
BY THE COMPTROLLER GENERAL

Report To The Congress

OF THE UNITED STATES

Proposed Changes In Federal Matching And Maintenance Of Effort Requirements For State And Local Governments

Federal matching and maintenance of effort requirements do not often effectively promote the Federal interest of enhancing the fiscal and management commitments of State and local governments to Federal programs. While more stringent Federal requirements would promote these Federal fiscal and managerial objectives, they would screen out needy grantees from participating in the program, thus jeopardizing the ability of the intergovernmental grant system to provide services of national interest on a nationwide basis. Also, by encumbering State and local funds in a growing number of federally funded areas, the requirements induce distortion of State and local budget priorities and may promote fiscal stress as well.

GAO recommends that matching requirements be strengthened but used more sparingly and only where a clearly articulated Federal interest does not conflict with the broader purposes of Federal programs themselves. Maintenance of effort requirements serve a clear, primary Federal interest, but should be changed to more effectively prevent fiscal substitution while not penalizing bona fide State and local spending reductions.



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To the President of the Senate and the
Speaker of the House of Representatives

This report examines the impact of Federal matching and maintenance of effort requirements on State and local governments. The report explores the appropriateness of these requirements as a tool for attaining Federal policy objectives and recommends legislative changes which can better achieve Federal objectives and minimize distortions of State and local policy.

We are sending copies of this report to appropriate House and Senate committees; the Director, Office of Management and Budget; appropriate Federal department and agency heads; and organizations representing State and local government.

A handwritten signature in black ink, reading "Thomas B. Stearns".

Comptroller General
of the United States

D I G E S T

Federal matching and maintenance of effort requirements are often not effective in accomplishing their intended purposes of generating State and local government fiscal and managerial commitments to Federal programs. Further, even when effective from this standpoint, the requirements can produce unintended adverse effects by distorting State and local priorities and screening out needy grantees. Consequently, changes are needed in both matching and maintenance of effort requirements.

While more stringent requirements would promote Federal fiscal and managerial objectives, they could correspondingly jeopardize the ability of the intergovernmental grant system to promote State and local fiscal stability and to provide a minimum level of federally funded services nationwide.

Matching and maintenance of effort provisions comprise the principal means through which Federal programs influence State and local budgets. Matching provisions require State and local governments to bear a minimum share of program costs as a condition for receiving Federal assistance. Maintenance of effort provisions are designed to prevent State and local grantees from reducing their spending in federally funded program areas.

Their aggregate burden on State and local governments has become an important issue due to the rapid growth of matching Federal grant programs over the past 15 years as well as the recent wave of fiscal constraints and expenditure reductions faced by all levels of government. For this reason, their appropriateness and effectiveness have become important issues for the entire public sector.

requiring new resources. When the matching requirement is stringent enough to impose a fiscal burden on State and local governments, new resources and top management interest are stimulated. Yet, stronger matching requirements can also adversely affect the interests of all three levels of government. (See p. 24.)

A strong matching requirement may screen out those governments most in need of a program but least able to finance a match. As a result, Federal grant funds may not reach the very jurisdictions they were most intended to help. In addition, most Federal grant programs lack the flexibility to ease the requirement for States and localities with low fiscal capability. (See p. 31.)

Matching requirements may also distort State and local spending priorities if they entice these governments into providing match for low priority local programs at the expense of higher priority programs not funded by Federal grants. In fact, 17 of 23 governments facing budget cuts that were covered by GAO's review protected their Federal grants and were forced to disproportionately cut other services not eligible for Federal grants. As dependence on Federal grant funds has increased, State and local governments have locked a growing portion of their budgets into meeting the match for Federal grants. (See p. 32.)

Thus, while strict matching requirements could stimulate new resources and top management interest, the cost would be in nonparticipation and increased fiscal strain at the State and local level.

Legislative histories rarely show an explicit rationale for why matching was required or why a given rate was assigned. This lack of rationale has resulted in a wide diversity of matching requirements and arrangements which influences how State and local governments

requirements, used to prevent State and local governments from using Federal funds for activities that would otherwise have been non-federally funded, are not enforced by many Federal agencies due to the substantial problems in ascertaining State and local spending intentions. (See p. 54.)

Stronger requirements, however, could have significant adverse programmatic and fiscal effects by reducing the flexibility available to State and local governments to manage their own resources more effectively. (See p. 60.) Strong maintenance of effort requirements may discourage some State and local governments from participating in the grant program itself, thereby imperiling the cooperation of State and local governments which many Federal programs have come to need.

Stronger provisions could intensify the adverse effects that GAO observed from the implementation of existing requirements, including: (1) distorting State and local priorities by requiring a combined Federal-State effort level deemed to be excessively large or wasteful by State and local officials; (2) penalizing bona fide spending reductions arising from fiscal crisis, taxpayer revolts, or productivity improvements; and (3) discouraging program innovation undertaken with State and local resources prior to the Federal grant program. Therefore, GAO believes that maintenance of effort requirements must be made more flexible to avoid penalizing bona fide spending reductions as well as program innovation. (See p. 69.)

At the same time, maintenance of effort requirements, while providing flexibility, also need to be standardized within uniform parameters to improve Federal implementation and assist State and local governments in their own compliance efforts. (See p. 69.)

GAO recommends that the Congress strengthen maintenance of effort requirements to prevent fiscal substitution and provide more flexibility by not penalizing bona fide spending reductions. (See p. 70.)

Moreover, if incorporated into every major grant program, an overly stringent maintenance of effort requirement could actually harm the Federal interest by discouraging State and local participation in grant programs. The sanction of total withdrawal would appear especially inequitable in those programs where Federal grant outlays have actually declined in recent years.

In response to OMB's concern, GAO added to the recommendation a provision that Federal grants should be reduced by the same percentage as the grantee's own spending so that the Federal share of costs does not increase.

GAO also received favorable comments from the Advisory Commission on Intergovernmental Relations and State and local government officials. (See p. 74.)

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ABBREVIATIONS

| | |
|------|----------------------------------------------------|
| ACIR | Advisory Commission On Intergovernmental Relations |
| CETA | Comprehensive Employment and Training Act |
| GAO | General Accounting Office |
| HEW | Department of Health, Education, and Welfare |
| LEAA | Law Enforcement Assistance Administration |
| NCSL | National Conference of State Legislatures |
| OMB | Office of Management and Budget |

CHAPTER 1

INTRODUCTION

In recent years, the size and scope of the Federal domestic assistance system has grown dramatically. Federal aid to State and local governments has more than tripled, growing from \$24 billion in 1970 to an estimated \$89 billion for fiscal year 1980. Federal funds now comprise about 25 percent of total State and local expenditures up from 10 percent in 1950. This assistance is provided through a growing number of Federal programs--513 as of fiscal year 1979, according to the Catalog of Federal Domestic Assistance.

Federal influence in State and local affairs has grown accordingly. Not only has the Federal Government become more involved in funding and regulating a broader range of State and local services, but also the Federal presence has been extended to nearly every general purpose local government in the country through the General Revenue Sharing Program.

This trend has alarmed some students of American government who are concerned that this growing Federal presence may be transforming our federal system of government into a unitary system, with subnational governments clearly subordinate to and dependent on the national government for setting priorities and financing public services. The fiscal effects of Federal policies have become more noticeable in recent years, as some States and localities have been faced with a fiscal crunch arising from a growing mismatch between rising expenditures and declining revenues.

Matching and maintenance of effort requirements are two principal means through which Federal programs impact on the State and local budgetary process. Match is defined in this study as the minimum share of program costs to be borne by grantees as a condition for receiving Federal assistance. Conversely, match also defines the maximum or upper limit of program costs to be borne by the Federal Government.

Maintenance of effort requirements are provisions intended to ensure that Federal funds are used to supplement existing State and local programs, and not be used as a substitute for existing State and local resources. In most cases, these requirements are intended to prevent State and local governments from reducing their spending in federally funded areas as a condition for receiving Federal grants.

programs and policies seeking to alleviate State and local fiscal distress. The General Revenue Sharing Program, for example, provides funds which State and local governments can use to satisfy matching requirements of other Federal programs. Thus, at the same time the Federal Government can be exacerbating as well as alleviating State and local fiscal problems.

OBJECTIVES, SCOPE, AND METHODOLOGY

While viewed as increasingly burdensome by some State and local officials, matching or maintenance of effort requirements help promote certain Federal purposes, including spreading the costs of implementing expensive domestic programs and ensuring State and local responsibility and accountability for the growing number of Federal grant programs. These Federal concerns can become increasingly salient as the Federal Government itself experiences strong pressures to control spending. Matching and maintenance of effort provisions, thus, become a more important issue for the entire public sector as all three levels of government engage in renewed efforts to curtail expenditure growth.

This report explores the appropriateness of matching and maintenance of effort requirements by examining the extent to which both requirements:

- Achieve their intended objectives as envisioned by the Congress and Federal program administrators.
- Cause undesirable consequences for State and local fiscal stability and independence.
- Tend to frustrate the achievement of other Federal objectives in the assistance system, e.g., distribution of Federal funding to grantees most in need and other Federal efforts to bring fiscal stability to the State and local sector.

We conducted this review through both extensive fieldwork at State and local governments and analysis of Federal grant programs and policies at Federal headquarters and regional offices.

To assess the impact of match and maintenance of effort requirements, we visited 10 States, 11 counties, 10 cities, and one regional council of governments. During the course

CHAPTER 2

MATCHING REQUIREMENTS NEED TO BE STRENGTHENED BUT USED MORE SPARINGLY

Matching requirements often do not achieve their Federal fiscal and managerial objectives. They do not limit Federal grant outlays at the national level except in those few programs that are not controlled by appropriations ceilings. In the majority of other programs, the objectives of match are not met due to the desire of all levels of government to minimize the fiscal burden and maximize grantee participation in Federal grant programs.

As a result, matching requirements usually:

- Do not stimulate additional State and local resources for grant programs.
- Do not encourage top State and local officials to deliberate the merits of participating in Federal grant programs.
- Do not promote grantee oversight of grant program management.
- Do not reflect the proportionate benefits accruing to grantees from the grant programs.

These Federal objectives are best promoted when the matching requirement itself is fiscally stringent enough to cause significant fiscal burdens on State and local governments. If stimulation of new resources is desired, match must call forth the kind of fiscal effort from grantees that will yield new non-Federal resources for the program. If more careful State and local selection of grant programs and management oversight are to be encouraged, the match must elicit a State or local expenditure commitment sufficient enough to give top officials a stake in the nature and operation of the grant program. In other words, for match to effectively serve Federal fiscal and managerial objectives, it must be fiscally significant, perhaps even painful, for State and local governments.

Ironically, while stringent non-Federal matching requirements would promote Federal fiscal and managerial objectives, they would also undermine broader purposes of the Federal

Interestingly, matching requirements can tend to stimulate, rather than limit, Federal spending. Because the Federal Government need not bear the full costs of matched programs, it may be enticed into new program initiatives that would otherwise not have been undertaken had there been full Federal funding. For example, an official with the Office of Personnel Management (OPM) stated that the Intergovernmental Personnel Program's 50-percent matching requirement strengthens its budgetary proposals to OMB by enabling OPM to argue that limited Federal dollars can leverage a total program twice the size of the Federal investment.

Limited impact on Federal funds going to grantees

By limiting the Federal dollar commitment to any one project, matching requirements are justified as a way to spread limited Federal dollars to a larger number of grantees. The amount of Federal funds going to grantees, however, is usually not determined by the match.

Under an ideal cost sharing arrangement, the Federal grant amount would be primarily a function of its stipulated share of total project costs. However, for 56 percent of fiscal year 1980 Federal grant funds, the maximum amount of Federal grant money for each grantee is primarily a function of a predetermined allocation formula based on various program need indices. Although the maximum Federal allotment under formula grants is unrelated to total State and local project costs, 56 percent of formula grants had matching requirements according to the Advisory Commission on Intergovernmental Relations (ACIR). Unlike open-ended programs where the Federal Government matches total eligible State and local expenditures, formula grants work so that State and local governments match a predetermined Federal dollar allotment. The combination of Federal and non-Federal shares only accidentally equals total project costs. The extensive overmatch resulting from prior State and local spending that we found in formula grant programs requiring a match attests to the fact that total project costs are often unrelated to the Federal share. (See page 16.)

Project grants, as opposed to formula grants, distribute Federal funds on the basis of competitive applications from grantees. Awards are made by a discretionary decision of Federal officials, and the amount of Federal funds going to each grantee presumably bears a more direct relationship to actual project costs. While OMB figures indicate that 78 percent of Federal grants are project in nature, these grants comprise only 19 percent of fiscal year 1980 Federal grant outlays.

Federal dollars alone will produce. For match to achieve this stimulative objective, State and local governments must spend money they otherwise would not have spent for the program.

Congressional intent on stimulation was perhaps best expressed during the reauthorization of the Law Enforcement Assistance program (LEAA), which was amended in 1971 and 1973 to prevent the use of existing in-kind resources as match and instead require all non-Federal match to consist of hard cash. The Senate Committee report in 1971 justified the change by noting:

"Hard match is designed to guarantee that Federal funds will in fact draw new State and local funds into the criminal justice system and avoid the real danger that Federal funds will merely replace State and local funds * * *."

In the governments we visited, matching requirements sometimes did cause State and local governments to spend their own money or raise new taxes for federally funded programs they otherwise would not have allocated funds for in the absence of the Federal grant. More often, however, match did not stimulate the allocation of new grantee resources but rather triggered the identification of existing grantee costs related to the grant project. This weak stimulation effect can be attributed to a combination of factors, such as Federal policies allowing the use of existing resources as match and large prior State and local expenditures in many federally funded program areas.

How match is supposed to stimulate State and local spending

In theory, the fiscal lure of Federal grants entices State and local governments into allocating new resources to satisfy the non-Federal match for programs they otherwise would not have funded on their own. While State and local jurisdictions may not be willing or able to fully fund a program from their own resources, they would most likely agree to spend new resources on the same project if most of the project costs were paid by the Federal Government.

Some economic studies have found that Federal grants with matching requirements appear to stimulate new State and local expenditures. In our review, we did find cases where matching requirements forced State and local governments to allocate funds for programs or services that would otherwise not have been funded. For example:

satisfy one-third of the total minimum non-Federal match required in the aggregate by all Federal programs without stimulating new State and local resources. Finally, heavy prior grantee fiscal commitment to a grant program area makes it difficult for a matching requirement to stimulate new resources.

Existing resources are usually allowed as match

If matching requirements are to stimulate new State and local spending, the non-Federal match should consist of resources over and above what the grantee would otherwise have spent. Yet, nearly all of the 36 largest grant programs requiring a match allow the match to be provided from existing resources.

Of the 15 programs with both match and maintenance of effort requirements, the match may be provided from existing resources reported for maintenance of effort purposes in most cases. In fact, the Federal Highway Safety program allows the 30 percent match to be met from existing State resources unrelated to the specific project aided by the grant; thus, according to Federal officials, existing State expenditures for driver education can be counted as the match for Federal funds awarded to erect mile post markers. Two of these 15 programs--LEAA and Community Action--have had policies requiring that non-Federal match consist of new grantee resources for each grant project.

Of the 36 largest programs requiring a match, 22 do not have any maintenance of effort requirement. In these programs, grantees may substitute Federal funds for non-Federal resources and use the freed-up State and local funds to finance other activities.

In-kind match is allowed in lieu of cash

Cash match is far more likely to stimulate new resources than in-kind match. Officials in 25 of 28 jurisdictions we visited stated that in-kind match generally does not stimulate new spending while cash match typically does. Yet, most Federal programs allow in-kind resources to be used as a source of match. In 1971, the Office of Management and Budget (OMB) established Government-wide policy on in-kind match as part of its overall effort to standardize grant administration. OMB Circular A-102 requires agencies to honor in-kind contributions as match unless prohibited by law and established uniform Government-wide definitions of in-kind match.

--An Eastern city used the salaries of its police force to match an LEAA grant for the purchase of walkie-talkies during the time when LEAA accepted in-kind match.

While in-kind match is financially beneficial to most grantees, it can also impose its own administrative and paperwork burdens. In-kind match can be more difficult to document and track than cash match, especially when accounting systems are not well developed. As such, in-kind match can place additional burdens on Federal auditors charged with verifying grantee compliance with the matching requirement. The valuation and documentation of private contributions and volunteer time can be especially burdensome. For example, officials of a Midwestern Community Action Agency estimate that about one-sixth of the accounting staff's time is used to document in-kind match. Similarly, the collection and storage of data used for in-kind match (e.g. the time of volunteer workers) consumes about 25 percent of a Western Community Action agency's fiscal officer's time.

Aggregate State-wide matching is permitted

Many major Federal grant programs allow match to be met in the aggregate rather than on a project-by-project basis. Grantees can use aggregate match to avoid allocating new resources as match. This occurs when the grantee's existing resources for one project far exceed the minimum non-Federal match; the overmatch or excess can then be spread to cover the non-Federal share for other projects funded.

Of the 20 largest grant programs with match that pass funds through States to local governments, 18 allow the match to be met on an aggregate basis. The State can provide the entire match itself, relieving all local governments of any match burden, or vary the match required of local governments based on financial condition, using the overmatch from some governments to make up for the undermatch of other governments. We found that several States varied the match required of local governments. For example, a Western State's Department of Highways imposed a match of varying percentages on local governments participating in the Federal Highway Safety program.

Use of Federal funding sources to satisfy matching requirements

While 22 of the 36 largest Federal matching programs have general prohibitions against using Federal funds to satisfy non-Federal matching requirements, funds received by grantees under two major broad purpose programs, General Revenue Sharing

significantly outstrips the Federal grant it is difficult and perhaps inappropriate for Federal agencies to promote additional State and local spending in the program area.

On a national aggregate basis, State and local governments frequently outspend the Federal Government by a wide margin in broad purpose programs that nevertheless require a match. State and local/Federal expenditures ratios for four programs illustrate this point:

| <u>Program</u> | <u>Ratio of Federal to non-Federal funds required</u> | <u>Ratio of Federal to actual calendar year State and local spending in the program area</u> |
|------------------------|-------------------------------------------------------|----------------------------------------------------------------------------------------------|
| | ------(percent)----- | |
| Law Enforcement | 96 1/4 - 3 3/4 | 2 - 98 |
| Highway Safety | 75 - 25 | 7 - 93 |
| Vocational Education | 50 - 50 | 11 - 89 |
| Child Welfare Services | 66 2/3 - 33 1/3 (Variable) | 9 - 91 |

In addition, we found large grantee overmatches were reported for grant programs where State and local spending significantly exceeded the Federal grant. One Western State we visited had an extensive child welfare services program of its own when Federal funds became available. As a result, the match is provided from the salaries of existing social work personnel. Moreover, State officials told us that all existing expenditures are not reported because existing State funds for the program exceed the required match. Similarly, one New England State incurred expenses of \$8.3 million for child welfare services but reported less than \$1 million of this to meet match requirements of the Title IV-B program.

Overmatch is a prevalent pattern in many grant programs, as illustrated by the following data from Federal Region II:

MATCH IS USUALLY NOT AN
EFFECTIVE SCREENING DEVICE

It is argued that match serves as a litmus test of State and local interest in grant programs. If match requires a significant State or local fiscal effort, it is believed that top managers and political officials will deliberate more carefully on the merits and design of the proposed grant project. As a result, Federal grants will better reflect State and local interests. The Federal interest is also served by ensuring that only those grantees with a serious commitment to the program will participate, ensuring a higher quality program.

This philosophy was expressed by the Assistant Secretary for Commerce in defending an administration proposal to include a matching requirement in a proposed antirecession public works program:

"We felt that a 10 percent cash contribution on the part of the local sponsor was an effective way of ensuring that indeed the local community, when it set its priorities on projects, had some investment, had some stake if you will, in terms of what projects were selected and what work was undertaken.

So quite frankly, it was an attempt to put a little bit of screening mechanism in * * *."

Match can promote greater deliberations by State and local officials in deciding the merits of grant program participation. We found, however, that for this to occur, the non-Federal match rate must be sufficiently high and require grantee appropriation of cash from public funds. In other words, the match must require a significant increase in expenditures to promote interest by State and local policymakers.

Overall, the rate of match required from grantees has been decreasing over the years. Before 1935 nearly all grants with matching required a 50-percent non-Federal match. The explosion of Federal grant programs during the past two decades had been accompanied by a reduction in the rates of non-Federal match typically required. As of fiscal year 1978, only 46 grant programs--or about 9 percent of all programs--required a 50 percent or greater non-Federal match. According to our analysis of the Catalog of Federal Domestic Assistance, most programs require either no non-Federal match (37.2%) or a relatively low non-Federal share.

have the practical effect of making legislative review of grant proposals more difficult. One Western legislature, whose review of Federal grant projects has been limited to the appropriation of State match, does not control programs with in-kind match through the appropriations process due to the accounting problems involved. According to a State audit report, a Midwestern State legislature was unaware that its State had begun to participate in a Federal Coastal Zone Management Program because the match was provided from in-kind resources that were not separately identified as a line item in the State agency's appropriation.

The Pennsylvania State Legislature was unable to use the matching requirement of LEAA to prevent the Governor from establishing an LEAA funded project because of the State's use of aggregate match. The project did not need a State match because the overmatch of other projects already met the minimum non-Federal match for the State as a whole. As a result, the legislature reappropriated all Federal grant funds coming into the State in order to prevent this gubernatorial initiative--a process that was challenged in court by the Governor and threatened the State with the loss of all LEAA grant funds. A recent State court ruling upholding the legislature's power to reappropriate Federal funds has settled the issue in that State.

Since most Federal programs have non-Federal match rates of less than 25 percent which can be met by in-kind resources, we would conclude that matching requirements usually do not call forth intensified deliberation or review by top officials. This is not to say that Federal programs do not receive close scrutiny by top officials of State and local governments. However, we found that other factors integral to Federal grant design may be more important than match in stimulating local review and screening. The absence of matching requirements does not necessarily mean there will be less review of grant proposals by State or local officials.

Many State and local officials told us that the prospects of assuming responsibility for the full funding of project costs when Federal money terminates is a more important factor in deciding whether or not to accept Federal grants. Once started, federally funded projects develop their own constituencies and clientele groups which are dependent on the funded services as well as State and local personnel whose employment is dependent on continued funding of the project. Thus, once Federal funding is terminated, State and local governments often feel pressured to continue the project with State or local money. Officials of a large Midwestern county, for example, felt that the continuation of programs started with Federal

critical factor in promoting State and local central managers' oversight of Federal grant programs. However, when a substantial State fiscal outlay is generated by strong matching requirements, a higher level of real attention by central managers to program operations may be promoted.

Presumably, State or local fiscal and managerial controls are activated and enforced when the jurisdiction has some fiscal stake in the program. Thus, match should enable the Federal grant program to reap the rewards of effective State and local oversight. This rationale was perhaps best stated by an official of the Environmental Protection Agency's Wastewater Treatment Construction Grant program:

"If the community doesn't participate [in the financing] it is like handing them a blank check--they won't participate conscientiously."

Most State and local officials we interviewed, however, stated that match does not cause grantees to exercise more effective central management controls over Federal grant projects. Most jurisdictions said that the same formal financial management controls were exercised for both 100 percent federally funded programs and those with a match. Many grantees said that the threat of adverse audit findings also stimulated management oversight. In fact, in 1970 the city council of a large west coast city instituted a rigorous monitoring process for all Federal grant programs to identify potential problems in program management before they were found by Federal or State auditors. Other officials said that Federal grant funds may receive more management attention than others to assure compliance with Federal regulations.

These findings are consistent with a survey of State and local officials taken by ACIR. In this survey, 86 percent of State agency directors responding agreed that Federal funds are subject to the same financial controls as State funds. 1/

However, this same survey also revealed that 47 percent of these officials felt that their Federal program operations in general were subjected to less central management review or legislative oversight than programs funded with State

1/Advisory Commission on Intergovernmental Relations, "The Intergovernmental Grant System As Seen By Federal, State, and Local Officials," (A-54) (Washington, D.C.; GPO, 1977).

For the NCSL questionnaire, the fiscal officers were asked to rank their legislature's oversight of 11 specific grant programs, (General Revenue Sharing, 2 block grants, 2 open-ended matching programs, and 6 categorical grant programs) with respect to 5 key program elements: objectives, organization, budget, personnel, and substate funds distribution. Responses to the questionnaire were quite revealing of the current variation in legislative oversight. Only five of the programs were subject to a moderate degree of legislative oversight; the other six were ranked as receiving slightly higher than minimal oversight. Not surprisingly, the programs receiving the highest levels of oversight were those which permitted substantial State discretion (revenue sharing and the block grants) or required substantial State financial commitments for matching purposes (Aid for Dependent Children and Medicaid, both with 45-55 percent non-Federal matching requirements). Interestingly, several programs with lower matching requirements (Vocational Rehabilitation - 20 percent; Comprehensive Planning - 30 percent) received less intensive oversight than compensatory education programs which have no required match. This indicates that central oversight and management attention may be promoted by matching requirements only when the requirements are strong enough to generate a large State fiscal commitment.

BENEFITS RECEIVED BY GRANTEEES ARE NOT
REFLECTED BY EXISTING MATCH RATES

Although economists often argue that optimal efficiency in financing public programs is attained when, like in the private market, those who benefit pay the costs, we did not find that the Federal Government uses this argument extensively to justify matching requirements. An optimal Federal grant for an activity, according to advocates of the argument, would have the Federal Government share the costs in proportion to the external, or national, benefits accruing from the project. Correspondingly, a State or local government should be required to provide matching money in proportion to the benefits accruing to its own residents. By requiring State and local governments to share costs in relation to benefits, it is also thought that the self interests of grantees will prevent overexpansion of programs.

In general, however, match rates are not deliberately chosen to reflect any analysis of external versus internal benefits accruing from the program. In fact, an ACIR analysis noted that the Federal Government makes financial contributions to service areas with high local benefits (police protection,

stimulation of new grantee resources is desired. Nevertheless, significant intergovernmental problems can be caused when match requirements are stimulative in nature, especially when the impact of the matching requirements of all Federal grants received by larger State or local governments is considered in the aggregate. We found cases where matching requirements did have the following adverse impacts on all three levels of government:

- Screening out those State and local governments most in need of the Federal program, but unable to fund the required match. As a result, Federal grant funds may be diverted from those grantees that the program was intended to help.
- Distorting the priorities of States and localities, particularly those experiencing budget reductions, by forcing these jurisdictions to reduce resources in nonmatched programs to provide the match to continue or increase Federal funding. This distortion process has intensified in recent years with the growth of Federal grant program initiatives, reflected by the fact that the minimum non-Federal match required for all Federal grants has increased from 8 to 12 percent of State and local own source spending over the past 10 years.

Match can have these adverse fiscal impacts when it is most stimulative in nature. The following conditions seem to promote a significant fiscal effect:

- When the non-Federal match is high, e.g., 50 percent.
- When a cash match must be provided from new resources.
- When the grant program funds new activities or services not previously supported by many State and local governments.
- When the grantees being funded are fiscally poor or small, with no extensive existing resources investments or overhead costs available for allocating as match.

These cases indicate that matching requirements could be a severe fiscal burden to some State and local governments and may also deter the widespread distribution of Federal funds

Raising cash match was a problem for other jurisdictions we visited, especially smaller cities and nonprofit agencies. For example:

- Inability to raise required match for the National Institute on Drug Abuse programs is one reason why a number of local drug abuse programs have been discontinued in one Western State.
- Community action agencies in Midwestern counties we visited rejected available Federal grant funds for alcoholism and senior citizen programs due to an inability to raise the match.

We have noted in prior reports situations where matching requirements impeded the implementation and targeting of Federal grant programs:

- Match, at least partially deterred participation in the Civil Defense Preparedness program by high-risk communities most in need of civil defense preparedness. While these communities' nonparticipation may have been due more to lack of interest in the program rather than lack of funds, the match nevertheless served to screen out grantees most in need of program benefits from the Federal perspective. 1/
- The 50 percent match required under the Outdoor Recreation program prevented needy local governments from fully participating in this grant program. We recommended a variable match rate to account for differences in fiscal capacity. 2/

Officials from larger cities and counties undergoing budget cuts told us that they were not able to apply for all grant money potentially available. The Mayor of New York City stated that at a time when the city was forced to cut its own services and expenditures, loss of Federal funds due to the inability to provide match imposed "a cruel double penalty" on city residents. As a result of the inability to meet all of its matching requirements during a period of extreme budget retrenchment, New York City lost Federal highway, outdoor recreation, and

1/"Civil Defense: Are Federal, State, and Local Governments Prepared for Nuclear Attack?", (LCD-76-464, Aug. 8, 1977).

2/"Greater Benefits To More People Possible by Better Uses of Federal Outdoor Recreation Grants," (B-176823, Oct. 5, 1972).

| | <u>Per capita income rank</u> | <u>State outlays for match as a percent of Federal grants received</u> (percent) |
|----------------|-----------------------------------|-------------------------------------------------------------------------------------------------|
| Hawaii | 8 | 13.2 |
| California | 9 | 42.7 |
| Michigan | 11 | 67.9 |
| Kansas | 15 | 16.5 |
| Pennsylvania | 19 | 55.6 |
| Minnesota | 22 | 55.1 |
| Rhode Island | 23 | 56.9 |
| Arizona | 29 | 17.0 |
| Idaho | 36 | 11.7 |
| South Carolina | 46 | 18.6 |

Source: Advisory Commission on Intergovernmental Relations, Categorical Grants: Their Role and Design, (A-52), 1977, pp. 194-195.

Furthermore, the per capita match for several major grant programs also does not correlate with per capita income as the table below shows. This means that a State like Alabama or South Carolina with low per capita income must tax its residents more than higher per capita income States to meet a similar per capita match. The per capita match for the Medicaid Program, on the other hand, is less for lower income States by virtue of the Federal match formula which varies the match to recognize differences in per capita income. The following table illustrates for three programs the per capita State match needed to use the Federal allotment:

| | <u>Law Enforcement Assistance (10% State-wide match)</u> | <u>Vocational Reha- bilitation (20% State-wide match)</u> | <u>Medicaid (Variable match from 18 to 50%)</u> |
|-------------------------------------------|------------------------------------------------------------------|-------------------------------------------------------------------|---------------------------------------------------------|
| 10 highest per capita income States | \$.199 | \$0.91 | \$50.00 |
| 10 lowest per capita income States | \$.197 | \$1.26 | \$26.00 |

Inadequate Federal policies exist
to adjust or waive the match

Within the context of individual programs, matching requirements are usually fixed and uniform for all grantees. According to the ACIR, only seven Federal programs, including Aid to Families With Dependent Children and Medicaid, adjust match for fiscal capacity as measured by per capita income. Several other grant programs, especially in the public health area, decrease the non-Federal match for poverty areas.

Differing fiscal capacities can also be recognized through reductions in the match ratio, yet, only 7 of the 36 largest grant programs with match allow waivers for grantees in fiscal or economic distress. The criteria for granting waivers vary widely among these programs:

| <u>Program</u> | <u>Criteria</u> |
|---------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Community Action | --Match can be eliminated for grantees unable to meet the match. |
| Construction Grants For Waste- water Treatment Works | --The Federal Government will guarantee loans to localities unable to finance the local share on the bond market. |
| State and Com- munity Highway Safety | --The non-Federal match of 25 percent can be eliminated for Indian tribes. Match can be reduced to 5 percent if State has a large amount of public land. |
| Head Start | --Match may be reduced to further program objectives. |
| Drug Abuse Services | --Match may be reduced for fiscal hardship. |
| Public Works and Economic Develop- ment | --Fifty percent match can be reduced for grantees who (1) have exhausted their revenue resources or (2) are in distressed areas. Match is also waived for Indian tribes. |

In the State or local budget process, the leveraging effect of the State or local dollar can be a key factor used in deciding resource levels among competing programs. The prospect of obtaining a \$9 return of Federal funds for a \$1 investment in State or local match is often irresistible to State and local officials. In a number of cases, State or local governments funded the match for a Federal program due to the favorable ratio of Federal dollars returned, even though the program itself may have been of such low local priority that it would never have received own source funding in the absence of the Federal grant. Since financial resources are always limited in any budget process, funding the match of low priority federally funded projects implicitly involves foregoing the opportunity to commit the same amount of State or local dollars to a non-Federally funded project that may be of higher priority. The table below illustrates the superior "buying" power of one State or local dollar associated with a 75 percent Federal grant program (the bulk of Federal programs have a 75 percent or greater Federal share).

| | Program A (75% Federal grant) | Program B (No Federal grant) |
|--------------------|----------------------------------|---------------------------------|
| Local resources | 400,000 | \$400,000 |
| Federal funds | \$1,200,000 | -0- |
| Total project cost | \$1,600,000 ===== | \$400,000 ===== |

On the financial merits alone, Program A is obviously the superior choice, allowing purchase of 4 times the level of services from a given State or local dollar investment. For Program B to be chosen over Program A, its benefits must be at least 400 percent better in the eyes of State or local officials.

In times of budgetary growth, the price of funding the match can be foregoing the opportunity to begin or expand other programs. For example, officials of a New England State told us that the need to match available Federal highway funds for new construction meant the State could not adequately fund other highway programs of high State priority, such as maintenance.

| | |
|----------------------------------------------------------------------|-------|
| Average reduction for activities receiving substantial Federal funds | 0.7% |
| Average reduction for activities receiving minor Federal aid | 10.9% |
| Average reduction for activities not receiving Federal grants | 14.3% |
| Average reduction for <u>all</u> activities | 10.1% |

The consequences of this distortion have been addressed by a study of New York City's budgetary trends, which argues that federally induced budgetary distortion is harmful to the city's future. The study showed that during periods of growth, the city decided to invest new revenues among competing functions based in part on the Federal dollar return while in periods of budgetary cutbacks, federally funded services can escape severe cuts. The report concludes that the disproportionate reduction in basic services and the shift towards federally funded services was a product of the Federal categorical grant system and was counterproductive to New York City's long-term fiscal, administrative, and social well-being because services that attracted dependent groups to the city continued to be funded while basic "housekeeping" services that benefit the entire city were cut. 1/

It is clear that, as State and local governments have become more dependent on Federal funds, the distortive impacts of matching requirements may become more severe. On a national basis, minimum non-Federal match required for all Federal grant programs has increased from 8 to 12 percent of State and local own source expenditures since 1971. The amount of local funds available for discretionary purposes may have declined proportionately. Distortion has certainly increased in the eyes of State officials: a recent nationwide survey of State agency heads revealed that the percentage agreeing that Federal funds distort priorities for State programs has increased from 29 percent in 1948 to 83 percent in 1974.

1/Temporary Commission on City Finance, "An Historical and Comparative Analysis of Expenditures in the City of New York," (1976).

If the purposes of matching are to be achieved, we believe that matching requirements would have to be significantly strengthened. Any effort to strengthen matching requirements should address the following weaknesses:

- Many grant programs do not have maintenance of effort requirements and do not explicitly require match to consist of new grantee resources that would otherwise not be spent. Match can be provided from existing State and local funds.
- Many grant programs allow match to be met in the aggregate, which can reduce the stimulative impact of match on particular program projects.
- Federal grant funds in several large programs can be used as grantee match reducing the need to increase State or local resources.

In addition, the requirements do not usually relate the rate of match to the differing fiscal capacities of State and local governments, further accentuating the inequities of matching requirements. Grantees with good fiscal outlooks and extensive existing resources have little trouble meeting matching requirements with their existing resources while those with inadequate resources may lose out on Federal grant programs. Also, because most matching requirements cannot be waived, communities experiencing fiscal decline must pay a high price to fund their matches and thereby continue the flow of needed Federal grant dollars by disproportionately cutting basic services not Federally funded. The fiscal strain induced by matching requirements on communities already undergoing fiscal problems may not be in keeping with various Federal grant policies designed to assist fiscally distressed communities.

RECOMMENDATIONS TO THE CONGRESS

Because of the diversity of the Federal assistance system, universal prescriptions for matching requirements in grant programs are not feasible. As a minimum, however, greater attention needs to be paid to the impact of each matching requirement on the fiscal resources and discretion available to State and local governments in the aggregate. Accordingly, we recommend that match be used more sparingly in Federal programs and only after careful deliberation. Most importantly, we believe that a matching requirement is not desirable when the primary purpose of the grant program is to distribute funds broadly to

As a vehicle to implement these recommendations, the Congress may wish to set forth its policy on matching requirements in the form of an amendment to the Intergovernmental Cooperation Act of 1968, (42 U.S.C. 4201). This act was designed to improve the administration of grants-in-aid to State and local governments and to achieve improved cooperation and coordination of activities among the levels of government. We recognize that this would not be a self-policing measure, in that individual pieces of legislation could contain matching provisions in conflict with these policies. Therefore, each House of Congress may wish to designate a single point of referral to review the matching requirements contemplated by proposed grant program legislation.

In a study completed in 1977, ACIR concluded that:

"* * * committees generally pay closer scrutiny to the national purpose policy decision and less attention to the proportion of costs for which each level of government should be responsible* * * when Congress does consider reimbursement percentages and matching ratios, it is generally in terms of whether non-Federal requirements should be lower or remain the same. Congress seldom gives explicit consideration to the rationale for any particular cost-sharing level and even less attention to the underlying principles reflected in cost-sharing arrangements."

Match rates differ within the same functional area

Match rates often differ for similar programs in the same functional area as shown in appendix II. The inconsistency among match rates within a program may be intended to reflect relative national priorities. For example, the basic Vocational Education grant to the States requires a 50-percent match, but certain demonstration programs and grants targeted for the disadvantaged require no match at all, presumably due to the high national benefit inherent in demonstration programs.

However, many variances within program areas cannot be accounted for, except by noting that grant programs serving the same functional area are often authorized by different congressional committees and implemented by different administrative agencies. As a result, several Federal programs funding similar grantee activities have different matching rates. For example:

--Social services. Federal funding for day care is available under a number of Federal programs with different matching requirements. The Title XX Social Services Block Grant program requires a 25 percent State match for most of its funds and no match for \$200 million of additional Federal funds appropriated separately. The Work Incentives Program (WIN) also funds day care for welfare recipients but requires a 10 percent State match. Day care can also be funded with Community Action funds, which require a 20 percent local match.

First, some programs with higher non-Federal matching rates may be underutilized by grantees seeking out similar programs with lower non-Federal matching rates. In some cases, this differential in match rates may be intended by the Congress and the agency as a way to better direct the use of limited program funds by grantees. For example, LEAA authorized a 90 percent Federal share for most programs, but only a 50 percent Federal share for construction projects, thus insuring that States did not widely use LEAA funds for construction purposes. As a result, limited Federal dollars were not concentrated on building expensive new facilities but spread more broadly to a number of projects.

However, in some cases, different match rates in the same functional area seem to occur unintentionally from the uncoordinated Federal actions. In these cases, the match rates essentially do not reflect the relative priority of the various Federal programs. As a result, some Federal programs may be underused by grantees seeking similar grant programs with lower non-Federal match rates. For example:

--Local governments used only a small percent of Highway Trust funds for urban mass transit projects, even though the Congress has encouraged using these funds as a way to increase use of mass transit and reduce highway congestion in urban areas. Key Members of Congress became concerned about the underutilization of highway money for mass transit and asked us to review the problem. We found that one reason communities were not using highway funds for mass transit was that the non-Federal rate for urban system highway aid was 28 to 30 percent for most States, but the same community could receive Federal funding with only a 20 percent match if its mass transit projects were funded by the Federal Urban Mass Transit capital improvement grant program. 1/

--In his 1977 Water Resources policy proposals, the President declared that differing matching rates in the water resources area biased grantee project selection against water resource options

1/"Why Urban System Funds Were Seldom Used For Mass Transit," (CED-77-49, Mar. 18, 1977).

most programs generally prohibit the use of Federal funds as a source of match, a few Federal programs, such as General Revenue Sharing and the Community Development Block Grant, authorize the use of program funds to satisfy the matching requirements of other programs. (See p. 14.)

States further vary matching requirements

The variety of matching arrangements facing local governments proliferate due to State actions. Most Federal grant programs that pass funds through the States to local governments allow States to change the match required of local governments. We found that States frequently take advantage of this opportunity.

In some programs, State agencies have imposed stricter matching requirements on local governments. For example, since 1973 the LEAA program required only a 5-percent match from local governments, but most States imposed a higher local match which increased over the life of the project. Other State policies which make it more difficult for local governments to meet matching requirements include (1) requiring all match to be in cash although the Federal program allows in-kind and (2) limiting the recognition of indirect costs.

On the other hand, many States vary the match required of local governments on the basis of relative need or ability to pay. One Western State, for example, establishes the local match for Federal social services programs on the basis of a formula that considers population whereas another Western State varies the local match for Maternal and Child Health Care on the basis of need and ability to pay. In addition, some States fund a part of the match, thereby reducing the match required of local governments. Two New England States, for example, contribute a substantial share of the 50 percent local match required for the Outdoor Recreation Program.

DIFFERING MATCHING REQUIREMENTS ADVERSELY AFFECT ALL LEVELS OF GOVERNMENT

When they have a choice, grantees apply for grants with a lower non-Federal match, even if this distorts their priorities. While it may be rational for grantees to "shop around" for the most favorable match rate, the distortion towards lower non-Federal match programs may not have been intended by Federal policymakers and in fact has inhibited the implementation of some Federal programs.

CONCLUSIONS

Matching rates need to be rationalized and made more uniform within functional program areas to avoid unintended distortions of Federal, State, and local priorities. While the Federal Government may find it impossible to comprehensively rank its priorities and assign an appropriate match rate, it needs to better coordinate the development and reauthorization of grants in the same functional program area to minimize unnecessary differences in the rates or types of match required. In pursuing uniformity, it should also reexamine the authority of States to vary match rates.

RECOMMENDATION TO THE CONGRESS

We recommend that the Congress make match rates more uniform within each functional program area to avoid conflicts that may impede the achievement of Federal objectives. In making such changes, the Congress should consider how much latitude the States should have to modify federally determined matching requirements.

To facilitate this process, the Congress may wish to consider amending the Intergovernmental Cooperation Act of 1968 to enable the President to propose plans to standardize match rates within functional program areas subject to Congressional approval.

is used to substitute for ongoing or planned State and local expenditures, the ultimate effect of the Federal program funds is to provide fiscal relief for recipient States and localities rather than to increase service levels in the program area. When fiscal substitution occurs, narrow-purpose categorical Federal programs enacted to augment service levels are transformed, in effect, into broad purpose fiscal assistance like revenue sharing. Maintenance of effort provisions, if effective, can prevent substitution and ensure that the Federal grant is used by the grantee for the specific purpose intended by the Congress.

The Congress has expressed a strong interest in effective maintenance of effort provisions in several major grant programs. For example, the House Committee Report on the 1978 Education Amendments stated that "Federal aid must supplement-- not supplant--State and local expenditures. The historic intent is that Federal dollars must represent an additional effort for the target [program] * * *." (Underscoring supplied.) Likewise, Congressional concern over substitution of federally subsidized public service jobs for regular State and local positions culminated in the 1978 Comprehensive Employment and Training Act amendments designed to maximize the use of Federal funds to increase employment and minimize its use as fiscal relief by grantees.

Most Federal grant programs incorporate some kind of maintenance of effort requirement. Of the 52 largest grant programs (\$100 million or more in annual outlays), 39 have maintenance of effort requirements. In dollar terms, programs with maintenance of effort accounted for over \$62 billion in fiscal year 1980 grant outlays. The table in appendix III displays the types of maintenance of effort provisions found in these Federal grant programs.

Generally, two types of provisions are found in Federal grant programs to ensure maintenance of effort:

- Fixed level of effort: requires grantees to maintain at least some prior-year level of spending for the program area. Reductions in grantee spending are penalized by reductions in the Federal grant, even if they are bona fide and would have occurred in spite of the grant.
- Nonsupplant: requires that Federal funds be used to supplement, not supplant, grantee funds that would otherwise have been expended in the absence of the Federal grant. Unlike fixed level of effort,

Base periods for determining State and local expenditure effort are inadequate

Of the 39 largest programs requiring maintenance of effort, 28 have fixed level of effort provisions. Of these, 11 set a fixed base year that is not updated for grantee expenditures. As shown by the table in appendix III, programs have base years going back as far as 1934 for highway spending, 1968 for maternal and child health care, and 1972 for vocational rehabilitation services.

Outdated fixed level provisions permit a high degree of fiscal substitution. For example, in the Maternal and Child Health Care program, a West Coast State was only required to maintain its 1968 expenditures of \$4.7 million. Since its current expenditures for this program approached \$200 million, the State could use its entire \$10 million Federal grant to substitute and still have enough effort to satisfy the Federal requirement 42 times over. Similarly, the 1972 base year expenditure figure for the Rehabilitation Services program is so low that this State exceeds its 1972 spending levels by simply providing the 20 percent State match needed to draw down the entire Federal allotment.

While fixed level requirements with a moving or updated base year presumably do not allow for as much substitution, inflation can still render the spending levels of prior years obsolete if service levels are to be maintained. For example, with a 10 percent annual increase in inflation, a State or local government that funded at the same salary rate 10 special education teachers last year can only support 9 teachers this year if it maintains last year's spending level.

Eighteen of the 28 Federal programs with fixed levels of effort included a provision with a moving or updated base year. With the exception of CETA, fixed level requirements do not require maintenance of prior service levels.

Overly broad or vague level of effort definitions permit substitutions

Fixed level of effort provisions are sometimes too broad to ensure that Federal funds for each project are supplementary. Grantees can maintain their prior fiscal effort in the broad program area, and still substitute Federal for non-Federal funds for projects within the broad program area. For example, a Midwestern county was allowed to use LEAA funds for a public defender program as long as the county's total criminal justice spending increased. Similarly, program management officials

program told us States that honestly report all vocational education expenditures could be penalized by having to maintain that level of effort in future years.

Others did not feel it was worth the time and effort to identify additional expenditures for maintenance of effort where they had already met or exceeded Federal matching requirements because identifying these additional State or local expenditures would not enable them to draw down any additional Federal grant funds.

Underreporting creates a good opportunity for grantees to supplant this "hidden reserve." As new Federal funds become available, they can be used to replace these unreported State or local expenditures without Federal knowledge. In our opinion, this tendency is abetted by the overly broad and vague definitions of effort imposed by the Federal Government.

Fixed level of effort provisions
cannot prevent "prospective" fiscal
substitution

Fixed level requirements are inherently unable to control for substitution, even if they were updated to account for inflation, because they cannot prevent "prospective" substitution, i.e., the withdrawal of planned State and local funding commitments as a result of receiving Federal grant programs.

Several local governments we visited told us that Federal funds freed up local money that would "otherwise" have been spent. For example, a Midwestern city official told us that Federal Highway Safety funds were used to purchase ambulances that the jurisdiction would otherwise have had to buy later with its own funds. Several governments in our review withdrew appropriations for new programs when Federal funds became available. Because this money had not yet been spent, fixed level provisions would not be applicable. Likewise, a prominent economist has suggested that the \$2.5 billion Public Works program of 1976 which funded a wide range of local government public work projects, may have been used by many State and local governments to fund new capital projects that they otherwise would have supported with their own money. As a result, State and local capital spending from their own source revenue plummeted in the year following passage of this program. 1/

1/Edward M. Gramlich, "State and Local Budgets, The Day After It Rained: Why Is The Surplus So High?," Brookings papers on Economic Activity, (January 1978).

Some programs abdicate any pretense of enforcement. For example, regional officials at the Community Services Administration told us that they do not audit for nonsupplant. LEAA officials told us that the agency will not uphold nonsupplant audit findings for individual projects. An official with the Adult Education program told us that because program reviews are done for 1 week every 5 years in each State, there is insufficient time to audit for compliance with nonsupplant provisions. An official with the Agriculture Department told us that nonsupplant is not enforced in the Child Care and Summer Food Service programs due to the lack of criteria defining nonsupplant violations. Due to the administrative burden imposed, a Department of Health, Education and Welfare (HEW) Grants Administration Advisory Committee, in a 1969 report, recommended that nonsupplant requirements be eliminated.

Problems encountered by Federal program officials who have attempted to enforce the requirement further illustrate the enforcement issue. Specifically, two major programs--Title I, Elementary and Secondary Education program and CETA--have made special efforts to enforce nonsupplanting requirements due to mounting Congressional concern that program funds were being dissipated in fiscal relief and not reaching intended beneficiaries. Both programs have established elaborate tests to identify supplanting. Yet, an HEW study showed that tests needed to determine supplanting in the Title I program forced HEW to involve itself in determining the appropriateness of the use of Federal funds for each service provided by local schools. This led to a level of Federal involvement in local educational policymaking that was unacceptable to Office of Education program officials. As a result of the internal conflict on this issue, management reviews and audits of nonsupplant have declined appreciably in recent years.

The CETA program imposes an array of specific requirements to enforce nonsupplant. However, in spite of the intense Congressional concern on this issue, the agency feels that it can only pursue supplanting violations on a complaint basis. Agency officials feel that a large bureaucracy would be needed to review the public service employment plans of each grantee to determine if CETA participants are being used to substitute for regular local employees. Furthermore, the Director of the CETA program told us that it is impossible for the Labor Department to analytically determine what local governments would do in the absence of CETA funds. The Labor Department considered launching an effort to project public employment levels of a city based on historical data and then hold the city to continuing to fill its "normal" quotient

country. Neither Federal agency nor grantee personnel were aware of the implicit criteria being used to assess supplanting. As a result:

- Two-thirds of the supplanting cases found by the Office of Education used services rather than funds as the basis for measuring grantee effort. The choice of services or funds often determines whether a supplanting violation exists.
- The level of analysis used to evaluate effort was chosen based on the availability of data and records and varied significantly among the audits studied.
- Different timeframes were applied in different reviews to define grantee effort. The same practice could be condoned if grantee effort is defined in prior year terms (i.e., fixed level criterion) but be cited as a supplanting violation if grantee effort is defined in terms of future commitments.
- The Federal agency often overruled audit findings of supplanting due to basic internal disagreement over the supplanting issue. Specifically, program reviews and audits done by Federal education officials were inconsistent in their use of services as the unit of measurement, the level of analysis used to evaluate supplanting violations, and the burden of proof for supplanting violations.

As a result, Federal auditors and managers were confused and refrained from taking action on supplanting cases. The study noted a marked decline in supplanting findings made in program reviews in recent years.

Exclusion of General Revenue Sharing
Funds hampers effective maintenance
of effort requirements

Federal maintenance of effort requirements relate only to fiscal effort funded by State and local sources. Federal grant funds, including General Revenue Sharing, are not included as part of the base. The supplemental effect of Federal grant programs can be negated if Federal funding sources are merely substituted for other Federal grants.

policy of encouraging the funding of innovative projects. Under the LEAA program, State Planning Agencies use innovativeness as a criteria for awarding Federal pass-through funds among competing applicants. LEAA officials feel that this policy protects against fiscal substitution more than the maintenance of effort requirement.

Concerned by studies showing widespread fiscal substitution, the Congress amended CETA to require grantees to create new projects for CETA participants. To ensure the temporary nature of CETA-subsidized jobs, the Congress also placed tight restrictions on eligibility, limited the duration of employment for any one employee under CETA, and lowered the maximum and average wage rates that local governments could pay CETA workers.

Federal restrictions on reimbursements for State or local administrative costs can be another strategy used to prevent fiscal substitution. Although OMB Circular A-87 directs Federal agencies to recognize all administrative and indirect costs allocated to the grant project, legislation authorizing grant programs sometimes places limits on administrative costs on the grounds that indirect overhead expenses of grantees would be incurred regardless of the Federal grant. For example, Title I of the Higher Education Act of 1965 limits reimbursements for State administrative costs to 5 percent of total program costs.

State and local fiscal and political pressures
may induce expansion, not substitution

It would be erroneous to assume that the primary aim of State and local governments in using Federal funds is to substitute or displace their own resources. Although some central budget officials might seek to use Federal funds for fiscal relief, substantial fiscal and political pressures can induce these officials to use Federal funds for program expansion instead of substitution.

Temptations to supplant would seem to be greatest for Federal block grants where funding is potentially available for a wide range of services currently being funded from State or local sources. Yet, major studies by the Brookings Institution of the fiscal effects of two major block grant programs--CETA and Community Development--found substitution to be far less than has been assumed. Under CETA, displacement accounted for 20 to 25 percent of the positions supported by CETA. Under

find cases where maintenance of effort requirements not only prevented cuts and distorted priorities, but also penalized program innovation and expansion. Inconsistent and vague requirements have also led to grantee confusion. These cases indicate that maintenance of effort requirements could be a significant burden to governments facing budget cutbacks, and should give pause to those who would strengthen and strictly enforce maintenance of effort requirements.

Fixed level of effort can penalize
bona fide budgetary reductions

State and local governments that have a legitimate need to reduce spending can be thwarted by fixed level of effort requirements. Budgetary reductions necessitated by fiscal crisis, taxpayer revolts, or productivity improvements could trigger either a proportionate or total withdrawal of Federal funds. To retain their Federal grant funds, State and local governments can either reallocate necessary reductions to programs not receiving Federal grants or decide not to implement reductions.

In theory, maintenance of effort requirements are designed to prevent only contrived budget reductions by governments seeking to replace their own funds with Federal grant funds. Bona fide State or local grantee budget reductions caused by independent events that would have occurred regardless of the Federal grant could theoretically occur without supplanting taking place because grantee spending levels would decline regardless of the presence of Federal funds. While nonsupplant requirements allow Federal agencies to consider the nature of the reductions, fixed level of effort requirements without waiver authority can penalize all expenditure reductions regardless of the cause. Of the 28 largest programs with fixed level requirements, 17 do not explicitly allow the Federal agency to waive the requirement for grantees with bona fide fiscal problems.

Reductions due to fiscal crisis

Governments in fiscal distress must cut disproportionately in programs not protected by maintenance of effort requirements, or face the loss of Federal grant funds. City officials in both a large Northeastern and Western city told us that budget cuts had to be directed at city departments without CETA participants, due to CETA's prohibition against layoffs of regular employees in job titles with CETA participants.

In contrast, the fiscal crisis in another large Northeastern city caused it to terminate funding for adult education, which triggered a total withdrawal of the city's Federal

appear to be wasteful from a more narrow State and local perspective may be viewed by Federal officials as being beneficial to the nation as a whole.

Maintenance of effort requirements
can distort State and local priorities

When they are effective, maintenance of effort requirements can also inhibit the ability of State and local governments to allocate their own funds as well as Federal funds in accordance with State and local priorities. While Federal officials may intend through maintenance of effort to ensure that Federal priorities are realized, the aggregate impact of all maintenance of effort requirements on the flexibility available to State and local budget officials may not be fully appreciated at the Federal level.

Maintenance of effort limits budgetary flexibility

The flexibility available to State and local governments to budget their own funds in accordance with their own priorities could be limited by effective maintenance of effort requirements. The potential inhibiting effects of maintenance of effort requirements on State and local budgetary flexibility can be more readily appreciated in the aggregate. A large local government can be required to maintain its spending at some previous years' level as a condition for receiving Federal assistance in the following areas:

- Law Enforcement to qualify for LEAA funds.
- Mass transit for Urban Mass Transit operating subsidies.
- "Services to meet the needs of the poor" for Community Action funds.
- Community mental health expenditures for Community Mental Health Staffing Grants.
- General education for a number of Federal education programs.
- Child nutrition for several child nutrition programs.
- Local public services eligible for Community Development Block Grant funding.

--A large Eastern city complained that LEAA's non-supplant requirement forced the city to allocate its LEAA grants to new innovative projects at the same time that several thousand police officers were being laid off and other criminal justice services were being cut back.

--The Budget Director of a large Midwestern city felt that Community Development Block Grant funds should be used to reduce the local tax burden at a time of fiscal austerity. However, city agency officials discouraged him by arguing that the program's maintenance of effort provisions preclude the use of block grant funds for this purpose.

Fixed level of effort requirements can lead to inefficient large programs by forcing State and local governments to maintain a high level of existing funding that may no longer be necessary due to the presence of Federal funds. State and local fiscal officials told us that because of maintenance of effort requirements, necessary reductions of State funds could not be made. The result was the continuation of unnecessarily large programs. For example:

--A Western State had to appropriate more State funds for libraries than the legislature felt was needed when additional Federal Library Services and Construction Act funds became available because of the program's maintenance of effort requirement.

--Budget officers of a Mid-Atlantic county felt that the county's air pollution budget was excessive but felt that it couldn't be cut due to the Federal requirement for spending to be maintained at last year's levels as a condition for receiving air pollution control grants.

--Budget officers of a Midwestern State said that the Federal Library Services and Construction program forced them to maintain spending above normal levels for libraries due to previous spending on a one-time effort to update regional State libraries.

One State we visited risked the consequences of violating maintenance of effort requirements. To avoid a larger than needed program, the State withdrew \$2 million of its own funds when \$2 million of new Federal money became available for vocational rehabilitation.

result, State and local governments could defer program initiation until Federal program funds are available. We found this to be the case in a Western State where local governments waited to buy recreation land until Federal Outdoor Recreation funds became available. According to a State official, these deferments result in higher project costs due to rising land values.

Inconsistent and vague requirements lead to grantee confusion on maintenance of effort

The inconsistencies of fixed level requirements and the vagueness of nonsupplant requirements create confusion for State and local fiscal officers called upon to make budgetary decisions. The vagueness of nonsupplant provisions makes it very difficult for these officials to know with any certainty the reaction of the Federal Government to a particular budgetary action reducing State or local funds.

The National Institute of Education study of the administration of Title I, Elementary and Secondary Education Act, notes that Federal program officials were unable to give State and local officials clear guidance on how to restructure their programs to avoid supplanting because of the internal Federal confusion on this issue. State education officials can exploit this conflict by working closely with those Federal officials whose supplanting positions are more lenient.

We found several cases where Federal regional agencies dealing directly with grantees were unclear themselves about the nature and scope of their program's maintenance of effort requirements. In one case, Federal officials in two different regions responsible for the Outdoor Recreation program both asserted that this program has neither a fixed level of effort nor a nonsupplant requirement. However, headquarters staff correctly noted that each grant agreement contains a nonsupplant requirement.

We found that local agency program specialists, anxious to avoid budget reductions in their programs, can step into this policy void and communicate misleading or erroneous interpretations of maintenance of effort requirements to central budget officials. These officials rely on their program specialists for interpretations of complex Federal rules. For example:

--A Southern State legislature for several years, was led to believe that the maintenance of effort provision of the Social Services Block Grant program (Title XX) precluded State use of Federal funds for

- The base period be defined as the average grantee expenditures over the prior 3 years.
- Nonrecurring expenses be excluded from calculations of the base level.
- Scope of effort be limited to Federal grant-eligible activities.
- Penalties for reduction in effort be proportionate, not total reductions of grant funds.
- Nonsupplant requirements be eliminated.

The Department did not adopt the recommendations of this Committee.

CONCLUSIONS

Maintenance of effort requirements serve a central Federal purpose by ensuring that Federal grant funds are used to support additional program activities as intended by the Congress, not to replace State or local support for these activities. When substitution occurs, categorical grants enacted to provide services in the given program are in effect transformed into general fiscal assistance grants and used by States and localities for their own discretionary purposes.

Most existing maintenance of effort requirements, however, are not strong enough to prevent a significant amount of fiscal substitution by State and local governments. Fixed level of effort requirements are seldom updated to keep pace with inflation. When they are relatively current, fixed level requirements still cannot prevent prospective fiscal substitution that occurs when grantees cancel planned funding commitments that they otherwise would have funded. Nonsupplant requirements, on the other hand, theoretically control both fiscal retrenchment as well as prospective substitution. However, they are rarely enforced by Federal agencies due to the substantial conceptual and practical problems involved in ascertaining State and local spending intentions. Therefore, stronger maintenance of effort provisions are needed if the Congress is to adequately ensure the supplementary nature of Federal grant funds.

Stronger maintenance of effort provisions, however, although justifiable from the standpoint of each Federal program, may discourage State and local governments from participating in grant programs.

- The activities for which effort is to be maintained should be the same as the activities eligible for Federal reimbursement, not broader. This would help minimize the scope of grantee expenditures controlled and reduce the vagueness of current overly broad requirements.
- Penalties for reducing effort should be a proportionate reduction in Federal funds, not total withdrawal. By reducing the penalty, this change would make it easier for State and local governments to cut back in Federally funded programs to reflect their own priorities. However, the Federal funds should be reduced by no less than the same percentage reduction applied to State or local funds to insure that the Federal Government's share of program costs does not increase. Careful Federal monitoring would be needed to determine if this change leads to a reduction in State and local effort for selected Federal programs, which could indicate either that the maintenance of effort provision should be strengthened or that the need for the Federal program itself be reassessed.
- Waiver authority should be incorporated in programs to allow for bona fide grantee spending reductions due to genuine fiscal problems or management improvements. To minimize conflicts among programs and subjectivity, the Congress should consider designating a Federal agency to promulgate Government-wide criteria to guide agencies on the eligibility of grantees for waivers.

Waivers allowing a certain amount of fiscal substitution for innovative grantees with pre-existing programs may also be desirable to avoid providing disincentives to innovation. However, such waivers may not necessarily be appropriate for all programs. A major purpose of some grant programs, for example, is to equalize benefits or services across the entire Nation by enticing all States into a program previously provided by only some States. For these programs, it may be more appropriate and a more effective utilization of limited Federal resources to provide funds only to States without prior programs.

We recommend that nonsupplant requirements not be used due to the problems involved in their enforcement. We recognize that our recommended standard fixed level of effort requirement cannot prevent the prospective substitution of

CHAPTER 5

AGENCY COMMENTS AND

OUR EVALUATION

OFFICE OF MANAGEMENT AND BUDGET

OMB felt that the report was an interesting and useful analysis of the effects of matching and maintenance of effort requirements. In response to our recommendations, OMB agreed to revise the Catalog of Federal Domestic Assistance so that programs with a maintenance of effort requirement will be identified. Prospective applicants could then obtain details about the requirements along with other details about the program from the Federal funding agency.

OMB had a number of specific comments on other aspects of the report. It suggested that our recommendation that the Congress enact cross-cutting policies for matching and maintenance of effort would not affect the consideration of these requirements in the development of individual programs. We agree that our proposal would not necessarily be self-policing and modified the report to suggest that the Congress may wish to establish a single point of referral within each House to consider matching and maintenance of effort requirements when proposed in legislation.

OMB disagreed with the specific element of our maintenance of effort recommendation that would penalize grantee spending reductions with a proportionate, not total, reduction in Federal grant funds. OMB believes that adoption of this element would give grantees an incentive to reduce their spending, and thereby substitute Federal for State or local funds until the combined total of non-Federal and Federal funds equaled the level of non-Federal funding prior to the grant. This is an area where no solution can simultaneously satisfy the interests of both levels of government. Total reduction, while it protects the Federal interest, constitutes a severe penalty with effects on State and local budgets and priorities that may be inappropriate during a period of budgetary retrenchment. Moreover, if incorporated into every major grant program, an overly stringent maintenance of effort requirement could actually harm the Federal interest by discouraging State and local participation in grant programs. The sanction of total withdrawal would appear especially inequitable in those programs where Federal grant outlays have actually declined in recent years.

THE CHANGING CONTEXT OF
THE INTERGOVERNMENTAL GRANT SYSTEM

Over the past 30 years, the size of the Federal grant system has grown dramatically to a point where over 25 percent of State and local expenditures now consist of Federal grant funds. Accordingly, the Federal Government has become more involved in funding and regulating a broad range of State and local services.

However, since the mid-1970s, the growth rate of State and local expenditures themselves has declined, with actual budget reductions occurring in many jurisdictions. This slowdown in the State and local sector combined with the growing Federal fiscal presence raises new questions about the appropriateness of grant policies like matching and maintenance of effort that seek to stimulate additional State and local expenditures. The appropriateness of stimulation as an objective of Federal grant policy is also questionable in view of the series of Federal programs and policies developed in the 1970s to ease fiscal pressures facing State and local governments.

DECLINING STATE AND LOCAL
EXPENDITURE GROWTH

During the 25-year period ending in 1974, the State and local sector was the Nation's leading growth industry. Expenditures increased at a faster pace than the Federal Government and the private sector. Also, between 1956 and 1976, State and local sector employment increased almost 160 percent, compared to 23 percent for the Federal Government and 57 percent in the private sector. However, since 1975, a slowdown in the rate of growth has occurred, as shown in the following chart:

State and local expenditures from own source revenues fell from 11.5 percent of Gross National Product in 1975 to 10.5 percent in 1979. Comparable declines in the rate of growth in State and local employment have also been registered from a 7.6 percent annual rate of growth between 1949 and 1974 to a 2.5 percent rate between 1974 and 1979.

This slowdown can be attributed to budgetary cutbacks undertaken by many State and local governments either by choice or necessity.

Cutbacks by necessity

Some central cities in the Northeast and Midwest have not been able to stem the erosion of their economic base. Businesses and revenues have tended to flee older central cities as social problems accumulate. While the social problems of the Nation's older cities have been with us at least since the 1960s the combination of recession and inflation in the mid-1970s has caused fiscal and governmental problems as well. As these cities can no longer stretch shrinking revenues to meet their growing social needs, many have been forced to cut back. In 1976, for example, more than half of the Nation's 20 largest cities reduced the number of employees on their payrolls. Leading students of urban finance expect this mismatch and consequent budget declines experienced by these cities to continue. 1/

Cutbacks by choice

Recently, other State and local governments have been forced to cut back on public spending due to citizens' desires to reduce their tax burdens. Opinion polls confirm a growing public distaste for government spending. A Time magazine poll showed in 1958 that only 42 percent of the people felt government spending to be excessive, while in 1978, over 78 percent felt this way.

Passage of Proposition 13 by California voters in June 1978, triggered a new wave of tax reductions in jurisdictions throughout the Nation. California's Proposition 13 reduced local property taxes to one percent of market value, depriving California's local governments of \$6 billion in annual

1/Roy Bahl "Federal Policy and the Fiscal Outlook for Cities," paper prepared for the Conference On Fiscal Crisis and the American City, Washington, D.C., June 15, 1978.

Growth of Federal Assistance

The Federal Government became involved in the 1960s and 1970s in funding services traditionally dominated by State and local government. In 1965, the Federal Government funded only two functional areas at levels exceeding \$1 billion. The following table shows that this involvement has been dramatically extended in recent years.

| Function | YEAR | | | | | |
|-------------------------------------------------------|--------------------------------------------|---------|---------|---------|---------|---------|
| | 1950 | 1955 | 1960 | 1965 | 1970 | 1975 |
| | ----- (In millions of dollars) ----- | | | | | |
| Income Security | \$1,335 | \$1,715 | \$2,648 | \$3,530 | \$5,813 | \$9,279 |
| Commerce and Transportation | - | - | 3,001 | 4,100 | 4,545 | 5,872 |
| Education, Training, Employment, and Social Services | - | - | - | - | 5,745 | 11,638 |
| Health | - | - | - | - | 3,831 | 8,810 |
| Community and Regional Development | - | - | - | - | 2,428 | 3,335 |
| Revenue Sharing and General Purpose Fiscal Assistance | - | - | - | - | - | 6,971 |
| Natural Resources, Environment, and Energy | - | - | - | - | - | 2,497 |

Source: Advisory Commission on Intergovernmental Relations, Categorical Grants: Their Role and Design, A-52, 1977, p. 38.

their own. Other programs fund only initial capital construction costs, such as the sewage treatment construction program, but leave operation and maintenance of new facilities for funding entirely from State and local sources.

In addition, mandates and regulations imposed as conditions for receiving grants can have major financial implications. While local governments are not directly required to comply, the potential loss of Federal assistance is usually punishing enough to force compliance. A recent comprehensive study of mandates found that 1,260 Federal mandates exist in laws and regulations as conditions for the receipt of Federal grant funds. The costs of implementing these mandates attached to Federal grant programs were paid from local revenues in over 45 percent of the cases. ^{1/} For example, substantial costs involved in complying with Federal safe drinking water standards are not federally reimbursed at the present time, while the Federal Government shares only 12 percent of the costs of compliance with the Federal program requiring free public education for handicapped children.

GROWING FEDERAL CONCERN FOR STATE AND LOCAL FISCAL STABILITY

The period that spawned the explosion of categorical grants was also marked by the emergence of a series of countervailing Federal policies seeking to give fiscal relief to State and local governments. The Federal Government has manifested a growing interest in both the overall fiscal viability of the State and local sector as well as the fiscal impact of the Federal grants system on States and localities.

This Federal concern became evident in the 1970s with passage of the General Revenue Sharing program, a loan program to help fiscally troubled New York City, and a countercyclical program of general purpose aid to local governments experiencing the fiscal fallout of national recession. In addition, block grants were established in the 1970s to give States and localities broader discretion in using Federal funds. Generally, the block grants give Federal fiscal assistance and support to State and local governments for implementing their own priorities within broad Federal

^{1/}"Federal and State Mandating on Local Governments: An Exploration of Issues and Impacts," Report by the Graduate School of Administration, University of California at Riverside to the National Science Foundation, June 20, 1979.

FEDERAL DOMESTIC GRANT PROGRAMS BY BUDGET FUNCTION AND MATCH RATE 1/

| <u>Functional program area</u> | <u>0% match</u> | <u>1-10% match</u> | <u>11-25% match</u> | <u>26-49% match</u> | <u>50% & over match</u> | <u>Variable match</u> | <u>Cost sharing</u> | <u>Total grant programs</u> |
|---------------------------------------------------|---------------------|------------------------|-------------------------|-------------------------|---------------------------------|---------------------------|-------------------------|---------------------------------|
| <u>NATIONAL DEFENSE</u> | | | | | | | | |
| Department of Defense- military | 1 | - | 1 | - | 5 | - | 0 | 7 |
| <u>GENERAL SCIENCE, SPACE, AND TECHNOLOGY</u> | | | | | | | | |
| General science and basic research | - | - | - | - | - | - | 7 | 7 |
| <u>ENERGY</u> | | | | | | | | |
| Energy supply | - | - | - | - | - | - | 1 | 1 |
| Energy conservation | 3 | - | - | - | 1 | - | 2 | 6 |
| Energy information, policy and information | 1 | - | - | - | - | - | 1 | 2 |
| <u>NATURAL RESOURCES AND ENVIRONMENT</u> | | | | | | | | |
| Water resources | 1 | - | - | - | 3 | - | 2 | 6 |
| Conservation and land management | 2 | - | 2 | 2 | 4 | - | 4 | 14 |
| Recreational resources | - | - | 2 | - | 2 | 2 | - | 6 |
| Pollution control and abatement | 4 | 10 | 5 | - | 1 | 6 | 1 | 27 |
| Other natural resources | 1 | - | 1 | - | 1 | - | - | 3 |

| <u>Program title</u> | <u>CFDA number</u> | <u>Maintenance of effort requirement</u> | <u>Base for fixed level requirement</u> | <u>Can MOE requirement be waived?</u> | <u>Sanctions for not maintaining effort</u> | <u>Fiscal year 1980 Federal outlays</u> (millions) |
|--------------------------------------------------------------------------------------|--------------------|------------------------------------------|--------------------------------------------------------------------------|---------------------------------------|-----------------------------------------------------------|-------------------------------------------------------|
| Program for Education of Handicapped Children in State Operated or Supported Schools | 13.427 | Fixed level | Preceding year compared to second preceding year; 2% reduction permitted | Yes-under exceptional circumstances | No reductions proportionate reduction, or total reduction | \$ 147.9 |
| | | Nonsupplant | N/A | No | Return supplanted funds | |
| | | Comparability | N/A | No | Total reduction/return of funds | |
| Educationally Deprived Children - Local Educational Agencies | 13.428 | Fixed level | Preceding year compared to second preceding year; 2% reduction permitted | Yes-under exceptional circumstances | Total reduction | 2,630.0 |
| | | Nonsupplant | N/A | No | Return supplanted funds | |
| Educationally Deprived Children - Migrants | 13.429 | Nonsupplant | N/A | No | Return supplanted funds | 249.8 |
| Handicapped Preschool and School Programs | 13.449 | Fixed level (local level) | Previous fiscal year | No | Total reduction | 821.5 |
| | | Nonsupplant (State level) | N/A | Yes | Return supplanted funds | |
| | | Comparability | N/A | No | Agency uncertain | |

| <u>Program title</u> | <u>CFDA number</u> | <u>Maintenance of effort requirement</u> | <u>Base for fixed level requirement</u> | <u>Can MOE requirement be waived?</u> | <u>Sanctions for not maintaining effort</u> | <u>Fiscal year 1980 Federal outlays</u> (millions) |
|--------------------------------------------------------------------------------------------------------------|--------------------|--------------------------------------------------------------------------------------|--------------------------------------------------------|---------------------------------------|---------------------------------------------|-------------------------------------------------------|
| Administration for Children, Youth and Families - Head Start | 13.600 | Nonsupplant | N/A | No | Proportionate reduction or total reduction | \$ 735.0 |
| Rehabilitation Services and Facilities - Basic Support | 13.624 | Fixed level | FY 1972 (services) Prior 3 Years' average (facilities) | No | Proportionate reduction | 817.5 |
| Special Programs for the Aging - Title III Parts A and B - Grants for States and Community Programs on Aging | 13.633 | Fixed level | Previous fiscal year | No | Proportionate reduction or total reduction | 269.5 |
| Social Services for Low Income and Public Assistance Recipients | 13.642 | Fixed level | FY 1973 or FY 1974, whichever is lower | No | Total reduction or 3% reduction | 2,697.0 |
| Medical Assistance Program | 13.714 | Fixed level for intermediate care facilities | FY 1975 | No | Proportionate reduction | 14,770.9 |
| | | Fixed level for inpatient psychiatric hospital services for individuals under age 21 | FY 1971 | No | Proportionate reduction | |

| <u>Program title</u> | <u>CFDA number</u> | <u>Maintenance of effort requirement</u> | <u>Base for fixed level requirement</u> | <u>Can MOE requirement be waived?</u> | <u>Sanctions for not maintaining effort</u> | <u>Fiscal year 1980 Federal outlays</u> (millions) |
|---------------------------------------------------------------------------------|--------------------|------------------------------------------|---------------------------------------------------|---------------------------------------|---------------------------------------------|-------------------------------------------------------|
| Criminal Justice - Part D Formula grants | 16.530 | Fixed level | FY 1980 | No | Increase fixed level MOE on future awards | \$ 239.2 |
| Comprehensive Employment and Training Programs | 17.232 | Fixed level (public service jobs) | Current year employment level | Yes-for "bona fide" reductions | Total reduction in affected job title | 5,296.6 |
| | | Nonsupplant public service jobs) | N/A | No | Return supplant-ed funds | |
| | | Nonsupplant (training) | N/A | No | Return supplant-ed funds | |
| Senior Community Service Employment Program | 17.235 | Nonsupplant | N/A | No | Return supplant-ed funds | 266.9 |
| Highway Research, Planning, and Construction | 20.205 | Fixed level | June 18, 1934 | No | Total reduction | 8,850.0 |
| Urban Mass Transportation Capital and Operating Assistance Formula Grants | 20.507 | Fixed level | Average operating subsidy for prior 2 years | No | Proportionate reduction | 1,375.0 |



EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OCT 2 1980

Mr. William J. Anderson
Director
General Government Division
U. S. General Accounting
Office
Washington, D.C. 20548

Dear Mr. Anderson:

The draft report entitled "Matching and Maintenance of Effort Requirements" is an interesting and useful analysis of the effects of these requirements on the grant system.

The draft was widely circulated within OMB and a number of suggestions were received. These have been synthesized and are presented as Enclosure 1 to this letter for your consideration.

The draft recommends that OMB include maintenance of effort information in the Catalog of Federal Domestic Assistance. The Catalog contains summary information on federal assistance programs and on the procedures and requirements for obtaining that assistance. The Catalog contains so much information now that it has been criticized as being too cumbersome. Nonetheless, we plan to revise the Catalog so that those programs with a maintenance of effort requirement will be identified. The prospective applicant can then obtain the details of these requirements, along with other details about the program, from the funding agencies.

During the OMB study done under the Federal Grant and Cooperative Agreement Act, a paper was written on cost participation. This paper presents a number of points not mentioned in the draft report, including seven possible reasons for cost participation, and an analysis of options for change. A copy is enclosed for your review.

From a broader view, four related subjects have recently been considered by GAO - matching, maintenance of effort, future assumption of costs, and recipient responses. This report concentrates on the first two. A previous GAO report on "seed money" addressed future cost assumption. Both reports deal with recipient response, while a third draft report on the role of state legislatures goes deeper into long-term response patterns. We believe that a single analysis drawing on all three reports

Enclosure 1 to OMB Letter on Draft GAO Report:
"Matching and Maintenance of Effort Requirements"

1. Chapter II states that matching requirements do not achieve their purposes. These purposes are not listed in the report. They are only inferred. As a result, it is not clear whether limiting outlays, spreading awards and screening are or are not regarded by GAO as purposes.
2. The report correctly indicates a wide range of matching and maintenance of effort requirements. It paints them as a picture of inconsistency. It also shows that congressional intent behind a specific program is frequently hard to recapture. But by not listing and discussing the various purposes that matching and maintenance of effort might serve, it fails to show how deliberate choices from the alternatives could still result in wide diversity, fulfilling some purposes while failing to fulfill others.
3. The general course of the draft suggests a need for a practical method of analyzing how the requirements should be applied to individual programs. With matching and maintenance of effort requirements included in many statutes, we do not see how amending the Intergovernmental Cooperation Act would have any practical affect. We are reluctant to suggest how the Congress should manage its own operations, but until it develops a capacity for ensuring compatible requirements across the range of assistance programs, we believe there will continue to be inconsistent statutory policies.
4. The report does not distinguish between financial and program management in its discussion of the effects of matching requirements on recipient management. In cases of low match, state and local governments may not make the same type of allocation decisions for federal funds as they do their own. But if the report is suggesting that recipients exercise less program or operational management, it is a serious point that needs factual support. If true, it raises basic design questions for much of the grant system. This needs to be clarified.
5. The draft uses two studies of block grant programs to support the view that state and local fiscal and political pressures induce program expansion rather than substitution. The CETA study was based on subjective judgements by observers of what localities' levels of effort would have been in the absence of the program. As the draft observes, this is speculative. Other studies, which have their own methodological weaknesses, have found substitution rates in PSE as high as 90 percent. We suggest the data presented in the draft are not an adequate basis for a general conclusion about substitution.

Enclosure 1, page 3

9. The titles, conclusions, and recommendations of the four chapters are not as mutually consistent or thought through as they might be. For example, the title of Chapter 3 stresses standardization, but the conclusions of the chapter do not. More important, if there is reason to believe that revising the Intergovernmental Cooperation Act could be a solution, it needs to be explained. The explanation should include a projection of who would take what actions to resolve problems of existing programs or avoid such problems with new programs. As the conclusions and recommendations now stand, we do not see them as consistently pointing to an effective course of action.

(017450)

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Enclosure 1, page 2

6. The draft recommends that where a recipient reduces its level of effort, there should be a proportional reduction of the federal grant rather than a complete termination. This recommendation could lead to frustration of the congressional intent in adding the level of effort requirement that federal funds be used to increase the total spent in a target area. Acceptance of the GAO recommendation would permit recipients to reduce their effort until proportional reduction of federal funds bring the combined total to the level of recipient funding prior to the grant. The effect would be a substitution of federal for recipient funds, with no net increase.
7. While the other broad conclusions of the study are probably generally correct, there are some important considerations at the individual program level. For example, the Medicaid formula has the particularly perverse effect of allocating most of the funds to the high eligibility/high benefit/high income states, while leaving millions of low income persons in low income states without any coverage. This is a specific case in support of the discussion that begins on page 23 about needy governments not being able to raise matching funds. Conversely, it runs counter to the discussion that begins on page 16 about matching requirements not being effective screening devices. The two discussions should be tied together and address the issue of what screening accomplishes where it is effective.
8. On page 17, the report indicates that overall, the rate of match required from grantees has been decreasing over the years. This statement appears to be based on an average of program matching rates. When the actual dollars for these programs are extended by the rates, the picture is not so clear. Our figures show the following overall matching shares since 1971.

| <u>Fiscal Year</u> | <u>Matching Share (% of \$)</u> |
|--------------------|---------------------------------|
| 1971 | 30.2 |
| 1972 | 30.7 |
| 1973 | NA |
| 1974 | NA |
| 1975 | NA |
| 1976 | 27.1 |
| 1977 | 27.7 |
| 1978 | 26.2 |
| 1979 | 26.5 |
| 1980 (est.) | 27.5 |
| 1981 (est.) | 28.9 |

A major reason for the recent pattern, in addition to the elimination of the state share of General Revenue Sharing, is that grant programs (such as public assistance and medic-aid) with high matching shares have grown faster than others.

and perhaps the enclosed OMB study paper would be helpful to the Congress and the Executive Branch. A brief but careful explanation of the interactions of all four subjects would be particularly useful.

Such an analysis could show how the objectives of past federal actions may conflict with state and local objectives, and vice versa. This is particularly true where each level of government has deliberately caused other levels of government to increase expenditures. Thus, what was designed to be "stimulation" at the federal level is viewed as "distortion" at the recipient level. It could also show how the alternative federal objectives may conflict. We believe that such an analysis, showing the objectives and effects of federal, state, and local actions would go directly to the heart of much of the current intergovernmental friction.

We appreciate the opportunity to comment on this draft report.

Sincerely,



Wayne G. Granquist
Associate Director for
Management and Regulatory Policy

Enclosures

| <u>Program title</u> | <u>CFDA number</u> | <u>Maintenance of effort requirement</u> | <u>Base for fixed level requirement</u> | <u>Can MOE requirement be waived?</u> | <u>Sanctions for not maintaining effort</u> | <u>Fiscal year 1980 Federal outlays</u> (millions) |
|------------------------------------|--------------------|------------------------------------------|-------------------------------------------------------------------------------------------------------------------|---------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------|
| State and Community Highway Safety | 20.600 | Fixed level | Average of FY 1964 and FY 1965 | No | Total reduction | \$ 194.5 |
| Community Action (Title 221) | 49.002 | Fixed level | FY 1975 | Yes-through administrative regulations only | Proportionate reduction or total reduction | 383.8 |
| General Revenue Sharing | None | Fixed level | Overall State assistance to local governments averaged for prior 2 years must equal average for preceding 2 years | No | Reduction in State entitlement equal to the shortfall between prior 2 years and preceding 2 years' assistance to local governments | 6,820.7 |

LEGEND:

CFDA - Catalog of Federal Domestic Assistance

| <u>Program title</u> | <u>CFDA number</u> | <u>Maintenance of effort requirement</u> | <u>Base for fixed level requirement</u> | <u>Can MOE requirement be waived?</u> | <u>Sanctions for not maintaining effort</u> | <u>Fiscal year 1980 Federal outlays</u> (millions) |
|------------------------------------------------------------|--------------------|------------------------------------------|------------------------------------------------------|--------------------------------------------------------|---------------------------------------------------------------------------------------------|-------------------------------------------------------|
| Supplemental Security Income | 13.807 | Fixed level | State's prior year supplement of Federal SSI payment | No | Total reduction of Medicaid | \$5,590.0 |
| Community Development Block Grants/Entitlement Grants | 14.218 | Fixed level for "public services" | Prior year for "public services" | Yes-if events were beyond the control of the applicant | Reduce next year's grant or seek partial or total recovery of the current fiscal year grant | 2,794.2 |
| | | Nonsupplant | N/A | No | Return supplanted funds | |
| Community Development Block Grants/Small Cities Program | 14.219 | Fixed level for "public services" | Prior year for "public services" | Yes | Reduce next year's grant or seek partial or total recovery of the current FY grant | 996.0 |
| | | Nonsupplant | N/A | No | Return supplanted funds | |
| Outdoor Recreation - Acquisition, Development and Planning | 15.400 | Nonsupplant | N/A | No | Return supplanted funds | 300.0 |

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| <u>Program title</u> | <u>CFDA number</u> | <u>Maintenance of effort requirement</u> | <u>Base for fixed level requirement</u> | <u>Can MOE requirement be waived?</u> | <u>Sanctions for not maintaining effort</u> | <u>Fiscal year 1980 Federal outlays</u> (millions) |
|---------------------------------------------------------------------------|--------------------|----------------------------------------------------------------------------|--------------------------------------------------------------------------|---------------------------------------|-----------------------------------------------------------|-------------------------------------------------------|
| School Assistance in Federally Affected Areas - Maintenance and Operation | 13.478 | Fixed level | Second preceding year | Yes-under exceptional circumstances | Proportionate reduction | \$ 772.0 |
| Vocational Education - Basic Grants to States | 13.493 | Fixed level | Preceding year compared to second preceding year, 2% reduction permitted | Yes-under exceptional circumstances | No reduction, proportionate reduction, or total reduction | 474.8 |
| Vocational Education - Program Improvement and Supportive Services | 13.495 | Fixed level | Previous fiscal year | Yes-2% reduction without penalty | Total reduction | 112.3 |
| Emergency School Aid Act - Basic Grants to Local Educational Agencies | 13.525 | Fixed level | Second preceding year | No | Total reduction | 118.8 |
| | | Nonsupplant (applies only to the implementation of desegregation programs) | N/A | No | Return supplant-ed funds | |
| Instructional Materials and School Library Resources | 13.570 | Fixed level | Previous year, if higher than second previous year | Yes-under exceptional circumstances | Proportionate reduction | 171.0 |

| <u>Program title</u> | <u>CFDA number</u> | <u>Maintenance of effort requirement</u> | <u>Base for fixed level requirement</u> | <u>Can MOE requirement be waived?</u> | <u>Sanctions for not maintaining effort</u> | <u>Fiscal year 1980 Federal outlays</u> (millions) |
|----------------------------------------------------------------|--------------------|------------------------------------------|-----------------------------------------|----------------------------------------------------------------|---------------------------------------------|-------------------------------------------------------|
| Maternal and Child Health Services | 13.232 | Fixed level | FY 1968 | No | Proportionate reduction | \$ 243.4 |
| Drug Abuse Community Service Programs | 13.235 | Fixed level | Prior year | No | Proportionate reduction | 142.1 |
| | Con-tracts | Nonsupplant | N/A | Yes, determined on case-by-case basis | Partial or total termination of contract | |
| Health Planning - Health Systems Agencies | 13.294 | Nonsupplant | Average of preceding 3 years | Yes | Proportionate reduction | 124.7 |
| | Con-tracts | None | N/A | N/A | N/A | |
| Community Mental Health Centers-Comprehensive Services Support | 13.295 | Nonsupplant | N/A | No | Return sup- planted funds | 256.9 |
| Adult Education - State Administered Program | 13.400 | Fixed level | FY 1978 | Yes-one time only for exceptional and unforeseen circumstances | Total reduction | 100.0 |
| Bilingual Education | 13.403 | Nonsupplant | N/A | No | Return sup- planted funds | 166.7 |

| <u>Functional program area</u> | <u>0% match</u> | <u>1-10% match</u> | <u>11-25% match</u> | <u>26-49% match</u> | <u>50% & over match</u> | <u>Variable match</u> | <u>Cost sharing</u> | <u>Total grant programs</u> |
|-----------------------------------------|-----------------|--------------------|---------------------|---------------------|-----------------------------|-----------------------|---------------------|-----------------------------|
| <u>VETERANS BENEFITS AND SERVICES</u> | | | | | | | | |
| Hospital and medical care for Veterans | 5 | - | - | 1 | - | - | - | 6 |
| <u>ADMINISTRATION OF JUSTICE</u> | | | | | | | | |
| Criminal Justice Assistance | 9 | 2 | - | - | - | 4 | 3 | 18 |
| <u>GENERAL GOVERNMENT</u> | | | | | | | | |
| General property and records management | 1 | - | - | - | - | - | - | 1 |
| Other General Government | - | - | - | - | 1 | - | - | 1 |
| TOTALS | 191 === | 44 == | 60 == | 11 == | 47 == | 54 == | 106 === | 513 === |
| PERCENT | (37.2%) | (8.6%) | (11.7%) | (2.1%) | (9.2%) | (10.5%) | (20.7%) | (100%) |

1/Source: 1979 Catalog of Federal Domestic Assistance. Note: Programs are grouped into budget sub-functions according to the catalog, however, GAO staff re-allocated certain programs in order to correct mistakes in the catalog and clarify functional groupings. Only formula or project grants to State and local governments are included. General Revenue Sharing is not included.

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| <u>Functional program area</u> | <u>0% match</u> | <u>1-10% match</u> | <u>11-25% match</u> | <u>26-49% match</u> | <u>50% & over match</u> | <u>Variable match</u> | <u>Cost sharing</u> | <u>Total grant programs</u> |
|-------------------------------------------------|---------------------|------------------------|-------------------------|-------------------------|---------------------------------|---------------------------|-------------------------|---------------------------------|
| <u>AGRICULTURE</u> | | | | | | | | |
| Farm income stabilization | - | - | - | - | - | - | 1 | 1 |
| Agricultural research | 5 | - | - | - | 1 | - | 1 | 7 |
| <u>COMMERCE AND HOUSING</u> | | | | | | | | |
| <u>CREDIT</u> | | | | | | | | |
| Mortgage credit and thrift insurance | 1 | 1 | - | - | - | - | - | 2 |
| Other advancement and regulation of commerce | - | - | 1 | - | 1 | - | - | 2 |
| <u>TRANSPORTATION</u> | | | | | | | | |
| Ground transportation | - | - | 4 | 1 | 2 | 4 | - | 11 |
| Air transportation | - | - | - | - | - | 2 | - | 2 |
| Water transportation | - | - | - | - | 2 | - | - | 2 |
| Other transportation | - | - | - | - | 1 | - | - | 1 |
| <u>COMMUNITY AND REGIONAL DEVELOPMENT</u> | | | | | | | | |
| Community development | 4 | - | 1 | 1 | - | - | 2 | 8 |
| Area and regional development | 25 | 1 | 26 | 3 | 1 | 12 | 2 | 70 |
| Disaster relief and insurance | 1 | - | - | - | 1 | - | - | 2 |

constraints as contrasted with the more specific and stimulative intent of categorical programs. To date, five block grants are generally recognized--Law Enforcement Assistance, Community Development, Social Services, Partnership for Health, and Comprehensive Employment and Training.

In addition, the executive branch has recently required Federal agencies to detail the State and local fiscal impact of new program proposals or regulatory actions. Both of these actions were central points of the Carter Administration's Urban Policy and regulatory reform efforts.

The growing range of Federal assistance has been provided primarily through categorical grants, each serving a narrow purpose allowing only minimal grantee discretion. The 1960s and 1970s saw an explosion in the number of these grants going to State and local governments. Since 1962, ACIR has recorded a 300 percent increase in the number of Federal categorical grant programs available for State and local governments. Categorical grants are expected to comprise over 75 percent of total Federal grant outlays to State and local governments on fiscal year 1981.

Cost impact of grants

Federal grant programs often increase State and local spending over and above the amount of the Federal grant, irrespective of match and maintenance of effort requirements. Communities have learned that even 100 percent Federal grants are not "free."

Grants stimulate public spending in a variety of ways. First, Federal grants are premised primarily on the notion that the State and local sector is not spending enough for services or programs with high national interest. In providing financial assistance for a program, a grant essentially entices State and local governments to participate in a program that they otherwise may not have sufficiently funded from their own resources.

While this accomplishes the national intent, as the number of grant programs has grown, State and local governments have been enticed into participating in a growing array of programs with high national priority, but not necessarily high State or local priority. While Federal funds are available to defer partial program costs, grant programs typically force State and local governments to assume additional financial burdens over the long term.

Much of the financial impact can be explained by the political processes of State and local governments. By arousing new expectations and dormant constituency groups, Federal grants can induce State and local governments to spend more than they previously considered necessary for particular programs.

Also, many Federal seed money programs are designed to only fund initial costs, forcing State and local governments to fully fund future year program costs or face the unenviable task of terminating programs that have gained a clientele of

tax revenues. While increased State fiscal assistance prevented massive local spending cuts, California local governments did experience a material reduction in their spending growth rates from 12 percent annually to 7 percent. ^{1/} Following California's lead, taxpayers in 12 States voted approval of either tax or spending limitation measures in November 1978.

It seems clear that most State legislatures have already gotten the taxpayer's message. According to the Tax Foundation, for the first time in 4 years, aggregate State taxes were reduced by a net of \$2.3 billion in 1978. In 1979, 37 States voted some kind of net tax reduction. The future growth rate of State and local government is likely to be slowed by such measures.

If public opinion polls are any guide, the desire of citizens to constrain government growth and limit their tax burdens may not abate soon. With continuing inflation feeding the public's perceptions that the cost of living is rising faster than their incomes, the growing tax bite stands out as the one item subject to popular control. Taxes on the average family income doubled between 1953 and 1977, from 11.8 percent to 22.8 percent of annual earnings.

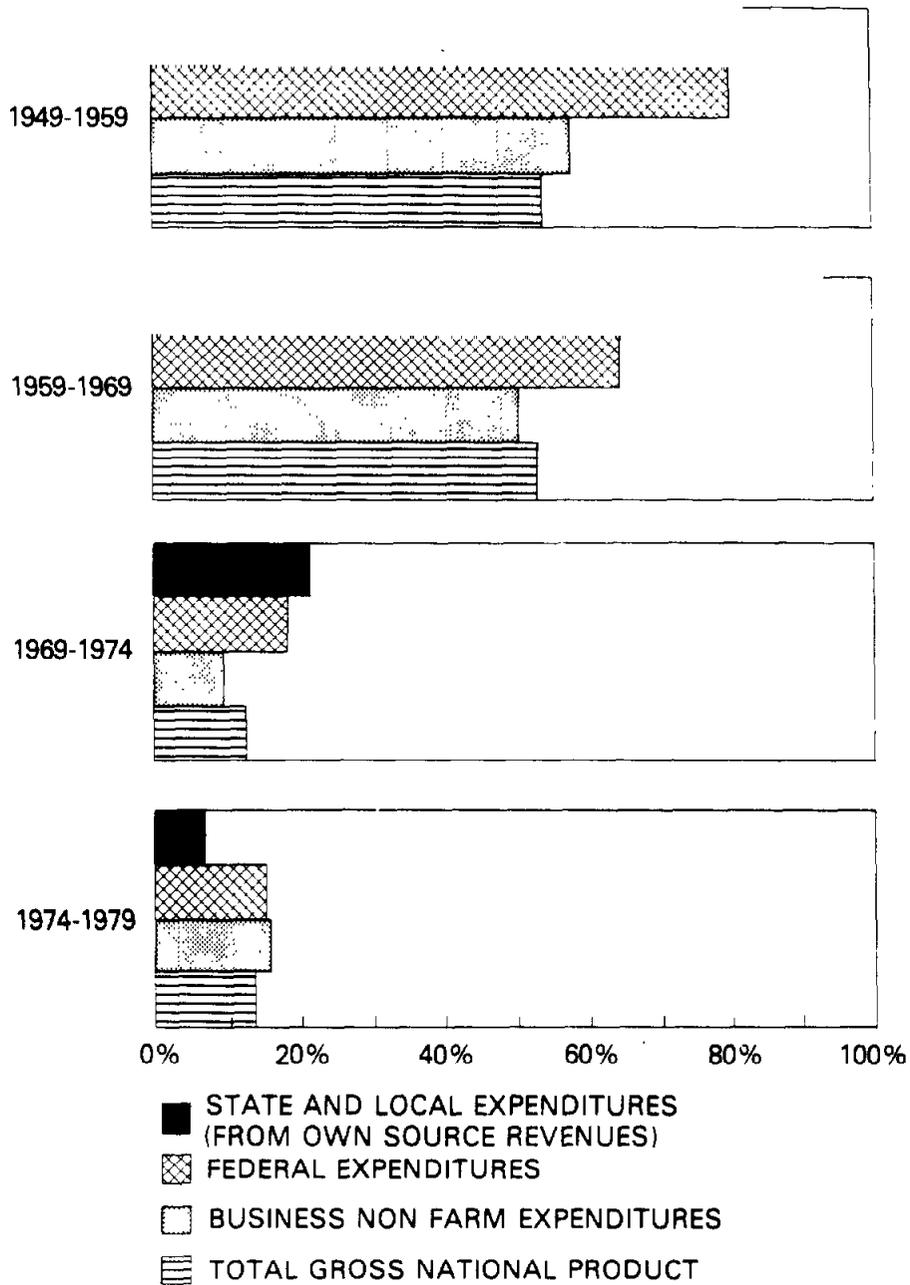
GROWING FISCAL IMPACT OF FEDERAL GRANTS

Federal grants have tended to stimulate additional State and local expenditures in a growing array of new program ventures. The expenditure impact of Federal grants has grown over the past 10 years due both to the increasing dependency of State and local governments on Federal funds and the extension of Federal grant involvement in numerous new program areas, which traditionally have been the province of either the State-local or private sectors.

As federally funded services have consumed a growing share of State and local budgets, that portion of State and local budgets available for discretionary use to meet local needs and demands in non-federally funded areas has declined.

^{1/}"Proposition 13--How California Governments Coped With A \$6 Billion Revenue Loss," (GGD-79-88, September 28, 1979).

**COMPARATIVE GROWTH RATES AMONG SECTORS
OF THE ECONOMY 1949-1979
(ADJUSTED FOR 1967 DOLLARS)**



NOTE GAO Analysis of data extracted from Economic Report of the President, 1980

Proportionate reduction does need to be implemented with some care to prevent the encouragement of widespread fiscal substitution by grantees. Accordingly, in response to OMB's concern, we added to our recommendation a provision that Federal grants should be reduced by the same percentage as the grantee's own spending so that the Federal share of total program costs does not increase as a result of the grantee's decrease. Also, we believe that Federal agencies should closely monitor the effects of this sanction on grantee spending patterns. Widespread grantee spending reductions could trigger a reexamination of the desirability and appropriateness of Federal financial involvement in particular program areas.

We have attempted to clarify sections of the report in response to other OMB comments. For example, we have clarified our analysis of the effects of matching on grantee management to reflect a focus on the impact of matching on central management oversight, not on program management. We also changed our titles and emphasis in chapter 3 from standardization to the need to develop match rates on a more uniform or coordinated basis within Federal functional program areas.

OTHER COMMENTS

In its comments, ACIR stated that the report was an incisive and thorough effort. It further indicated that the maintenance of effort analysis represents an excellent response to a 1978 ACIR recommendation that the Congress request the General Accounting Office "* * *" to research and report on the effect of existing maintenance of effort requirements in categorical grants."

We received oral comments from officials of State and local government and interest groups representing State and local governments. One representative of State and local government interests thought the report was excellent and raised a number of issues that deserve to receive more deliberation and debate at the Federal level. This person did disagree with the proposal in our draft report that General Revenue Sharing funds be counted as State and local funds for maintenance of effort purposes. We deleted this proposal on the grounds that revenue sharing funding has become uncertain.

Federal funds for State and local resources that would have been spent in the future. We believe, however, that the control of prospective fiscal substitution inappropriately involves the Federal Government in speculative hypothesizing about future State and local plans which are themselves quite uncertain. Such an effort extends Federal control over State and local spending decisions and requires Federal enforcement based on usually unverifiable assumptions about the motivations of State or local officials. As a result, the enforcement of nonsupplant requirements is not only administratively difficult but may also be inappropriate.

Once again, we recognize that this proposed standardized maintenance of effort requirement would not be a self-policing measure, in that individual pieces of legislation could contain provisions conflicting with these policies. Therefore, as we noted in our recommendations on matching (p. 39), each House of the Congress may wish to designate a single point of referral to review maintenance of effort provisions contemplated by proposed grant program legislation.

RECOMENDATION TO THE DIRECTOR,
OFFICE OF MANAGEMENT AND BUDGET

We recommend that OMB include information on maintenance of effort requirements in the description of each Federal program listed in the Catalog of Federal Domestic Assistance. This will help promote better understanding and reduce confusion about maintenance of effort requirements throughout the intergovernmental community.

Stronger provisions could also have significant negative fiscal and programmatic effects on those governments continuing to participate in the grant program, such as distorting State and local priorities, penalizing bona fide spending reductions arising from fiscal limitations or productivity improvements, and discouraging program innovation from State and local resources. If the State or local sector continues to experience budgetary decline, it is likely that enforcement of Federal maintenance of effort provisions will increasingly conflict with bona fide State and local cutback strategies. Therefore, we believe that maintenance of effort provisions should be made more flexible to avoid penalizing bona fide expenditure reductions as well as program innovation.

RECOMMENDATIONS TO THE CONGRESS

We recommend that the Congress amend the Intergovernmental Cooperation Act of 1968 (42 U.S.C. 4201) to enact a standard maintenance of effort requirement applicable to those grant programs where the Congress wants to prevent fiscal substitution.

A standard maintenance of effort requirement should include the following measures to strengthen protection against fiscal substitution as well as soften some of the potential adverse impacts on State and local governments:

- The level of effort to be maintained must be reasonably current based on a moving average of the prior 2 years' expenditures. While this would not totally preclude supplantation during periods of high inflation rates, it would serve to minimize the amount of existing spending that grantees could substitute.
- The requirement needs to be passed through to local governments which are subgrantees of the State under many Federal grant programs. This would minimize substitution for each grant project within the State.
- Nonrecurring or one-time expenditures should be excluded from the effort base to be maintained. Since one-time expenditures are not likely to be substituted for, this change would reduce the burden on grantees without appreciably increasing the likelihood of fiscal substitution.

reimbursement of existing eligible social services expenditures. As a result, the State agency was able to compile a substantial surplus in Federal Title XX money that it used over and above State appropriations. When the legislature investigated and learned that Title XX funds could be used to reimburse State appropriations, this practice changed.

--The coordinator of the Community Development Block Grant in a Mid-Atlantic county told us that he successfully used the maintenance of effort requirement to force the State's Highway Department to forestall projected cuts, even though State spending is not constrained by the requirement.

Other grantees displayed a lack of understanding of the requirements. For example, a State Budget Director told us of his imminent decision to use additional Federal funds to supplant existing State funds. He assured us, based on his perusal of the Catalog of Federal Domestic Assistance, that the Federal programs in question did not have maintenance of effort requirements. The Catalog, in fact, contains no information on maintenance of effort.

The lack of any centrally available information on maintenance of effort does not help budget officials trying to cope with confusion. The Catalog of Federal Domestic Assistance is the primary source of information on grant programs for State and local governments. While the descriptions of each program in the Catalog list a number of important grant conditions, they do not include maintenance of effort.

No Government-wide effort exists to standardize the confusing array of Federal maintenance of effort provisions. A number of other grant requirements affecting the administration of Federal grant programs by State and local governments, including match requirements and procurement standards, were standardized in the early 1970s as part of the Federal Assistance Review effort initiated by OMB to simplify and standardize the administration of Federal grants. Maintenance of effort requirements, however, are not addressed by any of the Government-wide circulars aimed at standardizing and simplifying grant administration.

We were able to identify only one prior attempt to standardize and systematize maintenance of effort requirements by any major Federal agency. In 1968, an HEW Grants Administration Advisory Committee recommended that the maintenance of effort provisions of HEW programs be standardized and simplified. This Committee recommended that:

Maintenance of effort requirements
can penalize innovation and planning

Maintenance of effort requirements can penalize State and local governments that initiated programs before the Federal funding became available even though these State and local programs are often used as models for the development of Federal grant programs. These governments cannot use the Federal grant funds to substitute for their current levels of effort, rather they must either supplement their existing program levels or forego the opportunity to participate in the Federal grant program. State and local governments that have not preceded the Federal Government with programs of their own, of course, do not face this dilemma.

We found many examples of the inequities faced by innovative grantees:

- Local school districts in a Midwestern county, with good existing programs serving the handicapped received less Federal handicapped education funds than districts that had not been serving the handicapped. Of \$1,153,000 received throughout the county, the first \$508,000 went to the six districts not currently serving handicapped students, while the remaining \$645,000 was split among all 36 districts on a per capita basis.
- Public Schools of a large Midwestern city were not eligible for Federal remedial education funds because of their existing remedial education programs.
- A Mid-Atlantic county could not obtain a Federal Community Mental Health Staffing grant for an existing county mental health facility because it was already providing staffing funds.
- A Midwestern State lost an opportunity to receive \$20 million in Federal funds for a public employee unemployment compensation program because this State already had a similar program ongoing in 1974 when the Federal program was created.

Governments could be discouraged from starting projects with their own money, due to fears of being locked in to high spending levels when Federal funds become available. As a

The State and local budget process can be further constrained by excessively broad maintenance of effort requirements scope. A Midwestern State, for example, objects to reporting expenditures of \$120 million as its effort level for the Federal Vocational Education program when only \$14 million is needed as match. The State feels that this gives the Federal Government control disproportionate to its 10 percent investment in the State's vocational education program.

Maintenance of effort provisions that include nonrecurring expenditures as part of the effort base can be especially onerous for State and local governments. State and local governments could be prevented from reducing program budgets that may have been artificially high in prior years due to support of certain one-time expenses, such as construction. As a result, State and local programs budgets could become locked into inflated spending levels far in excess of ordinary costs required to operate the program. A Midwestern county rejected a higher education grant because it would have been forced to maintain prior years' spending levels which were extraordinary due to a construction program.

Finally, State and local governments must pay a high price in many programs for reducing their effort. In over one-third of the largest programs with maintenance of effort, any reduction in grantee effort--regardless of magnitude--is penalized by a total withdrawal of Federal funds.

Maintenance of effort requirements
can result in low priority and
unnecessarily large programs from
the State and local perspective

Some State and local officials feel that low priority and unnecessarily large projects are supported by Federal funds due to maintenance of effort requirements. From their perspective, supplanting can be a rational strategy to ensure that available Federal funds are used for programs of high State and local interest. In fact, several State appropriations laws incorporate provisions requiring the reduction of State funds when Federal money becomes available for the same program.

Jurisdictions facing budget cuts find Federal policies requiring program expansion and innovation to be inappropriate at a time when basic services are being curtailed. Clearly, they would rather use Federal funds to ease their fiscal dilemmas and help retain basic services. For example:

Adult Education grant. California's local school districts are losing some of their Federal Impact Aid funds because passage of Proposition 13 forced them to reduce their levels of school expenditures supported from locally derived revenues.

Reductions due to productivity improvement

Maintenance of effort requirements can also discourage State and local government efforts to improve productivity or efficiency if the resultant cost savings cause them to reduce their minimum level of effort needed to retain Federal funding. For example, officials of a New England State felt that they could not eliminate an inefficient State vocational rehabilitation agency due to the maintenance of effort requirement in the Federal Rehabilitation Services grant program.

Federal Vocational Education officials told us that the program's fixed level of effort requirement can penalize States seeking to provide the same level of services at reduced costs, thereby increasing productivity. For example, if a State replaces 10 retiring senior teachers with 10 lower paid entry level teachers, its payroll expenditures would decrease considerably even though service levels remained constant. The State would nevertheless be forced to maintain the higher level of expenditures due to the inflexible maintenance of effort requirement.

The Urban Mass Transit Administration's Section 5 Operating Subsidy program also penalized reductions in public transit system deficits by requiring State and local financing of these deficits to be maintained. As a result, a New England State did not seek a fare increase that would have reduced the deficit.

Productivity may also be adversely affected if maintenance of effort provisions encourage larger programs than needed. State and local officials feel that excessively large programs occur when Federal funds must be added on to existing State and local spending for a program that they perceive as being adequate. However, it must be noted that genuine disagreements regarding the size and efficiency of programs between Federal and nonfederal levels of government could mask genuine differences in priorities. Maintenance of effort may encourage larger programs than needed in the view of State and local officials. However, these officials may not adequately perceive the external benefits to other jurisdictions of a larger program that presumably led to the creation of the grant program itself. Thus, larger programs that

the Community Development Block Grant program, only 6 percent of the Federal funds provided to the sample localities were found by Brookings to be used for substitution. 1/

A primary reason explaining these relatively low substitution rates is the unwillingness of many State and local officials to become too dependent on Federal funds for financing the continuing operating costs of their basic public services. Many local officials contacted during the Brookings study were reluctant to use CETA funds to subsidize ongoing services because of the uncertain prospects for continuation of Federal funding under this program.

The inclination to supplant can also be deterred through the political pressure of influential constituency groups and bureaucracies dependent on the services funded by the Federal grant. Maintenance of effort requirements can become grist for local political conflicts between central fiscal officials and program advocates. Community groups in a Southwestern city, for example, have taken the city to court for its alleged substitution of Community Development Block Grant program funds for its own expenditures, thereby depriving the community of additional services. Budget officials in several jurisdictions stated that maintenance of effort is used by departments and program advocates as a club to force their governments to maintain or increase spending for their programs. The Director of the CETA program told us that the Department of Labor views public employee unions as a viable deterrent to attempts by cities to use CETA funds for fiscal substitution.

MAINTENANCE OF EFFORT REQUIREMENTS
CAN ADVERSELY AFFECT STATE AND
LOCAL GOVERNMENTS

Most State and local governments we visited were not having problems meeting maintenance of effort requirements because the requirements themselves were generally too weak to cause changes in budgetary actions. Furthermore, most of the governments were not faced with the kind of severe budget cuts that could reduce required effort. Nevertheless, we did

1/For a summary of these studies, see Richard D. Nathan, "The Brookings Monitoring Research Methodology for Studying the Effects of Federal Grant-in-Aid Programs," paper presented to the American Political Science Association Annual Meeting, Washington, D.C., September 1979.

State and local governments can use categorical grant funds to replace their General Revenue Sharing funds in a program and then use the freed-up revenue sharing funds for other State or local programs. The real effect of this transaction would not be to provide new services through the categorical program, but rather tax relief. Even though revenue sharing funds are considered as non-Federal money for matching purposes, the Department of the Treasury's Office of Revenue Sharing has ruled in one case that they are not to be considered as non-Federal funds for maintenance of effort purposes. The Treasury ruling was partly justified on the grounds that inclusion of revenue sharing in fixed level of effort bases would permanently lock grantees into a higher future level of effort even though they are not assured of continuation of the revenue sharing program in the future. The uncertain future of General Revenue Sharing as a funding source has been confirmed in recent months by the proposed elimination of State Government from the program. Also, due to the fungible nature of revenue sharing funds, it would be difficult for Federal program officials to know for sure how jurisdictions actually allocate these funds among various program areas.

Other forces can prevent fiscal substitution

In spite of the ineffectiveness of most maintenance of effort requirements, other features of our intergovernmental system such as Federal program design and State and local fiscal and political pressures, can prevent fiscal substitution. Federal grant programs incorporate a variety of other grant requirements to avoid extensive subsidization of State and local budgets. In addition, the internal politics of the State and local budget process can also prevent fiscal substitution as local interest groups seek to ensure that Federal grant funds received by the community are used for program augmentation rather than fiscal substitution. Furthermore, central budget officials will often overcome any short-term impulse to supplant in order to avoid becoming overly dependent on the Federal government for financing basic State and local services.

Federal program design features can prevent fiscal substitution

Regardless of maintenance of effort requirements, many Federal grant programs have policies and program design features to avoid extensive substitution of State and local budgets. First of all, some programs, like LEAA, have a general

of jobs from its own funds. This was rejected because growth rates based on historical data change and it is impossible for a Federal agency to determine that a change in public employment growth rate was caused by the availability of CETA funds. In practice, this official told us that maintenance of effort questions are decided in negotiations where all parties engage in a "big bluff game."

Even if the analytical problems could be surmounted, agency judgments on supplanting could be controversial, especially in hard-pressed cities undergoing fiscal crisis. For example, under the CETA program, Federal funds were available to support regular employees if a city could show that its fiscal crisis would otherwise force layoffs in the absence of CETA funds. While the agency collects data on the fiscal outlook and prospects of each city requesting use of CETA funds to defer layoffs, the basic decisions to waive rules to allow major cities to continue using CETA funds for regular employees have been made at the highest level of Government, according to a top CETA official.

Lack of criteria results in overly subjective and inequitable determinations

While a fixed level of effort requirement can objectively define the scope and unit of effort to be maintained, nonsupplant requirements call for a subjective assessment by Federal program administrators.

Most Federal agencies assess supplanting cases on an ad hoc basis and are guided only by informal rules or subjective judgments. Most agencies have not developed clear guidelines or criteria defining explicitly the grounds for supplanting violations. As a result, supplanting violations are often based on informal rules applied by program administrators and auditors on a case-by-case basis. For example, the Community Development Block Grant has a general provision preventing substantial reductions in local financial support for community development activities. However, HUD has decided against issuing detailed guidance defining such critical terms as "substantial" and "community development activities" in favor of a case-by-case determination. While this gives the appearance of greater flexibility, it can also foster confusion at the grantee level.

More importantly, inconsistencies and inequities arise. Studies of the administration of supplanting requirements in the Elementary and Secondary Education program by the National Institute of Education and the Stanford Research Institute found widespread enforcement inconsistencies throughout the

Nonsupplant requirements are generally not applied

Nonsupplant requirements can in theory prevent prospective fiscal substitutions by prohibiting grantees from using Federal grant funds to reduce their own funds that would "otherwise" have been spent. Nonsupplant requirements, however, are typically not applied by Federal agencies, because such provisions call for them to speculate on what State or local government budget actions would have been taken in the absence of Federal grant funds. The analytical and political problems posed by this task are compounded by the absence of explicit and consistent criteria to guide Federal enforcement efforts.

Difficulty in determining grantee spending intentions

Most Federal program officials we contacted agreed that nonsupplant is difficult, if not impossible, to enforce because it calls for an external judgment on what grantees would have done if Federal funds were not available. Basically, this calls for a Federal agency to assess the motives behind particular changes in State and local plans or budgets and to judge whether the presence of Federal grant funds drove the particular State or local action.

The budget process of any complex government is governed by the inscrutable dynamics of politics, making it difficult to predict the specific programmatic impact of a given change in resources. In fact, it can be argued that State and local governments find it difficult to identify what their own budgetary intentions would be without Federal funds. For example, a large Northeastern city faced with an intractable financial crisis causing massive public employee layoffs, intended to use Federal public employment funds to retain police officers whom it felt would otherwise have to be laid off. However, when the Federal agency ruled that these funds could not be used for this purpose this city devised a financing scheme to retain these patrolmen with its own money. This was clearly an action that was unanticipated when the Federal grant was prepared.

Most of the 19 largest Federal grant programs with nonsupplant requirements do not even attempt to ascertain what grantees would otherwise spend in the absence of Federal funds. Most programs that attempt to enforce their nonsupplant requirements tend to apply the requirement as if it were a fixed level of effort provision. These agencies assess what grantees would otherwise have spent by reviewing only what grantees have in fact, spent in prior years for federally funded activities.

responsible for the Social Services Block Grant (Title XX) program suggested that their program was prone to a high rate of substitution because States could maintain prior levels of social services in the aggregate and still use Federal Title XX funds to substitute within the broad program area.

The 10 programs that allow States to account for a fixed level of effort on an aggregate State-wide basis could also be used to substitute for spending reductions by particular local governments within the State as long as these reductions were offset by appropriate increases from other governments within the State.

The vague nature of several fixed level requirements also frustrates effective enforcement. Federally defined classifications of effort do not necessarily correspond to State and local cost accounting systems. As a result, calculating State or local effort for Federal grant programs can impose significant burdens on grantors and grantees alike. For example, officials of a New England State told us that the State did not receive Medicaid reimbursement for outpatient psychiatric services because it could not compute its 1971 expenditures for this program, the base level required by Federal law.

Some effort classifications are so vague that enforcement is impractical. A prime example is the Community Action program which provides that non-Federal spending to meet "the needs of the poor" be maintained at fiscal year 1975 levels. Federal regional CSA officials told us that they require no data from grantees on this and do not audit the requirement because of the difficulty in identifying spending levels for each social program within the community.

Vague maintenance of effort requirements give grantees considerable discretion in determining the expenditures to report to the Federal agencies. For example, in reporting prior investment for highway safety, States can decide what portion of their highway patrol force is related to highway safety as opposed to law enforcement in satisfying the LEAA maintenance of effort requirement. Many grantees also told us that they did not fully report all eligible expenditures for maintenance of effort purposes. Some wanted to avoid getting locked into a higher effort level. An official of one Midwestern grantee said that they hide some expenditures as a way to hedge against bad years when budget cuts could cast doubt on their ability to maintain effort. A Federal regional official in charge of the Vocational Education

non-supplant requirements take into account the reasons for the grantee's reduction in effort and would not be enforced where the expenditure reduction was bona fide rather than contrived to take advantage of Federal funds.

MAINTENANCE OF EFFORT REQUIREMENTS
DO NOT PREVENT FISCAL SUBSTITUTION

Most maintenance of effort provisions, in themselves, do not effectively prevent grantees from using Federal grant funds to substitute for their own funds that would otherwise be spent. Since many fixed level of effort provisions are based on fiscal effort several years past, inflation alone gives grantees flexibility to substitute a significant amount of Federal funds for their own money. The vagueness and breadth of some requirements also make it difficult for Federal agencies to effectively monitor State and local expenditures for maintenance of effort purposes. Nonsupplant requirements are usually not enforced by Federal agencies due to the absence of criteria governing their application and the difficulty of ascertaining what grantees "would have done" in the absence of Federal funds. Finally, since counting General Revenue Sharing funds as non-Federal funds for maintenance of effort purposes may be infeasible, grantees can replace General Revenue Sharing funds invested in a program with a categorical Federal grant and blunt the supplemental impact of Federal programs.

Fixed level of effort requirements
are outdated, vague, and unable to
forestall prospective substitution

Many fixed level of effort requirements only require grantees to maintain their spending at a level pegged to an outdated base year. Even when the base year used to define grantee effort is updated to the prior year, inflation can render this level obsolete in terms of maintaining the prior year's program level. Overly broad or vague fixed level requirements also discourage effective Federal enforcement and permit significant fiscal substitution by grantees.

Finally, fixed level of effort requirements inherently cannot forestall prospective fiscal substitution, i.e., the modification of State and local spending plans as a result of Federal grant revenues.

CHAPTER 4

STRONGER MAINTENANCE OF EFFORT REQUIREMENTS

SHOULD DISCOURAGE FISCAL SUBSTITUTION BUT

NOT INHIBIT BONA FIDE SPENDING REDUCTIONS

Maintenance of effort requirements need to be strengthened and standardized if they are to fulfill their objective of preventing the substitution of Federal for non-Federal funds. Widespread inconsistencies and vagueness among the current requirements have led to confusion and a lack of enforcement. Stronger maintenance of effort requirements would better serve the Federal interest.

Revised requirements could eliminate confusion and more effectively achieve the Federal objective. If rigidly applied, however, they might also aggravate the adverse effects which grantees sometimes already experience by

- undermining legitimate efforts to cut budgets,
- distorting budget priorities,
- penalizing innovation, and
- making participation in grant programs less attractive.

To minimize these effects, stronger maintenance of effort requirements should include enough flexibility to ease the burden on States and localities experiencing bona fide expenditure reductions.

PURPOSE AND SIGNIFICANCE OF MAINTENANCE OF EFFORT REQUIREMENTS

Like matching, maintenance of effort is another major Federal requirement that constrains State and local control of spending. Maintenance of effort requirements are used by the Federal Government to ensure that Federal grant funds will supplement or augment existing programmatic spending by grantees.

In theory, the requirements exist to prevent State and local governments from using Federal grant funds to replace State or local money that would otherwise have been spent in the absence of the Federal grant. When Federal grant money

Adverse effects on State and local governments

Grantees are likely to select lower non-Federal match programs when several match programs are available to support a grantee's given project. While selecting Federal programs on the basis of match often financially benefits State and local governments, it can induce them to reshape or distort their project proposal to accommodate the restrictions of the lower non-Federal match Federal programs. In some cases, local program priorities are driven by the matching arrangements. For example:

- A Midwestern community action agency applied for a \$90,000 CETA grant with no match rather than for a Food and Nutrition grant, with a 40 percent non-Federal match, even though the latter grant better suited local priorities.
- A Western city, unable to meet the matching requirement for the Federal Urban Systems program to repair city streets, used funds from another Federal highway program without a required city match to repair State streets within the city. City officials said that their highest highway priority, however, was the repair of city streets.
- New York City's decision to build an interstate highway for its West Side transportation corridor was heavily influenced by the differing Federal and State matching rates available for transportation programs. According to a recent analysis, in spite of substantial community support for a mass transit alternative (80 percent Federal match share) and for reconstruction of the existing highway (70 percent Federal match share), these alternatives were ruled out due to the 90 percent Federal match share available for interstate highways. 1/

Adverse effects on the Federal Government

Achievement of Federal objectives and priorities may be inhibited by the existence of differing match rates among similar programs in the same functional area.

1/Regina Hozlinger, "Costs, Benefits, and the West Side Highway," The Public Interest, (Spring 1979), 77-78.

considered to be more in the Federal interest. For example, expensive structural flood control measures, such as the construction of reservoir channels, have a lower non-Federal match than less expensive nonstructural measures, such as land use controls or flood proofing.

Differing match rates in programs funding similar services create management weaknesses by giving grantees financial incentives to inappropriately charge costs to Federal grants with lower non-Federal matching rates or to stretch or ignore Federal program guidelines to fund marginally eligible projects under programs with lower non-Federal matching rates.

--Vocational Rehabilitation. The co-existence of two separate Federal vocational rehabilitation programs with different match rates leads grantees to stretch or ignore Federal guidelines to secure funding under the Federal grant program with a lower non-Federal matching rate. We found that States approved construction projects using Federal establishment grants, with a 20 percent non-Federal match, that did not comply with program regulations, while they should have legitimately been funded by a Federal construction program with a higher non-Federal share. 1/

--Social Services. Twenty Federal programs with differing match rates reimburse States for the costs of administering various social services programs. Since, in any one State, the same department and even the same employee may administer these different grant programs, there is a tendency by grantees to misallocate administrative costs to the Federal program with lower non-Federal matching rates. Also, the varying match rates cause complexity and confusion in accounting fully and properly for costs. Audits by Federal agencies have found that States charge costs to a Federal grant program requiring only a 25 percent grantee match rather than the appropriate program which requires a 50 percent match. One Federal agency disallowed \$11 million of claims by one State because the costs were improperly charged to a program with lower non-Federal matching rates.

1/"A Single Federal Authority Is Needed For Establishing Or Constructing Rehabilitation Facilities," (HRD-79-84, Aug. 23, 1979).

--Education. Three major programs--Title I Assistance for Educationally Deprived Children, Head Start, and Vocational Education--have the potential to fund a school district for disadvantaged target groups. Yet, Title I requires no match, while Head Start requires a 20 percent match and Vocational Education requires a 50 percent match. Meanwhile, Labor Department's Employment and Training programs, similar in objectives to the Vocational Education programs, require no State and local matching funds.

--Transportation. The urban mass transit construction program has a 20 percent non-Federal rate, while the interstate highway program has a 10 percent non-Federal rate. The 20 percent rate for mass transit was selected with an eye towards coordinating with highway programs; by striking a rate between interstate (10 percent) and non-interstate (25 percent) Federal highway match, the Federal Government felt that equitable and equal treatment would be given to mass transit. However, as will be discussed further, the 10 percent difference between the interstate highway and mass transit rates has discouraged some States from utilizing available Federal funds for mass transit.

Differing types of match

In addition to variations in match rates in the same functional area, differing requirements have been established under individual Federal programs to meet match. These differing requirements vitally affect the nature and burden that match imposes on grantees.

In its classic sense, match connotes a sharing of actual project costs by State and local grantees from their own resources. While OMB has tried to fashion a uniform administrative policy on in-kind sources for non-Federal match, Federal laws nevertheless still allow for much diversity among programs. Most Federal programs allow match to be met from existing non-Federal resources, while several require the match to consist of new resources. Federal agencies allow in-kind resources to be used to satisfy matching requirements unless program legislation requires cash match only. Some programs allow match to be met in the aggregate by the State, permitting the required non-Federal match to vary among projects within the State. Other Federal programs require each federally funded project to meet the required match. While

CHAPTER 3

MATCHING RATES NEED TO BE MADE MORE UNIFORM WITHIN FUNCTIONAL PROGRAM AREAS

Because matching requirements have been developed on a program by program basis, a complex and confusing array of matching requirements has emerged. Grant programs in the same functional areas serving similar purposes often require different matching rates and recognize varying ways to meet the match.

As a result, State and local government grantees are faced with a perplexing range of match requirements. Differing match requirements lead grantees to distort their selection of Federal grant programs to take advantage of more favorable match rates and conditions. In some cases, where differential treatment of match is not intended by the Federal Government, this distortion has a negative impact on the implementation of Federal priorities as well.

THE DIVERSE ARRAY OF MATCHING REQUIREMENTS

A non-Federal match is required in 63 percent of Federal grant programs available to State and local governments, which account for over 71 percent of Federal assistance dollars. However, the type, nature, and rates of match vary widely even in grant programs funding the same type of service or activity. These differences among match requirements critically affect the impact of match on State and local governments.

The legislative histories of many Federal grant programs do not reveal explicitly documented rationales for requiring match. Furthermore, when programs are first authorized, the rate of match itself is often established using rather arbitrary criteria.

In 1976, OMB asked Federal agencies for information on rationales for having or not having matching requirements in 34 of the largest Federal grant programs. The legislative and administrative histories reviewed by the agencies provided rationales for only 5 of the 25 programs with matching requirements. Of the nine programs without a match, only in four could agencies account for the reasons for not requiring a match.

State and local governments based on program need as is the case with most formula grant programs. Furthermore, we do not believe that a matching requirement is appropriate in those program areas where State and local investment heavily outweighs Federal grant outlays.

More specifically, we suggest that in creating new programs or reauthorizing existing programs, the Congress require a match only when one or more of the following conditions exist:

- It is needed to limit total Federal outlays in open-ended reimbursement programs.
- High level of recipient management attention, oversight, and commitment to the program as evidenced by willingness to fund a share of projects costs, is critical to the program's success or is a relevant criterion that should be used to screen participation in programs of limited applicability or that are demonstration in nature.
- Primary benefits of the grant programs accrue to residents within the State or local community.

When the Congress decides to require a match, we recommend that the following conditions be incorporated in any matching requirement:

- Include an effective maintenance of effort requirement for Federal programs to ensure that existing resources will be maintained and that resources used for the match will indeed be new grantee resources.
- The match should be for each project funded rather than provided in the aggregate.
- Allow, as appropriate, variable matching rates for grantees with low fiscal capacity, as measured by per capita income or other objective indices of taxing capacity.
- Permit Federal agencies to either reduce or eliminate the requirement temporarily on a case-by-case basis for grantees experiencing fiscal crisis.

CONCLUSIONS

Fundamental changes are needed in existing matching requirements. If they are to achieve their Federal fiscal and managerial purposes, matching requirements need to be strengthened to a point where significant State and local fiscal effort is called forth; otherwise, the matching requirement should be eliminated. Yet, because strengthened matching requirements could have an adverse impact on the implementation of broader Federal objectives, they should be used more sparingly and only when clearly appropriate.

The appropriateness of matching requirements should be assessed against the purposes of Federal grant programs themselves. The Federal Government has a clear interest in distributing grant funds on the basis of need and promoting fiscal stability in the State or local sector. Matching requirements mandating a specified level of non-Federal support may conflict with these interests by making participation contingent on State and local governments' ability and interest to finance the match.

In other cases, the purposes currently served by matching requirements in many grant programs may no longer be appropriate themselves. The stimulation of new State and local resources may no longer be an appropriate Federal objective. With less resources in the entire public sector, stimulative Federal grant policies aggravate fiscal pressure at all three levels of government. In addition, the sheer growth of Federal involvement in a host of program areas may make stimulation increasingly less tenable and more distortive of State and local priorities.

Finally, the Federal objectives other than stimulation may be appropriate but can be achieved through grant policies less disruptive than matching requirements. For example, more extensive State and local management oversight could be promoted through more widespread use of productivity incentives in Federal grant programs. Federal outlays on a national as well as grantee basis are already largely limited by factors other than matching requirements.

When the Federal objectives are deemed appropriate, existing matching requirements need to be changed because they do not generally help achieve these objectives. They are not strong enough in many cases to stimulate new fiscal commitment by States and localities to grant programs.

In times of budgetary decline, the price that must be paid to match Federal grants becomes more apparent and real. During periods of extreme austerity, financing the costs of existing or new federally funded programs can mean reducing local programs not eligible for Federal assistance. During our review, officials of 17 of 23 State and local governments experiencing fiscal retrenchment told us that they choose to retain their match in federally funded programs, forcing disproportionate cuts in their own locally funded programs. There is considerable economic logic for this--budget cuts are needed to reduce expenditures based on insufficient locally derived revenues. In order to live within a constrained local resource base, it is not nearly as productive to cut a program funded mostly from Federal grants. For example, a cut in a Federal program with a 25 percent non-Federal match would reduce the program by a ratio of 4:1--for every \$1 of local funds, \$4 of total program funds would be reduced. However, when a program is funded entirely from local revenues, a \$1 cut is far less devastating in programmatic terms.

Officials from several State and local governments which had undergone budgetary retrenchment told us that federally funded programs were spared while local or State funded programs experienced large cuts. For example:

- Officials of a large western city told us that a 1976 budget cut forced a 50 percent reduction in street maintenance to avoid reducing match for Federal programs.
- The Alcohol and Drug Abuse Division of a New England State suffered a 10 percent budget cut that was totally absorbed by the one half way house project not receiving Federal funds.
- Another New England State's budget cut was absorbed almost entirely by State-funded programs.
- A Western council of governments had to reduce funds available for discretionary local programs in order to finance Federal grant matching requirements.
- A Western county's 1976 budget cuts were apportioned in the following manner:

Matching requirements can distort State and local budgetary priorities

When match stimulates new State and local money for a federally funded program, State and local governments can raise the needed funds by either increasing revenues through taxation or distorting their budgets to divert resources away from nonfederally funded programs. The actual fiscal burden imposed on State and local governments by matching requirements is difficult to estimate because most grants can be matched with existing in-kind resources. However, half of the \$30 billion in non-Federal dollars required to meet minimum matching requirements in 1979 was accounted for by the cash match required by the two largest open-ended grant programs--Aid to Families with Dependent Children and Medicaid. The cash match required by these programs represents almost 6 percent of State and local own source expenditures. Governments with large caseloads must earmark a substantial share of their budgets to match these two programs alone. For example, the State of California devotes at least \$3.2 billion or 17 percent of its own source expenditures to match the 52 largest Federal grant programs. Included in this total is the \$2.4 billion the State pays in cash to match these two Federal open-ended welfare programs, representing 13 percent of the State budget. Similarly, in 1979 New York City spent \$744 million to match Federal Aid to Families with Dependent Children and Medicaid programs, accounting for 6 percent of its operating budget.

We found that money to match was often found through budgetary distortion by diverting State and local resources away from other non-Federally funded programs. Budget distortion was especially pronounced in the 23 governments experiencing budgetary cutbacks, as 17 of them chose to retain their spending levels for Federal grants requiring a match by cutting disproportionately in basic services funded with own source revenues.

While distortion of State and local spending towards grant programs may be the Federal intent for each program area, the aggregate price that must be paid in terms of reducing basic services that would otherwise be funded with State and local dollars, may not be fully realized at the Federal level. This price may be growing, as the proportion of State and local dollars needed to fund the minimum non-Federal match for all Federal grant programs has grown over the past 10 years.

Stimulative matching policies can deter participation

State and local grantees regardless of fiscal condition can be deterred from participating in programs where the match requirement is fiscally stringent, regardless of the rate.

Discouraging grantee participation can inhibit the extent to which Federal grant funds can be spread to jurisdictions most in need of the program. For example, even though the LEAA program required only a 5 to 10 percent non-Federal share, the cash nature of this match has discouraged participation, as has the Vocational Education program's 50 percent cash match requirement. For example:

- An LEAA Juvenile Justice grant was delayed 12 months because a Midwestern city could not raise the needed cash match (5 to 10 percent of \$400,000).
- A Midwestern county school district could not raise the 50 percent cash match needed to obtain a \$90,000 Vocational Education grant for occupational training development.
- A large Western State decided not to seek Medicaid funds for mental retardation services provided at Intermediate Care Facilities because the 50 percent match was coupled with a maintenance of effort requirement for this service. This meant that to qualify for Federal funds the State match had to consist of new resources over and above its already extensive investment in this area. The State decided that it could not afford to spend more at that time.

If a grantee does not have extensive resources already invested in the program, the matching requirement could deter participation in the grant program even if the match can be satisfied through the use of existing and in-kind resources. For example, a Mid-Atlantic county was unable to obtain and use its entire Federal Title XX allocation because no services were ongoing to use as in-kind and cash was not available. Within one large Midwestern city government, officials report that larger departments can meet the match by using existing resources, while other smaller city agencies might need to apply new resources to meet matching requirements.

adult education grants. Other local governments experiencing fiscal distress also provide examples of the impact on their participation in Federal grant programs:

- Officials of a large Western city told us that new Federal grant projects requiring a cash match were not being sought.
- A Midwestern county cut cash match earmarked in its budget for Federal grants due to a growing deficit.
- California local governments generally were forced to hold down their normal expenditure growth after passage of Proposition 13. As a result, many local government officials told us that they would be very reluctant to participate in additional Federal grant programs requiring a high match or future local assumption of costs.

Fiscal burden on fiscally poor grantees

When State and local governments with low fiscal capacity fund a matching requirement, they must exert a higher level of fiscal effort than wealthier communities. Jurisdictions with lower fiscal capacities have to make a greater fiscal effort to provide the same level of resources and services as wealthier communities.

Since most matching requirements are uniform for all States, it is not surprising that fiscal capacity, as measured by per capita income, bears no apparent relation to the match provided by States as a percent of Federal grants. For example, according to data extracted from a report by ACIR, California, ninth in per capita income, spends approximately \$.43 for every Federal dollar received, as compared with Hawaii, which ranks eighth in per capita income, but spends only \$.13 for every dollar of Federal grant funds received.

based on need. These problems must be considered in the formulation of Federal matching requirements for individual grant programs.

Screening out fiscally poor grantees

A high non-Federal match can cause problems for State and local governments with low fiscal capacity. In some cases, these jurisdictions will not participate in the grant program at all. When this occurs, the distribution of Federal funds can be diverted away from grantees most in need of program benefits. When they decide to fund the match and participate in the Federal grant program, these jurisdictions must make a much higher fiscal effort to meet the match than wealthier grantees. From an equity standpoint, an unfair burden is imposed by uniform match rates that treat fiscal unequals alike. Federal matching policies are very inadequate to deal with this problem.

Nonparticipation by poorer jurisdictions with greater program needs

In several cases, grantees with low tax bases or grantees with fiscal problems decided not to participate in Federal grant programs with a high non-Federal match. States generally experience the least amount of difficulty in raising match due to their broad tax bases. Counties and cities experience more problems due, in part, to their more constrained revenue sources.

The most dramatic case we observed of match diverting the distribution of grant funds away from fiscally poor and program needy grantees was in the Federal Maternal and Child Health Care program in a Midwestern State. Our analysis showed that 66 percent of the Federal funds coming to the State went to 4 counties with the least need for the program, as measured by four need indices, (rurality, income, and numbers of physicians and dentists per capita). Only 10 percent of the funds went to the 21 counties with greatest program needs. State officials confirmed that the need to raise the 50 percent required match skewed the distribution of funds away from those counties most in need. Because the State provided no match from its own funds, projects were funded in counties that could raise large amounts of match to help the State meet its overall match requirement. As a result, projects in areas with no present services were not funded. If no matching requirement were imposed, it would be easier for the State to fund more needy areas.

library services), while State and local governments retain substantial fiscal burdens for services involving perhaps the highest degree of national benefits (education, parks, welfare). Also, because the ratio of benefits flowing from a given program will vary for each grantee, one prominent economist argues that the match rates should therefore also vary for each grantee. ^{1/} However, the majority of grant programs with match do not permit this kind of flexibility.

As our earlier analysis of grantee screening showed, the matching requirements of most programs usually do not promote greater deliberation and review of program scope or size. Indeed, our review showed that match only rarely caused grantees to turn back available Federal funds or limit project size. We would conclude, therefore, that the rates are generally too low to serve as a control on the size of public programs.

Finally, it may not be appropriate for beneficiaries to pay their full share of costs in many public sector programs. First of all, many programs are financed through taxation in the public sector because their benefits accrue to the community or the nation as a whole, not to different groups or individuals. Such "pure public goods" as national defense or clean air benefit all members of society, regardless of whether or not they want to pay for the services.

Secondly, the benefit principle can conflict with the equity principle--ability to pay. If public services are distributed only to those willing to pay, they will also be skewed away from those not able to pay. The equalization of benefits to poorer jurisdictions has been used as a rationale for the creation of some Federal grant programs. The benefit principle may also conflict with another major purpose of Federal grant programs--to provide a minimum level of program benefits for all States regardless of the States' own willingness to pay.

MATCHING REQUIREMENTS CAN ADVERSELY
AFFECT ALL THREE LEVELS OF GOVERNMENT

As discussed previously, matching requirements are not having the kind of fiscal impact that could be expected if

^{1/}George F. Break, Intergovernmental Fiscal Relations In The United States (Washington, D.C.; The Brookings Institution, 1967)

funds. While this survey did not indicate whether match was a factor in promoting greater oversight, several legislative and central budget office directors in States we visited stated that 100 percent federally funded programs, while subject to the same formal controls, receive less real attention and oversight than State funded programs.

In a prior report we noted that, in general, Federal grants do not offer incentives to State and local governments to improve productivity in aided services, because dollar savings from more efficient operations accrue to the Federal Government in proportion to its matching share. ^{1/} For example, a former State budget director stated that there was no incentive for his budget analysts to review the level of unemployment compensation spending for administrative costs because any identified savings in that 100 percent federally funded program would accrue entirely to the Federal Government. Similarly, a Southern State Legislature's evaluation group chooses not to devote scarce analytical resources to the evaluation of 100 percent federally funded programs.

While we found little evidence that match has generally caused central managers to provide more formal oversight, strong matching requirements may help promote a higher level of actual oversight and attention to grant program management on the part of central managers.

For example, a recent nationwide survey of State legislative fiscal officers, conducted by the National Conference of State Legislatures (NCSL), found that the actual degree of Federal funds oversight by State legislatures varies from program to program. The extent to which a legislature may review a particular grant program depended on several factors, including but not limited to:

- the amount of State and Federal funds involved;
- the extent to which participation in a grant program commits the State to future expenditures; and
- the amount of State discretion allowed.

^{1/}"State and Local Government Productivity: What Is The Federal Role?", (GGD-78-104, Dec. 6, 1978).

funds cause more distortion of priorities and fiscal pressures than matching requirements. Indeed, a primary reason for the growing movement among State legislatures to appropriate and control all Federal grant funds has been their desire to place limits on the future budgetary liabilities of the State for federally funded programs. Our report to the Congress on Federal seed money programs documented these problems. 1/

State and local governments also seem to devote considerable attention to those block grants which give them maximum discretion in setting program priorities. Block grant programs like CETA and Community Development Block Grant that do not require a match nevertheless have promoted much internal debate at the highest levels of local government regarding program priorities and management. For example, officials of a Midwestern county told us that there is more deliberation over these no-match block grant programs than over the categorical programs with a match. Similarly, an official of a Western county told us that there is more local review of neighborhood restoration projects funded by the Community Development Block Grant program with no required local match than there was under an earlier categorical program with a local match.

Finally, the political impact of grants will often arouse controversy and deliberations over the need for the program even if no match is involved. For example, a Western county decided not to participate in several 100 percent federally funded grants because of local opposition. A nationwide study of State participation in the Federal Occupational Safety and Health program confirms the point. The study concluded that if the Federal share for consultative services were increased from 50 to 80 percent, 14 of 20 nonparticipating States would still not enter the program due to internal political opposition to a State role in the program.

MATCH DOES NOT USUALLY PROMOTE
BETTER MANAGEMENT OVERSIGHT

Closely related to the screening rationale is the argument that State and local governments will take a more active interest in overseeing and managing the Federal grant project if their own money is involved. Match is generally not a

1/"The Federal Seed Money Approach: More Careful Selection And Application Needed," (GGD-78-78, June 22, 1979).

Distribution of match rates among Federal programs

| <u>Required non-Federal share</u> | <u>Numbers of programs</u> | <u>Percent of programs</u> |
|---------------------------------------|--------------------------------|--------------------------------|
| 50% and above | 47 | 9.2 |
| 26 - 49% | 11 | 2.1 |
| 11 - 25% | 60 | 11.7 |
| 1 - 10% | 44 | 8.6 |
| 0 | 191 | 37.2 |
| Variable | 54 | 10.5 |
| Negotiated cost sharing | 106 | 20.7 |

Lower match rates and in-kind match--found in the majority of Federal grant programs--do not appear to foster any more deliberation than occurs for 100 percent federally funded programs. More importantly, State and local officials told us that other Federal program features, such as the discretion given to State and local officials to set program priorities, the future costs to be borne by non-Federal sources when the Federal grant terminates, and the political appeal of the grant itself are of equal or greater importance in triggering full State or local review of grant participation.

Staff in the budget office of a Western State, for example, said that a 25 percent or less non-Federal match offers a good return on State money and would not be intensively reviewed. Several other States also indicated that, in general terms, a 25 percent non-Federal share marks a critical threshold--grants with a greater non-Federal share seem to call forth more intense State scrutiny.

Officials of most jurisdictions we visited also stated that grants with in-kind match will not trigger top level deliberation because they know in-kind matching can be satisfied without new resources. In fact, several jurisdictions we contacted considered grants with in-kind match to be "free." As a result, Federal grants can be used for programs of low local priority or questionable effectiveness. For example, a Midwestern State Legislature questioned the success of the Federal Work Incentive program. However, when additional work incentive program funds became available, the State accepted the grant because the 10 percent non-Federal share could be met from existing State resources.

State legislative leaders have noted that existing Federal rules on matching, particularly in-kind and aggregate match,

| | <u>Urban Mass Transit operating subsidies</u> | <u>Vocational education</u> | <u>Law enforcement assistance</u> | <u>Maternal and child health</u> |
|----------------------------------|-----------------------------------------------------------|---------------------------------|-------------------------------------------|--------------------------------------|
| | ----- (percent) ----- | | | |
| Actual non-Federal match: | | | | |
| Illinois | 68 | 91 | 16 | 50 |
| Indiana | 50 | 64 | 13 | 63 |
| Michigan | 53 | 86 | 28 | 50 |
| Minnesota | 80 | 98 | 26 | 62 |
| Ohio | 69 | 87 | 24 | 57 |
| Wisconsin | 57 | 91 | 25 | 69 |
| Required non-Federal match | 50 | 50 | 10* | 50 |

*Changed in 1979 to 3.75 percent of grant award.

In several cases, heavy prior State and local expenditures in a federally funded program area not only made the match non-stimulative but also probably resulted in substitution of Federal for local funds that would otherwise have been spent. For example:

--A Mid-Atlantic city had budgeted \$1 million of its own funds for bicycle trails. When Federal Outdoor Recreation funds were awarded for this purpose, the city replaced \$437,000 of its own money with the Federal grant, leaving the rest to satisfy the matching requirement.

--Four of six localities in a Midwestern State budgeted less non-Federal transit spending during the first year of Urban Mass Transit operating subsidy grants than the year before, in spite of the grant program's 50 percent match requirement.

and Community Development Block Grant, and several smaller programs can be used to satisfy the match required under other Federal programs. The use of Community Development funds to satisfy a match is conditioned upon the proper inclusion of the grant project (for which the match is required) in the grantee's community development program. Once that condition is satisfied, Community Development funds are viewed as local resources for the purpose of satisfying the other program's local matching requirements.

Given the highly fungible nature of general revenue sharing funds, it would be difficult, if not impossible, to prevent State and local governments from indirectly using these funds as match regardless of formal Federal policy. For example, officials of a Southern State said that general revenue sharing money is used to fund State education programs which frees up State money to be used in other areas.

Officials from 19 of 25 State and local governments said they used either General Revenue Sharing or Community Development Block Grants to satisfy matching requirements for their other Federal grant programs. For example, in a New England State, as much as 70 percent of the local match for Federal Outdoor Recreation program funds was comprised of Community Development Block Grant funds. State and local officials feel justified in such practices because, in their view, these funds have been given to them to use at their own discretion. According to officials of a New England State, local governments would not be able to participate in the Outdoor Recreation Program which requires 50 percent match if they could not use Federal funds as match.

This practice does, of course, inhibit the stimulation of new State and local resources for Federal programs. In fact, the combined \$11 billion in Federal fiscal year 1980 outlays for both the General Revenue Sharing and Community Development Block Grant programs could significantly offset the impact of the \$31 billion in minimal non-Federal match required in the aggregate by all Federal grant programs. State and local governments could offset fully one-third of their matching obligations by using these funding sources as match.

Prior State and local spending often exceeds the non-Federal match

When a grantee is allocating significant non-Federal resources to a program area, it is unlikely that match will be stimulative. In areas where current non-Federal spending

In-kind contributions represent the value of noncash contributions provided by (1) the grantee, (2) other public agencies and institutions, and (3) private organizations and individuals. In-kind contributions may consist of charges for real property and equipment and the value of goods and services directly benefiting and specifically identifiable to the grant program. Existing indirect costs of both public and private organizations, including the value of volunteers' time, may in some cases be counted toward the non-Federal share as long as these resources directly benefit the federally funded project.

Many grantees use in-kind match extensively, especially where high overhead or indirect costs can be allocated to meet the matching requirement. For example, a large Midwestern city estimated that its in-kind match is four or five times the amount of cash match allocated for grant programs. City officials stated that meeting matching requirements does not present problems due to the opportunity to use in-kind resources, especially for larger city departments with extensive overhead.

Several grantees stated that they view Federal funds with an in-kind match as "free" Federal money. To illustrate their point, officials from several local governments said that while cash match would be reflected in their budgets, in-kind is not because existing resources are used. Other grantees said that in-kind resources enabled them to participate in the grant program because no new public funds have to be raised. For example, a Midwestern community action program had to raise \$500,000 in match for its Federal grant, of which only \$1,000 was in cash, while the rest consisted of in-kind time contributed by volunteers. Local agency officials felt they could not have raised all of the match in cash from area local governments. Similarly, a New England State used land donated by private sources as its contribution in 10 of 12 projects funded recently under the Federal Outdoor Recreation Program. State officials told us that the required match could not have been provided from public funds. A Western State official told us that his State would have to reduce or discontinue many programs if in-kind match were changed to cash.

Other examples of existing in-kind costs used to satisfy a matching requirement follow.

--A Western State used the fringe benefit costs of social services department employees that it would have had to fund anyway as match for the Social Services Block Grant (Title XX) program.

- The budget director of a Southern State said the State has been spending more on social services in recent years due to the pressure to match all available Federal Title XX Social Services funds.
- The chief engineer of a Midwestern city said he uses match as a lever to pressure the budget office for more city funds in Federal program areas. For example, without the match, he doubts that the city would spend as much as it does on street reconstruction. Also, the city's contribution to a project extending highways into an industrial park is greater than it otherwise would have been due to the match required for the Federal economic development grant supporting the project.
- Executive and legislative fiscal officers of a Southern State felt that, without the matching requirements, the State would probably not provide current levels of funding for outdoor recreation or family planning.

However, we found in many of the governments we contacted that matching does not stimulate new resources, but rather triggers the identification of existing resources to satisfy the matching requirements.

Why matching does not produce stimulation

A matching requirement would not be stimulative if the match were provided from existing resources that the grantee would have provided anyway for the grant program area.

Several Federal policies and rules serve to blunt the stimulative impact of match. Most programs do not require the match to consist of new non-Federal resources. Furthermore, the Federal policies which recognize in-kind resources as match lend themselves to the identification of existing rather than new resources. Program rules allowing match to be met in the aggregate by an entire State rather than for each project also reduce the stimulative effect. Perhaps of even more significance is the availability of major unrestricted Federal General Revenue Sharing funds and Community Development Block Grant funds, both of which can be legitimately used to match other Federal grant programs. These funds could potentially

Our analysis showed that 56 percent of all Federal project grants require a match.

Strategies other than matching are often used to spread limited project grant funds to a maximum number of grantees. According to ACIR, 47 of the project grant programs constrain competition for funds by imposing a limit on grant outlays that can be funded for each State area. Other Federal project grants impose unit cost limitations to further limit payment to each grantee. For example, the Occupational Safety and Health Administration consultative services program matches 90 percent of State program costs but will reimburse each State only for the number of inspectors up to 25 percent of the Federal inspectional staff working in that State.

In another example, while a Federal drug abuse program official asserted that match helps the National Institute on Drug Abuse spread Federal project funds, he acknowledged that the agency has an informal allocation system for its discretionary, competitive grant program to spread funds more broadly to grantees. Furthermore, when grantees apply for more than is available, his agency works with them to scale down the projects. The agency's rules establishing maximum cost per client also help spread limited Federal funds.

States that pass through Federal funds to local grantees also impose funding ceilings on individual projects. For example, a Mid-Atlantic State's Medical Facilities Plan limited the maximum amount of funds awarded to any given health care facility project to \$625,000, regardless of the stipulated match share. Other States imposed unit cost reimbursement ceilings which also limited funding to any one project. For example, a Midwestern State allowed a maximum \$7,500 per vehicle for local governments purchasing ambulances under the Federal highway safety program, even though actual costs were estimated to be \$20,000 per vehicle. Finally, States often place limits on the amount of indirect costs that may be claimed by grantees so funds can be spread to more grantees for direct program costs.

MATCHING REQUIREMENTS OFTEN DO NOT
STIMULATE NEW STATE AND LOCAL SPENDING

A program's congressional and administration sponsors can be so convinced of the program's value that they try to design the grant instrument to leverage a total public sector resource commitment far exceeding the limited Federal dollars available. By requiring a non-Federal match, the Federal Government attempts to stimulate a larger program than limited

intergovernmental grant system. This system is concerned with (1) providing a minimum level of services judged to be in the national interest and (2) reducing fiscal pressures on State and local governments, especially those whose lower fiscal capacities would require a disproportionate effort to provide these minimum services. For those programs with strong or stimulative matching requirements, those governments choosing to participate have to exert a greater tax effort or reduce nonfederally funded services to fund the match, thus distorting priorities or increasing tax burdens. Those State and local jurisdictions that can not easily afford to satisfy the match sometimes choose not to participate in Federal grant programs and as a result, the distribution of Federal grant funds is diverted away from jurisdictions most in need of program benefits but least able to pay.

MATCHING USUALLY DOES NOT LIMIT FEDERAL GRANT OUTLAYS

Matching can be justified as a way to help the Federal Government limit total budgetary outlays and spread limited dollars to a larger number of grantees by passing on some of the costs to non-Federal sources. However, the limits on total Federal outlays for most grant programs is not primarily a function of matching requirements but rather of program appropriations ceilings. Furthermore, the amount of Federal funds flowing to grantees is primarily determined by criteria other than match.

Limited impact on total Federal grant outlays

Matching serves to limit total Federal outlays for a grant program when the Federal Government is obligated to match a portion of all eligible State and local expenditures without any ceiling. For these open-ended programs, Federal outlays are controlled by total eligible State and local expenditures, which are presumably somewhat constrained by the match requirement. There are currently three major open-ended grant programs with matching requirements--Medicaid, Public Assistance, and National School Lunch. These programs comprise \$20 billion in annual Federal outlays, or 25 percent of total Federal grant dollars.

The vast majority of Federal assistance programs, however, are close-ended in nature. By this we mean that total Federal outlays for the entire grant program are controlled by a fixed annual appropriation, not by the match. Under close-ended grants, therefore, Federal agencies can only fully match all eligible State and local costs up to the appropriated dollar ceiling.

of our State and local visits, we met with executive and legislative budget officials, departmental program staff, and Federal grants coordinators. In the course of our field visits, we examined the response of the State and local budgetary process to Federal grant funds. In each government visited, we discussed the variables that affect State and local budgetary decisions for Federal grant programs in general with all actors in the budget process. We then did an in-depth analysis of the decisionmaking process at each government for 10 major Federal grant programs to deepen our understanding of the fiscal impact that match and maintenance of effort requirements may have in different program contexts.

To broaden our State and local coverage, we enlisted the assistance of public interest groups to solicit information from other selected governments. Intergovernmental grant coordinators from selected cities and counties were asked by their Washington based associations to respond to a list of propositions we developed about the effects of matching and maintenance of effort requirements. In addition, the Governor's offices of two States (Florida and Michigan) submitted a separate questionnaire we prepared to their respective administrative departments. Finally, we benefited from extensive consultation with the Intergovernmental Relations Committee of the National Association of State Budget Officers, the National Association of State Legislative Fiscal Officers, and the National Association of Counties' Council of Intergovernmental Coordinators. Members of these organizations provided us with further examples illustrating the impact of matching and maintenance of effort requirements.

To analyze the Federal formulation and administration of these requirements, we performed in-depth reviews of 18 Federal grant programs containing a mix of matching and maintenance of effort requirements. These programs were administered by eight Federal agencies. For each of these programs, we reviewed legislative intent and discussed program implementation with administrators in headquarters offices. In addition, to gain a more comprehensive understanding of the significance and scope of these requirements, we contacted officials of the 52 largest Federal grant programs to develop information on the type of requirements, available waivers, and sanctions. (See app. III.)

While the history of matching and maintenance effort requirements is fairly obscure, both requirements have become enduring features of the Federal assistance system. Since 1890 when match from the States was first required, some form of non-Federal financial participation has been required in most programs. Presently, according to the Catalog of Federal Domestic Assistance, a non-Federal match is required in 63 percent of the 513 Federal grant programs available to State and local governments, representing over 71 percent of Federal assistance dollars. OMB estimates that grantees will allocate nearly \$31 billion in fiscal year 1980 to provide the minimum non-Federal match required for Federal grant programs, representing almost 12 percent of State and local own source expenditures, up from 8 percent in fiscal year 1971.

While data on maintenance of effort is not readily available for all programs, our analysis of the 52 Federal grant programs with over \$100 million in fiscal year 1980 Federal outlays showed that 39 of these grant programs, which accounted for 74 percent of total Federal assistance outlays, had some form of maintenance of effort requirement. (See app. III.)

The fiscal effort that grantees must maintain to be eligible for Federal funds effectively serves as a matching requirement. Many Federal programs including the Community Development Block Grant program, major Federal education programs, and the Comprehensive Employment and Training Act program (CETA) are ostensibly 100 percent federally funded. However, the maintenance of effort requirements of each of these programs could encumber a large share of State and local budgets.

These requirements grew in an ad hoc, incremental way to become a dominant feature of the Federal assistance system at a time when the State and local sector itself was growing at a vigorous pace. To some degree, Federal requirements like match and maintenance of effort were implicitly premised on this extraordinary growth, and, in fact, further stimulated growth. The recent slowdown in the growth of the State and local sector combined with the growing Federal fiscal presence in a broader range of State and local services raises questions about the appropriateness of Federal policies encouraging greater State-local expenditure growth in an increasing number of national priority areas. The declining fiscal growth rates in the State and local sector and the growing scope of Federal assistance are discussed in more detail in appendix I.

The wisdom of stimulative grant policies is further undermined by the development of a series of countervailing Federal

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GAO also recommends that nonsupplant requirements no longer be used due to the problems involved in their enforcement. As with matching, the Congress may wish to designate a single point of referral to review maintenance of effort provisions contemplated by individual grant program legislation. GAO also recommends that the Office of Management and Budget (OMB) include information on maintenance of effort requirements in the description of grant programs listed in the Catalog of Federal Domestic Assistance. (See p. 72).

AGENCY COMMENTS

OMB said that the report was an interesting and useful analysis of the effects of matching and maintenance of effort requirements. (See p. 73.)

OMB agreed with GAO's recommendation that it revise the Catalog of Federal Domestic Assistance to identify the existence of maintenance of effort requirements in Federal grant programs.

OMB had some specific comments on other aspects of the report. It suggested that GAO's recommendation that the Congress enact cross-cutting policies for matching and maintenance of effort would not affect the consideration of these requirements in the development of individual programs. GAO agrees that the proposal would not necessarily be self-policing and modified the report to suggest that the Congress may wish to establish a single point of referral within each House to consider matching and maintenance of effort requirements when proposed in legislation.

OMB believes that adoption of GAO's maintenance of effort recommendation that would penalize grantee spending reductions with a proportionate, not total, reduction in Federal grant funds would give grantees an incentive to reduce their spending, and thereby substitute Federal for State or local funds. Total reduction, while it protects the Federal interest, constitutes a severe penalty with effects on State and local budgets and priorities that may be inappropriate during a period of budgetary retrenchment.

use Federal grant opportunities. (See p. 40.) These governments tend to apply for grants with lower non-Federal match or are tempted to improperly charge costs to such programs. As a result, some programs with higher non-Federal match are underused, to the detriment of Federal objectives. (See p. 43.)

Because present matching requirements do not always achieve Federal objectives and are often arbitrarily developed, changes are needed. GAO recommends that the Congress apply matching requirements more deliberately and sparingly and offers criteria to assist the Congress in making its decisions. (See p. 37.)

To ensure that the aggregate impact of matching requirements is considered in the development of individual grant program legislation GAO also suggests that each House of Congress establish a single point of referral to review the matching requirements contemplated in legislation. (See p. 39.) When the Congress deems that matching requirements are necessary, GAO recommends that the match rates be more uniform within functional areas. (See p. 47.)

MAINTENANCE OF EFFORT REQUIREMENTS
SHOULD BE STRENGTHENED BUT MADE MORE
FLEXIBLE

Maintenance of effort requirements serve a central Federal purpose by ensuring that Federal grant funds are used to support additional program activities as intended by the Congress, not to replace State or local support for these activities. Most existing maintenance of effort requirements, however, are not strong enough to ensure that Federal funds will be used by State and local governments to increase programs, and not to replace State and local funds that would otherwise have been spent.

Fixed level of effort provisions, which require State and local governments to maintain past spending, are often not updated to keep pace with inflation. (See p. 50.) Nonsupplant

Matching requirements need to be used more sparingly and only where a clearly articulated Federal interest does not conflict with the broader purposes of Federal grant programs themselves. Maintenance of effort requirements, while usually serving a clear Federal interest, need to be changed to more effectively prevent the substitution of Federal for State and local funds as well as provide for more State and local budget flexibility by not penalizing bona fide State and local budget reductions.

MATCHING REQUIREMENTS NEED TO BE
STRENGTHENED BUT USED MORE SPARINGLY

Matching requirements usually do not satisfy their Federal fiscal and managerial objectives. They do not limit Federal grant outlays at the national level except in those few programs that are not controlled by appropriations ceilings. In the majority of other programs the objectives are not met because all levels of government want the greatest participation in Federal programs with the least financial burden. Thus, non-Federal matching requirements are typically low and can often be met with existing resources. As a result, matching requirements usually

- do not stimulate additional State and local resources for grant programs (see p. 8),
- do not encourage top State and local officials to deliberate the merits of participating in Federal grant programs (see p. 17),
- do not promote grantee oversight of grant program management (see p. 20), and
- do not reflect the proportionate benefits grantees derive from grant programs (see p. 23).

These Federal objectives are more likely to be achieved if matching requirements are strengthened by increasing the rates and

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