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Cities in the New Federal Order: Effects of Devolution

by Peter Eisinger

This article examines the possible effects on cities of the ongoing effort to shift responsibility for domestic programs from the federal government to state and local governments. Political Science and Public Affairs Professor Peter Eisinger, who presented this paper at the Baker Institute Annual Conference, argues that local leaders must shift their roles from being leaders on social issues to emphasizing public management of resources.

The effort to construct what might be called a New Federal Order, which began in earnest more than 25 years ago, is still very much a work in progress. President Clinton and most members of Congress have clearly embraced aspects of this federal arrangement from its New Deal–Great Society predecessor, such as diminishing federal intergovernmental aid, block grants, and formal devolution of federal responsibilities. But the scope and details of implementation of this latest iteration of the federal arrangement are not yet fully worked out. The bare walls of the edifice have been erected, but there is little interior decoration.

As members of the tripartite federal partnership that came to its fullest expression in the Great Society and the years immediately following, local governments have a deep interest in the process and outcomes of federal realignment. As the outlines of the New Federal Order of the 1990s have taken shape, the implications for urban government clearly are manifold. Nevertheless, even though many of the problems and issues reshaping federalism are concentrated in urban areas, much is uncertain about the role of cities in the emerging federal arrangement. Curiously, city representatives and city interests have been, in political scientist Margaret Weir's words, "conspicuously absent from the congressional debate about devolution."

Certain developments in national politics make this an appropriate moment to take stock and to speculate about the future of cities in the New Federal Order. In summer 1996 Congress passed and the president signed the new welfare law, converting cash support for poor people from an open-ended federal entitlement to fixed block grants to the states. Devolution through block grants is the focus of debate in other areas of public policy, from law enforcement to job training to housing, all policy domains in which the local government role is clearer and more formalized than in the welfare realm. Not only is there now broad interest in block grants, but deficit-averse Democrats no longer resist the intergovernmental aid reductions put in place in Republican Washington in the 1980s. This article, then, explores what is known about cities in the New Federal Order, what their role might be, and the effects on cities of the changes in the federal arrangement.

I suggest that to the extent that cities are increasingly cut off from intergovernmental fiscal aid and federal program initiatives, mayors must focus more and more on making the most of the resources they control. Thus the arts of public management are becoming the primary tasks of local political leadership. This represents an important change in the moral climate of local poli-

Director's Perspective

On the board opposite my desk at the La Follette Institute is a list of 24 projects now under way—from leadership training for state legislators to an effort to help Indian nations build new governance systems. La Follette scholars find their research in demand across the country and around the world. The long list of projects grows continually, thanks to La Follette's increasing visibility and reputation.

Immediately after the November 1996 election, Governor Thompson asked me to chair the Blue-Ribbon Commission on Campaign Finance Reform. The commission, staffed at La Follette and focused on a thorough, fundamental review of the state's campaign finance system, is working to craft reforms that will help solve the problems afflicting the state's electoral process. The commission will report its findings to the governor by May 1.

This *Policy Report* touches on important issues the faculty have explored recently. One theme is devolution. As the federal budget moves toward balance, state and local governments are affected in huge and sometimes unpredictable ways. Professors Eisinger and Reschovsky contribute in these pages some of their most up-to-date scholarship. In the lead piece, Eisinger defines and discusses the implications of what is likely to become a fairly large-scale rearrangement of responsibilities and authority among governments. He calls the phenomenon the "New Federal Order." Reschovsky's piece is a distillation of a longer work on the potential effects on states of balancing the federal budget, with a brief discussion of the effect of Wisconsin.

Maria Cancian and Daniel R. Meyer's article on life after welfare reports their research predicting the effects on women and children of recent welfare reform initiatives. They examine how often individuals return to welfare once they leave it. If welfare is no longer an option, women and children may face poverty just the same, the authors conclude.

Don Nichols's study of the Wisconsin economy and its significant unemployment figures ties in with Cancian and Meyer's study. Nichols suggests that Wisconsin's welfare reform program can work here as well as anywhere because of the state's low unemployment. Wisconsin's businesses and industries are hungry for workers, and an important issue for public policymakers is how to attract them, in what numbers, and at what rates.

My article on ISO 14000 also relates to devolution. The paper comes from a Madison roundtable conducted with the University of Pennsylvania's Wharton School and the states of Pennsylvania and Wisconsin. The effort, examining new strategies for environmental management, will continue with roundtables in April and in the fall.

The Institute launched its first fundraising drive this year, reaching out first to alumni, with plans to seek wider support. A lecture series, an expanded student internship program, and training programs for policymakers will be made possible by such gifts. We will continue to work hard at integrating the Institute's research with society's problems in service to the "Wisconsin Idea": the proposition that the university's resources can be brought to bear on the issues that most concern citizens.

Donald F. Kettl

Donald F. Kettl

tics, for city hall is far less likely to be used these days as the bully pulpit from which mayors once sought to exercise leadership on major social and economic issues.

The New Federal Order

The move to the New Federal Order began with President Nixon's efforts to devolve authority from Washington to subnational governments through block grants and general revenue sharing and continues today as Congress, President Clinton, and governors combine to contract the role of the federal government in domestic policy. Although the initial efforts in the 1970s to transform the federal system were seen as partisan attempts to diminish Washington's influence, both parties seem to agree today not only that "the era of big government is over" but that the proper locus of policy invention and administration is at the state and local levels. The Clinton administration, for example, had approved 78 state welfare demonstration projects prior to the passage of the 1996 reform bill. More generally, the president's urban policy, according to Michael Stegman, assistant secretary of the U.S. Department of Housing and Urban Development, "recognizes that the most pressing problems facing older cities can no longer be addressed through countercyclical grant-in-aid programs."

Several aspects of the process of creating the New Federal Order must be distinguished. One aspect is simply the *contraction of federal intergovernmental aid*. This trend represents the devolution by default of fiscal responsibility to states and localities. A second aspect is the *formal devolution of power from Washington to subnational government*, a rearrangement of responsibilities that for the most part has not yet greatly affected the powers and responsibilities of city governments. A third feature concerns the *indirect consequences* of devolution to the states. These spin-off fiscal and political effects are manifold, and they do affect the cities in important ways.

Fiscal Contraction

Federal fiscal assistance to cities is much diminished since the late 1970s. The contraction of aid has been so dramatic that Washington's loss of interest in urban affairs is one of the signal stories of the great transformation to the New Federal Order. Yet a focus on the big picture alone may be somewhat misleading:

cities have not been entirely cut adrift to live or die by their own wits.

In 1977, the year before federal aid contraction began, municipal governments looked to Washington for 15 percent of their total revenues. By 1992 federal assistance had fallen to only 3.1 percent of local revenues. Total federal grants-in-aid to state and local governments regained their high-water mark of 1978 (in constant dollar terms) in 1991, but the functional distribution of intergovernmental fiscal assistance had changed in ways particularly disadvantageous to the cities. Whereas grants for education, job training, and social services, much of which go to local governments, accounted for 23.9 percent of federal intergovernmental aid in 1980, the figure had fallen to 15.8 percent by 1994. Community development assistance fell in this period from 7.1 to 2.9 percent of federal aid, while grants for sewer and water construction and environmental cleanup went from 5.9 to 2.0 percent. In the meantime health-related grants, mainly Medicaid, which is channeled through the states to individuals, rose from 17.2 percent of all federal intergovernmental assistance to 42.1 percent, according to the Advisory Commission on Intergovernmental Relations. In short, a much smaller proportion of federal aid is devoted to urban programs than was true just 15 years ago.

An analysis by the U.S. Conference of Mayors of funding of key urban programs shows how severe the cuts have been from the perspective of the cities. Between 1981 and 1993 funding of Community Development Block Grants, Urban Development Action Grants, general revenue sharing, mass transit aid, employment and training programs, clean water construction, assisted housing, and the various programs of the Economic Development Administration fell by a total of 66.3 percent in real dollar terms. Table 1 shows the decline for individual categories of programs.

States did little for their municipalities to make up for the evaporation of federal funds. Reeling from the losses of federal aid they themselves were experiencing, especially with the end of the state portion of general revenue sharing in 1980, states initially reduced the rate of growth of aid to their local governments in the early 1980s. Whereas in 1981 states increased their assistance to local governments by slightly more than 10 percent, the annual rate of increase fell by 1983 to only 2.6 percent. Altogether, state aid to local governments as a proportion of local revenues remained steady at roughly 30 percent from 1978 to 1992.

Although urban-oriented federal aid had dropped substantially by the mid-1990s, Washington did not abandon the cities altogether. As President Clinton's first term came to a close, federal aid to urban governments had achieved a certain equilibrium. The era of the drastic cuts appeared to have ended. A budget analysis prepared by the U.S. Conference of Mayors compares the final federal funding for "municipal" programs for fiscal years 1995 and 1996. Of the 84 programs analyzed, funding increased for 26 and stayed the same for an additional 15. Funding declined, sometimes marginally, sometimes significantly, for the remaining 43.

An examination of Table 2 suggests that programs that suffered often serve politically unpopular functions and politically weak clienteles. The National Endowment for the Arts and the National Endowment for the Humanities, which serve urban theater, arts, and music activities, have been embroiled in the so-called "culture wars" and have experienced sharp funding decreases. Congress also cut funds for immigrants (bilingual education), homeless people (Homeless Assistance Act), general social services to needy people (social services block grant), and drug users (substance abuse treatment). On the other hand, municipal governments saw increases in funding between 1995 and 1996, occasionally substantial ones, for a variety of law enforcement programs, youth job training, and assisted housing. Moreover, despite the end of the "era of big government," the Clinton administration was seeking increases for the 1997 fiscal year from the prior year for 60 of the 84 municipal programs.

Formal Devolution

The devolution of specific responsibilities and authority from Washington to states and localities lay at the heart of President Reagan's New Federalism, one element of which involved a failed proposal to carry out a "great swap": Washington would assume full responsibility for Medicaid in return for complete state takeover of Aid to Families with Dependent Children (AFDC) and Food Stamps.

A second aspect of President Reagan's devolutionary rearrangement was implemented: the consolidation of 77 categorical grants-in-aid into 10 broad block grants to states. The consequence was to strip Congress of the authority to designate specific uses of federal assistance for a variety of mainly health and education programs. States can now establish their own priorities within the broad boundaries of these new block grants. In both instances the focus of the devolutionary reforms was mainly on the states; 47 of the categorical programs had previously delivered funds directly to local governments.

TABLE 1

Federal Funds for Cities, 1981-1993
(in billions of constant 1993 dollars)

Program	*Fiscal Year 1981*	*Fiscal Year 1993*	*Percentage Real Cut*
Community Development Block Grant	$6.3	$4.0	-36.5%
Urban Development Action Grant	0.6	0	-100.0
General Revenue Sharing	8.0	0	-100.0
Mass Transit	6.9	3.5	-49.3
Employment and Training	14.3	4.2	-70.6
Economic Development Administration	0.6	0.2	-66.7
Assisted Housing	26.8	8.9	-66.8
Clean Water Construction	6.0	2.6	-56.7

Source: U.S. Conference of Mayors, *The Federal Budget and the Cities* (Washington, D.C.: USCM, February 1994).

TABLE 2

Federal Funding for Municipal Programs, 1995 and 1996
(in millions)

Program	*Fiscal Year 1995*	*Fiscal Year 1996*
National Endowment for the Arts	$162	$99
National Endowment for the Humanities	172	110
Museum Grants	28	21
Community Policing	1,300	1,400
Local Law Enforcement Block Grant	0	459
Anti-Drug Enforcement	450	500
Juvenile Justice	155	149
Violence Against Women	28	175
Local Partnership Act	0	0
Community Schools Youth Service	0	0
Safe and Drug Free Schools	441	441
HUD Drug Elimination	290	290
Drug Courts	12	18
Substance Abuse Treatment	1,442	1,324
Substance Abuse Prevention	238	90
Title I Education for the Disadvantaged	7,228	7,228
Impact Aid	728	693
Bilingual and Immigrant Education	207	178
Vocational and Adult Education	1,380	1,340
Student Financial Assistance	7,586	6,259
Goals 2000	372	350
Clean Water Loans	1,885	1,848
Superfund	1,354	1,300
Food Stamps	25,576	26,353
Child Nutrition Programs	7,477	7,966
Women, Infants, and Children (WIC)	3,450	3,694
Commodity Assistance	190	166
Ryan White CARE	633	738
Centers for Disease Control Prevention	590	590
Medicaid	96,391	95,977
Medicare	189,097	197,588
Community Health Centers	757	760
Family Planning	193	193
Healthy Start	104	93
Maternal and Child Health Block Grant	684	679
Preventive Health Block Grant	158	145
Sexually Transmitted Diseases	225	228
Immunizations	464	470
Lead Poisoning Prevention	36	36
Homeless Assistance	1120	823
Emergency Food and Shelter	130	100
Education for Homeless Children	29	23
PATH Formula Grants	29	20
Community Development Block Grant	4,600	4,600
HOME Investment Partnership	1,400	1,400
Public Housing Operating Subsidies	2,900	2,800
Public Housing Modernization	2,885	2,500
Severely Distressed Public Housing	500	480
Housing Opportunities for People with AIDS	171	171
Section 202 Elderly	1,176	1,013
Section 108 Loan Guarantees	2,054	1,500
Section 8 Renewals	2,159	4,008
Youthbuild	40	20
Preservation	175	624
Lead-Based Paint Demonstration	15	65
Economic Development Administration	383	329
Community Development Financial Institution	50	45
Aid to Families with Dependent Children	16,025	16,946
Headstart	3,534	3,570
Social Services Block Grant	2,800	2,381
Low-Income Home Energy Assistance	1,000	900
Child Care Block Grant	935	935
Community Service Block Grant	458	435
Administration on Aging	876	829
Refugee and Entrant Assistance	400	402
AmeriCorps Grants	470	403
Adult Job Training	997	850
Youth Training	127	127
Summer Youth	867	625
One-Stop Career Centers	100	110
Dislocated Workers Assistance	1,229	1,100
Job Corps	1,089	1,094
School-To-Work Program	123	170
Community Service Employment (Aged)	396	373
Opportunity Areas for Youth	0	0
Airport Improvement	1,450	1,450
Airport Facilities and Equipment	1,960	1,875
Airport Operations	4,573	4,643
Federal Aid Highways	17,192	17,714
Transit–Operation	710	400
Transit–Capital	1,574	1,491
Transit–Discretionary	1,725	1,665
AMTRAK	794	635

Source: "Funding Levels for Key Municipal Programs," *U.S. Mayor*, May 12, 1996, p. 8.

The Reagan federalism reforms failed to stem the growth of categorical grants, whose number had achieved an all-time high of 618 by 1995. Despite this, interest in devolution has remained high, in Washington and the statehouses, fueled by the increasingly bipartisan conviction that, in most matters of domestic policy, government closest to the people governs best.

For proponents of devolution, the 1990s began in a promising way with the passage of the Intermodal Surface Transportation Efficiency Act, which greatly expands the ability of state and local governments alike to reallocate transportation funds among specific modes. For example, in 1995 subnational governments shifted more than $800 million from one purpose to another, such as the New York City Transit Authority's transfer of money initially designated for highways to mass transit projects, including station upgrades and signal modernization, according to 1996 testimony by then-Secretary of Transportation Federico Peña.

Another significant success at devolution during the Clinton years promises to be the 1996 welfare reform legislation, which created the Temporary Assistance for Needy Families (TANF) Block Grant. Henceforth, states will receive a fixed amount of funding from which to provide income support and work programs. States are now responsible for establishing eligibility requirements and time limits. The shift of welfare responsibility to the states creates no formal local role, however, although clearly there are indirect implications for cities.

Two other developments of the mid-1990s are important to this analysis—the Unfunded Mandates Reform Act of 1995 and the Empowerment Zone and Enterprise Cities Act of 1993. Neither devolves new specific powers to subnational governments, but both promise to expand the scope of local self-determination. Among other provisions, the Unfunded Mandates Reform Act prohibits Congress from imposing mandates that will cost more than $50 million to carry out unless federal funding is provided. This will presumably discourage the imposition of major regulations, relieving states and localities from carrying out (and funding) activities they might not otherwise choose to do. The cumulative effect for cities of the unfunded mandate law will be to carve out a larger domain of action at the local level that is free of federal regulation and oversight.

The Empowerment Zone and Enterprise Cities program offers each selected community a $100 million grant under the Title XX Human Services Block Grant program for social services and economic development. For these cities, the program represents a devolution of capacity rather than a devolution of programmatic authority or responsibility in economic and community development, which already rest primarily at the subnational level. By stimulating a competitive planning process in quest of empowerment zone status and by passing back a significant block grant with few strings attached, Washington has enhanced the capacity of a select number of municipal governments to carry out functions they have chosen and designed.

The bare walls of the edifice have been erected, but there is little interior decoration.

Although little formal devolution from Washington to the cities has yet occurred, various proposals on the political agenda could expand the urban role in the New Federal Order. Former Secretary of Housing and Urban Development Henry Cisneros recommended consolidating existing programs to create a block grant for local governments to serve homeless people. According to *Governing*, Cisneros was said to believe that "homelessness is a local problem that is best solved . . . at the local level. . . . The most Washington can do is show the way." There has also been talk in Washington of consolidating 60 current HUD programs into three block grants for housing assistance, housing production, and community development.

More recently, congressional Republicans sought to eliminate the Community Oriented Policing Services program and substitute a $10 billion block grant to localities for law enforcement, but President Clinton vetoed the appropriations bill that threatened to transform this signature program.

As these examples make clear, devolution is increasingly a shared goal of both political parties. Unlike the devolution of the Reagan years, the expansion of state authority is not the sole focus of federal reform. Although little formal authority has yet been transferred to local governments, some of the groundwork has been laid by expanding the scope of autonomy through mandate reform and by forcing cities to rely more heavily on their own resources. Cities may anticipate playing an even more central role in the federal rearrangement.

Indirect Consequences of Devolution

As federal devolution proceeds, cities are increasingly subjected to a variety of indirect effects. Some of these are a function of the increased burdens on state governments, while others stem from the cities' growing fiscal self-reliance. There are at least three categories of indirect consequences: potential fiscal effects of welfare devolution; burden-shifting in a variety of functional areas, as federal aid reductions force cities to provide services now supported by shared funding; and consequences for the nature of local politics and political leadership. In particular, political reputation and success increasingly rest on public management skills rather than the ability to exercise moral suasion on matters of social policy. These latter effects, already strongly in evidence, are signs of a deep change in the texture of urban politics.

Fiscal effects

Political scientist Margaret Weir predicts states will adjust to reductions in federal funding by poaching on local revenue sources, although how widespread this might become and the particular forms it might take are not yet apparent. One modest fiscal challenge to local government revenues derives from the new welfare law, which could result in a slight diminution of local economic activity in the consumer sector. With a few notable exceptions, most cities do not currently share the direct costs of AFDC. The shift to capped block grants to the states will, therefore, have no immediate direct effects on local revenue allocations. But the time limit on cash assistance under TANF may ultimately have an indirect impact on local revenues by reducing municipal tax collections and creating demands for local public service jobs and education.

After a maximum of two years on TANF, recipients must leave the welfare rolls and engage in some sort of "work." Some will succeed, finding unsubsidized jobs in the private sector. Others, however, will not. Indeed, this outcome is the more likely in many cities, for there are simply not enough entry-level jobs to absorb the number of adults who will come off the welfare rolls. If all the unemployed adults not on public assistance and all welfare recipients in Chicago were to look for work, there would be six workers for every available entry-level job, according to Weir. In New York City approximately 470,000 able-bodied adults are on welfare. They will join about 271,000 unemployed people not on welfare in the job search. These roughly three-quarters of a million people will be competing for employment in a local economy that is producing about 20,000 new jobs per year, many of which require substantial skills and education.

Of those who do not find work in the private sector, some will migrate from the state and others will fall back on relatives or friends. In either case, they will no longer have the steady, even if modest, spending power provided by cash welfare assistance. Miami University of Ohio researchers argue that one result of this loss of cash assistance by people otherwise not gainfully employed will be to lower a city's property and sales and local excise tax base by reducing both rental housing demand and consumer spending.

Others who cannot find work in the private sector and who do not vanish from administrative view by moving in with relatives or leaving the state have several options, according to the law. They may seek subsidized employment in the public sector or community service programs; they may seek job skills training directly related to employment; or, for high school dropouts, they may return to high school. Although block grants to the states may fund some of these options, local government resources are likely to be sought to create public service jobs or classroom training and education because the new law does not provide enough funding to finance subsidized work and training. The Congressional Budget Office estimates the shortfall in support of the work requirement at $12 billion during the next six years. States may pick up some costs but they are likely to push others onto cities. The 1996 welfare reform, then, will not be cost-free for cities.

Service burden-shifting

Some welfare recipients who reach their time limits will find neither shelter with relatives or friends nor work. Some will no doubt find themselves literally on the streets. Locally funded homeless programs will certainly feel the impact. Other unsuccessful job seekers will resort to crime, increasing the burden on the local criminal justice system.

Although anyone eligible for welfare on July 16, 1996, will remain eligible for Medicaid even after the new welfare reform goes into effect, there is no guarantee that Congress will not change the entire Medicaid program. The House and the Senate nearly agreed late in 1995 to create a Medicaid block grant to states that would have reduced funding over the next seven years. If such a proposal is successfully revived, one effect on cities surely will be an increase in demand on public hospital emergency services, according to a 1996 report by the Center on Budget and Policy Priorities.

Leaders must demonstrate skills in managing scarce resources.

Public management as urban politics

The most important impact on the cities of the shifting balance in the federal arrangement has been to change what could be called the moral tenor of urban politics. In short, good public administration has displaced the urban social agenda that had dominated local politics since the 1960s. By increasingly forcing local leaders to make do with less intergovernmental aid and by making them husband local resources, the New Federal Order has placed a premium on local public management skills and discouraged grand visions of social and racial reform. As a U.S. Conference of Mayors spokesperson told the *National Journal* in August 1996, "In the last few years, our attention has shifted from trying to increase aid to cities in any form to trying to streamline it and make it more effective. Let's talk about how we can make better use of what we're getting."

Some see this simply as part of a broad national trend toward conservatism, one that reaches down "even into the generally safe Democratic and minority reaches of urban leadership," political scientists Raphael Sonenshein, Eric Schockman, and Richard DeLeon wrote. Others see a more complex phenomenon taking place: Terry Clark, for example, in his book, *Urban Innovation*, argues that a new political culture has emerged in the cities, one that features lifestyle and consumption concerns (especially lower taxes) rather than redistribution and material issues like housing and community development for disadvantaged people. Clark traces the crystallization of this middle-class urban politics to the decline of federal and state grants, many of which were targeted to people in poverty. Thus the contraction of federal aid has meant not only less money for cities, but also less policy guidance.

In a political climate where fear of taxpayer revolts is always present and where continuing flight of the middle class is a constant threat to urban health, leaders must demonstrate skills in managing scarce resources. Social issues may or may not be present on current mayoral agendas, but if they are a concern, the new mayors make clear that they can best be addressed by better management. This set of management tasks contrasts significantly with the mayoral challenge of the 1960s and 1970s, whose dimensions were laid out most clearly by the Kerner Commission report of 1968. "Now, as never before," the commission wrote, "the American city has need for the personal qualities of strong democratic leadership" to address racial polarization, slum clearance, housing, police misconduct, poverty, and unemployment. In the welfare of the cities lay the welfare of the nation itself, Leonard Ruchelman wrote in the introduction to *Big City Mayors.*

The prototype mayors of this earlier period were people like John Lindsay of New York, Jerome Cavanagh of Detroit, Kevin White of Boston, and Richard Lee of New Haven. They excelled in grantsmanship, and they understood how to use city hall as a bully pulpit in their efforts to bridge racial and class divisions. Sonenshein, Schockman and DeLeon wrote of these leaders, "Sympathetic to the urban poor, supported by private philanthropy and federal aid, seeking redevelopment, these liberal mayors redefined the mayoral role."

In the new political culture, however, mayors seek guidance to accomplish their leadership tasks not first by reference to the moral compass of liberal reform but rather from the more neutral market. As Indianapolis Mayor Steven Goldsmith argued in *Governing*, market forces and competition ultimately serve the citizens of his city better than the government monopoly. Mastery of the market requires the ingenuity of the entrepreneur and the management skills of a chief executive officer.

Where and who are the new mayors who exemplify these qualities and what do they believe? To begin with, the new mayors seem at ease with their fiscal self-reliance. Nashville Mayor Phil Bredesen professed in the *Wall Street Journal*, for example, that "it's not all bad [that] Washington is busy extricating itself from . . . responsibility for well-being [in the cities]." Cities now have more freedom to experiment. Milwaukee Mayor John Norquist made a similar point about the freeing effects of federal divestment: federal grants, he said in *Governing*, "are only costing us more money, because they force us to . . . do things we wouldn't otherwise do."

The new mayors speak the language of modern public management and run their administrations accordingly: they believe in reinvention, innovation, privatization, competition, strategic planning, and productivity improvements. They favor economic development and low taxes, partnership with the business sector and good housekeeping. As Mayor Norquist said in the *Wall Street Journal*, his success is a function of performance, not ideology.

The issue of privatization illustrates how the commitment to the new public management crosses partisan and racial boundaries. Although Mayor Goldsmith, a Republican who once declared that he wanted to become the "CEO of Indianapolis," is noted for his leadership in privatizing public services, the same policies have been pursued with equal fervor by Democratic Mayor Richard Daley Jr. of Chicago and by successive black mayoral administrations in Detroit. Daley has been particularly vigorous in contracting formerly public responsibilities to private firms, including the parking garage at O'Hare airport, sewer cleaning, office janitorial services, the management of public golf courses, water customer billing, abandoned automobile collection, parking ticket enforcement, and tree stump removal, among others.

The change in the moral tenor of urban politics is perhaps nowhere more evident than in the cities governed by black mayors. The agenda of Mayor Dennis Archer of Detroit is to fashion a "reinvented" city government "that pays its bills on time," improves its low bond rating, and "picks up garbage on time and keeps the streetlights on all night." Mayor Archer, who has established close ties to the white business establishment in pursuit of economic development objectives, is contrasted in *Governing* with his predecessor, Coleman Young, for "rejecting the politics of class and race."

Similarly, Bill Campbell, mayor of Atlanta, is compared to the "civil rights giants" (Maynard Jackson and Andrew Young) who preceded him in city hall. Although Mayor Campbell is a strong supporter of affirmative action, according to the *New York Times*, he is said to see himself as "the vanguard of a new generation of black leaders who embrace a less conspicuous brand of racial politics. . . . His agenda is less about the fight for black empowerment than about paving potholes, encouraging job growth, making neighborhoods safer and building downtown housing."

The most important impact on the cities of the shifting balance in the federal arrangement has been to change what could be called the moral tenor of urban politics.

Whereas the social agendas of mayors of two decades ago once captured the attention of the news media and urban observers, the public spotlight is on the new public managers today. "America's boldest mayors," according to William Eggers in *Policy Review*, are Philadelphia's Edward Rendell, Milwaukee's John Norquist, and Indianapolis' Steven Goldsmith. What is bold about these urban leaders is their management initiatives: Mayor Rendell's Private Sector Task Force on Management and Productivity, which saved the city more than $150 million; Mayor Norquist's strategic budget process; and Mayor Goldsmith's introduction of competitive bidding between city service providers and private firms.

Urban electorates apparently want these leadership skills in this age of local fiscal self-reliance. In fact America's "boldest mayors" hardly stand out from their colleagues in other cities. According to Sonenshein, Schockman and DeLeon, Mayor Edward Riordan of Los Angeles, a businessman turned politician, runs his city in the style of a CEO—nonideological, managerial, eschewing the "arts of political leadership and public appeals." Even Rudolph Giuliani of New York, an aggressive and brash former public prosecutor, came to office promising to reinvent city government by cutting and streamlining its massive size.

Conclusion

In the New Federal Order the fiscal links between Washington and the cities have become severely attenuated. More than at any time since the early Great Society years, cities can spend only what they can raise. Cities are responding in several ways, one of which is to raise taxes to maintain the array of service responsibilities that people have come to expect. Beginning in 1982 and continuing through the decade, cities increased per capita tax revenues to offset rising expenditure burdens. Another response is to engage vigorously in economic development activities, seeking to raise additional revenues by growing the indigenous tax base.

Another response, ever-sensitive to citizen resistance to higher taxes, is to husband the resources that cities control through more careful management strategies characterized by contracting out, strategic planning, downsizing, and reorganizing.

The resultant emergence of a public management agenda in place of a social reform platform might be seen as a narrowing of political vision. In a different light, better and more innovative management of the scarce resources under local control may be seen as simply a realistic response to a fiscal world very different from that of a quarter of a century ago. In a sense, the absence of a growing stream of federal dollars has meant that city political leaders cannot afford, fiscally or politically, to push an agenda of social and racial reform financed by local taxpayers alone. Nor can municipal leaders find much encouragement for defying these realities. Left to confront the great urban racial and economic polarities, few elected officials would be so foolhardy as to risk inevitable failure by initiating solutions based solely on the modest and limited resources that they themselves can raise. It is far easier and the outcome more certain to lower taxes, reduce government employment, and fill potholes. City limits have never been more in evidence. ■

A Balanced Federal Budget: The Effect on States

by Andrew Reschovsky

This article is based on a report Andrew Reschovsky wrote for the Twentieth Century Fund as part of its series on the balanced budget debate. For copies of the full report, entitled The Balanced Budget Debate: What Would a Balanced Budget Amendment Mean for Wisconsin?, *contact the Twentieth Century Fund, 41 East 70th St., New York, NY 10021, (212) 535-4441, e-mail: xxthfund@ix.netcom.com. Andrew Reschovsky is professor at the La Follette Institute of Public Affairs and the Department of Agricultural and Applied Economics.*

At the top of the fiscal agenda of the Republican majority in the new Congress is the approval of a balanced budget amendment to the U.S. Constitution. President Clinton opposes the amendment, but nevertheless has committed himself to bring the federal budget into balance. Although the president and Congress have not agreed on details of achieving a balanced budget, their decisions to date will result in a substantial devolution of federal responsibilities to the states and fundamental changes in the nature of federal–state relationships.

President Clinton and the Republican leadership in Congress have agreed that the budget will be balanced by the year 2002, and that balance will be achieved without any cuts in Social Security benefits or defense spending. Instead of raising taxes to help balance the budget, the budget-balancing plans proposed by both the Congress and the president included substantial tax cuts.

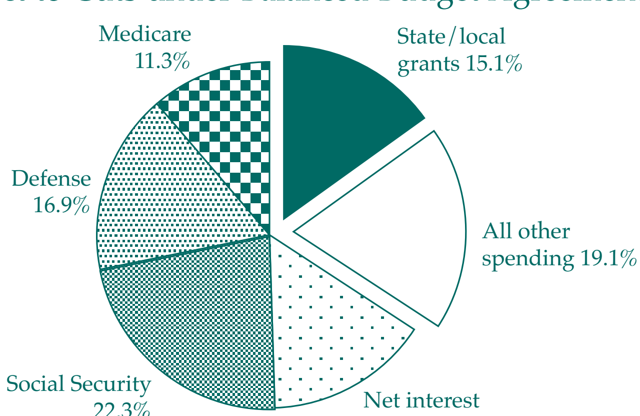
The congressional budgetary resolution generated substantial savings by reducing spending on Medicare. President Clinton used these proposed cuts in Medicare as a potent political weapon against the Republicans during the presidential campaign. As a result, both parties' plans will likely attempt to balance the budget without making substantial cuts in Medicare.

The consequence of these bipartisan agreements is that the entire cost of balancing the federal budget must come from spending cuts alone. Because spending on Social Security, Medicare, defense, and interest payments account for two-thirds of total federal government spending in fiscal year 1996, all the spending cuts must come from the one-third of the budget that remains "on the table" (see Figure 1).

Of the one-third of government spending subject to cuts, more than 40 percent is made up of grants to state and local governments. The remaining 60 percent includes spending on the FBI, the Secret Service, federal prisons, veterans hospitals, and the IRS. As it is highly unlikely that financing for these government functions will be reduced, it appears almost inevitable that balancing the federal budget will be possible only with large cuts in federal payments to state and local governments. The implication of this budget-balancing strategy is that by 2002 grants to state and local governments will need to be about 25 percent less than what they would be under current law.

FIGURE 1

Proportion of Federal Fiscal Year 1996 Spending Subject to Cuts under Balanced Budget Agreement



Source: Office of Management and Budget, *Budget of the United States, Fiscal Year 1996.*

Almost independent of these legislative efforts to balance the federal budget is a strong movement to enact a balanced budget amendment. In 1995 a balanced budget amendment was approved by the House of Representatives by a large margin, but failed by one vote to attain the required two-thirds majority in the Senate. A second Senate vote in June 1996 failed by only two votes. Support for the amendment remains strong, and there is a reasonable chance for a successful Senate vote in the 105th Congress.

In this article, I explore the fiscal implication for state governments of achieving and maintaining a balanced federal budget. I try to determine how well states are positioned to deal with the cuts in federal funds that will accompany efforts to balance the budget. To answer this question for any particular state requires posing several further questions. How large a role do federal funds play in the state's economy and in the financing of government services? What is the economic condition of the state? Is the economy robust and able to withstand increases in state taxes? What role do factors outside the control of state and local government officials play in strengthening or weakening the fiscal prospects of the state? In what way do existing state policy priorities constrain the ability of a state to respond to cuts in federal grants?

The Impact of Cuts in Federal Grants to State and Local Governments

In fiscal year 1996, the federal government distributed $250 billion in grants to state and local governments. Of this total, $99 billion (40 percent) was distributed through the Medicaid program, $38 billion (15 percent) through other entitlement programs such as AFDC, child nutrition, foster care and adoption assistance, and child support enforcement programs, and the remaining $113 billion (45 percent) through a large number of non-defense discretionary grant programs. In general, discretionary programs are concentrated in two areas. They provide assistance to individuals and families with low incomes by distributing grants for a range of services including housing, education, and job training. They also contribute funding for the building and maintenance of states' physical infrastructure, with the single largest grants financing highway maintenance and construction.

Estimates by Iris Lav and Richard May of the Center on Budget and Policy Priorities suggest that if the budget plan approved by the Congress in November 1995 had been implemented, by 2002 total federal grants to state and local governments would be $95 billion lower than under current law. More than one-half of this amount ($50 billion) would be in the form of lower federal Medicaid reimbursements. The congressional plan also stipulated that cuts in non-defense discretionary spending would become progressively deeper in each year between now and 2002. By 2002, total spending would be 30 percent lower than the levels currently planned. Although actual spending would be determined each year through the appropriation process, Congress would presumably enact annual spending caps that would enforce the budget cuts specified in the final legislation.

In 1995, the latest year for which such data are available, the Office of Management and Budget calculated that federal grants equaled 23 percent of state and local government expenditures. In a number of states, federal grants play an even more important role in the financing of state governments. If we assume that by 2002 federal grants will be reduced by about 25 percent relative to current law, and that federal grants account for about a quarter of the total revenues of state governments, then in the average state, available revenues will drop by approximately 6.25 percent (one quarter of 25 percent).

Averages tend to obscure the fact that the federal government plays almost no role in financing many state government activities at the same time that it plays a dominant role in other state activities. For example, the Medicaid program is funded jointly by the federal government and state governments. In Wisconsin, the federal government is contributing 62 percent of Medicaid costs during the current (1995-97) biennium. The federal government also plays a major role in the financing of state expenditures on transportation, primarily highway maintenance and construction. In Ohio, for example, 45 percent of the budget of the state's Department of Transportation came from the federal government in fiscal year 1995. In contrast, the federal government plays only a minor role in state government spending on corrections and a relatively small role in financing elementary and secondary education. The direct consequence of the very unequal distribution of federal funds among state spending categories is that unless state funds are substantially reallocated, cuts in federal grants and transfer payments will have large impacts on state government functions that currently depend heavily on federal aid.

Congress would enact annual spending caps that would enforce the budget cuts.

In addition, reductions in federal government purchases and in federal payrolls could lead to a reduction in state personal incomes. This drop in income then will be reflected in a reduction in state tax revenues. In the long run, smaller federal budget deficits should result in lower interest rates and faster economic growth. Estimating the impact of both of these effects, however, is quite difficult. One study on the economic impact of House and Senate budget resolutions passed in 1995 found that both budget balancing plans would reduce employment relative to baseline projections in most states at least through the year 2005. The negative employment impact of balancing the budget will be particularly severe in states where federal government employment and purchases of goods and services are high.

How Will Wisconsin Cope with Federal Budget Cuts?

To get a complete picture of how states are likely to cope with federal budget cuts, one needs to look separately at each state. Not only will the magnitude of federal cuts differ across states, but economic conditions and the fiscal environment vary from state to state. Knowledge of these state-specific characteristics are central to any analysis of a state's capacity to respond to large reduction in federal aid.

Wisconsin is blessed with a very strong economy. In November 1996 the unemployment rate was 2.7 percent. In only two states was the rate lower. At first glance, Wisconsin appears to be in as good a position as any state to deal with federal budget cuts. The strong economy generated a healthy flow of revenue and reduced service demands, perhaps most notably by contributing to a 26-percent reduction in welfare caseloads since fiscal year 1992. Despite the strong economy, however, the fiscal situation in Wisconsin is overshadowed by two recent policy decisions—a major effort by state government to provide property tax relief and to "get tough on crime" by increasing the length of prison sentences.

Wisconsin is a high-property-tax state. In fiscal year 1992 (the latest year for which these data are available), the ratio of property taxes collected to personal income was 24 percent above the national average. By 1993 the public outcry for property tax relief reached a fever pitch, undoubtedly spurred by well-publicized efforts in neighboring Michigan to take the financing of public education completely off the property tax. The legislature responded with a two-pronged approach to property tax relief. First, it agreed the state would pay two-thirds of the cost of primary and secondary education beginning in the 1996-97 school year. Second, to guarantee that the new aid would not be used to finance increases in school district spending, the legislature enacted permanent revenue caps to limit the annual amount by which most school districts can increase revenues, and hence expenditures. This "two-thirds initiative" not only required the state to come up with $1.2 billion in additional state school aid by fiscal year 1997 (general purpose state revenues currently amount to about $8.5 billion), but mandated that in the future K-12 education would get first call on state revenues.

The state's "get tough on crime" policies will also have a big impact on Wisconsin's future fiscal health. Since the late 1980s, the Wisconsin legislature, at the urging of Governor Tommy Thompson, has stiffened penalties, instituted longer sentences, and restricted the use of parole. The collective effect of these policy changes has been a rapid increase in the state's prison population. In 1987, 5,968

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Economic Well-Being of Women and Children after AFDC

by Daniel R. Meyer and Maria Cancian

This article reports on the economic well-being of women who exit AFDC. National survey data are used to trace welfare use, poverty status, and primary sources of income in the five years following exit. Maria Cancian is assistant professor of public affairs at the La Follette Institute and holds a joint appointment in the School of Social Work. Daniel Meyer is assistant professor in the School of Social Work. Both are affiliated with the Institute for Research on Poverty.

The goal of many previous welfare reform proposals has been to move women and children off welfare rolls. The 1996 Personal Responsibility and Work Opportunity Reconciliation Act signed into law by President Clinton goes much further, eliminating individual entitlement and imposing strict time limits and work requirements. Implicit in much of the welfare reform debate is an assumption that leaving welfare moves a family to self-sufficiency. Yet recent research shows that many women who leave welfare return, some of them quickly, suggesting that life after welfare is a time of economic insecurity for many women and their children.

Although women who have left AFDC in the past are likely to be systematically different from those who would be forced to leave under the new policy proposals, their experiences provide some of the best information available on the conditions of life after welfare. To date, there is a surprising lack of information on the post-welfare period and little analysis of the extent to which families are able, or not able, to move out of poverty and into lives of self-sufficiency. Our research begins to fill this gap.

Most research on life after welfare has focused on the chances that a woman will return to AFDC. Although estimates of the percentage who return differ across studies due to the procedures, time periods, and data sources used, a general finding has been that a substantial proportion of those who exit welfare do return. Estimates from various national survey data show that about one-third of women who exit return within a year and about 40 to 50 percent return within two years. Women are most at risk of returning to AFDC immediately after they exit; the likelihood of returning decreases for women who stay off for some time. Findings on the types of women more likely to return are generally consistent with each other and with microeconomic theory. For example, Kathleen Mullan Harris at the University of North Carolina at Chapel Hill finds that those most likely to return are young women, have more children, have less than a college degree, or live in urban areas.

Only a few quantitative studies have looked at broader indicators of the economic well-being of women who exited AFDC. For example, Harris, who examined only those who leave and stay off welfare, found that of those who left through marriage or cohabitation, 28 percent were poor one year after exit, compared to 46 percent of those leaving through work and 75 percent of those leaving for another reason. Some research suggests that economic status improves over time while other research finds stagnant wages.

Our research is based on data from the National Longitudinal Survey of Youth, a nationally representative survey that includes more than 5,000 civilian women who were 14 to 21 years old in 1979 and for whom annual data are available through 1992. These data allow us to track subsequent welfare use, poverty status, and primary sources of income in the five years after these women left welfare.

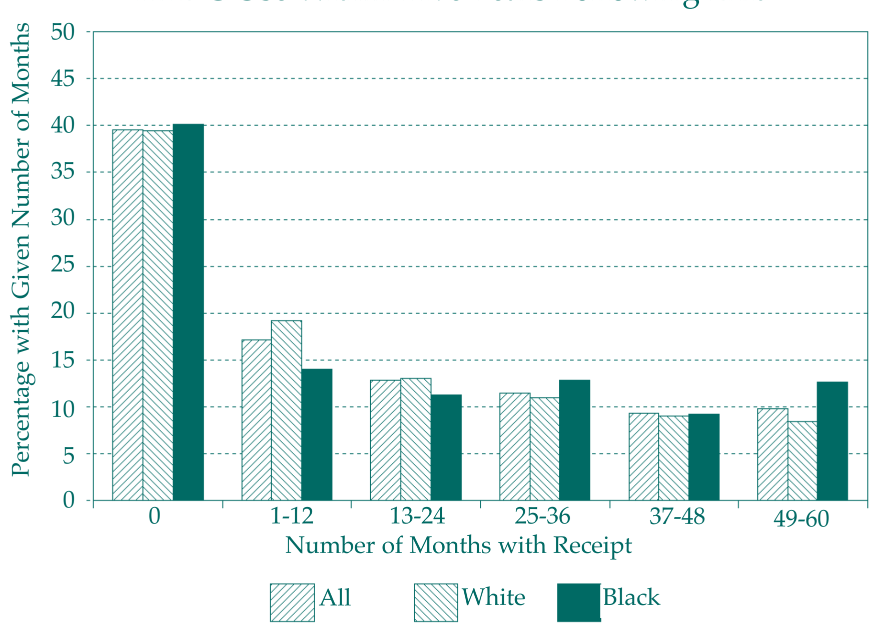
We provide descriptive information on the lives of these women after they have left welfare. We provide information on the patterns of use of AFDC and other means-tested transfers following an exit. Our focus, however, is on the extent to which women and their children achieve a moderate level of economic well-being after leaving welfare. In particular, we consider patterns of poverty and near-poverty following an exit. We use the detailed income data available for most of our sample to explore the contribution of women's own earnings, spouses' and partners' earnings, child support, transfers, and other sources of income after AFDC exits. Finally, we discuss the possible effects of recent welfare reform initiatives on poor families receiving government assistance.

Use of AFDC and Other Means-Tested Benefits after Exit

One straightforward approach to examining returns to welfare is to calculate the

FIGURE 1

AFDC Use Within Five Years Following Exit



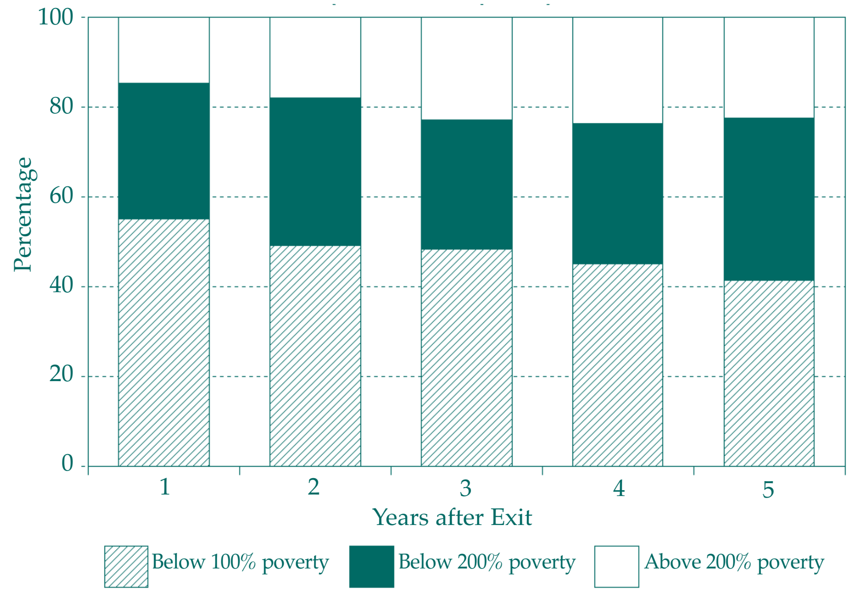
Source: Authors' calculations using National Longitudinal Survey of Youth data.
Sample: Women who exited AFDC for whom five years of post-exit AFDC data are available. (Unweighted n=878.)

percentage who return within a given interval. We find that 15 percent of women who exit return within six months, 37 percent within a year, and 50 percent within two years. Our results are generally consistent with other research. This type of analysis ignores the fact that some who return exit again and may return again. A second way to look at later use of AFDC is to count the months women received AFDC in the first five years after they exited the program. Figure 1 shows the number of months of AFDC receipt during the first five years post-exit. About 40 percent of all those who exit do not receive AFDC again within the next five years. Sixty percent do return, with 17 percent returning for less than one year and 10 percent for more than four of the next five years. Figure 1 also shows AFDC information separately for white and black women. Patterns of use are quite similar, with 39 percent of white women and 40 percent of black women not receiving AFDC again. Compared to black women, white women are somewhat more likely to receive AFDC again for less than 12 months and somewhat less likely to receive it for more than four years.

The extent to which women are able to stay off AFDC is an important—but quite limited—measure of economic well-being. One limitation is that some women who stop using AFDC may continue to receive benefits from other programs for the poor. We examine the number of months in which a woman received any means-tested benefit, including AFDC, Food Stamps, public assistance, and Supplemental Security Income (SSI). Many women who leave AFDC continue to receive other welfare benefits, primarily Food Stamps. Figure 1 shows that 40 percent of those who leave AFDC do not receive AFDC benefits again within the first five years; in contrast, 20 percent go the entire five years without using *any* means-tested transfer. About one-fifth of the women who exited AFDC continued to use means-tested transfers in more than 48 of the next 60 months. Black women are particularly more likely to continue to use means-tested transfers after they leave AFDC. About 30 percent of black women (as opposed to 16 percent of white women) use means-tested transfers during at least 49 months in the five years after they first leave AFDC. This is largely a result of the lower incomes of black women. As we document below, even

FIGURE 2

Income-to-Poverty Ratios for First Five Years After AFDC Exit



Source: Authors' calculations using National Longitudinal Survey of Youth data.
Sample: Women who exited AFDC for whom five years of post-exit family income data are available. (Unweighted n=637.)

FIGURE 3

Years Poor in First Five Years after AFDC Exit

Source: Authors' calculations using National Longitudinal Survey of Youth data.
Sample: Women who exited AFDC for whom five years of post-exit family income data are available. (Unweighted n=637, 296 white women and 299 black women.)

TABLE 1

Characteristics of Those Exiting AFDC (in percentages)

	All Exiters	Always Poor	Never Poor
Background Characteristics			
Race			
Black	38.0	63.4	26.9
White	57.8	31.2	67.2
Other	4.2	5.4	5.8
Missing	0.7	0.0	3.2
Family Structure at Age 14			
Two-parent	54.3	47.3	59.4
Parent and stepparent	13.2	9.9	13.5
Mother only	23.3	26.7	19.6
Other	9.2	16.1	7.5
Missing	0.1	0.0	0.0
Respondent's Mother's Education			
Less than high school	57.0	70.2	49.4
High school	34.4	29.8	36.9
Greater than high school	8.6	0.0	13.7
Missing	6.8	17.0	3.0
Characteristics at Exit			
Number of Children at Exit			
None	3.8	4.2	0.8
One	52.0	41.8	44.3
Two	31.9	33.7	42.5
More than two	12.3	20.3	12.4
Age of Youngest Child at Exit			
0-1	37.0	40.9	32.8
2-3	41.0	34.8	44.4
4 or older	22.0	24.3	22.8
Missing	3.8	4.2	0.8
Education at Exit			
Less than high school	43.0	59.5	30.6
High school	43.4	36.3	50.5
Greater than high school	13.6	4.2	18.9
Missing	1.6	1.6	1.7
Marital Status at Exit			
Married	37.0	12.3	58.9
Separated, divorced, or widowed	24.4	27.9	18.2
Never married	38.6	59.8	22.9

Source: Authors' calculations using National Longitudinal Survey of Youth data.
Sample: Women who exited AFDC for whom five years of post-exit family income data are available. (Unweighted n=637, 144 women who were always poor and 126 women who were never poor.)

when black women leave AFDC, they are less likely to have incomes high enough to leave the Food Stamp program.

Poverty Status after Exit

We now turn to an assessment of the poverty status of women who leave welfare. The poverty line for a family of three persons is $11,186 in 1992 dollars. Figure 2 shows that a substantial proportion of women are poor during each of the next five years, and a large proportion of the remainder are near-poor (that is, having income between the poverty line and twice the poverty line). There is a trend toward improved economic status over time, with the percentage of poor women dropping from 55 percent in the first year to about 40 percent in the fifth year, and the proportion of women with incomes more than two times the poverty line increasing from 15 percent to 22 percent. The trends are similar for blacks and whites, but the levels are different: white women are substantially less likely to be poor than black women. For example, the percentage of poor white women falls from 47 percent in Year 1 to 33 percent in Year 5 for whites, whereas 69 percent of blacks are poor in their first year after leaving AFDC, compared to 55 percent being poor in Year 5. For whites and blacks we find that women's economic prospects may improve in the years following an exit. Nonetheless, a substantial portion, particularly of black women, remain poor or near-poor five years after leaving welfare.

Figure 2 is based on a cross-sectional snapshot; Figure 3 explores poverty status from a longitudinal perspective. About one-fifth (22 percent) of all women are never poor in the first five years, and about one-fifth (18 percent) are poor all five of the first five years. The remaining 60 percent are almost evenly distributed, with close to 15 percent living in poverty in one, two, three, or four of the five years after leaving AFDC. The second and third bars in Figure 3 show that white women are substantially more likely than black women to be poor in three or fewer years out of five, about 80 percent to 50 percent.

We also examined the extent to which women have incomes above two times the poverty line. We found that fewer than 5 percent of the sample have incomes above two times the poverty line in all five of the five years following an exit, with very little difference between white and black women. More than half (55 percent) of all women never reach that income level in the first five years. Black women are particularly unlikely to have incomes above twice the poverty line: 67 percent never reach this level in any of the first five years following an exit, compared to 48 percent of white women.

Table 1 shows descriptive information on the women included in the sample. Figure 3 shows that about one-fifth of women are always poor and about one-fifth are never poor following exit. Descriptive information on these two groups is provided in the last two columns of Table 1. Women who are never poor are more likely to be white, to

TABLE 2

Income Sources for Women Exiting AFDC

	Year 1		Year 2		Year 3		Year 4		Year 5	
Median Family Income	$10,533		$12,096		$12,789		$13,751		$14,908	
	% > 0	Median $ > 0	% > 0	Median $ > 0	% > 0	Median $ > 0	% > 0	Median $ > 0	% > 0	Median $ > 0
Respondent's Earnings	59.7	5,509	64.3	5,558	59.3	7,292	60.1	7,925	63.9	8,961
Respondent's Unemployment	6.7	768	6.4	930	6.2	1,828	5.2	1,252	5.7	984
Partner/Spouse's Income	42.3	14,086	43.3	14,929	42.1	17,290	43.6	18,905	40.2	18,975
VA/Workers Comp/ Disability	3.8	1,087	2.5	409	4.3	1,163	5.0	2,135	6.2	2,399
Child Support/Alimony	17.7	1,454	17.0	1,163	18.0	1,350	16.6	1,131	18.9	1,482
AFDC	28.7	2,186	38.0	3,614	35.9	3,843	34.1	3,864	33.2	4,030
Food Stamps	49.3	1,519	48.6	1,630	43.9	2,000	40.4	1,859	40.2	2,161
SSI/Public Assistance	16.9	3,367	8.8	4,298	8.8	3,970	6.5	1,944	5.1	3,736
Other Sources	10.0	77	11.8	128	11.7	130	12.1	160	12.1	203
Percentage with Partner or Spouse	45.3		47.7		46.1		46.8		47.8	
Percentage with Total Income > 0	97.4		99.2		98.9		99.2		98.6	

Source: Authors' calculations using National Longitudinal Survey of Youth data.
Sample: Women who exited AFDC for whom five years of post-exit family income data are available. (Unweighted n=637.)
Note: All dollar amounts are in 1992 constant dollars.

have lived with both parents at age 14, and to have mothers with higher education. Those who are always poor are more likely to have had more than two children when they exited. Women who are never poor are much more likely to have graduated from high school or to have some college and are much more likely to have been married at exit.

To understand the economic prospects of women who exit AFDC, we now review the level and distribution of alternative sources of income. Table 2 examines all who exit and shows that median incomes increase over the first five years following exit, from about $10,500 in the first year to about $15,000 in Year 5 (1992 constant dollars). In each year, about three-fifths of these women have positive earnings, making their own earnings the most prevalent income source. In each year, about 40 percent of the women have income from a spouse or partner; when this source is present, the income is substantial. AFDC and Food Stamps are the only other sources of income received by more than 20 percent of the women. Thirty to 40 percent of women receive AFDC with the median amounts ranging from $2,000 to $4,000. Forty to 50 percent of women receive Food Stamps with the median amounts ranging from $1,500 to $2,200. Relatively few women (17 to 19 percent) receive child support or alimony; among those who did, median amounts are less than $1,500.

A substantial portion remain poor or near-poor five years after leaving welfare.

Three income sources increase by more than $1,000 during the five-year period. Median own earnings among those who have earnings increases dramatically during the period, from $5,500 in Year 1 to $9,000 in Year 5. Similarly, income from a spouse or partner increases from $14,100 in Year 1 to $19,000 in Year 5. AFDC income also increases, from $2,200 in Year 1 to $4,000 in Year 5.

We also examined income sources for women who are always poor (18 percent of the women exiting) and for women who are never poor (22 percent of the sample). Women who are consistently poor are less likely to have their own salaries as income sources (27 to 38 percent) than are women who are never poor (77 to 86 percent), highlighting the importance of earnings as a way to move out of poverty. When the always-poor women do have earnings, amounts are substantially lower, $1,600 to $4,000 compared to $8,600 to $12,400 for the never-poor women. Women who are always poor are also less likely to have income from a spouse or partner (5 to 11 percent), compared to 73 to 78 percent for those who are never poor.

As would be expected, consistently poor women are more likely to have income from AFDC, Food Stamps, and SSI or other public assistance than women who are never poor. In contrast, women who are always poor are less likely to receive social insurance payments (unemployment compensation, veterans benefits, workers compensation, or disability insurance). There is little difference between the women who are always poor and those who are never poor in the likelihood of receiving child support and alimony, but amounts are lower for those always poor.

Conclusions

The new federal legislation requires most welfare recipients to begin working after two years of receiving assistance and limits the total amount of time receiving benefits to a maximum of five years. The experiences of women who left welfare voluntarily can give us only limited information on the prospects of families that will be forced to leave in the future. Microeconomic theory suggests that those women who leave welfare for work are likely to be those with the best economic potential. Similarly, we might expect those who leave voluntarily to include those with the best marriage prospects. Thus the levels of economic success documented here probably serve as an upper-bound estimate of the likely economic status of families who will leave welfare under current reforms. On the other hand, because of the magnitude of change, women who move from welfare to work under current reforms may follow very different patterns. Proponents of the reform have argued that eliminating entitlements, restricting cash assistance, and requiring work will fundamentally alter the employment and family formation patterns of welfare recipients.

While the results reported here may serve as a point of reference, the scope of welfare reform legislation makes it difficult to predict the economic prospects of families who will be affected. States now have substantial discretion in designing and implementing policies to move women from welfare to work. Some states may provide support services, and even jobs, enhancing opportunities for women. Wisconsin's current plan, for example, calls for the creation of community service jobs and state-subsidized, private-sector jobs, as well as substantial long-term child-care subsidies and health insurance. Because of these benefits and a strong state economy, some current welfare recipients will be better able to leave welfare and move out of poverty. But even under the Wisconsin plan, women who are unable or unwilling to hold consistent full-time employment will receive substantially reduced benefits. Most other states have higher unemployment rates and less money for job creation and support services. For many current participants, welfare reform likely will mean greater poverty in the short term and possible longer-term economic vulnerability. ■

Regulatory Reform and Public Management: ISO 14000 and Collaborative Governance

by Donald F. Kettl

Public Affairs and Political Science Professor Donald Kettl offered the following comments at a round-table discussion with government officials, business and industry representatives, university policy experts, and spokespersons for environmental groups. It introduced their discussion of an experimental design for how companies' environmental standards can be certified. Since 1991, the Geneva-based International Organization for Standardization (ISO) has been developing a system by which companies can choose to establish environmental standards based on outcomes. Regulators can then examine results rather than the ways companies achieve them.

The American public sector, at all levels, is boldly experimenting with reform of government regulation. A near-universal consensus has emerged that, in the words of best-selling author Philip Howard, government regulation represents "the death of common sense." Critics argue the rules intrude too deeply into the lives of citizens, that they disrupt the efficient operation of business, and that they impose excessive costs on the regulated and the regulator. The federal Occupational Safety and Health Administration (OSHA) has yet to live down its silly fliers warning farmers about the need for care near barnyard manure. The drug industry complains that the Food and Drug Administration's rule-making process denies needed drugs to the sick and unfairly drives up research costs. Even though it has a thankless job, the Internal Revenue Service has few friends anywhere.

The widespread disdain of government rule-making has fueled a wholesale assault on government regulation. As part of the "Contract with America," the Republican Congress in 1995 tried to roll back environmental regulations. The offensive not only failed to achieve its goals, it also opened a path for a vigorous counterattack by the Clinton administration, whose officials accused the Republicans of trying to stymie 20 years of progress in cleaning up the nation's air and water and of subjecting the nation's children to the risks of eating tainted meat.

In wrestling with these regulatory issues, Americans show a disquieting contradiction. They hate regulations and disdain the administrators who manage the rules. When threats to health and safety arise, however, anxious questions quickly surface. After the tragic crash of a ValuJet DC-9 in the Florida Everglades in May 1996, critics wondered why the Federal Aviation Administration had not more closely supervised the rapidly growing airline. Why had the Food and Drug Administration not overseen the safety of the nation's food chain more carefully, critics asked after a child died in 1993 from eating a tainted hamburger served at a Jack-in-the-Box restaurant in the Pacific Northwest.

The political controversies surrounding these events revealed two tough issues lurking just below the surface of regulatory politics. First, if the regulatory regime had few friends, it was impossible to kill. Periodic crises underline the need for government to solve problems that the public was not sure it wanted government to attack in the first place. Critics complain about the cost of the Environmental Protection Agency's clean water rules, but when impurities crept into the City of Milwaukee's water supply, killing 100 people and injuring thousands of others, the public demanded an instantaneous fix. Worried citizens elsewhere, including those in the nation's capital, wondered if their water might be next.

Government regulation might be unpopular in general, but the demands for strong and effective rules are inescapable in the particular, especially in the wake of highly publicized disasters that provoke a "why-didn't-government-prevent-this-from-happening?" response. Everyone favors cutting back unnecessary regulations, but getting a consensus on which regulations are truly unnecessary is impossible. The irony is that someone thought that each regulation was necessary on the day it was issued.

Second, the often-fierce debate over government regulation hides a subtle distinction between the rules that government ought to adopt and how the government ought to enforce them. While most of the political attack on regulation surrounded the former, the real issues focused on the latter. Even regulation's toughest critics do not argue for dirty air or tainted water. They quarrel, instead, with what they view as government's heavy-handed strategies for enforcing the regulations. No one thinks that tax cheats ought to be free to steal from the government, but critics do object to the way that the IRS audits taxpayers. There are exceptions, of course. Some reformers contend that the tax code is simply too complicated (though simplifying it is the work of Congress, not faceless, mindless minions at IRS). Others contend that broadcasters ought to be free to air any program they like, without government requirements for educational programming. For the most part, however, the real issue with regulation is more the *how* than the *what*, more the government's strategies for managing compliance with the rules than with the policies that prompted the rules themselves.

These two issues, along with the sharp political battles over regulation that surrounded the "Contract with America" and its aftermath, point in turn to a dilemma: neither the public nor its elected officials are content to support the regulatory status quo, but neither are they willing to abandon the regulatory regime that has grown up in the United States over the last century. Budget cutters have happily trimmed the enforcement staff in some agencies, and political support for some agencies is tenuous. Regulators thus face a genuine dilemma of effectively managing regulations with a staff under constant political and fiscal assault.

That focuses the debate squarely on compliance: after a bit of tinkering around the edges of how much regulation to impose, someone must figure out how to administer the regulations in the least burdensome and most effective ways possible. For economists, it is a question of how to reduce the transaction costs of government rule-making.

That is what makes the proposed ISO 14000 standard so interesting. The standard was designed to reduce industry's complaints that government regulations were making businesses less competitive, especially for companies struggling against competitors based in countries with lower (and therefore cheaper) environmental standards. ISO 14000 was developed by an international standards organization, in collaboration with private industry, to level the playing field. Companies that wish to pursue this innovation are required to establish their own environmental management system (EMS) and to comply with existing environmental standards. If an external, nongovernmental auditing body certifies that the company's plan meets ISO 14000 standards, the company would be allowed great flexibility in deciding how best to meet governmental standards. The companies, moreover, would be able to adopt a single EMS to cover their operations in different states or, for that matter, in different countries that agree to join the system.

Both the international organization that crafted ISO 14000 and the private industry representatives collaborating with the organization have invested years thinking through the tough issues.

From industry's point of view, supporters hope, the advantages would be greater operational flexibility, less government intrusiveness, less variability in company operations among different plants located in different jurisdictions (and therefore greater managerial effectiveness) and, overall, lower "transaction costs." From government's point of view, its regulatory agencies would build a stronger partnership with regulated parties, allow regulators to cope with a regulatory environment whose expectations have increased while resources have shrunk, improve compliance (and, hence, regulatory outcomes), and reduce the conflict inherent in the regulatory process. Its supporters, in short, envision ISO 14000 as a win-win game. Citizens would get a cleaner environment but the costs of the products they buy would be lower; companies would gain greater flexibility and a more level playing field; government would solve a tough political problem while improving compliance with regulatory policy.

Moving from hope to reality, however, will create huge challenges for both private and public managers. The standards are tough and insiders expect the certification process to be rigorous. Both the international organization that crafted ISO 14000 and the private industry representatives collaborating with the organization have invested years thinking through the tough issues; industry leaders have a head start in determining how they would cope with the certification processes' trials.

For public managers the scale of problems is bigger than for private managers, and the competing demands that must be satisfied are more sweeping. Moreover, if the public managers do not solve these problems, ISO 14000 pilot projects will collapse. Regardless of efforts by private managers, pilot projects can work only if government managers make them work by redefining their own responsibilities, improving their effectiveness, and learning where they need to give private managers more elbow room. The transformation to the new regulatory regime focuses two big public policy challenges: for the private sector participants in ISO 14000 and for the public sector managers shaping government environmental strategies.

Collaboration and Corporate Citizenship

The most basic regulatory decisions are political, not managerial; the forces are complex and varied; the goal is not filling out forms or catching violators but ensuring compliance with the law. The law and its interpretations, in turn, are the products of complex political forces. For public regulators, the issue is more than dealing solely with regulated companies. It is dealing with regulatory issues within the far broader context of governance in the American system. These issues create important responsibilities for private partners in regulatory reform strategies like ISO 14000.

Two problems shape governance. First, a given approach to regulation must maintain political support to survive. Most of the really difficult and important regulatory decisions are issues of interpretation. Should the Food and Drug Administration classify cigarettes as a "drug delivery system" and thereby dramatically increase its regulatory leverage? Which state plans are adequate to deal with air and water pollution and which are not? How safe is safe enough for air travel? If regulators lose political support for their decisions, the decisions cannot long stand. Political support, or at least the absence of powerful opposition, is a necessary condition for decision-making by government regulators, regardless of the law.

Second, because the opportunities for contesting regulators' decisions vary wildly, regulation must also avoid political opposition if a given approach is to survive. Legislative committees can rarely resist the instinct to micromanage. They can hold hearings that probe into the regulators' exercise of discretion, send powerful signals about the course of action desired, and issue not-so-subtle threats about shifts in the law and budget. The legislative branch can change the law or cut the regulator's budget. Elected executives, from governors to presidents, can rarely resist putting their distinctive stamp on big regulatory issues. And the courts can reverse regulatory decisions.

In each branch of government, moreover, interest groups can influence policy. Indeed, for well-funded and well-connected interest groups, regardless of which side they support, no policy decision is ever final. There is always another arena in which to challenge any decision. Interest groups can comment on and thereby try to shape proposed rules. On rules or compliance strategies with which they disagree, they can try to find an audience in a congressional committee hearing. They can complain to friends on the White House staff or in the media. They can press their case for a smaller (or larger) budget for regulatory agencies. They can challenge any interpretation in court. If courts rule against them they can return to the legislature. Since so many regulatory decisions, especially in environmental policy, involve delegated power from the federal to the state governments, that even further multiplies the opportunities for influence.

This complex arena poses important questions for reform strategies like ISO 14000. ISO 14000 builds on the proposition that, left to devise their own environmental management strategies, private industry could produce an environment just as clean at a lower cost to everyone. Regardless of the validity of that assumption—and whether it is true for industry as a whole, for only specific sectors, or for only some companies—some players within the political system will strongly contest that assumption. Some environmental interest groups, for example, might see ISO 14000 as a fox-in-the-hen-house problem: private industries being allowed to craft their own environmental policy, with a weak regulatory agency overseeing the process. If sufficiently perturbed, these (or any other) interest groups could at the least create long delays and multiple roadblocks for the collaborative process envisioned in ISO 14000. At the most, they could successfully challenge the process in general or an individual state plan and bring the entire process to a halt.

That imposes a three-step governance challenge for public managers trying to implement ISO 14000. First, managers must develop, in collaboration with their private sector partners, a process to ensure that the environmental management system satisfies environmental standards. Second, managers must behave in a way that forestalls challenges from interest groups that might disagree with the process as a whole or the behavior of a particular industry. Finally, managers must build broad support for the effort among the public at large to forestall a corrosive lack of confidence.

For well-funded and well-connected interest groups, no policy decision is ever final. There is always another arena in which to challenge any decision. Interest groups can comment on and try to shape proposed rules.

The biggest political threat to ISO 14000 would for the public to become convinced that government was selling out to private industry, that the regulated had captured the regulators. This is not an idle specter; few ideas have had more staying power in regulatory politics over the last century. News stories or interest group charges about an improper sharing of power with private companies could slow, stagger, or even stop ISO 14000 pilots.

What this suggests, at the core, is that the ISO 14000 experiment not only requires a close and innovative partnership between government regulators and private industry, but also all participants—government regulators and private industry officials alike—to behave in ways that encourage trust and confidence in the entire process. It is impossible to define precisely what all those steps are, or to list the behaviors that ought to be proscribed. The basic principles are clear: transparency in operations and broad participation in policy discussions can enhance trust and confidence—in the industries and in government. Secrecy and the creation of insider games, even in appearance, can diminish trust and confidence.

For industry participants, in particular, this suggests an unusual level of publicness in operations. It surely does not mean that industry must divulge competitive secrets or give local communities veto power over operations. It does mean, however, that industry leaders must think carefully about how their decisions could promote trust and confidence, and which of their decisions might diminish it. The lower the stock of trust and confidence, the less resilient the system will be to problems and the more prone to devastating political attacks. Given the central role of private industry in shaping and implementing ISO-certified environmental management systems, moreover, the behavior of the private partners in ISO 14000 will be most important in shaping trust and confidence in the experiment, and therefore in its success.

ISO 14000 requires, therefore, a level of corporate citizenship in excess of what would normally be expected by private industry. The fundamental responsibility of regulators is implementing the law, and ISO 14000 is an innovative experiment to determine if granting private industry more flexibility could improve implementation. With ISO 14000 private companies gain substantial additional discretion in exchange for a freer hand in implementing the law. The advantage of that discretion is potentially greater return for shareholders and more flexibility in operation; the price of the extra discretion is being more responsive to the public. To ask for the extra discretion without behaving in a way that reinforces public trust and confidence in the system is to undermine governance and to court political attack that could bring down the experiment.

Collaboration and Public Management

The government managers responsible for shaping ISO 14000 experiments face special challenges of their own. These challenges begin with the fundamental risk of ISO: ISO 14000 neither changes the underlying legal requirements nor the regulator's responsibility for ensuring that those requirements are met. For the government, the case for ISO 14000 rests on the need to deal with the growing political assault on regulation and regulators. The government's case also rests on the hope that collaboration with the regulated can achieve environmental goals without further eroding (and perhaps even by building) political support. This poses a series of public management challenges.

Ensuring legitimacy

The risk inherent in ISO 14000 is a two-edged sword. On one hand, the status quo in regulatory policy is not an option for regulators. There is little political support for the current approach to government regulation. On the other hand, the ISO 14000 experiment risks making a sham of the whole regulatory process. Critics might contend, for example, that the companies in the experiment are getting an easier ride, with less government oversight and greater flexibility. (Imagine a newspaper story suggesting that elected officials, tight with big corporate campaign contributors, have surrendered environmental policy to the companies.) Corporate flexibility, of course, comes at a high price for the companies involved, but these costs might not be visible to critics. The public management of ISO 14000, therefore, must begin with a strategy for ensuring the legitimacy of the public process, just as the private sector must begin by devising a strategy ensuring public trust and confidence in the private process.

Culture change

ISO 14000 requires a major culture change within public organizations as well as private ones. It requires that the regulators build a supportive partnership with companies instead of asserting authoritative oversight over regulated companies. That requires strong leadership: a clear vision of what that relationship ought to look like; the creation of strong incentives to take the risks that such a partnership demands; and protection of employees against the criticisms that inevitably will follow any ISO 14000 experiment.

A two-track regulatory process

Until all companies are ISO 14000-certified—and that is likely to be a very long time—public managers will have to devise and use a two-track environmental management process: one track to deal with the tough ISO 14000 process and a second to continue traditional command-and-control regulations for companies not certified for ISO 14000. For private companies, the challenge of defining and promoting an ISO-centered culture will of course be enormous. For public regulators, the challenge will be even greater: to work for a radical transformation in the most fundamental regulatory strategies while holding non-certified companies to existing rules. Creating a two-track regulatory system, which inevitably feeds separate cultures, at the same time that a government agency is attempting nothing less than a fundamental transformation to a new regulatory regime, is a task that few private managers could envy.

Developing the new ISO 14000 techniques will require innovative approaches to public management that are substantially beyond anything now at work in the public sector.

Training

The simple truth is that no one really knows how to do this. At best it will be a matter of trial and error. The transition will, moreover, require substantial training to define and reinforce new norms. Few public agencies have encountered such a challenge. Only strong and ongoing training will help employees adjust—and prevent them from drifting back into old patterns.

Monitoring and enforcement

ISO 14000 anticipates that government's regulatory approach will change, from intrusive oversight of companies' operations to indirect monitoring of environmental quality. That, in turn, requires a shift from an input focus (inspections conducted) to an outcome focus (results produced). This problem in itself lies at the very cutting edge of public management reform in the United States and around the world. The federal government is involved in a half-decade-long effort to move to results-based performance measures; progress there has been slow and difficult. ISO 14000 anticipates that regulators will not only solve these problems but also develop tactics for assessing the performance of its private partners. Without assurances that environmental quality has not been compromised, ISO 14000 will be vulnerable to political attack. Developing the new techniques, however, will require innovative approaches to public management that are substantially beyond anything now at work in the public sector.

Sanctions

Finally, public managers will face the question of what to do about disclosures of violations that the ISO process might produce. Companies themselves are taking big risks by engaging in the ISO process. They are likely to want to be held harmless for any problems they themselves discover and correct. To do otherwise would create strong incentives against transparency in operations, and that in turn would undermine public trust and confidence in the process. Public regulators, however, risk charges of favoritism if they punish companies—especially for violations of legal standards—that are subject to traditional regulations but not those involved in ISO 14000 experiments. That, of course, would stimulate companies not ISO-certified to undertake the process, but it would court big political problems: regulators might appear to have double standards because some companies might be allowed to get away with polluting while others are punished for the same behavior.

The public management challenges of ISO 14000 are daunting and, if anything, more difficult and complex than those facing private companies. Many private companies have extensive experience with previous ISO standards, including the ISO 9000 customer service standard. Public regulators have none. Private companies have a relatively narrow focus: to reduce costs, improve operations, and increase profits. Public regulators must answer to a broader set of interests and cope with these issues while maintaining traditional regulation, which further complicates things. Public managers have further to go with less of a head start, yet if they do not solve these problems, the ISO 14000 process could grind to a quick and painful halt.

Toward Information-Based Regulation

Most fundamentally, ISO 14000 builds a strategy that shifts the foundation for government regulation from authority to information. In the authority-based approach, founded in the Progressive movement, government wrote rules and inspected companies' operations to ensure compliance. Companies were responsible for following the rules and putting up with the inspections. In the ISO approach, companies gain greater freedom in deciding how to meet regulatory standards. Government's role shifts to measuring outcomes to ensure that the standards are being met.

In exchange for greater freedom, companies assume, at least implicitly, greater responsibility for corporate citizenship.

The change creates new roles for companies and government regulators alike. In exchange for greater freedom, companies assume, at least implicitly, greater responsibility for corporate citizenship. Government agencies assume challenging new responsibilities for ensuring that the standards are met without getting in the way of the companies trying to meet them—while simultaneously seeing that companies not part of the ISO process meet the standards through the traditional process.

Given the century of tradition of government regulation, it would be hard to envision a more fundamental shift. The tremendous political battles over regulation, coupled with the costs in competitiveness imposed on private companies, leave few options but to change fundamentally. The route from the current system to the new one is a road largely uncharted and unexplored. The fundamental question is: Can information supplant authority and produce a cleaner environment at lower cost while ensuring public trust and confidence in the system? The ultimate success of the ISO 14000 experiment, in the end, will depend on how this question is answered. That answer, in turn, depends critically on finding innovative and successful answers to complicated public policy puzzles. ■

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adults were in Wisconsin prisons; at the beginning of 1996, the adult prison population had grown to 11,300. Current projections by the Department of Corrections indicate that the adult prison population will reach 16,150 by the beginning of 2000, an annual rate of increase of 9.3 percent. Although longer-run projections have not been made, the cumulative effect of mandating longer sentences and a reduced probability of parole is likely to result in continued increases in the state's prison population into the twenty-first century. In light of this, it is not surprising that corrections have been the most rapidly growing portion of the state budget, and, according to current projections, will consume an increasing portion of the state's budget.

To determine whether Wisconsin will experience fiscal difficulties in meeting its joint commitments to property tax relief and the increased incarceration of criminals without sacrificing other state programs, I have estimated the budgetary costs between now and 2005 of fulfilling the state's commitments and continuing to fund state services at their current levels. In general, I have assumed that most categories of spending other than K-12 education and corrections will experience real growth equal to the state's (relatively slow) rate of population growth. Growth of the University of Wisconsin (UW) System budget is tied to the population growth rate of 18- to 24-year-olds and the historical difference between the higher education price index and the overall consumer price index.

I then compared these projected "current services" budgets to estimates of the revenue the state will have available in each year if it maintains its current tax policy and the economy continues its robust rate of growth. These revenue projections are based on the historical relationship between the growth of tax revenue and personal income in Wisconsin and long-run projections of personal income growth in the state. The results of these calculations indicate that state general fund revenue will grow at an annual rate of approximately 2.3 percent (in 1996 dollars) between fiscal years 1997 and 2000, and by slightly less than 2 percent between 2000 and 2005.

To the extent that current service budgets exceed available revenue in future years, the state will face structural deficits. The bottom line of Figure 2 indicates that Wisconsin's structural deficit will be about $250 million in fiscal year 1997. By 2000, the annual structural deficit will be about $850 million (in 1996 dollars) and by 2005, it will rise to more than $1.1 billion, an amount that will equal 11 percent of available general fund revenue in that year.

Dealing with structural deficits of this magnitude will be difficult, even if federal aid to Wisconsin is not reduced. If balancing the federal budget requires cuts in federal grants of the magnitude discussed above, Wisconsin will face even larger structural deficits. The top line in Figure 2 illustrates the growth of the structural deficit in Wisconsin between 1997 and 2005 under the assumption that the federal budget is brought into balance by 2002 along the lines proposed in the congressional balanced budget plan. In the first year of the next biennium, Wisconsin would face a structural deficit of more than $525 million. This annual deficit would grow to $2.2 billion in 2002 and $2.6 billion in 2005 (all measured in 1996 dollars). These deficits represent a large portion of Wisconsin's total budget. In 1998 the deficit would be about 11 percent of the state's total general fund revenues. By 2002, the annual deficits would climb to more than 22 percent of general fund revenues.

There will be no easy way for Wisconsin to close structural deficits of this magnitude, but the state may choose one or more of the following options: (1) reduce the costs of public services by operating government more efficiently; (2) increase revenues; (3) cut public services; or (4) shift the cost of public services to local governments or, where possible, to the private sector.

The ideal way to close the state's structural deficit would be to reduce government spending by making the government operate more efficiently. Governor Thompson, along with many other governors, has argued that freedom from federal regulations will allow states to provide public services at substantially reduced costs. A review of the evidence, however, suggests that the potential savings arising from reduced federal regulations and requirements are quite modest.

To raise enough new revenue to erase the structural deficits would require massive tax increases. If the entire revenue increase were to come from the sales tax, the state's 5 percent sales tax rate would have to be increased to 6.75 percent in fiscal year 1998 and to 8.4 percent by 2002. Alternatively, if increases in the individual income tax are relied on to eliminate the structural deficit, by 1998 the top rate on married couples would have to be raised by more than 12 percentage points to 8.49 percent, with proportional increases in other rates. By fiscal year 2002, the top rate would need to be increased by 3 full percentage points to a rate of nearly 10 percent.

In light of the probable strong public opposition, the legislature is unlikely to approve sales or income tax rate increases of these magnitudes. Although modest tax increases might be more acceptable and are less likely to discourage economic development, they would not be adequate to close the state's structural deficit. For example, in 2002, an increase of one percentage point in the state sales tax rate combined with a proportional increase in income tax rates, would eliminate only 63 percent of the structural deficit. A structural deficit of more than $810 million (in 1996 dollars) would remain.

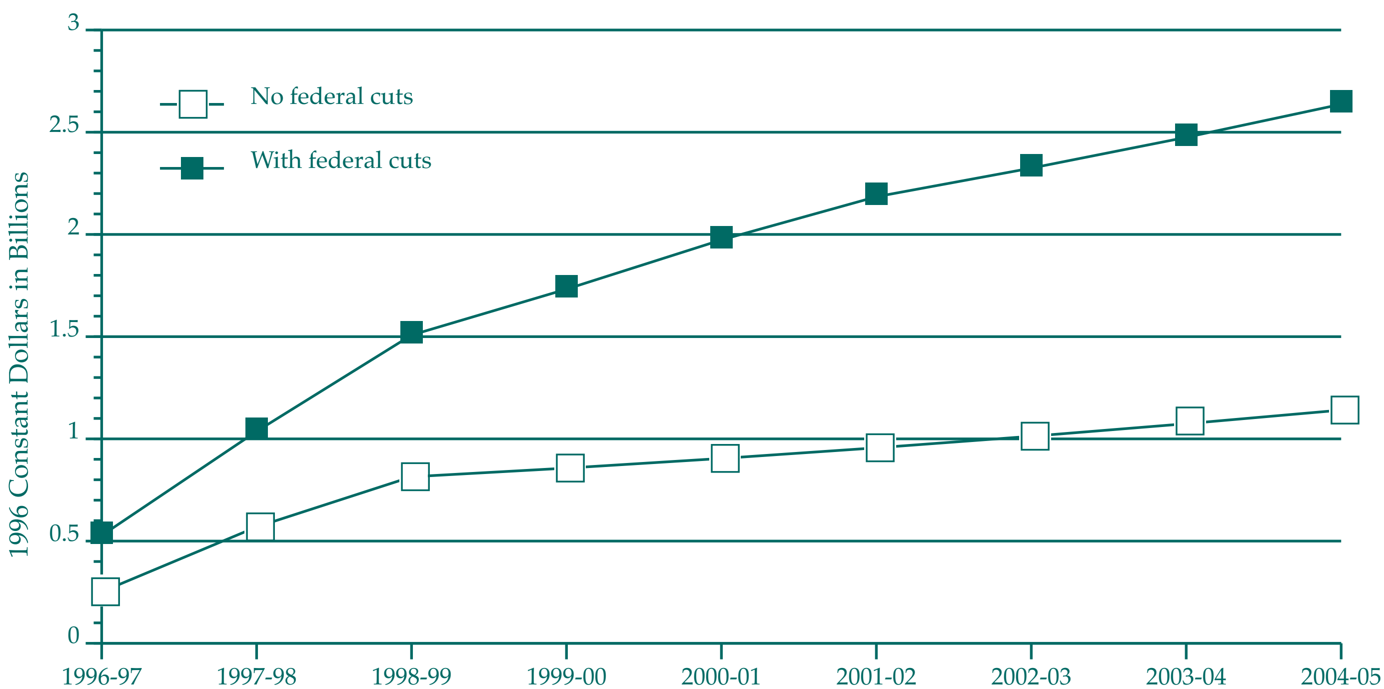
If increasing taxes at all is politically impossible, then what reductions in state spending would be required to eliminate the structural deficit? Assuming that the state maintains its current commitment to pursue property tax relief vigorously and to build more prisons, any spending cuts will have to come from about one-half of the budget. This in turn implies that closing the structural deficit by cutting spending will require, on average, a nearly one-third reduction in spending, across all spending categories other than K-12 education and corrections.

A look at the broad outlines of how the state allocates its general fund budget suggests both the magnitude and location of likely budget cuts. Likely targets for major budget cuts include environmental protection, housing and community development, mass transit, and financial assistance to local governments. If history is any guide, state funding for highway maintenance and construction is not likely to be reduced significantly. Spending on highways does not come from the general fund, but rather from a "segregated" transportation fund, which is the beneficiary of all revenues generated by the state's gasoline excise tax. Although the legislature could pass laws that would allow it to use gasoline excise tax revenues for non-transportation-related purposes, any such change would undoubtedly face stiff opposition from the powerful highway lobby.

The UW System would almost certainly be a major target of spending cuts. During the current biennium, the system received general fund appropriations of more than $1.6 billion, 10.3 percent of total appropriations. Only Medicaid, K-12 public education, and state fiscal assistance to municipal and county governments received larger appropriations. Federal funding cuts for research coupled with cuts in state financing would necessitate a major downsizing of the UW System or a substantial increase in tuition. To continue admitting the same percentage of Wisconsin's high school graduates, the

FIGURE 2

Wisconsin's Structural Deficits
With and Without Cuts in Federal Aid



Source: See text for a discussion of how the structural deficits were calculated. For additional details, see the author's Twentieth Century Fund report. Data on federal cuts are from unpublished calculations on likely reductions in federal grants to Wisconsin state and local governments made by the Center on Budget and Policy Priorities. These data were adjusted by the author to net out cuts in grants to local governments in Wisconsin.

UW System would need to accept an additional 10,000 students between now and 2001—a 6.6 percent increase in the number of admissions. The immediate consequence of funding cuts is thus likely to be a reduction in the proportion of Wisconsin's high school graduates admitted into the system.

The final alternative to closing its structural deficit is for the state to try to maintain services but to shift the costs to other governments. One obvious, though politically difficult strategy, would be to reduce the amount of general-purpose shared revenue the state sends to municipal (city, village, and town) governments. Compared with most states, Wisconsin provides a large amount of aid to municipal governments—more than $2 billion during the current biennium. These funds undoubtedly finance higher levels of municipal services and allow for lower property taxes than would be possible without state aid. If state aid is cut, many municipalities might consider raising property tax rates to replace the lost state aid. It is possible, however, that the legislature might prevent municipal and county property tax increases because any such increases would serve to offset the reduction of school property taxes resulting from the "two-thirds initiative." If municipal and county governments are successfully prevented from raising property tax revenues, they will have no choice but to cut local public services.

The Impact on States of a Balanced Budget Amendment

Despite current efforts in Washington to achieve a balanced federal budget, there remains substantial support, in Congress and among the general public, for the enactment of a balanced budget amendment to the U.S. Constitution. Supporters argue forcefully that without a balanced budget amendment, political pressures on Congress and the president to expand popular programs and to reduce taxes will prevent Congress from ever balancing the federal budget.

The amendment considered by Congress in 1996 required that total federal government spending for any fiscal year cannot exceed total government receipts unless three-fifths of the total membership of each house of Congress approve excess spending by a roll-call vote. The amendment also required the president to submit a balanced budget to Congress for consideration. The wording of the amendment suggested that if receipts are lower than expected during any year, Congress must take immediate action to increase revenue or to cut spending.

Congress is likely to balance the budget using spending cuts rather than tax increases. If the budget needs to be brought into balance during the year, cutting spending usually would have quicker results than generating additional revenue through raising taxes because there is usually a considerable lag between the enactment of a tax increase and an actual increase in tax revenue. Furthermore, the amendment itself makes raising revenue harder than cutting spending. Any bill to increase revenue must be approved by a majority of the full membership of each house by a roll-call vote. Spending cuts, on the other hand, require the vote only of those present and voting, and can be approved by a voice vote. No records are kept of how individual members of Congress vote.

The balanced budget amendment may force the federal government to take actions that directly exacerbate the economic woes and the hardships created by a recession.

In the eyes of most economists, one of the great strengths of our macroeconomic system is that during recessions, federal spending automatically increases and tax revenues fall. As the economy enters a recession, incomes fall and unemployment rises, and as a consequence more people become eligible for federal entitlement programs such as Food Stamps, Medicaid, and, until the recent passage of the welfare reform legislation, welfare. At the same time, lower incomes mean that federal income, payroll, and excise tax payments fall. This rise in spending and fall in revenues result in a larger federal deficit. Deficits during a recession act as automatic stabilizers, stimulating economic growth. Similarly, during periods of rapid economic expansion, revenues rise and spending on entitlements falls. The resulting surplus, or smaller deficit, serves to restrain economic growth.

A balanced budget amendment would completely defeat this counter-cyclical aspect of our current fiscal system. If the government is forced to cut spending or raise taxes during a recession to balance the budget, a more severe recession is likely. This increased volatility in the economy also may lead investors to be more conservative and less likely to make long-term investments. The result would be slower economic growth, exactly the opposite effect that proponents of a balanced budget amendment hope the amendment would achieve.

The inability of the federal government to run deficits during a recession would have direct and decidedly detrimental impacts on states. Recessions bring a rise in unemployment and a fall in state incomes. During previous recessions, individuals were protected from the full force of the economic downturn by the increased federal funds that automatically flowed to those who found themselves without jobs.

If a balanced budget amendment is enacted, the federal government, in its effort to balance its own budget, would in all likelihood be forced to reduce federal funds available to help individual families weather unemployment. In addition, federal employees around the country may be laid off, and federal purchases of goods and services reduced. Thus rather than cushioning the impact of an economic downturn, the balanced budget amendment may force the federal government to take actions that exacerbate the economic woes and the hardships created by a recession.

Even the strongest proponents of a balanced budget amendment do not claim that the enactment would prevent economic downturns. Thus when the inevitable recession occurs, states would face declining state tax revenues and a reduced flow of federal funds. State governments would be forced to cut state services drastically just when many individuals who have lost their jobs are most in need of government assistance. Alternatively, states could raise taxes, an action that would not only be politically difficult, but would tend to depress the economy further just when economic stimulation is needed.

Conclusions

Efforts to balance the federal budget are likely to create a serious fiscal crisis in Wisconsin and in other states. A review of recent studies from three other states—Illinois, California, and Washington—suggests that Wisconsin's fiscal situation is not unique (see sidebar). Each of these three other states is likely to face serious structural deficits, even in the absence of efforts to balance the federal budget.

State governments face constraints arising from policy decisions made by state legislatures or imposed by voters, and from economic or demographic factors largely outside the control of state government officials. Each state will respond differently to the fiscal pressures created by efforts to balance the federal budget. State services will be cut and there will be pressure to raise taxes. The possibility of raising additional revenue through tax increases will be limited in some states by voter-imposed tax limitations. If history is a guide, many states will attempt to close their structural deficits by shifting costs to lower-level governments, directly cutting state aid or shifting responsibilities for service provision. The declining political power of city governments in state decision-making suggests that central cities will be particularly hurt by state government cost shifting.

Another, perhaps less visible, form of cost shifting is likely to occur if budget cutting at the state level results in holes in the "social safety net." For example, one likely outcome of cuts in federal funds for welfare, Medicaid, Food Stamps, and Supplemental Security Income is that some individuals will lose eligibility for program benefits. At least some of these individuals will have no other sources of support and will be unable to work or to find jobs. What will happen to these individuals is unclear, but an increase in poverty is almost certain. A substantial body of research suggests that severe poverty is associated with higher infant mortality, increased rates of illness, and for children, lower performance in school. Increases in poverty may also lead to higher crime rates and more homelessness.

These problems not only create hardship for the people involved, they result in increased costs for state and local governments, and, in many cases, for the average citizen. For example, the costs of providing health care for the uninsured generally gets shifted to state taxpayers or to individuals in the form of higher health insurance premiums. If school districts are limited in their ability to increase spending, the higher costs associated with an increase in the number of poor children will result in fewer resources being available to educate the nonpoor. Any increase in crime also involves cost shifting. Victims bear obvious and direct costs. The criminal justice system at both the local and state levels faces higher costs. And the average citizen bears some costs in the form of both higher theft insurance rates and increased anxiety about personal safety.

I have argued that current efforts to balance the federal budget by 2002 will place tremendous fiscal burdens on the nation's state and local governments. The response, however, should not be to give up on the goal of balancing the federal budget and reducing the budget deficit, but rather, to minimize the deleterious impacts on state and local governments of achieving these goals.

Even though the budget deficit has been reduced by about 50 percent since 1992, it remains large. Although it is possible to have a reasonable debate about the precise year in which the budget should be brought into balance, or even whether zero deficits are an appropriate goal, no one should lose sight of the fact that federal budget problems after 2002 dwarf anything we are facing today.

Starting in the next millennium, federal spending on Social Security, Medicare, Medicaid, and federal employee retirement programs will grow rapidly. The growth in these entitlement programs will accelerate rapidly as the baby boom generation begins to retire after about 2010.

Major entitlement reforms must occur. Without these reforms, Social Security and Medicare will develop substantial revenue shortfalls early in the next millennium. Delaying entitlement reforms will not solve the problems. Delay will only increase the size of the required reductions in benefits or increases in taxes necessary to maintain solvency of the Social Security and Medicare programs. By taking entitlement reform "off the table" our public officials have only exacerbated the long-run problems.

Finding a solution that does not involve shifting the burden of federal budgetary problems onto the states requires a strategy that includes Social Security and Medicare reform, a broad mix of defense and non-defense spending cuts, and a package of modest tax increases. The ability of states to provide adequate public services for their citizens will require a continued commitment by the federal government to maintain and strengthen an active partnership between the federal government and the states. ■

Beyond Wisconsin . . .

Wisconsin is likely to face large structural deficits because of decisions by the legislature and governor to increase spending on prisons and K-12 education. Although the fiscal future is undoubtedly rosier in some states, recent fiscal analyses conducted in several states indicate that large structural deficits are by no means unique to Wisconsin. Fiscal decisions made by state legislatures or imposed by voter-approved initiatives have restricted revenues or mandated spending in a number of states. Rapid population growth and other demographic patterns beyond control of government officials also contribute to structural deficits in some states.

- Fred Giertz, Therese McGuire, and James Nowland of the University of Illinois estimate that by 2005 Illinois will face a structural deficit of $1.8 billion (nearly 10 percent of state revenues for that year) assuming federal government grants to Illinois remain constant.
- In California, Stephen Carroll and Eugene Bryton of the Rand Corporation estimate that by 2002 fiscal constraints will force the state to cut spending by more than 10 percent in all categories other than K-14 education, corrections, and health and welfare.
- In Washington, according to an analysis conducted by the Fiscal Policy Center of the University of Washington, in 2002 the state will face a gap of about $300 million between the costs of providing the current mix of public services and state spending limits imposed by a voter-approved initiative.

Labor Shortage in Wisconsin

by Donald A. Nichols

Economics Professor Donald Nichols is director of the La Follette Institute's Center on the Wisconsin Economy. He is also director of the Initiative for World Affairs and the Global Economy, which strengthens the international component of professional training, outreach, and research at the Madison campus. With a longstanding reputation for accurate economic forecasting, he is a frequent adviser to business and banking groups, including the Federal Reserve Bank of Chicago.

With Wisconsin now at full employment, employers are reporting difficulty finding skilled workers. After almost a decade of employment growth at rates above the national average, Wisconsin cannot expect to outperform the rest of the nation this year simply because there are not enough workers for new jobs.

Wisconsin's employment growth exceeded that of the rest of the nation for almost a decade starting in 1986. But in late 1993, the gap closed. From then until late 1995, employment in the rest of the nation grew at roughly the same rate as in Wisconsin. In 1996, employment in the rest of the nation grew more quickly than in Wisconsin, and in the near future, I expect that experience to be repeated. That is, employment growth in the United States in 1997 will exceed that in Wisconsin, possibly by as much as three-fourths of a percentage point.

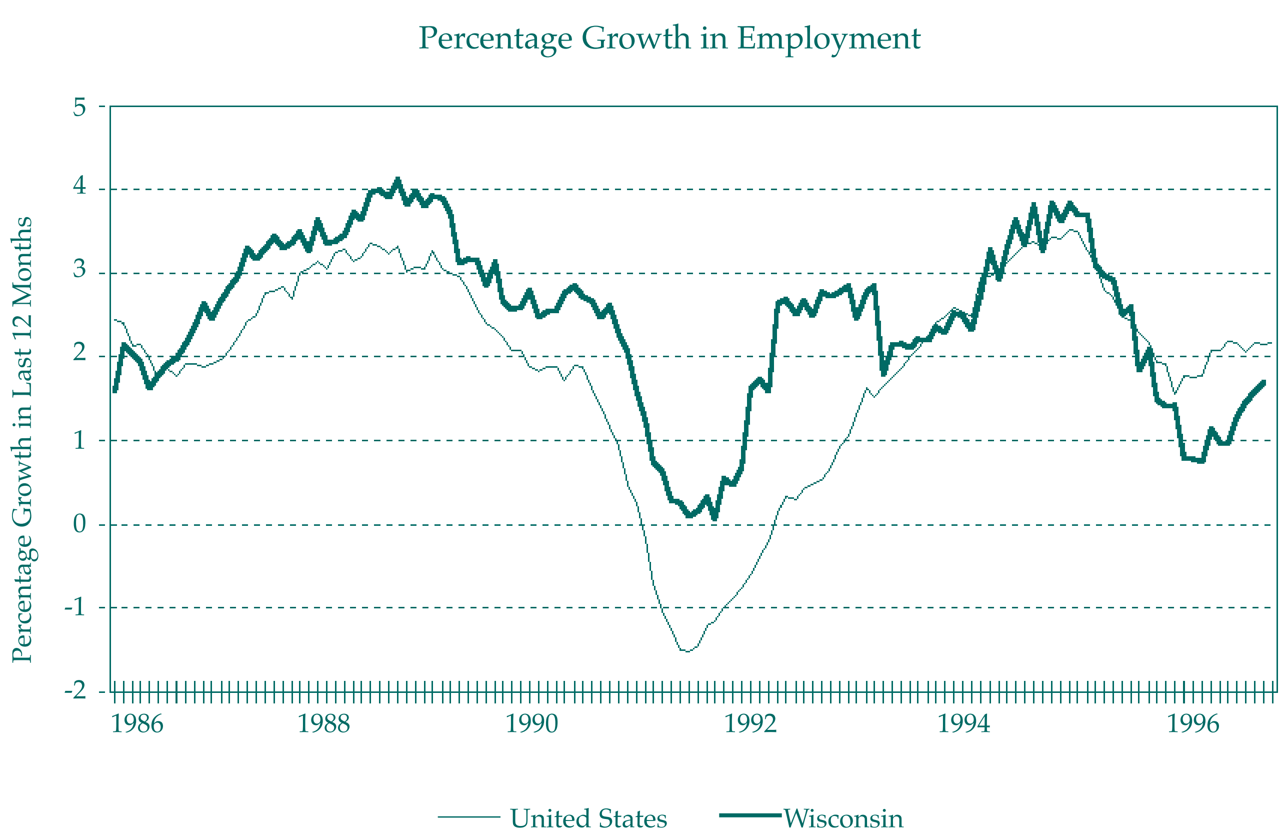
Figure 1 shows the rates of growth in employment in Wisconsin and the United States during the past decade. Growth is measured in percentage terms for each month of the past decade. The period between November 1995 and November 1996 records the most recent growth of employment at 1.7 percent. This point is connected to the preceding level of 1.6 percent, which is the growth between October 1995 and October 1996.

Employment growth in Wisconsin is likely to fall short because of a lack of workers, not a faltering economy. The broadest measure of labor availability is the unemployment rate, which in Wisconsin has been about two percentage points below the national average in recent years. In mid-1994, Wisconsin's unemployment rate reached 3.5 percent and has fluctuated around that level since. This is about as close to full employment as can be attained statewide, though monthly readings as low as 3.1 percent have been observed. Figure 2 compares Wisconsin's and the nation's unemployment rates.

Some local markets report very low unemployment rates. Madison's unemployment was in the 1.0 to 1.5 percent range throughout 1996, a level that in many months was the lowest in the nation. This low unemployment rate drew national attention and was an important ingredient in the formula that led to Madison being ranked by *Money* magazine as the No. 1 place in America to live.

With little growth anticipated from further reductions in the unemployment

FIGURE 1



Source of Data: U.S. Bureau of Labor Statistics rate, future employment growth in Wisconsin must come from two sources: (1) in-migration: and (2) increased labor force participation.

In-migration has not been strong in recent years, even though job availability can be a strong motive to migrate. Partly this is because wages in Wisconsin are not above average and partly because jobs are not scarce in other states, though economies there may not be quite as robust as Wisconsin's. The economic push and pull factors are not strong enough at this time for workers to choose to migrate, despite Wisconsin's recent record of rapid growth.

Long-term migration has favored the Sunbelt in recent years, and census projections indicate that this pattern is likely to continue. The Yankelovitch survey taken as part of the work of Wisconsin's Strategic Development Commission more than a decade ago found that while Wisconsin natives considered their state a very good place to live, residents of other states did not think much of Wisconsin. Prevailing against other states' residents' skepticism about Wisconsin and against the long-term trend in migration that favors the Sunbelt will not be easy and probably would require a conscious policy to encourage in-migration. We would have to sell Wisconsin as a good place for workers to live.

Developing a policy to encourage workers to move to Wisconsin would be controversial. Some will want to encourage new workers to come to Wisconsin because fast economic growth provides increased opportunities for current residents to improve their economic well-being. Others will not want to encourage in-migration because greater population growth may threaten the environmental amenities that provide a high quality of life in Wisconsin.

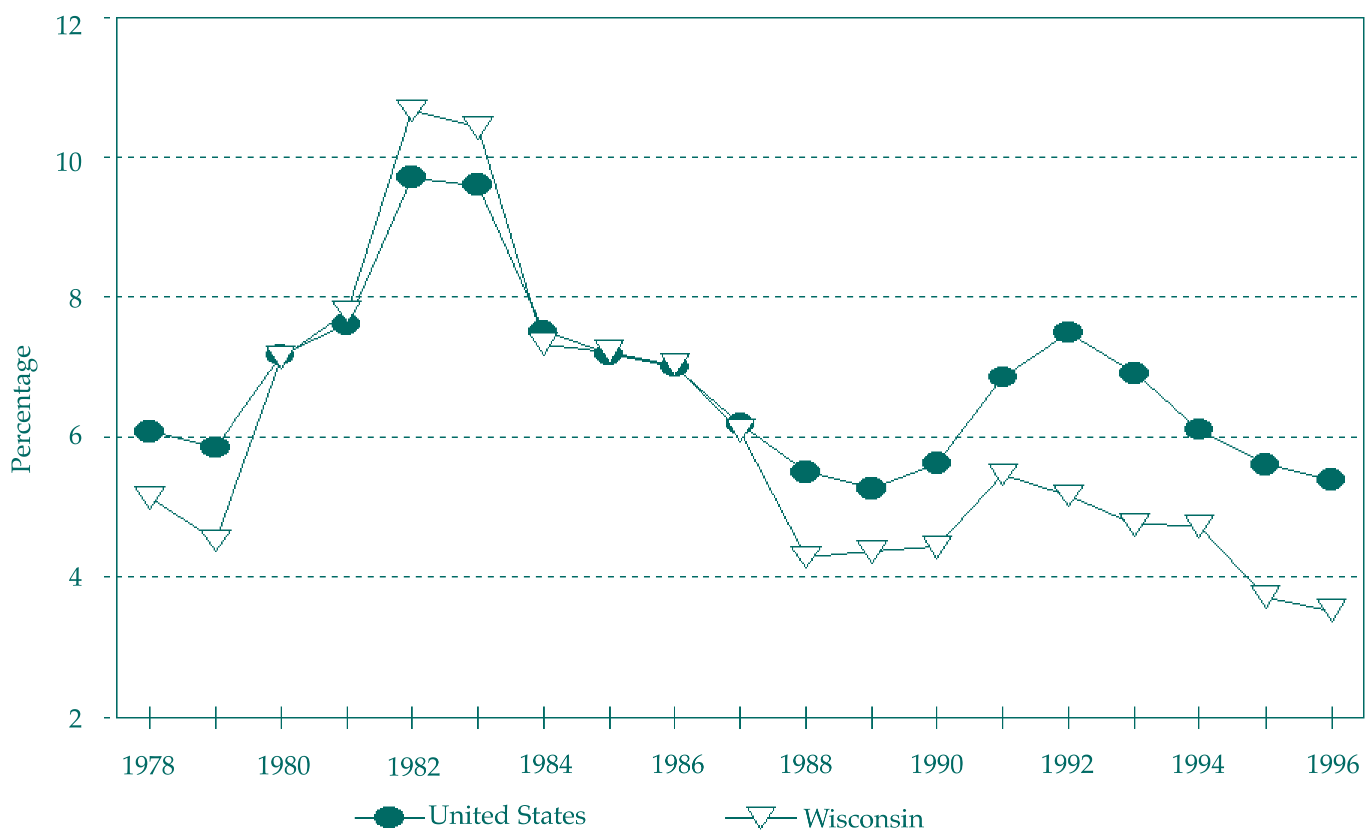
While the migration issue may become increasingly visible in the future, I expect that we will see little change in the number of workers migrating to Wisconsin in 1997. Hence, Wisconsin's long-term trend of less-than-average population growth is likely to keep the state's growth in labor force below average.

A second source of additional workers is in people who already live in Wisconsin but do not work. Wisconsin Works (W-2), Wisconsin's new welfare program, is intended to introduce to the labor force a large group of people who now receive aid. As the program moves into high gear, as many as 50,000 welfare recipients will be expected to seek work. This is about 2 percent of the Wisconsin work force. How ready and able to work these individuals will be remains to be seen. And even if they could quickly provide an expanded pool of qualified workers for entry-level jobs, the further question remains of how to upgrade the skills of current workers to relieve the shortages for skilled workers.

Macroeconomists, who make forecasts despite the enormous uncertainties

FIGURE 2

Unemployment Rates in Wisconsin and United States, 1978-1996



Source of Data: U.S. Bureau of Labor Statistics involved, cannot anticipate how successful this transition will be. Forecasts, including those by the Department of Revenue, do not foresee a large bulge in employment in 1997. In particular, they do not anticipate a return to employment growth in Wisconsin at rates above the national average.

On the other hand, an acceleration of employment growth in Wisconsin in the last few months has coincided with reports of increased employment among the formerly welfare-dependent population. The social work delivery system has been preparing for the new program by increasing the emphasis on job searching.

In the best of all worlds, many who are now employed in unskilled positions would move up the job ladder to increasingly challenging positions, while their old jobs would be filled by people who are now on welfare. This work-force upgrade would obviate the need for in-migration, and Wisconsin's economic growth could continue, without the social and environmental costs that in-migration can bring.

While no one knows how successful W-2 will be, a program designed to move aid recipients into work has the greatest chance of success in an environment of full employment such as the one that now exists in Wisconsin. ■

The LaFollette Policy Report

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