THE FINANCIAL PARTICIPATION OF THE FEDERAL GOVERNMENT IN STATE WELFARE PROGRAMS

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THE FEDERAL GOVERNMENT has been making grants-in-aid to the States for a number of decades. The amounts appropriated for the earlier grants were generally small and, with the exception of the grants for highways during the 1920's, the grants for single programs seldom exceeded $10 million annually prior to 1933. Some of these earlier grants were given outright without any requirement as to the amounts the States should expend from their own funds. In other cases a requirement of this sort was included. Because the amounts involved were relatively small, the States rarely encountered difficulties in matching the Federal funds when that was a prerequisite for receipt of the Federal grant. The major financial problem, accordingly, was to devise a satisfactory allotment formula for apportioning the limited Federal appropriation among the States. In the earlier plans the allotment was characteristically based on such factors as population, area, miles of road, and the like. The early Federal grants-in-aid to States related only to a very limited degree to the financing of welfare programs such as health and public assistance or to programs in related fields such as education.

During the decade just ended both the number of Federal grants-in-aid programs and the dollar amounts involved increased markedly. Total Federal grants-in-aid to the States in the fiscal year 1937-38 amounted to $633 million, a sum equivalent to about 20 percent of State tax revenues exclusive of receipts from taxes on pay rolls.[1] This total grant figure does not include Federal expenditures for local work-relief projects and similar programs, since payments under these programs are made not to State treasuries but directly to individuals. If these expenditures were added to the grants-in-aid, the percentage cited would obviously be much higher. Nearly all the new grants in recent years have been made in connection with State and local programs involving the provision of welfare services. Similarly, the major part of the increase which has occurred in the total dollar amount of Federal grants has been occasioned by grants in the welfare field.

Three grants-in-aid programs in the field of welfare are now administered by the Social Security Board—assistance to needy persons over the age of 65, to needy blind persons, and to needy dependent children. Federal grants under the Social Security Act are also made to the States under titles V and VI by the Federal Children's Bureau, the United States Office of Education, and the United States Public Health Service.

A new and extensive program of grants-in-aid in the field of health is proposed in the national health bill introduced in the last session of Congress by Senator Wagner, based on the recommendations of the Interdepartmental Committee to Coordinate Health and Welfare Activities. Additional grants-in-aid in the field of education are included in the Federal aid-to-education bills introduced by Senators Thomas and Harrison and by Representative Larrabee in the first session of the 76th Congress. Hearings on both the health and education bills were held in 1939 before subcommittees of the Senate Committee on Education and Labor.

Because Federal grants-in-aid to the States in the welfare and related fields may become increasingly important in the future, the characteristics of such grants deserve careful examination. It is the purpose of this article to analyze some of the financial problems which arise when there is joint participation by the Federal and State governments in the costs of State and local welfare programs. Subsequent articles will deal with various special phases of the broader problems treated here.

The Fiscal Significance of Federal Grants for Welfare

The decline in national income, the large volume of unemployment, and the losses of accumulated savings which accompanied the onset of the depression created a greatly increased demand upon governments to increase the provision of

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[1] *Bulletin of the Treasury Department*, August 1939, p. 4.

welfare services. Traditionally, the function of providing these services—so far as it was a function of government—was lodged primarily with the local units of government and less frequently with the States. The intensity and persistence of the need for such services, however, eventually proved to be a financial burden which the localities and even the States did not appear to be able to support by themselves.

It became evident that the financial assistance of the Federal Government would be required if the needed services were to be provided on a basis that was at all adequate. The Federal Government had a relatively wider scope for taxation and more ample borrowing facilities than did other units of government. This combination of circumstances was one of the major factors which led to the enlarged participation by the Federal Government in the financing of welfare services.

The grant-in-aid was one of the fiscal procedures adopted for providing Federal financial assistance. The Federal grant-in-aid is a financial arrangement by means of which a portion of the costs of operating State and local welfare programs is transferred from State and local budgets to the budget of the Federal Government. It is evident that, if the volume of Federal grants-in-aid continues to grow, they may lead to significant changes in the budgetary trends of both Federal and State governments. Their further growth, also, would exert an important influence upon intergovernmental fiscal relationships, and particularly upon present practices with respect to the sharing of tax sources.

When a Federal grant-in-aid arrangement is established in connection with a welfare program, the actual operation of the program remains in the hands of the States and localities. The Federal Government shares in the cost in order to ensure that reasonably adequate provision can be made for the various needs to be met. If direct controls can be instituted to ensure that the jurisdictions receiving the Federal grants use them in an efficient and effective manner for the purposes for which they are intended, it is possible under some programs—provided it is otherwise desirable—to make the Federal grants without requiring the receiving jurisdictions to put up funds of their own as a condition for receiving the grant. Since it is generally agreed, however, that administration should not be completely divorced from all financial responsibility, it has been considered desirable, when such direct controls are not possible, that the States also participate in the financing to ensure that the grants received are carefully spent.

In an examination of the significance of Federal grants-in-aid in the field of welfare from the standpoint of fiscal policy, it is important to call attention to another consideration. The Federal tax system includes taxes such as the income and estate taxes and the excises on luxuries, which are progressive in effect and which yield a substantial part of total tax revenues. Accordingly, the inhabitants of States in which income levels are higher contribute, on a per capita basis, a relatively larger portion of Federal revenues than do those of other States. Because of the extent to which State contributions to the general revenues of the Federal Government differ, the enactment of Federal grants-in-aid programs in the field of welfare leads to larger contributions to welfare services from those sections of the country which are better able to pay than from those with less ability to finance their own welfare services.

In the major aspects of contemporary economic life all sections of the country are interdependent, irrespective of the political boundaries of the States. Markets are Nation-wide, and business enterprises in each State draw their labor, their capital, and finally their profits from all parts of the country. It is this economic unity of the Nation which has led some to urge that the welfare of each section of the country is—in greater or lesser measure—the concern of all sections and that there should be some pooling of tax resources to meet welfare needs through levies in accord with ability. Those embracing this view believe that it follows that the welfare services available to some individuals should not be substantially less than those available to others simply because the recipients happen to live in different States. Under this approach the Federal grants-in-aid for welfare are regarded as a fiscal mechanism by means of which it is possible to ensure that reasonably adequate welfare services can be provided in each State irrespective of the resources which the several States may possess.

If larger and larger sums are to be expended by the Federal Government in the form of grants to

States for welfare programs, and if this fiscal mechanism is to be extended into new fields of welfare services, it is increasingly important to examine carefully the terms upon which the grants are made available to the States and the principles underlying their apportionment. Unless the formula for the distribution of the grants among the States is carefully drawn, it may operate in such a way as to nullify one of the primary results anticipated by many from establishing such grants. If those States which contribute relatively more heavily to Federal revenues receive back relatively the largest grants, the net result is that a good deal of money has flowed in and out of the Federal Treasury without rendering any assistance to those sections of the country with the greatest need. If the share of the total grants under all programs which goes to the wealthier States exceeds a certain point, it may mean that not only have such States received back all they contributed to Federal revenues but they may also have received a portion of the revenues contributed by the less wealthy States. If this point were ever reached, the Federal grant program would actually work in a manner contrary to that which many regard as desirable.

In view of these considerations it is now necessary to examine the extent of the differences in the financial resources of the States and the operation of the matching arrangement as affected by these differences.

Differences in the Financial Resources and Needs of the States

Numerous types of available data shed some light on the financial and economic resources of the States. Official figures can now be obtained which show the amount of income received by the inhabitants of the various States during yearly periods—including wages and salaries, profits, interest, dividends, rents, and all other types of income. These incomes are the sources out of which nearly all taxes must finally be paid and are, accordingly, an excellent measure of the financial resources of the States. Similarly, the wealth localized in a State gives some clue to its resources, although such wealth will aid continuously in taking advantage of the Federal grants only as it provides a current stream of income within the State from which taxes can be withdrawn. Expenditures in the form of retail purchases also indicate indirectly the extent of the resources of the inhabitants of the State, although such expenditures naturally are conditioned by the level of income, and to some extent by special or local circumstances.

Table 1 presents the latest available figures indicating for recent years the average income, the average wealth, and the average retail sales of each of the States. The figures have been converted to a per capita basis in order that States of different population may be compared with one another. This table indicates that there are wide relative differences between the financial and economic resources of the various States, whether these are viewed from the standpoints of income, wealth, or consumption. The range between the highest and lowest per capita incomes of the States is from $923 to $207. The corresponding range for average wealth is from $6,511 to $736, and for average retail sales from $444 to $89.

The tabulations of taxable wages reported under old-age insurance confirm the belief that there are substantial differences in the economic levels prevailing in different States. On the basis of the earnings in covered employment reported for 1937, the mean taxable wage per employee ranged among the States from $1,102 to $413, and the median from $1,059 to $200.[2] The figures do not include wages in employments excepted from old-age insurance or wages from any one employer in excess of $3,000, but they do bear out the general conclusion made here.

It is not the purpose of this discussion to explain why the differences in financial resources exist but merely to demonstrate the fact that they do exist. To study the causal factors which have been responsible for these differences would require exploration of such matters as the natural resources of the States, their geographic location, the extent to which the factors of production are combined more effectively in some States than in others, the extent and character of "absentee ownership," and other similar matters.

An examination of the economic differences among the States should include a consideration of the differences in relative need for welfare services as well as differences in financial resources.

[2] See Wasserman, Max J., and Arnold, John R., "Old-Age Insurance: Covered Workers and Average and Median Taxable Wages in 1937," *Social Security Bulletin*, April 1939, pp. 3-8.

The determination of need in this field is extremely difficult, whether it be the need for welfare services generally or for a particular type of welfare service. Since the need of an individual for public aid stems basically from an absence of or deficiency in his income, however, it seems not unlikely that the need for some type of public aid is relatively greater in States where average income is low than in States where it is higher. There are, of course, important exceptions to this rule, particularly when the distribution of income within a State is substantially different from the patterns prevailing in most of the other States.

Table 1.—*Per capita income, wealth, and retail sales, and the ratio of children and aged to persons 18-64 years of age, by States*

State	Per capita income 1937 [1]	Per capita wealth 1936 [2]	Per capita retail sales 1935 [3]	Ratio (percent) of total persons aged 0-17 and 65 and over to persons aged 18-64, 1937 [4]
All States [5]	$547	$2,293	$260	61.3
New England:				
Maine	494	2,323	275	68.5
New Hampshire	503	2,357	304	65.0
Vermont	445	2,258	263	68.7
Massachusetts	668	2,618	334	56.7
Rhode Island	692	2,795	323	58.4
Connecticut	767	2,935	324	58.3
Middle Atlantic:				
New York	859	3,885	368	49.8
New Jersey	623	2,209	285	54.1
Pennsylvania	580	2,742	247	62.6
East North Central:				
Ohio	625	2,395	292	58.5
Indiana	494	2,373	228	61.7
Illinois	643	2,580	278	52.7
Michigan	675	2,605	293	59.7
Wisconsin	565	2,700	300	63.4
West North Central:				
Minnesota	521	1,919	312	63.0
Iowa	427	2,590	257	64.3
Missouri	461	1,834	242	57.9
North Dakota	316	2,189	215	73.0
South Dakota	314	2,473	213	70.4
Nebraska	424	2,265	264	64.7
Kansas	435	2,174	239	63.9
South Atlantic:				
Delaware	923	2,554	300	60.1
Maryland	650	2,440	277	58.4
Virginia	358	2,017	179	72.6
West Virginia	400	1,536	183	76.4
North Carolina	285	1,265	136	82.3
South Carolina	261	1,165	135	83.3
Georgia	288	968	160	72.7
Florida	483	1,250	204	60.7
East South Central:				
Kentucky	295	1,198	136	75.0
Tennessee	298	1,298	171	69.6
Alabama	233	988	119	75.7
Mississippi	207	736	89	74.7
West South Central:				
Arkansas	212	770	120	73.7
Louisiana	367	1,253	162	68.1
Oklahoma	323	1,349	173	70.0
Texas	411	1,592	212	65.1
Mountain:				
Montana	590	5,628	357	60.4
Idaho	486	2,625	293	69.4
Wyoming	616	3,576	356	58.8
Colorado	568	1,963	285	61.3
New Mexico	417	1,654	210	78.1
Arizona	577	2,401	298	66.8
Utah	483	2,233	256	77.7
Nevada	911	6,511	444	50.7
Pacific:				
Washington	614	2,602	324	52.8
Oregon	570	2,583	333	53.5
California	837	2,742	388	47.2

[1] U. S. Department of Commerce, *State Income Payments, 1929-37*, p. 6.
[2] National Industrial Conference Board, *Economic Record*, Vol. 1, No. 11 (Oct. 5, 1939), p. 124.
[3] Total retail sales by States from U. S. Department of Commerce, *Census of Business: 1935, Retail Trade Survey*, p. 2. The amounts representing total retail sales have been divided by Bureau of the Census estimates of State population as of July 1, 1935.
[4] Computed from the estimates of the number of persons in the 3 age groups made by the Division of Public Assistance Research, Bureau of Research and Statistics, Social Security Board, with the advice of the U. S. Bureau of the Census; estimates as of July 1, 1937.
[5] Excludes Alaska and Hawaii.

Differences among the States in the proportion of persons potentially eligible for public aid under a single welfare program limited to a specialized category are, of course, influenced by other factors as well as the income factor, such as differences in age composition. In programs involving the provision of some type of welfare service to children or the aged, for example, the varying proportions from State to State between the number of persons in these age groups and the number of persons in the intermediate age groups bear directly on the relative degree of need. Under such programs the number of children and aged constitute the potentially dependent group, while those in the intermediate age groups represent the "productive" group on whom the major portion of the burden of caring for the dependent group rests.

Table 1 also shows for each State the ratio of the population aged 0-17 and 65 and over to the population aged 18-64 in 1937. A comparison of the relative positions of the States on the basis of these percentages with their positions on the basis of per capita income reveals the interesting fact that in general the States with higher per capita incomes are those with a relatively low proportion of children and aged to the population in the intermediate age groups. The rankings in both series are in the same quartile for about two-thirds of the States; in the case of only one State are the rankings on the two bases in neither the same nor an adjacent quartile. In view of the two facts (1) that there is a close correspondence between the positions of the States with respect to both their average incomes and their dependency-productive group ratios, and (2) that the prevailing income levels in each State naturally will influence the proportion of the total number of persons in the "dependent" age groups who will need public aid, the differences in the per capita income figures of the States may be regarded as reflecting in a general way the relative variations in the needs of the

States for welfare services for children and the aged, in addition to indicating the relative financial resources of the States.

The Interdepartmental Committee to Coordinate Health and Welfare Activities has found a close association between poverty and sickness. Accordingly, the differences in the relative needs of the States in the field of health are also reflected in the variations in their per capita incomes. It is thus clear from the preceding discussion that, even in the case of welfare programs limited to a single category of persons, there is more than a negligible relationship between differences in the relative degree of need in the States and differences in their average incomes. The broader the category embraced, the more are variations in income levels likely to be reflected in the degree of need.

Effects of the Matching or Uniform-Ratio Requirement

In most of the welfare programs for which Federal grants-in-aid are made, the States are also required to participate in the cost. Typically this result has been accomplished by requiring the States uniformly to match (i. e., to furnish sums equal to) the Federal funds provided. In certain other instances in which a uniform percentage has been written into the statute, the Federal Government has confined its participation to some percentage below 50, as in the case of the program for aid to dependent children prior to the amendment effective January 1, 1940. No specific statutory requirement regarding the extent of State participation existed in connection with the grants-in-aid made by the Federal Emergency Relief Administration; this matter was left to the discretion of the administrator.

Under the matching and other uniform-ratio types of grant the decision concerning the extent of a State program is left to the State legislature. The Federal Government maintains simply a standing offer to advance one dollar (or whatever the ratio may be) for each dollar of State (or local) funds expended under an approved State program for purposes included in the statute establishing the grants. The enabling act authorizing Federal grants-in-aid for public assistance places no limit on the total amounts of Federal appropriations for such grants.

It has sometimes been assumed that the matching or uniform-ratio type of grant-in-aid would lead automatically to an outflow of grants which would make possible reasonably similar levels of services in all States. So long as the amounts involved are relatively small, as is the case in some of the existing grants programs, the use of the uniform-ratio grant may achieve this result reasonably well. When larger programs are set up, however, such as the public-assistance plans under the Social Security Act, which involve State and local expenditures running to hundreds of millions of dollars annually, substantial differentials begin to appear in the relative amounts of grants going to different States. A cursory inspection of the volume of Federal grants to the States under the public-assistance program might yield the impression that these differences are entirely fortuitous—that there is no specific causal factor at work with which the differences may be correlated. Upon closer examination, however, it becones apparent that, with some exceptions, the States which have been receiving relatively small grants are the States whose financial and economic resources are also relatively small.

It is obvious that the large differences in the population of the States are an important factor in explaining variations in the total volume of grants which the States have received under the public-assistance program. In order to take account of this factor and to convert the figures for grants made under this program to a comparable basis, it is necessary to divide total grants received by each State by the population of the State and to derive thereby the amount per inhabitant represented by the total grants. This has been done in table 2 which shows in the second column the amounts per inhabitant represented by total Federal grants to each State for old-age assistance, aid to dependent children, and aid to the blind since the inception of these grants in the first part of 1936. The States have been arrayed in the order of these per capita grants. The third column shows the average per capita income of each State in 1937.

This table indicates that many of the States which have received relatively small per capita Federal grants under the three public-assistance titles of the Social Security Act also have relatively low per capita incomes. Those States with the lowest per capita incomes, excepting in a few instances, have received relatively the smallest

volume of grants. About three-fourths of the States whose per capita grants are below the average for all States also had per capita incomes in 1937 which were below the national average.

The relation between grants received and financial resources as measured by income is by no means constant, and several States constitute striking exceptions to any general observation.

Table 2.—*Per capita Federal grants*[1] *for special types of public assistance, February 1936–October 1939, and per capita income,*[2] *1937, by States*

States	Amount per inhabitant of total grants under titles I, IV, and X of Social Security Act, February 1936–October 1939[1]	Per capita income, 1937[2]
All States[3]	$3.63	$547
Colorado	13.80	568
Utah	12.59	483
Washington	12.23	614
California	11.70	837
Minnesota	11.03	521
Idaho	10.80	486
Massachusetts	9.72	668
Montana	9.60	590
Ohio	8.93	625
Oklahoma	8.45	323
Nebraska	8.13	424
Oregon	7.98	570
Arizona	7.87	577
Wyoming	7.83	616
Wisconsin	7.82	565
Nevada	7.25	911
Iowa	7.18	427
South Dakota	7.06	314
Indiana	6.19	494
Missouri	5.99	461
Maryland	5.81	650
Michigan	5.79	675
Illinois	5.46	643
Texas	5.22	411
Maine	5.14	494
Pennsylvania	4.95	580
Vermont	4.56	445
Connecticut	4.55	767
New York	4.44	859
New Hampshire	4.41	503
Florida	4.40	483
North Dakota	4.40	316
Louisiana	3.92	367
Rhode Island	3.66	692
Kansas	3.58	435
Delaware	3.43	923
New Jersey	3.42	623
New Mexico	3.39	417
West Virginia	3.38	409
Kentucky	2.09	205
Tennessee	2.04	208
Arkansas	1.87	212
South Carolina	1.66	201
North Carolina	1.59	285
Georgia	1.49	288
Alabama	1.47	233
Mississippi	1.14	207
Virginia	.42	358

[1] On a checks-issued basis as reported by the Office of the Commissioner of Accounts and Deposits of the U. S. Treasury Department. Population as of July 1, 1937, estimated by the Bureau of the Census.
[2] U. S. Department of Commerce, *State Income Payments, 1929–37*, p. 6.
[3] Excludes Alaska and Hawaii.

Differences in financial resources cannot fully explain the variations in the extent to which States take advantage of the Federal offer to match funds. States may differ, for example, in their willingness to establish a comprehensive program of public assistance. The relatively smaller grants received by some States with high per capita incomes may reflect a lack of interest in welfare programs generally or a desire to concentrate funds in welfare programs other than public assistance. Similarly, States in which per capita incomes are low but which have received relatively large grants may be making a tremendous fiscal effort in connection with the public-assistance program alone, while devoting a relatively small portion of their financial resources to other welfare or related programs.

Moreover, the amount expended by a State for its public-assistance program is influenced by such matters as its general attitude regarding the degree of social responsibility for the care of needy persons, the extent to which relatives are held responsible for the support of the needy, the attitude regarding the proper relationship between levels of assistance payments and wages in the State, practices with respect to supplementation from general relief, whether the family or individual method of budgeting is utilized, and so forth. The comparison is also influenced by the length of time during which the States have had approved plans in operation, although delay in setting up such plans may itself reflect limited financial resources. Despite the existence of these other factors, however, the inverse relationship between per capita income and per capita grants in table 2 is sufficiently marked to suggest that differences in the financial resources of the States may have been one of the most important factors responsible for the variations in Federal grants for public assistance.

This experience under the public-assistance program indicates that, under any Federal grant-in-aid program in which the ratio of Federal financial participation in the costs of the welfare program is uniform for all States, the States with the largest resources will generally be able to make fullest use of the Federal grants. States with limited resources in relation to their population are unable to raise a substantial volume of funds by themselves and, accordingly, will be able to

use only to a more limited extent the Federal offer of participation. This situation will prevail whenever the percentage of Federal participation in the costs is uniform for each State—whether that percentage be 33⅓, 66⅔, or any other—and whenever the amounts of money involved in "complete" participation by the States strain the financial resources of the States where resources are relatively low.

It is evident that an arrangement which tends to result in relatively smaller Federal grants to the States with the smallest financial and economic resources eliminates what many have thought to be one of the major advantages of adopting the grants-in-aid device: namely, the pooling of the resources of the Nation to ensure that reasonably adequate welfare services are made available to all persons who are in need of them, irrespective of their place of domicile. The true inverse character of this process becomes still more apparent when account is taken of the fact that the States with smaller financial resources tend not only to receive small Federal grants but also frequently have a higher proportion of their population in need of governmental assistance than do other States. The relatively smaller amounts available from Federal as well as State and local sources in the States with smaller financial resources will inevitably result in correspondingly low levels of assistance payments under State programs.

In the light of these considerations, it is interesting to examine the average levels of payments which are currently being made under the public-assistance programs in each of the States. In table 3 the States have been arrayed according to their per capita income in 1937, the latest year for which data are available. In the adjoining columns are shown, as of November 1939, the average payments per recipient of old-age assistance and of aid to the blind in each State operating such programs, and the average amount per family represented by payments under the program for aid to dependent children. This table indicates that, with a few exceptions, the composition of the group of States with small financial resources is not very different from that of the group of States in which the current levels of public-assistance payments are relatively low. Although data for a single month may not represent a continuing situation and though the differences among the States in average payments are partially due to other factors, variations in financial resources must be regarded as a major causal influence.

At this point some may urge that lower costs of living are associated with States with low average

Table 3.—*Per capita income, 1937, and average amount of obligations incurred per recipient of old-age assistance and aid to the blind and per family receiving payments for aid to dependent children, by States, November 1939*

State	Per capita income, 1937 [1]	Average amount of obligations incurred in November 1939 per—		
		Recipient of old-age assistance [2]	Recipient of aid to the blind [2]	Family receiving aid to dependent children [2]
All States [3]	$547	$19.23	$23.23	$31.81
Delaware	923	10.97		31.39
Nevada	911	20.61		
New York	859	24.60	25.24	40.29
California	837	32.89	48.10	43.19
Connecticut	767	26.15	24.04	
Rhode Island	692	19.17		46.26
Michigan	675	16.46	25.21	37.51
Massachusetts	668	28.67	22.71	59.39
Maryland	650	17.39	21.05	31.43
Illinois	643	19.89		
Ohio	625	22.82	19.41	38.22
New Jersey	623	20.12	22.90	29.87
Wyoming	616	23.25	27.63	31.60
Washington	614	22.06	30.29	29.81
Montana	590	17.93	20.66	27.40
Pennsylvania	580	21.69		35.42
Arizona	577	20.50	25.57	32.04
Oregon	570	21.35	25.34	30.92
Colorado	568	31.38	28.15	29.76
Wisconsin	565	21.61	22.91	38.20
Minnesota	521	20.80	26.35	35.18
New Hampshire	503	21.00	22.77	42.19
Maine	494	20.66	22.84	38.00
Indiana	494	17.51	20.06	27.71
Idaho	486	21.51	21.52	27.33
Utah	483	21.03	26.53	32.20
Florida	483	11.71	12.38	20.62
Missouri	461	18.94		19.29
Vermont	445	15.50	20.81	30.39
Kansas	435	18.77	19.64	27.61
Iowa	427	20.05	23.31	
Nebraska	424	14.48	19.70	21.31
New Mexico	417	13.12	16.58	24.62
Texas	411	8.61		
West Virginia	409	12.29	15.63	19.64
Louisiana	367	10.76	13.72	21.37
Virginia	358	9.66	12.63	21.36
Oklahoma	323	17.59	15.05	12.17
North Dakota	316	17.77	21.17	31.63
South Dakota	314	17.27	15.82	
Tennessee	298	10.04	11.01	18.31
Kentucky	295	8.67		
Georgia	288	8.09	10.02	20.41
North Carolina	285	9.93	14.85	15.24
South Carolina	261	8.15	10.75	16.28
Alabama	233	9.50	8.86	12.84
Arkansas	212	6.01	6.48	8.09
Mississippi	207	7.49	7.33	

[1] U. S. Department of Commerce, *State Income Payments, 1929–37*, p. 6.
[2] See monthly section of *Social Security Bulletin* entitled: "Public Assistance." Where no figure for a State is shown under 1 or more of the programs, the State has no plan in operation which has been approved by the Social Security Board.
[3] Averages for all States include Alaska, District of Columbia, and Hawaii.

incomes and that, accordingly, the Federal grants to these States may justifiably be less, since smaller dollar payments to needy individuals in these States will provide levels of adequacy comparable to those in other States. It is extremely important in analyzing the validity of this argument to avoid confusing geographic differences in standards of living with geographic differences in the costs of identical goods. In States where the average income is small the average standard of living will generally be low also, since income controls directly what standard of living may be achieved. This does not mean, however, that the costs of purchasing the same quality and quantity of food, clothing, housing, and other necessities of life differ widely from State to State, or in the same or in similar proportions to differences in income.

Studies of costs of living do not indicate that there are large and clearly defined differences between one State or region and another in the costs of identical or equivalent goods.[3] The extent to which the market for many products has become national in scope itself would indicate otherwise. Moreover, because of the diverse levels of consumption prevailing within any given State, it is very difficult to summarize the "cost of living" for one State in a single figure. To justify relatively small Federal welfare grants to States with low average incomes by the low standards of living in those States would appear to be in conflict with one of the basic purposes of Federal grants-in-aid.

To summarize the preceding discussion: There are wide differences in the financial and economic resources of the States. If the percentage of Federal participation in the financing of the costs of welfare services is uniform for each State, and if the absolute extent of that participation is conditioned by the funds supplied by the States, the larger per capita grants will generally go to the States with the greater resources, and the States with the smallest resources will as a rule receive the smallest per capita grants. This result prevents Federal grants-in-aid in the field of welfare from ensuring that reasonably adequate services are available to needy persons irrespective of the State in which they are living.

[3] See, for example, *Monthly Labor Review*, Differences in Living Costs in Northern and Southern Cities, July 1939, pp. 22-38.

Methods of Increasing Federal Financial Participation for Some States

The preceding analysis raises the question whether a formula can be constructed for allocating Federal grants-in-aid among the States which will ensure that the combination of the Federal grant with State and local funds will be sufficient to finance adequate welfare services for the needy in each State.

One method of attaining this objective, of course, would be to retain the principle of a uniform percentage of Federal participation for all States and to raise this percentage to a point sufficiently high so that adequate sums might be available even in States with the smallest resources. This would necessitate the adjustment of the Federal percentage to the resources of the poorest State. It is not possible to specify just what this percentage would need to be, but it might conceivably fall somewhere between 75 and 90 percent. While this would result in generous aid in even the poorest State, it would also involve an increase in the ratio of Federal participation for all States and would obviously necessitate the inclusion of much larger amounts in the Federal budget for grants-in-aid for individual welfare programs.

If the Federal Government were to contribute as much as 75 to 90 percent of the total cost of a welfare program in all States, the effect would be practically to eliminate the association of financial responsibility with actual administration. In such a case it might appear simply a matter of ordinary budgetary prudence that the Federal Government should actually assume administration of the program since it provided the bulk of the funds, although other important factors would have to be weighed in reaching such a decision. Such a result would mean a sacrifice of the advantages of State and local administration. If the principle were extended to a sufficiently large number of programs, the Federal Government might be forced to draw upon State tax bases to a considerable degree in order to carry this additional financial burden.

Another approach which has been suggested is to abandon completely the principle of uniformity in the ratios of Federal participation in the various State programs and, instead, to establish a system wherein the percentage of Federal participation in

the financing of the costs varied from State to State.[4] Under such a plan of "variable-ratio" grants, the percentage of Federal participation would be related to the significant differences in the resources of the States; the Federal percentages would vary inversely, and the State percentages directly, with the resources of the States when adjusted for population.

Under a plan of this sort, relatively low percentages of Federal participation would be assigned to States with large financial and economic resources in relation to their population. The relatively smaller Federal contribution, when added to the larger volume of funds which the States would be required to derive through their own tax systems, would presumably be sufficient to provide an adequate level of welfare services, or a level which was at least as close to adequacy as that achieved in other States. In contrast, in States with lesser resources the increased Federal grant would offset the relatively small amount of funds which the States obtain through their own tax systems, making it possible for such States to provide welfare services at levels of adequacy not much different from those of States with larger financial resources.

It should be emphasized that this variable-ratio plan would not require that the Federal grants-in-aid to States with limited resources be necessarily larger in absolute amount than those going to States with larger resources. It would merely provide that the share of the total cost of State welfare programs which would be covered by the Federal grant would be larger in the case of the former group of States than in the case of the latter. The States with large populations, even though their financial resources when expressed on a per capita basis were large, would continue to receive grants which, in absolute amount, might be many times as large as those which would go to States with smaller populations but only limited resources.

In contrast to the large increase in the Federal cost of a plan which would raise above 50 the percentage of Federal participation in all States, a system of variable-ratio grants would not necessarily lead to total Federal costs in excess of those occasioned by use of the traditional matching arrangement. The exact aggregate Federal cost of a plan with such variable percentages would, of course, be dependent upon the range within which the percentages were allowed to vary and upon the response of the States to such percentages. It is likely, however, that a plan in which the Federal percentages varied between 33⅓ and 66⅔ percent, or between 25 and 75 percent, would result in total Federal outlays which would not exceed the outlays which result from the use of a formula in which the Federal Government uniformly bears 50 percent of the cost of the program in each State. The contrast is, in other words, between variable-ratio grants and uniform-ratio grants, and not necessarily between larger and smaller total Federal expenditures.

Attention should be called to the fact that the principle of varying the degree of financial participation by the granting jurisdiction in the programs of the receiving jurisdiction is not new to American fiscal practice. For many years a number of States have used such a principle, primarily in connection with highway and education programs, in the grants-in-aid which they have made to the municipalities and other subordinate jurisdictions within their own borders. Between one-half and two-thirds of the States currently endeavor to take account of ability as well as need in distributing a part or all of their school grants to subdivisions. It is probable that the motive underlying the establishment of this type of State-local arrangement in the past has been similar to what has been described above as one of the principal advantages of Federal grants-in-aid—the desire to ensure that the programs financed in this way would achieve a reasonable degree of adequacy in each of the subordinate jurisdictions. The system of variable-ratio grants discussed above would represent simply an extension of this widespread fiscal practice to the field of Federal-State financial relationships.

How Can Differences in the Resources of the States Be Measured?

If a plan of variable-ratio grants were adopted, one of its necessary elements would be the selection of an accurate index to measure the financial and economic resources of the various States. Fortunately, statistical measures are now available which adequately reflect these differences and which possess a reasonable degree of accuracy. In

[4] See "Proposed Changes in the Social Security Act: A Report of the Social Security Board to the President and to the Congress of the United States," *Social Security Bulletin*, Vol. 2, No. 1 (January 1939), p. 17.

selecting among these measures, the primary consideration should of course be to select the one which most accurately reflects existing differences. A second consideration should be to select the most simple method of measurement which is satisfactory for the purpose at hand, namely, a single measure if possible.

It might be assumed that comparisons of current tax revenues of the States, when converted to a per capita basis, would provide the most useful measure for this purpose. The reasoning underlying this idea might be that the volume of taxes now being collected indicates better than anything else what proportion of the costs of their welfare programs each State can finance. This approach would possess more merit if all States were at the present time taxing themselves with equal intensity. This, however, is by no means universally the case.[5] If the ratio of Federal financial participation were related in some way to existing tax yields, it is obvious that a State which had chosen in the past to tax itself heavily would be penalized, whereas a State now taxing itself relatively less heavily would receive a premium. Rewards and penalties of this type are not among the objectives of the plan outlined above. Since the various States are not exploiting their tax resources uniformly, it is necessary to use some more fundamental index than current tax yields and to undertake to measure the underlying financial resources of the States from which ultimately all taxes must be derived.

It has also been proposed that the average per capita income of the various States is the best and most equitable single measure which might be used as a basis for determining the Federal percentages in a variable-ratio grants plan.[6] The income payments received by the inhabitants of the various States—including wages and salaries, interest, dividends, rents, profits, and all other types of income—when adjusted for differences in population, would appear to constitute an appropriate basis for determining the percentage of Federal participation which would be applicable to the various States. The income of the inhabitants of a State represents the funds which are currently and actually at their disposal during a given time period. Furthermore, since taxes ultimately have to be paid out of income, income payments received are the best indication of the basic tax-paying ability of the States. A comparison of the average income of the different States, in addition, provides at least a rough measure of differences in the relative needs of the States for welfare services, since large welfare needs are ordinarily associated with small incomes, and vice versa.

Dissimilar distributions of the total incomes of the States among their inhabitants may affect to a degree both the extent of need indicated by the average income of the States and the readiness with which the States can tax such income. Assume, for example, that there are two States with the same total income and the same population; both, accordingly, have the same average or mean per capita income. Assume further that in one of the States there is a high concentration of income in relatively few hands and that in the other State the income is much more broadly distributed. In the first State, as a result of the concentration, the modal income as contrasted with the mean income is probably smaller than in the second State. Similarly, it is probable that more persons are in need of welfare services as a result of the lowness of their income in the first State, even though the average or mean per capita incomes of the two States are identical.

The availability for tax purposes of the two income totals is also different if generally similar tax systems are used in both States. Which type of distribution would yield the greater revenue would depend upon the type of tax used. For example, if major reliance were placed on a graduated income tax, the larger amount of taxes would probably be collected in the State where the concentration was greater. But if the tax revenues were derived mainly from a fixed-rate tax on incomes with moderate personal exemptions, the higher yield might be obtained in the State with the lesser concentration of income.

It should be noted, moreover, that the Federal tax system impinges somewhat differently upon the income of the inhabitants of various States to the extent that there are differences in the distribution of income. Both the Federal income and

[5] See Wueller P. H. et al., *The Fiscal Capacity of the States: A Source Book*, 1938, Social Security Board, Bureau Memorandum No. 29, tables R-VII, R-VIII, and R-IX.

[6] See Senate bill No. 2203 (76th Cong., 1st Sess.) introduced by Senator Byrnes; S. 1620 introduced by Senator Wagner; and H. R. 5736 introduced by Congressman Voorhis. See also Groves, Harold, *Financing Government*, New York, 1939, p. 619.

Federal estate taxes have a progressive rate structure, and accordingly they tend to extract relatively more from States where income is concentrated than from States where income is more widely distributed. Moreover, some Federal excise taxes are imposed on what are described as "luxuries," with the result that they represent a heavier levy upon the income of the inhabitants of some States than upon others.

The Federal taxes paid by the inhabitants of a State are compulsory levies from outside of the State, and the State itself has no jurisdiction over them. They represent a reduction in the income of the State, and, since the proportional extent of this reduction is not the same for all States, it might be desirable to adjust downward the State income figures to take account of Federal taxes paid. The adjusted figure would represent the amount of income or resources over which the States have effective jurisdiction for tax purposes.

There is no doubt that some differences actually exist in the distribution of income within the different States. Available data bearing on this point are, unfortunately, very fragmentary. Whether the distribution curves for the majority of the States are sufficiently dissimilar, however, to warrant a special adjustment to take account of such differences is questionable. Moreover, in connection with the allocation of Federal grants-in-aid among the States, it can be argued that the Federal Government need do no more than take account of the total income of the States in relation to their population; and that it is the responsibility of each State individually to decide how closely it is willing to adapt its tax system to its particular type of income distribution. In view of these considerations, it would appear that the State per capita income figures by themselves constitute, in principle, a reasonably satisfactory index for the purpose of variable-ratio grants.

Characteristics of State Income Data

The selection of the average per capita income of the States as the controlling factor in determination of the Federal ratios of participation in the costs of the welfare programs of each State appears still more appropriate when this series is compared with other statistical measures of State resources. Examination of other economic series which have the same broad coverage as the income figures indicates that, so far as the relative positions of the States are concerned, the use of most of these other series would produce substantially the same results. This results from the fact that, basically, the alternative series measure economic variables which are eventually conditioned by incomes in the States.

Procedures for determining income are already well developed in the main. These methods have been improved over a period of years to the point at which successive revisions and adjustments in the data produce only minor changes in the results. The basic methods utilized and the components included in income have been the subject of analysis by economists and statisticians for a number of years, and there is substantial agreement concerning the major components which should be included in measuring such income. The Department of Commerce, which has been measuring national income for a number of years, has prepared official income figures for each of the States for the years from 1929 through 1937.

The sources of data used in determining income are extremely varied. To a considerable extent the figures are obtained through the use of data already assembled for other purposes. This ensures, among other things, that the results are objective and unbiased. Most of the data come from official Government sources. Basically, the figures are derived from sources which represent practically complete coverage in particular fields, such as the census of manufactures, the census of agriculture, the census of mines, the census of business, and the like. These censuses contain data both on pay rolls and on other types of income paid out by the various industries. Other data based on partial coverage or on samples, such as the Bureau of Labor Statistics indexes of employment and pay rolls, are especially valuable in preparing the figures for intercensus years.

The information reported to the Bureau of Internal Revenue in connection with its administration of the Federal income tax provides the primary source for the figures for such types of income as interest and dividends. The farm income figures are assembled by the Bureau of Agricultural Economics of the Department of Agriculture from the extensive volume of agricultural statistics collected by that Department. Income payments by railroads are available from the Interstate Commerce Commission, which obtains accounting reports from the railroads under

its jurisdiction. Pay rolls of the Federal Government are available from the Civil Service Commission. Official and comprehensive data are thus available for a high percentage of the total amount of income. The field of arbitrary decision in the preparation of the income figures is thus limited; and even in those areas where some decision must be made, guiding principles which suggest sound lines of choice have been generally accepted.

Table 4.—*Frequency distribution of States*[1] *according to number of times ranking of annual per capita income changed from 1 year to the next by more than 2 places, 1929–37*[2]

Number of changes of *more than* 2 places from 1 year to next	Number of States		Number of changes of *more than* 2 places from 1 year to next	Number of States	
	Single-year basis	3-year moving-average basis		Single-year basis	3-year moving-average basis
Total	48	48	4	3	0
0	19	33	5	0	0
1	12	9	6	0	0
2	6	3	7	0	(3)
3	8	3	8	0	(3)

[1] Excludes Alaska, District of Columbia, and Hawaii.
[2] Based on per capita income figures obtained from Department of Commerce, *State Income Payments, 1929–37*, p. 6.
[3] When the 3-year moving average is used, data can be compared with respect to only 6 possibilities of change, since first year for which 3-year average can be obtained is 1931.

As a result of the considerations described above, the use of the per capita income of the States as the controlling factor in establishing the percentages which would be used under a variable-ratio plan of Federal grants-in-aid appears to many students of the subject as the most desirable choice. A reasonably good case might possibly be made for the use of certain other types of economic series in place of average income for this purpose. Both from the standpoint of the pertinence of the income series, however, and in view of the fact that it would tend to produce results not very dissimilar to those obtained by using other income series, it would appear that average per capita income is probably the best choice. Since the plan outlined above would fix the Federal percentage for each State separately instead of setting up a limited number of brackets within which States would be assigned, it is evident that any slight errors in the income figures would not substantially affect the Federal percentage assigned to any State. In other words, a small margin of error in the figures could not push a State over a borderline into a bracket within which a much lower percentage applied. At the worst, such an error would cause simply a minor difference in the percentage of Federal participation assigned.

An analysis of the relative positions of the average incomes of the different States during the period 1929–37 indicates that there has been a high degree of stability in these positions. In other words, despite the fact that substantial changes have occurred from one year to another in the national income, there has been a tendency for the incomes of most States to change in the same direction and in somewhat the same proportional degree. Table 4 summarizes the shifts in the positions of the per capita incomes of the States during the period 1929–37. Shifts of only one or two places in State rankings from one year to another have not been included. The table gives a frequency distribution of the States according to the number of times (out of a possible total of eight) that the ranking of their per capita income has changed from one year to the next by more than two places. Per capita income in 19 States did not once change during the 9-year period by more than two ranks from one year to the next. Per capita income in 31 States did not so change more than once. None of the States so changed more than four times.

If a 3-year moving average of per capita income is used, the degree of stability in the ranking of the various States is increased still further. The rankings of the 3-year moving averages for 33 of the States did not during the entire period change by more than two places from one year to the next.

It is evident from this analysis that the use of State per capita income as a basis for variable-ratio grants-in-aid would result in a high degree of stability from one year to another in the percentage of Federal participation which would be applicable to each of the States. Where a real trend downward or upward was taking place in the average income of a particular State in relation to that of other States, the use of a 3-year moving average would not prevent this change from influencing the Federal percentage assigned to the State. The change would operate fairly gradually, however, except in years when catastrophic changes occurred in the relative income ranking of particular States. The vari-

able-ratio plan, therefore, would still permit States to plan the financing of their programs reasonably far in advance without being confronted suddenly with a large change in the percentage of their welfare expenditures which would be borne by the Federal Government.

It is hoped to examine in future articles some of the particular phases of the general principles outlined above. Among other matters, it is hoped to analyze at a future date the formulas incorporated in various Federal grants-in-aid plans now in operation; the nature, composition, and behavior of State income figures over time; the formulas which might be used for translating the average income figures of the States into variable Federal percentages; differences in the ranking of the States on the basis of per capita income and on the basis of other economic series; and similar problems. The purpose of the present article is to indicate the financial difficulties arising when the Federal Government participates at a uniform percentage rate in the costs of the welfare programs of all States, and to outline one method by means of which at least some of these difficulties might be surmounted.

In this, as in many other fields of activity, it may not be possible to achieve perfect justice in the sense of being able to establish a highly refined equilibrium between Federal grants, economic resources, and needs throughout the various States. The inability to achieve perfection, however, should not act as a deterrent against steps in that direction if the general objective is regarded as desirable. The average per capita income of some of the States, for example, is more than four times that of others. If it were decided at the outset of the introduction of a variable-ratio plan to confine the range of Federal financial participation within the limits of 33⅓ and 66⅔ percent, the use of this narrower range would not represent a step backward simply because it failed to remove all inequalities in the grants received by the different States. The very fact that some recognition had been given to differences in the financial and economic resources of the States would itself constitute a significant development in the field of Federal grants-in-aid, since it is evident from even this brief survey that systems of matching and uniform-ratio grants may have serious limitations.