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CONCEPT PAPER ON LARGE-SCALE FEDERALISM INITIATIVE

discuss in LSG monday

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I. Objective

Develop a large-scale Federalism policy initiative that:

- o Serves the Administration's conservative domestic policy agenda;
- o Measureably eases the budget gap over FY 83-86;
- o Splinters and realigns the anti-spending cut constituency forces which are coalescing against the Administration;
- o Offers a major, affirmative legislative package for 1982 to help relieve the fiscal retrenchment theme that inevitably will characterize much of the FY 83 budget program.

II. Proposal

- o A $30-50 billion turn back of tax revenues and current Federal programs to be accomplished over a five year transition period.

- o The programs turned back would be functions federalized in the post-1960 era that properly belong at the state and local level, i.e. health, social service, public assistance, and local infrastructure (bridges and sewer grants).

- o Revenue sources turned back would have two characteristics:

  - o Capability of being levied in all states with roughly even yield (i.e. windfall tax on oil would not qualify, but tobacco excise tax would).

  - o Currently levied jointly so that the turned-back Federal tax base would easliy integrate with existing state tax systems (i.e. gas tax, alcohol and tobacco, etc.).

The tax turn-back mechanism initially would work as follows:

Taxes would be Federally levied and deposited in a trust fund with 50 separate state accounts in the amount originated in each state. During the transition period these deposits would fund either:

- Federal categorical, block grant and revenue sharing programs designated for phase-out; or

- An enhanced revenue sharing payment if states choose early withdrawal from earmarked Federal programs.

By the end of the transition period the states could elect to either:

- Receive continued credit from the Federal trust fund in the amount of receipts generated within their jurisdiction; or

- Elect to assume execution and administration of the "Federal taxes" and extinguish their Federal account (i.e. eliminate the routing of taxes raised within the state through a Federal account).

o The fiscal design would be to fund the state tax accounts in a ratio of 3:1 or 4:1 between new and existing dollars raised by the taxes designated for turn back. In the case of a $40 billion program, for example, the deficit would be reduced by $30 billion if the 3:1 ratio were used (i.e. $30 billion new, $10 billion existing).

o On the program side, the general design would be to turn back $3 in taxes for every $4 of program activity devolved to state and local government. This would be measured from pre-Reagan FY 80-81 levels and would capture the general fiscal principle used in the block grants.

o In terms of basic fiscal design, the following would occur on a fully implemented basis:

State/Local Fiscal Ledger

a)	Revenue turned back	$+40
b)	Federal programs turned back measured from FY 81 status quo..	-53
c)	Net change..	-13

Federal Fiscal Ledger

a)	Programs tunred back................................	$+53
b)	Existing revenues turned back........................	-10
c)	Net gain...	+43

o Obviously all policy variables could be altered to meet fiscal and political requirements:

- o Program/tax turn back ratio;
- o New/existing tax source ratio.

III. Program Detail

A) Candidates for program turn back:

- o Revenue sharing:
- o 1981 enacted block grants and new block grants proposed in FY 83 budget;
- o CDBG and UDAG;
- o Public assistance (AFDC, food stamps, low-income energy and child nutrition);
- o Sewage treatment grants;
- o Non-interstate highway and airport grants;
- o Rehabilitation services grants.

The theory behind these candidates is:

- o Block grants devolve policy and administrative reponsibility. Tax turn back completes the circle and devolves financing responsibility.
- o Most of these are traditionally local/state functions. Tax turn back ultimately re-establishes the link between spending levels and revenue raising -- a fundamental conservative objective.

B) Candidates for tax turn back:

- o Alcohol and tobacco tax;
- o Gasoline and other highway excises;
- o Telephone tax.

C) Transition features:

- o All turn back programs would be held harmless for FY 83-86 at 75% (or alternate variable) of their FY 81 funding levels. This would provide funding stability.
- o Federal agencies administering turn back programs would deduct distributed grant amounts from the state's tax turn back account. Any surplus remaining would be paid out as enhanced revenue sharing during the transition period.
- o If states opted out of programs early, their surplus would increase and enhanced revenue sharing payment would be raised.

D) Medicaid/public assistance swap:

- o Medicaid could be Federalized as part of this initiative, but would have to be factored into the design ratios discussed above, i.e. tax turn back would equal 75% of the net difference between public assistance savings to the Federal government and medicaid cost increases.