The Changing State of Fiscal Federalism in the U.S.

Merl Hackbart

In practice, the American federal system is a balancing act among three orders of relatively independent governments, federal, state, and local, that have responsibilities for the provision of public services and the power to levy taxes and borrow funds. But only two of those orders are mentioned in the Constitution – the state and the federal. The third, the local governments, have roles largely determined by the states. Within those guidelines, the actual roles and responsibilities of the federal and state governments for public programs are continually changing. This situation leads to periodic conflict between different orders of government. The courts play an important role in resolving such conflicts. In the end, this flexible system has proven to be stable and accommodating to changing social, political, and economic conditions.

But there are other problems that even a carefully balanced federal constitution and court system have not been able to fix: constraints on federal and state revenues, rising program costs, increasing demands for services by the public, and longer-term economic and demographic trends. These problems make headlines during debates and decisions on state and federal budgets and are often ignored at other times. And whenever the federal government has dealt with them by shifting program financing responsibilities to the states, the problem has reappeared in the state legislatures. In most cases, the states have adopted temporary financing strategies and initiatives to meet the shortfall in joint state-federal programs. But such “temporary fix” budget strategies by individual states have enlarged many state budgets to the breaking point. Individual states then often enact fiscal policy adjustments to balance their budgets as required by law or by their constitutions.

The federal government’s role in the U.S has often been to provide broad guidelines and resources while state and local governments have been the front line public service providers. Maintaining a strong intergovernmental partnership has been challenging for the states as they have had to be responsive to their unique state needs while sharing the cost and insuring the delivery of public services with their federal government partners. The growing tendency to nationalize policy areas, such as the recent “Homeland Security” and “No Child Left Behind” federal legislative initiatives, has increased governmental interdependence. There is a growing dependence of the federal government on the states to implement federal programs and to ensure the attainment of national goals. As a result, while many policy areas have been nationalized and federally funded, greater responsibility has been devolved to state and local governments for implementing programs to achieve national goals**.** Any change to a shared program by one order of government – for example, a cutback - can have a major impact of the fiscal ability of another order of government to meet its program and fiscal management responsibilities.The U.S. Constitution grants significant fiscal policy powers to the federal government, such as the ability to levy taxes, borrow funds, regulate interstate and foreign commerce, pay debts, and provide for the general welfare. However, it also imposes limits on federal fiscal policy authority, including a restriction on the ability of the federal government to tax or impose a duty on articles exported from any state. While the authority of the federal government has limited the ability of the states to interfere with interstate and international commerce and trade, it has also severely limited the states’ taxing powers for multi-state or international business transactions. Such limitations have reduced the fiscal capacity of the states to finance their program responsibilities in an increasingly global economy.

The states are granted some fiscal authority in the Constitution. Specifically, the tenth amendment grants states "residual power" regarding fiscal policy and their principal leverage to negotiate with the federal government regarding program responsibilities and finances. However, states are limited too: they are required by the Constitution to follow due process in their policies and actions and to provide equal protection under the law within their jurisdictions. Local governments, which are created by state governments, have only such fiscal power and authority as provided by the states.

The tendency of the federal government to become involved in a broader array of domestic policy issues, including those traditionally in the domain of state government, has blurred the roles and responsibilities of the various orders of government. The shared responsibility for such domestic programs has led to intergovernmental disputes and tensions over accountability and responsibility.

One major issue for fiscal federalism in the U.S. is the lack of a formal or informal process for effectively coordinating U.S. intergovernmental fiscal policy. As a result, federal government initiatives are often in conflict with state policies. State policies are also frequently in conflict with local government policies. Areas of fiscal policy lacking essential intergovernmental coordination include tax and revenue policy, and jointly administered programs such as health care, education, and infrastructure, among others.

Efforts to reduce the large federal deficit and mounting federal debt have driven the federal government to shift program financing responsibilities to the states. Policy decisions designed to manage the federal government's budget often involve reductions of federal support for domestic programs. Many of these are programs in which the federal, state, and local governments have cooperated to provide public services. When such federal fiscal cutbacks occur, the states and local governments are forced to assume additional responsibility. It has been difficult for the states and local governments to develop strategies and policies to manage their ongoing financial commitments while accommodating shifts in intergovernmental fiscal responsibility.

A second issue for fiscal federalism involves a weakening of the states' role and authority within the U.S. system of federalism. More specifically, **while the U.S. Constitution reserves for the states all authority and responsibilities not specifically given to the federal government, the states are experiencing a steady erosion of their authority.** The emergence of unfunded mandates, the preemption of state authority, and the devolution of programs from the federal to the state order are examples of the increasing dominance of the federal government.

Unfunded mandates are created by federal government legislation that requires the states to implement programs designed by the federal government, without federal financial support. Federal preemption of state and local authority has also occurred, and has been defended with the Supremacy Clause of the U.S. Constitution, which indicates that federal laws enacted in accordance with the U.S. Constitution are the supreme law of the land. Devolution, another development at the federal order, refers to shifting program responsibility downward to the states. These recent practices have changed the balance of power between the federal and state governments.