Federal Grants-in-Aid:
A Bulwark of State Governments

by George E. Bigge*

The grant-in-aid is probably one of the most widely used and least understood activities or devices of government today. In the past 10 or 15 years, many studies have been undertaken and many volumes have been written about grants-in-aid, and yet the nature of the grant, its place in our system of government, its purpose, and its effect are little understood—and are often seriously misunderstood. Since grants have become such an important element in our governmental structure and are involved in so many important activities of government, it seems essential to develop a clearer understanding of what the grant-in-aid is and how it works.

The grant-in-aid may best be regarded as a device through which the costs of government are distributed among the various "levels" of government—local, State, and national—somewhat differently from the way in which functions are allocated. This device has been used to some extent from the beginning of our history—in education and public roads, for example—but only in recent years has it become really important at the national level. Twenty years ago only 1½ percent of State and local expenditures were covered by grants from the Federal Government. Today Federal grants cover about 9 percent of State and local expenditures. And the end is not yet. Recent legislation, together with other proposals before Congress, if enacted, would add hundreds of millions of dollars annually to the grant expenditures. In short, the grants involve so much money, and so many essential services to the people, that they are bound to be a matter of major interest, quite aside from their potential effect on our Federal system of government.

But it is from this latter point of view, its effect on our form of government, that the question is first of all considered. Grants-in-aid are regarded by some as, at best, a necessary evil and, at worst, an insidious device for undermining State and local governments and transferring responsibility for many important functions of government to Washington. Either interpretation misconceives the nature and misreads the history of grants-in-aid.

It is true that total government activity in the fields of health, welfare, and education has increased tremendously in the 15 years since the Social Security Act was passed. It is also true that the National Government has entered the picture as never before and that many of these programs involve grants-in-aid. But it is not true that the grant has as its purpose or its effect the undermining of State and local governments or the transfer of functions to the National Government. The explanation of what has happened is quite different.

In the past 20 years the people of this country have demanded of government—whether local, State, or national—a variety of services and a standard of service that were never dreamed of before. Such demands arose in the 1930's, when many localities and a number of States found it impossible to meet the needs of the people without imposing an unconscionable tax burden on the limited resources within their reach. First the localities looked to the State, and then the State to the National Government, for help.

If the citizens demand action, and their local government or their State government cannot or does not meet the need, they will naturally look to the National Government. If the demand is urgent enough and persistent enough, it will be satisfied somehow. The National Government can do this in one of two ways. It can carry on the services directly, in which case it will tend to undermine State and local governments and transfer functions to Washington. Or it can grant funds to the States and localities, so they can meet the needs more adequately. This action does not weaken State or local governments; it tends to strengthen them by helping them do a job that they could not otherwise do.

Tax Resources

It is often insisted that the Nation cannot meet these demands any better than States can; that it has tax resources no greater than and no different from those of the States; that all such tax sources must be located in the several States, so the States can reach them directly and leave Washington out of the picture. In practice this is not the case. The nature of our industrial and financial organization and the distribution of income are such that the more productive tax sources, and those that can be utilized most equitably, can be reached effectively only on a national basis. It is true that the physical property of the steel companies, the railroad companies, the telephone and telegraph companies, the tobacco and liquor companies, and so on is located in particular States, but physical property is not a good basis for taxing such enterprises. Even aside from the danger of interstate competition in such taxes, these concerns are national in scope; they derive their income from the whole country and should pay their taxes, in the main, to the Nation as a whole and not to the particular State in which the plant or head office happens to be located.

It is frequently suggested that the States' lack of tax revenues is due to the National Government's preempting the most natural and most productive tax resources. It is proposed that the National Government withdraw entirely from certain fields of taxation and let the States alone...

utilize them so that the States would have the revenues to support the services now supported in part by grants-in-aid. Grants-in-aid would then be reduced proportionately. Something could be done along this line, but there are two serious limitations. In the first place the most productive national taxes are the personal and corporate income taxes and the excise taxes on liquor and tobacco. These cannot be levied, either effectively or equitably, at the State level. Large personal and corporate incomes are derived, in the main, from Nation-wide operations. The fact that the individual receiving the income happens to reside in a given State or that the corporation has its headquarters in a State does not mean that the revenue secured should be available to that State alone. The income is of national origin and should be taxed for the benefit of the Nation as a whole and not for the benefit of a particular State. The same is true of the excise taxes on liquor and tobacco. While the operations directly affected are located in a very few States, the revenues come from all parts of the country—wherever the product is sold. Obviously, such revenue should be available Nation-wide and not only in the State where the plants are located.

An equally serious defect is that such tax sources, even if released to the States, would be available in only a few States. Most States would benefit very little, if at all. There are some national taxes—those on luxuries and admissions, the gasoline tax, and the like—where the proposal has some merit. Here the tax sources are more widely and more evenly distributed, and all States would derive some benefit from the National Government's withdrawal from the field. But even in these items, the tax revenues that would become available to the several States would not be distributed in a way at all parallel to the need for the services now financed in part by such revenues through grants-in-aid. In other words, the States where the tax sources are situated are usually not the ones that need Federal aid to support these various services, and having the Federal Government withdraw from both taxes and grants would not necessarily make taxes available to take the place of the grants that would be lost by individual States. The most effective, as well as the most equitable and the most economical, way to meet this problem is to have the National Government collect the taxes on a national basis and make the money available to the States where the services need to be rendered.

**Allotment and Matching Provisions**

Our present grants-in-aid, unfortunately, do not serve this purpose as well as they might. In practically all instances, the State that has few resources and the State with the greatest resources are required to match the Federal funds to the same extent. In the Children's Bureau grants there is the unmatched “B” fund, which is allotted in part according to the financial need of the State. This helps a little. In two of the public assistance programs the Federal Government meets three-fourths of the first $20 of the average monthly payment and only half the next $30, so the Federal Government does carry a larger portion of the cost in a State that pays an average of $25 a month, presumably a poor State, than in one that pays $50 a month. But the wealthiest State as well as the poorest State gets three-fourths of the first $20 for each individual.

In fact, under the Federal Security Agency there is only one program, the hospital construction program, in which the matching requirement is related to the State's ability to pay. At first, that program allotted relatively more money to the poorer State than to the wealthier one, but to benefit by the Federal allotment the poorest State still had to put up $2 for every $1 of Federal money. Fortunately, the law has now been changed so that the State's and locality's ability to pay is taken into account in the matching provisions as well as in the allotment formula. It seems clear that if such variable allotment and matching provisions were applied to all Federal grants, a given amount of Federal money would go much farther in achieving a reasonable level of service throughout the Nation. Or, alternatively, we could support the present standard of service with considerably less Federal money.

Of course, since programs such as public assistance have been on the present basis for a long time, it would be difficult to change them to a variable or equalization grant basis now. It would mean that a number of States would get less Federal money or that they would have to put up more money of their own or both. As a result, no important change has been made in matching provisions up to the present time. But, even if it is not feasible or expedient to change the existing programs, it still seems that if we are interested in keeping down Federal expenditures—and Federal taxes—any new or expanded grant program should be so devised that a large portion of the Federal grant will go to those States that have difficulty in financing the aided activities from their own resources. This proposal has been incorporated in many of the new plans but by no means in all of them. In the proposed program for general aid to education, for example, the provision to give every State at least $5 per school-age child would use up half the Federal funds provided before anything is distributed on the basis of the State's need for help. This is not the most economical way to use Federal funds.

It is true, too, that if Federal grants are distributed on the basis of ability—or inability—to pay, with more Federal money going to States with limited resources, the discrepancy between the Federal taxes paid in a wealthy State and the grants-in-aid to that State would be even greater than it is at present. But this whole comparison is quite irrelevant. In a recent discussion a table was published showing that the people of the State of New York pay something more than 18 percent of the Federal taxes and receive in grants and direct Federal aid to individuals less than 6 percent of the total distributed as Federal grants. But there is nothing wrong about that; it is just what would be expected. The tabulation indicates, among other things, that the State of New York has a lot of very wealthy individuals and corporations paying Federal income tax. The money derived from this tax is used largely to support the Military
Establishment, to help veterans, to aid Europe, and so on. A relatively small part goes for grants-in-aid—a little more than $2 billion out of $40-odd billion collected. And to make that little go farthest, it really should go where it is needed most—to the poorer States.

If Congress were to do as some have suggested—repeal a variety of excise taxes and at the same time discontinue grants-in-aid—the State of New York would probably pay an even larger percentage of the remaining Federal taxes and might get no grants at all. As long as we have progressive taxation—levied according to the ability to pay—and government assistance to needy individuals, there will be no necessary relationship between the taxes paid by an individual or group of individuals and the direct service or assistance they get from the government. That holds true of the group of people making up a State, as well as for other groups.

Effect on State Budgets

It is frequently stated, too, that Federal grants have tended to warp State budgets. The argument runs that, since Federal funds are available for some purposes and not for others, and since a State dollar spent in one grant program brings more Federal money than if spent in another, the States naturally use their limited funds for grant-in-aid purposes for which they get Federal supplementation, and predominantly in those programs in which they get the largest supplementation, and neglect other State functions.

While there may be something to this reasoning, it is doubtful that the grants, as such, have caused any significant shift in the purposes for which State funds are spent. It is doubtful true that some States established unemployment insurance programs when they would not otherwise have done so. Unemployment insurance is not strictly a grant-in-aid program, however, and States budget no general revenues for this purpose, so that no State funds can be diverted. Undoubtedly some States have established child welfare programs because grants were available. Such stimulation is an important purpose of some of the specialized programs. But in the main the health programs and the programs for the aged and the blind and for dependent children have been developed because of the need, because people demanded them; if Federal funds were not available, more rather than less State money would have to be spent for these purposes. Old-age assistance payments may be used as an illustration. Among the States with low payments there are a number paying $25 a month or less on the average, and the Federal Government furnishes about three-fourths of that. Surely these States would not spend less than their share of this amount, less than an average of $5 or $6 per month, if the Federal Government were to withdraw. Then there are the States with liberal programs—Colorado and California, for example. The high payments in these States are not due to the fact that Federal funds are available. It is organized pressure that has brought about these situations. The availability of Federal funds only makes it a little easier for the States to finance their programs. In Colorado, for example, a fixed percentage of specified revenues is distributed among the persons on the rolls, regardless of Federal funds. And Colorado is just as liberal with people aged 60-64, if they meet residence requirements, as with those aged 65, although no Federal funds may be used for those under age 65.

It is true that in some States there is a tendency to pay benefits to needy persons over age 65 while ignoring all those under that age. This is double- less due in part to the fact that payments to those over age 65 will be matched by Federal funds, while payments to others will not. As a result, the money the States provide for the needy goes disproportionately to those over age 65. But it is very doubtful that any State is spending more for the care of all needy persons than it would if no Federal grants were made for this purpose. In other words, while there are doubtless some cases in which State funds are drawn into a particular field because Federal funds are available for matching, this is by no means the usual situation. In the main, it seems clear that Federal grants have helped States meet the demand for assistance to the aged, the blind, and dependent children, and for other services, with somewhat smaller expenditures from their own funds, thus leaving more State funds for other purposes.

Requirements for Receipt of Funds

Another common criticism of existing grants-in-aid is that they come to the States with a lot of conditions, a lot of strings attached. There is much discussion of "block grants," meaning grants without specific conditions attached, which the States may use practically as they see fit. States frequently do make such grants to localities, grants that may be used for any governmental purpose; and it is suggested that Federal grants should be of this nature. This, again, is a question of the nature or purpose of the Federal grant. A grant may serve one or both of two different purposes. It may be a purely fiscal aid, in effect a form of tax-sharing, in which case no special conditions are necessary. The money is available to support any of the functions of government.

Or the grant may be made to encourage the State or locality to undertake certain activities that are felt to be in the national interest and that the States might otherwise not undertake. This is the functional grant, as distinct from the purely fiscal grant. In this type of grant the granting government, whether of the Nation or the State, will necessarily attach such conditions as will assure the use of the money for the purpose for which it is appropriated and granted. These functional grants may have some special fiscal aspects as well; that is, they may be distributed to the localities or States according to the need or the ability to collect taxes, but the basic purpose is to assure the establishment and operation of certain programs that are in the general interest. This purpose could not be accomplished by general, unconditional, fiscal grants.

The grants made by the National Government to the States are all of this second type. They are special purpose, and indeed very special purpose, grants. There are, for example, grants for aid to the needy, but not all the needy—only the aged over 65, or the blind, or dependent children.
and each of these is treated a bit differently. There are special grants for child welfare, for crippled children, and for maternal and child health. There are grants for public health generally, and special grants for venereal disease, tuberculosis, mental health, and so on. These must all be accounted for in relation to the special purpose of the appropriation. It would be much simpler, of course, if the grants were grouped in a few large classes—one for health, one for aid to the needy, one for children, perhaps one for education, and so on, but there seems to be no inclination on the part of Congress to do this. There are special groups interested in each special field who will be satisfied only with a special appropriation for particular purposes. And so long as this situation continues, there will necessarily be such conditions attached as are necessary to make sure that the funds are used for the purpose for which they are intended.

It is not always easy to do this, especially in situations where there is a single organization handling a number of different grants. Federal officials, particularly the auditors, if they object to miscellaneous charges to these special funds, are sometimes accused of undue interference with the operation of a State or local program. But they have no choice. Congress has appropriated the funds for particular purposes and wants to be assured that they are spent for those purposes. If the Federal officials ask the State agencies to make a showing that the funds are so spent, this should not be regarded as interference in a State's operations. The Federal auditor generally attempts only to determine what the money was used for, not how it was used. If money granted for tuberculosis control is used for that purpose, the State is free to determine how it will be used to achieve that purpose. If child welfare funds are shown to be used for child welfare, the Federal auditor will ask no questions as to how they are used. The best approach to the problem, it would appear, is for the Federal and State officials to work together so that the necessary showing can be made in the simplest and most reasonable way. If, in the future, Congress sees fit to group the grants under broad headings, this particular type of difficulty will be largely removed.

There is still another kind of condition in most cases. The State is required to provide such methods of administration—organization, procedure, controls, and so on—as are necessary to assure proper and effective operation of the program. One of the most important elements in administration is personnel, so most of the laws administered by the Federal Security Agency require a merit system of personnel administration. This requirement is based on the assumption that, in the main, a career system will attract, and develop, and retain better personnel and therefore will assure better administration. The experience of the past 10 years seems to have justified that assumption.

No doubt, all will agree that when large sums of money are granted to States with certain conditions attached, the conditions should be stated as clearly and objectively as possible so that everyone will know just what the conditions are. But most of the conditions attached to grants, such as those mentioned above, are such that they cannot be stated explicitly, definitely, in detail. It is usually a matter of degree, and here is where difficulties arise.

Let us take old-age assistance as an illustration. In this case Federal funds may not be used to pay benefits to anyone under age 65. That provision is clear and explicit, and an action is either right or wrong in this respect. Consequently, there is rarely any difference of opinion with respect to this type of requirement. But there is also a requirement that all income and resources must be taken into account in determining need. This is just as much a requirement and just as important as the attainment of age 65, but it is different in application. Resources may be "taken into account" in a variety of ways. Some States actually deduct from the budget all or any income or resources that an individual may have. Others may exempt a small amount, or permit some flexibility in budgeting. And, at the opposite extreme, some States have proposed to exempt from consideration such large amounts that it would nullify the requirement entirely in the vast majority of cases. Somewhere a line must be drawn between what is a reasonable and what an unreasonable interpretation of the requirement. Wherever the line is drawn the decision will appear more or less arbitrary, and the Federal agency may be accused of interfering with a State's operations. In every program there are similar conditions that require interpretation and the exercise of judgment or discretion, and it is in these areas that difficulties arise. Opinions and judgments differ, and there is no single right answer that can readily be formulated.

We often speak of standards in this connection, standards to guide decisions. Standards of various kinds have been developed, and they have proved helpful. But most of these standards do not provide the answer directly, either. For example, in the field of merit system administration there is a set of standards developed 10 years ago that is quite generally accepted as a reasonable basis for judging whether or not a State meets the Federal requirement. The standards say there must be competitive examinations, there must be certification of a limited number from the top of the register, there must be tenure in office, and so on. But none of these standards are comparable in definiteness to the age-65 requirement, for example. When is an examination competitive? How often must examinations be given? How secure must the tenure in office? All of these are questions of degree. So, in the last analysis, it is still bound to be largely a matter of judgment as to whether or not the requirement is being met. It would be much simpler if the requirements were such that any given situation is either black or white, right or wrong, but that is not the case. Most of the requirements or conditions are general, and the administrative officials—both Federal and State—have to exercise discretion in applying them in a given situation. If this fact is recognized by both Federal and State officials, and they cooperate in working out such standards, then it should not be extremely difficult for the State agencies to meet

(Continued on page 18)
Table 2.—Estimated average taxable wage \(^1\) per wage item \(^2\) by size of concern, first calendar quarter 1945-48

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\(^1\) Wages paid for covered employment during first calendar quarter; excludes wages paid in excess of $3,700 paid by any 1 employer to any 1 worker.
\(^2\) A wage item represents a single report of taxable wages as indicated on the individual employer tax return.

1945-48 the percentage increase in average taxable wage per wage item varied from 13 percent for firms with 10,000 or more employees to 37 percent for firms that had 8-19 employees.

By the same token, it is important that some of these matters be better understood in order that the grant-in-aid may serve its purpose. The grant-in-aid is the only device that will enable us, as a Nation, to achieve certain national objectives, especially those relating to the welfare of the individual citizen, without taking away from the States some of their most important and most cherished functions. It is true, grants do involve a certain amount of supervision or control, but the alternative course in most cases is far less attractive. The only alternatives in many States are either an altogether inadequate service and exorbitant State taxes on the one hand, or direct operation by the National Government on the other. Neither is satisfactory in our democratic, Federal system of government. The Council of State Governments in its report on grants-in-aid examined this question in some detail and concludes:

"There can be no disputing the fact that grants lead to various forms of control. However, it has been demonstrated that abolishing of grants-in-aid would not necessarily bring about any reversal in the trend toward centralization. On the contrary, a number of grant programs have served to halt a swing in that direction."

That is to say, the demands made upon government have brought about a trend toward centralization. The grant-in-aid, far from promoting that trend, has halted it, in a measure, by enabling State and local governments to serve more adequately. And, as to the effect of the whole grant-in-aid approach, the Council of State Governments further concludes:
“Grants-in-aid to which administrative supervision is an inevitable hand-maiden, are frequently criticized on the grounds that they are an insidious method by which the central government frustrates local democracy. Analysis quickly reveals, however, that State aid is an important instrument for the preservation of strong local government.

“Financial aid gives localities the means to maintain activities demanded of them. In the absence of aid, localities would have to follow one or more undesirable courses of action. For one thing, localities might be forced to leave important services without sufficient support: this would inevitably damage their prestige and popular support. A second unfortunate consequence might force localities to widen their revenue systems to include taxes obviously ill suited for local collection: this would result in great inequities and an economically unsound tax structure. A third unwholesome course might lead State governments to assume functions which could be administered more effectively on the local level.

“State assistance to localities avoids each of these contingencies. It provides minimum standards of service, utilizes the most effective tax base, and prevents the wholesale transfer of local functions to the State level. Thus, State aid increases, rather than decreases, the activities and the strength of local governments.”

If in this statement “State” is put in place of “local,” and “Federal” in place of “State,” the conclusions summarize very well the argument presented here. The grant-in-aid, properly conceived, properly organized and used, is probably the best device for enabling our present form of government to function effectively in the face of the demands that are being made upon it. If we will, we can make the grant, not the enemy, but the most important bulwark of State and local government in our complex modern world.

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