RICHARD P. NATHAN
FRED C. DOOLITTLE

Reagan and the States

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RICHARD P. NATHAN,
FRED C. DOOLITTLE,
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Dedicated to the memory of
DAVID L. AIKEN
valued colleague and friend

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Preface

This is the final summary volume on a study begun shortly after Ronald Reagan was elected president of the United States and it became clear that he would seek to make substantial changes in domestic policies and programs of the national government. The study focuses on the effects of Reagan policies for federal grant-in-aid to state and local governments. This is an area in which the president made many of his deepest cuts and most basic changes in national policy.

The study is a collaborative effort, using a field network evaluation methodology involving an interdisciplinary group of academic social scientists (political scientists and economists). Field researchers in fourteen states studied the effects of Reagan's changes in grants on these state governments, plus forty local governments within the sample states. Two previous volumes and a number of shorter reports and articles have been issued on findings of this research. This volume focuses on the states, and particularly on the effects of Reagan's policies on state governments and on American federalism. A major effort has been made to place Reagan's actions in historical perspective.

The previous publications on this study combined the field data across the sample sites. By contrast, this volume presents individual case studies, along with overview chapters analyzing the observations made in the fourteen states.

The book consists of six overview chapters—five introductory and one concluding chapter—which we have written. In addition, there are nine case-study chapters, which have been selected, as explained in chapter 1, because they represent a cross section of responses to the Reagan changes. Four of the five case studies belonging to the complete research study have been published in other places.[1] The field research for the case studies was begun in the spring of 1981. The case studies were first submitted in June 1984; revisions of the nine case-study chapters included in this volume were completed as of January 1986.

The overall project is a team effort, and there are many people who deserve credit and thanks for their participation. First and foremost, we extend thanks to the field researchers who authored the fourteen case studies on which the volume is based. Our own staff at the Woodrow Wilson School of Public and International Affairs at Princeton University did yeoman service in checking, conforming, and managing the editorial process of this volume. We especially pay tribute to John Lago at the Princeton Urban and Regional Research Center of the Woodrow Wilson School. Others at the Center who aided in this work are Nan Nash, Loretta Haggard ('86), Andrea Nervi ('85), and Alison Tracy ('84). Anne Marie DeMeo provided word processing assistance. David L. Aiken provided editorial assistance on the introductory overview chapters. Mary Capouya provided editorial assistance on the case-study chapters; Catherine Claxton proofread the manuscript.

We would also like to thank Dean Donald E. Stokes, Ingrid W. Reed, Agnes M. Pearson, and Audrey J. Pitman for making Princeton's Woodrow Wilson School a happy home for our research.

Funding for this research was provided by the Ford Foundation and the Commonwealth Fund. Appreciation should be expressed to Susan V. Berresford, vice president, and David Arnold and Shepard Forman, program officers, at the Ford Foundation. At the Commonwealth Fund, we would like to thank Margaret E. Mahoney, president, Thomas W. Moloney, senior vice president, and Susan Aldridge, senior program officer.

Sanford G. Thatcher, Elizabeth Gretz, and Ann Hirst at the Princeton Uni-

[1] Lynn Rittenoure, Larkin Warner, and Steve B Steib, "Oklahoma's Legislative Process in a Period of Fiscal Change," *Public Budgeting and Finance* 4, no 2 (Summer 1984):42–57; William O Farber, *The Impact of Reagan Federalism on South Dakota and South Dakota State Government* (Vermillion, S.D.: Governmental Research Bureau, University of South Dakota, December 1984); Richard W Roper, John R. Lago, Nancy G. Beer, and Martin A. Bierbaum, *Federal Aid in New Jersey, 1981–84*, Council on New Jersey Affairs working paper no. 9 (Princeton, N.J.: Princeton Urban and Regional Research Center, March 1986), Susan A. MacManus, Robert M. Stein, and V. Howard Savage, "The Texas Response to Reagan's New Federalism," in Lewis Bender and James Stever, eds , *Managing the New Federalism* (Boulder, Colo.: Westview Press, 1986).

The case study on Missouri was written by George Dorian Wendel and Mary Collins Wendel. This case study focuses on health policy issues and has been used as a major component of this overall research on the effects of the changes made under the Reagan administration in the Medicaid program. This research is directed by Dr Gilbert S. Omenn, Dean of the School of Public Health and Community Medicine, University of Washington at Seattle. See *Restructuring of Medicaid* (Baltimore, Md · Johns Hopkins University Press, forthcoming).

versity Press were wonderfully supportive and helpful throughout the process of assembling and reviewing the material for this volume. Among our professional colleagues, a number of people deserve special thanks: Thomas J. Anton at Brown University and the anonymous readers who reviewed this manuscript. We also were aided by an advisory committee, whose members are listed on pages xi-xii.

Finally, this research could not have gone forward without the help of the literally thousands of people who provided assistance and information to us and to the field researchers on the character and effects of Reagan's policy shifts. We thank them all.

Richard P. Nathan
Fred C. Doolittle
Princeton, New Jersey
January 1987

Overview Chapters

RICHARD P. NATHAN AND FRED C. DOOLITTLE

✲

Introduction

Woodrow Wilson said in 1908 that "the question of the relation of the states to the federal government is the cardinal question of our constitutional system." It cannot be settled, said Wilson, "by one generation, because it is a question of growth, and every new successive stage of our political and economic development, gives it a new aspect, makes it a new question."[1] The focus of this book is on the way in which this central debate in federalism was reopened during the first term of the Reagan administration, a period in which basic changes were occurring in the mood of the country and the attitude of the public on the role of the government in domestic affairs.

The analysis presented in this volume is based on research begun in 1981 when it became evident that Ronald Reagan's new administration was likely to achieve significant cuts and changes in federal grants-in-aid. A network of field researchers was established to study a sample of state and local governments in order to assess the resulting changes in their policies, operations, and roles as the effects of the Reagan changes were felt. Two books and several other publications have been produced based on this research.[2] This book, which pre-

[1] Woodrow Wilson, *Constitutional Government in the United States* (New York: Columbia University Press, 1908, reprinted 1961), p. 173.

[2] The books are John W. Ellwood, ed., *Reductions in U.S. Domestic Spending. How They Affect State and Local Governments* (New Brunswick, N.J.. Transaction Books, 1982), and Richard P. Nathan, Fred C. Doolittle, and Associates, *The Consequences of Cuts: The Effects of the Reagan Domestic Program on State and Local Governments* (Princeton, N.J.: Princeton Urban and Regional Research Center, 1983) Articles include Richard P. Nathan, "State and Local Governments Under Federal Grants Toward a Predictive Theory," *Political Science Quarterly* 98, no. 1 (Spring 1983):47–57; Richard P. Nathan and Fred C. Doolittle, "The Untold Story of Reagan's 'New Federalism,' " *The Public Interest*, no. 77 (Fall 1984):96–105; and Richard P. Nathan and Fred C. Doolittle, "Federal Grants: Giving and Taking Away," *Political Science Quarterly* 100, no. 1 (Spring 1985):53–74.

sents the main findings of this research, is based on these earlier publications plus fourteen state-focused case studies summarizing the effects of cuts and changes made in federal grant-in-aid programs during the first term of the Reagan administration. The fourteen states in the sample are listed below:

Arizona	New Jersey
California	New York
Florida	Ohio
Illinois	Oklahoma
Massachusetts	South Dakota
Mississippi	Texas
Missouri	Washington

The sample was chosen to be representative in terms of size, location, and economic and social characteristics. This volume includes nine individual case-study chapters written by the researchers who conducted the field research and six chapters of general analysis drawing on the findings of the case studies.

In both the study and in this book, we have tried to do two things. First, we have looked at budget cuts and other changes in federal grant-in-aid programs and how state and local governments responded to them. Much of the business of the federal government in domestic affairs is transacted in the form of grants-in-aid. Reagan's policies in this area, in effect, have two aspects. His efforts to cut spending under federal grants-in-aid (an area in which budget cuts have been concentrated under Reagan) reflect the administration's *retrenchment* objective. Also under grants-in-aid, Reagan has proposed changes reflecting his federalism reform objective of *devolving* power and responsibility from the federal government to state governments.

Reagan's biggest successes in pursuing both types of changes under federal grant-in-aid programs—retrenchment and devolution—came in 1981. The cuts made in grants-in-aid in Reagan's first year in office were historic. This was the first time in over thirty years that there had been an actual-dollar decline in federal aid to state and local governments. The cuts produced a 7 percent reduction for fiscal year 1982 in overall federal grants-in-aid to state and local governments as shown in table 1.1. This amounted to a 12 percent decline in real terms. The same legislation which contained these cuts, the Omnibus Budget Reconciliation Act of 1981, also included major changes in the structure of federal aid programs to create block grants that assigned a greater role to state governments.

In addition to describing and analyzing the effects of Reagan's cuts and changes in federal grants, our second objective in this book is to assess how changes in the domestic policies of the national government made during Pres-

Table 1.1. Federal Grants as a Percentage of Total Federal Outlays

Federal fiscal year	*Federal grants in millions of dollars*	*Federal grants as a percentage of total outlays*
1981	94,762	14.0
1982	88,195	11.8

SOURCE: Table 12.1, "Summary Comparisons of Total Federal Grants-in-Aid (Including Shared Revenue) to State and Local Governments, 1940–1990," Executive Office of the President, U.S. Office of Management and Budget, *Historical Tables, Budget of the United States Government, Fiscal Year 1986* (Washington, D C.. Government Printing Office, 1985), p 12.1(2).

ident Reagan's first term have affected the roles and relationships of the three levels of government in our federal system: national, state, and local. Although this subject was largely neglected in 1981 in the debate about the merits of eliminating or trimming particular programs and cutting taxes, we believe the policies of the Reagan administration in the domestic public sector have contributed to a fundamental shift in the balance of power and responsibility in American federalism. This shift involves the enhancement of the role of state governments vis-à-vis both the national government and local governments.

The purposes of the overview chapters in this volume are to describe the Reagan program, its roots and significance; to summarize the responses made by the sample state governments to the Reagan changes; and to analyze the reasons for the differences in these responses both on a program-by-program and a state-by-state basis. We begin by examining the theory of federalism advanced by the Reagan administration and its relationship to other objectives which the administration has pursued in the field of domestic policy.

Reagan's Theory of Federalism

President Reagan's domestic policy initiatives during his first term reflect a theory of federalism grounded in the Tenth Amendment to the Constitution which reserves to the states or to the people all powers not delegated to the national government. One of Reagan's major goals throughout his public career has been devolution to the states, that is to curtail the role of the federal government in domestic affairs and enlarge the role and responsibilities of state governments.[3] As governor of California he argued strongly for such a shift. When he

[3] The term "decentralization" is often used interchangeably with "devolution." We prefer the former term because its meaning, to transfer authority, is broader, although both terms are used in this volume. The term "federal government" is used in a number of places in this volume in

was running for the Republican presidential nomination in 1976, he delivered a speech calling for a "systematic transfer of authority and resources to the states." This set of proposals, affecting $90 billion in federal programs, evoked widespread criticism because of the inability of Reagan and his advisers to spell out the details and explain its consequences. But the proposals did accurately reflect the candidate's basic position.

These views had not changed by 1980 when Reagan was elected president. In his inaugural address in 1981, he promised to curb federal powers and to "demand recognition of the distinction" between federal powers and "those reserved to the states." News accounts at the time said that Reagan's comments on federalism brought a cheer from the section where the governors were seated at the inaugural.[4]

Thirty days after his inauguration as president, Ronald Reagan told a group of governors at the White House that it "is a long-time dream of mine, this thing of balancing up the divisions of government."[5] A few months later, he told state legislators that the federal system is like a masonry wall, and that what is needed is "a proper mix" of the bricks (i.e., the states) and the mortar (i.e., the federal government). "Unfortunately," according to the president, "over the years, many people have come to believe that Washington is the whole wall—a wall that, incidentally, leans, sags, and bulges under its own weight."[6]

Reagan's "dream" (a term he has used often in this context) of bringing about a "proper mix" between federal and state roles needs to be viewed in relation to what we consider to be the preeminent goal of the Reagan administration in the domestic public sector—social program retrenchment. Not only did Reagan wish to increase the authority of the states, but he also had strong opinions about how they should exercise that authority: they should join the federal government in its effort to reduce the size of the public sector. Since his conversion to conservatism and Republicanism in the early 1960s, Reagan has strongly opposed the values or at least the methods associated with many domestic social and urban programs at every level of government. He has consistently criticized welfare and redistributive social service programs, which conservatives believe undermine the work ethic and encourage dependency. In addition, Reagan has

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the conventional way it is used in the United States to refer to the national government. We have sought to make clear where we use the terms "federal system" or "federalism" that we are referring to the larger political system including the national, state, and local governments

[4] *Congressional Quarterly*, January 24, 1981, p. 164.

[5] "National Governors' Association" (Remarks at a White House meeting, February 23, 1981), *Weekly Compilation of Presidential Documents* 17, no. 9 (March 2, 1981):177.

[6] "National Conference of State Legislatures" (Remarks at the annual convention in Atlanta, Georgia, July 30, 1981), *Weekly Compilation of Presidential Documents* 17, no. 31 (August 3, 1981):834.

viewed subsidy programs to distressed areas as distorting markets and market relationships. His speeches and policies reflect steady opposition to "social engineering" and generally to the values which conservatives identify with the domestic programs that grew rapidly both in size and number at every level of government in the United States in the 1960s and 1970s.

Many conservatives and liberals alike have assumed that devolution and retrenchment would go hand in hand. As program responsibility was devolved to the states, less would be done by the states because of competition among states to attract business and higher income residents with low taxes and the generally more conservative orientation of state governments. The assumption was that if social program retrenchment occurred at the federal level in combination with devolution, the states, too, would pull back on social programs. The service reductions implied by the federal aid cuts would stick, and perhaps even be compounded by parallel state and local action.

It is our contention based on the field research we have conducted that this assumption has not proven true in many cases in the first term of the Reagan administration. It is true that public service levels in some program areas are lower than they were in 1981 because of cuts at the federal level. But it is also true that the state and local government responses to the 1981 federal aid cuts—through replacement funding, through a wide variety of financial coping and delaying measures, and through administrative reforms—has produced higher service levels than otherwise would have been the case due to the Reagan cuts. We also believe that the developments at the state level outlined in the case studies suggest that the states are poised to do even more in the future to protect and even extend service levels.

In sum, during this period in U.S. history, liberals seeking support for social programs have fared better in many states than they have in the nation's capital. Social programs have had a larger constituency in many states than expected. This is not the first time that liberals have found the states more receptive than the federal government. During the 1920s, Washington kept cool with Coolidge, while some states were passing child labor laws, experimenting with unemployment insurance plans, and expanding social services and benefits to mothers and children, the aged, the disabled, and other groups.

The lesson here is an important one for American federalism. A general pattern in the United States in the period since World War II has been for liberals on social issues to favor central government action, while conservatives tend to favor devolutionary strategies from the national government to states and localities. What we have now added is the observation that these positions may not be that astute, at least not as a general rule for political behavior.

In liberal periods (here, we refer to periods in which there is widespread support for social spending), it is true that it is likely to be easier and more efficient for the supporters of social programs to seek resources from one central source. But the flip side of this proposition is often ignored. In conservative periods, the supporters of social programs are likely to find that in many instances their best strategy is a devolutionary one. They may well find in particular areas of domestic policy that the best approach is to seek support from those states and major local governments which for various reasons are sympathetic to proposals for increased social spending.

These observations have important implications for the Reagan administration. Our initial assumption, and we believe the same assumption was made by officials of the Reagan administration, was that devolutionary measures would aid and abet the administration's overarching domestic commitment to retrenchment in the sphere of social policy. But this was not always the way it worked out. There is evidence from this study and from other sources that Reagan's federalism reforms have stimulated and are continuing to stimulate state governments to increase their efforts to meet domestic needs in the functional areas in which the national government either was cutting grants-in-aid or threatening to do so.[7]

Like most generalizations, there are caveats to be entered. We found that even the most active and responsive state governments did not step into the breach in all of the federal aid areas in which the Reagan administration was pursuing its retrenchment and devolutionary policies. On the whole, the more highly targeted a program was on the poor, the more likely it was to be cut by the national government and the less likely it was that these cuts would be replaced by state and local governments.

In addition, the American federal system, as the case-study chapters in this volume amply demonstrate, is a many splendored and varied political system; the roles of different political institutions are influenced by many forces. In the case of state governments, federal aid policy is but one of the forces that affects the relative standing and influence of these middlemen of our political system.

Economic conditions also have a major effect. The steep 1981–82 recession hit some states much harder than others and caused changes in the relative re-

[7] George E. Peterson, "Federalism and the States: An Experiment in Decentralization," in John L. Palmer and Isabel V. Sawhill, eds., *The Reagan Record* (Cambridge, Mass.: Ballinger, 1984). See also reports published by the U.S. General Accounting Office in Washington, D.C.: *Maternal and Child Health Block Grant: Program Changes Emerging Under State Administration*, May 7, 1984; *States Used Added Flexibility Offered by the Preventive Health and Health Services Block Grant*, May 8, 1984; *States Fund an Expanded Range of Activities Under Low-Income Energy Assistance Block Grant*, June 27, 1984; *Public Involvement in Block Grant Decisions: Multiple Opportunities Provided but Interest Groups Have Mixed Reactions to States' Efforts*, December 28, 1984; *Block Grants Brought Funding Changes and Adjustments to Program Priorities*, February 11, 1985.

sponsibilities of states and localities. Moreover, in a number of states, important causes of changes in the state role predated the Reagan presidency. In several of the study states, for example, a major factor in bringing about changes was the passage in the 1970s of referenda that limited state and local taxes and spending. Nevertheless, in the pluralistic environment of the American political system, we believe that the behavior of state governments in response to the Reagan brand of federalism reform is notable and surprising.

The authors of the case-study chapters in this volume have in our view made a good effort to put Reagan's program in perspective. They repeatedly call attention to other forces at work affecting the role of state governments in the period of this study. At the same time, there is a strong and consistent theme across the sample states to the effect that the policy-making, administrative, and often the financial role of state governments is becoming more important, both relative to the central government and relative to local governments as a result of the way in which the Reagan system of ideas in domestic affairs has shined a spotlight on the state level. In many of the case studies, state efforts have focused on ways to continue services cut by Congress at President Reagan's urging.

One additional point needs to be made here before we take a closer look at the Reagan program; it concerns timing. Although there is no definitive barometer or scale of the health and vitality of state governments, the consensus among the experts who work in this field is that over the past two decades there have been a series of changes in the structure and procedures of state governments that have improved both their standing and capability. In January 1985, the U.S. Advisory Commission on Intergovernmental Relations published a summary report on the capability of state governments. Drawing on a wide range of studies on the finances, management, and institutional behavior of states, the report reached a very upbeat conclusion: "This study concludes that state governments have been transformed in almost every facet of their structure and operations."[8] The situation, says the report, is vastly different from that of the 1930s when one expert quoted in the report said, "The American state is finished."[9]

The point here is that the timing of Reagan's federalism-reform program was propitious from the point of view of supporters of social programs. The states were ready; and the strong signal and action of Reagan's program for federalism reform appears to have had a deep effect on the policy agenda in many states.

[8] U.S. Advisory Commission on Intergovernmental Relations, *The Question of State Government Capability* (Washington, D C . Government Printing Office, January 1985).

[9] Ibid , p. 1. The quote is from an article by political scientist Luther A. Gulick. The article was published in 1933.

The American political system is intrinsically change-resistant. This is why we so often understand and interpret policy change as incremental rather than fundamental. And it is also for this reason that strong and highly visible policy shifts are required to bring about basic institutional changes in American government. We believe the Reagan program, and the way in which it has been discussed and understood in the field of domestic affairs and the media, is an event of sufficient importance that it appears to have permeated the political system and is likely as a result to have a lasting effect on American federalism.

Cuts and Changes in Federal Grants-in-Aid under Reagan

In Reagan's initial set of budget recommendations put forward in the spring of 1981, both of the objectives discussed above—social program retrenchment and devolving national government responsibilities to the states—were prominent. Despite the hope of David Stockman that "weak claims rather than weak clients" would be the target of federal spending reductions, the Reagan cuts were concentrated primarily on lower income groups—and especially the working poor, which had benefited most heavily from the spurt in social spending that had occurred since the inception of Lyndon Johnson's Great Society programs.[10]

Reagan explicitly linked many of his proposed cuts to the objective of the devolution of federal responsibilities. This linkage was most clearly reflected in Reagan's advocacy of block grants, i.e., merging groups of so-called "categorical" grant programs into broader and more flexible grants. In the address before a joint session of Congress announcing his economic recovery program in February 1981, the president said:

> . . . while we will reduce some subsidies to regional and local governments, we will at the same time convert a number of categorical grant programs into block grants to reduce wasteful administrative overhead and to give local governments and States more flexibility and control. . . .
>
> Now, we know of course the categorical grant programs burden local and State governments with a mass of Federal regulations and Federal paperwork. Ineffective targeting, wasteful administrative overhead—all can be eliminated by shifting the resources and decisionmaking authority to local and State government. This will also consolidate programs which

[10] William Greider, *The Education of David Stockman and Other Americans* (New York: E. P Dutton, 1982) and Jack A. Meyer, "Budget Cuts in the Reagan Administration: A Question of Fairness," in D Lee Bawden, ed., *The Social Contract Revisited: Aims and Outcomes of President Reagan's Social Welfare Policy* (Washington, D C.: The Urban Institute, 1984).

are scattered throughout the Federal bureaucracy, bringing government closer to the people and saving over $23.0 billion over the next 5 years.[11]

Our initial analysis of the cuts and changes in grants made in Reagan's first year as president showed five things:

1. The cuts in 1981 were appreciable.
2. These cuts fell more heavily on actual or potential welfare beneficiaries (notably the so-called "working poor" group) than on state or local governments.
3. Several changes, especially the creation of new block grants and the passage of provisions giving states new authority to reshape the Medicaid program, shifted responsibilities from the national government to the states.
4. State and local governments responded initially to federal aid reductions in many programs with coping strategies using carryover funds, shifting funds among accounts, and in other ways putting off the day of reckoning for the cuts enacted in 1981.
5. These kinds of coping actions generally did not occur for welfare programs (such as AFDC and food stamps) and the public service employment program, where the 1981 cuts tended to be passed on directly to recipients.

After 1981, the momentum of Reagan's retrenchment policies in domestic affairs was dissipated as Congress rejected most of the administration's proposals for further cuts and approved some new domestic spending to stimulate the economy and reduce unemployment during the steep 1981–82 recession.

Two major pieces of legislation enacted at the initiative of the Congress in 1982 and 1983 provided large new infusions of federal aid funds. The Surface Transportation Assistance Act of 1982 raised the federal excise tax on gasoline from 5 cents to 9 cents per gallon, producing an increase of nearly 50 percent in the amount of federal aid available for highway and mass transit programs from the highway trust fund. In March 1983, the Congress followed suit with the emergency jobs act, which added $2.8 billion for a wide range of existing grant programs, including some which had been cut in 1981. The overall result was a jump in federal aid spending in nominal terms, as shown in table 1.2. Nevertheless, even in fiscal year 1985, federal aid was 5 percent below fiscal 1981 levels in real terms. In many functional areas, these antirecession increases in federal aid, plus state-local coping actions, the unwillingness of the

[11] "Program for Economic Recovery" (Address before a joint session of Congress, February 17, 1981), *Weekly Compilation of Presidential Documents* 17, no. 8 (February 23, 1981):131–33.

Table 1.2. *Historical Trend of Federal Grants-in-Aid Outlays, Federal Fiscal Years 1976–85 (dollars in millions)*

		Federal Grant as a Percentage of	
Federal fiscal year	*Total grants-in-aid*[a]	*Total budget outlays*	*Domestic outlays*[b]
1976	$59,094	15.9	21 4
1977	68,415	16 7	22.4
1978	77,889	17.0	22.5
1979	82,858	16.5	21.8
1980	91,451	15.5	20.6
1981	94,762	14.0	18.7
1982	88,195	11.8	16 1
1983	92,496	11.4	15.8
1984	97,577	11.5	16.0
1985 est.	107,016	11.2	15.6

SOURCE. Executive Office of the President, U.S Office of Management and Budget, *Special Analyses, Budget of the United States Government*, 1986 (Washington, D.C. Government Printing Office, 1985), p H-19

NOTES. [a] Includes outlays that are off budget under current law; legislation is proposed to include them on budget Such outlays began in 1973

[b] Excludes outlays for national defense and international functions

Congress to accede to Reagan's later requests for federal aid cuts, and actions by state and local governments to replace federal aid cuts out of own-source funds, meant that the service impact envisioned for the 1981 cuts simply never occurred. Some federal policy shifts that enhanced the role of states did take place even after 1981, however. The most notable was the 1982 passage of the Job Training Partnership Act, which gave state governments the lead role in setting policy for job training programs.

Even though Reagan's early cuts were large, we observed a tendency by both politicians and scholars to exaggerate their size and scope and to downplay the political effects (namely, the devolutionary effects) of Reagan's policies. The view commonly expressed in the media was that the president failed to follow through on his "new federalism" proposals. This label was used in the press (although not by the administration) to refer to the proposals Reagan made in 1982 to "swap and turn back" a wide array of domestic programs on a basis that would shift authority from the federal government to the states. Though less radical than Reagan's 1976 campaign proposal, the 1982 plan resembled it in its scope and basic character.

Reagan devoted the bulk of his January 1982 State of the Union message to his "swap and turnback" initiatives. Programs with total 1982 appropriations of

$46.6 billion were to be realigned between 1984 and 1991. The federal government was to assume responsibility for Medicaid, which is administered by state and local governments. In exchange, the states were to assume responsibility for the aid to families with dependent children (AFDC) program and food stamps. The plan also called for establishing a trust fund to finance "turnbacks," i.e., programs that would be devolved to the states. Certain federal taxes were to be relinquished to the states to help finance the programs to be turned back to them. Despite the fact that these "swap and turnback" proposals were never even introduced in Congress, our interpretation, as stressed in this volume, is that Reagan in his first term significantly advanced his federalism reform ideas, reflecting his state-centered theory of American federalism.

The Impact of Economic and Fiscal Conditions

We need at this junction to look more closely at the economic and fiscal setting of the Reagan changes in federal aid. In 1981, when Congress accepted many of President Reagan's proposals to cut federal aid, it took even stronger action in following up on the administration's proposals for large "supply-side" federal tax reductions. Later, when congressional enthusiasm for further budget cuts waned and tax revenues leveled off because of the income tax cuts of 1981, the national government as a result faced large and growing deficits. In this situation, Reagan's advocacy of federal spending restraint gained credibility. Even in the depths of the 1981–82 recession, new federal spending initiatives were modest in comparison with countercyclical programs in previous recessions.

Politicians and program advocates will debate for a long time whether the Reagan administration deliberately created the federal deficit to force Congress to cut further spending.[12] But what is not debatable is the inhibiting effect of the deficit on proposals for new federal programs. The signal from Washington was clear; new social program initiatives would have to occur elsewhere.

In an important way, the business cycle also influenced the responses of state governments to the changes in federal policy. By far the biggest federal aid cuts were made in 1981. Shortly after the 1981 budget act was adopted, the nation entered a sharp recession. Typically in a recession period, state and local governments overreact. Fearing the worst, and forced by state constitutional mandates to balance their budgets, they cut spending, increased taxes, and, generally speaking, "battened down the hatches." This behavior was clearly manifest in the 1981–82 period, since the recession came on so suddenly and hit so hard.

[12] Daniel Patrick Moynihan, "Reagan's Inflate-the-Deficit Game," *New York Times*, July 21, 1985, p. E-21.

Thirty-eight states raised taxes in 1983. According to the U.S. Bureau of the Census, the tax revenues of state governments in 1984 showed a dramatic 14.8 percent increase in 1984. State fiscal analyst, Steven D. Gold, notes that "Real state general fund spending rose at a significant rate in 1984, 1985, and 1986."[13] Focusing on the condition of state finances in 1984, Steven D. Gold and Corina L. Eckl note a marked improvement: "State finances are in much better shape today than they have been in the past several years. . . . The upturn is the result of the unexpectedly vigorous economic recovery, large tax increases in 1983, and restraint in spending."[14]

As a result of these actions and the sharp economic upturn, many state governments were relatively flush near the end of 1983.[15] Moreover, since it always takes time for policy changes made in Washington to percolate through the system, it was not until the economic recovery was under way that many of the cuts in federal grants made in 1981 were felt with full force.

This volatile pattern of state finances and the delayed effects of federal policy changes meant that many states were in a position to consider claims from groups that either experienced federal aid cuts or feared them.

Long-Term Changes in Domestic Politics and Intergovernmental Relations

At this point in the analysis, a basic political observation needs to be added. Retrenchment involves more than money: *It sends a signal.* Reagan sent a signal to the domestic public sector—and it was strong and explicit—that the federal government should and would do less, and that states and localities, especially nonprofit institutions that provide social services and the private sector, should do more. Not surprisingly, the politics of social programs changed in ways that reflect the seriousness which service providers attributed to Reagan's policies. Increasingly, the proponents of federal domestic programs turned to others for succor. In particular, claims were made at the state level at just the time, as it turns out, that many states could respond to them.

It will take a while before we can analyze census and other data on government finances to assess the magnitude of state responses to these new and

[13] Steven D. Gold, "Developments in State Finances, 1983 to 1986," *Public Budgeting and Finance,* forthcoming.

[14] Steven D. Gold and Corina L. Eckl, "State Budget Actions in 1984," Fiscal Affairs Program, National Conference of State Legislatures, Legislative Paper no 45 (September 1984):1.

[15] David Levin, "Receipts and Expenditures of State Governments and Local Governments, 1980–83," *Survey of Current Business,* September 1984, pp 19–23 and John Herbers, "States Discover Large Surplus in Their Income," *New York Times,* December 4, 1983, p. 1.

stronger claims. Moreover, such analysis is never easy due to the large number of factors that influence governmental finances. The evidence from our research, however, suggests that state governments have been—and still are being—activated by the Reagan program, and as a result are playing a larger role in domestic affairs. In these terms, political dynamics can be seen to be changing.

These shifts have been commented on by other observers. A 1985 article in the *National Journal* reported that organizations which support social programs have produced a level of liberal and minority-group political activism heretofore unknown in state capitals.[16] Similarly, a lead survey article in the *New York Times* in May 1985 noted an increase in the activities at the state level on the part of the leaders of civil rights groups and lobbyists for the poor. "On a wide range of social issues, including education, civil rights, and health care for poor people, they [the leaders of these organizations] said the states had been quicker to respond to their appeals than the federal government in the last few years."[17]

These developments can be expected to disappoint conservatives to the extent that they hoped that shifting responsibilities from the national government to the state level would bring about a general decline in governmental activity. According to the article in the *National Journal* quoted above, "[C]onservatives who gleefully assumed that shifting the responsibility for social programs to the states would mean the end of the programs have discovered that state governments were not as conservative as they thought."[18]

Past research suggests that "innovative" policies tend to be adopted by the larger, generally more liberal or progressive state governments.[19] Our research provides support for these findings in that the most pronounced response to the Reagan changes usually—but not always—came in states that fit this definition. This is particularly true for the states that were from the outset most willing to commit new or additional revenues from their own sources to replace actual or anticipated federal aid cuts. But there is also evidence of the beginning of a broader response, in some cases involving traditionally less progressive states, where the political ideology was seen to be shifting during the period of our study.

We can only speculate about the future: We see a likelihood that as state gov-

[16] Jerry Hagstrom, "Liberal and Minority Coalitions Pleading Their Cases in State Capitals," *National Journal* 17, no. 8 (February 23, 1985), p. 426.

[17] Robert Pear, "States are Found More Responsive on Social Issues," *New York Times*, May 19, 1985, p 1

[18] Hagstrom, "Liberal and Minority Coalitions," p. 426.

[19] Jack L Walker, "The Diffusion of Innovations Among the American States," *The American Political Science Review* 63 (September 1969):880–99 and Virginia Gray, "Innovations in the States A Diffusion Study," *The American Political Science Review* 67 (December 1973):1174–85

ernments take on a larger role—initially perhaps concentrating on increased policy and administrative responsibilities for devolved federal programs—they will eventually commit additional resources to these functions, and that, over time, though it is very hard to measure in a close way, this will be reflected in higher levels of state spending than would otherwise have occurred. As the program advocates in the areas in which the federal government is pulling back turn increasingly to the state level as a new arena of action, the link between devolution and retrenchment, in our view, is likely to be even weaker.

Up to now, we have dealt with Woodrow Wilson's cardinal question about the relationship between the federal government and the states in the customary way—*involving money*. It is true, as many experts in the field have stressed, that money has increasingly become the glue of American federalism.[20] Grants-in-aid and their attendant regulatory requirements have influenced the character of state and local governmental activities and the levels of funding devoted to different public purposes. This is the area of our expertise and it is the focus of this study. We have tried to deal not just with grants and their requirements in a mechanical way, but also with the signals transmitted by Reagan's changes and proposed changes in the grant system.

There are, however, other federalism policy issues that are outside the scope of this study or only tangentially fall within the purview of the federal aid system. Some involve admonitory ("bully pulpit") tactics presidents can use to influence the behavior of state and local governments that do not involve the federal aid system. Although Reagan's changes in federal aid policy in the field of education, for example, would have to be described as modest, his actions in other ways have had a decided effect on educational policies and practices and on American federalism that this study does not capture. Reagan's position on school prayer, for example, as well as the dramatic national report issued by a commission, which was appointed by his secretary of education in August 1981, have influenced state governments and local school districts in important ways. In some cases, they have increased the influence of the national government, as in the case of school prayer, although this is not an area in which concrete policy change was accomplished in Reagan's first term. In other cases, these actions, as was true in the case of the 1983 report, *A Nation at Risk*, have catalyzed state action and appear in this case to have increased the relative position of the states in the field of elementary and secondary education.[21] These

[20] Michael D Reagan, *The New Federalism* (New York: Oxford University Press, 1972), chapter 3, argues grants-in-aid make cooperative federalism "a functioning reality instead of a constitutional lawyer's phrase."

[21] In the introduction of the 1983 report, the commission stated: "If an unfriendly foreign power had attempted to impose on America the mediocre educational performance that exists today, we might well have viewed it as an act of war. As it stands, we have allowed this to happen to

issues and others like them—for example, involving the way in which federal power in the Reagan period was used to enforce the twenty-one-year-old drinking-age requirement—are not covered in this study, which focuses on grants-in-aid.

We point this out to remind readers that one needs to consider this broader landscape in assessing our thesis that Reagan's actions on grant-in-aid policy issues are stimulating states to play a larger and more important leadership role in American federalism. Although we see the need to put our findings in this broader context, the consideration of other developments in the Reagan period that have influenced federal-state relations and American federalism does not in our view diminish the strength of importance of the findings of this research.

Research Methodology

Our research approach in this study and in previous field evaluation studies we have conducted emphasizes the need to go beyond centrally available statistical data in studying both the effects and implementation of major changes in the intergovernmental policies of the U.S. national government.[22] In field evaluation studies of the effects of changes in federal grant-in-aid policies we have conducted, beginning with the general revenue sharing program enacted in 1972, we have based our analysis on observations about political processes and relationships as well as financial and program data. This research has been conducted on an interdisciplinary basis; economists and political scientists have participated both in the field and in the conduct of the central analysis to combine the field data. Frequently in these studies, we have focused on questions of economic analysis; we have been interested in the *impacts* of new federal aid policies. Our previous research projects, for example, have asked whether a particular new grant-in-aid program expanded the public or the private sector (in the case of revenue sharing); aided the poor or other groups (in the case of

ourselves. . . . We have, in effect, been committing an act of unthinking, unilateral educational disarmament." National Commission on Excellence in Education, *A Nation at Risk: The Imperative for Educational Reform* (Washington, D.C.: U.S. Department of Education, April 1983), p. 5.

[22] See, for example, Richard P. Nathan, Allen D. Manvel, Susannah E. Calkins, and Associates, *Monitoring Revenue Sharing* (Washington, D.C.: The Brookings Institution, 1975); Richard P. Nathan, Charles F. Adams, Jr., and Associates, *Revenue Sharing. The Second Round* (Washington, D.C · The Brookings Institution, 1977); Paul R Dommel and Associates, *Decentralizing Urban Policy: Case Studies in Community Development* (Washington, D.C.· The Brookings Institution, 1982); Richard P Nathan, Robert F. Cook, V. Lane Rawlins, and Associates, *Public Service Employment A Field Evaluation* (Washington, D.C.: The Brookings Institution, 1981); and James W. Fossett, *Federal Aid to Big Cities: The Politics of Dependence* (Washington, D.C.: The Brookings Institution, 1983)

the community development block grant); or caused more employment as opposed to displacing jobs that would have been filled anyway (in the case of the CETA public service jobs program under the Comprehensive Employment and Training Act, CETA).

In studying the Reagan domestic program, we are again interested in impact issues: Were the services affected by Reagan's cuts in grants-in-aid replaced or in other ways protected by state and local governments, or did these governments ratify the cuts by passing them on to the programs and people who otherwise would have been served?

It is our experience that the answers to questions such as these cannot be provided on the basis of the analysis of centrally available data from the U.S. Bureau of the Census, the Office of Management and Budget, and the Treasury Department. The data from these sources are aggregated at too high a level; they often do not provide the needed information or sufficient detail to analyze the effects of changes in federal grant-in-aid and policies on the finances and services of state and local governments.

Our conclusions are based on research in the sample of fourteen states shown earlier. In each of the case-study states for this research on the effects of Reagan's cuts and changes in federal grant-in-aid programs, we also selected a major city to examine the way the Reagan changes have affected local governments and state-local relations.

The sample was chosen to be representative in terms of size, location, and economic and social characteristics. All fourteen case studies cover the same time period, the first term of the Reagan administration; they were written according to a similar organizational plan. The case studies were initially presented at a conference on this research held at Princeton University in June 1984.

The nine case studies chosen for inclusion in this volume were selected on a somewhat different basis from the original sample. While we sought to preserve the representative character of this group on the bases indicated above, we also gave attention in the selection of the states to be included as the subject of case-study chapters in this volume to the degree and character of the response made to the cuts and changes in federal grants-in-aid during the Reagan first term.

As a first step, all fourteen states in the sample were classified according to the relative degree of their response to the Reagan changes as shown in table 1.3. Five states are classified as having made the "*most pronounced*" response to the Reagan changes. This classification was made on the basis of two criteria—fiscal and institutional. Specifically, the two criteria are: (1) the replacement out of state funds of federal aid cuts that were made or threatened under

Table 1.3. *Sample States Grouped by Degree of State Role Enhancement*

Most pronounced state response	*Intermediate state response*	*Low state response*
Florida	*Mississippi*	*California*
Massachusetts	*Ohio*	
New Jersey	Texas	
New York	*Washington*	
Oklahoma	*Arizona*	
	Illinois	
	Missouri	
	South Dakota	

NOTE: States included in the case-study chapters of this volume are shown in italics

the Reagan administration; and (2) the actions taken by the sample state governments to play a stronger policy-making and administrative role in response to the changes made in federal grant-in-aid programs under Reagan. In effect, these two criteria can be thought of as *fiscal and institutional replacement* in the areas in which the federal role in domestic policy was reduced under the Reagan administration. The five states in the "most pronounced" response group, in alphabetical order, are Florida, Massachusetts, New Jersey, New York, and Oklahoma.

At the other end of the scale, California is classified as having made a minimal response to the Reagan changes, because according to the field researchers the enactment of major state referenda affecting state finances, and the debates about others, swamped the effect of the Reagan federal aid policy shifts.

The remaining eight states in the sample are classified in one category that we label the "*intermediate-response*" group, although we need to indicate important differences among these states. Three states in this group were found to have replaced some federal aid cuts (or threatened federal aid cuts) out of their own funds—Mississippi, Ohio, and Texas. In all three of these cases, there was both a fiscal-replacement and an institutional-replacement response to the Reagan cuts and changes in federal grants-in-aid; however, these responses were not as strong as in the case of the five states classified above in the "most pronounced" response category. One state in the sample, Washington, initially decided to replace anticipated cuts in federal aid, but then rescinded these replacement actions when its economic situation deteriorated sharply in 1981. Four states in this "intermediate-response" group were found not to have replaced federal aid cuts out of their own funds; however, they did take steps to exercise a stronger policy-making and administrative role in functional areas in which the devolutionary policies of the Reagan administration involved the assignment of greater discretion to state governments. The four states in this subgroup are Arizona, Illinois, Missouri, and South Dakota.

The nine states chosen for inclusion as the subjects of case-study chapters in this volume were selected to represent a cross section of the different types of responses just described. Three states from the "most pronounced" response group are included—Florida, Massachusetts, and New York. Two of the states in the "intermediate-response" group, which did take fiscal-replacement actions, are included—Mississippi and Ohio. The other three states in this group that are the subject of case-study chapters are Washington (which initially voted and later rescinded federal aid replacement actions), Arizona, and Illinois. All three of these states took steps to increase their policy or administrative role in areas in which Reagan's decentralization policies assigned a greater role to state governments. The ninth state included as the subject of a case-study chapter in this volume is California, which, as indicated above, is classified as having made a minimal response to the cuts and changes made in federal grants-in-aid during the Reagan first term.

These nine states reflect the substantial diversity that is customarily found in the policies, finances, and political values and behavior of state and local governments in American federalism. This diversity presents a formidable challenge to researchers. We have tried in this book to strike a balance. In the six overview chapters, we present generalizations about the responses to the Reagan policies; at the same time, a fuller picture of the intricacy and complexity of our subject matter is presented in the case studies included in this volume.

A major premise of the field network evaluation studies in this series, beginning with the study of the general revenue sharing program, is that our role as researchers should be to describe and analyze the effects of major changes in the federal grant-in-aid policies of the national government. Our concern in this research lies not with making a judgment about the wisdom of these policies, but rather in understanding how they played out in the diverse, complex, and fragmented real world of American government. Whether one views Reagan's policies as good, bad, or indifferent, successful or unsuccessful, depends on the values and preconceptions that each reader brings to the subject matter.

The remainder of this volume is divided into four main parts. The next two chapters describe the history of federal grants-in-aid to state and local governments. Chapter 2 considers the history of federal grants up to the turnaround that occurred in the middle of the Carter years. Chapter 3 describes the efforts made since then to curb federal aid spending and devolve federal government responsibilities. Chapters 4 and 5 present the overview analysis of the findings of the field researchers on the responses of the sample jurisdictions to the cuts and changes in federal grants made during the Reagan first term. Chapter 4 discusses how the responses differed on a *program-by-program* basis; chapter 5 summarizes the findings on a *state-by-state* basis. Chapters 6–14 are the case studies. Chapter 15 presents our concluding observations about the implications of the material presented in this volume for American federalism.

2

The Evolution of Federal Aid

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Federal grants-in-aid to state and local governments have played a crucial role in the development of U.S. federalism. According to Michael Reagan and John Sanzone, "the grant relationship is far and away the most decisive means of intergovernmental cooperation today."[1] Similarly, Kenneth N. Vines observes that grants-in-aid have become "a vital way in which the nation and the states relate to each other."[2]

It was during the time that the United States operated under the Articles of Confederation that the Continental Congress adopted the first grants-in-aid to the states, putting aside land for the support of public schools in the territory west of the Ohio River. Starting in 1802, when Ohio became the first state to be carved out of this territory, each new state was given sections of land to distribute to localities, which usually sold them and used the proceeds to support public schools.[3]

In the two centuries since the first land grants were made, intergovernmental transfers from the federal government to states and now also to localities have increased markedly in number, diversity, and magnitude. Along the way there have been many important shifts and permutations in federal policy, of which the Reagan cuts and changes of 1981 is but one, albeit important, example. As background for our consideration of the Reagan changes—what they were and

[1] Michael D. Reagan and John G. Sanzone, *The New Federalism* (New York: Oxford University Press, 1981), p. 75.

[2] Kenneth N. Vines, "The Federal Setting of State Policies," in Herbert Jacob and Kenneth N. Vines, eds , *Politics in the American States, A Comparative Analysis*, 3rd edition (Boston and Toronto: Little, Brown, 1976), p. 20.

[3] James A Maxwell, *The Fiscal Impact of Federalism in the United States* (New York: Russell & Russell, 1970), pp. 67–69. Originally published by Harvard University Press in 1946.

how they affected the recipient jurisdictions—it is useful here to present a brief history of federal aid. This chapter reviews the evolution of federal grant policy from the pre-Constitution period through the mid-Carter years; chapter 3 describes the retrenchment in aid programs that began under Carter and accelerated under Reagan.

Early Forms of Federal Grants

Like early aid for public schools, other grants were given in the form of land during the nineteenth century. They included land grants to states to support the construction of roads, canals, railroads, colleges, river and harbor improvements, and other capital projects. Land was also granted to private companies formed to construct roads, canals, and railroads, and even directly to individuals, as in the case of the homestead program and land grants made by the Continental Congress to veterans of the Revolutionary War.

Land was used in these early programs because "land was plentiful and money was not," as Daniel Elazar has noted. Furthermore, politicians who were opposed to money grants on grounds that they were not authorized by the Constitution could rationalize land grants as "gifts by the federal government in its capacity as property owner rather than grants made in its governmental capacity."[4]

The earliest grant-in-aid programs had few strings. The first land grants specified the purposes for which proceeds from the sale of land were to be used, but they made little provision for checking on how states distributed the land or how localities used the proceeds, nor did they establish any sanctions for improper uses. Increasingly detailed specifications were written into grants of land to states that came into the Union later, as Congress determined the need for such controls and as the federal government gained strength in relation to state governments.[5]

[4] Daniel J Elazar, *The American Partnership: Intergovernmental Co-operation in the Nineteenth-Century United States* (Chicago: University of Chicago Press, 1962), p. 143.

[5] James A. Maxwell notes, "It is a matter of common knowledge that this endowment was not always wisely used. . . In most cases a permanent public-school fund was set up . . . but some states . . . diverted the funds to other uses. There is a temptation to lament the squandering of a magnificent endowment, and to wish that Congress had insisted upon strict conditions or had even kept control of the endowment in its own hands. . . But pretty plans about what might have been do not take into account the temper of the times. Congress was in no mood up to the Civil War, and for several decades afterwards, to lay any conditions upon the states; and only an optimist can have a conviction that Congress, until nearly the twentieth century, would have been a better trustee than the states themselves." Maxwell, *The Fiscal Impact of Federalism*, p. 69.