FOIA Number: 2006-0462-F

FOIA MARKER

This is not a textual record. This is used as an administrative marker by the William J. Clinton Presidential Library Staff.

Collection/Record Group: Clinton Presidential Records

Subgroup/Office of Origin: Speechwriting

Series/Staff Member: Terry Edmonds

Subseries:

OA/ID Number: 17510

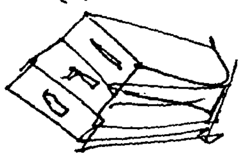
FolderID:

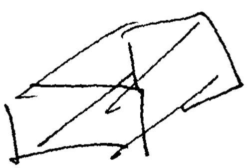
Folder Title:
NGA [National Governor's Association] 2/28/00 [1]

Stack:	Row:	Section:	Shelf:	Position:
S	0	0	0	0

r^W UGA fol 28 a

Joshua Smith



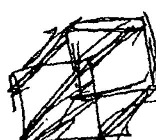


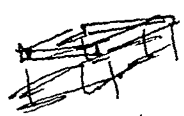
New Jersey —
many pet accom

Disc-

Drew Fast

Bible Stud





Final 2/27/00 5:45pm
Edmonds

2-28-00

PRESIDENT WILLIAM J. CLINTON

REMARKS AT NATIONAL GOVERNORS ASSOCIATION ANNUAL MEETING

THE EAST ROOM

FEBRUARY 28, 2000

copied
Gottheimer

Acknowledgments: Governor Leavitt, Gov. Glendening, John Podesta, Mickey Ibarra, members of my Cabinet.

Good morning. And welcome back to the White House. Hillary and I ~~always look forward to this annual gathering. And we~~ especially enjoyed the time we spent with you last night ~~at dinner~~.

I~~t is hard to believe that I have been involved~~ in ~~some way with these NGA meetings for more than 20 years now. As you know, I have a special appreciati~~on ~~for the work you do to build strong communities and provide critical services to millions of Americans~~.

2·28·00

I have tried, over the last seven years, to build a genuine ~~be a good~~ partnership with you based on gtr res., gtr flex., more explicit commitment to shared goals. Results have been good — ~~partner by giving you more resources and flexibility to meet your local challenges.~~ ~~The fruits of that partnership are evident in everything from our success in~~ cutting welfare rolls in 1/2 ~~and moving millions of people from welfare to work, to~~ to enrolling 2 million children in the State Children's Health Insurance Program, ~~to our success in~~ to getting 150,000 young people involved in AmeriCorps. to improving Ed. This yr we have ~~And I know I don't have to tell all of you how important it is that we all~~ to work together in that same spirit to count every American in the ~~this year~~'s census. I thank you For all that we have done together and all that we will do in the future, ~~I want to thank you~~.

~~Largely because of our joint efforts~~, We are beginning this new century on a very high note. ~~Just last week, we learned that our economy grew at an annual rate of 6.9 percent~~

Ec growth was 6.9%, the

~~per~~t in the last three months of 1999 -- ~~the~~ fastest

fastest

growth in more than a decade, ~~And we've had growth of~~

This mo, expansion became

~~more than 4 percent for four years in a row, while keeping inflation at its lowest level in 30 years. This is further evidence that we are in the midst of the longest and~~

the

strongest ~~economic expansion~~ in our nation's history.

Our social fabric is also on the mend; ~~Together, our efforts have cut crime by 20 percent~~ -- the lowest crime level in 25 years.

2-25-00

Teen births are down, seven years in a row. Adoptions are up 30 percent, ~~And~~ and welfare rolls ~~have been cut in half~~ ~~to their~~ lowest levels in 30 years, pov lowest in 30 yrs, AA, Hisp ~~un~~ lowest ever,

Gov't role is to ~~[illegible]~~ give the tools & condits to ~~[illegible]~~ ~~the~~ advance the New Econ.
~~So, these are good times.~~ But we all ~~know that they didn't happen by accident. We got here because of our commitment to~~ fiscal discipline, investments in our people, and ~~a strategy of opening~~ new markets for American products and services. ~~Our task is to build on this progress so we can build an even brighter future for our children.~~

~~In a few minutes~~ Today we will ~~conduct~~ have a roundtable discussion of three issues vital to our continued success: health care, trade – especially the importance of giving American business, farmers and workers access to 1 billion new customers by passing Permanent Normal Trade Relations for China, and the impact of digital technology on this new economy. We will also talk about what we have already done, and what more we can do to help American families cope with rising home heating oil prices -- especially in the Northeast.

On Friday, I sent a supplemental appropriations request to Congress to replenish the LIHEAP fund to help more hard-hit families through this crisis.

2-28-00

We also want to ensure that there is enough money in the fund for others who may need help later in the year when the weather gets hot.

Since January, we have allocated $295 million to help those in need. In addition to making up that shortfall and ensuring that there are sufficient funds for the future, we are also requesting $19 million in additional funds for the Department of Energy's weatherization programs. These funds will help increase the energy efficiency of homes and reduce energy costs for families. We are also requesting resources that will help make $86 million in SBA loans available to small HHO distributors ~~businesses affected by rising oil prices~~.

~~This will allow home heating oil dealers, for example~~, to extend flexible payment terms to their ~~heating oil~~ customers who were hit hard by the recent price spike.

I urge the governors who are receiving these LIHEAP funds to adjust eligibility standards to assist as many low and moderate-income families as possible under the law, keeping in mind ~~I also want to remind you that federal law permits~~ states can ~~to~~ use Temporary Assistance for Needy Families (TANF) funds to provide emergency heating assistance to very low-income families with children.

2

As you know, Secretary Richardson is conducting a 60-day study of diversifying energy supplies and possibly converting factories and other major oil users to other fuels in order to free up oil supplies for home heating use.

3

We ~~have~~ also ask~~ed~~ refiners to keep producing at full-throttle until this crisis is past. 4 ~~And~~ we have also directed the Coast Guard to expedite deliveries of home heating oil ~~to~~ th~~e affected areas~~.

Finally, I hope we can begin a discussion of how to make our economy even more energy efficient so we are not so dependent on the ups and downs of supplies and not so affected by future price increases.

Whether in response to an earthquake, hurricane, flood, or farm crisis, Americans have always pulled together to help each other to meet our toughest challenges. Families in the Northeast need our help now -- and we're going to make sure they get it.

Before we begin our roundtable discussion, I want to say a few words about three other issues that are important to every governor in this room and every citizen across the nation: education reform, the current debate over the best way to provide a Medicare prescription drug benefit, and environmental stewardship.

Over the past seven years, even while we balanced the budget, turned deficits into surpluses and positioned ourselves to pay off the national debt in 13 years, we have still worked together to invest more in our schools and demand more in return. We have worked hard for higher standards, greater accountability and extra help so all children can meet those high standards. Virtually every state has embraced that approach. Last year, with your help, we enacted a landmark school accountability fund that will provide $134 million to help states and school districts turnaround failing schools. Last week, I announced new guidelines to help states invest in what works. We can't expect our children to aim high in schools that are performing low.

I want to thank you for your partnership in the accountability movement and I want to ask you to stay with us as we work to strengthen our focus on results.

Another issue of increasing importance to states is the growing challenge presented by the lack of prescription drug coverage for seniors. Many people don't know that states, through their Medicaid programs, are the single largest purchasers of drugs in the world. Increasing drug costs are likely to be one of the fastest growing components of Medicaid programs in the years to come.

We all recognize that we need to modernize and reform the Medicare program – to extend its life, while making it more efficient, competitive and better able to meet the challenges of the aging of America. I hope, as part of this broader reform, we can work with you to develop a privately contracted, voluntary, Medicare prescription drug benefit. This is a life and death issue for many seniors. We must not let another year pass without taking action. Tomorrow, I am planning to release a state by state analysis of the health, financing, and demographic challenges facing the Medicare program and the tens of millions of Americans it serves.

Finally, let me say that this also is the year to secure permanent funding for the protection of precious lands across our nation. Last year, Congress approved a substantial increase in our Lands Legacy initiative. Two weeks ago, as part of this initiative, I announced $60 million in grants to states to create parks, save open space and protect forests.

My new budget proposes another substantial increase -- a record $1.4 billion to protect land and coastal resources. And I am proposing to make this higher level of funding permanent. At least half of this funding would support state and local conservation efforts. Let's work together to make this our gift to the future.

Now, I'd like to call on your chairman and my friend, Gov. Leavitt to make some opening remarks.

Thank you.

TE
NGA

Governance in the New Economy

by Raymond C. Scheppach

and

Frank Shafroth

Since their initial meeting in 1908 to discuss interstate water problems, the Governors have worked through the National Governors' Association to deal collectively with issues of public policy and governance. The association's ongoing mission is to support the work of the Governors by providing a bipartisan forum to help shape and implement national policy and to solve state problems.

The members of the National Governors' Association (NGA) are the Governors of the fifty states, the territories of American Samoa, Guam, and the Virgin Islands, and the commonwealths of the Northern Mariana Islands and Puerto Rico. The association has a nine-member Executive Committee and three standing committees—on Economic Development and Commerce, Human Resources, and Natural Resources. Through NGA's committees, the Governors examine and develop policy and address key state and national issues. Special task forces often are created to focus gubernatorial attention on federal legislation or on state-level issues.

The association works closely with the administration and Congress on state-federal policy issues through its offices in the Hall of the States in Washington, D.C. The association serves as a vehicle for sharing knowledge of innovative programs among the states and provides technical assistance and consultant services to Governors on a wide range of management and policy issues.

ISBN 1-55877-330-4

The responsibility for the accuracy of the analysis and for the judgments expressed lies with the authors; the report does not constitute policy positions of the National Governors' Association or individual Governors.

Printed in the United States of America.

Table of Contents

Foreword

There have been times in U.S. history when the rate of change was so rapid that it would have been prudent to pause and reevaluate existing institutions, processes, societal norms, business practices, and governance. During its 224-year history, this nation has experienced at least three periods when such a reevaluation was necessary—the Industrial Revolution, Progressive Era, and the New Deal. However, too often the decisions that shape many facets of American life are made incrementally rather than as part of a plan or vision.

America is once again on the edge of a major revolution with technology and globalization as key forces driving change in the economic landscape and the federal-state partnership. *Governance in the New Economy* raises issues, poses questions, and discusses options to begin a debate on a blueprint for a new, more vibrant federalism. To jump-start these discussions, it looks at four critical areas of federal-state governance—discretionary grants, entitlement programs, tax and revenue systems, and regulations. The intent is not to provide answers but merely to propose guiding principles and possible models. This report also contains a special section with specific perspectives by Governors Roy Barnes of Georgia, Jeanne Shaheen of New Hampshire, and Jim Geringer of Wyoming. These three Governors looked at specific issues critical to their states' participation in the new economy and at what changes, over the next decade, will be required to ensure the success of the state-federal relationship.

Hopefully, over time, this discussion will lead to a shared new vision for a strong federal-state partnership in the twenty-first century. This debate will begin with the first historic meeting of the U.S. Senate and the nation's Governors on February 29, 2000.

Governor Michael O. Leavitt, Utah
Chairman
National Governors' Association

Governor Parris N. Glendening, Maryland
Vice Chairman
National Governors' Association

Acknowledgements

The authors express their appreciation to Joanne Snow Neumann, director, Washington, D.C., Office, Utah; and Elizabeth R. Pyke, director, Washington, D.C., Office, Maryland, for their insightful comments and valuable guidance.

The authors also thank the following individuals who contributed greatly to this report and its preparation: Terrell Halaska, Christine LaPaille, Tess Moore, Gretchen Odegard, Matt Salo, and Kathy Skidmore-Williams of the National Governors' Association; and Karen Glass, editor.

Summary

Sometime in the not too distant future, Governors will make decisions about where in their state to target federal resources for economic development based on communities' ability to design and implement a plan that will achieve measurable results. At the end of the fiscal year, the state will provide the federal government with data that determine whether the economic development programs have succeeded in revitalizing the targeted communities. Citizens will participate in determining success or failure. The data will have to justify the expenditure of multi-agency funds from a flexible, federal account with predetermined measures of success. If communities have surpassed their economic development goals, the state will receive a federal funding bonus that can be spent on additional economic development efforts.

Take this scenario one step further and envision the communities as "customers." State and local leaders will be able to comprehensively and strategically plan for revitalized local economies, as a result of a single grant from the state's "economic development account" that the federal government funds. The grant will provide funds to retool outdated manufacturing facilities to accommodate new, high-technology businesses as well as to train workers to prepare for the new high-technology jobs. The support services that workers need, such as child care and transportation to training sites, will be provided in this same grant as part of a new, holistic approach to government services and programs. In addition, the marketing strategies to attract private-sector investment in these communities will be funded from the same grant, bringing the economic development cycle full circle. Each year, communities must show measurable progress, according to predetermined criteria established by the federal-state economic development partnership.

To some, this may sound like a governance model for the future. Yet the future is now. As the world hurtles forward in this global and digital age, the need to make fundamental changes in the way government does business takes on added urgency.

The National Governors' Association's *Governance in the New Economy* examines the forces shaping the U.S. economy and influencing American governance. It identifies guiding principles and new models to restructure the partnership between the states and the federal government to better serve citizens and businesses in the twenty-first century. It looks at governmental strategies and governance issues that leaders at both levels must address to enable the United States to compete in the new economy. It also explores innovative, customer-friendly ways to deliver and administer government programs and services.

Governance in the New Economy raises issues, poses questions, and discusses options to begin a debate on a blueprint for a new, more vibrant federalism. To jump-start the discussions, it looks at four critical areas of federal-state governance—discretionary grants, entitlement programs, tax and revenue systems, and regulation.

Competing Forces Bring Challenges and Opportunities

Globalization, technology, and deregulation are forces that are reshaping the economic environment and prompting changes in the way the nation governs. Most levels of government have begun to take small steps to accommodate these forces in their approach to governing. For example, the Internet is fast-becoming an accessible and valuable source of information about government programs and services, and, in some cases, government services are available online.

Yet the government that "customers" of the twenty-first century want and expect is more accountable and responsive to their needs. This will require further devolution of federal programs and measures to assess performance.

In contrast, the international marketplace requires more uniformity. Businesses can no longer accommodate the existing patchwork quilt of state laws, regulations, and tax programs. Consequently, the federal government must have a greater role in setting uniform standards in many areas. However, in doing so, the federal government need not impose limits on states' sovereign powers. Careful thought must be given to which decisions could be moved to the federal government and which could be shifted to state and local governments.

To assist the United States in maintaining its world economic leadership and citizen support, governments at all levels must adopt new strategies such as the following.

Reengineer government to become more flexible, adaptable, customer-oriented, and performance-driven. This includes focusing on results, decentralizing decisionmaking, and using technology to improve service delivery.

Make strategic investments to build the intellectual and physical infrastructure needed in the new economy. This includes providing lifelong learning opportunities and enhancing transportation and telecommunication systems to support commerce and improve the quality of life.

Reshape the economic environment to facilitate business expansion and eliminate market distortions caused by outmoded taxes and regulations. This includes revising tax systems, simplifying regulations, refocusing research and development on economic outcomes and commercialization, and increasing access to venture and seed capital.

Responding to the forces of change and implementing these strategies requires a dynamic federal-state partnership and new models of governance.

A New Federalism Is Required

The current governance system that contributes to ad hoc, narrow-sighted decisions must be replaced with a new, broad vision of federalism. In developing a blueprint for this new federalism, guiding principles could include the following.

First, to develop more performance-oriented and accountable government, the roles and responsibilities of the respective levels of government need to be clarified. For example, should the federal government be responsible for all programs dealing with the elderly and disabled? Should states be responsible for programs focused on working Americans and their children? The current overlap in responsibilities could be reduced over time to increase performance and accountability.

Second, it is important to decide which level of government should create regulations and which level should enforce them. The higher the cost to industry of fifty different state regulatory systems and the more the issue is interstate, the more the responsibility begins to tip toward federal standard-setting. The lower the cost and the greater the need for experimentation, the more the scale tips toward state responsibility. State enforcement of federal standards would often be appropriate to develop the most flexible and cost-effective regulatory systems that protect consumers.

Third, additional federal programs for the nonelderly could be devolved to states to increase customer responsiveness, performance, and accountability. This trend was established several years ago for welfare, children's health care, and other programs. More experimentation with multiagency and multijurisdictional programs may also be needed.

Fourth, it is critical to coordinate and rationalize federal, state, and local tax systems. Such a restructuring will enable citizens and businesses to understand which level of government is taxing and which is providing services. It also is important to craft a simplified tax structure that is fair and equitable.

The tasks of developing guiding principles and a blueprint for a new federalism will require mutual effort and commitment. Although it is critical that debate begins, governance models must remain flexible to accommodate further change in a century marked by change.

Major Areas of Federal-State Governance Need Rethinking and Reshaping

The existing federal-state governance system is antiquated, and it may fail during the next decade absent fundamental changes. The difficulty of reconciling historic and emerging tensions between the two levels of government should not divert policymakers from the task of restoring accountability and jointly shouldering the responsibility to shape the future and frame the questions that must be answered. The United States must steer a new course of governance for the new economy. In particular, four major areas of federal-state governance require considerable focus and attention—discretionary grants, entitlement programs, tax and revenue systems, and regulation. In each area, questions must be posed to provide a foundation for important discussions that need to begin today. Leaders who meet the challenge of answering these questions will be laying the groundwork for a dramatic culture change throughout government at all levels with regard to how this nation serves its citizens and businesses.

Discretionary Grants

Flexibility, accountability, and responsiveness to consumer needs are cornerstones of a new system for administering discretionary grants. Without flexibility, states cannot transform the grants into responsive, customer-driven programs. In exchange for flexibility, the federal government could ask states to ensure accountability by meeting certain performance measures. Specific strategies include consolidating similar categorical grants at the federal level or allowing states to combine disparate federal programs into a single grant. A more experimental model would aggregate federal dollars from various grant programs and give the funds to a consortium of state and local governments to meet the needs of a particular region.

Entitlement Programs

Historically, providing for the health and welfare of the nation's citizens has been a shared responsibility of the federal and state governments. In the past, the division of responsibility has been fairly straightforward. The federal government has been responsible primarily for assisting the elderly and the disabled. States have administered programs for children and low-income families. Although this is an oversimplification, states have been responsible for populations that will soon be in, are in, or may return to the workforce, while the federal government has been responsible for populations that have left the workforce.

These new "unofficial criteria" for determining eligibility have evolved as a result of legislative initiatives. However, to design a more coordinated, "citizen-as-customer" approach to providing the safety net, policymakers need to ask questions such as the following.

Are these distinctions between federal and state responsibilities still meaningful?
Should the responsibility for different populations be divided between the states and the federal government?
How can programs with common goals be coordinated to improve service delivery?
How can programs be designed to ensure flexibility and accountability?
If policy reforms are made, how must financing change?
What are the implementation concerns?

Tax and Revenue Systems

A public finance system for the twenty-first century must overcome the systemic and institutional shortcomings that handicap the current system. This will clearly require greater interstate and federal-state cooperation. Rethinking the nation's tax and revenue systems will also require finding ways to avoid tax competition among the different levels of government. New models should strive to meet several objectives, including simplicity, equity, accountability, neutrality and transparency, and sovereignty.

Regulation

Regulatory models for the new economy should be cost-effective and customer-friendly for regulated entities and individuals, afford flexibility in how standards are met, and provide protection to consumers. Such models also need to respond to calls for uniform standards in an international marketplace. Where fifty different state rules and regulations are burdensome to the private sector and the issue is primarily interstate, then federal standards might be appropriate. Where the activity occurs primarily within state borders and there is a need to experiment with regulation, a state regulatory approach might be appropriate. Another model could use minimum federal standards while retaining states' abilities to impose higher standards

America's Leaders Must Respond

Most successful, information-age corporations recognize that their ability to create products and deliver services with smaller, flexible, and autonomous units of operation is critical to their ability to compete in the new economy. The same principle holds true for governments. Smaller, more flexible, and more autonomous governance structures will be far more effective in overcoming the inertia characteristic of bureaucracy and much better able to respond to the fundamental changes occurring in the U.S. economy and society.

The twenty-first century will bring together profound forces that will reshape how the federal, state, and local governments work together to serve America's citizens and businesses. Globalization, technology, and deregulation will forever alter the way this nation governs and will reconstitute the federal system.

The nation's leaders have an unprecedented opportunity to respond to these economic changes and forge a dynamic federalism that incorporates the extraordinary strengths and diversity of the United States. The writings of Woodrow Wilson are as relevant today as they were nearly a century ago: "The question of the relation of the States to the federal government is the cardinal question of our constitutional system. At every turn of our national development we have been brought face to face with it."

How Governors, together with the President and Congress, embrace the forces of change and rise to the challenges and opportunities they present will determine the course of governance in the new economy and the continued prosperity of America in the twenty-first century.

Chapter 1

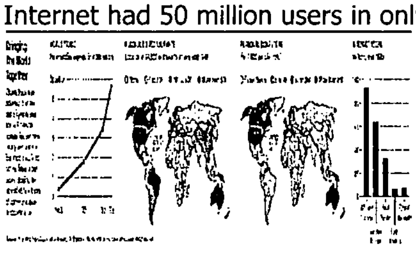
Challenges and Opportunities of the New Economy

"Once technology enabled change, but now it is driving change."
—Thomas Freidman, *The Lexus and the Olive Tree*

Technology, globalization, and deregulation are powerful forces driving economic change. Together, they are bringing about a "new economy" characterized by different sources of wealth, interdependence, dynamic markets, consumer choice, and new investment needs. The forces that are altering the nation's economic landscape also have implications for citizens' well-being and their support of government and governance in the twenty-first century.

Driving Forces

The United States is at an economic crossroads with the convergence of computing and telecommunications. The Internet, which is a major component of this new digital revolution, is eclipsing all other technology that has preceded it. Radio existed for thirty-eight years before 50 million people tuned in, while television took thirteen years to reach 50 million viewers. The Internet had 50 million users in only four years.



Although technology is clearly a driving force of change, two other major economic forces are evident. The United States is becoming more integrated into a private-enterprise, world economy. U.S. imports and exports exceed 25 percent of the gross domestic product (GDP) today; between 1929 and 1970, they averaged only 9.5 percent of GDP. The United States also is continuing to deregulate the remaining major, regulated sectors of the U.S. economy—telecommunications and public utilities.

Figure A. Source: NYT Graphics/*New York Times*, December 20, 1999.
Used by Permission.

Technology, globalization, and deregulation are completely restructuring the U.S. economy. The very basis of economic value has changed. Natural resources, for example, lumber and iron, used to be combined with labor to create value. Today, knowledge is coupled with technology to create value. The value of electronics now exceeds the value of steel in the automobile.

Characteristics

The changes that are transforming the U.S. economy are revolutionary and will ultimately affect every business and citizen. From the viewpoint of Governors, salient characteristics of this new economy include the following.

Products are becoming weightless. Outputs are becoming more knowledge-based and service-oriented. For many products, the ratio of weight to value is dropping every year. In just the past two years, the weight of the average cell phone has decreased from 10 ounces to 4 ounces.

Productivity is increasing. During the past four decades, productivity grew only 1 percent per year. In the next two decades, it could grow 2 percent per year. This means that real wages will begin to increase. The potential productivity gains from the Internet and online transactions are substantial. If a teller transacts a loan payment, it costs the bank $1.20; if an individual makes an online transaction, the cost is seven cents. It is estimated that by 2004, online business-to-business transactions will generate $1.7 trillion in savings; half of the savings will be realized in the United States. Productivity gains could lead to an economy of falling prices. Together, increasing productivity and decreasing prices could considerably increase the real wages of U.S. citizens.

The world is becoming smaller. The world is shrinking, metaphorically, and borders are disappearing with advances in transportation and telecommunication systems. News now travels the globe in minutes. Capital mobility has become instantaneous. In world money markets, $3.2 trillion moves across international boundaries every day.

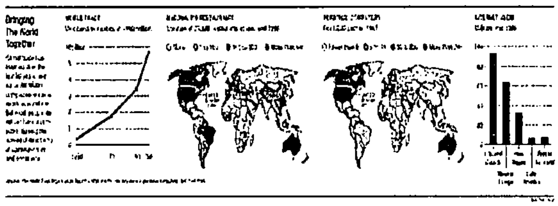


Figure B. Source: NYT Graphics/*New York Times*, December 20, 1999. Used by Permission.

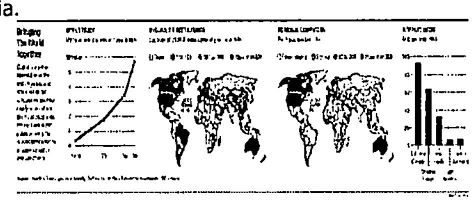
Entrepreneurs are spurring economic growth. Gazelles, or small, rapidly growing, venture capital-backed companies that capture new markets, are driving the new economy. Examples include Amazon.com, Yahoo, Cisco, Dell, and Microsoft. At the start of the twentieth century, ten of the top twelve U.S. companies were natural resource companies. Today, the only company remaining in the top twelve is General Electric; most of the others are high-technology companies.

New partnerships are the wave. Today, corporations partner on some products while competing on others. For example, IBM may compete with Cisco on enhancing disk storage capacity but partner with Cisco on making laptop computers. This new "co-competition" creates a very flexible economy.

The distribution of income is changing. Although on average real wages will increase in the future, most of the gain will go to workers with high levels of education and training. Those with old economy skills will not likely gain in real income, and those with limited education and skills will likely continue to experience declines in real income. For example, in 1997 the average college graduate made 77 percent more than the average high school graduate, and the average information technology worker earned 77 percent more than the average worker across all industries.

Markets are becoming dynamic. The market in the old economy was stable, and relationships between buyers and sellers continued for long periods. Competition existed, but it was limited. In the new economy, large numbers of buyers and sellers set prices in a dynamic market. Business-to-business sales on the Internet will total more than $1.3 trillion by 2003, and the competition among thousands of sellers drives prices down. Innovation, quality, time to market, and cost will define competitive advantages. Firms are very mobile geographically. Competition also has shifted from being national to being global.

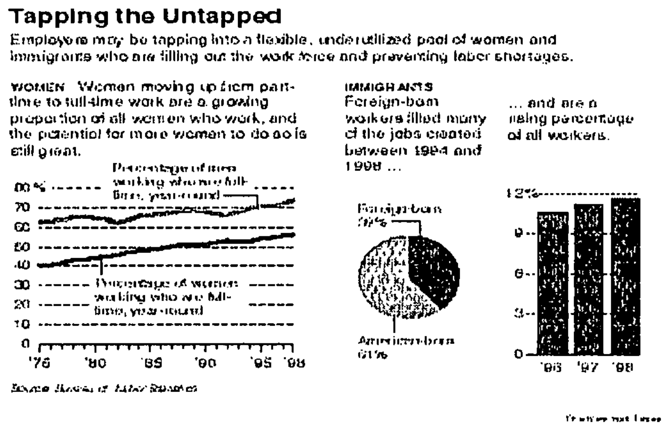
Figure C. McDonald's is a good example. It delivers around the world, but customizes everywhere. No Big Macs in India.



The organization of production is becoming flexible. The old economy had mass production. The new economy has flexible production, so products can be tailored to consumers' needs. Consider computer companies' ability to customize computers and ship in three to five days. The auto industry is now reorganizing to develop a similar business model. Furthermore, businesses are shifting from hierarchical and bureaucratic organizations to network and entrepreneurial structures. (See Figure D)

Source: NYT Graphics/*New York Times*, December 20, 1999.
Used by Permission.

The skill mix is changing. The old economy placed a premium on job-specific skills needed in a production line. The new economy values broad skills, flexibility, and cross-training. The nature of employment will change from one marked by stability to one marked by risk and opportunity. Similarly, labor-management relations will shift from being adversarial to being more collaborative.



N.Y. Times News Service
Date: 12/19/99
Slug: OUTLOOK_Labor
Size: 30p6 x 4
With Story: (BC-OUTLOOK-DEMOGRAPHICS-NYT)

Figure D. Source: NYT Graphics/*New York Times*, December 20, 1999, Used by Permission

Implications

With these economic changes comes hope and optimism. Reengineering government to be compatible with the new economy will reap substantial increases in productivity and equally large increases in the real wages and standard of living of all Americans. Similarly, success will be seen in greater participation in government. Yet the accelerating speed of technological change, coupled with the integration of the U.S. economy into the international marketplace, also poses significant risks. Citizens will bear significant costs if mistakes are made. Failure could mean productivity declines, reduced wages, and a decreased standard of living for all Americans. It could also lead to less involvement in this nation's democratic form of government. To respond to the challenges and opportunities of the new economy, governments and governance must manifest key characteristics and new strategies.

Chapter 2

emergence of "networked" government

As the United States leads the world in a new, global economy, the need for smaller, more accessible, and more responsive government increases. Just as the information economy is shifting from a reliance on mainframe computers to the use of personal computers, palm pilots, and wireless, broadband technologies that reflect the acceleration of change away from central sites and central planning, so, too, must "networked" governments evolve to stimulate creativity and growth. As the nation tries to adjust to change, and change occurring on Internet time, it has to redefine the roles and responsibilities of governments. Most of the creativity and growth will continue to come from the incentives of a free market. However, the resolution of many issues—ranging from the need for common regulations, to the assurance of adequate physical and human infrastructure, to the effective delivery of services to sustain this creativity and growth—cannot be left to the free market or a centralized bureaucracy. As the United States enters this uncharted territory, it must radically recast government to ensure citizen support and pioneer new approaches to governance.

Governance in the twenty-first century must become flexible and adaptable, market-oriented, consumer-friendly, reinvented with technology, innovative, performance-driven, and accountable. Governments at all levels must adopt three broad strategies to sustain America's prosperity. They must reengineer themselves to ensure competition, choice, and quality. Moreover, governments must focus on human and physical infrastructure to meet the needs of new economy workers and businesses. Finally, governments need to redefine the economic environment to facilitate business expansion and eliminate market distortions caused by outmoded taxes and regulations.

The new economy requires a dynamic federal-state partnership. The forces of change, key characteristics of governance, and overarching governmental strategies can help in designing a new blueprint for federalism.

Competing Forces Affecting Governance

Technology, globalization, and deregulation will forever alter the U.S. economy. These forces that are driving economic change will also reconstitute the governmental system. How well Governors, together with the President, Congress, and local leaders, address these changes will determine how well the federal, state, and local governments can meet the needs of citizens and businesses in the many towns, cities, counties, states, and regions of this diverse nation. Understanding and responding strategically to these forces are integral to America's leadership in the twenty-first century.

Technology, globalization, and deregulation are competing forces. On the one hand, they press to eliminate borders, threaten sovereignty, and mandate one-size-fits-all standards. On the other hand, they offer the promise of vastly increasing the ability of state and local governments to respond more quickly and effectively to public and corporate needs and demands.

Currently, the federal government regulates major interstate industries, while state and local governments regulate other industries. However, the globalization of the economy, as well as calls for both national and international deregulation, will increase pressure to preempt traditional state and local government authority in land use, zoning, health care, labor, insurance, and environmental matters. Decisions in these arenas have important consumer protection, tax and revenue, and economic development ramifications.

In the new economy, there will be greater pressure to move toward national and international uniformity in regulations and revenue authority. New international trade treaties and negotiations, including the North American Free Trade Agreement, the World Trade Organization, and the proposed Multilateral Agreement on Investment, will rewrite existing federal, state, and local laws and regulations affecting ownership, real estate regulation, and securities. Sometimes, a greater reliance on federal standards will be the right public policy choice. Other times, the right public policy choice will be to devolve responsibilities to state and local governments, rather than centralize them at the federal level.

Key Characteristics of Governance

To continue global leadership and maintain citizen trust, America's governance structure must exhibit several key characteristics. These characteristics often guide the conduct of leading, private-sector firms and can be emulated successfully by the public sector.

Flexible and Adaptable

Federal and state governance must be sufficiently consistent to provide citizens with the appearance of a seamless system. Yet these integrated systems must be flexible enough to account for the significant geographic, socioeconomic, demographic, and cultural differences that exist among states and between regions. These differences result in varying demands for government services and infrastructure investment. There must be sufficient flexibility to set priorities in revenue requirements, so those closest to the citizens receiving services are making the final decisions, and to ensure that the same basic benefits and burdens are distributed consistently among all citizens.

Market-Oriented

The Internet is fast-becoming the primary mode of business in the private sector because it is very responsive. Companies providing services in the new economy are very sensitive to purchasers' needs and reactive to consumers' demands. As a result, people are accustomed to being able to articulate their preferences and influence the market. For government to be perceived as a "player" in this new system, it must be responsive to citizens' needs and cognizant of their perceptions of the appropriate role of government in providing services in the new economy, particularly educational opportunities and technology and transportation infrastructure. Consumers are used to receiving service and feedback twenty-four hours a day. Although it may not be necessary to provide twenty-four-hour service, increased responsiveness from government will be absolutely necessary.

Consumer-Friendly

Changes in the way business does business have enabled small businesses to efficiently search for the best products or services, provide information on their products and services to the global marketplace, and communicate conveniently and inexpensively with suppliers and consumers. Government can use the same strategies and tools to make itself less confusing to citizens and alter the impression that inquiries to government employees will be met with an "it is not my job" response. Technological tools can enable governments to provide information to the public on common areas of concern and obtain input on policy issues that shape legislative, regulatory, and programmatic initiatives.

Reinvented with Technology

The digital marketplace must be mirrored in a new digital government, where there is logic in the way tax, revenue, and other systems are implemented. It will no longer be practical or advisable to have a system replete with exceptions to general rules. Systems must work so that government reporting requirements are fully automated, citizens' questions can be answered with response times comparable to what is considered standard for businesses, and citizens can voice their concerns. It is critical that technology be used to enable citizens to attain a sense of participation or feeling of investment and ownership in the governance process.

Innovative

States that use the most innovative approaches to attract the new technology-based businesses will also benefit from using creative approaches to provide government services. With many new jobs being created in new sectors and other jobs disappearing in the "established" manufacturing sector, public education and training agencies and institutions will need to anticipate and address the workforce preparation needs of highly mobile, new economy workers and businesses. The existing model is premised on a system of governance that evolved during the heyday of the manufacturing economy. Employees/citizens are typically looking for more choices and for a more active role in decisionmaking than has existed previously.

Performance-Driven

In a global economy, it is no longer sufficient to maintain the status quo. Companies that will succeed and continue to grow are ones that continuously reinvent themselves. There is a new reliance on performance. Experience is less important than who or what is productive. Governments need to shift their focus from inputs to results. They must adopt performance measures for all types of government outputs. The new system of governance should take advantage of technological changes to ensure better outcomes and more responsive services.

Accountable

Probably the most important requirement for effective governance is accountability at all levels of government. Citizens' frustration with the governance system that evolved through the most recent decade is manifested in recent legislation requiring term limits, referendums requiring voter approval for tax increases, and a general antipathy toward "politics as usual." The Internet enables information to be disseminated to the public immediately, individuals and small businesses can monitor legislative developments without making a substantial lobbying investment, and citizens are better able to voice their opinions to, and require greater accountability from, those elected to represent their interests. It is essential that the governance structure use technological tools to streamline performance and accountability systems for the next century.

Overarching Governmental Strategies

All levels of government need to adopt new strategies to assist the United States in maintaining its world economic leadership and citizen support. These strategies should create a synergy that makes government innovative and on the cutting edge of change.

Reengineer government to become more adaptable, customer-oriented, flexible, and performance-driven. Government is in the service business, and it has much to learn from the most innovative private firms about how to organize work and improve customer service. To function more efficiently and effectively in the new economy, government will need to focus on results and measure performance, decentralize decisionmaking, employ partnerships, consider new ways to deliver government services, and use technology to improve and transform service delivery.

Make strategic investments to build the intellectual and physical infrastructure needed in the new economy. Human capital investments should focus on lifelong learning, providing opportunities from early childhood through adulthood for people to gain the requisite skills for the coming decades. Physical investments should focus on the institutions and facilities needed to acquire these skills and the infrastructure needed to support businesses and improve the quality of life.

Reshape the economic environment and eliminate the potential for market distortions. Tax systems need to be realigned to create simplicity and equity for businesses and citizens. University linkages to the private sector need to be strengthened and refocused toward economic development strategies. Research and development investments must be increased and refocused on economic outcomes and commercialization. Business regulation needs to be simplified and moved away from traditional command-and-control models. The expanding role of entrepreneurs, and their ever-increasing venture capital needs, must be accommodated.

Achieving these changes will require a blueprint for a new federalism and new governance models.

Nearly a century ago, Woodrow Wilson wrote, "The question of the relation of the States to the federal government is the cardinal question of our constitutional system. At every turn of our national development we have been brought face to face with it." The changes ushered in by the Industrial Revolution were probably at the forefront of Wilson's thinking when he wrote that statement at the beginning of the twentieth century. Yet his assessment is equally true as the nation enters the twenty-first century and comes face to face with the changes that are transforming society and the new economy.

Blueprint for a New Federalism

The globalization of markets, the pervasiveness of technology, and the renewed focus on deregulation are dramatically altering America's economic landscape. These changes are creating enormous tension between levels of government. There are intense centripetal pressures—economic and political—toward uniformity and the elimination of differing state and local rules, practices, and tax systems. There are countervailing, centrifugal forces to force the lowest level of government to deliver services and infrastructure investment uniquely packaged for a community's citizens and businesses. In addition, government is far behind the private sector in changing the way it does business to improve performance and customer responsiveness. Unless states and the federal government can rethink and restructure how they jointly regulate, deliver services, and make human and physical investments during the next decade, government support will increasingly erode. This could lead to an erosion of the underpinnings essential to U.S. leadership in the global economy.

The current, patchwork governance system that contributes to ad hoc, narrow-sighted decisions must be replaced with a new, broad vision of federalism. In developing the blueprint, it is important to agree on several key principles. First, to develop more performance-oriented and accountable government, the roles and responsibilities of the respective levels of government need to be clarified. For example, should the federal government be responsible for all programs dealing with the elderly and disabled? Should states be responsible for programs focused on working Americans and their children? The current overlap in responsibilities could be reduced over time to increase accountability.

Second, it is important to decide which level of government should create regulations and which level should enforce them. The higher the cost to industry of fifty different state regulatory systems and the more the issue is interstate, the more the responsibility begins to tip toward federal standard-setting. The lower the cost and the greater the need for experimentation, the more the scale tips toward state responsibility. State enforcement of federal standards would often be appropriate to develop the most flexible and cost-effective regulatory systems that protect consumers.

Third, additional federal programs for the nonelderly could be devolved to states to increase customer responsiveness, performance, and accountability. This trend was established several years ago for welfare, children's health care, and other programs. More experimentation with multiagency and multijurisdictional programs may also be needed.

Fourth, it is critical to coordinate and rationalize federal, state, and local tax systems. Such a restructuring will enable citizens and businesses to understand which level of government is taxing and which is providing services. It also is important to craft a simplified tax structure that is fair and equitable.

The United States needs to steer a new course of governance to succeed in the new economy. That course will have to recognize the fundamental growth in the importance of regions in a global economy, regions that often cross even national boundaries. It will also have to recognize that what works well in one state may not work well in another. So, too, must it allow the people in a state or community to achieve their own consensus on, for example, how to deal with growth, improve schools, or enhance livability. In cities and states, micro-allegiances between communities and industry will most effectively flourish.

The difficulty of reconciling the conflicts between the Supremacy Clause and the Tenth Amendment should not divert policymakers from the task of restoring accountability and jointly shouldering the responsibility to shape the future and frame the questions that must be answered. This task will require mutual effort and commitment. It will require rethinking and reshaping four major areas of federal-state governance—discretionary grants, entitlement programs, tax and revenue systems, and regulations.

Although it is critical that debate begins on guiding principles and a blueprint for a new and more vibrant federalism, governance models must remain flexible to accommodate further changes. The beauty of this nation's democratic system to date is its ability to adapt to change. Change will be the hallmark of the new economy and the next century.

Chapter 3

Strategies for Discretionary Spending

Discretionary grant programs aim to achieve different goals, ranging from building bridges to providing affordable housing. Some of these programs, such as the Community Development Block Grant, provide state and local governments with substantial flexibility. Others have restrictions that direct the program's purposes, such as with regard to eligible beneficiaries and uses of funds. They reimburse states, rather than deliver services, but give state and local governments little discretion to decide how best to run the program and help constituents. Rethinking the federal-state partnership for discretionary grant programs in the new economy requires exploring key system characteristics and new strategies for administration.

Key Characteristics

A new system for administering discretionary grant programs should have three key characteristics: flexibility, responsiveness to customer needs, and accountability.

Flexibility

Flexibility must be the cornerstone of a new system for administering discretionary grants. Without flexibility, states cannot transform the grants into responsive, customer-driven programs. Flexibility is provided when states can use performance measures—jointly agreed to by states and the federal government—indicators, and outcomes as measures of progress. Any agreement on performance would have to hold states accountable. This would enable states to experiment with different strategies to achieve the desired outcomes. Similarly, states must provide localities and regions with the same flexibility to ensure that those closest to the customer make important program decisions.

Responsiveness to Customer Needs

Responsiveness to customer needs should be an important goal of discretionary grants. Grants are awarded to citizens, organizations, and businesses to achieve results, for example, affordable housing, job training, or cleaner air or water. States and the federal government have the same customers—citizens, businesses, and those who want to serve or do business with citizens and businesses. States and the federal government have the same source of funds for those services—citizens and businesses. The two levels of government must work together in using available resources to achieve the goals of discretionary grant programs and better serve customers.

Accountability

Governments should be held accountable for their performance on the programs they administer. Discretionary grant programs should identify the lead agency responsible for performance and streamline record-keeping requirements. Discretionary grants should be performance-based, using sanctions and incentives to ensure competition and accountability.

New Strategies

Three strategies can jump-start discussions about new approaches for discretionary spending in the twenty-first century: consolidate existing programs with performance accountability, create performance partnership agreements, and develop regional consolidation models.

Consolidate Existing Programs with Performance Accountability

Perhaps the quickest step the federal government could take to respond to the challenges of the new economy is to collapse similar federal grant programs of the different federal agencies into one simplified program that permits states to draw down funds after submitting one- or two-year performance measures. The goals for this program consolidation would need to be modified to match the circumstances of various states and regions. The measures would ensure that states know what has to be achieved in spending the funds and permit federal agencies and Congress to review efforts based on performance.

In this approach, states, in close communication with the federal government, would be responsible for developing performance measures to meet the needs of a particular region or segment of the state's population, crafting strategies to meet the performance measures, and overseeing operations. These responsibilities would help the programs be more accessible and responsive. They should stimulate technological solutions based on the state's capacity and infrastructure and promote results-driven, performance-oriented projects. The federal government's oversight role would be evaluating whether the desired outcomes were achieved and reviewing annual performance outputs. Broadening the range of services under each consolidated fund would streamline federal-state communications and shift the focus from separate programmatic procedures to comprehensive outcomes.

Part of rethinking discretionary grants must involve thinking about flexibility, incentives, and sanctions. Discretionary grants recognize differences in places and peoples and in needs and priorities. They also recognize the validity of experimenting with different approaches. The tension is between federal goals and state and local goals. The rethinking will also require considering sanctions for not meeting critical minimum performance measures and rewards for exceeding them. Should the federal government allocate only 80 percent of the discretionary grant, holding back the remainder in a bonus pool, so states that eventually meet the goals would receive their full amount and those that significantly exceed them would receive a bonus? Should a bonus be strictly monetary, or should it take the form of greater flexibility to meet the needs of a similar population?

This approach could be implemented in several policy areas. For example, dozens of different federal agencies operate separate economic development programs. Although these programs spend millions of dollars each year, states rarely even know what these various federal programs are doing within state borders. Certainly these efforts could be improved under a consolidation with accountability approach.

Create Performance Partnership Agreements

Another approach is to allow states to combine funds from disparate federal programs into a single grant. This would enable states to focus on the most serious problems. For example, by combining transportation, housing, and economic development grants into a single grant, a state could address high-priority needs, facilitate creative problemsolving, and better respond to citizens.

This model would promote efficiency and flexibility, because states could experiment with different strategies to serve customers and achieve the desired outcomes. States could adapt their programs and services to changing needs, and they would have the necessary federal funding to accommodate a shift in priorities. As employment or housing markets change, so, too, could state programs change. Similarly, the model has the potential to be market-oriented and consumer-friendly; resources could be reallocated to provide more choices to the customer, whether it be longer hours of service or increased use of interactive technologies. As program managers are freed from requirements to design services based on a federal template, innovation would also be encouraged.

By focusing on outcomes, states would be freed from measuring success based on inputs. They could use performance measures, indicators, and customer feedback as measures of progress. Accountability to the federal government could be addressed by requiring initial federal approval of the performance measures, after consultation and negotiation with the state. A joint evaluation by the state and the federal agency would enable mutual understanding of successes and failures. If a state successfully meets the outputs established by the agreement, it could be rewarded with additional bonuses, flexibility, or other benefits. Failure to meet minimum performance measures could result in sanctions.

This model would enhance efficiency by reducing administrative overhead costs and the paperwork states must provide to the federal government to receive annual grants. More importantly, it defers to state governments to select the highest priorities for spending federal dollars, while ensuring the federal government and the public that programs will be delivered in a flexible and accountable manner.

Uniformity could be a significant issue. By definition, a performance partnership agreement will vary from state to state. States will focus on different priorities based on their needs and available resources. Businesses that operate nationally could not be assured that the services provided by one state would be delivered with the same intensity by its neighbor. Moreover, potential beneficiaries could have no expectation that eligibility or awards in one state would be comparable in a neighboring state.

Develop Regional Consolidation Models

As regional economies become more important, federal and state leaders must rethink discretionary programs along multi-issue, multi-agency, and multijurisdictional lines. For example, in virtually every high-technology corridor, traffic congestion is an overwhelming problem. Traffic connects jurisdictions and is related to zoning and land-use decisions. Consequently, traffic congestion can only be addressed by local, state, and federal agencies working together. Similarly, global regions that have succeeded have found unique ways to benefit from the diversity of strengths within their respective region, suggesting that economic development and training programs would benefit from a radical reshaping.

Perhaps allowing a state and various local governments to aggregate federal dollars from a variety of grant programs and focus them on a particular region would be a solution. For example, a state could designate a low-income, rural region for an intensive economic development effort. Federal housing, transportation, workforce development, and rural economic development funds could be consolidated into a package and directed to several communities within the targeted region. The state and various local governments would need flexibility in how they use the funds to address the region's needs most effectively. To minimize overlapping responsibilities and clarify lines of accountability, the state could designate a specific agency to lead the effort.

A regional consolidation model would be accountable not only to its recipients and customers, but also to the federal granting agencies. This is because measurable outcomes would be negotiated by all levels of government. Focusing on a particular region of the state gives the model the ability to seek input from the citizens and businesses that would be directly impacted by the assistance. Cooperative planning could occur in the region, and the process could seek direct participation from the communities. Local governments in the region would need to be intimately involved in determining the shape and scope of the development. State efforts would have to be consistent with local plans and institutions. Bonuses and sanctions for not meeting critical performance measures could also be part of this model.

Chapter 4

Approaches for Entitlement Programs

Historically, providing for the health and welfare of the nation's citizens has been a shared responsibility of the federal and state governments. Medicare, Medicaid, the Food Stamp program, Temporary Assistance for Needy Families (TANF), and Social Security are the largest entitlement programs serving low-income families, the elderly, and the disabled. In the past, the division of responsibility has been fairly straightforward. The federal government has been primarily responsible—through Medicare, Social Security, and Supplemental Security Income—for payments and other targeted assistance to elderly persons and individuals with disabilities. States—through the Food Stamp program, Medicaid, TANF, and before TANF, Aid to Families with Dependent Children—have been responsible for administering programs for children and families. Although this is an oversimplification, the federal government has been responsible for populations that have left the workforce entirely, while states have been responsible for populations that will soon be in, are in, or may return to the workforce. Several questions and issues can guide discussions about restructuring the federal-state partnership for entitlement programs in the new economy.

Questions Guiding the Discussion

In the twenty-first-century world of health and human services, one of the major policy challenges will be whether the current division of federal and state program responsibility still makes sense and, if so, whether policymakers can make changes to improve outcomes, service delivery, and accountability. However, before developing new models, several questions should be addressed. For example, are the distinctions between federal and state responsibilities still meaningful? Should the responsibility for different populations be divided between the states and the federal government? Medicaid covers not only 40 percent of the nation's births, but also is by far the largest purchaser of long-term care for the frail elderly and adults with severe disabilities. Although the Food Stamp program provides services to low-income families that may be making the transition from welfare to work, it also provides a safety net for the elderly and the disabled. Which level of government should be responsible for which programs? How should the funds needed to operate these programs be raised?

Moreover, does it make sense to continue large programs characterized by the "silo effect," where one individual may be eligible for multiple services that are operated independently with different delivery systems, information systems, and eligibility criteria? Or should health and human services programs adapt to the needs of the future and become more accountable and easier for beneficiaries to understand? Would low-income families and children be better off if states run one comprehensive program that provides a broad range of services and takes into account individual needs and community resources? Similarly, would the elderly and adults with disabilities be better off if the federal government runs one comprehensive program? Such changes might seem overwhelming, but they could radically improve the current fragmented nature of health and human services delivery.

Issues Guiding the Discussion

In developing proposals for health and human services programs, especially the major entitlement programs, several issues must be carefully considered. These issues are related to goals, eligible populations, flexibility and accountability, financing, and implementation.

Goals

Within the major health and human services entitlement programs, many common goals apply to all of the services provided. When considering reform of specific entitlement programs, it may first make sense to consider what each program aims to achieve. What are the goals of the program? What other programs share these goals? How can programs with similar goals be coordinated to improve service delivery? Common goals across various programs suggest ways to coordinate services. This could ultimately lead to a more effective system of providing assistance to those in need.

Common goals of the major health and human services entitlements are:

prevention;
self-sufficiency;
poverty reduction; and
improvement of quality of life.

Each of these goals can be articulated differently depending on the program to which it applies, though the goals are common across many programs. For example, within the Food Stamp program, one goal is to prevent hunger. For Medicaid, the goal of prevention can translate into preventing disease through immunization. TANF seeks to achieve the goal of self-sufficiency by encouraging work. The Social Security program focuses on reducing poverty and promoting self-sufficiency among the elderly. Although virtually all health and human services entitlement programs aim to improve the quality of life for individuals served, certain programs address this goal explicitly, such as when Medicaid services are provided for those with degenerative health conditions.

Besides the major health and human services entitlements, other related programs may have similar goals. Debate about the goals of existing programs continues. Whatever the intended goals of various programs, it is essential that they be clearly articulated. Furthermore, maximizing the coordination of services among and within programs that seek to achieve the same goals will undoubtedly lead to improving the well-being of the individuals and families being served.

Eligible Populations

Eligibility for the majority of health and human services entitlement programs is based primarily on need—financial, medical, or other. Access to benefits is not necessarily universal. However, other than the common characteristic of meeting the needs-based criteria, there are differences in the populations served within programs. For example, although food stamps are provided to many elderly and disabled, the majority of food stamp recipients are low-income families. Similarly, although the majority of Medicaid expenditures are for the elderly and disabled, the Medicaid population is predominantly women and children.

When considering reform of the populations served within the various entitlement programs, several questions must be raised. Does it make sense to apply different policies to separate populations within the same program? Should government apply varying conditions for receiving assistance, or varying eligibility criteria, depending on different populations? For example, within the Food Stamp program, eligibility for low-income families could be tied more closely to meeting work requirements, as must those under TANF, while eligibility for the elderly and disabled could be based solely on ongoing financial need. Moreover, are there different goals for different populations even within the same program? Some would argue that providing food stamps to a low-income family is very different than providing food stamps to an elderly individual.

If states and the federal government desire effective service delivery to individuals in need, it may make sense to consider separating the responsibility for serving different populations between states and the federal government. Would services be delivered more effectively if state government focused on coordinating services for one population, such as low-income families, and the federal government focused on coordinating services for other populations, such as the elderly and disabled? This will be an especially important question to answer because of the rapid growth in the number of older Americans and the disproportionate percentages of these individuals in certain states. In contrast, the number of families and children in poverty are likely to remain more stable and the percentages more evenly distributed across states.

If states could radically restructure programs, there is great potential for simplification. Currently, there are hundreds of mandatory and optional avenues for Medicaid eligibility. Not all people who are poor are eligible, and not all people who are eligible are poor. Understanding the eligibility rules and all their intricacies requires an 800-page manual. If states could simply cover people with incomes below 133 percent of poverty, what would that mean for health outcomes?

Flexibility and Accountability

To effectively coordinate the delivery of services such as health care, nutritional assistance, and housing, states need relief from the programmatic constraints that currently hinder such coordination. They need greater flexibility to tailor services to recipients' needs. However, such flexibility should not come without a price. So long as states are responsible for spending federal program dollars, there must be an equally strong emphasis on accountability. Policymakers should decide whether clearly delineating responsibility for certain populations would increase accountability for states and the federal government. Just as important is the need to be accountable to the citizens served by government programs. The policy dilemma is how to balance the need for flexibility with the need for accountability.

Yet another concern is the form this accountability should take. If increased flexibility will lead to greater efficiency and subsequent improvements in outcomes, should part of this accountability take the form of reduced funding? Or should any potential program savings be reinvested so more people can be served or more services provided?

The accountability structure should include performance-based bonuses and rewards as well as sanctions. However, performance-based penalties such as reduced funding need to be considered carefully to avoid exacerbating the causes of poor performance. Should the accountability structure guarantee only a certain amount of program financing, such as 85 percent, with the full 100 percent available if certain goals are met and bonuses available if other goals are met?

Financing

How should health and human services be financed in the twenty-first century? If radical reforms are considered and the roles of the state and federal governments are to change significantly, will financing mechanisms also have to change significantly? Given the experience with welfare reform and congressional attempts to penalize states for saving money for potential economic downturns, can states rely on the federal government to maintain its commitment to vital health and human services entitlement programs?

If the federal government provides comprehensive services to the elderly and disabled, should its share of expenditures for families and children be reduced or eliminated? Should states provide comprehensive services for families and children totally with state dollars? If states provide services without federal assistance, should the federal government have any legitimate claim regarding how those services are rendered?

If less radical reforms are considered, what are the implications for federal and state budgets? Should financing be guaranteed on a per-capita basis so more money is available in times of greater need? Should financing be stable to provide incentives for efficiency?

Currently, the federal share of Medicaid financing is based on a complicated determination of a state's per-capita income. Wealthier states can pay fifty cents of every dollar of coverage, while poorer states can pay twenty cents of every dollar. The same federal rules apply to all states regardless of the contribution level. Is this reasonable? If the federal government is contributing more toward one state's program, can it demand higher outcomes or call for more stringent requirements? Should a state be able to set its own level of federal participation based on the federal requirements it is willing to live with?

Implementation

If states are given more flexibility to consolidate programs and funding streams, would they have to follow one model or would they be able to choose which programs to consolidate? Comprehensive reform of existing systems cannot be discussed without considering how the changes would be implemented. What are the practical implementation concerns? Can the current infrastructure support the reforms? What is a reasonable timeline for implementing the reforms? Without considering such questions, reform could result in unintended consequences, such as decreased efficiency in service delivery.

Achieving a more effective, seamless service delivery system requires looking at customer needs and demands on agencies and agency personnel. Ideally, states and the federal government would have the capacity to tailor services to individuals. Moreover, reform of this magnitude takes time. Three years after the enactment of welfare reform, state welfare offices are becoming job centers and former eligibility workers and case managers are becoming job coaches. Welfare reform requires a dramatic culture change by agencies and personnel. Is it reasonable to expect this culture change across a broad range of programs? How quickly could states and the federal government adapt their infrastructure to support comprehensive reform?

Perhaps incremental reform is worth considering. Should entitlement reform be implemented nationwide or should certain states experiment with entitlement reform? Within states, should reform be tested at the county or local level, as was done in many states during the first stages of welfare reform?

Chapter 5

Intergovernmental Tax and Revenue Models

The new economy has created a misalignment between economic activity and the federal, state, and local tax and revenue systems. The foundation of the tax and revenue system of each level of government is built on borders that are becoming increasingly irrelevant. There is a growing lack of coordination among governmental tax and revenue systems that is causing burdens and complexity for industry. There also is an increasing lack of accountability and a growing tendency to "spend" or reduce another level of government's revenues. Such developments require policymakers to carefully examine the implications of the new economy, identify objectives for an intergovernmental tax and revenue system, and craft models of taxation.

Implications of the New Economy

If information and services are engines of growth, how do the three levels of government move to a new system of taxation that does not burden this growth but ensures that it contributes a fair share of governance and investment costs? Is the federal role to provide incentives for states to adopt a consistent sales tax that applies to all goods and services and is destination-based, whether or not there is "nexus," provided the system does not impose unreasonable burdens? Should revenues from a federal sales tax be pooled in a trust fund and distributed to state and local governments?

Most assessments of federal, state, and local tax and revenue systems identify four shortcomings that must be addressed if those systems can adequately finance government services in the twenty-first century while respecting the needs of the new economy.

Certain taxes were designed for a manufacturing economy and have not kept pace with changes in economic activity. Consequently, these taxes are not as responsive as they should be and create artificial differences among very similar activities and enterprises.

The increasing globalization of economic activity creates increased opportunities for income shifting and tax planning. It requires rethinking certain tax principles so certain taxes can remain vibrant and distortions in the marketplace can be avoided.

The deregulation of various economic sectors has had profound impacts on certain types of taxes. These taxes must be updated to reflect the new regime.

Taxes at the federal, state, and local levels have generally been administered independently of one another. The result is increased complexity and burden imposed on businesses and individuals making a good faith effort to comply with tax laws.

The increasingly global nature of business, crossing not only state but also international borders, presents unique challenges for federal and state tax writers. Large firms can shift income across these borders for tax purposes, so the taxable income of these enterprises in the United States and within each state may sum to less than the total accounted for on tax returns. The corporate tax base is becoming increasingly more unpredictable, and serious inequities may be introduced between large multistate or multinational firms and smaller in-state businesses. As an increasing number of electronic commerce, technology, health care, natural resources, financial, and telecommunication firms become international, or simply move off shore, the federal government and states will have to work together to eliminate these inequities.

Designing a public finance system that overcomes the shortcomings of the current system clearly requires greater interstate and federal-state cooperation and more extensive partnerships. States can no longer "go it alone" in designing tax policy if they desire a system that operates in sync with the new economy and produces adequate revenue to finance the services needed by their citizens and businesses. States need to recognize that the requirements and challenges posed by the borderless, global economy mean that the federal government must be more involved in establishing parameters for state and local tax systems than was true when economic activity respected state borders. The federal government must recognize its role in assisting states to develop workable, viable tax systems. It can no longer view itself principally as a "court of last resort" to redress perceived grievances with state and local tax systems.

Rethinking the nation's tax and revenue systems requires a renewed commitment to some sort of reciprocal immunity and to far better accountability vis-à-vis shared revenue bases and sources. Many states have income taxes, as does the federal government; the federal government also has excise taxes, which bring in almost $58 billion annually. The federal government issues bonds, as do state and local governments. Federal bonds finance the operating debt of the government; the interest on these bonds is exempt from state and local taxation. State and local governments issue bonds largely to finance capital investment. The interest on state and local bonds is exempt from federal taxation, though this principle has eroded some in recent years. Only the property tax seems unique to one level of government, local government. This "division" of federal, state, and local revenue roles is an unseemly jumble that cannot possibly meet the needs and demands of the new economy.

Objectives

An intergovernmental revenue system appropriate for the new economy should strive to meet several objectives.

Simplicity. In a borderless economy, the more the nation can eliminate complexity, the better it can serve the economy and the less governmental tax policy can create market distortion.

Equity. Any new model should treat similar taxpayers similarly.

Accountability. Each level of government should be accountable to its taxpayers, and other levels of government should not interfere with, tax, or serve as the avenue of redress for another level. Taxpayers should have a better sense of how their tax dollars are being spent.

Sovereignty. Any model must preserve taxpayers' ability to determine what level of revenues they want and need and how they prefer those revenues to be raised.

Neutrality and Transparency. Tax policy should not bias or create different outcomes for comparable transactions.

Adequacy. Tax and revenue systems need sufficient flexibility to ensure fiscal stability and resources.

"Administrability." New models must focus on ease of administration to facilitate fair enforcement and ensure taxpayer fairness and trust in the system.

If there are three hands in every taxpayer's pocket, which government is taking what and how will those taxes be used? The difficult question is whether the federal, state, and local governments should "disentangle." This question raises issues of accountability, sovereignty, and equity. Disentangling requires revitalizing the doctrine of reciprocal immunity, meaning that states may not tax the federal government and vice versa. For example, should the federal government turn over to states the $58 billion it collects through excise taxes each year? Should the federal government confirm state authority to require the collection and remittance of sales and use taxes on remote vendors in return for states conceding corporate income tax revenues and granting all property and personal property tax revenues to local governments? Should the federal government adopt a tax and set aside fixed percentages of the revenues raised for each level of government so all would have a greater stake in coordinating infrastructure investment and service delivery?

Models

Nearly every model and suggestion for greater coordination of federal and state tax policy, as well as for greater simplification and uniformity in state tax policy and administration, implies some sacrifice or diminution of state sovereignty and local autonomy. Every step that states and localities take to conform their taxes to the federal tax or to make their taxes more uniform with one another reduces their flexibility and decisionmaking authority. Reform is not an action to be taken lightly, but the difficulties should not prevent movement toward a streamlined, intergovernmental tax system suited to the new economy. State officials need to weigh the effects of reform on sovereignty against the benefits to be realized from an updated revenue system. They need to keep their eye on important tax principles and activities. This means ensuring that federal actions or laws preserve states' sovereignty to choose which taxes they want to use and the extent to which they want to use them. Furthermore, it means being able to control, through tax rates and exemptions, the distribution of the tax burden among taxpayers. It also means focusing less on administrative matters and definitions of items in the tax base.

A hallmark of a streamlined, intergovernmental tax system in which tax bases and tax administration are more integrated among states and with the federal government is the increased interdependence among levels of government. In particular, decisions made at the federal level about the nature of certain tax bases may have a much greater impact on states and localities than in the past. This interdependence requires a true partnership among levels of government in making revenue decisions. One level should not necessarily control what another may do, and there should be full consultation prior to making changes that affect other levels. There should also be institutional mechanisms to ensure that the impacts across levels of government are appropriately identified and assessed. Consideration should also be given to allowing adequate time to adjust and plan for changes before they become effective. In addition, new institutions or mechanisms may be needed to govern certain aspects of the tax system where states, by law or practice, function in a cooperative and uniform manner.

Accountability in tax policy and administration is not as clear cut as in other areas. Historically, there have been discussions of assigning certain revenue sources to one level of government or another, but it seems unlikely that the major taxes can be assigned to a particular level of government to administer and control alone. Remedies for an ailing public finance system revolve around more, not less, partnerships and interdependence.

Although there are relatively few intergovernmental—interstate or state-federal—tax coordination mechanisms, several models can help in considering future approaches. Some of these models are long-standing, while others are relatively recent. They include the death tax credit model, the federal-state income tax model, the multistate coordination model, hybrid approaches, and the investment model.

Death Tax Credit Model

The state death tax credit, which has been a permanent feature of the federal estate tax since 1926, is probably the most far-reaching model of intergovernmental tax coordination. Each taxable estate is allowed a 100-percent credit against the federal estate tax for state death (estate or inheritance) taxes paid, up to a certain level. The model establishes a floor below which combined federal and state death taxes cannot fall. The goal is to ensure coordination of the federal and state death tax bases and minimize interstate tax competition. (A similar mechanism exists for federal-state unemployment taxes.)

The death tax credit model is effective in ensuring coordination. However, it places serious limits on state flexibility and autonomy, because states must conform to federal rules to take advantage of the credit. Yet the model could be considered for certain types of excise taxes where interstate price differentials are significant, thus promoting efforts to thwart tax evasion.

Federal-State Income Tax Model

Federal and state personal income taxes exhibit a reasonably high degree of coordination. The coordination results not from federal legal requirements, but from practical considerations by states. All but five of the states with a broad-based personal income tax conform substantial parts of their tax base to the federal income tax base and start the computation of state income tax liability from a specified point on the federal return.

Federal-state income tax conformity has several advantages for taxpayers and states. From a taxpayer perspective, it obviously eases the filing burden associated with income tax compliance because it promotes consistency in the definitions of income and expenses. From a state perspective, conformity enables the state to rely on federal information-reporting requirements, information-exchange programs, and other audit and enforcement efforts in securing compliance with the state tax. These benefits can be enjoyed without sacrificing the ability to establish independent rates and exemptions that enable states to control and distribute the state income tax burden. Yet the conformity approach puts the state fiscal position somewhat at risk, because substantial federal tax changes, generally taken without consultation or consideration of the state-level impact, affect state finances.

Multistate Coordination Model

A third model for coordinating tax policy and administration involves only states and aims to promote uniformity and cooperation on a multistate basis. The underlying rationale for such efforts is that it is in the best interests of these states and the taxpayers of these states to jointly design their tax policy and administration because of the tax issues or taxpayers involved.

Two primary examples of this approach are the Multistate Tax Commission (MTC) and the International Fuel Tax Agreement (IFTA). MTC was formed in 1967 as part of a state response to proposed federal legislation that would have significantly constrained state taxation of interstate commerce and businesses. The commission operates programs to promote uniformity in the taxation of interstate commerce as well as several multistate compliance and taxpayer service efforts. More than forty states participate in one or more aspects of MTC activities.

IFTA seeks to reconcile the importance of borders in fuel taxation and transportation services with the requirements of an interstate economy. It provides a vehicle for apportioning the fuel tax paid by interstate motor carriers among the states in which the carriers operate but limits their filing, audit, and other reporting obligations to interactions with a single, base state. IFTA began as a voluntary, cooperative effort among states; later, federal law effectively mandated state participation.

Multistate cooperative approaches such as MTC and IFTA provide maximum latitude and flexibility to participating states in designing approaches to resolve the issues they deem important. They also recognize the interdependence of states and can be effective in addressing the needs of the new economy. However, alone, this model is unlikely to be sufficient to overcome the legal and institutional taxation hurdles that states will face in the twenty-first century.

New, Hybrid Approaches

A fourth model that could be explored is one that combines and takes the best features of the other approaches. This model would likely provide for a substantially greater federal role in establishing parameters or standards for state and local tax systems than has before been considered appropriate. Yet the nature of the issues confronting states requires that new approaches be considered.

For example, the federal government, in consultation with states and localities, could establish minimum standards for some types of state taxes so the taxes respond to the needs of the new economy for simplification, uniformity, certainty, and ease of administration. The federal government could also provide incentives to encourage states to meet such standards. These incentives could come in the form of financial incentives or in the form of removing certain legal and institutional impediments to sound tax policy. Alternatively, interstate compacts approved by Congress could achieve the same results but afford states and localities greater latitude in spelling out the details of tax policy.

The essential point is that an effective intergovernmental tax system and policy for the new economy requires that current legal and institutional barriers be overcome. These barriers can be removed, at least in part, by federal action. Consequently, it is reasonable to expect that the removal or reduction of these barriers be accompanied by state-local tax systems that meet certain standards of neutrality, simplicity, uniformity, and ease of administration. However, it is important that the federal government views its role in this endeavor as a partner in shaping an intergovernmental public finance system and not merely as a broker of interests between state and local governments and others.

Investment Model

A fifth model would expand on existing state and local capital investment partnerships with the federal government. From environmental infrastructure to state revolving loan funds to the federal low-income housing tax credit to single-family and multifamily low- and moderate-income housing bonds, federal tax policy creates incentives to leverage capital investments by state and local governments while preserving their flexibility to tailor the investments to meet their unique needs and priorities. Expansion of the investment model would require retention of this essential flexibility and adaptability, but it could be an essential model as governments and industry work together to address concerns about traffic congestion and school needs in high-technology and other regions that cross local borders.

Chapter 6

Options for Regulation

Few areas of governance manifest greater tension than the regulatory arena. As some businesses increasingly want greater national and even international uniformity, states want more flexibility to experiment with alternative regulatory approaches. Similarly, as some businesses move to a global platform, states are increasingly concerned about consumer protection.

States and the federal government have a complex relationship of which regulatory responsibility forms one part. Historically, the federal government and state governments have regulated the actions and activities of businesses and individuals. Although their respective spheres of influence are occasionally separate and distinct, often they overlap. Blurred lines of authority among federal, state, and local regulatory agencies, coupled with overlapping and sometimes competing goals, feed companies' claims that they are frustrated in their ability to conduct business across state lines.

As a general rule, the greater the perceived cost to businesses and industries to comply with conflicting state regulations, the more they seek uniformity. This translates into federal rather than state regulation. It certainly raises several questions. What level of government should set standards? If the federal government sets a regulatory standard, how should a waiver process work? Should states set standards without federal interference? If the federal government sets the standards, should states be able to supersede them? Who should be responsible for enforcing and financing federal standards or regulations? Should there be a distinction in enforcement as it applies to individuals and businesses? How can state sovereignty be balanced with uniformity-based regulatory initiatives? Given the involvement of different levels of government, the regulatory function offers a particularly challenging arena in which to identify defining characteristics, resolve competing objectives, and consider new models for the twenty-first century.

Defining Characteristics

Regulatory models for the new economy should have several defining characteristics. They should:

- be cost-effective for regulated entities and individuals;
- afford states flexibility in how standards are met;
- be accountable and transparent to citizens and all intended parties;
- be customer-friendly;
- allow for experimentation and innovation; and
- provide protection to consumers.

Clearly, the federal role should be greater when the issue is interstate and when the cost to businesses of fifty different state approaches is significant. Where the activity is largely constrained within state borders or where significant experimentation on how to regulate is needed, then the balance should tip toward a state regulatory approach. A hybrid model is more appropriate where there is a minimum federal standard that can be exceeded by states, where there is a significant interstate component but more experimentation is necessary, or where the need for consumer protection differs substantially across states.

Accountability must be one of the hallmarks of a constructive, federal-state regulatory relationship. States receive significant federal funding for implementing and enforcing many federal statutes, and they must ensure that the funding is used to meet these statutes' goals. States can provide accountability in different ways. They can improve their reporting of compliance data, preferably in electronic form, to federal oversight agencies. They can also increase the transparency of their decisionmaking to the public and the regulated community by establishing stakeholder advisory committees, posting compliance data on web sites, and seeking input from customers on the state's priority-setting methods.

States should also seek ways to fulfill their regulatory responsibilities while providing better customer service and improving outcomes. Ultimately, the purpose of regulation at both the state and federal levels is to protect consumers and workers, preserve the environment, foster economic growth, and promote citizen well-being. The federal-state partnership should be crafted to optimize the performance of these responsibilities. It does not matter so much who protects consumers or how they do it; what really matters is how effectively and efficiently consumers are protected.

Competing Objectives

Competing objectives pose a difficult challenge for regulatory oversight. Consumer and environmental protection illustrate the conundrum. Government has a fundamental responsibility to protect consumers and the environment. However, in implementing and enforcing regulations to achieve these results, government cannot impose overly burdensome requirements that stifle innovation, impede economic growth, and eventually lead to consequences that have detrimental effects on the citizens the regulations are intended to protect.

This challenge is heightened in the new economy. The critical need for states to experiment and innovate must be balanced with the costs of industry compliance and the burden of conflicting requirements. The diminishment of borders makes the cost and capacity to protect consumers more problematic. A criminal or fraudulent business in one state can victimize consumers in a different state. The sale of prescription drugs, pornography to minors, and cigarettes and alcohol over the Internet illustrates how information technology is breeding new federal-state regulatory issues and tensions that challenge existing regulatory regimes.

Options

As the nation moves into the twenty-first century and the economy becomes more technology driven and globally oriented, there is an accelerating need for more federal standards. At the same time, there is a counterforce toward more discretion in regulatory enforcement by lower levels of government that are closer to the people. Given the important role of regulation in governance, thoughtful consideration of new models is critical. Federal standards, federal-state standards, multistate agreements, and multifunctional and multijurisdictional standards are options that could be explored.

Federal Standards

Under this option, the federal government would establish baseline standards and a state would not be allowed to exceed the standards. This model should be used primarily in areas where the regulatory issues are overwhelmingly interstate, where different state standards would impose significant costs on industry, and where there is limited need to experiment with the standards. States would be the primary implementer and enforcer of the standards. The federal government would afford states substantial flexibility to decide how the standards are enforced (e.g., through permit processes, licenses, and other mechanisms). The federal government would provide set funding to states each year for enforcement. States would report compliance data to the federal government, ensuring the opportunity for federal oversight.

Where state accountability tools already mirror federal guidelines, the federal government should allow state tools to prevail. Considering only the number and frequency of monitoring reports sent to the federal government, accountability to the federal oversight agencies is a positive feature of this model. Yet accountability also requires states to enhance opportunities for interactive relationships with their citizens and customers. States' attainment of performance standards or quantifiable outcomes need to be accorded adequate deference by federal agencies as indicators of success; the focus must shift away from concerns about missed reporting deadlines or other process-oriented variables. The federal government must approach the model as a true federal-state partnership that requires federal-state collaboration. The federal government cannot simply look for fraud, abuse, and noncompliance. It must act as a true partner intent on making program accountability work.

Federal-State Standards

This model is relatively similar to the federal standards model, except the federal government would establish national minimums and states could exceed these minimums. This model should be used where there is a significant interstate and intrastate component, where there is need for additional experimentation, or where states differ substantially in terms of the level of consumer protection they desire. The federal government would fund enforcement, and states would be given considerable flexibility in determining how the standards are met.

Multistate Agreements

Under this model, the federal government would provide financial or other incentives to encourage states or regions to enter into compacts. The federal government would approve the compact for the performance of a particular service. This model is very efficient because it focuses its efforts and organizes its functions and staff toward providing the service. Another major advantage is that the compacts would involve groups of states with similar goals.

The model is flexible for state governments because it allows the compact, using the host states' laws, to select and develop the most appropriate way of providing the service. Approved regional compacts could also negotiate service access and customer costs. Pursuant to the statute, flexibility could be broad or limited with regard to any safety or technical requirements as well as the degree of public involvement in planning and implementation.

This model could be very responsive to its primary customers, the businesses that will use and benefit from the service. Keeping records, reporting, and providing information to the public would be primarily state functions, enabling states to streamline these procedures while ensuring accountability to customers.

Multifunctional and Multijurisdictional Standards

In the future, particularly in major urban areas, it may be important to move toward more holistic regulatory approaches that encompass multiple functional areas and multiple jurisdictions. For example, transportation, environmental, and open space goals may be more efficiently met when state and local governments jointly agree on a plan that is negotiated with several federal agencies. Such a model could result in more flexible standard-setting and enforcement. It could also be more effective in meeting the specific needs of citizens in a region. Lead agencies would be specified, and all relevant regulatory standards from all three levels of government would have to be part of the negotiated plan. State and local enforcement responsibilities would be identified. Funding could come from all three levels of government.

Appendix 1: Essays on the New Economy by Governors Roy Barnes, Georgia; Jeanne Shaheen, New Hampshire; and Jim Geringer, Wyoming

February, 2000

Roy E. Barnes, Governor
Georgia

The Internet has eliminated two long-standing barriers to communications—time and distance. And, as the barriers fall, the ability of individuals to associate with those of similar interests and desires transcends geographical boundaries. Where once groups were confined to communities residing in contiguous territories, groups are now physically scattered yet electronically connected.

Our system of government was established almost 225 years ago as an experiment establishing direct representation in government of peoples of diverse ethnic, religious, economic, and geographic backgrounds. As this nation started, people with like backgrounds settled together in communities. The boundaries of government were set by geography and powers were reserved for the states to protect individual freedoms in commerce, property, health, and welfare. States were accorded these powers as state government was closer to the individuals whose freedom and welfare the government was designed to protect. The intermingled roles exercised by state and federal governments are, of course, better known as federalism.

But, the Internet has provided a way to erase geographical boundaries that once formed a logical basis for division of powers within and among governments. The Internet has essentially changed the assumptions of our Founding Fathers. Today, we must guard against a tyranny of the minority as vigilantly as our early representatives guarded against tyranny by majority. Where groups and communities once formed in geographical locations, these groups now form over electronic networks. So, as we progress into the 21st century, we must consider whether our concept of federalism is appropriate.

The Internet presents us with a puzzle. It provides individuals with great access to information, and this access empowers individuals to make decisions for which they alone are accountable. Empowering individuals in business has led to greater productivity and larger profits. Business has discovered that a centralized bureaucracy is no longer necessary to enforce rules designed to insure productive efforts.

From one perspective, empowering individuals in society should decrease the need for bureaucratic agencies to enforce government regulations. Thus, government should shrink while individualism flourishes. Taken another step, empowerment of the individual necessarily implies a weakening of state government.

Georgia is investing in technology to provide all of its services and information to the public on the web. Georgia will experience what business has already discovered—higher quality service at lower cost. Other states are unveiling ambitious plans that will give those with Internet access greater knowledge and flexibility in dealing with government.

While the Internet provides the means to decentralize much of government, it also gives us the means to consolidate power and thus tip the balance towards a stronger central government.

Consider the current legislation in Congress regarding e-commerce. One federal effort will severely affect state revenue dependent upon sales tax by exempting Internet commerce activity from sales tax. Another initiative focused on electronic signatures will radically affect state efforts to regulate contracts and protect consumers. Yet another federal proposal would profoundly affect an individual's privacy in conducting business under the guise of protecting the confidentiality of consumer credit and medical information. All of these efforts tread upon areas once set aside for states to manage.

While the struggle between the states and the federal government regarding powers is nothing new, the scope of the struggle is definitively exacerbated with the invention of the Internet.

But, should we rush into decisions regarding whether the federal government or state governments should regulate commerce on the Net, protect individual rights, and secure the future of our economy?

I say no. While the freedom of the Internet must be protected, we should not regard transactions and other business opportunities centered around the Internet to be any different simply because the Internet is involved. Simply reduced, commerce on the Internet still revolves around the exchange of property. The protection of property, and the interest of the individuals who possessed it, was seen as a justification for government by the early leaders of this nation. Traditionally, states have exercised most of the effort with regards to property protection, enforcement of contracts, and regulation of fraud in such commerce. These activities must continue, whether the Internet is an integral part or not.

It is important that states preserve their traditional roles as well as continue to function as the laboratories that have created the innovations in governing that make our system vibrant and successful. Just as we dare not burden the Internet with regulations that may or may not kill its spirit of independence and innovation, we dare not destroy the ability of states to experiment with different programs to determine what best works in the 21st century.

Balancing the roles of states and federal government will be as important to the success of the nation for the next hundred years as it was for the past two hundred years. States must continue to focus on the services they are best suited to provide, and states must make the most of the advantages offered by new technologies such as the Internet as quickly as possible even if these technologies force a reengineering of traditional government services.

And, the federal government must continue its role in positioning the nation to compete globally in the new economy. Efforts by the federal government should focus on eliminating barriers for states to compete with labor from other countries— so goods and services can be offered with little fear of excessive tariffs and regulations—and expanding economic opportunities for all citizens.

Federalism must continue to evolve, but the evolution must continue with a partnership between the federal and state governments. While the Internet presents a new dynamic, it does not remove the principles upon which this system is based.

Jeanne Shaheen, Governor
New Hampshire

A New Focus on Early Education Is Critical to Success in the New Economy

As we enter this new century, we find ourselves on the cutting edge of the new economy. It's a global economy based on ideas, innovation and information. Our economic prosperity in this new economy will depend on what our citizens know. Now more than ever, we need a well-educated workforce.

To create the knowledge workers we need for the 21st century, we need a fundamental and dramatic philosophical change – on the national and state levels – in how we think about education. Learning begins at birth, and we now know the learning that takes place in the earliest years is crucial. New flexible and innovative public policies must be developed to address this challenge, and a new partnership among the state and federal governments and the private sector must be forged.

At one of the first National Governors' Association conferences I attended, we were shown two graphs. The first graph showed a child's brain development, with a steep upward curve during the first years of life and then a gradual leveling off. The second graph showed when we invest in children, and this graph was virtually a complete inverse of the first. In the early years – when children's brains and learning skills are developing the quickest – there is almost no public investment in children. Nothing else I have seen in my three years as governor has made a greater impression on me than the juxtaposition of those two graphs.

Research shows the quality of early care and education our youngest children receive today affects their long-term success. Children who receive a high-quality early education are more likely to do better in school and in society. They are less likely to drop out, less likely to repeat grades, less likely to need special education and less likely to get into trouble with the law. The experiences children have in their first few years will affect them – and our society – for the rest of their lives.

A study by the Carnegie Foundation found that the costs of reversing a poor start in life, and in education, increase as a child grows older, while at the same time the child's chances of success diminish. The Perry Study, which followed 123 children for 27 years, estimates that every dollar we spend on quality early childhood education will save us over $7 later. The return on investment can be counted both in terms of dollars saved on remediation efforts and in what these children will be able to contribute to society as they grow into healthy, educated adults.

This July I will assume the chair of the Education Commission of the States. I intend to spend my year as chair focusing on early childhood education because I believe it is one of the most critical and overlooked issues we face.

Federal and state governments – and the business community – must rethink how they look at child care and early childhood education and begin investing resources to ensure that families have access to high-quality early care and education for their children. This is not just an issue for parents. This is an economic issue that will help determine our prosperity now and in the future.

Today, over 60 percent of mothers with children under the age of six are in the workforce. Most are in the workforce so that their families have the income they need to live. Our businesses and the economy need them in the workforce to grow. But too often, working parents can't find the child care they need for their pre-schoolers and infants at a price they can afford. Too often, they simply can't find it at all.

Right now, our national child care shortage is costing us millions of dollars in lost productivity and lost opportunities. In New Hampshire alone, our businesses estimate they lose $24 million a year because of child-care related absenteeism. In a recent New Hampshire survey, 25 percent of parents reported that at least one parent had to quit a job or switch from full-time to part-time work because of child care responsibilities. And as we attempt to move people from welfare to work, we often find the biggest barrier is finding affordable, quality care for their children.

In the new economy, where a worker's knowledge and skills are of paramount importance, it has never been more critical to invest in quality child care and education, from the very start.

Perhaps the most important investment we can make is in the people who provide the care for our children in child care settings across the country. Child care workers spend as much as 10 hours a day with children at a period in their development when they are the most vulnerable. Yet, child care workers are often paid just above the minimum wage and rarely receive benefits. This contributes to high turnover and a shortage of qualified, experienced personnel. If we are to improve the quality of care that is available to our youngest citizens, we must take steps to improve both the supply and quality of child care workers.

One strategy would be to extend student loan forgiveness programs to people seeking early childhood education certification. Another, recommended by the Carnegie Foundation, would involve providing supplementary block grants, beyond the Child Care Development Block Grant. These grants could be used to improve the quality of child care by enhancing training and raising pay levels for child care workers or upgrading and expanding facilities.

States need federal funding that is flexible enough to allow us to experiment with new initiatives and that encourage involvement and support from businesses, parents, schools and communities. Supplementary block grants could help us achieve this.

Our federal tax policies must also begin to reflect the value of early child care and education. The Low-Income Housing Tax Credit has generated over $12 billion in private investment in housing for low- and moderate-income families. We should encourage similar investments in early child care and education facilities with a tax credit for potential investors. We should also expand the Child and Dependent Care Tax Credit and the Dependent Care Assistance programs so that they help more middle income families manage child care costs.

As we improve the quality of child care workers and the financing of child care, we must also look at better coordinating our efforts. The federal government provides a patchwork of funding programs that support early care and education – the Child Care Development Fund, Head Start, Early Head Start, Even Start, Title I and early special education. We must review these programs in terms of where and how they overlap, and whether they work together to ensure the best results for our children.

We must also better coordinate child care and early childhood education programs with our public schools. Research shows that by the time kids get to kindergarten, there are already disparities in what they know and what they are able to do. Incentives should be created to encourage our public school systems to build links with early childhood education programs.

Because business has a direct stake in the quality of early care and education, government should encourage business involvement in child care solutions. In New Hampshire, I brought businesses to the table for the first time to work with us on how to improve the quality and accessibility of child care. Ideas that arose from my Business Commission on Child Care include providing tax credits to businesses that promote the development of family-friendly work place policies, such as flexible scheduling, telecommuting, earned time expansion, and child care subsidies. We also should encourage partnerships between businesses and child care providers. For example, businesses can offer child care centers much-needed technical assistance on business management and planning.

Now is the time to begin a national discussion on how we should care for and educate our youngest children. Success in the new economy will be founded on the ability of our people to use their minds to their fullest potential. The federal and state governments must be flexible and innovative so that we can reach our children in their earliest years, and we can't afford to wait.

Jim Geringer, Governor
Wyoming

A New State-Federal Partnership to Support Postsecondary Education in the New Economy

Wyoming's New Economy is characterized by a shift from traditional manufacturing to knowledge-based businesses. The common denominator for all business will be increased global competition and decreased regulation. Access to cutting-edge research, venture capital, sophisticated communications networks, and pools of highly skilled workers will be standard requirements to sustain and grow businesses throughout our state. That's true for existing as well as for new businesses. Technology will be used, not only to leverage the production of products and services, but also to market, sell, and distribute these outputs. While our national economy will continue to need Wyoming's ample supply for energy and raw materials, our goals for real wage growth and economic development in Wyoming will require a heavy investment in human resources, particularly in our youth. In order to build a more diversified economy, we must continue to invest in additional infrastructure that will support new and growing technologies, and Wyoming's workforce will need to upgrade its skills and knowledge base in order to be competitive, in our region, in our nation, and in the global economy.

The New Economy places a high value on knowledge and the ability to add value to a company through knowledge. That's why support for improved K-12 education and access to postsecondary education is crucial. But the New Economy needs some old fashioned economic support as well, such as a stable tax structure, competitive labor costs, access to capital, and a favorable regulatory climate.

Education is the foundation upon which everything else is built. It is the key to Wyoming's mastery of the social, personal, and economic goals of the new millennium. We need to increase the potential of every person in our state. But that doesn't come without a price. Projections show that in the near future, the revenue needed to fund education will be an even bigger part of our budget. We must plan ahead now for our children. We must ensure that today's children have the skills to compete tomorrow in a global market whether located in Wyoming, the nation or overseas.

Large numbers of high school students continue to graduate from high school without the skills for either college or work, and those who enter college often need extensive remediation. Improved K–12 education is crucial for preparing students to enter postsecondary education institutions or the workplace. Increasingly in the New Economy, postsecondary education will be a prerequisite for employment. Not all workers will need bachelors or advanced degrees, but many will need postsecondary training for specific job related knowledge and skills. To succeed in the New Economy workers must be prepared to enhance their skills and make a commitment to lifelong learning. Further, as postsecondary education becomes more important for worker success, many postsecondary learners will need and want the ability to access learning anywhere and anytime. Thus, postsecondary institutions and providers should promote access to postsecondary education outside the walls of the traditional institutions and provide innovative programs and delivery systems.

I envision a society where everyone has equal access to postsecondary education, where quality postsecondary education is affordable for all, and where competition ensures that every student achieves the best education and training for employment in the traditional and New Economy. By the end of 2010, I see a world where every person has a computer and can access the Internet, federal grants cover the cost of education and training for all students and workers who need assistance, and courses are offered when full-time workers can access them. I also see a world where colleges charge fair tuition prices and control costs without lowering academic quality. Finally, I envision postsecondary institutions that provide programs that meet the needs of employers in the New Economy.

Efforts to improve postsecondary opportunities for students and workers largely require state and university-led initiatives, but federal initiatives can effectively support state and local policies. In Wyoming, I am proposing a revamped funding formula for the state university and community colleges that will give our postsecondary institutions the ability to provide education and training to a larger number of students and an opportunity to compete for students from a broader region. To support our state efforts, the federal government can continue its commitment to student aid and university-led research, but it may also need to reexamine its definitions of postsecondary institutions and students, offer aid to a broader range of postsecondary students, and conduct research about the rising costs of postsecondary education. In the New Economy issues of access and affordability will be paramount.

In order for these visions to become a reality, the federal government may want to consider ways to support the policies of the state governments. For example:

> The federal government and the states can examine their aid policies and programs and cooperate to devise aid programs that support one another and increase access for lower income and nontraditional students.
>
> Federal and state policymakers can also examine current regulatory systems that currently restrict access to postsecondary education for adult learners, and can revise those systems to ease their reentry into postsecondary education.
>
> Each year, college tuitions increase at a rate above the rate of inflation and each time concerns are raised about why postsecondary education budgets are so high. University administrators respond that if they cut costs they will have to lower academic quality. The federal government can support states and postsecondary institutions by examining postsecondary spending trends and strategies for curtailing rising costs. That information should be accessible to states to determine if their institutions are efficient and are held accountable for costs and spending.

> Postsecondary institutions need to become more entrepreneurial and flexible in responding to market demands. Private and for-profit providers are effective because they meet economic needs by providing crucial training support for workers and businesses. The federal government can support these efforts by making funding available to these institutions and alternative providers.

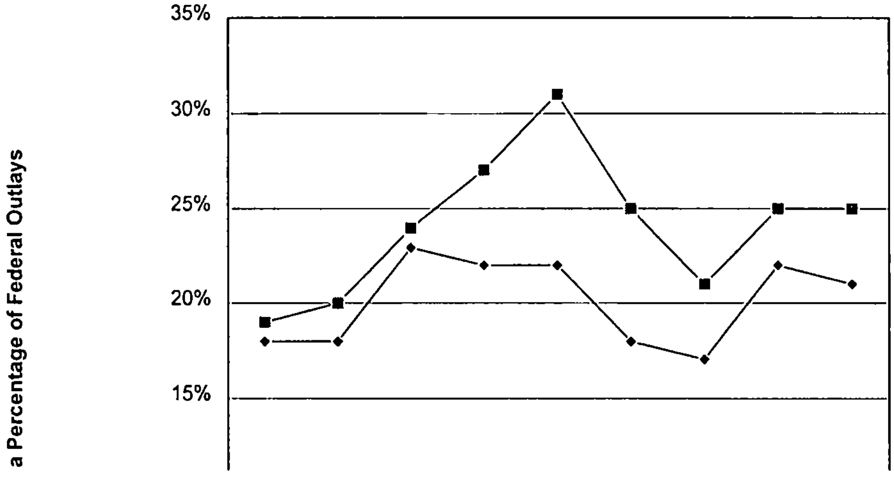
As we embrace the 21st century and the New Economy, access to postsecondary education has to have a new meaning. That will require some rethinking, coordination, and synergy between states and the federal government. Some students will continue to avail themselves of a more traditional postsecondary education, but hopefully all Americans will have access to higher education institutions to provide them with the knowledge and skills they need to succeed in a rapidly evolving economy. To achieve these changes, many more postsecondary students will be nontraditional—workers who need to update their skills and knowledge, develop new skills, and learn new technologies. Cooperation between the federal and state governments is crucial for ensuring access and affordability for all students, whether they are 18 or 48, newly graduated from high school or embarking on a second, third, or fourth new career.

Appendix 2: Federal-State Relations in the 1990s

Few issues have been more enduring since the birth of this nation than the tension between the federal government and the states. It was at the heart of the debate about whether to adopt articles of confederation or the Constitution. Ultimately, the founders created a dual system of governance that allocates power between the federal government and the states. The Supremacy Clause states that federal laws made pursuant to the Constitution are the supreme law of the land. The Tenth Amendment makes clear that states retain all governmental power not granted to the federal government by the Constitution. The founders created the Supreme Court to serve as a balancing scale.

To determine what governance in the new century should look like, it is important to look at trends in federal grants to state and local governments during past decades, especially the last decade (see Figure 1) Were there significant changes in how states and the federal government worked together? If so, what were they? Do they offer lessons for the significant changes that will be necessary for the future?

Figure 1: Trends in Federal Grants to State and Local Governments



Source: Office of Management and Budget, *Budget of the U.S. Government, FY 2000* (Washington, D.C.: U.S. Government Printing Office, February 1999)

Assaying the federal-state balance has been central to the history of this nation, confronting not only the executive, legislative, and judicial branches with fundamental issues, but also testing the measure of the nation through one of the most grueling wars in history. Those tensions have manifested themselves in the ebb and flow of federal mandates, devolution, funding, and preemption. What is changing is the pace of change and the pressure it imposes on what historically has been mainly reactive governance. The shift in the economy from one that was site-based to one that is increasingly borderless raises hard questions about the role of government and whether that role can even be based on the experiences of the last decade.

During the 1990s, the federal-state relationship did not change very much. Federal unfunded mandates to states have become a diminishing problem. In welfare, health care, education, and drinking water, there has been a genuine step forward to devolve authority and flexibility to states. Yet a countervailing force to this constructive development is the propensity of the federal executive and legislative branches to preempt traditional state authority. Federal actions affecting or limiting state tax authority are on the increase.

In a less overt way, federal-state relations in the 1990s were distinguished by an increasing and dominant part of the federal budget being earmarked for entitlement programs. These changes have caused federal funding not to keep up in areas as diverse as crime, transportation, and education, because of the federal government's growing role in entitlement programs affecting the elderly. Although these changes have occurred largely through inaction, they are no less important to the federal-state relationship.

Unfunded Mandates: A Diminishing Problem

The federal government's imposition of unfunded mandates posed a significant problem for the states in the early part of the 1990s. Faced with growing budget deficits, the federal government increasingly sought to achieve its policy agenda by creating new programs and imposing the responsibility for implementing and paying for them on state and local governments. Twenty-five states responded to an Advisory Commission on Intergovernmental Relations' survey on existing mandates, identifying more than 200 mandates. The commission identified fourteen of the most onerous existing mandates in its January 1996 preliminary report. As expected, the most costly unfunded mandates concerned the environment, labor relations, and health care.

Congressional Action

In response to this disturbing trend, state and local governments achieved passage of the Unfunded Mandates Reform Act of 1995 (UMRA). This act does not prevent the federal government from imposing unfunded mandates on states, but it does increase its accountability for doing so.

The act requires the Congressional Budget Office (CBO) to provide an analysis of legislation that would impose costs of greater than $50 million on states.

It allows legislators to raise a point of order, which can be overcome by a simple majority vote, against legislation that exceeds the $50-million threshold.

UMRA is at least partially responsible for the significant decline in the number of unfunded mandates imposed by Congress during the years since the passage of this legislation. CBO cost studies have played an important role in reducing these mandates by making legislators aware of the fiscal impact that proposed legislation may have on states. Unfunded mandates are now questioned regularly in Congress, and there have been only a few new regulatory mandates in recent years.

The Congressional Budget Office is thoroughly analyzing the effects of unfunded mandates on states. CBO completed 718 cost estimates that affect state and local governments and 673 that affect business for legislation reported by congressional committees in 1996. Of the 718 government impact bills, sixty-nine contained mandates and only eleven mandates had cost impacts of more than $50 million. Of these eleven mandates, seven were in the minimum wage bill and the other four—immigration reform, securities reform, mental health parity, and occupational health and safety—were amended to reduce the costs of the mandate below $50 million. Members requested cost estimates for 10 percent of state and local mandates before committee action and for 5 percent after committee action, which shows CBO's constant surveillance of new mandates before and after committee action.

The threat of a point of order on the floor gives new enforcement powers to the law, and it has changed congressional consideration of mandates. The new unfunded mandates law has been used successfully in discussions on telecommunications, immigration, crumb rubber, speed limits, trip reductions, an Indian gaming commission, occupational safety and health, and the minimum wage. Only on the minimum wage issue was the point of order on the mandates rejected. This was partially because most state and local governments did not weigh in on the discussions. Moreover, some local governments supported the new mandate, which will cost state and local governments $1 billion during the next five years.

The fact that a point-of-order procedure is available against new mandates has sensitized members of Congress. It causes them to reflect on the impact of their proposals beyond the Beltway, the special interest groups, and the cost to taxpayers. More members than ever are asking CBO to review proposals before committee action.

The Unfunded Mandates Reform Act of 1995 has affected specific issues, including the following.

Telecommunications. The threat of a point of order caused conferees to modify preemptive language over state authority in collecting fees and local participation in locating new towers.

Indian Gaming Commission. CBO ruled that giving the commission subpoena powers creates a mandate. However, the cost estimate was less than the $50 million needed for a point of order. The key point is that the new law was used to evaluate a semijudicial procedure.

Minimum Wage. Although the CBO cost estimate for state and local governments was $1 billion over a five-year period, a point of order against the mandate failed by a vote of 161 to 267. UMRA does not prevent new mandates, but it gives members of Congress the option to ask for a roll-call vote that cannot be denied by other rules and procedures.

Immigration. The CBO cost estimate of between $80 million and $200 million to reformulate drivers' licenses caused the Senate to amend its bill with a less onerous mandate and add a six-year transition period for implementation. CBO did not estimate the costs to state and local governments of implementing the "deeming" requirements in the bill because of the scope and complexity of the affected programs. However, CBO acknowledged that these costs could be significant.

Highway Mandates. Requirements related to crumb rubber, speed limits, motorcycle helmets, and trip reduction were all eliminated, primarily because they were identified as some of the most costly mandates.

Agency Regulatory Review and Compliance

Title II of the Unfunded Mandates Reform Act of 1995 requires federal agencies to develop a process for obtaining meaningful and timely cost estimates after consultations with state, local, and tribal governments, especially small governments. This process is required for any regulations costing more than $100 million to governments or private businesses. An Office of Management and Budget (OMB) publication notes that agencies have completed two reports on government impacts and fourteen on private-sector impacts as well as developed pilot projects on increasing flexibility for small governments. OMB indicates that only two regulations have exceeded the $100-million threshold for review. (Regulations on welfare reform, safe drinking water, and telecommunications were developed in consultation with state and local officials.)

The President's new Executive Order on Federalism, No. 13132, issued on August 4, 1999, and effective on November 2, 1999, emphasizes consultation with elected officials of state and local governments and sets forth fundamental principles of federalism, federalism policymaking criteria, special requirements for preemption, special requirements for legislative proposals, specific procedures for intergovernmental consultation, and increased flexibility for state and local waivers. It covers all federal agencies, except independent ones, such as the Securities and Exchange Commission and Federal Communications Commission.

The new order on federalism covers deference to state laws and procedures, an expedited waiver process, prior consultation with state and local elected officials, written certification of compliance, and a summary of the comments printed in the preamble of the proposed rule. The order is only now being implemented, so it is too soon to determine whether the order will have a constructive impact on agency regulatory review and compliance.

Devolution: A Major Step Forward

Along with the recognition that mandates from Washington, D.C., impose costs and burdens on the public and private sectors, there is recognition that a vital partnership must involve both levels of government. In welfare, health care, education, and drinking water, there has been genuine progress in devolving responsibilities and providing flexibility to states. In all of these areas, the federal government has retained a key role in setting national standards but recognized that different circumstances require implementation at the state level. Legislation enacted during the 1990s demonstrates that the federal government can build in incentives for adaptability and performance and delegate substantial decisionmaking authority to the level of government best equipped to respond.

Welfare Reform

Perhaps the most significant example of devolving program responsibilities from the federal government to state governments is the 1996 welfare reform law. This law resulted from the strong leadership role played by states and the pressure exerted to implement a federal waiver process to develop innovative welfare reform approaches. The 1996 law repealed the Aid to Families with Dependent Children (AFDC) program, which had existed for more than thirty years, and created a new Temporary Assistance for Needy Families (TANF) block grant. Under AFDC, individuals were entitled to a federal welfare payment under federally prescribed rules. TANF affords Governors the flexibility, within certain federal guidelines, to make decisions about how to run welfare programs in their state and how to distribute assistance to individuals.

Rather than receiving federal funds based on their welfare caseloads, states agreed to accept level funding for TANF in exchange for flexibility in program administration. Today, states are primarily responsible for welfare programs because of the 1996 law. However, this historic agreement is based on mutual trust, and the continued success of TANF depends on a strong federal-state partnership. Congressional threats to cut the federal financial commitment to TANF could damage this promising example of devolution.

Health Care

Significant devolution of health care responsibilities has occurred through state innovations in the Medicaid program using Section 1115 waivers. Although the Medicaid program allows for state-by-state variation, comprehensive changes require a waiver of program requirements that have remained unchanged since the program's enactment in 1965. States were allowed to make substantial program improvements in the mid-1990s, including enhanced eligibility, modifications to the traditional benefits package, and wide-scale adoption of managed care as a delivery system. Waivers have become the norm, rather than the exception, with every state having at least one and often multiple waivers of various federal standards. This explosion of state innovation has kept the Medicaid program attuned to the needs and demands of the modern health care system.

With the passage of the State Children's Health Insurance Program (SCHIP) in the Balanced Budget Act of 1997, Congress recognized that the best way to improve health care access and outcomes for children is to empower states. Rather than simply allowing states to expand Medicaid with an enhanced federal match, Congress gave them considerable flexibility to design programs that more closely match private insurance plans but still meet the goals of improving access and outcomes. States have always been laboratories of democracy, especially in health care. A potential benefit of SCHIP is national recognition that devolving responsibility for health care to states can improve health care access and outcomes more effectively than a one-size-fits-all federal approach.

Education

Another small step toward devolving authority and flexibility came on April 29, 1999, when the President signed the conference agreement on the Education Flexibility Partnership Act of 1999 to expand the Education Flexibility Demonstration (Ed-Flex) to all states. The new statute allows the U.S. secretary of education to waive certain federal statutory or regulatory requirements in exchange for states waiving comparable state regulations. States that are in compliance with Title One and have a comprehensive school improvement plan that has been approved by the secretary may apply for Ed-Flex. The Department of Education has released draft guidance on the expanded program, and several states are developing applications to become Ed-Flex states.

Drinking Water

In 1996 Congress passed, and the President signed into law, amendments to the Safe Drinking Water Act. This legislation is another milestone in devolving authority and flexibility. Recognizing the extraordinary differences in watersheds and aquifers, the law authorizes a primacy state to establish treatment requirements. It also grants a state primary enforcement responsibility for systems during any period for which the administrator of the U.S. Environmental Protection Agency (EPA) determines that such state has drinking water regulations that are no less stringent than the federal regulations; two-year extensions are permitted under specified circumstances. In addition, the law created a program to provide financial assistance to facilitate compliance with the national standards and for projects to further the health protection objectives of the act. It directs EPA to enter into agreements to make capitalization grants to eligible states, contingent on their establishing a drinking water treatment revolving loan fund.

Additional Restrictions: A Growing Concern

Notwithstanding the progress on the devolution front, there has been increasing federal pressure on states to meet rigorous performance standards and detailed reporting requirements. For example, the Food Stamp program is a federally funded, state-administered human service entitlement program that affords states little flexibility and has a burdensome quality control system that is not appropriately linked with desired outcomes. In addition, although states have substantial flexibility to administer welfare programs through TANF, excessive data reporting requirements are a burden.

The elimination of one federal entitlement program (AFDC) and creation of two state entitlement programs (TANF and SCHIP) could signal an important change in the long-term direction of federal-state relations on entitlement programs. Such actions leave important questions of resources and flexibility in the delivery of those resources for important health and human service programs focused on the next generation of corporate and government leaders.

Preemption: A Serious Threat

The number of unfunded mandates has significantly declined during the past several years, partially as a result of the passage of UMRA and partially as a result of improved federal fiscal health. However, federal preemption of state laws has increased. In some instances, it threatens the states' role in the American system of government and Governors' ability to conduct a wide range of activities, ranging from protecting citizens to promoting economic development within state borders. More than half of the federal preemptions have been enacted since 1969, and the frequency of preemptions has accelerated since the mid-1990s. This acceleration has not been accompanied by a concomitant increase in analyses of potential impact; of 11,414 federal rules promulgated between 1996 and 1998, only five included a federalism assessment. If the trend continues, state and local governments will be forced to settle for a radically altered role in the American federal system.

Preemption has taken place in a wide range of areas, including international trade telecommunications, health care, financial services, and revenue generation. Preemption can prohibit economic regulation and other activities by state and local governments. It can also require states to enforce federal laws, conform their laws to federal standards, and take on new responsibilities. Perhaps most critically, preemption can undermine political accountability, effectively shifting power from state and local elected officials to federal bureaucrats and courts.

In some cases, Governors have agreed with the need for federal action and supported preemption. For example, Governors supported the Health Insurance Portability and Accountability Act, also known as Kennedy-Kassebaum, even though it expanded the federal government's role in insurance regulation. Nonetheless, Congress has passed several bills and considered many others during the past several years that preempt state laws.

International Trade. The federal government has adopted comprehensive trade measures that preempt numerous state laws. The North American Free Trade Agreement (NAFTA) and General Agreement on Tariffs and Trade (GATT) are major initiatives that Governors supported. Yet, to accommodate the needs and desires of international trade partners who would rather deal with one uniform policy governing trade than fifty different state laws, NAFTA and GATT supersede many state laws. These agreements downgrade the status of state laws from actions that derive from constitutionally determined powers to trade barriers that international agreements can obviate.

Financial Services. The National Securities Markets Improvements Act of 1996 preempted states' authority to license nationally traded securities, mutual funds, and large investment advisers. Despite preserving states' ability to collect licensing fees, they lost their historical power to regulate many aspects of securities activities within their boundaries. The Securities Litigation Uniform Standards Act of 1998 has similar adverse implications for states' rights. In addition to prohibiting class action suits based on the violation of state laws, the act permits viable class action suits to be moved from state courts to federal district courts.

Food Inspections. The Food Quality Protection Act of 1995 preempted state regulation of pesticides in the shipping, handling, and production of food.

Telecommunications. The Telecommunications Act of 1996 overhauled the regulation of local telecommunications services. The act ostensibly sought to deregulate the local telephone industry, but it effectively reregulated the industry by stripping state and local regulators of their traditional authority over local telephone service and transferring this power to the Federal Communications Commission (FCC). Consequently, the federal legislation eliminated or seriously impaired states' ability to control the range, quality, and affordability of telecommunications services available to their citizens. Historically, state public utilities commissions had the responsibility for ensuring that essential telecommunications services were available to businesses and citizens in their states at a reasonable cost. The 1996 act transferred this function to the FCC, centralizing responsibility at the federal level for ensuring that consumers receive adequate *local* telecommunications services. The legislation significantly weakened states' authority to enforce zoning restrictions for television antennas, wireless transmission towers, and small satellite dishes. The FCC gained authority to preempt state and local zoning regulations that conflict with the Telecommunications Act, again transferring power over inherently local issues to federal decisionmakers. Moreover, House-passed telecommunications legislation dealing with the practice of "slamming"—the unauthorized switching of a consumer's long-distance provider—would have preempted state laws that were stronger than the standards the bill would have required.

Revenues Restrictions: A Growing Concern

What distinguishes this nation from almost any other is states' sovereign authority to create and change their tax systems to raise the revenues their citizens determine are necessary to meet investment needs and priorities. Similarly, some local governments have home rule or other state-granted independent authority. Yet this very independence creates tension, because federal, state, and local taxes apply to all citizens and businesses.

Perhaps more than any other area of governance, taxes and revenues have evolved on separate trajectories (see The Three-Legged Stool of State and Local Revenue Systems). The federal tax system has added thousands of provisions to become a complex maze confounded by thousands of dense regulations to implement changes for special interests that have been incorporated into the code during the past decade. These changes bear little relationship to the systems of the United States' major international trading partners or to state tax systems. State and local tax systems have similarly continued to evolve in response to parochial needs and priorities, with little concern about consistency with changes in other states and localities. The result is more than 7,000 state and local tax systems that neither recognize the deregulation of the financial services, telecommunications, or technology industries, nor the critical need to achieve greater simplicity and conformity in a global economy.

The Three-Legged Stool of State and Local Revenue Systems

Since the nation's founding, state and local governments have sought revenue-raising structures that balance citizens' desire for minimal taxation and demand for tax fairness with the need to generate sufficient revenue for essential services. In the nineteenth century, this search led state and local governments to the property tax as a primary revenue source, because most of the nation's wealth was concentrated in real property. As the nation became more mobile and industrialized and antiproperty tax sentiment increased, it became clear that a property-intensive tax structure could not provide sufficient revenue to serve the needs of the rapidly growing population. The search for balancing the base and addressing potential revenue erosion led to increased state adoption of the personal income tax and the general sales tax, which came of age in the 1930s. The share of state-local revenue accounted for by property taxes has fallen from nearly one-half to less than one-third since 1970, while the personal income tax share has doubled from less than 10 percent of state-local tax revenues in 1965 to just more than 20 percent by 1994. The sales tax also grew as a portion of state-local revenue during this period, from 33.4 percent in 1965 to 35.8 percent in 1994.

Source: Scott Mackey, *State and Local Tax Levels* (Denver, Colo.: National Conference of State Legislatures, November 1998).

For most of the twentieth century, state and federal tax systems were guided by a doctrine of reciprocal immunity, meaning that states could not tax the federal government and vice versa. This doctrine has generally referred to the bonds issued by the respective levels of government, but it has accrued wider construction; there has been a greater acceptance of noninterference with revenues that states or the federal government collect to provide services.

The doctrine of reciprocal immunity originated with the creation of the federal income tax in 1913, as states and the federal government took into account the potential competition for revenues from the same sources. The rapidly evolving global, information-based economy threatens to increase this competition and undermine accountability to taxpayers at all levels.

The significant trends in taxes and revenues during the past decade reflect decisions that occurred in a noncomprehensive forum. Unlike unfunded mandates, there has been less effort to consider the impact of federal revenue changes on state and local tax systems. Unlike devolution, revenue decisions have increasingly been characterized by preemption. With the advent of the new economy, this issue has become more serious. Federal declarations to make the Internet free of taxation and regulation have, at least so far, applied only to state and local taxes and regulations, not to federal taxes or regulations. Such interference does not contribute to a constructive rethinking of what kinds of revenue systems have to work together to complement the new information-based economy. It threatens revenues for investments in human and physical infrastructure that are fundamental to long-term growth. Particularly in the areas of telecommunications and the Internet, the past decade witnessed potentially ominous changes.

Telecommunications

The Telecommunications Act of 1996 overhauled the regulation of local telecommunications services and preempted local authority to tax satellite television. This action signaled significant interference with another level of government's tax authority as well as reflected intrusion by nontax committees in Congress. The act did not bar, or propose any changes to, federal taxes.

The Internet

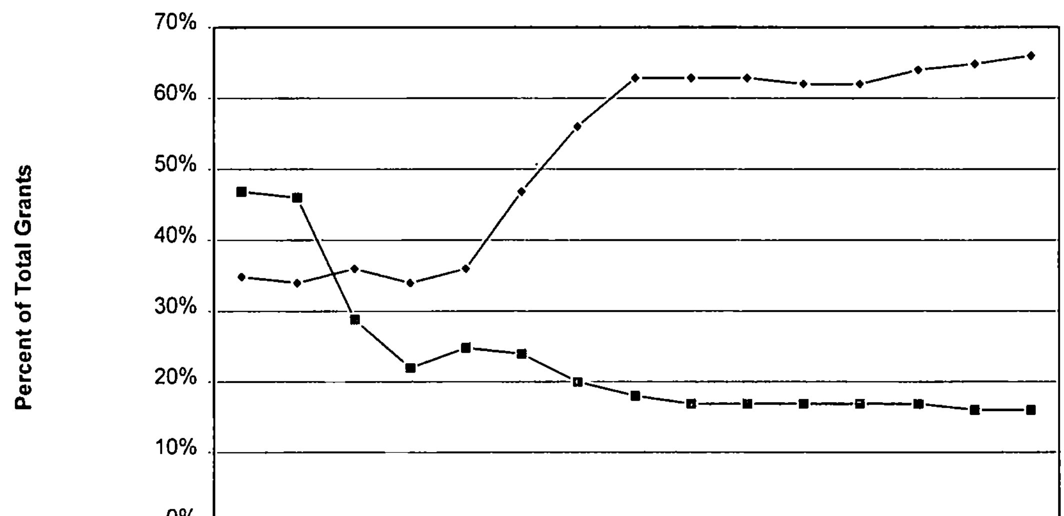
When Congress passed the Omnibus Appropriations Act for fiscal 1999, it included the Internet Tax Freedom Act (ITFA). The federal tax legislation sets no restrictions on whether states can tax sales over the Internet. However, it prohibits state and local governments, during a three-year moratorium from October 1, 1998, to October 1, 2001, from adopting *new* taxes on Internet access charges. As enacted, the federal tax legislation imposes no moratorium or limitations on any existing or new federal taxes on the Internet. ITFA also established an advisory commission on electronic commerce to explore issues related to state and local taxation of the Internet and telecommunications.

The Budget Intersection

The nation is reaching a "budget intersection" by means of a silent revolution that is gradually but significantly shifting federal expenditures from means-tested programs to nonmeans-tested entitlements. The bulk of federal funding used to go to states for physical infrastructure investment. Today, more and more federal dollars go directly to individuals, including those above age sixty-five and those who are leaving or have left the workforce (see Figure 2).

The share of discretionary funding as a percentage of the federal budget has declined sharply. During the past two decades, the share of federal funding for state-run entitlement programs—programs that mainly provide services to low-income families and children—has increased from 6 percent to 9 percent of federal spending. Yet federal entitlement spending for Medicare and Social Security has increased from 24.0 percent to 33.5 percent of all federal spending. The federal budget has come to be dominated by spending for these two programs, leaving little financial support and flexibility for other important health and human service programs. This means there has been erosion in federal support to states for investment in the human and physical capital so critical to the new economy.

Figure 2: Trends in Federal Spending



	1960	1965	1970	1975	1980	1985	1990	1995	1998	1999	2000	2001	2002	2003	2004
Payments for Individuals	35%	34%	36%	34%	36%	47%	56%	63%	63%	63%	62%	62%	64%	65%	66%
Physical Capital	47%	46%	29%	22%	25%	24%	20%	18%	17%	17%	17%	17%	17%	16%	16%

Year

Source: Office of Management and Budget, *Budget of the U.S. Government, FY 2000* (Washington, D.C.: U.S. Government Printing Office, February 1999).

Endnotes

U.S. Department of Commerce, *The Emerging Digital Economy* (Washington, D.C., April 1998).

Edward Yardeni, "The Economic Consequences of the Peace in 1990 and Beyond," *Deutsche Bank Research Topical Study No. 43* (New York, Deutsche Bank Research, January 6, 1999), at <http://www.yardeni.com>.

Michigan Economic Development Corporation, *State Smart: Michigan—A Plan for Accelerating the Growth of Technology-Based Jobs: Report to the Governor's Innovation Forum* (Lansing, April 23, 1999).

Alan Greenspan. U.S. Federal Reserve Board, Washington, D.C. (remarks at the Haas Annual Business Faculty Research Dialogue, University of California, Berkeley, California (U.S. Federal Reserve Board: Washington, D.C.: September 4, 1998), at <http://www.bog.frb.fed.us/BOARDDOCS/SPEECHES/1998/19980904.htm>.

U.S. Department of Commerce, "Major Sector Productivity and costs Index," Series ID:PRS85006092, (Washington, D.C., January 31, 2000), at <http://146.142.4.24/cgi-bin/surveymost>.

"U.S. On-line Business Trade Will Soar to $1.3 Trillion" (press release of Forrester Research, Cambridge, Mass., December 17, 1998, at <http://www.forrester.com>.

Elinor Harris Solomon, *Virtual Money: Understanding the Power and Risks of Money's High-Speed Journey into Electronic Space* (New York: Oxford University Press, 1997).

U.S. Small Business Administration, "The New American Solution: The Role and Impact of Small Firms" (Washington, D.C., June 1998), at <http://www.sba.gov>; and Robert D. Atkinson and Randolph H. Court, "The New Economy Index" (Washington, D.C.: Progressive Policy Institute, November 1999), at <http://www.neweconomyindex.org>.

U.S. Department of Commerce et al, "21st Century Skills for 21st Century Jobs" (Washington, D.C., January, 1999), at <http://www.ecommerce.gov>.

Forrester Research, *Resizing On-Line Business Trade* (Cambridge, Mass.: Forrester Research, November, 1998).

Advisory Commission on Intergovernmental Relations, *The Role of Federal Mandates in Intergovernmental Relations: A Preliminary ACIR Report* (Washington, D.C., January, 1996).

Theresa Gullo, chief, State and Local Cost Unit, Congressional Budget Office, conversation with authors, 11 February 2000.

Office of Management and Budget, *Agency Compliance with Title II of the Unfunded Mandates Relief Act: Annual Report to Congress from the Director of the Office of Management and Budget* (Washington, D.C., March 22, 1996).

"Executive Order on Federalism, No. 13132," 64 *Federal Register* 43255 (August 10, 1999).

L. Nye Stevens, director, Federal Management and Workforce Issues, General Government Division, Government Accounting Office (testimony before the Senate Governmental Affairs Committee on "Federalism: Implementation of Executive Order 12612 in the Rulemaking Process," GAO/TGGD-99-93, May 5, 1999).

Office of Management and Budget, *Budget of the U.S. Government, FY 2000* (Washington, D.C.: U.S. Government Printing Office, February, 1999), Historical table.