

# Federalism, Block Grants and the Safety Net

*By James Hosek and Robert Levine*

*Everyone is unhappy with welfare and Medicaid, even liberals. Republicans in congress excoriate the programs as hopelessly flawed, ruinously costly. The states want flexibility to fashion their own programs free of Washington's mandates -- and are willing to take less federal money to get it. Are block grants the answer?*

## What is Federalism? And Why "Fiscal"?

Broadly defined, federalism is about the distribution of power between the central government and the states. The American debate over the proper balances between government and the private sector and among the various government entities goes back to the Articles of Confederation. In a democracy, such choices are properly made by the political process, and that has been the rule for the United States, where these balances have swung back and forth throughout our history. The new federalism is the latest swing of the pendulum, carrying more power to the states and away from the federal government.

However, the new federalism has a fiscal dimension that was missing in earlier manifestations. It fundamentally changes the way tax money is used to pay for social programs. Legislation that would bring this about is the central focus of the Contract with America, the legislative agenda set forth by the Republican majority in the House of Representatives of the 104th Congress.

The changes would eliminate open-ended funding for entitlement programs, such as Medicaid and Aid to Families with Dependent Children (AFDC), the largest and most controversial component of welfare. Instead, these and job training programs would be underwritten by block grants -- specific federal appropriations that the states could use at their discretion within broad federal guidelines.

But block-grant funding would be fixed at levels lower than currently projected for the programs. Thus the trade-off looming for the states is stark: the promise of greater flexibility in exchange for fewer federal dollars.

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Several societal forces have coalesced to fuel the new federalism. One is the growing strength of the states' rights movement, reflecting concern that the states' power to set policy and fund programs has been sapped over time by the expansion of federal policy-making and taxing authority.

On a pragmatic level, governors are striving to gain more control over budgets distorted by unfunded federal mandates, which states and localities must pay for, and by the spiraling costs of entitlement programs. The burden of mandates and matching requirements for AFDC and Medicaid comes at a time when many states' revenues are growing slowly and other needs -- such as education and infrastructure -- are pressing.

Another powerful current is federal deficit control. The drive to reduce the deficit -- a goal perennially acknowledged but long postponed -- now appears to be moving toward a credible bipartisan consensus. Both sides of Congress also agree that a balanced budget will require significant cuts -- upwards of 15 percent -- in domestic programs.

### **Hoped-For Gains**

The states and the federal government anticipate gains from a block-grant approach to funding. Even though block grants will come with federal guidance and at reduced funding levels, states will nevertheless have greater freedom to change eligibility requirements, devise programs that recognize differences among groups, and improve the coordination of activities across agencies.

For its part, the federal government should be able to make progress toward reducing the deficit. Block grants will be funded at levels below currently anticipated program costs, and further, because block grants are fixed, the federal government will be relieved of the responsibility to cover added costs if states should broaden their program eligibility, increase benefits, or fall on hard times as a result of economic downturns.

Political advantages may also accrue. By shifting program responsibility to states, federal lawmakers hope to deflect backlash from advocates of programs that are being cut, and state legislators hope to gain strength by constructing programs better suited to the state's economy and population.

Still another impetus behind these changes is a widespread public perception that the programs, particularly AFDC and Medicaid, are hopelessly flawed.

To critics, AFDC provides weak incentives to work and encourages single motherhood, marital dissolution and welfare dependence. Medicaid has resulted in runaway costs and has been a major source of unfunded mandates from a federal government eager to expand benefits. Moreover, with its weak incentives to control costs, Medicaid has become a prominent indirect means of covering the health costs of the uninsured. In addition, job training encompasses scores of small, categorical grant programs that are overlapping in scope and clientele, and which, despite past efforts to improve their administration, are widely regarded as failures.

On net, this critique paints an image of programs that are too costly and, in the case of welfare-related programs, offer little incentive for personal responsibility and self-reliance.

### **What Opponents of Change Fear**

However, much of the new welfare structure is controversial. Apparent political consensus exists on the desirability of reducing federal spending and decentralizing programs, and on the failure of current AFDC and Medicaid programs. But the size of reductions, the abandonment of national entitlements, and the program structures themselves are subjects of ongoing dispute.

The central fear of those who oppose the changes is that the end of national entitlements will tear holes in the safety net through which many people in need, particularly children, will fall. Under the old structure, the federal government guaranteed some level of welfare and medical support to all those within defined categories of need.

Block-grant proposals turn decisions about who gets aid, and how much, over to the states, where incentives for reducing benefits and limiting eligibility are strong. Federal funding will be cut, so that any maintenance of standards in the face of rising caseloads or growing costs will more and more be borne by state and local taxpayers. Some fear a "race to the bottom," in which all states will be under pressure to pare benefits so as not to attract poor people from other locales.

The welfare-to-work emphasis of welfare reform is universally applauded, but opponents doubt whether the new programs will achieve the goal any better than the old ones did. With fewer federal dollars to go around, mothers will

have a harder time getting child care -- the one support many believe to be crucial to getting women off welfare and into work.

## **Making It Work**

If states and communities are to realize the potential of block grants, they must work together on a host of activities. These include establishing and administering new programs, fairly allocating block-grant funds and state funds across localities, evaluating policy options to determine the best policy approach, monitoring effectiveness, sharing information to learn from each other, and -- underpinning all of this -- creating integrated data-management systems.

Further, states must devise funding and financing strategies to cope with the end of entitlements. Once set, block grants cannot be adjusted with changes in population, demographics, or economic conditions, all of which can vary across states and within states. States and localities must either cover the added costs of contingencies or reduce coverage, benefits, and quality of service. The situation is complicated by the slow growth of state revenues, the pressing needs for other uses of state funds, and the constraint of balanced-budget requirements. All states except Vermont have constitutional amendments that prohibit budgets intentionally based on deficit funding, even during recessions.

Changes in the federal funding structure bring state and local relations into the spotlight. Because block grants come to the states, their political incentive may be to retain control of funds but push down responsibility for implementation.

From the trenches, local agencies worry that state government would merely replace the federal government as a source of unfunded mandates. States could impede local efforts to innovate by adding new restrictions and accountability requirements, finding ways to divert block grants to other uses, and reducing safety-net spending. State balanced-budget requirements, too, raise the specter of funding cuts to localities.

## **Needed: A Compromise on Entitlements**

The debate over the new fiscal federalism underscores the tension between devolving greater authority to the states by means of block grants and maintaining the strength and resiliency of the safety net by means of

entitlements. Block grants can help the federal government reduce the deficit, but the end of entitlements spells the end of federally underwritten, open-ended support for all eligible people among the nation's disadvantaged.

Compromise between these positions, should it occur, might take the form of constrained entitlements, that is, maintaining the federal entitlement concept but with changes in program structure that control usage and limit cost growth.

But maintaining the entitlement concept, even with constraints, is at odds with devolving authority to the states. Entitlements require the federal government to bear major funding liability, rather than capping it as block grants would, and history suggests that so long as it bears the brunt of the funding burden, the federal government will want to retain considerable control.

Additional flexibility might be gained by maintaining entitlements but rewriting the rules of AFDC and Medicaid to allow greater state autonomy in program design and execution. Federal oversight might take the form of periodic reviews to assess program effectiveness and cost. Coupling the continuation of entitlements (and thus of federal involvement) with an easing of the rules would protect the interests of the disadvantaged at the same time that it allowed states to explore alternative programs.

Finally, local governments, agencies and institutions have so far been the state's quiet partners in the new fiscal federalism, but their role is critical to its success. Their challenges will be to innovate, to ensure that added resources accompany added responsibility, and to invest in expanding their capacity to govern by creating modern, integrated data systems.

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