

# THE IMPACT OF NEW FEDERAL BUDGET PRIORITIES ON AMERICA'S CITIES

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## INTRODUCTION

The Republican victory in the 1994 Congressional elections has sharply altered Washington's political landscape. Old assumptions about what is politically possible have given way in the face of new demands and new political realities. Especially in the House of Representatives, the new Republican leadership has sought to enact some of the most far-reaching changes in the federal government's role in domestic affairs since the heyday of the Great Society.

Some of the most radical changes are likely to occur in policies and programs through which Washington has sought to address the problems of America's cities. As the Republicans work to fulfill their pledge to balance the budget by 2002, and simultaneously to cut taxes, overall federal spending on urban programs is certain to decline. Some familiar programs will disappear altogether, and will be replaced by new initiatives that reflect very different ideas about the role the federal government can play in addressing the needs of urban America.

Some representatives of urban areas have predicted that the new Republican policies will create severe hardships in cities throughout the nation. At a forum sponsored by New York University's Taub Urban Research Center in June, 1995, Congressman Donald Payne of Newark, New Jersey expressed this concern:

*I think that this so-called balanced budget will really wreak havoc on many low-income people. [It] could deny school lunches to over seven million children in our country. Two million young children and pregnant women can lose their nutritional assistance through the WIC program....Next fiscal year, the Summer Youth Employment Program will be eliminated.... They've totally eliminated programs like drug prevention....I believe that misery will increase. I believe that we are going in the wrong direction.*

Yet not all city officials see the changes in federal policy now being hammered out in Washington as inimical to the interests of their constituents. A group of Republican mayors, calling for a new "Contract with America's Cities," has asserted that:

*It is now time for federal and urban policy makers to acknowledge that much....federal investment has been misdirected and has yielded a negligible – and in some cases, negative – return. Inner city residents know this. Federal taxpayers know it. And we mayors know it, and we are willing to say so publicly....We reject the conventional call of past urban leaders for a new multi-billion dollar, federally administered Urban Marshall Plan. What we mayors*

*need is not that more money be spent, but only that the money we are already spending be used more wisely....*

In a very real sense, both of these perspectives are correct. Reductions in federal spending will involve real costs for residents of America's cities. But systematic reduction of the federal deficit will bring economic benefits as well. And the wholesale restructuring of federal programs could provide an opportunity to establish a less restrictive, more productive relationship between Washington and the cities.

This report assesses the implications of changing federal policies for America's cities. It provides an overview of Congressional plans to balance the budget by 2002, and of President Clinton's ten-year alternative; examines proposed budgetary and policy changes in seven major program areas of particular concern to cities; and explores several major issues of concern to cities that cut across these program areas.

We have not sought to describe or analyze in this brief report every change in federal programs and policies that could materially affect America's cities. Such a comprehensive analysis would be beyond the scope of the report – and would in any case be of limited value, given the speed with which the details of the budget and various Congressional initiatives can change. We have instead sought to provide enough detail to convey an overall sense of how new federal policy directions will affect urban interests, and to provide a basis for some judgments about how the nation's cities should respond.

Our principal conclusions can be summarized as follows.

- While the spending reductions required to balance the budget will in the short term carry substantial financial and economic costs for U.S. cities, the macroeconomic effects of eliminating the deficit should ultimately prove beneficial, especially as interest rates decline.
- How the budget is balanced is particularly important to America's cities. The choices made in the course of moving toward this goal can make the difference between a process that is difficult but bearable, and one that is truly calamitous in its consequences for the cities.
- Controlling the growth of Medicare and Medicaid spending is central to any strategy for balancing the federal budget. Limiting the rate of growth to about 5.5 percent for Medicare and 4 percent for Medicaid, as the Congressional budget resolution proposes, will be difficult – but not impossible. Holding spending increases to these levels would undoubtedly halt the rapid growth in health care employment that cities have experienced in recent years – but it need not result either in massive layoffs or in severe disruptions in the delivery of health services in urban areas.
- The highest priority for urban America in the debate on the budget should be to preserve the federal government's commitment to maintaining economic security and promoting economic self-sufficiency among low-income residents of the nation's cities. This means maintaining a strong federal commitment to state-administered welfare programs, preserving the Earned Income Tax Credit,

maintaining federal aid to cities under successful programs such as Head Start and Title I school aid, and ensuring federal support for state, local and private-sector job training.

We recognize that the goal of balancing the budget cannot be accomplished without cutting social spending – and in particular, without sharply reducing the unsustainable growth of Medicare and Medicaid. But it should also be recognized that the federal government's relatively modest investment in improving the lives of poor Americans is not the primary source of its fiscal difficulties; and gutting that investment will not solve the problem.

- The drive to balance the budget provides an opportunity to redefine Washington's relationship with cities in ways that will help offset the effects of cuts in spending, and that could lead to a more constructive, more productive federal involvement in addressing urban problems. Washington can help the nation's cities by shifting from narrow categorical grant programs to broader and more flexible funding mechanisms, and by eliminating many of the mandates and prohibitions that inflate state and local costs and limit cities' ability to devise their own solutions to local problems.
- Proposed changes in the structure of federal taxation could have profound implications for cities. While everyone might agree on the desirability of reforms aimed at simplifying the tax code, each of the many possible approaches to simplification creates its own set of winners and losers. Cities need to be vigilant about ensuring that their interests are taken into account in the coming debate on tax reform.

The report concludes with some recommendations on how America's cities should define their priorities in the debates on the federal budget, and on the recasting of federal programs, that will be occurring in Washington during the next several months.

## I. THE NEW BUDGETARY DISCIPLINE

For the past two decades, members of Congress and representatives of the executive branch have sought to reduce the federal budget deficit on terms reminiscent of St. Augustine's youthful prayer: "O Lord, help me be chaste – but not just yet." Presidents Bush and Clinton won Congressional approval for deficit-reduction programs; but neither formulated a plan that would have radically reduced, let alone eliminated, the deficit.

That a balanced budget now seems within reach is testimony to just how much Washington's political landscape has changed. The argument has shifted from one over whether a balanced budget was possible or desirable at all, to one over whether that goal should be achieved in seven years or ten. A year ago, talk of balancing the budget and simultaneously cutting taxes seemed wildly unrealistic. Today, the question is how large the tax cut should be, and whom it should benefit most.

### A New Budgetary Consensus – And Some Unresolved Issues

Much work remains to be done before Congressional budget resolutions and presidential initiatives are translated into appropriations bills and changes in authorizing legislation. Nevertheless, a tentative consensus is emerging – one that will probably determine the shape of federal fiscal policy for the remainder of the 1990's.

- The federal budget should be brought into rough balance, some time within the first half of the next decade.
- This outcome should be accomplished through reductions in federal spending and natural revenue growth, rather than through tax increases.
- To stimulate economic growth (and to ensure that the pressure to reduce spending is maintained), federal taxes on a wide range of taxpayers should be reduced.
- The federal government establishment should be downsized, bureaucratic and regulatory procedures should be streamlined, and state and local governments should be given greater freedom to manage federal programs in ways that are more responsive to local needs and interests.

But within this broad consensus, critically important differences remain to be resolved.

- How quickly should the goal of a roughly balanced budget be achieved? The spending discipline required to meet that goal by 2002 could be significantly more stringent than that required to hit the target in 2005. The difference in FY 2002 federal outlays under the seven-year plan approved by Congress and under the president's ten-year plan is summarized in the following table.

**FY 2000 Federal Outlays:  
Congressional Budget vs. Clinton Proposal  
(\$ billions)**

	FY 1995	FY 2000 Congress	FY 2000 Clinton
Defense	\$269.6	\$270.9	\$267.8
International affairs	18.9	11.9	15.9
Science, technology	17.5	15.5	16.1
Energy, environment, natural resources	26.6	21.1	22.7
Community development	11.6	6.2	8.6
Transportation	39.3	33.2	36.8
Education, training, social services	54.7	48.2	61.9
Health care	276.8	354.5	391.0
Income security	259.6	310.5	317.4
Justice	17.1	20.9	24.6
Other spending, fees	-46.0	-42.1	-33.0
Interest	235.3	282.0	280.8
Total outlays	1,529.9	1,778.2	1,854.2
Revenues	1,355.2	1,697.4	1,712.0
Defecit	-174.6	-100.3	-142.2

(Source: *Wall Street Journal*)

- Will the new budget discipline have to accommodate a substantial increase in defense spending, as the Republican majority in Congress has proposed? If not, the required reductions in domestic spending become a bit less daunting.
- Will Congress and the Clinton Administration simply reduce spending, without changing the manner in which federal funds are spent – or will they take the new budget discipline as an opportunity to restructure relationships among Washington, the states and the cities?
- Will tighter control over federal spending be achieved in part by conversion of entitlement programs such as AFDC, Medicaid and Food Stamps – which commit the federal government to providing benefits to anyone who is eligible – to block grants, which limit the federal government's liability to amounts specifically appropriated by Congress?
- Will near-term tax cuts be followed by a major overhaul of the federal tax system? And who will be the primary beneficiaries of any changes in federal tax laws?

Regardless of how these issues are resolved, the new fiscal policy consensus will have profound implications for America's cities. It means that the federal government will be spending substantially less money on programs that address urban needs – on health care, job training, low-income housing, mass transit aid and many other purposes. But the reduction in federal

spending might in part be offset by relaxation or elimination of federal mandates that Congress has over the years imposed on states and cities; and by other changes in the structure of federal programs that would allow cities to use limited federal resources more effectively. Evaluating the net effect of these tradeoffs will be one of the most difficult challenges facing America's cities in the months ahead.

### Gauging the Macroeconomic Effects of a Balanced Budget

Substantial reductions in the federal budget deficit will also have macroeconomic consequences. Cities will find that these macroeconomic changes will affect their interests both positively and negatively.

Federal spending cuts will result in the direct loss of jobs – federal, state and local government jobs, as well as private-sector jobs in industries that depend heavily on government support, including defense, health care, day care and education. There will also be some loss of jobs through a "reverse multiplier effect," as people who lose their jobs spend less on food, clothing, entertainment and other routine purchases.

But a sharp reduction in the federal deficit could also lead to a substantial decline in interest rates – by as much as two full percentage points, according to DRI/McGraw Hill. A reduction of this magnitude would benefit industries that are critical to the economic health of America's cities – real estate, residential and commercial construction and the production of capital goods. Lower interest rates would also mean lower state and local borrowing costs, which would enable state and local governments either to reduce their annual debt service costs or to increase their investments in local public works.

<b>Impact of Congressional Budget On Regional Employment (Net Change From DRI's 2002 Baseline Forecast)</b>	
<u>Region</u>	<u>Net Job Gain or Loss</u>
New England	-19,500
Middle Atlantic	-80,900
South Atlantic	-60,100
East North Central	79,300
East South Central	19,900
West North Central	-1,600
West South Central	65,200
Pacific Northwest	-19,000
Pacific Southwest	-64,100

(Source: *Business Week*)

The economic costs and benefits of a balanced budget will not be distributed evenly throughout the country. DRI/ McGraw-Hill estimates that the net impact of a balanced budget on payroll employment would be mildly negative as of 2002; but that the effect would turn positive in subsequent years. Within this overall picture, however, DRI finds that some regions – notably the Northeast, the Southeast and the Far West – would suffer significantly greater losses, while the Midwestern and South Central states would register substantial gains.

### **Turning Austerity Into Opportunity**

The issue facing urban America is no longer whether there will be major reductions in spending affecting cities in the United States. Rather, the issue is how spending reductions can be accomplished in ways that are most compatible with urban interests – and how to use Washington's newfound determination to control spending as an opportunity to effect changes in federal policies and programs that will benefit cities.

The next section of the report describes some of the spending reductions and other policy changes now being considered in Washington that will affect the nation's cities.

## II. THE OUTLOOK FOR MAJOR PROGRAMS AFFECTING CITIES

The budget resolution approved by the U.S. House of Representatives and the U.S. Senate in June, and the alternative approach to balancing the budget proposed by the White House, provide a starting point for analysis of the impact of Washington's new fiscal discipline on America's cities. Neither of these documents, of course, represents anything like the final word on federal spending. The details of FY 1996 spending plans will only be resolved during the coming weeks, as the House and Senate complete the appropriations process, and as the White House responds. And the debate on major reforms in some areas – including welfare, Medicaid, Medicare and federal tax policy – will no doubt carry over into 1996, and perhaps beyond.

Nevertheless, there is sufficient basis for a preliminary evaluation of the impact of new directions in federal policy on the nation's cities, and for identifying some of the issues of greatest concern to cities. This section of our report briefly describes proposed spending reductions and related policy changes now being considered in seven program areas:

- Health care.
- Welfare reform.
- Education and job training.
- Transportation.
- Housing and community development.
- Crime and criminal justice.
- Tax policy.

### Health Care

Reductions in the rate of growth in Federal spending on health care (primarily Medicare and Medicaid) are central to both Congressional and presidential budget-balancing plans. Just how central health care is to the budget debate is evident from a single statistic: Of the \$133 billion reduction in program spending (that is, all spending other than interest payments) the Republicans say their plan would achieve in FY 2000, reductions in Medicare, Medicaid and other health programs account for \$86 billion – 65 percent of the total cut in federal program spending.

The Clinton Administration and the Republican Congress differ sharply with respect to the magnitude of the reductions that these programs can sustain. Indeed, the more stringent limits on the growth of health care spending proposed by Congress account for more than 80 percent of the difference in projected FY 2000 outlays under the Congressional and White House plans.

The Congressional budget resolution estimates that federal Medicare spending between FY 1996 and FY 2002 will total \$949 billion. This, according to House and Senate conferees, would require a reduction in projected spending of \$270 billion, or about 22 percent. To achieve this saving, the budget resolution calls for cutting the Medicare spending growth rate in half – from about 11 percent per year to 5.5 percent.

<b>Health Care Spending: Congressional Budget vs. Current Law (\$ billions)</b>								
	<b>95</b>	<b>96</b>	<b>97</b>	<b>98</b>	<b>99</b>	<b>00</b>	<b>01</b>	<b>02</b>
<b>Medicare</b>								
Current	161	182	201	219	240	264	290	318
Proposed	161	174	183	192	203	215	230	247
<b>Medicaid &amp; Other</b>								
Current	116	126	138	150	163	177	192	208
Proposed	116	121	128	132	136	140	144	149

(Source: *House-Senate Conference Report*)

The president's budget-balancing plan, in contrast, would cut Medicare spending over the same period by \$124 billion, or about 10 percent. This would require holding the annual rate of growth in Medicare spending to about 8.5 percent.

Neither the Congressional budget nor the president's plan offers much detail as to how the Medicare savings they forecast are to be achieved. The Republican leadership is considering a plan that would offer Medicare beneficiaries a fixed sum of money with which to buy private health insurance in the open market. Beneficiaries would have the option to retain "traditional" fee-for-service Medicare coverage, but in order to encourage a shift to lower-cost private plans, out-of-pocket premiums required under the traditional program would be substantially increased.

Congress would also reduce federal Medicaid spending by about \$182 billion over seven years, to a total of \$773 billion – a 19 percent reduction off currently projected spending. This assumes a reduction in the rate of growth to 7.2 percent in FY 1996, 6.8 percent in 1997, and 4 percent annually thereafter. (The Congressional Budget Office estimates that under current law, Medicaid spending growth would average 10.2 percent annually through 2002.) The budget resolution does not specify how these savings are to be achieved, although it acknowledges that both the House and the Senate are exploring the feasibility of converting the Medicaid program to a block grant.

The White House plan, in contrast, assumes a \$55 billion savings over seven years – a reduction of only 6 percent against currently projected growth. Proposed cost-cutting measures would include:

- Expanded use of managed care;

- Reductions in the "Disproportionate Share Hospital" program, which provides extra payments to hospitals that serve especially large numbers of Medicaid patients;
- Repeal of statutory and regulatory provisions mandating minimum payment levels for various types of providers;
- Giving states greater freedom to pursue innovative service delivery strategies without having to seek federal waivers;
- Limiting the growth of Medicaid payments to each state on a perbeneficiary basis, rather than through a fixed block grant.

Representatives of America's cities have good reason to be concerned about the impact of reductions in health care spending. Many cities include large concentrations of poor people who depend on Medicaid for basic health care; New York City residents, for example, represent about 40 percent of the total population of New York State, but account for about 70 percent of the state's Medicaid expenditures. And in many cities, health services industries represent a significant part of the local economic base.

Reductions in spending of the magnitude proposed by Congress might have dire consequences for U.S. cities, if the result were simply to reduce the revenues available to a health care system that delivered services in largely the same manner as they are delivered today. But that probably will not be the case. Continued pressure from both public and private payors is already forcing a broad-based restructuring of the health care sector; further cuts in Medicare and Medicaid will accelerate the process.

Perhaps the principal danger for America's cities in this process is that retrenchment and restructuring could make it more difficult for low-income inner-city residents to gain access to basic health services. This could occur if hospital closings are concentrated in poor neighborhoods, if clinic hours are drastically cut back, and if states seek to cut costs by dropping Medicaid coverage of important but "optional" services such as dentistry and eye care.

For those who are concerned about the state of health care in urban America, the central question may thus be whether improvements in health services productivity can offset a reduction in the rate of spending growth from 10 percent to 4 or 5 percent annually, while maintaining at least minimally adequate health care in the inner cities. Achieving such improvements will not be easy – but neither is it impossible.

Even under the best of circumstances, however, the impact on employment trends in the health services industries will be dramatic. Limiting the growth of health care spending to the rates projected by Congress will at a minimum brake the growth in health care employment. (Nationwide, health care employment grew from 5.3 million in 1980 to 8.8 million in 1993 – an increase of 68 percent, almost three times the rate of growth for all private-sector jobs.)

Holding annual spending growth to 5 percent need not result in massive layoffs, as some doomsayers have suggested. But in an industry that spends two-thirds of its revenues on labor, it will certainly bring to an end the rapid employment growth that characterized the 1980's and

early 1990's. In many cities, that growth has during the past fifteen years been an important source of job opportunities for people with limited skills.

As the Clinton Administration and the Congress begin to define their health care cost control plans in greater detail, city representatives need to focus on the issues that will be most significant for their constituents. Important city interests will include:

- Ensuring that basic health services for poor people, as funded through the Medicaid program, do not bear a disproportionate share of the burden of restructuring.
- Phasing in spending restrictions over a period of several years, so that health care providers have more time to restructure, and local labor markets can more effectively absorb the impact of retrenchment in health services.
- Protecting the country's strategic investment in medical research and education – perhaps the most city-centered element of the nation's health care system, clearly one of its greatest strengths, and a key to America's continued competitiveness in biomedical industries worldwide.

## **Welfare Reform**

While the changes in Medicare and Medicaid represent the greatest absolute-dollar reductions in spending under the plan proposed by the Republican majority, the changes they have proposed in Aid to Families with Dependent Children and other welfare programs represent the most radical departure from long-established public policy.

House and Senate Republicans have both proposed to replace the AFDC program – which reimburses states for a percentage of their expenditures on behalf of all eligible recipients – with a block grant, under which each state would receive a fixed allocation of federal funds. This proposal would end AFDC's sixty-year history as an open ended matching program. Both the House and Senate versions of this proposal would also fold into the block grant emergency assistance funds and the JOBS program, which provides matching grants to the states for employment and training services for AFDC recipients. The Senate version would fold in child care funds as well.

Both the House and the Senate proposals would require states to accelerate the movement of welfare recipients into jobs or job training, and would impose a five-year limit on the receipt of benefits. The House bill ("The Personal Responsibility Act of 1995") would also prohibit payments to unmarried teenage mothers, to most legal aliens, and for children born to women on welfare; the Senate bill contains no such prohibitions. Neither bill would require states to provide any matching contributions.

The allocations to each state under the Senate bill are based on the reimbursements the states received in FY 1994 under the programs being merged into the block grant; the House formula is more complex but produces roughly similar results. But because federal spending would be capped at these levels, the amounts saved (relative to projected spending under current law)

would be substantial. House Republicans project that their bill would yield savings of \$101 billion over seven years; the Senate majority projects savings of \$80 billion over the same period.

The House and Senate have proposed consolidation of several other programs into block grants. The House proposes to combine several child welfare programs into a single child protection block grant, including two – adoption and foster care subsidies – that now operate as open-ended entitlements. Various nutrition programs would be combined into two block grants (for family and school-based nutrition), ending the open-ended entitlement status of school breakfast and lunch programs and the Women, Infants and Children (WIC) program.

The block grants proposed in the House would not directly reduce the funds available to the states for child welfare and nutrition programs. But they would make it easier for Congress to limit future spending growth; and because they carry no matching requirements, would leave states free to reduce their spending on services for children and families.

Both the House and the Senate have proposed to tighten eligibility standards under the Supplemental Security Income program, denying assistance to non-citizens and to those whose disabilities result from alcohol or drug abuse.

Finally, the Republican majority has proposed legislation to slow the growth of federal liabilities under the Earned Income Tax Credit program. In 1993 Congress (with strong bipartisan support) approved a Clinton Administration proposal to expand eligibility for EITC; as a result, the cost to the Treasury is expected to increase from \$20 billion in FY 1994 to \$27 billion in FY 1996. Congress now aims to reduce the projected cost of the program by \$27 billion over the next five years, by making childless taxpayers ineligible for the credit, eliminating indexation of EITC benefits, and more effectively screening out undocumented aliens.

The Clinton Administration also proposes to achieve substantial savings as a result of welfare reforms – \$64 billion over seven years – but through measures less drastic than those proposed by the Republicans. The President has endorsed a plan introduced by Senate Democrats that includes more stringent work requirements and a five year limit on AFDC eligibility, but that maintains the status of AFDC as an open-ended matching program. At the same time, the Administration has emphasized its readiness to help states undertake their own reform initiatives by using more aggressively the broader authority to grant waivers of federal requirements that Congress enacted in 1988.

The Administration has also proposed some modest tightening of EITC eligibility – including elimination of undocumented aliens from the program – for a saving of \$3 billion over five years.

Cities with large concentrations of welfare recipients could be hit hard by the proposed AFDC "reforms." The prohibition on aid to legal aliens, teen mothers and children born to parents on welfare – which have been attacked by some Republican governors as "replacing liberal mandates with conservative mandates" – could leave states and cities either to assume the full cost of aid to hundreds of thousands of indigent families, or to drop them from the program. Elimination of alcohol and drug abusers from the SSI

**Welfare Cutbacks and the Cities:  
Life at the Bottom of the Food Chain**

*If we are going to cut people off welfare, it's going to increase Philadelphia's costs for providing services to the homeless. If 30 percent of the people who would be cut off AFDC go into our shelter system, we estimate that our shelter costs will rise from \$24 million to \$93 million.*

*The states can have a choice. Either they make up the difference, often causing them to raise taxes – or they look at the city and county governments and say, "Aha, we don't have to raise taxes, we can just drop this problem down to them." County and city governments are the last on the food chain; and if my state won't pick up that \$69 million – and I doubt they will – what happens?*

*We've just eliminated a billion-dollar-plus deficit. We produced the first cut in our wage tax in fifty years. But this one thing – the additional shelter-care costs that will come from cuts in AFDC – could eradicate our tax cut, and maybe force us to raise taxes. If we raise taxes, all we do is drive people out in the long run, and worsen the city's problems.*

– Mayor Edward Rendell, Philadelphia, Pa.  
*Taub Urban Research Center Conference, June 1995*

Because it makes no allowance for increases in the eligible population, the welfare block grant could prove particularly damaging to cities in states experiencing the fastest population growth. And because Congress can't repeal the business cycle as easily as it repeals legislation, the welfare block grant would leave all states and cities vulnerable to the effects of a prolonged recession. Moreover, since emergency assistance would be folded into the block grant as well, states and cities will be more vulnerable to the effects of a major disaster, natural or man-made.

Elimination of non-federal matching requirements will create a further incentive for states to reduce welfare benefits. This might provide some budgetary relief in those states where localities are still required to pick up part of the non-federal share – such as New York – but will only deepen the plight of those city residents already forced to live on very low incomes.

Finally, the proposed changes in the Earned Income Tax Credit will result in higher taxes on "working poor" city residents. An analysis by the U.S. Treasury Department suggests, for example, that enactment of the Senate version of the Republican proposal would cost low-income taxpayers in New York City a total of \$667 million over seven years.

It might be more difficult to defend continuation of the federal government's commitment to financing economic assistance to the poorest Americans if such assistance were a major cause of Washington's budgetary problems. But it is not. Federal support for AFDC (including emergency assistance and employment and training services for AFDC recipients) in FY 1995 will total about \$18 billion – only 1.2 percent of the federal budget. In 1995, the year-to-year increase in Medicare spending is greater than total spending on AFDC and related programs.

The total for all of the major means-tested income support programs (AFDC, SSI, Food Stamps and the Earned Income Tax Credit) is of course higher – about \$85 billion in 1995. But even this total represents only 5.5 percent of federal budget outlays. Public assistance and related programs are clearly not the source of Washington's fiscal problems; and the beneficiaries of those programs should not be asked to bear a disproportionate share of the burden of spending reduction.

America's cities bear a large part of the burden of poverty and dependency. As the table on the following page indicates, the percentage of the population with incomes below the official poverty threshold is higher in most cities than it is for the nation. Moreover, in some cities the incidence of poverty has increased sharply during the past ten to fifteen years. The varied experiences of U.S. cities with respect to the spread of poverty should stand as a warning against the pitfalls of simplistic approaches to reform that would fix federal spending at certain dollar levels, without regard to future changes in regional or local conditions.

	1992 Pop. (thousands)	Poverty Rate, 1989	% Change in Rate 1979-1989
United States		12.8%	9.4%
New York, NY	7,312	19.3	3.5
Los Angeles, CA	3,490	18.9	15.2
Chicago, IL	2,768	21.6	6.4
Houston, TX	1,690	20.7	63.0
Philadelphia, PA	1,553	20.3	-1.5
San Diego, CA	1,149	13.4	8.1
Dallas, TX	1,022	18.0	26.8
Detroit, MI	1,012	32.4	47.9
San Antonio, TX	966	22.6	8.1
Baltimore, MD	726	21.9	-4.4
Columbus, OH	643	17.2	4.2
Milwaukee, WI	617	22.2	60.9
Boston, MA	552	18.7	-7.4
El Paso, TX	544	25.3	19.3
Seattle, WA	520	12.4	10.7
Cleveland, OH	503	28.7	29.9
New Orleans, LA	490	31.6	19.7
St. Louis, MO	384	24.6	12.6
Tulsa, OK	375	15.0	44.2
Miami, FL	367	31.2	27.3
Minneapolis, MN	363	18.5	37.0

(Source: *U.S. Department of Commerce*)

Proposals to reduce the federal government's role in income maintenance also ignore one of the most compelling lessons of the past seven decades' experience in crafting social and economic

policy in the U.S. State governments cannot function effectively – and cities even less so – as engines for income redistribution. Cities simply do not have the requisite fiscal capacity; and in an era of ever-more-intense regional competition for business and economic activity, the pressure on states and cities to compete by driving down social spending can be irresistible. Without a strong federal commitment to the maintenance of the "social safety net," the danger that it will unravel becomes very real.

The economic and social well-being of America's cities ultimately depends on their ability to perform efficiently the function that cities have historically performed in our society – generating the economic opportunities that enable poor Americans, both native-born and newcomers, to make better lives for themselves. Cities thus have a powerful interest in real reforms that will encourage and assist – and when necessary, force – people to make the transition from welfare to work. But they should have no interest in – and could be seriously hurt by – legislation that, while clothed in the rhetoric of reform, really has little or no purpose other than to reduce Washington's contribution to state and local welfare programs.

## **Education and Training**

The Congressional budget resolution reduces outlays for discretionary education and training programs over seven years from \$378 billion to \$341 billion – a reduction of 9.9 percent. The Republican plan preserves Title I funding – no doubt the most important federal education program, from the perspective of the cities – but reduces or eliminates funding for a number of other programs. Among the more notable casualties is the President's "Goals 2000" program, which in FY 1995 allocates \$372 million to the states to support school reform initiatives; and the Americorps program.

In addition to these reductions in discretionary programs, the Congressional budget assumes a \$10 billion reduction in the cost of the student loan program, and implicitly targets this saving on elimination of interest subsidies on loans to graduate and professional students.

The changes that Congress has proposed in employment and training programs are more far-reaching. The House proposal – H.R. 1617, the CAREERS Act of 1995 – would consolidate ninety federal programs into four: block grants for youth workforce preparation (\$2.4 billion), adult training (\$2.3 billion), and adult education (\$280 million); and the vocational rehabilitation program, which would remain an entitlement. These totals represent a reduction of approximately 20 percent in youth and adult training, and 10 percent in adult education. One of the casualties of the Republican approach is the Summer Youth Employment Program, which the House has already voted to eliminate from the FY 1996 budget.

The Senate bill – S. 143, the Workforce Development Act – would consolidate a similar list of programs into just two block grants – one for job training, adult education and vocational education; and another that combine services to at-risk youth and the Job Corps program, which would be transferred to the states. The bill would provide \$7 billion for the first program and \$2.1 billion for the second; overall, this represents a 9 percent reduction from the aggregate total of funds now committed to the programs being folded into the two block grants.

President Clinton, in contrast, has proposed no reduction in federal spending for education and training. Indeed, by providing a new tax deduction for tuition expenses, the President's "middle-class tax cut" program would effectively increase the federal government's commitment in this area.

While preservation of Title I can be seen as a victory for the cities, urban schools will suffer a loss of funds in other areas, such as bilingual education. But given the small share of local school spending that is supported by federal aid, the overall impact of these losses will be fairly modest. In 1994, for example, federal funds accounted for 10.3 percent of the \$7.56 billion budget of the New York City public schools; and Title I funds accounted for about 55 percent of the city's federal aid. (Some educators would argue that federal grants represent an important source of support for innovation in urban school systems; and that these figures therefore tend to understate the real significance of federal aid to city schools.)

One of the greatest challenges that urban school systems throughout the country now face is the need to upgrade deteriorating schools, and to increase overall capacity to keep pace with rising enrollments. A two percentage-point decline in interest rates (the result, as projected by DRI/McGraw-Hill, of gradually eliminating the federal budget deficit) would significantly enhance the ability of urban school districts to carry out needed capital improvements. In 1994, for example, the Chicago School Finance Authority borrowed \$405 million to finance its capital program. A two-point reduction in rates would have reduced annual interest costs for this bond issue by about \$6.75 million.

The reductions in federal spending on employment and training that the Republican majority has proposed will have a greater impact, since in most cities federal funds account for a much greater share of publicly-financed job training and placement services. In New York City, for example, federal funds allocated to the city under the Job Training Partnership Act and several small categorical programs accounted for more than 99 percent of the \$108 million budget of the Department of Employment.

Reductions of 10 to 20 percent in federal funds will further erode America's already-inadequate public investment in technical training; and they could be particularly harmful to cities with large numbers of residents who need to upgrade their skills in order to be able to participate more productively in an increasingly complex economy. The restructuring of existing federal programs into a few broader, more flexible block grants could nevertheless provide an opportunity for cities to work with state governments and the private sector to develop substitutes for existing programs – many of which, by any measure, are not very effective.

## **Transportation**

While the debate over Medicare and Medicaid is essentially an argument about how rapidly health care spending should be permitted to grow, both the Congressional budget and the president's counterproposal call for an actual reduction in transportation spending. In some areas of particular concern to cities, proposed budget cuts would be especially severe.

The Congressional budget resolution provides for \$293 billion in budget authority and \$245 billion in outlays for transportation programs over a seven-year period. This represents a reduction of \$24 billion (7.6 percent) in budget authority and \$34 billion in outlays (11.8 percent) from the spending levels that would be expected under current law.

However, because reductions would be phased in over several years, the decline in "out-year" spending would be somewhat greater. In FY 2000, for example, transportation outlays would be \$33.2 billion – 17 percent lower than the level projected under current law, and 15.5 lower than estimated outlays for FY 1995.

President Clinton's plan would also reduce federal transportation spending – although not as sharply as the Congressional budget would. His plan, for example, calls for total outlays of \$36.8 billion in FY 2000 – an 8 percent reduction from the level projected under current law.

<b>Transportation Spending: Congressional Budget vs. Current Law (\$ billions)</b>								
	95	96	97	98	99	00	01	02
Current	39.3	39.6	39.7	39.7	39.8	40.0	40.0	40.0
Proposed	39.3	38.9	37.6	36.6	34.1	33.2	32.4	32.0

(Source: *House-Senate Conference Report*)

The House and Senate budget committees assumed that the savings they project could be achieved in several ways – some of which would directly affect cities. They include a phase-out of mass transit operating subsidies and federal support for AMTRAK, and elimination of "demonstration projects" – a euphemism for special appropriations that individual members of Congress secure for favored projects in their own states or districts. Several smaller programs – including grants for local rail freight projects and subsidies for airlines serving small communities – would also be eliminated; and others, including federal support for development of "intelligent transportation systems," would be sharply reduced.

Although the Clinton Administration's ten-year budget-balancing plan would not cut as deeply as the plan envisioned in the budget resolution, the Department of Transportation has been willing to go farther than leaders of the relevant Congressional committees in restructuring the federal government's role in transportation. DOT, for example, has proposed that a self-supporting government corporation be created that would take over modernization and operation of the nation's air traffic control system; the House Appropriations Committee has instead proposed to make the Federal Aviation Administration a separate federal agency.

The House has also rejected a DOT proposal to consolidate federal grant programs into a single Unified Transportation Infrastructure Investment Program, which would have given state and local officials greater flexibility in determining how and where to invest federal funds. (The Senate, in contrast, has approved a DOT proposal that would permit states to use some of their

highway trust fund allocations to capitalize "infrastructure banks:" state-managed revolving funds that would help finance projects such as local toll roads with loans rather than grants. The Senate also proposes to shift \$250 million from DOT's airport grant program to help capitalize new state infrastructure banks.)

Politically attractive as some of the categorical programs now threatened by Congress may be, it is difficult to argue that any of them is truly vital to the interests of America's cities. Indeed, some transit experts argue that the billions of dollars the federal government has poured into new mass transit systems have actually hurt cities like Los Angeles, by inducing them to invest scarce local resources in extravagantly expensive projects that will serve relatively few riders, but that will create enormous long-term operating liabilities.

Even under the plan embodied in the Congressional budget resolution, the core of federal support for state and local infrastructure spending – the transportation trust funds – will remain intact. The most important battles that cities face during the next several years will probably not be over the fate of marginal programs, or even overall funding levels, but instead over how much flexibility Washington is willing to give state and local authorities in determining how to and where to invest federal funds.

Moreover, since more transportation infrastructure is financed by state and local borrowing than is funded through federal grants, any federal action that affects the terms on which state and local authorities can issue bonds is also a matter of concern to cities. Transportation agencies in many cities would no doubt benefit substantially from any drop in interest rates resulting from the decline of the federal deficit. The Port Authority of New York and New Jersey, for example, estimates that a two-percentage-point decline in interest rates would enable it to increase capital spending from a projected total of \$750 million annually in the late 1990's to \$950 million.

The benefits derived from lower interest rates could be erased, however, if as part of a broad-based tax reform program Congress decides to end the tax-exempt status of state and local bonds issued to finance transportation infrastructure projects. The outlook for such reform is discussed below.

## **Housing and Community Development**

Among all of the programs affected by the Republican majority's budget-balancing plan, housing and community development programs would sustain some of the deepest spending cuts. The Congressional budget resolution would reduce community development outlays (including the Community Development Block Grant, the Economic Development Administration and various rural development programs, but not housing subsidies) by 22.5 percent over seven years. In FY 2000, outlays would be 30 percent below the level provided for under current law. The budget committees assume a 28 percent reduction in CDBG funding, and complete elimination of some other programs, such as those of EDA.

For FY 1996, the House Appropriations Committee has proposed reducing the budget of the Department of Housing and Urban Development by 25 percent, to \$19.1 billion. The Committee's cuts differ from those assumed in the budget resolution in one important respect.

The Committee proposes to maintain funding for CDBG and the HOME program at current levels (\$4.4 billion and \$1.2 billion). It would compensate by cutting various categorical grant programs more deeply. Programs targeted for elimination include Youthbuild, the John Heinz Neighborhood Development Program, the Pension Fund Initiative, and the Community Development Finance Initiative. McKinney Act programs for the homeless would be cut by nearly \$900 million.

The Committee's recommendations would permit HUD to extend existing Section 8 contracts, but would eliminate the Department's authority to enter into new contracts. The Committee would also reduce Section 8 "fair market rents" to the 40th percentile of local market rents, and establish minimum tenant rents in public housing.

The Clinton Administration's ten-year budget-balancing plan calls, in effect, for no reductions in community development spending. While projected outlays in FY 2000 would be lower than FY 1995 outlays, they would be consistent with the spending levels projected under current law. The Administration has proposed changes in the federal government's housing role, however, that in some respects go beyond those proposed by the Republican majority. Perhaps most notable among these changes is the proposed conversion of direct subsidies for low-income housing – including public housing – into tenant vouchers.

Congress and the president have both recognized the need to restructure the FHA's mortgage insurance program, in order to avoid increased federal liabilities in future years. The Administration has proposed converting the FHA into an independent, self-supporting government corporation. Congressional sources have emphasized the need to restructure FHA's portfolio, and to increase the fees home-buyers pay for FHA insurance.

The spending reductions proposed by the Republican majority will inevitably translate into cutbacks in community development efforts in cities throughout the country.

There are nevertheless several factors that might soften the impact of federal cuts.

- Congress seems willing to maintain the Community Development Block Grant program, even if this requires deeper cuts elsewhere. CDBG is one of the most flexible sources of federal funding available to city governments.
- A two-percentage-point decline in interest rates – the projected effect of eliminating the budget deficit, according to DRI/McGraw-Hill – would stimulate residential construction, and as the following example shows, would help bring homeownership within the reach of many working-class city residents.

### **The Impact of Lower Interest Rates On the Cost of Owning a Home**

*The effect of a two-percentage-point drop in interest rates on the cost of owning a home could be substantial. At 9.00 percent, for example, monthly payments on a \$90,000, 25-year mortgage would total \$755. If we assume that mortgage payments (not including taxes, insurance and other related costs) equal 25 percent of income, then a home with a \$90,000, 9 percent mortgage would be affordable to a family with an income of \$36,250.*

*At 7.00 percent, the monthly cost of the same mortgage would decline to \$636 – making the same home affordable for a family with an income of \$30,500.*

*In many city neighborhoods, this difference is significant. In the East Tremont area of the Bronx, for example, a drop in rates from 9.00 to 7.00 percent would increase the percentage of all families that could afford a \$90,000 mortgage (based on 1990 census figures) from 30 to 39 percent.*

It should be noted, however, that any tax reform that eliminated the deductibility of home mortgage interest payments, as House Majority Leader Dick Armey has proposed, would more than offset the benefits of lower interest rates.

## **Crime and Criminal Justice**

Although federal support for state and local efforts to combat crime represents a relatively small part of overall federal spending, it affects issues that are at or near the top of the public agenda in virtually every city in America. Moreover, how best to reduce crime is an issue that highlights in particularly striking fashion the irresistible impulse among liberal Democrats and conservative Republicans alike – even in this season of devolution – to tell state and local officials how to do their jobs.

In 1994, Congress enacted an omnibus "anti-crime" bill that combined stiffer penalties for various federal crimes, federalization of a list of crimes previously left to local jurisdiction, federal aid for construction of state prisons, aid to localities earmarked for the hiring of additional police officers, and funding for a wide range of community-based crime prevention strategies. While the final bill won the support of most mayors and other urban interests, it was criticized by some local officials who opposed the earmarking of funds for specific narrow purposes such as hiring police; and by conservatives for committing billions of dollars to crime prevention programs that they saw as thinly-veiled, wasteful "social spending."

Rewriting the 1994 crime bill has been a top priority for the new Republican majority. In its place, the House has approved a package of bills collectively labeled the "Taking Back Our Streets Act." The bill eliminates the funds for hiring police and for crime prevention programs; and instead authorizes a program of "law enforcement block grants," which local authorities could spend either on law enforcement personnel or on equipment. The five year authorization

for the new block grant would be \$1.4 billion less than the amount authorized in last year's bill for police and prevention.

At the same time, the House bill increases the funds allocated to the states for prison construction from \$8 to \$10.5 billion. The bill also establishes a new requirement – to be eligible for these funds, states must ensure that criminals sentenced by state courts serve at least 85 percent of their original sentences.

### **More Cops vs. Better Communications in Savannah**

*Two years ago we squeezed some money out of a very tight budget, financed with local taxes, so that we could hire and train 25 additional law enforcement officers in each of those two years. Well, then the federal government comes along with this bill that says, "OK, now you can hire ten more, and we're going to give you \$244,000 to help you pay for them." But guess what it would cost us, in addition to that \$244,000, to hire ten cops? It would cost us an additional \$240,000. And that's just the first year – the amount we were going to get from the feds would have decreased in the second and third years.*

*But more importantly, we didn't need more police officers – we were already hiring more. What our cops really need is a new communications system, so they can all talk to each other. That would cost a million dollars, and the federal money would have helped. But there's no flexibility written into the bill. They said, either we take it the way it's mandated or we don't take it. So Savannah decided not to take it.*

– Mayor Susan Weiner, Savannah, Georgia  
*Taub Urban Research Center Conference, June 1995*

Many cities will no doubt welcome the greater flexibility offered under the Republicans' law enforcement block grant program. But they are unlikely to benefit from a shift of resources into construction of still more prisons, or from Congressional micromanagement of the sentencing process.

The Republican program seems to reflect a deep ambivalence about how to address the problem of crime prevention. Conservative spokesmen often stress the importance of inculcating traditional values as an element in any effort to bolster inner-city neighborhoods against the twin plague of drugs and crime. But conservatives in Congress castigate federal support for local investments in programs that teach such values as "new social spending masquerading as crime prevention." Presumably newly-constructed prison cells are now considered more effective settings for transmission of traditional values than schools and community centers.

The Congressional Republicans similarly advocate the adoption of "get-tough" measures such as permitting prosecutors to use evidence obtained through illegal search and seizure, if police are acting "in good faith" – if they claim not to have known that they were acting illegally. But they

reject any effort to combat crime and violence by reducing the availability of guns on America's streets – a stance that from the perspective of the nation's inner cities amounts to a willful denial of reality.

Cities could benefit from a federal program that provides flexible support for locally-devised crime prevention strategies – including, if that is what local communities want, support for the programs Republicans criticize as wasteful social spending. But if the price of federal aid is a continuation of Congressional efforts to micromanage the criminal justice system according to the prevailing rhetoric of the moment, then cities would probably be better off with no federal "help" at all.

## **Tax Policy**

The fiscal policy debate now occurring in Washington is not limited to the spending side of the budget. President Clinton and the Republican majorities in Congress have both proposed broad-based reductions in federal taxes. The Congressional budget resolution assumes a net tax reduction of \$245 billion over seven years. Major elements of the proposal include:

- A \$500-per-child tax credit, which would be phased out for families with incomes between \$200,000 and \$250,000.
- Liberalized depreciation allowances;
- A reduction in taxes on capital gains;
- A reduction in the federal estate tax.

President Clinton has proposed a more modest tax reduction program, including:

- A \$500-per-child tax credit, phased out for families with incomes between \$65,000 and \$75,000.
- A new deduction of up to \$10,000 per year for post-secondary tuition and fees.
- A doubling of income-eligibility limits for individual retirement accounts, up to single taxpayers with incomes of \$50,000 and couples with incomes of \$80,000, as well as expansion of the purposes for which funds can be withdrawn without penalty.

Although the commitment on the part of both Congress and the President to provide tax relief intensifies the pressure to reduce spending, the proposals for tax relief now on the table do include some that city residents will no doubt find attractive. For a family with two children and an income of \$25,000 – the kinds of families that are the backbone of so many working-class neighborhoods – a \$1,000 increase in net income is a substantial benefit. Lower- and middle-income taxpayers would also benefit from being able to take a deduction for tuition payments.

Looking to 1996 and beyond, proposals for a more radical overhaul of the federal tax structure could prove to have more significant implications for cities. Most of the proposals that have been

advanced in recent months – including Representative Arney's "flat tax," and Representative Gephardt's simplified five-tier tax – would compensate for a reduction in tax rates by broadening the base of taxable income. While such tradeoffs seem intuitively appealing, they could have some troubling implications for the nation's cities.

- Eliminating the deductibility of home mortgage interest (as the Arney plan would do, but the Gephardt plan would not) could effectively heighten the competitive disadvantage suffered by cities with high housing costs.
- Eliminating the deductibility of state and local taxes – as both the Gephardt and Arney plans would do – could similarly work to the disadvantage of those communities with the highest combined state-local tax liabilities, most of which are cities.
- Ending the tax-exempt status of state and local bonds – as both plans propose to do – would increase state and local borrowing costs, and thus the cost of investing in schools, infrastructure, health care facilities and other capital projects.

Even if they support the goals of tax simplification and rate reduction, representatives of the nation's cities need to identify tax code provisions that are particularly vital to their interests, and be prepared to defend them during the coming debate on tax reform. Virtually every organized interest in America recognizes the central importance of tax policy; cities cannot afford to be any less vigilant.

### **III. IMPLICATIONS OF THE NEW BUDGET DISCIPLINE: SOME CROSS-CUTTING ISSUES**

In addition to issues that affect particular program areas, Washington's newfound determination to balance the budget gives rise to a number of broader policy issues that are central to the process of redefining the federal government's relationship to America's cities.

#### **Restructuring the Federal Role**

In many of the program areas most affected by the new budget discipline, Congress and the administration will face a choice – simply reducing federal spending, without significantly changing the nature of the federal government's responsibilities; or redefining in a more fundamental way the federal government's role in some program areas.

The Department of Transportation, for example, has proposed legislation that would permit states to use a portion of their highway trust fund allocations to capitalize "state infrastructure banks." SIB's could use these funds to provide direct loans for surface transportation projects; or as a reserve fund for loan guarantees; or for interest rate subsidies to marginally viable projects; or for short-term construction loans to projects that would be "taken out" with long-term bonds after completion; or in other innovative financing arrangements.

SIB's would mark an important step away from Washington's traditional role in surface transportation financing, which has usually involved providing direct grants to reimburse states for construction expenditures on a project-by-project, "retail" basis. Instead, the SIB program would involve providing capital on a "wholesale" basis to state entities that would have considerable flexibility in structuring financial arrangements for each project. In addition, because the SIB concept would permit states to leverage federal funds more aggressively, it would enable the federal government to generate more than a dollar in construction – perhaps several dollars – for each dollar it puts into the program.

At the same time, the Congressional budget resolution proposes that Congress stop funding individual "demonstration projects" – a euphemism for the favored local projects for which Senators and Congressmen obtain federal money. Elimination of such funding will not be easy – public-works pork-barreling is one of Congress's most time-honored traditions. But it now seems probable that demonstration project funding, even if not eliminated entirely, will at least be cut back sharply.

A similar shift is evident in housing and community development. The Congressional budget resolution assumed a 28 percent reduction in the Community Development Block Grant program. But the House Appropriations Committee has instead chosen to maintain FY 1996 CDBG funding at its current level, and to compensate by cutting back or eliminating a long list of HUD discretionary grant programs.

Changes such as these could mark the beginning of a significant shift in Washington's relationship with the nation's cities. During the past several decades, the federal government's

approach to urban issues has been marked by a profusion of programs offering an endless array of small grants dealing with various social, economic or environmental issues. (The table on the following page provides some examples.) Despite the diversity of these programs, they have several general features in common:

- They are intended to show that Congress or the executive agencies are "doing something" about an issue;
- The level of resources provided is inadequate to have anything but the most marginal impact on the need being addressed;
- The cost of administering the program is high, relative to the benefits distributed.

While each of these programs has its own narrow constituency, cities are better off when they are able to obtain larger allocations of funds under more broadly defined categorical programs, or through block grants – especially if they offer increased flexibility with respect to the purposes for which, and the manner in which, federal funds can be used.

### **Block Grants: The Devolution Revolution**

As described in Part Two, one of the ways in which Congress is seeking both to control federal spending and to change the nature of the federal government's role is by consolidating various categorical aid programs into block grants – for welfare, education, employment and training and possibly for Medicaid. This trend raises a number of critical issues for cities.

- *How large is the proposed reduction in overall funding, relative to any possible gains from increased efficiency and flexibility?*

The savings from simply eliminating administrative duplication will probably be relatively modest – say, on the order of 5 percent. But if local authorities also have greater substantive flexibility concerning how to use federal funds more effectively, the gains could be greater.

- *What types of programs are being consolidated into the proposed block grant?*

The conversion of an individual entitlement such as AFDC into a block grant could have much more serious consequences – for individual recipients, for states and for cities – than a block grant that simply consolidates several categorical grant programs for which funding is already limited. In a severe regional recession, a state could find itself confronting a sharp increase in applications for assistance, without any commensurate increase in federal funds.

- *How will total funding change over time?*

The historical evidence on this score clearly suggests that in most cases federal block grants to states and cities do not keep pace with inflation. Given the prevailing political climate in Washington, it seems clear that Congress will use block grants to limit sharply the growth of federal spending in selected program areas.

In weighing the impact of block grants on the growth of federal spending, it is important to view projected growth rates not just against past experience, but also against what would be likely to happen in the future in the absence of block grants. A new Medicaid block grant that grows at only 4 percent per year might seem like a bad bargain relative to the program's historical growth rates – but even without a block grant, it is quite unlikely that either the federal government or the states would be prepared to support double-digit Medicaid growth indefinitely.

<b>Federal Discretionary Grant Programs: Selected Examples</b>		
Program/Agency	Purpose	Current Funding
Community Initiatives (HHS)	Job-creation in low-income areas.	\$35 mil
Lead Poisoning Prevention (HHS)	Grants to cities and states for outreach, screening, testing, follow up etc.	\$7.5 mil
Youthbuild (HUD)	Construction work experience for low income youth.	\$40 mil
John Heinz Neighborhood Development Program (HUD)	Support for neighborhood-based non-profit groups.	\$5 mil
Local Rail Freight Assistance Program (DOT)	Support for development of local rail freight service.	\$25 mil
Urban Community Service Program (Education)	Grants to colleges for student community service projects.	\$10 mil
McKinney Act Job Training (DOL)	Employment and training for the homeless.	\$12.5 mil
Urban Park Recovery Program (DOI)	Rehabilitation and management of urban parks.	\$5 mil
Corrections Options (DOJ)	Development and implementation of alternatives to conventional incarceration.	\$12 mil
Delinquency Prevention (DOJ)	Grants to local governments for recreation, remedial education, counseling.	\$13 mil

- *Does block grant legislation include provisions aimed at ensuring an equitable distribution of funds within the state?*

The education and training block grant program being considered in the House includes language requiring states to pass through most of the federal funds to the local level; the Senate version, in contrast, gives the states much broader discretion concerning the distribution of federal money.

- *Will block grants carry state matching requirements?*

Most categorical grant programs require some kind of state or local matching contribution; many block grants, however, do not. One of the most troubling aspects of the welfare block grant proposed by House and Senate Republicans is that it would eliminate the state match now required under the AFDC program. This would give the states a powerful new incentive to cut welfare benefits, since every dollar cut from the program would go directly to the state's bottom line, rather than being split 50-50 with the federal government. For the poorest residents of America's cities, the effects of such reductions could be devastating.

The Congressional budget resolution assumes, in contrast, that states would continue to match federal contributions under the proposed Medicaid block grant program. (Medicaid matching ratios now vary from state to state, with the federal government paying an average of 57 percent of total program cost, and the states an average of 43 percent.)

<b>Change in Real Dollar Value of Block Grants 1983-1993 (\$ millions)</b>				
	1983	1993	% Change	Inflation- Adjusted % Change
Community Development	\$2,380	\$2,790	17.2%	-18.6%
Social Services	2,675	2,800	4.7	-27.4
Low-Income Energy Assistance	1,975	1,346	-31.8	-52.7
Job Training	1,415	1,692	19.6	-17.0
Maternal and Child Health	478	664	38.9	-3.6
Substance Abuse	468	1,108	135.8	64.3
Education	462	440	-4.8	-33.9
Community Services	373	372	-0.3	-30.8

(Source: *Center for the Study of the States*)

Block grants should not be seen as a cure-all for the deficiencies of existing categorical programs. Sometimes the consolidation of categorical programs into a new block grant program – or combining two streams of funding in the name of giving states more flexibility – represents little more than Congressional unwillingness to bite the bullet on eliminating programs that cannot stand on their own. This tendency is reflected, for example, in current Senate proposals to permit the states to use highway trust fund money to replace federal subsidies to AMTRAK that the Republican majority proposes to phase out.

States and cities can often benefit by gaining greater flexibility in the use of federal funds. But flexibility is not an end in itself; it should not become an excuse for avoiding politically difficult decisions on whether federal financial support for a particular program or purpose is or is not justified.

### **Trimming Federal Mandates and Prohibitions**

Advocates of shifting responsibility for various programs from Washington to state and local governments, such as Governors John Engler of Michigan and Tommy Thompson of Wisconsin, have often claimed that they would gladly trade a reduction in federal funding for greater freedom from federal mandates and prohibitions. But as we noted above, whether states and localities gain or lose in such an exchange depends very much on the specific terms of the deal.

Administrative savings – elimination of duplicative annual application procedures, quarterly reporting requirements, etc. – will rarely offset more than a few percentage points' reduction in total funding. (This is especially so, given the ingenuity with which federal agencies can find new ways to intrude upon state and local management of programs that have been clothed in the rhetoric of devolution – a tendency now at work, for example, in the implementation of the empowerment zone program.)

The less-money-for-more-flexibility trade-off will in most cases prove worthwhile only if it involves elimination of the accreted mandates and prohibitions that are typically added to federal programs to protect the interests of particular groups. Examples of changes in federal law that might have a real impact on the bottom-line value of reduced federal aid to states and cities might include:

- Giving states complete freedom to use whatever methodologies they choose to adopt for setting hospital and nursing home reimbursement rates under the Medicaid program.
- Eliminating all federal restrictions on the types of user fees that local airport authorities can impose, and on the uses to which such fees can be put. (The Senate Appropriations Committee has taken a first step in this direction, by proposing to increase the federal cap on "passenger facility charges" collected by local airport authorities from \$3 per passenger to \$5 per passenger.)
- Repealing the Davis-Bacon Act, which requires payment of "prevailing wages" (which usually means union wages) on construction projects financed wholly or partly with federal funds.

**Federal Mandates: A Mayor's Perspective**

*We just got through renovating five elevators in our city-county building in Knoxville. We had to lower the buttons six inches on each elevator, inside and outside; \$25,000 per elevator – \$125,000. Did we really need to do it to all five? Would not have, say, changing the buttons on two of the five been sufficient, so we could save ourselves \$75,000? Would that have meant we were insensitive to the needs of the disabled? No, I don't think so at all.*

*And when you repave city streets, do you now have to put a curb cut on every single intersection, regardless of traffic, regardless of anything? If a federal court of appeals is upheld, the answer is yes. That would in effect be a 20 percent reduction in Knoxville's paving budget – and again, is there a good public purpose being served? Does every intersection on every street in America really need a curb cut?*

– Mayor Victor Ashe, Knoxville, Tenn.  
Taub Urban Research Center Conference, June 1995

**Shifting Program Costs to Beneficiaries**

One of the most broadly felt impacts of reductions in federal spending during the next several years will be to shift more of the burden of paying for publicly-financed services to the direct users of those services. For example:

- To compensate for the loss of federal operating aid, and for increased local matching requirements on capital projects, transit fares will rise.
- The share of highway and bridge investments financed from toll revenues will increase, as will the share of airport investments financed by passenger fees and other user charges.
- Use of co-payments and deductibles to help control Medicaid spending will probably expand.
- Graduate students will have to bear the full cost of interest on their student loans.
- Tenants in public (and publicly-assisted) housing will probably have to pay a higher share of their incomes in rent.
- Home-buyers will have to pay higher fees for FHA mortgage insurance.

A shift from general-revenue funding of public services and facilities to user-revenue financing is not necessarily a bad thing. Copayment requirements can help limit the use of health services that might be overutilized when consumers can treat them as a "free good." Capital projects are more likely to be more responsive to the market – and less likely to be overdesigned – when they have to be financed with revenue bonds rather than federal grants. And it is difficult to argue that

there is something inherently unfair about asking transit users to cover 60 percent of the cost of a ride, rather than 40 or 50 percent.

The principal issue that arises with respect to greater reliance on user revenues is, of course, the impact that such a shift will have on those least able to pay. This is a legitimate concern when increased user charges are required for services specifically targeted to poor people – as in the Medicaid program. Defining copayment levels that are high enough to discourage overutilization, but not so high as to discourage people from seeking care they really need, will not be easy.

But in many other cases, the majority of those who would be asked to pay a greater share of the cost of services – subway riders, Medicare patients, motorists, graduate students – are not poor. Raising user charges for these groups may be politically unpalatable; but it should not be considered objectionable as a matter of social policy.

### **The Shift to the States**

The shift of financing responsibility and decision-making authority from the federal government to the states is one of the central themes of the Republican revolution in Washington. This change could cause problems for the nation's cities. Their influence in state capitals has been eroding for some time, as the demographic, economic and electoral center of gravity has shifted to the suburbs.

Cities may be especially vulnerable if, as discussed above, the legislation that shifts responsibility to the states also eliminates state matching requirements, and does not require some equitable distribution of funds within the state. Moreover, as Washington's role shifts from "retail" to "wholesale" financing of aid to states and localities, cities may find that they can no longer rely on the traditional ability of senior members of Congress to bring home federal funds.

Despite these concerns, it should not be assumed that the ascendance of the states spells disaster for the cities. As Richard Nathan has noted, during earlier periods of conservative hegemony in Washington – the 1920's and the early 1980's, for example – state governments have often served as the primary source of innovation in a wide range of domestic policy areas.

Regardless of whether it is seen as a problem or an opportunity, the shift of responsibility to the states will require a similar shift in the political focus of urban interests. The ability to affect legislative and budgetary politics in the fifty state capitals will become more and more important; the ability to extract discretionary grants or pork barrel appropriations from Washington will become less and less significant. And at a more fundamental level, city officials and various city constituencies will need to break the habit of thinking first of Washington as the forum in which each newly-identified need should be addressed – to stop thinking, for example, that the logical response to the fact that some AIDS patients are victims of housing discrimination is to create a new federal program to finance "Housing for People With AIDS."

## IV. AN AGENDA FOR THE CITIES

During the next several weeks, Congress will be making decisions on the FY 1996 budget that will shape the federal government's relationship to America's cities for years to come. And in the months that follow, the Clinton Administration and the Congress will be wrestling with a series of major reform proposals that will even more profoundly affect Washington's role in addressing the nation's urban problems.

Individually and collectively, cities need to think clearly about the principles and priorities that will guide them through the political and governmental minefields that lie ahead. We conclude this report with some recommendations for what those principles and priorities might be.

That Congress will sharply reduce federal spending in a wide range of program areas that are central to the concerns of the nation's cities is now inevitable. While urban interests and their representatives in Washington will not be able to stop this process – at least in near future – they may be able to influence how budget cuts are effected.

### Protecting Low-Income City-Dwellers

The highest priority for city representatives should be to protect the integrity of programs that directly benefit low-income families and individuals. This is essential not only for protecting the cities' most vulnerable residents, but also for minimizing the adverse effects of spending cuts on the economic health of urban areas. Thus the cities should:

- *Support maintenance of federal funding of basic public assistance at current levels, and maintenance of the principle of increasing federal support for state and local programs as local needs increase.*
- *Oppose elimination of state matching requirements for public assistance.*
- *Support reforms aimed at encouraging and supporting state and local efforts to move recipients from welfare to work.*
- *Oppose efforts to reduce the scope or value of the Earned Income Tax Credit, while supporting efforts to curb abuses.*
- *Seek to ensure, even with reductions in Medicaid spending, that states continue to be responsible for providing at least a minimum package of primary health care services to their poorest residents.*

### Broad-Based Rather Than Narrow Categorical Funding

When spending reductions within major program areas appear to be inevitable, cities should seek to preserve programs in which the federal government provides broad funding streams – even if this requires deeper cuts in programs that provide narrow categorical grants – and to promote conversion of narrowly-defined grant programs into more flexible funding instruments.

The successful campaign by a coalition of urban interests to preserve CDBG funding in the House Appropriations Committee – which meant accepting even deeper cuts than the Congressional budget resolution had assumed in HUD's categorical grant programs – exemplifies this approach. Cities might similarly:

- *Support proposals to cut transportation spending by eliminating "demonstration projects," rather than by cutting the major categorical programs.*
- *Support proposals aimed at permitting state and local authorities to leverage federal funds more effectively – as in the administration's proposal for use of highway trust fund money to capitalize "state infrastructure banks."*
- *Support consolidation of miscellaneous employment and training programs into a small number of block grants to the states.*
- *Support consolidation of federal anti-crime funds into a block grant – provided that it gives local communities real flexibility to devise their own crime prevention strategies.*

### **Ensuring Equitable Treatment of Cities**

Given the near-certainty that at least some existing categorical and entitlement programs will be converted into block grants, cities have a vital interest in ensuring that state governments treat them fairly when it comes to distributing the available federal resources. To ensure equity Congress could, for example:

- *Require that federal funds be passed through to the local level – as now occurs under the Job Training Partnership Act, for example – based on some formula that fairly reflects the needs of the cities.*
- *In programs that provide benefits directly to individuals – public assistance, rent vouchers, training vouchers, etc. – require statewide uniformity in benefit and eligibility levels, except to the extent that intrastate variations reflect real regional cost differences.*

### **Eliminating Federal Mandates and Prohibitions**

If cities are to be subjected to sharp reductions in federal aid, they should at least press the Republican majority in Congress to make good on their rhetoric about relieving local governments of the burden of federal mandates and prohibitions. This may not be an easy task, given the organized interests that stand behind many of these prescriptions and proscriptions; one politician's "unfunded mandate" is another's "sound national policy."

The cities might, for example, press Congress to:

- *Eliminate federal restrictions on the methods states use to set reimbursement rates for hospitals, nursing home and other providers under the Medicaid program.*
- *Permit state and local authorities to impose tolls on highways constructed with federal funds.*
- *Eliminate federal restrictions on the types and levels of user fees that local airport authorities can collect, and on the purposes for which revenues derived from such fees can be used.*
- *Relax or eliminate the Davis-Bacon Act requirement that workers on construction projects financed in whole or in part with federal funds be paid "prevailing wages."*

### **The Cities' Interests – and the Nation's**

The political pressure on Washington to balance the budget is stronger than it has been in a generation. Cities stand to benefit in many ways from steady and substantial reductions in the federal deficit. To achieve that objective, all of the varied interests that now benefit from deficit spending – including the nation's cities – should expect to give something up.

But cities – and most particularly, low-income city residents – should not be expected to absorb more than their share of the pain. Congress does not need to cut so deeply into programs that benefit the urban poor in order to balance the budget – especially when so many agricultural and business subsidies have escaped relatively unscathed, and when both the House and the Senate have both sought to add billions of dollars to the defense budget for weapons the Pentagon has not requested, and does not need.

The cities' most compelling needs are not in conflict with the nation's most vital interests. Indeed, in the long run they are one and the same.

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