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Federalism and Budget Cuts During Reagan's First Administration

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The focus of this article is on the way in which federalism was responded to during the first term of the Reagan administration, a period in which basic changes were occurring in the mood of the United States and the attitude of the public to wards the role of the government in domestic affairs.

In this article, I have looked at budget cuts and other changes in federal grants-in-aid programs. Much of the business of the federal government in domestic affairs is transacted in the form of grants-in-aid. The Reagan administration's policies in this area had two aspects. Reagan's efforts to cut spending under federal grants-in-aid reflect his administration's retrenchment objectives. Under the grants-in-aid programs, the Reagan administration proposed changes reflecting their federalism reform objectives of devolving power and responsibility from the federal government to the state governments. The Reagan administration's biggest successes in pursuing both types of changes under federal grants-in-aid programs came in 1981. The cuts made in grants-in-aid in the Reagan administration's first year were historic. This was the first time in over thirty years that there had been an actual-dollar decline in federal aid to state and local governments. The cuts produced a 7 percent reduction for fiscal year 1982 in overall federal grants-in-aid to state and local governments. This amounted to a 12 percent decline in real terms. In addition to describing the effects of Reagan's cuts and changes in federal grants, the objective in this article is to assess how changes in the domestic policies of the national government made during Reagan's first term affected the roles and relationships of the levels of government in the federal system of the United States.

1. Reagan's federalism

Reagan's domestic policy initiatives during his first term reflected a theory of federalism grounded in the Tenth Amendment to the Constitution, which reserves to the states or to the people all powers not delegated to the national government. One of Reagan's major goals throughout his public career had been the devolution of power to the states, by curtailing the role of the federal government in domestic affairs and enlarging the role and responsibilities of state governments. When he was running for the Republican presidential nomination in 1976, Reagan delivered a speech calling for a systematic transfer of authority and resources to the states. This proposal, affecting $90 billion in federal programs, evoked widespread criticism because of the inability of president Reagan and his advisers to spell out the details and explain its consequences. But the proposal did accurately reflect the candidate's basic position. These views had not changed by 1980 when Reagan was elected President. In his inaugural address in 1981, he promised to curb federal powers and to demand recognition of the distinction between federal powers and those reserved to the states. Reagan's ideas of bringing about a proper mix between federal and state roles needs to be viewed in relation to what we consider to be the pre-eminent goal of the Reagan administration in the domestic public sector. Not only did Reagan wish to increase the authority of the states, but he also held strong opinions about how they should exercise such aulhority and that they should join the federal government in its effort to reduce the size of the public sector. Since his conversion to conservatism and Republicanism in the early 1960s, Reagan strongly opposed the values or at least the methods associated with many domestic social and urban programs at every level of government. He consistently criticized welfare and redistributive social service programs, which conservatives believe undermine the work ethic and encourage dependency.

Many conservatives and liberals alike assumed that devolution and retrenchment would go hand in hand. As program responsibility devolved to the states, less would be done by the state governments because of competition among the states to attract business and higher income residents by offering lower taxeses and a generally more conservative orientation. The assumption was that, if social program retrenchment occurred at the federal level in combination with devolution, the states would pull back on social programs. The service reductions implied by the federal aid cuts would stick, and perhaps even be compounded by parallel state and local action.

The general pattern in the United States in the period since World War II has been for liberals on social issues to favor central government action, while conservatives tend to favor devolutionary strategies. In liberal periods, it is true that it is likely to be easier and more efficient for the supporters of social programs to seek resources from one central source. In conservative periods, the supporters of social programs are likely to find that in many instances their best strategy is a devolutionary one.

These observations have important implications for the Reagan administration. It was thought by officials of the administration. That devolutionary measures would aid the administration's overarching domestic commitment to retrenchment in the sphere of social policy. But this was not always the way it worked out. Rather, it was found that even the most active and responsive state governments did not step into the breach in all of the federal aid areas in which the Reagan administration was pursuing its retrenchment and devolutionary policies. On the whole, the more highly targeted a program was towards the poor, the more likely it was to be cut by the national government and the less likely it was that these cuts would be replaced by state and local governments.

Economic conditions also had a major effect. The steep 1981-82 recession hit some states much harder than others and caused changes in the relative responsibilities of states and local governments. Moreover, in a number of states, important causes of changes in the state role predated the Reagan presidency. In several of the study states, a major factor in bringing about changes was the passage in the 1970s of referenda that limited state and local taxes and spending. In the pluralistic environment of the American political system, we believe that the behavior of state governments in response to the Reagan's federalism reform is notable and surprising.

2. Changes in federal grants-in-aid

As was previously described, in the Reagan administration's set of budget recommendations put forward in the spring of 1981, social program retrenchment and devolving national government responsibilities to the states were prominent. The Reagan administration's cuts were concentrated primarily on lower income groups which had benefited most heavily from the spurt in social spending that had occurred since the inception of Johnson administration's Great Society program. The Reagan administration explicity linked many of their proposed cuts to the objective of the devolution of federal responsibilities. This linkage was most clearly reflected in the Reagan administration's advocacy of block grants, namely, the merging together of groups of so-called categorical grant programs into broader and more flexible grants. In the address before a joint session of Congress announcing his economic recovery programs in

February 1981, Reagan stated: "While we will reduce some subsidies to regional and local governments, we will at the same time convert a number of categorical grant programs into block grants to reduce wasteful administrative overhead and to give local governments and states more flexibility. Now, we know the categorical grant programs burden local and states governments with a mass of Federal regulations and Federal paperwork. Ineffective targeting, wasteful administrative overhead can be eliminated by shifting the resources and decision-making authority to local and state governments. This will also consolidate programs which are scattered throughout the Federal bureaucracy".

The initial analysis of the cuts and changes in grants made in the Reagan administration's first year as president showed five things:

1. The cuts in 1981 were appreciable.
2. These cuts fell more heavily on actual or potential welfare beneficiaries than on state or local governments.
3. Several changes, especially the creation of new block grants and the passage of provisions giving states new authority to reshape the Medicare program, shifted responsibilities from the national government to the state and local governments.
4. State and local governments responded initially to federal aid reductions in many programs with coping strategies using carryover funds, shifting funds among accounts, and in other ways putting off the day of reckoning for the cuts enacted in 1981.
5. These kinds of coping actions generally did not occur for welfare programs and the public service employment program, where the 1981 cuts tended to be passed on directly to recipients.

After 1981, the momentum of the Reagan administration's retrenchment policies in domestic affairs was dissipated as Congress rejected most of the administration's proposals for further cuts and approved some new domestic spending to stimulate the economy and reduce unemployment during the steep 1981-82 recession. Even though the Reagan administration's early cuts were large, there was a tendency by both politicians and scholars to exaggerate their size and scope and downplay the political effects of the Reagan administration's policies. The view expressed in the media was that the Reagan had failed to follow through on his new federalism proposals. This level was used in the press to refer to the proposals Reagan made in 1982 to "swap and turn back" a wide array of domestic programs on a basis that would shift authority from the federal government to the state governments.

3. The impact of economic and fiscal conditions

In 1981, when Congress accepted many of President Reagan's proposals to cut federal aid, much stronger action was required to follow up on the administration's proposals for large supply-side federal tax reductions. Later, when congressional enthusiasm for further budget cuts waned and tax revenues leveled off because of the income tax cuts of 1981, the national government, as a result, faced large and growing deficits. In this situation, the Reagan administration's advocacy of federal spending restraint gained credibility. Even in the depths of the 1981-82 recession, new federal spending initiatives were modest in comparison with countercyclical programs in previous recessions. Politicians and program advocates will likely debate for a long time whether the Reagan administration deliberately created the federal deficits to force Congress to cut further spending.

In an important way, the business cycle also influenced the responses of state governments to the changes in federal policy. By far the biggest federal aid cuts were made in 1981. Shortly after the 1981 budget act was adopted, the nation entered a sharp recession. Typically in a recession period, state governments overreact. Fearing the worst, and forced by state constitutional mandates to balance their budgets, they cut spending and increase taxes. This behavior was clearly manifest in 1981–82, since the recession came on so suddenly and hit so hard. According to the United States Bureau of the Census, thirty-eight states raised taxes in 1983, and the tax revenues of state governments in 1984 showed a dramatic 14.8 percent increase. As a result of such actions and the sharp economic upturn, many state governments were relatively flush near the end of 1983. This volatile pattern of state finances and the delayed effects of federal policy changes meant that many states were in a position to consider claims from groups that either experienced federal aid cuts or feared them.

4. Changes during first term

In the first year of his administration, Reagan presented two major sets of proposals that affected both the size and structure of federal grants-in-aid to other levels of government and the relative roles of the national, state, and local governments. One was his economic program, announced in a speech to a joint session of Congress on February in 1981. It called for massive tax cuts plus reductions in the domestic spending to shrink the size of the federal government in the domestic area. Although the Reagan administration's 1981 economic program aimed at basic economic goals, it had an important effect on grants and federalism. A second set of proposals, announced in the Reagan's first year in office focused on grant programs and issues and the structure of American federalism. This was his "swap and turn back" plan to realign responsibility between the federal government and the states for funding many domestic programs.

The 1981 economic program of large tax cuts and reductions in domestic spending did not bring about growth in the economy sufficient to balance the federal budget. Instead, the desire to pay for increased defense programs, the refusal of Congress to accept all the domestic spending cuts requested by the Reagan administration, and lower than expected tax revenues due to the 1981-82 recession sent the federal deficit soaring. The Federal Reserve Board was restrained the money supply in an effort to hold down inflation. The deep recession in 1981 and 1982 dampened congressional enthusiasm for the Reagan's economic program and his domestic and social policies.

Reagan's efforts to obtain further domestic cutbacks in the fall of 1981, when it became clear that deeper budget cuts were necessary to solve his budget equation, were largely unsuccessful. In the following years, Congress restored some domestic programs to previous spending levels, added some new programs, and also took steps to raise federal taxes. These actions went against the Reagan administration's economic program and slowed the momentum of its conservative domestic policy realignment.

In light of the failure of the "swap and turn buck" plan and the partial reversal of some domestic spending cuts, many observers wrote off federalism and social program changes as an unimportant part of the Reagan program. But fundamental changes in domestic policy were enacted that had a lasting impact. Many recipients of public assistance who can be described as "the working poor" lost welfare eligibility or substantial benefits, and in some cases became subject to new job search and workfare requirements. The role of the state government was enhanced through ① changes in the form of grant-in-aid programs which gave states more authority than they previously had, and ② the signal sent by the federal retrenchment efforts of the administration that future initiatives in domestic policy would not come from the federal level.

After sketching the philosophical underpinnings of Reagan's approach to domestic policy and the broad outlines of his 1981 tax and spending changes, we describe what Reagan and the Congress did in the years after 1981.

5. Economic policy in the 1981

The three main themes of the Reagan administration embodied in his administration's 1981 economic policy that are most important for this analysis are: ① A commitment to the idea that the public sector should be smaller and less intrusive, and that the private sector should be strengthened and made more influential; ② A theory of federalism that involved reducing the role of the federal government by devolving federal responsibilities to state governments; and ③ A concept of programs to aid the poor that consists of providing adequate benefits to the truly needy for whom public assistance is a last resort and removing from the welfare rolls working persons receiving assistance to supplement low wages.

All three themes can be traced to views that President Reagan held before becoming President. In 1964, while supporting Senator Barry Goldwater's campaign for the presidency, Reagan said that the full power of centralized government was the very thing the Founding Fathers sought to minimize. As Governor, Reagan, in much the same way, had stressed his views on decentralization, stating: "I am one who believes that government has tended to grow further from the people and more centralized in authority—on up from the local government to the state, from the state to the federal government." By the end of his second term as Governor, three distinctive feature of Reagan's views on federalism were clear. First, he urged decentralization, but through what might be called the governmental chain of command. The federal government should devolve responsibility and authority to the states. The states had the responsibility to decide the proper role for local government. Direct federal and local relations did not fit into Reagan's ideas about intergovernmental relations. Second, although Reagan favored the devolution of many public services in California to the local level, welfare was an exception. His welfare reform program in California increased state control over eligibility determination and benefit calculation by tightening state regulations governing country administration of the program. Third, Reagan argued that domestic functions of the federal government should be reassigned. Many politicians were calling for a reallocation of domestic governmental functions in the early 1970s. What distinguished Reagan were his ideas about welfare. Most state and local officials advocated a federal takeover of welfare. Reagan argued that welfare should continue to be primarily a responsibility of state governments. The federal government should reduce its control over welfare programs, freeing state governments to hold down fast-growing assistance costs. On leaving the governorship in 1974, Reagan continued to develop and argue for his concepts of American federalism. Decentr alization became an important theme in his long campaign for the presidency. As former Governor of California, he presented himself as a successful chief executive who had put his ideas into practice rather than simply theorizing. When Reagan challenged President Ford for the Republican nomination in 1976, his federalism views came under intense public scrutin. Reagan, in his speech presented at the Chicago Executive Club in September 1975, and in subsequent briefings and back-up documents, named some of the federal programs to be reassigned. But as the questioning increased, he was unable to provide a full and satisfactory accounting of his program.

Shortly after Reagan's inauguration speech as President, he presented his program for economic recovery in a speech to a joint session of Congress on February 18, 1981. The speech wove together several strands of conservative economic thinking and closely reflected his political philosophy. His economic program had several elements. First, major reductions in taxes over three years were to give consumers more money to spend and firms more money to invest in new plants and equipment. Second, revisions in many types of regulations would free companies from what the administration saw as costly and unnecessary constraints. Third, federal spending was to be directed toward national defense and away from domestic activities that could be handled by other levels of government or private philanthropy. Programs that constituted a social safety net for the poor, however, were to be protected from major cuts. Forth, monetary restraint was to hold down inflation. The result, according to the President and his supporters, would be spurt in non-inflationary economic growth. The administration in March and July 1981 forecasted an average increase in gross national product of 4.5 percent after inflation between 1981 and 1986, and an inflation rate of about 6 percent per year.

6. Federal aid programs

In its proposals for domestic spending, President Reagan's program can be seen as an acceleration of trends present at the end of the Carter administration. Retrenchment percolated up through the federal system. The roots of retrenchment in domestic spending can be traced to local policy shifts in the 1970s, when a number of cities began to cut spending and reduce employment. These actions were taken to avoid the kind of fiscal crisis that befell New York City in 1975, when years of high spending and heavy borrowing collided with a dwindling tax base to bring the city government to the brink of default on the bonds it had floated to pay for current operating expenses.

Table 1 shows the changes in federal aid since 1978. In President Carter's last budget message, delivered just before he left office in January 1981, Carter said he was presenting a budget for fiscal year 1982 that would meet the nation's needs, while continuing a

Table 1. Federal Aid in Real Terms, 1978-84 (dollars in billions)

Federal fiscal year	Total outlays	Entitlements	Capital	Operating
Carter Pulls Back Over Three Years, 1978-81				
1978	77.9	20.6	18.3	38.9
1981	73.1	23.9	17.0	32.1
Change	−4.8	+3.3	−1.3	−6.8
	(−6%)	(+16%)	(−7%)	(−18%)
Reagan Makes Sharp Cuts in 1981				
1981	73.1	23.9	17.0	32.1
1982	64.1	22.7	14.9	26.5
Change	−9.0	−1.2	−2.1	−5.6
	(−12%)	(−5%)	(−12%)	(−17%)
But Then the Cutting Stopped, 1982-84				
1982	64.1	22.7	14.9	26.5
1983	64.9	22.9	14.3	27.7
1984	65.1	23.2	15.2	27.0
1985(est.)	68.9	24.3	16.6	28.0
Change	+4.8	+1.6	+1.7	+1.5
1982-85	(+7%)	(+7%)	(+11%)	(+6%)

SOURCE : Exccutive Office of the President, Office of Management and Budget, *Special Analyses: Budget of the United States Government*(various years).

four-year policy of prudence and restraint. The budget called for increased spending for only a few social programs, such as a basic skills program for unemployed youths; most other social programs would be kept at their fiscal 1981 levels, and some would be reduced. Carter's proposals were a compromise resulting from a political struggle within his administration between those who wanted to call for large cuts and thus preempt Reagan's position and those who favored holding the line, and in some areas expanding major social programs. In the end, Carter's proposals were ignored when the new Republican administration came into office. President Reagan's statements on his plans for domestic programs were quite different both in tone and substance from those of his predecessor. Not only would spending for domestic programs be constrained, it would be sharply cut in some areas. Reagan told Congress, as he presented his economic plan in February 1981, that spending by government must be limited to those functions which are the proper province of government. In March, Reagan submitted detailed proposals for spending changes in the form of amendments to Carter's budget for fiscal year 1982. He asked that budget authority be reduced by $37 billion compared with what it would have been under Cater's budget. While Reagan's proposed fiscal year 1982 budget was smaller than Carter's budget for the same year, both showed increases over fiscal year 1981 levels. Compared with the budget resolution Congress had passed for fiscal year 1981 in the fall of 1980, Carter's proposals would have increased budget authority by $115 billion while Reagan's 1982 proposed budget would have raised it by only $78 billion. Though he did not get all the domestic spending cuts he wanted in 1981, Reagan did get most of them. One reason for his success was the brilliant performance of his budget director, David Stockman, who showed his power of persuasion in innumerable congressional hearings. Another reason was that Reagan and his staff persuaded each house of Congress to hold a single vote on a package that had been put together by his congressional allies, a strategy that enabled him to blunt opposition to cuts in individual programs. By keeping support from almost all Republicans and attracting support from a number of conservative

Democrats, Reagan won passage in August 1981 of the Omnibus Budget Reconciliation Act.

7. The 1981 budget cuts

The 1981 budget cuts were concentrated in two areas; entitlement programs that assisted the poor and operating grants to state and local governments for a wide variety of programs. This focus arose in part from the Reagan administration's desire to implement conservative ideas and partly from the facts of budget making that would constrain any administration. The constraint referred to is that, of the hundreds of domestic programs, the bulk of federal domestic spending is concentrated in a handful of programs, consisting mostly of entitlement programs, some of which are extremely difficult, if not politically impossible, to cut. The biggest of these, Social Security retirement benefits and Medicare, are federally administered programs that benefit the elderly, whose numbers and political allies in Washington give them considerable clout. Other entitlement programs, which are relatively smaller than Social Security and also politically more vulnerable, include Medicaid, food stamps, and aid to families with dependent children. Aside from entitlement programs, the only functions that could be cut, once defense was exempted from reductions, were those supporting federal activities and grants to state and local governments for operating and capital programs in health, education, social services, community development, and transportation. Reagan's original budget proposals avoided cuts in Social Security and Medicare benefits, though his administration did impose a system of cost constraint on hospitals treating Medicare patients. The primary areas for Reagan's first round of domestic cuts were the means-tested entitlement programs operated by the states and a variety of operating grant-in-aid programs.

8. Welfare programs

The working poor is the group that Reagan has consistently believed should be weaned from the welfare system. This group consists of able-bodied persons of working age who have some earnings from employment and, at the same time, also receive welfare benefits. Many conservatives agreed with Reagan's chief domestic policy advisor, Martin Anderson, that these programs established a poverty wall that destroyed the financial incentive to work for millions of Americans. There are essentially two approaches to reducing welfare dependency; rewards and punishment. People who favor the former trend to support plans, such as the negative income tax, that provide a cash incentive to work by allowing welfare recipients to keep a portion of their assistance payments after they go to work. The second approach emphasizes policies like workfare that may deter people from ever getting on the welfare rolls. This is the approach favored by President Reagan and his principal advisers on welfare issues. The 1981 reconciliation act made three kinds of changes in programs affecting the working poor. First, the act put an income cap on eligibility for benefits. Households with gross earnings above 150 percent of the state's standard of need were no longer eligible for aid to families with dependent children(AFDC). Second, the character of the AFDC program was altered. Under the previous eligibility rules, which had been designed as an incentive to work, a family receiving AFDC benefits could keep thirty dollars per month of its earnings, plus one-third of the earnings above that amount. The 1981 reconciliation act removed this $30 and 1/3 exclusion after four months of eligibility. Both this provision and the 150 percent ceiling had the effect of removing families with sufficieut earnings from the AFDC rolls. A third change had to do with the categorical eligibility for Medicaid coverage of families receiving an AFDC benefits. In about half of the states, only people who received federally aided public assistance such as AFDC were eligible for Medicaid. For many working-poor households, medical and hospital insurance coverage under Medicaid was equal to the coverage these households could get in employment related medical and hospital insurance programs.

The reconciliation act contained still another important substantive change in welfare policy involving able-bodied welfare recipients of working age. Reagan had long supported the idea of workfare, whereby a person is required to work off the value of his or her welfare check. Under most workfare arrangements, a welfare recipient works in some public agency, usually at the minimum wage, for the number of hours required to earn the welfare benefit for which the family or individual is eligible. The Reagan administration proposed that workfare be made mandatory for AFDC family heads on a comprehensive basis throughout the nation, with the stipulation that child care arrangements be available or provided in all cases where this mandate was enforced. Reagan's victory in 1981 for securing these changes in the reconciliation act made it a historic piece of social legislation. It was not just a money bill; it also contained a wide range of major substantive changes in national policies, including the Reagan philosophy that a safety net should be established for those who cannot work, while those who can work are weaned from welfare.

Another of Reagan's goals was to redesign formulas for entitlement grants so that states would be encouraged to restrain spending under these programs. The most important such change was made in Medicaid, the largest and fastest growing federal aid program. The federal government provides an open-ended grant to each state that covers a certain percentage of the costs of providing Medicaid services to eligible persons. The percentage for a particular state is based on the state's per capita income in relation to the national average.

In 1981, seeking to restrain spending on welfare, Reagan proposed a ceiling on federal contributions to state Medicaid programs, so that the federal contribution for Medicaid to each state would be limited to no more than 105 percent of the federal payment in the previous year. This change moved strongly in the direction of convering Medicaid into a block grant. This was an approach that Reagan had also favored for AFDC during his 1980 campaign, although he did not advance this proposal in his package of budget cuts for fiscal year 1982. In one of his few defeats for the fiscal year 1982 budget, House Democrats substituted their provisions reducing the federal matching rate for Medicaid for Reagan's proposal to cap the federal contribution. Under the House plan, the Medical program was still open-ended, but the matching percentages were in some case reduced. Reagan argued that administration of welfare programs was lax and that fraud control programs had to be improved. In response, Congress passed a series of Reagan proposals requiring states to monitor more closely the income and eligibility of welfare recipients. Though the recession pushed up spending on public assistance programs during 1982 and early 1983, these changes had an important impact on federal welfare policy.

9. Block grants and other programs

The most important change in other grants-in-aid programs besides entitlements was the creation of new block grants and revisions to existing block grants, which were adopted as part of the 1981 budget act, and the passage in 1982 of a new program for job training. In March 1981, President Reagan proposed consolidating eighty-five categorical grant programs encompassing $16.5 billion into seven new block grants. Congress however gave him only part of what he asked for. The budget act of 1981 created or revised nine block grants that affected fifty-four existing programs with total budget authority for fiscal year 1982 of $7.2 billion. Four of the nine block grants contained only one established categorical program, while two of the new block programs were already block grants.

In a number of cases, the block grant legislation helped Reagan shrink the federal role in domestic affairs by reducing the spending compared with fiscal year 1981 levels for the previous programs. Reagan's rationale for spending cuts under block grants was that the block grants would reduce wasteful administrative overhead. His budget proposals requested an average cut in spending about of 25 percent, but Congress approved reductions averaging about 12

Table 2. New or Changed Block Grants Enacted in 1981

Block grant	Number of programs consolidated	Final federal fiscal year 1982 budget authority (dollars in millions)
Social servies	3	2,400
Low-income energy assistance	1	1,875
Small city community development	1	1,037
Elementary and secondary education	29	470
Alcohol,drug abuse,and mental health	3	432
Maternal and child health	7	348
Community services	1	348
Primary health care	1	248
Preventive health and health services	8	82
Total for nine block grants	54	7,240

SOURCE : John W.Ellwood,ed.,*Reductions in U.S.Domestic Spending*

percent. Reductions from the fiscal year 1981 outlays ranged from nothing in the case of the energy assistance block grant for low-income persons to 34 percent for the community services block grant. Although Reagan's block grant proposals were similar in many ways to the block grants enacted under the Nixon administration, one of the ways they differed was that Nixon's proposals had come with "sweeteners" in the form of spending increases, while Reagan's proposals came with the "bitter pill" of spending reduction. In contrast to the block grants enacted under the Nixon administration, which devolved authority to whatever level of authority Nixon was able to persuade Congress to devolve it to, Reagan's approach concentrated on shifting power to the states. Block grants enhanced state authority by giving them greater flexibility in administering these grants. Increased flexibility for the states also resulted from the removal or loosening of federal regulations governing such matters as how the states report their uses of federal grant-in-aid funds and the procedures they follow in procuring goods and services with these funds.

The Reagan administration won congressional approval for spending cuts and program changes in a number of other grants-in-aid providing funds for operating purposes. Though these were spread among a wide variety of programs, a number of changes affected programs with sizable proportions of low-income beneficiaries. The compensatory education program is an example. This program provides grants both to states and to local school districts. In 1981, much of the grant money was given in the form of concentration grants to districts with a high proportion of children from low-income families. The reconciliation act gave states the authority to allocated funds among local districts and provided more discretion in deciding what factors to use in making the allocations. These changes were expected to result in spreading funds more widely and thus decreasing aid to big-city school districts, which had received the bulk of such aid in the past.

Other revisions were made in several grant-in-aid programs for capital purposes. These cuts tended to be smaller than in the case of entitlement and operating grants. The net effect was to make federal funding less certain for capital grants for such purposes as highways, mass transit, wastewater treatment, and airports.

The Reagan administration's success in obtaining congressional approval for spending cuts in domestic programs reached its high point in August, 1981 with passage of the reconciliation act. In September 1981, President Reagan found Congress in a less receptive mood when he argued that the cuts in the budget reconciliation act had not been deep enough and sought $16 billion in additional spending reductions. After initially vetoing a supplemental appropriations bill, Reagan accepted one containing additional cuts of $4 billion. In 1982, when Congress received Reagan's fiscal year 1983 budget, lawmakers paid relatively little attention to Regan's requests for further spending cuts. They concentrated on trying to reduce the deficits by recapturing part of the revenues lost as a result of the 1981 tax cut, and on appropriating additional funds for programs designed to combat the effects of the recession that had begun in fall, 1981. In January, 1982, President Reagan, in his State of Union message, proposed a sweeping reform of the entire federal aid system, because his proposals for further cuts in federal domestic spending were encoutering stiff resistance in the Congress. Calling current patterns of federal aid a distortion in the vital functions of governments, he proposed to return to the state and local governments about $47 billion in federally funded programs, together with the means to finance them. The shift was to be implemented over a seven year period, from 1984 through 1991.

10. Summary

To summarize the discussion of the changes in spending for federal grants-in-aid during the first term of the Reagan administration, funding for federal aid dropped sharply with passage of the Reaganis fiscal year 1982 budget. Federal grants-in-aid declined by $6.6 billion in current dollars from the previous year, the first annual drop in nominal terms in more than twenty-five years. For the rest of Reagan's first term, overall federal aid funding was roughly constant in real terms. Congressional rejection of later Reagan budget proposals and restoration of some of the 1981 cuts during the recession, plus recession-induced increases in public assistance rolls, meant that the federal aid outlays in real terms stayed lower from 1982 through 1984, then increased somewhat in 1985. Finally, Reagan's cuts in federal aid came together in a way that fell disproportionately on one segment of the population,namely,the working poor. These effects were most drastic in the case of the cuts and changes in entitlement grants-in-aid programs, but they can be seen in the cuts and changes made in other types of federal aid programs as well.

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