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The Blockbuster Inside the

In the Rush to Fiscal Devolution, Has Anyone Figured

By Robert D. Reischauer

"POLITICALLY DARING," said The Washington Post's lead story. "Historic," said the New York Times. They were referring, of course, to the plan unveiled last week by Senate Budget Committee Chairman Pete Domenici (R-N.M.)—followed by an equally ambitious House Budget Committee plan—to balance the federal budget by 2002. And, indeed, both committees deserve considerable credit for doing what few have dared before—actually laying out with some specificity the benefit and service cuts required to do the job.

Now, though, Congress has to complete the work the committees have only begun: figuring out exactly how the program cuts would be carried out. Take, for one key example, the proposals to change the way the federal government pays for such means-tested entitlement programs as Aid to Families with Dependent Children (AFDC) and Medicaid. Instead of providing aid through the current open-ended matching grants that pay a share of the costs each state incurs for welfare, the federal government would give block grants—fixed amounts of money—to each state for these purposes.

From both Washington's and the states' perspectives such a change has first-glance appeal. Block grants would limit the federal government's financial exposure—a relief after a period of rapid and unpredictable growth in welfare-related spending. The budget plans, in fact, anticipate about $200 billion in savings over the next seven years from the switch to block grants. To the states, block grants hold out the promise of reduced federal regulation and a chance to use Washington's money to pay for state-designed programs that may be better tailored to local values and conditions. Sounds like a great idea—until you hit the details.

Consider, for starters, a seemingly simple question: "How would the block grant money be distributed among the states?" "Obvious," you may say. "Divvy it up by need"—that is, in proportion to the number of low-income residents in each state. Further thought might suggest paring the allocations to wealthier states somewhat on the grounds that they can afford to chip in more of their own funds than poorer states, but basically the plan is straightforward.

Straightforward until you look at the way that federal aid is currently shared among the states. In fact, if block grants were allocated according to need, there would be massive redistributions of federal aid. For example, if federal AFDC monies were allocated according to the number of poor children in each state, Alaska, Hawaii, Massachusetts, Rhode Island, Vermont and Washington would see their federal payments roughly halved, while Alabama, Arkansas, Louisiana, Mississippi, South Carolina and Texas would more than double their take.

Similarly, if Medicaid block grants were allocated according to the number of residents with incomes under 150 percent of the poverty threshold, the current flow of funds to New York would be cut in half while federal aid for this purpose to Virginia, Florida and Idaho would increase by at least three-fifths.

Okay, so Congress is not likely to agree on such a massive upheaval to state budgets. Why not just allocate block grants along the lines of the existing federal matching grant structure? But this means we would provide the nation's poorest state, Mississippi, with a block grant worth $302 per poor child (which is what its 1994 federal AFDC grant was) while we distribute to each poor child in Con-

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necticut, the nation's richest state, some $1,566. Sound fair?

We accept this inequitable distribution under the existing matching grant structure because it's the result of each state's decision about the amount of its own resources it wants to devote to welfare. Mississippi could increase its federal payment if it chose to spend more of its own money, that is, if it raised its AFDC benefit levels five-fold to match Connecticut's.

But under a block grant approach, where a state's own effort on behalf of the poor would not affect its federal aid, such an allocation would be indefensible. Congress would find itself faced with a choice of taking money away from some large, powerful states to increase the allocations to poorer states or increasing overall funding. The former would be a political nightmare; the latter would undermine the budgetary rationale for block grants.

Funding formulas are far from the only killer question about block grants. Think for a moment what would likely happen to state spending on the vulnerable populations they are meant to serve. Most likely, it would drop like a rock.

First, states would no longer be encouraged by generous federal matching rates to devote their own resources to low-income residents. Currently, the federal government rewards rich states by matching with a federal dollar every dollar they spend on AFDC and Medicaid; poor states such as Alabama and Arkansas receive roughly $3 from Washington for every state dollar they spend.

Without this inducement, state welfare spending, which amounted to $68 billion or 43 percent of the total spent on AFDC and Medicaid in 1993, will be squeezed out by more popular programs such as school aid and criminal justice. Fearful that they will become a Mecca for the poor if their welfare programs are more generous than those of their neighbors, states will compete in their stinginess. Future Congresses also will be tempted to cut federal allocations as they seek ways to reduce the deficit—far easier to do when the cuts play out through 51 separate state programs and the repercussions on affected individuals are less obvious.

But should we care if spending on the poor is reduced? After all, federal means-tested outlays have almost tripled over the past decade; maybe some belt tightening is in order. Surprisingly, the explosion of welfare costs does not mean that states have been lavishing benefits on the poor. Health care for poor elderly and disabled individuals accounts for much of the increase, while AFDC and food stamp benefits to welfare families have, on average, declined. As a result, means-tested cash, food and housing benefits are considerably less effective in lifting people out of poverty than they were a decade ago.

The unfortunate reality is that, as the economy has changed and divorce and out-of-wedlock births have soared, the poor population has grown—by 25 percent between 1988 and 1993—and the poor are poorer than they used to be. Scaling back resources for this group is not going to make it shrink. It is only going to increase hardship, homelessness and suffering.

And what would happen to a state if the need for welfare increased unexpectedly because of a national or localized recession, a natural catastrophe, immigration or other demographic factors? After all, over the last four years, AFDC caseloads in 14 states expanded by more than one-quarter, while those in 12 states contracted. The answer is that the state would be left holding the bag—just when its own resources were under greatest strain.

Finally one may ask whether, when all is said and done, block grants will really give states greater flexibility and freedom from federal regulation over the long run. The answer is "Probably not." String-free federal aid flies in the face of the Golden Rule of Fiscal Federalism: "He who provides the gold sets the rules."

Over time, federal intrusiveness will grow, driven by the inevitable desire of Washington policymakers to assert federal priorities and to ensure federal funds are not squandered. (See the detailed rules in the House-passed welfare reform bill as evidence that, even at the dawning of the block grant age, it is impossible to keep Congress from playing a major role in program design.) When the inevitable examples of fraud, waste and abuse in the block grant programs hit the headlines, Congress will feel compelled to impose ever more detailed regulations and controls. In time, the states could find themselves with most of the red tape they hoped to shed and without the generosity provided by the open-ended matching grant structure.

Block grants could well end up making an admittedly bad system even worse. This, however, should not be cause to defend the status quo. Several reforms could give the states more programmatic leeway and the federal government more budgetary certainty. The waiver processes, which have already given states flexibility to experiment with ways to save Medicaid and welfare dollars, should be expanded and encouraged. The underbrush of minor federal welfare regulations should be cleared away. Welfare budgets should be established to keep total spending within acceptable bounds while allowing these budgets to vary modestly with economic and demographic conditions. And finally, retaining the matching grant structure would preserve incentives for state contributions, but matching rates could be adjusted periodically to keep federal spending within limits. True, these changes won't produce massive, near-painless savings—but then neither will block grants.