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SYMPOSIUM ON THE DEVOLUTION REVOLUTION

FEDERALISM AND REDUCTIONS IN THE FEDERAL BUDGET

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INTRODUCTION

Our national constitution incorporates built-in tensions of economic federalism, enumerating certain powers for the central government, while reserving others for the states. The historical resolution of these tensions has a complex political and economic history.[1] Given the substantial inertia that is built into the U.S. federalism system, it is not surprising that the current set of economic responsibilities has evolved only slowly during the past two centuries.

Almost 15 years ago, it appeared that a new period in federal relations would begin when the Reagan administration proposed to reverse the long-term trend toward the centralization of financing of government services. The Reagan proposal sought to return to states and localities all financial responsibility for income redistribution (Aid to Families with Dependent Children (AFDC) and food stamps) as well as control over more than 60 federal programs targeted to low-income households, including education, community development (e.g., water and sewer programs), transportation, and social services. This was to be accomplished, in part, by a cut in specific grant programs and, in part, by the consolidation of other programs into a single block grant program.

The Reagan federalism initiatives forced a serious rethinking of the evolutionary path of the public economy, which had moved the financial and managerial responsibility for public goods and services steadily upward to the national level. While the core reforms of the Reagan "New Federalism" proposal never became law, the Reagan budgets significantly curtailed the levels of federal support for state and local governments. This curtailment was bifurcated: Federal support for spending on local goods and services declined dramatically, but federal support for distributional programs, especially those involving health care, increased substantially over the past decade and a half.

The budget issues that have divided the Clinton Administration and the 104th Congress mirror those of the Reagan initiative in many ways. Rather than

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marking a reversion to the New Federalism of the 1980s, the current debate may well signify the beginning of a new period of retrenchment in American federalism. The debate puts the presumptions of our entire federalist system under scrutiny and asks whether the current structure of responsibilities is appropriate to the 21st century.

There are at least two ways in which appeals to federalist principles can affect the revenue requirements at the federal level, the size of the federal deficit, and the economic relationship between central and local governments. These include "mandates," direct orders from the central government, and "grants," powerful but indirect incentives provided by the federal government. The second and third sections analyze the positive aspects of these two facets of federalism. The fourth section provides a more normative discussion and some brief conclusions.

BUDGET CUTTING THROUGH MANDATES?

Federal mandates—directives to state governments—are a built-in feature of America's federal structure. Mandates reflect the constitutional division between the enumerated responsibilities of national government and those reserved to the states by the Bill of Rights (in the tenth amendment).

At one level, the appropriate use of mandates encompasses fundamental questions of governance. Where in the system of governments should a policy be made? Who should be charged with the execution and implementation of a given policy? How much flexibility in execution should be afforded? Who should bear the costs of compliance? These philosophical and normative issues once dominated the budgeting policy debate. However, a narrower and more recent focus on "unfunded federal mandates" presupposes answers to these questions and invites the conclusion that central government directives have been used to save federal dollars by imposing expenditure responsibilities on state and local governments.

Federal mandates include a variety of distinct forms, encompassing differing rationales, costs, and levels of direction of state activity by central authorities. One indirect form of federal control, through conditional grants, is considered in the next section. In this section, we consider other more direct forms. These include direct orders, cross cutting requirements, crossover sanctions, and statutory preemptions.[2]

An economic taxonomy of federal government mandates is somewhat elusive. Table 1 presents our categorization of mandates by their economic rationale and the type of activity regulated. Objectives for federal mandates include the reduction of spillovers across states, the imposition of national standards, and the reflection of national norms. The first two are clearly efficiency enhancing rationales: air and water quality standards encourage concerted action by adjoining states on efficiency grounds. The requirement that highway access be provided uniformly for 40-ton trucks ensures a market for these vehicles. The prohibition against automotive fuel economy regulations by the states protects scale economies in auto design. In addition, many federal mandates are imposed on the basis of the third criterion, fairness—to ensure equal treatment of citizens across states (in antidiscrimination mandates or in drinking rules), equal access to mandated services (e.g., unemployment

TABLE 1
ECONOMIC TAXONOMY OF FEDERAL MANDATES

Type of Activity	Rationale: To Reduce Spillovers	Rationale: To Impose National Standards	Rationale: To Reflect National Norms
States must:			
1. Produce some good	clean air	highways appropriate for large trucks	unemployment insurance
2. Produce in a specified way	specific tests for drinking water	—	union wages in construction
3. Regulate firms and consumers (or refrain from regulation)	handgun waiting period	refrain from regulating fuel economy	drinking age at 21

insurance), or other forms of equal treatment (as in the removal of asbestos from schools).

The growth in the number of federal mandates, their complexity, and their costs to state and local governments was pointed out forcefully at the beginning of the Reagan administration (see Koch, 1980, for a characteristically sharp statement). In response, much more systematic information about the fiscal dimensions of proposed mandates is now available. (see Gullo, 1990; Barr, 1990).

Increased attention to the existence of mandates and their costs during the 1980s did little, apparently, to reduce the growth of federal mandates. For example, one count of conservatively defined statutory mandates reported that Congress enacted only one mandate in the 1930s, one in the 1940s, none in the 1950s, nine in the 1960s, and 25 in the 1970s. According to this definition, Congress enacted 27 more statutory mandates during the decade of the 1980s (ACIR, 1995).[3]

The increase in the number and complexity of mandates during the 1980s and 1990s raises the possibility that the federal government has been "saving" money by imposing fiscal burdens on lower levels of government. There is some documentation from the 1970s and 1980s supporting the second part of the statement—the increased financial burden on lower levels of government.[4]

There have been several recent efforts to increase further the salience of federal mandates and to make their costs more transparent. For example, the National Conference of State Legislatures now maintains and publicizes a "catalog" of federal mandates imposed on the states. In addition, recent legislation (the Unfunded Mandates Reform Act of 1995) provides a rather carefully constructed definition of those mandates which "impose an enforceable duty" on lower levels of government. This legislation requires the Congressional Budget Office to prepare timely cost estimates for mandates expected to cost as little as $50 million.

Several credible cost estimates are available for the most important mandates imposed on state and local governments. The Environmental Protection Agency has produced estimates of the magnitude of costs imposed on central and lower level governments by the most important

environmental mandates of the 1980s. These are summarized in Table 2. Clean air, water, and land conservation, together with chemical requirements and multimedia mandates, impose costs of about $13 billion annually on the federal government and about $31.6 billion on state and local governments. (Other costs to households and private firms, not shown, are estimated to add an additional $76 billion to the bill).

The U.S. Advisory Committee on Intergovernmental Relations has calculated that mandates relating to the education of the handicapped, together with the Americans with Disabilities Act, impose costs of $1.3 billion annually on state and local governments. The Fair Labor Standards Act is estimated to impose annual costs of slightly less than half a billion dollars. Price Waterhouse has surveyed city governments about the costs imposed by federal mandates. The firm estimated that the ten most important mandates will increase the costs borne by city governments by about $54 billion during the next five years.

These expenditures are certainly substantial, and they may be quite burdensome to the state and local governments required to undertake them. Nevertheless, from the viewpoint of the federal budget process, the numbers are really quite small. The cost estimates, $30 billion or more annually,

TABLE 2
COST ESTIMATES FOR MAJOR UNFUNDED MANDATES
(THOUSANDS OF 1994 DOLLARS)

Type	Federal Costs	State and Local Costs	Note
A. Annual costs			
Air quality[a]	$ 1,202	$ 1,318	Clean air act, radon gas
Water quality[a]	8,437	19,974	Clean water act, safe drinking water, marine protection
Land conservation[a] environmental	1,765	8,226	Resource recovery, comprehensive response
Chemical requirements[a]	413	125	
Multimedia[a]	1,175	18	
Education of handicapped[b]	—	643	
Asbestos[b]	—	164	
Disabilities act[b]	—	664	
Fair labor standards[b]	—	484	
B. Aggregate costs to cities[c] 1994–98	—		
Underground storage tanks	—	$ 1,040	
Clean water and wetlands	—	29,303	
Clean air	—	3,652	
Resource Recovery and Conservation Act	—	5,476	
Safe drinking water	—	8,644	
Asbestos	—	746	
Lead paint	—	1,628	
Endangered species	—	189	
Disabilities act	—	2,196	
Fair labor standards	—	1,121	

[a]Environmental Protection Agency, Report of the Administrator, *Environmental Investments: The Costs of a Clean Environment*, Island Press, 1991, pp. 8-51, Table 8-12A. (Estimates are for 1988 in 1994 dollars.)
[b]U.S. Advisory Commission on Intergovernmental Relations, *Federally Induced Costs Affecting State and Local Governments*, Information Report M-193, September 1994, pp. 13 and 15. (Estimates are for 1991 in 1994 dollars.)
[c]Price Waterhouse, *Impact of Unfunded Federal Mandates on U.S. Cities*, Second Printing, December 1994, p. 4.

are on the order of two percent of federal expenditures. We must conclude that, although mandates may provide a battle cry for states' rights, they have not provided a substantial opportunity for offloading federal expenditures to the states.

INTERGOVERNMENTAL GRANTS: REFORM OR BUDGET CUTTING?

As noted above, federal edicts can require expenditures by state and local governments—expenditures which can substitute directly for federal outlays. Consequently, these edicts can be used to reduce the central government deficit. Federal grants-in-aid to lower governments also impose spending requirements and stipulations on recipients. Moreover, they involve substantial central government expenditures. As a result, federal deficit reduction can be achieved by tightening state spending requirements and simultaneously cutting grant-in-aid programs. If these programs are cut or modified in form, the conditions of receipt will change, as will the incentives of state and local governments to continue the provision of the affected public services.

We note that even general revenue sharing, in effect between 1972 and 1982, imposed some relatively modest restrictions on recipient governments (Nathan, 1975). Most restrictions on grants-in-aid apply explicitly to categories of expenditure by lower level governments, and many involve matching programs. As a result, as currently constituted, these programs stimulate the provision of state and local services.

Reforms in the intergovernmental grant system can therefore have two significant effects. First, changes in regulations governing federal programs may provide ample opportunity for intergovernmental grants to be cut in magnitude and changed in form—the result could be a substantial budget reduction by the central government. Second, both cuts and reformulations of grant programs may lead to substantial reductions in state and local spending on programs such as health and welfare. We treat each of these issues in turn.

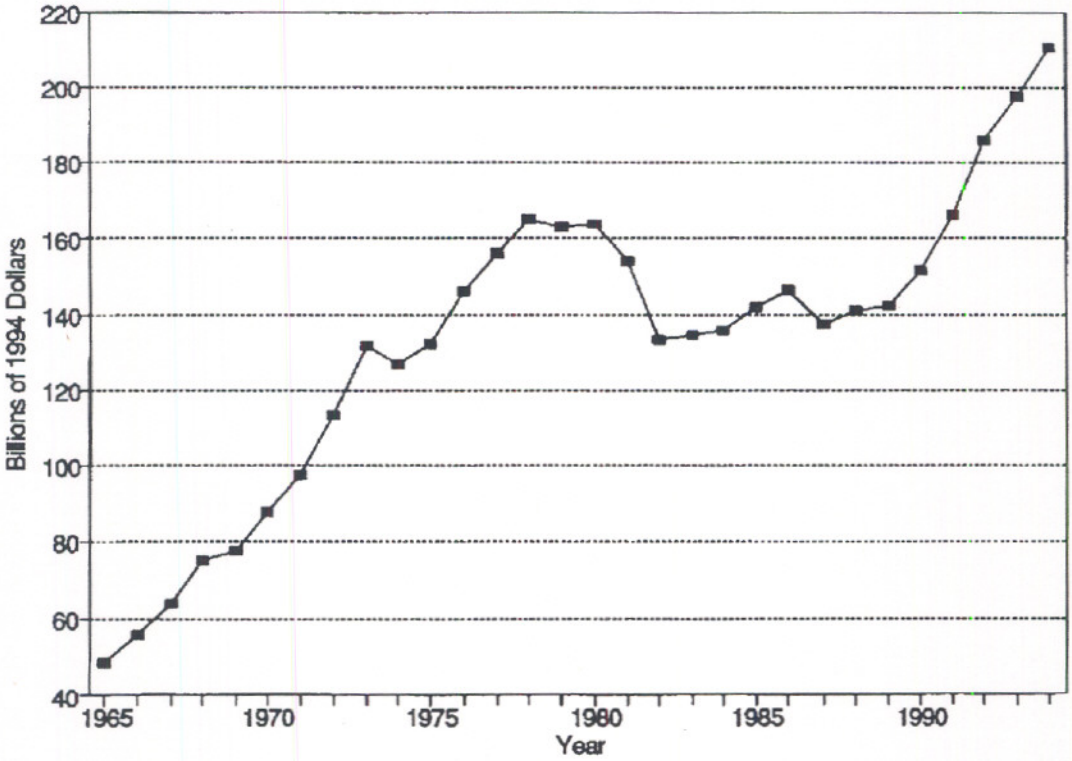
Reversing the Trend: Budget Cuts

Figure 1 reports the trend in federal government grant activity during the past three decades. In real terms, federal grants-in-aid quadrupled during the period, from under $50 billion to more than $210 billion (in current dollars). Importantly, more than one-fourth of this substantial increase has been registered in the last five years. Between 1989–94, federal grants in aid to state and local governments increased by more than $68 billion—from 2.4 to 3.2 percent of GDP.

Spending on grants exceeded 17 percent of federal spending in the late 1970s. The Reagan years saw a steady drop in the importance of grants, to about 11 percent of federal spending. However, since 1989, grants have increased again, up to roughly 15 percent of outlays.

Figure 2 reports trends in grants to state and local governments for the four largest expenditure categories: transportation, education and training, health, and income security.[5] As the figure indicates, there has been little change in the pattern of federal grants for transportation. The pattern of grants for education and training is more complex, but the current level of grant expenditures is substantially lower, in real terms, than it was in the late 1970s. The same cannot be said for federal grants for

FIGURE 1. Grants to State and Local Governments



Source: *Budget of the United States Government,* Fiscal year 1996, Historical Tables, Tables 10.1, 12.1.

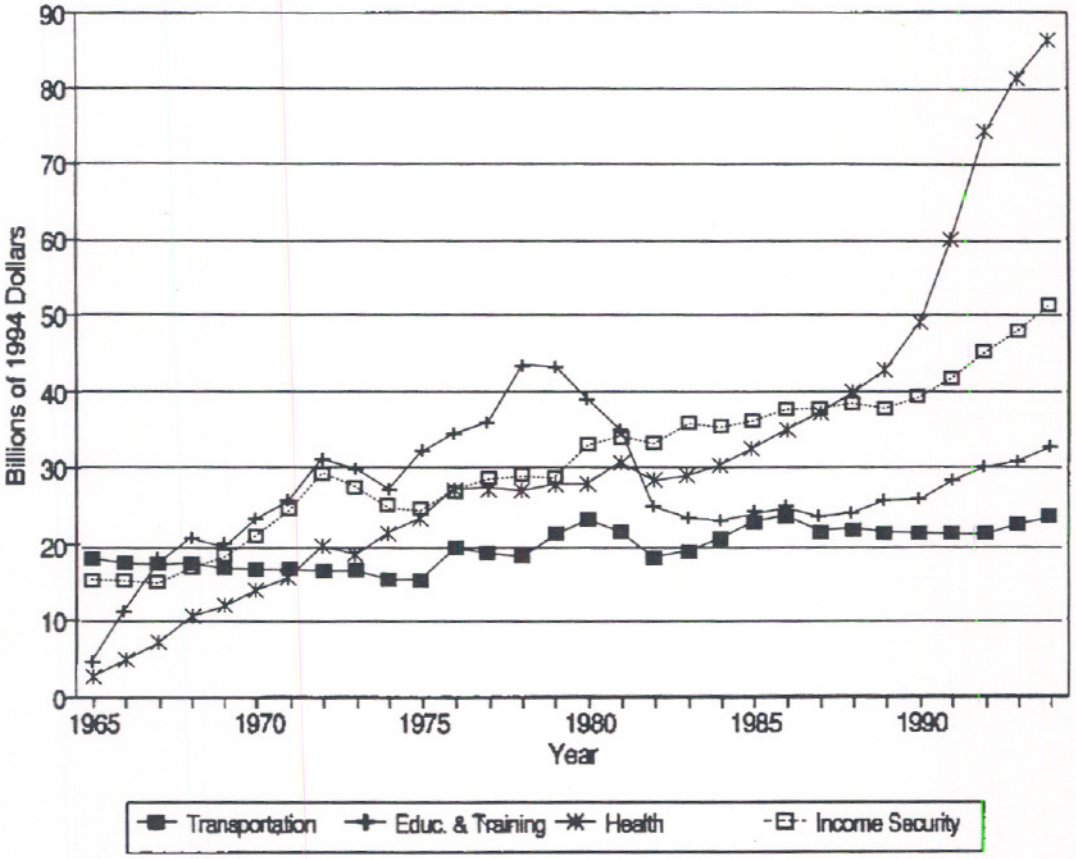
income security and for health. Grants to state and local governments for income security have risen steadily, from $15.7 billion in 1965 to $38 billion in 1989 (in current dollars). Since 1989, federal grants have risen sharply by $13.5 billion, or by more than one-third.

The increases in grants for health have been nothing short of explosive. Federal government grants to state and local governments increased from $2.8 billion in 1965 to more than $32.8 billion by 1985 (again, in current dollars). During the past decade, however, grants for health care have almost tripled, to $86.3 billion. The exponential growth of health care grants has continued—health care grants have doubled in the past five years alone.

Figure 3 reports the trend in federal grants to local governments for payments to individuals. Chief among these are, in order, medical care (chiefly Medicaid), public assistance (chiefly AFDC), housing assistance, and nutrition programs (not including food stamps). As the figure indicates, the trend between 1965–1980 is flat—grants for payments to individuals were something less than 35 percent of the total. The explosion since 1980 has almost doubled the fraction of grants to lower levels of government which are passed through as payments to individuals.

Similarly, there is a steady growth in dollar expenditures for grant payments to individuals until 1989—and an

FIGURE 2. Major Categories of Federal Grants



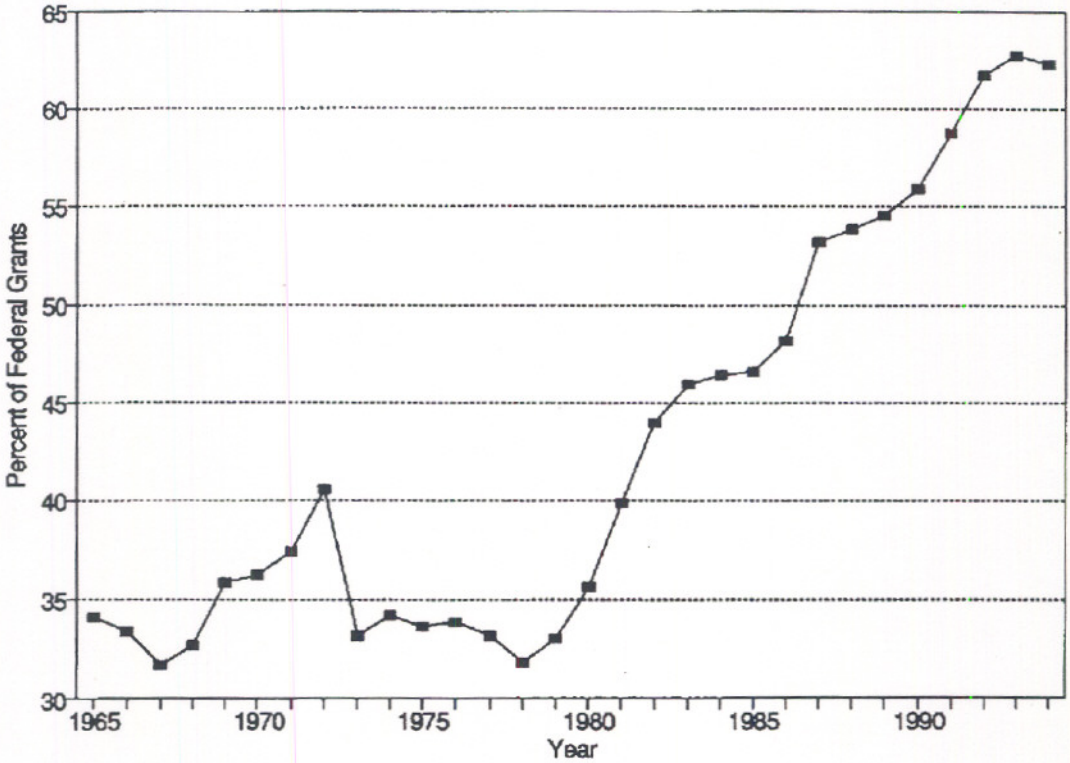
Source: *Budget of the United States Government*, Fiscal Year 1996, Historical Tables, Tables 10.1, 12.2.

explosive increase thereafter. These grants have *increased* by $53.4 billion in the past five years.

The trend in federal grants to state and local governments for payments to individuals is quite different from the trend in other types of grants-in-aid. Since the mid-1970s there has been a systematic decline in programmatic grants for education, transportation, and the production of local services and an increase in the extent of grants for payment to individuals—principally for medical care.[6] Since 1991, grants for medical care have exceeded *all* grants for goods and services provided to state and local governments.

The debate over whether the grant levels of the 1970s or even the 1980s were reasonable and appropriate will certainly continue for many years to come, as the specific public programs supported are reviewed and evaluated. Whatever one's view on the merits of specific programs, a serious commitment to deficit reduction implies changing the trends in federal expenditures on these programs. Indeed, much

FIGURE 3. Grants to Lower Level Governments for Inidividuals (as Percent of all Grants)



Source: *Budget of the United States Government*, Fiscal Year 1996, Historical Tables, Table 12.1.

of the current rhetoric for "reform" of health care and AFDC is explicitly motivated by deficit reduction efforts. No picture of budgetary reform can be complete, however, without considering the implications for the programs themselves of proposed changes in the federal system of intergovernmental aid. We now turn briefly to the possible effects that changes in grant programs will have on the state and local public sectors.

Local Governments' Response

Most state and local governments operate under balanced budget constraints. It is not surprising, therefore, that the aggregate of state and local budgets is in modest surplus rather than deficit. More to the point, however, the aggregate surplus has generally been declining for a decade.[7] Seen in this context, we should expect many states would choose not to provide equivalent services if they were given responsibility for health and welfare programs without the funding to support them.

The outcome of protracted budgetary debates between the Republican congress and the Democratic executive is unclear. There are clear incentives, however, to reform or replace current health and welfare programs—heavily subsidized by the federal government through a system of open-ended matching grants—by block grants of fixed size. For example, AFDC is

currently an open-ended matching program in which the price subsidy provided by the federal government varies inversely with state income, ranging from 50 to 78.6 percent. Medicaid matches state spending at the same rate as AFDC.[8] Even without any change in funding levels or other regulations, a switch from matching programs with price and income effects to block grants without price effects will lead to a reduction in state and local spending.

The state and local government responses to specific policy changes will vary substantially depending on current budgetary pressures and on preferences. Depending upon the regulations governing program change, we should expect that cuts in current programs will be very substantial. A review of the evidence on price and income elasticities of demand for transfer programs suggests the reasons. Recent work by Chernick (1996) provides some estimates of the responses of state and local governments to a programmatic change in which AFDC and Medicaid were converted to block grants. He suggests that the shift would raise the average price of a dollar of AFDC benefits and Medicaid outlays from 45 cents to one dollar.[9]

The magnitude of the spending response of lower levels of government will depend heavily on the size of the relevant elasticities and the course of reductions in federal spending on block grants. Even if federal budgetary cuts were small to begin with, they would almost certainly grow over time. Current proposals cap future increases in program expenditures at the federal level. The response magnitude also depends on the extent to which states alter their benefit levels to compete with other states—a decline in one state's benefits could lead (through a "race to the bottom") to substantial decreases in benefits offered by other states. At the high end in terms of predicted responses are Gramlich (1985) and Craig and Inman (1986), whose work suggests reductions in AFDC spending of from 70 to 85 percent. At the other extreme are Moffitt (1984, 1990) and Craig (1993), who suggest that substitution effects will reduce AFDC benefit levels by about 9 percent.

A large body of econometric evidence on state welfare spending and state AFDC benefit levels suggests that price elasticities are rather large, income elasticities are relatively small, and there is little substitution of food stamps for other forms of public welfare. Thus, studies by Gramlich (1982, 1985), Gramlich and Laren (1984), and Craig and Inman (1986) all find that the form and level of federal matching programs have substantial effects upon the amount of redistribution undertaken by the states. These studies are consistent with declines in benefit levels or state welfare spending of 70 to 85 percent. In contrast, two papers by Moffitt (1984, 1990) find smaller price elasticities and somewhat larger income elasticities—both of which would moderate the disastrous effects predicted by the others in moving to block grants.

The views of Gramlich and Laren (1984) and others are based, in part, upon the evidence that states responded to court-mandated increases in beneficiaries (arising from the "right to travel" rulings) by restricting benefits. This suggests that there will be a race to the bottom in the provision of welfare benefits as each state reacts in turn to the cuts in welfare levels proposed in neighboring states by cutting their own benefit levels. To the extent, however, that states are able to create constitu-

tionally acceptable devices for restricting benefit levels of new entrants, or more generally that states do not respond closely to the choices of benefit levels of neighboring states, the race may not be as extreme as suggested by Gramlich and Laren.

There is much less econometric evidence on the determinants of state spending on Medicaid. (An early review is by Inman, 1985.) Chernick's more recent review (1996) concludes that "the small number of studies of Medicaid price responses suggest that the absolute magnitude of the income and price elasticities is greater than for AFDC." If true, these findings imply even larger estimates of the effect of block granting on spending reductions for Medicaid and public medical care by the states.

This evidence is not conclusive. But, given that many states have become more fiscally conservative, and given the tightness of their budgets, we conclude that the effects of this reform upon program beneficiaries would be very substantial.

Apparently, only one factor could mitigate the substantial reductions in aggregate spending on transfer programs which would accompany the termination of current federally supervised matching grants—a large increase in *x*-efficiency accompanying a shift in control to state governments. Indeed, there are extravagant claims that the states are more creative and innovative in designing welfare programs, and they are better managers of these programs. Curiously, these claims are made more forcefully about transfer programs than about other government activity. There is little doubt that a shift to state administered block grants will involve less bureaucracy and will give more flexibility to states.[10] Beyond this, there is little or no systematic evidence about creativity or innovation.

Anecdotal evidence is not reassuring. It is reported that efforts to computerize child support and welfare payments in Maryland have been "disastrous"; the system will be two years late and 67 percent over budget. News accounts have estimated that Florida "lost" $170 million on food stamp errors, and state officials have acknowledged $28 million in "mistakes" in the Medicaid program. California's new welfare computer system is now estimated to be $455 million over budget, about 90 percent, and will not accommodate the volume of transactions necessary.

As far as management is concerned, one state's Secretary of Human Services suggests that passage of these federalism initiatives will be like "flying blind into a fog."[11]

Interpretation and Conclusions

The consensus normative model of federalism, summarized in Wallace Oates' 1972 book *Fiscal Federalism*, gives to the central government responsibility for financial oversight of those public activities distinguished by significant externalities involving spatially dispersed populations, while leaving to local governments responsibility for those public activities for which spatial spillovers are limited or absent. The guiding principle is to internalize all economic externalities at the smallest level of government possible—a principle formalized by Oates in his "decentralization theorem."[12] Decentralization to small collectives is favored since taste differences can best be accounted for by the political process if decision makers most closely represent their constituents. As Oates put it more

recently (1994, p. 130), "The tailoring of outputs to local circumstances will, in general, produce higher levels of well-being than a centralized decision to provide some uniform level of output across all jurisdictions . . . And such gains do not depend upon any mobility across jurisdictional boundaries."

The traditional consensus was that regulation of markets, national defense, public health, economic stabilization, and redistribution policies are best handled at the centralized, or national, level of government, while education and the maintenance and protection of private and public property are best left to decentralized state or local levels of government. The current political debate questions this view.

The normative model that comes closest to making the case for a decentralized system of local governments is the Tiebout model. In the simplified Tiebout model, there are no spillovers across jurisdictional boundaries. When a Tiebout government decides to engage in an activity such as primary education, the benefits are obtained only by the residents of the jurisdiction. When benefits and costs do extend beyond the local boundaries, the "optimal" fiscal unit is a higher level of government.

These spillovers can create competitive incentives that lead to further and more significant inefficiencies. For example, states can be encouraged to relax their environmental controls to encourage business migration. The net result is a race to the bottom, leading to regulatory standards that vary from state to state and which would be significantly more lax than states would prefer if common national standards were set (Revesz, 1992).

A further case for a national standard can be made on nonefficiency grounds. When there is support for a particular national norm, a centralized policy that reflects that viewpoint may be appropriate, regardless of whether there are significant spillovers. Thus, "fairness" may require that all individuals receive equal access to public services and, more generally, equal treatment under the law. Alternatively, fairness can involve a judgment about the appropriate allocation of economic entitlements, including judgments about progressive taxation.

By themselves, the presence of spillovers is not sufficient to undo the efficiency of a Tiebout economy. For example, if a public good benefits two or more Tiebout communities, a Coasian bargain *might* arise in which joint production internalizes the externality. With costly bargaining, a higher level of government can facilitate and enforce the bargain.

Perhaps the two most important examples of the failure of Coasian bargaining in a decentralized public economy are the agreement to redistribute income to needy households and the agreement to manage jointly the overall macroeconomic performance of the economy. Perhaps redistribution policy should allow for regional differences (Pauly, 1973); yet regional agreements—particularly interconnected regional agreements—may not emerge because of strategic bargaining. If so, a national redistribution policy that explicitly grants some degree of local choice is the second-best compromise. Similarly, strategic bargaining between localities would most certainly prevent the design of a coordinated macroeconomic policy—as it did during the days of the Articles of Confederation. The

only recourse, when a voluntary agreement cannot be reached, is a coercive, nationally directed fiscal policy.

We continue to adhere to the national consensus that poor and elderly U.S. residents should have access to minimum levels of health care. On the basis of this national norm alone, centralized regulation of health care is desirable. Further, however, destructive competition among states will lead to the underprovision of both health and welfare benefits. (Again, see Gramlich and Laren, 1984.) As a result, there is a powerful case for minimum national standards for both programs, financed centrally.[13]

It is clearly too early to know the direction in which U.S. federalism will move with much certainty. However, the current budgetary debate suggests strongly that we are entering a new period in fiscal federalism—a period marked by "restrained federalism." In this more limited federalist economy, the central government will encourage state responsibility for public regulatory and spending programs.

This review of the linkages between federal and lower levels of government does suggest three conclusions.

First, an increasing burden of federal mandates for expenditures has been placed on the states and local governments by the central government. Despite increasing attention to this issue during the past decade, the level and extent of unfunded mandates continue to grow. However, the evidence also indicates that these mandates provide only limited opportunities for budget reduction at the federal level. Cumulative state and local expenditures engendered by preemptions, direct orders, and crossover mandates are significant and large from the local perspective but are rather small in comparison with expenditures from the federal budget.

Second, the rapid rise in federal grants to local governments does provide a significant opportunity to reduce the budget of the central government by appealing to federalist principles. The federalist principles are dubious. They involve the assertion that benefit levels in transfer programs are better decided locally and that program operations and standards are better managed locally. We have seen no systematic evidence suggesting a better management capacity by local government. Further, while there may be gains from state experimentation with new programs, and with new ways to administer old programs, we recognize the fact that, under our current system, states already have substantial flexibility to experiment.

The budget opportunity arises from the shift from open-ended matching grants for substantial programs to block grants of fixed size whose increase can be controlled centrally. We are persuaded by the evidence that there are moderate price elasticities and small income elasticities at the local level. Given the real possibility of a race to the bottom as well, this suggests that budget savings at the federal level will be achieved by drastically reducing the aggregate size of these programs. This reduction could, of course, be put off temporarily by the addition of a "hold harmless" clause to any new block grant programs. With a hold harmless clause, a condition of receipt of a block grant would be that the state maintain nominal benefits at current levels.

Third, since budgetary savings arise from capping the future growth of these programs, the savings arise in some part from the elimination of federally imposed rules for eligibility and program participation. It is elimination of the entitlement aspects of the programs that permits them to be devolved to the states. Removal of this mandate imposed on states and localities can generate substantial budgetary savings to the central government (at the expense of low-income people), but it will substantially change the nature of federalism in the United States.

ENDNOTES

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[1] See, for example, Scheiber (1966) for a discussion.

[2] These and other distinctions in the extent and definition of mandates are discussed in Conlan (1991) and Musso and Quigley (forthcoming).

[3] Another study (Conlan, 1991) reported that more than half of all federal preemption statutes enacted since the founding of the republic had been passed since 1970.

[4] See, for example, Lovell et al (1979), Muller and Fix (1980), and Singh et al. (1988).

[5] These are gross categories. For example, the category "income security" includes substantial expenditures by the Departments of Agriculture and Housing and Urban Development as well as expenditures by the Department of Health and Human Services.

[6] See Quigley and Rubinfeld (1996) for a more detailed and qualified discussion.

[7] See Gramlich (1991, Figure 1). The National Income Accounts surplus began to decline in 1983, while the operating surplus has generally fallen since 1972.

[8] Specifically, the federal matching rate is $1 - 0.45(S^2/N^2)$, where S is state per capita income and N is national per capita income. See ACIR (1992) for an extensive discussion.

[9] The price would be higher than one dollar if the Food Stamp program were to continue to tax AFDC benefits.

[10] Gold (1995) develops these points.

[11] These anecdotes are reported in *Business Week* (Kelly et al.,1995) and by Babington (1995) among other popular sources.

[12] This theorem is closely related to the concept of "subsidiarity" which appears frequently in the current debates over the governmental structure of the European Union. See, also Breton (1965).

[13] This conclusion is more detailed (and qualified) in Quigley and Rubinfeld (1996).

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