Constitution did not precisely specify how this would work. Article I, Section 8 of the Constitution enumerates the powers allotted to the federal government, such as making treaties and printing money, and states that it may enact any laws that are “necessary and proper” to exercise these powers. The Tenth Amendment of the Bill of Rights further stipulates that all powers not expressly granted to the national government are reserved by the states. In effect, the division between these spheres of power was not clearly defined. The consequence has been a political system where the balance of power has shifted over time between national and state governments. A benefit is that American federalism has been a flexible concept that has been able to “respond to changing needs and circumstances” (Leach, 1970, p. 9). However, it has also been at the center of some of the most intense conflicts in American history. From the Civil War, to civil rights in the 1950s and 1960s, to the counting of ballots in the 2000 presidential election, this division of power has pitted national interests against states’ rights resulting in a federal balance under dispute to this day.

FEDERALISM AND ITS PHASES

The supremacy of states’ rights is the major focus of dual federalism. Dual federalism views states as powerful components of the federal system. From this perspective, the separate levels of government have distinct, autonomous spheres of authority. Each level had “its own particular responsibilities which were generally its exclusive province” (Elazar, 1962, p. 14). According to scholars, this is a fairly accurate portrayal of the government system in the early years of the country (Elazar, 1962; Peterson, 1995; Scheiber, 1989; Wright, 1988).

The Civil War and Reconstruction saw a shift of authority away from the states and toward the national government. Prosecuting the war had accelerated the growth of Washington’s power and preserving the union by force of arms made even more concrete the notion of an American nation (Donahue, 1997, p. 24). Moreover, the passage of the Fourteenth Amendment to the Constitution in 1868 mandated due process and equality before the law to citizens in all states with the federal government declared the enforcer of these rights. Adoption of additional amendments to the Constitution, such as the national income tax, brought
about further changes to the state-national balance as well as the development of a new, interdependent model based upon a system of shared activities and overlapping governments. This interpretation of federalism views the states and the national government as intertwined rather than as acting in separate spheres and is often referred to as cooperative federalism. However, in practice, the relationship may be either cooperative or competitive (Donahue, 1997, chap. 2; Wright, 1988). Such a relationship has been described as a “marble cake,” the decision-making and functions of state and national government swirled and intermixed, in contrast to the dual system’s “layer cake” with separated powers exercised by different levels of government (Grodzins, 1966).

In Table 1, Wright presents these federalism metaphors along with a chronology of seven phases in intergovernmental relations (IGR) from the 1800s through the 1980s (Wright, 1988). These descriptions do not encompass all aspects of intergovernment interaction during the time periods. Dates are approximate and patterns overlap; yet, the main problems and phase descriptors reflect the political, legal, and economic events of the time and provide one way “of cutting the IGR ‘pie’ (or cake) to gain insights into how the system is organized and operates” (Wright, 1988, p. 110).

One of the most important national-state interactions in the first century revolved around slavery and the national government as the protector of civil liberty. Although the central government’s role increased after the Civil War, particularly as a result of regulatory expansion of the Progressive Era, it was not until the Great Depression that the central authority of the national government dramatically grew. President Franklin Roosevelt’s New Deal legislation included federal job programs for the unemployed, Aid to Families with Dependent children (AFDC) and Social Security. These social welfare programs followed by the massive national mobilization of the Second World War marked the ascendance and expansion of the fiscal, personnel and administrative apparatus of the national government.

This expansion as well as the national commitment to solving social problems continued under President Lyndon Johnson and his declared “war on poverty.” Johnson promoted programs such as food stamps, Medicaid and Medicare to help the poor and older Americans. Because existing government approaches to poverty and social welfare were
thought unsuccessful, new ideas and partnerships were considered necessary to attack society’s problems. This phase is described as “creative federalism,” a period when the number of new federal grant programs grew from 132 to 379 between 1960 and 1968 and federal aid dollars more than tripled from $7 Billion in 1960 to $24 billion in 1970 (Conlan, 1998, p. 6).

### TABLE 1
Phases of Intergovernmental Relations (IGR)

<table>
<thead>
<tr>
<th>Phase</th>
<th>Main Problems</th>
<th>Participants Perceptions</th>
<th>IGR Mechanisms</th>
<th>Federalism Metaphor</th>
<th>Approximate Climax Period</th>
</tr>
</thead>
<tbody>
<tr>
<td>Conflict</td>
<td>Defining boundaries Proper spheres</td>
<td>Antagonistic Adversary Exclusivity</td>
<td>Statutes Courts Regulations</td>
<td>Layer-cake Federalism</td>
<td>1800s–1930s</td>
</tr>
<tr>
<td>Cooperative</td>
<td>Economic distress International threat</td>
<td>Collaboration Complementary Mutuality Supportive</td>
<td>Formula grants Tax credits</td>
<td>Marble-cake Federalism</td>
<td>1930s–1950s</td>
</tr>
<tr>
<td>Concentrated</td>
<td>Service needs Physical development</td>
<td>Professionalism Objectivity Neutrality Functionalism</td>
<td>Categorical grants Service standards</td>
<td>Water taps</td>
<td>1940s–1960s</td>
</tr>
<tr>
<td>Creative</td>
<td>Urban-metropolitan Disadvantaged clients</td>
<td>National goals Great Society</td>
<td>Program planning Project grants Participation</td>
<td>Flowering (proliferated &amp; fused)</td>
<td>1950s–1960s</td>
</tr>
<tr>
<td>Competitive</td>
<td>Coordination Program effectiveness Delivery systems Citizen access</td>
<td>Disagreement Tension Rivalry</td>
<td>Grant consolidation Revenue sharing Reorganization</td>
<td>Picket fence (fragmented)</td>
<td>1960s–1970s</td>
</tr>
</tbody>
</table>
TABLE 1 (Continued)

<table>
<thead>
<tr>
<th>Contractive Borrowing &amp; budget balancing Federal aid cuts &amp; changes Juridical decision-making Managing mandates</th>
<th>Aggressive-ness Contentious-ness Defensive-ness Litigiousness</th>
<th>Congressional statutes Court decisions Information sources Negotiated dispute settlement</th>
<th>De facto Telescope Whiplash</th>
<th>1980s–1990s</th>
</tr>
</thead>
</table>


Creative federalism placed an emphasis on the role of local government. It also marked a major expansion of national involvement in social programs and as civil rights protection. Categorical and project grants often contained crosscutting provisions aimed at correcting both racial and economic injustice. These grant programs further established intergovernmental links at all levels often bypassing the states, in effect, treating cities and states similarly despite the special constitutional status that set states apart. Part of the reason was the refusal of states to comply with federal orders. In addition, the federal government became involved in a number of areas that had traditionally been the jurisdiction of local communities.

During these years, national policies extended to primary and secondary education, law enforcement, community development and urban and rural anti-poverty programs. As Conlan (1998) observes this expanded federal role produced many positive outcomes: “It forced many backward state and local governments to modernize, and it increased fiscal reliance on the relatively more progressive federal income tax. It reduced levels of poverty and infant mortality and brought increased public services to many who had never known them” (p. 6). However, it also brought implementation problems to federal assistance programs as well as disputes about the proper size and role of the national government.
NEW FEDERALISM

Beginning with the Nixon administration there have been efforts to reduce national control over social welfare programs and shift programmatic responsibility to sub-national governments. The national government was thought to have grown too large and too intrusive, especially through the proliferation of grants for narrowly defined purposes. In response to Creative Federalism, President Nixon introduced New Federalism, an attempt to decentralize national programs to field regions, streamline services, and redirect funds to general levels of government through block grants and general revenue sharing (Walker, 1995, p. 35).

Fragmented spheres of authority, described by Wright and others as picket fence federalism frustrated Nixon (Conlan, 1998 p. 7; Wright, 1988, pp. 83-90). Nixon’s New Federalism sought to move away from this programmatic framework and restructure the roles and responsibilities of governments at all levels. His reforms were a response to the administrative dysfunctions stemming from Great Society programs and were aimed at moving from categorical grants to flexible block grants and revenue sharing. Spending would now be funded by the federal government but controlled at lower levels. This would challenge the iron triangle of power between the federal bureaucracy, Congress, and its staff and attempt to reverse the flow of power away from Washington. It would also reward and promote governmental activism and problem solving at state and local government levels. As Conlan (1988) writes, “this was a decentralization approach, but it was not intended to be antigovernment per se” (p. 6). Nixon sought to simplify intergovernmental relations and to produce a more rational approach than the one he inherited.

In contrast, Reagan viewed New Federalism as part of a broader strategy to roll back the modern welfare state and reduce the role of government at all levels. Block grants and revenue sharing enacted under Nixon, Carter, and Reagan gave state grantees greater discretion in implementing programs; however, it also set the stage for a withdrawal of federal fiscal support. As Donahue (1997, p. 29) observes:

Reagan sought to renounce the federal government’s responsibilities over large areas of policy. It was profound, indeed radical, in its theme of undoing several states of national consolidation. The Reagan plan aimed to redress the shift toward
coordinated social policy that had occurred under Johnson’s Great Society, and sought as well to reverse much of the New Deal’s centralization of power.

The Reagan Revolution of the 1980s was based on a desire to cut domestic spending and devolve, deregulate, and minimize government’s interference in the market place. Philosophically, Reagan wanted to bring government closer to people and provide for maximum citizen participation. His aim was to balance the budget by scaling back federal programs such as Social Security and Medicare. Yet, he also proposed tax cuts and increases in defense spending. A Democratic-controlled Congress went along with some of the tax reductions but it would not cut these entitlement programs. The *Omnibus Budget Reconciliation Act of 1981* (OBRA) established nine new block grants, and consolidated or terminated 139 categorical programs that strengthened the role of the states (Conlan, 1988, pp.158-159). However, the budget deficit ballooned and, as the deficit became a front burner issue, Congress reduced federal grant-in-aid funding during the early 1980s and began to increasingly use regulatory mandates to achieve national policy objectives. Shannon (1983, 1990) documented the reduction in funding and labeled the actions *de facto new federalism*, which he believed would bring about a “fend-for-yourself” environment where state and local governments would be expected to take on more government responsibilities.

**Devolution**

In the 1990s, the size of the federal government with its burgeoning deficit brought about promises from both the newly elected Republican Congress and Democratic President to streamline the federal bureaucracy and “devolve” power from Washington, D.C. to the states.

From the left, reinventors argued that government should be more customer centered. From the right, public choice proponents maintained that government needed to be more market driven. Both sides seemed in agreement with President Clinton’s declaration in his 1996 State of the Union speech that “the era of big government was over.” Contributing to this sentiment, was a continuing decline in citizen trust in the federal government and a belief that state and local based government could be more efficient and innovative than the federal bureaucracy (Pew Research Center, 1998).
In August of 1996, Congress passed, and Clinton signed, a historic welfare reform bill, the *Personal Responsibility and Work Opportunity Act*, a law that ended sixty-one years of direct cash assistance to poor families with children and gave states new authority to run their own welfare programs with block grants from the federal government. Yet, even before approving this legislation Clinton had granted waivers from federal regulation to forty states. Indeed, much of the Clinton’s administration devolution efforts are in “reinventing” health, welfare and social programs.

Vice President Gore’s National Performance Review (NPR) proposals called for the federal government to lessen top down control and red tape by granting state and local governments increased discretion in program administration. Accountability would shift from compliance with rules and procedures to accountability for results. Increased discretion is expected to enhance flexibility, responsiveness to citizens and improve performance (National Performance Review, 1993). NPR staff recommended strengthening the intergovernmental partnership by consolidating programs, giving relief from mandates, and more flexibility in block grants. This was partially accomplished through executive orders. However, David Walker characterizes the Clinton record on devolution as "unexceptional" (Walker, 1995, p. 170). In fact, he finds the Clinton record shows more categorical grants, new mandates, and an expansion of the federal government’s role in education, health care and law enforcement. This is indicative of more, not less, centralization, a point that causes some scholars to question whether the much touted shift in authority from the national government to the states is actually taking place (Conlan, 1998, pp. 224-225; Dilger, 2000, p. 103).

Nonetheless, as Donahue (1997) notes “the wisdom of shifting the public sector’s center of gravity away from Washington and toward the separate states enjoys something as close to consensus as American politics often sees” (pp. 3-4). Some of the arguments repeat the central values advanced at the formation of the federal design. Among the most fundamental is that of preserving diversity. States retain the power to develop laws and policies reflecting the unique mix of interests and desires of their own citizenry. Proponents of devolution argue that states and local governments are better able to adjust both the levels and types of government services they provide to deliver services that local citizens want. With diversity comes alternative approaches toward public
problems and the potential for lower levels of government to provide more innovative solutions.

As decision-making on public programs comes closer to the citizens served, it is also considered to be more efficient. Federalism was “founded in part, on a pragmatic recognition of the need for effective administrative decentralization of some kind” (Scheiber, 1989, p. 24). When government expands its scope and responsibilities, complexity rises, coordination is more difficult and the opportunities for bureaucratic waste and abuse are thought greater. Belief that public administration will erode, not improve, as government grows in scale has been a consistent argument in favor of decentralization over the course of American history (p. 24). Yet, beyond administrative efficiency, is the idea that opposite and rival interests of state and local governments can bring economies in service provision as jurisdictions compete to keep the cost of government service affordable (Dye, 1990).

Finally, because devolution reduces government size and brings it closer to the people, it makes citizen participation easier. Citizens are less frustrated when they have access to the policy making process. Policy issues may seem more understandable and the process more transparent. Moreover, there is greater accountability at the ballot box making states and local government more directly answerable to the citizens. In turn, citizens’ emotional bonds are stronger at state and local government levels bringing about a stronger commitment on the part of citizens to make their government work (Donahue, 1997, pp. 45-49; Williamson, 1990, pp. 11-12).

Still, devolution is not without problems and most of them financial. First, states and local governments may lack the fiscal and/or administrative capacity to deal effectively with social welfare problems of their citizens (Dilger, 2000, p. 102). Moreover, critics wonder how well state governments will be able to provide welfare during recessions, when state revenues decrease while unemployment and the demand for financial assistance increase. Another concern is that devolution will turn out to be just another name for passing costs on to other levels of government. Under the New Deal and War on Poverty programs, various types of grants-in-aid were created to improve individuals’ welfare, the distribution of federal-state-local fiscal burdens, and reduce economic inequalities across the states (Heller, 1966). These grants were subsidies
financed by federal budget expansion. However, now there is pressure to balance the budget and control entitlement spending.

This concern was apparent in the lobbying efforts of state and local government advocacy groups to win passage of the Unfunded Mandates Reform Act of 1995 (UMRA). Believing that Congress would shift the cost of entitlements or new programs and policies to the states in order to balance the budget, state governors developed an anti-mandates coalition (Gullo & Kelly, 1998). While grants-in-aid objectives may be enforced by the threat of withholding funds, mandates are directly enforceable. According to this law, an intergovernmental mandate is “any provision in legislation, statute, or regulation that would impose an enforceable duty upon state, local or tribal governments, except a condition of federal assistance or a duty arising from participation in a voluntary federal program [emphasis added]” (Gullo & Kelly, p. 380). The act allows a point of order to be raised on federal legislation that can be expected to impose an unfunded cost exceeding $50 million on these governments. However, given its limited definition, several studies conclude that UMRA has had relatively little impact (Gullo & Kelly, 1998; O’Leary & Weiland, 1996; Posner, 1997).

**Fiscal Federalism**

The sluggish national economy, compounded by the events of September 11, 2001, a declining stock market, and soaring health care costs combined to strain state budgets. Nearly every state is facing severe budget shortfalls in the current fiscal year, 2003. These deficits first appeared three years ago and have grown dramatically each year since. Cumulatively, states have had to close gaps approaching $200 billion through fiscal year 2004 that begins for most states July 1, 2003 (National Conference of State Legislatures [NCSL], 2003b). Complicating matters is an increasing trend on the part of the federal government to past costs on to the states (NCSL, 2003a). Unfunded mandates such as the No Child Left Behind Act and homeland security costs increase uncertainty in states’ budgets. Also, Medicaid is among the top worries for states as it is expected to grow more than 8 percent – two to three times faster than other categories of spending (Ecki, 2003).

Facing the worst budget shortfalls in half a century, state and local governments lobbied for and received $20 billion in aid as part of the $350 billion federal tax package. Ten billion dollars will go to the states
for Medicaid assistance and $10 billion in federal aid to state and local governments over the next two years (Weisman, 2003).

Looking back, Medicaid has been a major driver of total government spending. As shown in Table 2, the composition of federal government spending has shifted since the Great Society programs of the 1960s. One noticeable trend is the relative decrease in federal defense and international spending as the Cold War came to a close. Another is the parallel increase in federal transfer payments and interest on the national debt. Entitlement spending and debt used to finance these and other federal programs comprised over 40% of total government expenditures in 2002.

Another trend illustrated is the growing importance of state and local governments spending from their own sources. This has increased from approximately one quarter ($31.7 billion) of total government expenditures in 1960 to one-third ($1,041.6 billion) of the total government expenditures in 2002 (U. S. Office of Management & Budget, 2003, p. 296). In terms of percentage of the U.S. Gross Domestic Product (or GDP, which measures the size of the economy), state and local governments spending from own sources also grew more relative to the federal government’s. From 1960 to 2002, federal government spending changed from 17.9 to 19.4 percent of GDP, whereas state and local governments’ spending increase from 6.1 to 10.1 percent of GDP during the same period.

It should be noted that overall spending in the United States as a proportion of the total economy continues to be lower than that of other industrialized countries (U. S. Office of Management & Budget, 2000, p. 3). One reason proposed over the years is that Reagan’s approach to government spending “speaks for many Americans who, even though faced with rising demands and needs for public expenditure remain reluctant to open the public purse” (Leach, 1970, p. 199).

Linked to this philosophy is a belief that governments’ share of GDP should be limited and that the increase in general prosperity of the nation ought to flow back to the private sector that produced the wealth. This is reflected in the budget message of President George W. Bush who maintains: “We are strengthening our economy by allowing American families to keep more of their own money and encouraging businesses to save, spend, and grow” (Bush, 2003). Yet, events such as war, economic recession, terrorists attacks and the need for homeland security have
generated new administrative links and increased spending across all levels of government.

**TABLE 2**
Total Government Expenditures (Federal, State, and Local Government) by Major Category 1960–2002

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Total Government In Billions</th>
<th>Federal Payments for Individuals As Percentages of Total Government Expenditures*</th>
<th>State and Local From Own Sources (Except Net Interest) As Percentages of Gross Domestic Product</th>
</tr>
</thead>
<tbody>
<tr>
<td>1960</td>
<td>$124.7</td>
<td>41.0 6.2 9.1 10.3 8.0 25.4</td>
<td>24.0 9.8 1.5 2.2 2.5 1.9 6.1</td>
</tr>
<tr>
<td>1965</td>
<td>$165.5</td>
<td>33.8 5.9 10.3 9.7 12.4 27.9</td>
<td>24.1 8.1 1.4 2.5 2.3 3.0 6.8</td>
</tr>
<tr>
<td>1970</td>
<td>$278.3</td>
<td>30.9 5.5 13.1 10.2 10.9 29.4</td>
<td>27.5 8.5 1.5 3.6 2.8 3.0 8.1</td>
</tr>
<tr>
<td>1975</td>
<td>$475.4</td>
<td>19.7 5.0 16.3 16.0 13.0 30.0</td>
<td>30.5 6.0 1.5 5.0 4.9 4.0 9.1</td>
</tr>
<tr>
<td>1980</td>
<td>$820.3</td>
<td>17.9 5.8 18.4 15.5 13.8 28.5</td>
<td>30.0 5.4 1.8 5.5 4.7 4.1 8.6</td>
</tr>
<tr>
<td>1985</td>
<td>$1,304.9</td>
<td>20.6 9.3 19.6 13.2 9.2 28.0</td>
<td>31.5 6.5 2.9 6.2 4.1 2.9 8.8</td>
</tr>
<tr>
<td>1990</td>
<td>$1,789.5</td>
<td>17.5 9.9 19.8 13.0 9.5 30.3</td>
<td>31.2 5.5 3.1 6.2 4.0 3.0 9.5</td>
</tr>
<tr>
<td>1995</td>
<td>$2,229.3</td>
<td>12.9 10.5 22.9 16.5 5.3 31.9</td>
<td>30.4 3.9 3.2 7.0 5.0 1.6 9.7</td>
</tr>
<tr>
<td>2000</td>
<td>$2,718.9</td>
<td>11.5 8.1 22.8 15.9 7.3 34.3</td>
<td>28.0 3.2 2.3 6.4 4.5 2.1 9.6</td>
</tr>
<tr>
<td>2002</td>
<td>$3,050.7</td>
<td>12.2 5.5 23.1 17.7 7.4 34.1</td>
<td>29.5 3.6 1.6 6.8 5.2 2.2 10.1</td>
</tr>
</tbody>
</table>

Notes: *Percentage may not equal one hundred due to rounding.

Second-order Devolution

Even without constraints on the federal budget, grant-in-aid programs have imposed fiscal constraints on sub-national governments. For many years, these programs have moved beyond helping states and local governments carry on their own programs to offering support for new activities the federal government suggests be added. As Leach (1970) points out: “Here the states and local units are given unpleasant alternatives: either ignore the availability of the new funds and so appear blind to the needs they were designed to help alleviate … or accept them and be placed in an even tighter financial squeeze than before by having to find somewhere the matching funds conditional to the grant” (p. 203). The dilemma of participating in assistance programs that benefit local residents but displace other local uses of general fund revenues is only expected to increase with the current development of “second order devolution” (Nathan & Gais, 1998).

Under second order devolution, federal welfare programs and funding are transferred to the states; however, these program responsibilities then are devolved from state to local governments. While states have been granted greater flexibility in using federal dollars, with this discretion comes increased financial risk. State resources directed toward federal priorities will not be available for alternative state needs. Moreover, states and their welfare recipients also become “far more vulnerable to the effects of economic recession” (Conlan, 1998, p. 291). Similar to the federal government, states pass on fiscal constraints to local governments by means of unfunded or partially funded mandates. Moreover, in a political climate of “no new taxes” and “doing more with less” in government, state governments also act to restrict local governments fiscal discretion in raising revenues. In practical terms, local governments find themselves squeezed from both ends—both in restrictions on the sources of funds and expanded demands on spending.

Because local governments typically lack the revenue options available to the states, to fulfill mandates, they must use their own sources of revenue or find a way of passing the cost on to others. This is often done by imposing user fees and charges or even resorting to litigation. For instance, Yuma County in Arizona sued the City of Yuma to pay a pro rated share of Arizona Health Care Cost Containment System. These are health care expenses that Arizona counties must pay in order to provide services for the medically needy and indigent.
Another county, Maricopa, has threatened to sue the State of Arizona for their fair share of tobacco tax settlement funds to support these health care costs. The adversarial relationship between the state and local governments is recognized by local government managers who attest to the position that local governments “have the least enviable position of all in the federal system” (Leach, 1970, p. 205).

In discussions with city managers in the Phoenix metropolitan area, a common theme is that local governments are on the defensive against state government actions. Some of the problems they identify are the state: mandating new programs without or partially funding them; shifting more of the cost of health, welfare, and social programs to local governments; modifying shared revenue formulas and distributions, and restricting local revenue sources. To maintain the fiscal health of their cities under devolution, these managers believe they can no longer operate independently and compete with each other. Instead, local governments must collaborate. Furthermore, they believe local governments and the state must end their adversarial relationship and work together to meet the demands placed upon them by the New Federalism. According to these practitioners, state and local governments will have to pool all of their resources to meet the impending fiscal challenges. To this end, the state needs to consider the impact of statewide tax cuts on the local governments’ ability to deliver mandated services.

The recommendation for collaboration seems a good one. While the situation in Arizona cannot be generalized, the concerns raised merit attention. Statewide tax cuts since fiscal year 1993 have reduced the tax base in Arizona by approximately $1.1 billion (Stavneak, 2000). This resulted from the state legislature’s reducing corporate and personal income taxes rates as well as lowering property tax rates and assessment ratios.

Nationwide, states imposed net tax cuts over the past seven years of nearly $35 billion. This trend was reversed last year, 2002, when, facing huge deficits, states raised taxes by some $9 billion (Ecki, 2003). However, still plagued by anemic revenue performance, states are cutting back funds to local governments as a strategy to balance their budgets (CanagaRetna, 2003; National Association of State Budget Officers, 2002). Local governments have limited means to make up this loss of revenue. As the federal government continues to shift programmatic
responsibilities to sub-national governments, these governments will need to find ways to make the intergovernmental system more efficient. This ought to include reassessing policies between state and local governments and reshaping them to better respond to the greater responsibilities and fiscal burdens that they now share.

CONCLUSION

The Framers of the United States Constitution launched not only a nation but also an ongoing debate involving questions of the proper role of the national government in relation to that of the states, questions that Woodrow Wilson said each generation “faces anew, on terms reflecting the society and problems of its own day” (Wilson, 1921). American federalism has proven itself very resilient in responding to the problems of the times. It has worked well because it remains a dynamic arrangement for sharing power among governments.

New Federalism and its focus on decentralization has been a recent expression of how power should be divided. The benefits of devolving authority from the national to sub-national governments are many and reflect the arguments advanced by the Founders. Among these are: preserving diversity, increasing efficiency, enhancing innovation and bringing government closer to the people it serves. In addition to these values, public opinion is behind devolution. Americans have little confidence in the federal bureaucracy today and retain more trust in state and local officials. Citizens resent the cost of big government and want a reversal of its growth. Yet, the public also resists giving up government programs and benefits. An outcome is a pattern of government spending where entitlements and interest on the national debt dominate federal spending while state and local governments’ own-source spending comprises a larger share of expenditures.

An underlying purpose of the “old” federalism, represented by the Great Society programs, was to recognize and compensate for differences in the fiscal capabilities of state and local governments. Since this purpose has been to a certain degree abandoned, state and local governments increasingly operate on their own in a system of competition (Swartz & Peck, 1990, p. 13). Even in times of budget surpluses, conflict exists over intergovernmental mandates and how to pay for them. In the current situation of federal deficits and severe budget shortfalls across states and local governments, conflict and
competition intensifies. Federal and state elected officials want to offer tax relief to citizens while shifting more program responsibilities and costs down to lower levels of government. Local governments compete with each other for their share of intergovernmental dollars and find themselves squeezed by both expanded demands on their general fund and cuts to their sources of tax revenues. To both ensure their communities fiscal health and benefit from the advantages of devolution and local control, these sub-national governments must collaborate and move away from the present competitive system.

The future for American federalism holds a range of possibilities. It was a manufactured concept in 1787, conceived in a spirit of compromise, and developed with no precise guidelines to follow. The constant tension in our politics and shift in balance between national and sub-national governments was a product of a conscious strategy. Prolonged economic recession and terrorist threats may accelerate centralization of policymaking at the national level. Yet, as Agranoff (2001) observes: “Collaboration or at least a lack of federal control, exists by default, so to speak, because of the very real limits on the federal (and state) government’s ability to control sub-national officials’ actions”(p. 52). Fiscal constraints, devolution and increased federal reliance on state and local governments to implement domestic programs, including homeland security, suggest that collaboration among interdependent national and sub-national governments needs to be advanced.

Prescriptions for federalism have varied greatly and even after two centuries of debates, the concept requires continual reappraisal in light of changing conditions. As such, it must be understood in an evolving context with further changes expected in the years ahead that, ideally, will support a sharing of power that benefits all levels of government and their citizens.

NOTES

1. This discussion is based upon interviews with the following public managers: R. Bowers, City Manager of Scottsdale, Arizona, March 17, 2000; S. Cleveland, City Manager of Goodyear, Arizona, March 24, 2000; P. Sherman, City Manager of Show Low, Arizona, March 12, 2000, and M. Vanacour, City Manager of Glendale, Arizona, March 17, 2000.
REFERENCES


