November 24, 1982

WHY BLOCK GRANTS WORK

INTRODUCTION

The New Federalism initiative is one of the Reagan Administration's most promising attempts to reduce the size and role of the federal government and to return the responsibility for basic social programs to the states. Recent signs that the White House is retreating from its original proposals have appeared, ironically, just as evidence emerging from the 1981 block grant experience reveals the states to be sophisticated and efficient when given discretion over such programs.

Statements made during the summer indicate that top White House officials in the Office of Intergovernmental Affairs have all but agreed to the position of the National Governors Association that the only acceptable part of the New Federalism initiative outlined in the 1982 State of the Union address would be the nationalization of the $30 billion Medicaid program. The Administration has withdrawn from its original plan (opposed by the governors) to turn over the $9 billion Food Stamp program to the states, and has dropped part of its plan to streamline maintenance of effort standards, mandatory pass-through requirements, and other rules that increase costs and restrict experimentation.

Yet the experience of the 1981 block grants suggests that the states are capable of assuming administrative and financial responsibilities for even more programs. The data show that the states can absorb the cuts in federal aid associated with the blocks and make appropriate cost savings without unduly reducing services or increasing taxes. The evidence also shows, however, the need for greater flexibility to enable states to experiment further and better use their block grant funds.

It is important to the New Federalism debate that the experience of the 1981 block grants be understood and its lessons properly drawn. Failure to appreciate this experience has prompted many legislators and, apparently, Administration officials to press less vigorously than they should for the decentralization of basic support programs that is a key element of New Federalism.

BACKGROUND

Federal grants-in-aid to the states have been growing rapidly. Since 1961, the number of categorical aid programs slated for states has trebled, reaching 510 in FY 1981.[1] Federal spending for those programs amounted to $94.4 billion in FY 1981, up $3 billion from 1980 and $12 billion from 1979.[2] The average annual growth rate for those programs over the twenty-year period was 13 percent, or roughly three times the growth in Gross National Product. Categorical grants-in-aid to the states constituted 3.4 percent of the 1981 GNP, compared to 1.4 percent of the 1961 GNP.[3]

<u>The Advantages of Block Grants</u>

The rapid growth in federal aid was seen by many as a welcome indication of a national commitment to resolve supposed national problems and to offer states needed monies to finance basic service programs. However, such growth brought with it increased federal influence over state and local policies. The typical grant featured 300 to 500 separate spending requirements on state governments.[4] White House officials estimate that regulations attached to just one of the nutrition programs involved 62 million "burden hours" of paperwork annually.[5] Those millions of man-hours spent on paperwork did more than siphon resources that could have been directed to actual service delivery. They also were a clear signal that federal authorities intended to use the spigot of public monies to change the course of state and local policies.

This "mandate millstone," as New York City Mayor Ed Koch described the hundreds of thousands of changes states must make routinely in their own programs to accommodate federal directives, is a major problem to states in securing block grants. The millstone burdened each of the 500-plus categorical aid

---

1 A cogent history of categorical grants is given in Thomas Ascik, "Block Grants and Federalism: Decentralizing Decisions," Heritage Foundation <u>Backgrounder</u> #144, June 5, 1981, pp. 18-23.

2 See <u>Reagan and the States</u> (Washington, D.C.: American Legislative Exchange Council, 1981), p. 4.

3 Additional statistics about categorical grants-in-aid are provided in "Fact Sheet: Federalism Initiative," distributed by the White House, Office of the Press Secretary, January 27, 1982, pp. 2-4.

4 <u>Ibid.</u>, p. 3.

5 <u>Ibid.</u>, p. 4.

programs for the states. In some cases, mandates were reinforced with sanctions imposed by federal authorities to force states to comply.

The regulations and spending mandates that accompanied the Elementary and Secondary Education Act (ESEA) are but one example of federal influence. Federal spending in 1981 amounted to only 8 percent of all monies spent on education. Yet this had a disproportionate impact on states and localities because it financed almost 100 percent of student loan, nutrition, and specially targeted aid programs. To qualify for this 8 percent, the states (which bore 88 percent of all education costs) were required to prove compliance with a variety of curriculum, hiring, and admission standards. These forced states to start new programs or revise existing ones without regard to efficiency or local desires. Among the most controversial of the requirements are bilingual education and school busing.

The Critics of Block Grants

Criticism of block grants has mounted on several fronts. It is argued, for instance, that the states' own sources of revenue are so strained they cannot afford to bear the cuts in federal outlays that are a part of the block grant strategy.

A May 14, 1981, letter to all Members of Congress signed by 63 public interest groups maintained that: "These [block grant] proposals will certainly mean two things: less assistance to those in genuine need in these areas and a brutal political struggle at the state level where the most vulnerable and those without clout are certain losers."[6]

These critics presume that reductions in block grant monies would prove insurmountable obstacles to the states. The assumption was that costs would not be balanced by reduced overhead and compliance costs. This ignores the proved capability of state governments to make significant changes in priorities and coverage within a relatively short period.

Critics also maintain that the states would be unwilling and uncaring administrators of services. This implies that only the federal government is capable of compassion. Dozens of welfare and civil rights groups complained that states would use block

---

6 "Coalition Condemns Plan for Block Grants to States," Washington Post, May 21, 1981. A June 24, 1981, memorandum written by Susan Phillips of The Conservative Caucus demonstrates that many of the 63 groups were recipients of large amounts of federal grants. Mrs. Phillips documents, among other facts, that some of the groups are actually affiliates or projects of groups mentioned elsewhere on the list. Other groups had no phone numbers, were unaware that they were on the list of 63 groups, or were projects that existed solely through a federal grant.

grants as an opportunity to gut basic benefits and service delivery for the needy.[7] Carl Rowan, in a column entitled "Help for Needy Retreats to Block Grants Shelter," wrote: "In hundreds of [economic] areas of life, state and local officials were unable to meet the needs of families that couldn't pay fuel bills or dental bills, or bills of other vital needs. In some cases--food programs, for example--troglodyte local officials even rejected what they could have for free from Uncle Sam."[8]

Key lobby groups, such as the U.S. Conference of Mayors and the National Conference of State Legislatures (NCSL), oppose wholesale distribution of discretionary power to states--not because states are inexperienced or incompetent overseers of programs but rather because they see the states as stingy in distributing monies to the cities and counties.

Concern over the capabilities and dedication of state governments ignores the impressive political maturation of state legislatures during the last ten to fifteen years. Between 1974 and 1980, the number of legislative committees and support staff doubled. Professor Alan Rosenthal of Rutgers University concludes:

> State Legislatures have recently undergone significant change.... Legislatures are more likely to meet annually than biennially. They spend more time in session than before. Professional staff has increased. Research agencies nearly everywhere are larger, many more important standing committees have assistance and leaders in more than half the states have full-time staff support."[9]

In fact, it has been these improved resources that have enabled the states to establish such a commendable record on assuming responsibility for the block grants.

THE 1981 BLOCK GRANTS

The nine block grants, passed by Congress as part of the 1981 Omnibus Reconciliation Act, contain the following principal provisions:

Maternal and Child Health Services. Seven categorical grants are consolidated--Maternal and Child Health, Supplementary

---

7 For specific comments by those groups, see "Block Grant Proposal Carries Few Strings," Washington Star, March 7, 1981.

8 Washington Star, May 31, 1981.

9 Dr. Alan Rosenthal, Legislative Performance in the States (New York: The Free Press, 1974), pp. 2-3.

Security Income [Children], Hemophilia, Sudden Infant Death Syndrome, Lead-Based Poisoning Prevention, Genetic Diseases, and Adolescent Pregnancy. The consolidation is designed to enable states to improve the health of mothers and children and support special research, training, and service programs. This block grant is funded at $373 million for FY 1982.

Preventive Health and Health Services. This program consolidates eight categorical grants, including Home Health Incentive Grants, Fluoridation, Rat Control, Health Education/Risk Reduction, Hypertension, Emergency Medical Services, and Rape Crisis Counselling. The consolidation is designed to improve the health of recipients by preventing incidence of unnecessary injury, illness, or death. This block grant is funded at $95 million for FY 1982.

Alcohol and Drug Abuse and Mental Health Services. This consolidates five programs--Alcohol Project Grants, Alcohol Formula Grants, Drug Abuse Project Grants, Drug Abuse Formula Grants, and Mental Health Services. The consolidation seeks to improve the health of recipients by providing treatment, prevention, and rehabilitation services. This block grant is funded at $491 million for FY 1982.

Primary Care. This applies to only one categorical grant, the Community Health Centers, which is converted into a block grant by increasing state alternatives for providing primary health care. It is funded at $302 million for FY 1982.

Social Services. This block redesigns three programs previously authorized under Title XX of the Social Security Act--Social Services, Day Care Services, and State and Local Training. The primary purpose is to prevent or remedy neglect, abuse, or exploitation of vulnerable children and adults and to prevent inappropriate institutional care. It is funded at $2.45 billion for FY 1982.

Low-Income Energy Assistance. Designating the Low-Income Energy Assistance Program a block grant gives the states more flexibility in their assistance to eligible households for heating, cooling, and weatherization costs. Consolidation also reduces federal requirements for state assistance under the program. This block is funded at $1.87 billion for FY 1982.

Community Services. The consolidation redesigns programs previously administered by the Community Services Administration, including Community Action, Senior Opportunities and Services, Community Food and Nutrition, Training and Energy Conservation, Evaluation, and Technical Assistance. Consolidation is designed to enhance the anti-poverty efforts of federal, state, and local governments. This block grant is funded at $389 million for FY 1982.

State Community Development Block Grant Program for Small Cities. This consolidation gives states the option of taking over responsibility for a program previously administered by the Department of Housing and Urban Development. It seeks to enhance housing, income, and environmental living conditions for low-income individuals. The block is funded at $1.08 billion for FY 1982.

Elementary and Secondary Education. This consolidation has two chapters. The first streamlines programs in Title I of the Elementary and Secondary Education Act--Basic Grants to Local Education Agencies, Concentration Grants, Migratory Children, Handicapped Children, and Neglected and Delinquent Children. Chapter 2 consolidates 27 other elementary and secondary programs, such as Basic Skills, PUSH-EXCEL, Metric Education, Consumer Education, Library Resources, Community School Aid, Gifted and Talented, Ethnic Heritage, Teacher Corps, and Alcohol and Drug Abuse Education. This block grant is funded at $518 million for FY 1982.

HOW CONSOLIDATION WORKS

The Reagan Administration's 1981 economic recovery plan stressed two aims of block grants: (1) to reduce the cost and number of federal-state categorical programs and (2) to limit the growth of aid under such programs.[10] To achieve these goals, the Administration proposed to consolidate almost 100 different categorical programs into seven blocks--grants that would allow states to implement the programs free from the need for annual reports, maintenance of effort standards, state matching funds, or even the submission of applications for the grants. The grants would have been funded automatically without the means tests and application procedures associated with categorical programs.

The block grants were supposed to involve substantive regulatory reform for many categorical grants. This was to result in less overhead, a greater share of benefits going to the needy, increased flexibility for state and local officials, and improved political accountability for the programs. Robert Carleson, Special Assistant to the President for Policy Development, summarized the block grant rationale:

> In conjunction with regulatory reform, block grants are designed to reverse the trend towards greater federal control over state and local programs. They represent a means of ameliorating the impact of federal spending reductions, which are required in this economic climate.

---

10 "Consolidating Categorical Programs into Blocks," A Program for Economic Recovery, 1981, pp. 7-1 and 7-2.

> Block grants reduce state and local compliance costs, eliminate waste, reduce federal administrative costs, and make state and local officials directly accountable to their constituents.[11]

Despite Carleson's assurances, some observers point out that the consolidations are not true block grants, for they include the sort of restrictions that characterized the grant consolidations of previous administrations. Many governors, for instance, have their doubts. Said Governor James Thompson to the Illinois General Assembly: "We were promised relief from regulations and mandates. Instead, the states will receive these half-hearted, watered-down versions of the original proposals. We got the cuts, but not the flexibility."[12]

Earmarks

It is easy to understand why the 1982 grant consolidations might be considered "categorical" conversions instead of "block" conversions. In some cases, Congress attached provisions to the grants that escalated costs beyond what the states might have authorized otherwise. In other cases, Congress enacted spending and distribution restrictions that made the states little more than a conduit for carrying out a federally prescribed course of action. One example is the "earmark," a term referring to the percentage of grant funds that must be set aside for a purpose prescribed by statute.

Earmarks limit the range of spending and management options of a state. In the Elementary and Secondary Education Block Grant, for example, 80 percent of the funds available from the federal government must be "passed-through" automatically to local education agencies "on the basis of relative enrollment adjusted for relative numbers of higher cost children." With the education block, therefore, the states not only must give the lion's share of their monies to local entities, but also must distribute the monies in accordance with a formula mandated at the federal level. The earmarks in the education block are typical of the 1981 blocks. Six of the seven health block grants include such set-asides.

By reducing the states' ability to assign priorities for funding topic areas, the earmarks inhibit the states from redesigning previous categorical grants into a system uniquely responsive to their own needs.

---

11 The White House, Office of Policy Development, "Summary Fact Sheet: The Administration's Block Grant Proposals," May 14, 1981.

12 Quoted by Illinois State Representative Penny Pullen in "Guest Editorial," in The American Legislative Exchange Council's First Reading, October 1981.

Reporting and Audits

The spending mandates are one of the structural constraints imposed by Congress on block grants. Others require states to conduct reporting and audits of the block grant programs. Additionally, the blocks are still subject to federally required "cross-cutting mandates," even though the very purpose of the grant consolidations was to relieve the states of onerous tasks associated with federal rules. Cross-cutting mandates oblige the states to adhere to a wide variety of federal statutes of which they may not be aware. Those include affirmative action quotas, access to handicapped rules, Davis-Bacon construction wage requirements, and the Uniform Relocation Assistance Act. The latter raises potential financial problems for the states in that it requires governmental units to compensate individuals who are displaced because of a government project.

The GAO Findings

The block grant pitfalls left open by Congress were recently highlighted in an August 24 Report to the Congress by the U.S. General Accounting Office (GAO). The 57-page report noted the same earmarks and reporting requirements outlined above. The GAO added the observation that mandatory pass-through provisos and the slow rate of federal-state money disbursements complicated state planning efforts. In some states, according to the GAO, federal requirements forced the states to "sharply increase expenditures" in some of the blocks.[13]

In general, however, the GAO gave high marks to the states for overcoming initial obstacles to block grant efficiencies. One of the most important factors that favored the states at the outset was their working familiarity with block grant recipients. The report cited Colorado, Kentucky, Washington and Michigan as prime examples of states continuing to use previously funded grantees as service delivery systems. "Because of states' prior experience, relatively few organizational adjustments were needed," stated the GAO report. The GAO added: "In addition to employing existing organizational structures, states drew upon their institutional knowledge for carrying out block grant responsibilities. For most block grants, details on how the previous programs were run, their purposes, and the activities required were well known. Moreover, states often had existing relationships with service providers."[14]

The GAO report is useful to the extent that it reaffirms the states' abilities to be creative under pressure. However the report raises some unanswered questions that will be dealt with

---

13 Report to the Congress by the Comptroller General, "Early Observations On Block Grant Implementation," U.S. General Accounting Office, Report #GGD-82-79, August 24, 1982, p. 25.

14 Ibid., p. 12.

elsewhere in this Backgrounder. The report declares that states made few organizational changes during the categorical-block grant transition, but does not identify savings that states made in the process. The report mentions that private contractors from the categorical system were retained under the blocks, but does not examine how previously covered recipients are affected. It notes that state legislatures are becoming more active in oversight and implementation of the blocks, but does not analyze how their increased role affected eligibility criteria. The report identifies institutional obstacles that impede program efficiency, but does not suggest ways to improve the block grant structure in a meaningful way. And finally, the report restricts itself to 13 specific states, without any reference to successes achieved in the other 37.

Flexibility

The GAO study is correct in stating that the block grant legislation enacted in 1981 gives the states some important flexibility. In the Social Services and the Alcohol and Drug Abuse and Mental Health blocks, Congress repealed a matching fund requirement which, under the categorical system, obligated the states to appropriate monies from their own treasuries equal to the federal outlay. In four new blocks (Low-Income Energy, Community Services, Preventive Health, and Alcohol and Drug Abuse and Mental Health), states can transfer funds from one block to another. In all the blocks, states can decide how to design and write their applications for funding. Freed from standard forms, the states will "save" 5.4 million man-hours that would otherwise have been spent on paperwork, according to Office of Management and Budget estimates. These reductions in man- hours will reduce paperwork time by 83 percent.[15]

Flexibility is also gained in that the states can now decide the date of their participation in the block grant program. This option is an important political concession to the states since the final form of block grant legislation was not clear until several months after the states' fiscal year began (for 46 states, the date is July of each year). States needed time to develop applications, prepare demographic data, project expected participation, and itemize probable outlays. Granting discretion to the states regarding the date of participation gave them the opportunity to phase out efficiently the categorical system and the time to solicit bids from the private sector for some block grant functions.

In sum, it is debatable whether the 1981 grant consolidations represent true block grants. State governments did not have

---

15 U.S. Office of Management and Budget, "Block Grant Implementation: Effect of Block Grants on Paperwork Reduction," Attachment #3, September 21, 1981.

unbridled discretion regarding financial and administrative management. On the other hand, the states did have some latitude regarding contracting out of services, transfer of funding, and gradual conversion from categorical to block grants. Additionally, the block grant consolidation offered significant reductions in compliance costs and paperwork burdens.

PROGRESS OF THE BLOCKS: IMPLEMENTATION

Block grant enabling legislation was purposely vague on the matter of responsibility--in the case of all the blocks except education, "the state" meant the governor or the legislature. It was equally silent about process, state compliance with civil rights guarantees, distribution of benefits, and the procedures that each state should use to ensure public participation in the block grant process. The Children's Welfare League, the League of Women Voters, the Center for Community Change, and other interest groups expressed serious concern that the public would be excluded from the block grant process, once those jurisdictional and technical questions were resolved.[16]

Two-thirds of the nation's governors have formed task forces to review block grant problems; these are mainly advisory bodies and are not authorized to dictate the nuances of implementation.[17] Similarly, several state legislatures have voted themselves the authority to apply for or accept block grant applications. Most states are administering the blocks by using existing personnel. A handful of states, notably Louisiana and Texas, are using the federal block grants as an opportunity to merge similar state programs into a single state office.

Some states have found that block grants are useful for giving local governments more control over basic benefit programs. California and Oregon are the two states most actively decentralizing block grants to the county level--so-called mini-block grants. California officials have already given counties complete authority to administer the Social Services Block Grant. As a result, state officials feel that they can absorb the funding reductions that accompanied the block grant. Only a minimal number of state personnel is needed to oversee the counties' efforts. The counties, meanwhile, are using volunteer services and private contractors to cut costs. The California innovations have attracted attention; the Pennsylvania and Illinois General Assemblies, for example, are now debating the prospect of establishing mini-block grants for their state-local grant awards.

---

16 Those concerns are detailed in a lengthy "Briefing Book" about block grants (Washington, D.C.: Center for Community Change, 1981).

17 James Stockdale, Deputy Undersecretary for Intergovernmental Affairs, Memorandum to Regional Directors, U.S. Department of Health and Human Resources, May 24, 1982., p. 23.

Critics' fears that the public would be excluded from the process have proved unfounded. Federal enabling legislation requires states to conduct an initial public hearing about the distribution and structure of the blocks. Indeed, states had to hold such hearings before they could receive the block awards. The states have complied with this mandate and are making public hearings a regular, integral part of the block grant process. In a few states (notably Utah and Virginia), the executive branch of the state government has established toll-free telephone numbers through which the public can report problems or successes with the blocks.

Other states have been equally innovative in tapping public views of block grants. Efforts range from advertising in newspapers and on television to holding field hearings in the locations most likely to benefit from the blocks. At a Nebraska hearing, approximately 1,500 people turned up.

The block grant program is the first major federal-state effort that gives the public an opportunity to comment on plans for major grants-in-aid policies. This alone makes it a critical element of the New Federalism structure. The states' hearings constitute the first instance of the public at state and local levels being brought into the policy planning process. A February 1982 survey by the National Governors Association (NGA) found that state public hearings on block grants will be even more widespread in 1983.[18] "If nothing else," concluded the NGA survey, "the data provided by the states clearly and emphatically show that citizens were provided a multiplicity of opportunities to participate in the process....[F]or all the programs (except Title XX and Social Services Block Grant) this is generally the first year in which the public has been involved so heavily in the process of program decisions."[19]

PROGRESS OF THE BLOCKS: FINANCIAL MANAGEMENT

Once the states resolved the issues of authority and public participation, the immediate problem was how to manage the financing of the block grants. Initially, funding was not technically a part of the state budgets, since the states' fiscal years had already started at the time Congress approved funding. When the blocks were enacted, therefore, the states faced a number of problems.

1. <u>How to accommodate the budget reductions</u>. The Reagan Administration originally requested that the blocks be 75 percent

---

18 The NGA survey also shows that 35 states plan to increase public participation during FY 1983. "1982 Governors' Guide to Block Grant Implementation," National Governor's Association (February 1982), p. 21.

19 <u>Ibid.</u>

of the FY 1981 funding for the relevant categories. The states were expected to make up the budget gap through reduced overhead and compliance costs. The General Services Administration, however, estimated that administrative costs associated with the categorical grants amounted to only 5 to 15 percent of total outlays. Moreover, the economic recession increased normal demand for services under the grants program--services that, under the federal enabling legislation, required the states to cover certain categories of persons.

2. Whether to transfer funds between blocks. The enabling legislation allowed the states to transfer certain amounts of grant funds from one block to another. Though states can direct a small percentage of unused monies to another grant program in order to compensate for unexpected shortfalls in the blocks, such a grant diversion might reduce the funds available from the federal government in future cycles.

3. How to maximize service delivery with a minimum of administrative costs. This issue is particularly poignant for block grants because of the federally mandated cap on administrative expenses.

Accommodating the reduction of federal funds did not become a major problem. The reason: there was almost no cut in federal outlays to the states. Though all state officials had come to expect a uniform 25 percent reduction in funding for the blocks, the final cut, as set by congressional Continuing Resolutions, amounted to only 10 percent. Even this turned out to be far over the mark. The National Association of State Budget Officers estimates that, as of February 1982, the collective outlays for those programs (at the state level) dropped an average of just 0.5 percent,[20] meaning that the states have not had to cut budgets or raise taxes to accommodate the anticipated reduction in block grant funding--it never took place.

States were concerned with the distribution procedure for the funds. Disbursement is governed by two federal processes, the Intergovernmental Cooperation Act (ICA) and the Continuing Resolution of Congress. The first posed a cash-flow problem for states because it obliges the federal government to give grants to states only on an actual or immediate need basis. In other words, the state governments count block grant funds as part of their state budgets, but the federal government will disburse funds only on an incremental, quarterly basis. This restricts the states' abilities to deposit block grant monies for interest-yielding purposes in banks and other lending institutions--a

---

20 Ibid., p. 37. Individual state changes in federal funding for the blocks ranged from +2.3 percent to -19.8 percent.

common cash management practice. The ICA thus effectively reduces the total funds available for services.[21]

The federal government's reliance on a Continuing Resolution to fund programs compounds the cash management restrictions. The Continuing Resolution usually covers program funding for no more than a few months. In the case of block grants, the federal government's use of such stop-gap budgeting prevents the state governments from receiving funds on a predictable and regular manner.

The double restrictions of the ICA and the Continuing Resolution have caused particular problems for blocks subject to unusual demand, such as the Low-Income Energy Block Grant, designed to give aid to needy individuals who cannot pay their high heating bills. The Low-Income Energy Block Grant naturally incurs its greatest outlays during the winter months, but ICA guarantees the release of funds only gradually; financing via the Continuing Resolution, meanwhile, assured that the funds would be less predictable. Officials at the Office of Management and Budget apparently attempt to take into consideration the states' problems and give a high priority to expediting block grant disbursements. While the ICA required the government to make only quarterly payments, OMB officials try to make funds available in line with actual program operations.

Although there were fears that Low-Income Energy funds would be inadequate to meet states' needs, over two dozen states, as of Spring 1982, had transferred funds, capped at 10 percent by federal legislation, mainly to augment funding for the Social Services Block Grant. Five states transferred Low-Income Energy funds into weatherization programs,[22] and 26 states transferred funds into Title XX of the Social Services Program.[23] Therefore, in spite of initial cash-flow problems, the states have found surplus funds to be redirected into other block grants.

In the short run, the interblock transfer of funds has enabled states to reassign priorities within the blocks to the extent allowable under law. The long-run consequences are not as clear, however, because the transfer of funds out of a block may signal to future federal administrators that the state was awarded too much money for that block.

---

21 The technical procedure by which states receive their funds is explained in "The Block Grant Award and Cash Disbursement Procedures," a fact sheet (Office of Management and Budget, October 2, 1981). Additional details are given in a question-and-answer paper, untitled (Office of Management and Budget, September 29, 1981).

22 Colorado, Kansas, Maine, North Dakota, Oklahoma.

23 Alabama, Arkansas, California, Florida, Georgia, Iowa, Kansas, Kentucky, Louisiana, Maryland, Michigan, Missouri, Montana, Nebraska, New Jersey, New York, North Dakota, Oregon, South Dakota, Utah, Vermont, Virginia, Washington State, West Virginia, Wisconsin, and Wyoming.

PROGRESS OF THE BLOCKS: SERVICE DELIVERY

It is becoming evident that service delivery under the blocks is better than it was under the previous categorical programs. The states' successes can be examined in terms of: (a) the nature of new recipients previously excluded from the categorical grants and the scope of new services available; (b) the level of administrative activity and the proportion of block grant monies consumed by administration.

Scope of Block Grants

In all the blocks, there has been an increase in new, previously uncovered recipients--a change directly attributable to the reassignment of priorities within the blocks. In Montana, for example, one portion of the Maternal Child Health Block Grant was merged with the Handicapped Children's program. Montana's consolidation increased the projected participation in the program by about 11 percent. Similarly, Louisiana is regrouping all state community service programs into the same State Department of Labor division that will handle the Community Services Block Grant. New York State officials are merging the Social Services Block Grant and Alcohol and Drug Abuse and Mental Health Block Grant into an existing "Consolidated Services Planning Process." Thirty state governors have established a lead agency responsible for coordinating the blocks with state programs. Thirty-two state governors have created task forces whose mandates include the identification of existing federal or state rules that prevent augmentation of the blocks.

This consolidation by the states runs counter to the predictions of critics who believed that states would use block grants to cut aid to needy individuals. In fact, the consolidation has improved service to the needy since the programs are now designed to give priority to categorically needy persons.

The majority of states have drafted comprehensive lists of "risk factors" to serve as a precondition for distribution of block grant benefits. In the case of the Preventive Health Block Grant, states are giving priority to areas with either high rates of communicable diseases or areas with high propensity for health related problems (e.g., high crime areas where rape prevention programs may be useful). Similarly, some states are using the Community Services Block Grant to contract with private providers willing to address the needs of unserved populations. Under the Community Services Grant, there is a trend for new services to be provided for previously unserved groups via competitive bidding for contracts. Delaware and Arkansas have been especially active in the competitive bidding/contracting-out process.

Are the consolidations and redesigning by states adversely affecting previous recipients? Until the states complete their audits of the blocks, no definitive answer is possible. Thus far, however, the states seem to be taking steps to offset serious shortfalls in projected aid. In the case of the Maternal and Child Health Services Grant, the use of supplemental appropriations by the states is especially noticeable. Forty-five states are offering the basic matching fund required by federal law ($3 in state funds for every $4 in federal funds);[24] 19 states are matching federal funds in excess of the match prescribed by federal law;[25] and 19 states are requiring some sub-unit of state government to provide an additional match of federal monies.[26]

As of June 1982, approximately two-thirds of the states had not made changes in eligibility requirements for either individuals or grantees. The remainder of the states are considering changes in eligibility, but those changes, if enacted by the state general assemblies, will only affect recipients of the FY 1983 block grants. This preservation of eligibility requirements means that the blocks are still servicing the same broad groups of beneficiaries. What has tended to change is the priority under which the recipients are given benefits.

The states also have adequate safeguards to assure compliance with nondiscrimination provisions of the federal block grant laws. As of July 1982, no state had been sued or charged in a similar civil action that alleged discriminatory practices vis-a-vis block grants. Given the high degree of public and intergovernmental interaction on the block grant program, there are adequate checks to detect violations of civil liberties.

Economies in Administration

One group only has suffered from the institution of block grants: the state bureaucrats who usually audit, survey, monitor, or otherwise certify the progress of categorical grants.

Federal legislation still ensures a full public accounting of the blocks. Each state is required to provide federal agencies with an annual independent audit. Still, the paperwork burden formerly imposed on states through categorical grant regulations is noticeably absent. It is still too early to assess the impact of reduced paperwork on individual states. State budget officers, however, believe that the paperwork costs will be much lower than those under the categoricals--if for no other reason than that the latter required several reports for 57 different programs. In contrast, the new block grants require

---

24 The five exceptions are: Iowa, Nebraska, New York, Oregon, and West Virginia.

25 Alaska, Arizona, Arkansas, Georgia, Idaho, Illinois, Louisiana, Maine, Maryland, Michigan, Mississippi, Missouri, Nevada, New Hampshire, North Carolina, Ohio, Rhode Island, Tennessee, and Wyoming.

26 Alabama, Connecticut, Delaware, Georgia, Illinois, Indiana, Kansas, Minnesota, Montana, Nebraska, New Jersey, North Carolina, North Dakota, Oklahoma, Pennsylvania, Rhode Island, Tennessee, Texas, and Wisconsin.

only one or two smaller reports for just seven individual programs. Accordingly, states expect to spend at least 40 percent less on conducting audits and compliance reports than in FY 1981.

Preliminary trends suggest that the very modest funding reductions are not straining state financial resources. Inter-block transfers (especially for the Social Services block), supplemental funding (beyond the matching fund requirements of some blocks), and the projected reduction in compliance and paperwork costs have all contributed to the solvency of the blocks. In a handful of states, some innovative administrative action has further bolstered the self-sufficiency of selected blocks. Montana's decision to terminate specific projects under the Maternal and Child Health block and Washington State's action to impose limited user fees for nonpriority services are but two instances of cost-saving measures. That the states are making such decisions demonstrates that a fundamental purpose of the block grant system has been achieved: states have responsibility for program operations, to the point that they are now accountable for the grants.

Increasing Decentralization

The states also have shown that block grants are only a first step down the ladder of decentralization. For some states it has prompted the mini-block grant approach that has helped reduce unneeded overhead while returning responsibility to local officials. In the interim, the states' decentralizing programs are demonstrating a sophistication and sensitivity to local needs that refutes arguments of early critics that the states could not handle the grants fairly and effectively.

The irony is that states are making strides in spite of continued federal restrictions. Those restrictions, which have more to do with congressional action than with Administration policy, will dampen future state innovation. The restrictions are unnecessary, redundant, and inconsistent with the blocks' goal of permitting maximum flexibility for the states. That states established the mini-block systems on their own initiative suggests that they do not need the guidance and supervision inherent in the spending restrictions imposed by Congress. Unless such restrictions are removed, a future Administration or Congress may add further burdens. Only by drastically revising or repealing these restrictions now can decentralization accelerate.

NECESSARY REFORMS

Finance

Neither the National Governors' Association report nor the GAO study offers substantive recommendations about how to improve the block grant program enacted in 1981. The recommendations that the two reports do make are limited to technical transition and data collection changes -- hardly the sort of needed reforms that can bolster the long-range security of the blocks. The evidence presented above suggests that at least three financial reforms are needed. First, the federal government should require immediate disbursement of all available block grant monies to the states. The theory that the states should only be allotted funds on an actual and immediate need basis presumes that states will either overspend or misuse the funds. States have the financial maturity to handle large public funds deposits. Transmitting available funds to states immediately would reduce the reliance of the states on federal authorities for permission regarding the disposition of funds. State governments deserve a free hand in the management of public funds, if only because they are the entities responsible and accountable for block grant operations.

Second, the cash management of public funds should be reformed. Currently, states are allowed to use grant awards only for actual grant outlays, meaning that they cannot deposit block grant funds in banking institutions for interest-yielding purposes. The problem with this restriction is that unobligated grant funds (however large or small) should be accumulating interest while not being used. If the states are allowed to invest block grant funds on a periodic basis, they have a way to augment their initial grant award. As such, Washington should either authorize cash management of monies by states; or, at a minimum, allow states to receive proceeds from the federal management of undisbursed but obligated block grant monies.

A third financing reform concerns the day care portion of the Social Services Block Grant. Currently, almost two dozen states are implementing some form of Community Work Experience Program (CWEP), also known as "workfare." These CWEP programs require recipients of certain public aid programs to "work off" their benefits by taking positions with public service agencies, which often include day care centers. Since the CWEP approach is a goal of the Administration, and since the CWEP option is currently nonbinding on the states, the Social Services block should be revised to give states an incentive to establish a workfare program that includes day care options. The incentive for the state could be financial: States with a certified CWEP program that includes substantive day care provisions ought to be allowed to transfer funds from the day care portion of Social Services into another grant program. This approach would have the advantage of encouraging the remaining two dozen states to establish full or partial CWEP programs, while at the same time freeing a sizable portion of the largest block grant for use elsewhere.

Administration

There are several reforms that can be made in the administration of block grants. Each would reduce the costs of the block grant system, introduce competition into the process, and increase flexibility for the states. The reforms also would increase the service delivery potential of the blocks.

Bring block grant activity under the jurisdiction of OMB A-85 mandates, or else require states to contract-out certain functions of the grant awards. The contracting-out process can either be broadly worded to cover all possible activities that are not inherently governmental in nature; or the procedures can be restricted to services that are directly "private" in nature, such as data processing, records keeping, processing of claims, or warehousing.

Allow states the right to seek discretionary regulatory relief from the federal government. This option would allow states to seek a waiver from any federal regulation that is particularly inappropriate or inapplicable to their geographic area. Relief could require that federal waivers be printed in the Federal Register, along with the normal comment period and review cycles.

Allow states to transfer larger portions of funds between block grants. Currently the Community Services block allows only a 5 percent transfer, the Low-Income Energy block 7 percent, and the Alcohol and Drug Abuse and Mental Health block 7 percent. Expanding the scope of transfer capabilities would not necessarily diminish block grant service delivery since the evidence shows sincere efforts by the states to focus block grant benefits on needy and previously unserved populations. Increasing the inter-block transfer ability encourages states to find ways to better manage finances.

Allow states to deliver block grant benefits in the form of vouchers. The voucher approach, already used in the federal Food Stamp and G.I. Education program, would encourage block grant recipients to reduce expenses and would introduce more competition among vendors of services.

Repeal the matching fund requirements. These requirements increase block grant costs by forcing specified levels of state outlays. States can provide useful in-kind services to compensate for reduced matching requirements. Current efforts to consolidate state programs alongside federal programs and provide supplemental matching funds by sub-units of government suggest that states will augment blocks regardless of matching fund requirements.

All the suggested reforms require some statutory change by Congress. As yet, no effort has been made by Administration officials or congressional aides to introduce the reforms required in these recommendations. In fact, no effort has been made to reduce the regulatory burdens usually associated with the grants-in-aid system. If the block grant strategy is to be successful, then much more reform is needed.

CONCLUSION

In addition to reforms in the present block grants, Congress and the Administration should press forward with a plan to extend the block grant mechanism to the major social programs, as envisioned in the President's original New Federalism proposal. Income maintenance, nutrition, health, housing, and economic development should be examined as candidates for block grants. A blueprint for the consolidation of certain categorical grants in these areas has been outlined in publications by The Heritage Foundation and the American Legislative Exchange Council.[27] Consolidating another $50 billion in categorical programs would not hamper their administration or undermine the eligibility rights of needy individuals. Indeed, as this study has shown, the service programs surely would become more responsive to recipients, less expensive and less bureaucratic.

Far from retreating on the initial goal of transferring the planning and operation of major social programs to the states, the White House should make the consolidation of programs into block grants a top priority of New Federalism. While the desirability of funding these basic services at the state level may still be uncertain, the benefits of administration by the states are very clear.

Prepared at the request of
The Heritage Foundation
by Edgar Vash

---

27 Thomas M. Humbert, "Budget Cuts: The Key to Economic Recovery," Heritage Foundation Backgrounder #151, September 18, 1981; White Paper on New Federalism: The ALEC Alternative (Washington, D.C.: The American Legislative Exchange Council, 1982).

Edgar Vash is a Washington, D.C.-based consultant on state and local finance.