



# Federalism and Federal Grants

**FEBRUARY 2022**

*Ryan Lanier*

*Thomas Schatz*



1100 Connecticut Ave, N.W. Suite 650  
Washington, D.C. 20036  
[www.cagw.org](http://www.cagw.org)

## About CAGW

Citizens Against Government Waste (CAGW) is a private, nonprofit, nonpartisan organization dedicated to educating the American public about waste, mismanagement, and inefficiency in government.

CAGW was founded in 1984 by J. Peter Grace and nationally syndicated columnist Jack Anderson to build public support for implementation of the Grace Commission recommendations and other waste-cutting proposals. Since its inception, CAGW has been at the forefront of the fight for efficiency, economy, and accountability in government.

CAGW has more than 1 million members and supporters nationwide. Since 1984, CAGW and its members have helped save taxpayers more than \$2.3 trillion. CAGW publishes special reports, including the *Congressional Pig Book* and *Prime Cuts*, as well as its official newsletter *Government WasteWatch* and blog *The WasteWatcher*, to expose government waste and educate the American people on what they can do to stop the abuse of their hard-earned money. Internet, print, radio, and television news outlets regularly feature CAGW's publications and experts.

Ryan Lanier, State Government Affairs Associate  
Thomas Schatz, President



1100 Connecticut Avenue, N.W.  
Suite 650  
Washington, D.C. 20036  
(202) 467-5300  
[www.cagw.org](http://www.cagw.org)

# Federalism and Federal Grants

## Introduction

In his dissenting opinion in *New State Ice Co. v. Liebmann*, Justice Louis Brandeis famously remarked that the American federalist system allows an individual state to “serve as a laboratory of democracy” and test “novel social and economic experiments without risk to the rest of the country.”<sup>1</sup> The cleanest way for these experiments to take place is for the federal government to send money to the states with the fewest possible restrictions. But the proliferation of federal programs over the past century threatens this vision of state autonomy. Greater spending has been accompanied by more control and one-size-fits-all regulations. The result is decreased state power and sovereignty and more opportunities for waste, fraud, and abuse.

In 2021, Congress considered three major pieces of legislation to transmit hundreds of billions of dollars to the states. President Joe Biden signed the first bill, the American Rescue Plan Act (ARPA), into law on March 11, 2021, claiming it was a necessary supplement to the three COVID-19 relief bills passed in 2020. ARPA sent \$350 billion directly to state, local, and tribal governments. The second bill, the Infrastructure Investment and Jobs Act (IIJA) was signed into law on November 15, 2021, setting the stage for the implementation of federal infrastructure priorities through the states. Finally, the Build Back Better Act (BBBA), which passed the House on November 19, 2021, promised to expand federal government spending even further for childcare, the environment, and dozens of other areas.

Federal grant programs to the states have grown dramatically since the enactment of President Lyndon B. Johnson’s Great Society. In fiscal year (FY) 1960, grants totaled \$7 billion and then more than tripled to \$24 billion in FY 1970. Over the next 49 years through FY 2019, they grew by more than 300 percent to \$750 billion.<sup>2</sup> The \$350 billion in funding provided through ARPA alone is 47 percent greater than the total amount for federal grants to the states in FY 2019.

The increase in federal grants has made states more subservient to federal government rules and regulations. Federal grants increase spending in areas favored by whichever party is in power in Washington, D.C., and allows states to expand their budgets without initial concern about the fiscal impact. But when federal funds run out, states find themselves bearing the full cost of the programs, which always prove difficult to cut back or eliminate once they are in place. The federal programs can also crowd out more important state priorities and force state governments to raise taxes to cover those expenditures.

## Three Types of Federal Grants

Ranging from most to least restrictive, the three types of federal grants are categorical grants, block grants, and general revenue sharing grants. Most federal programs utilize categorical grants, and none currently use general revenue sharing grants.

---

<sup>1</sup> *New State Ice Co. v. Liebmann*, 285 U.S. 262 (1932), <https://www.loc.gov/item/usrep285262/>.

<sup>2</sup> Congressional Research Service, “Federal Grants to State and Local Governments: A Historical Perspective on Contemporary Issues,” R40368, Updated May 22, 2019, <https://crsreports.congress.gov/product/pdf/R/R40638>.

## Federalism and Federal Grants

Categorical grants contain the most restrictions of all federal grants and are divided into four subtypes. The first, project categorical grants, place the most conditions on how recipients can spend funds. Federal agencies distribute project categorical grants through an application process for specific projects with strict spending requirements set by Congress or the issuing federal agency. The second, formula categorical grants, divide funds among select recipients according to a formula established by legislation or agency guidelines.

The third, formula-project categorical grants, combine the first two types of categorical grants in a hybrid system. These grants use a formula to determine how much recipients will receive for a particular project and include strict conditions. Finally, open-end reimbursement categorical grants “provide a reimbursement of a specified proportion of recipient program costs,” thus eliminating competition among recipients as well as the need for an allocation formula.”<sup>3</sup> These grants allow for selective reimbursement of costs and leave no room for flexibility in funding.

Block grants offer a middle ground between restrictive categorical grants and the laissez-fair approach of general revenue sharing grants. They supply a fixed amount of funds to the states and allow the federal government “to provide state and local governments a specified amount of funding to assist them in addressing broad purposes, such as community development, social services, public health, or law enforcement.”<sup>4</sup> Like categorical grants, block grants are used for broad purposes. Unlike categorical grants, they also allow wide latitude in state spending as long as states spend the money within the established subject area. For this reason, some advocates of grant reform have called for a shift away from categorical grants towards an increased use of block grants. However, others caution that block grants do not allow sufficient federal accountability.

Finally, general revenue sharing grants allow wide latitude to state and local governments. They were part of President Richard Nixon’s efforts to reform the federal grants system and were provided from 1972 to 1986. During this 14-year period, a small amount of general revenue sharing grant programs provided a fixed amount of funds determined by formula to the states. Unlike the strict limits of categorical grants and the area-specific spending requirements of block grants, general revenue sharing grants allowed for more expansive uses with less input from the federal government.

### *The Development, Growth, and Evolution of Federal Grants*

Federal grants to the states did not become a significant part of American intergovernmental relations until the twentieth century. Concerns about centralized government control led the framers of the Constitution to place clearly defined boundaries on federal government power.

---

<sup>3</sup> Robert Jay Dilger and Michael H. Cecire, “Federal Grants to State and Local Governments: A Historical Perspective on Contemporary Issues,” Congressional Research Service, May 22, 2019, p. 3, <https://sgp.fas.org/crs/misc/R40638.pdf>.

<sup>4</sup> Joseph V. Jaroscak, Robert Jay Dilger, and Julie M. Lawhorn, “Block Grants: Perspectives and Controversies,” Congressional Research Service, December 21, 2020, p. 1, <https://sgp.fas.org/crs/misc/R40486.pdf>.

## Federalism and Federal Grants

Public opposition to a strong central government persisted through much of the nineteenth century and constrained the federal government's opportunities to provide aid to the states. But that changed to public support in the twentieth century as the nation faced a massive economic crisis leading to the Great Depression. In the aftermath of the New Deal, the federal government exercised greater authority in a variety of areas including healthcare, infrastructure, public housing, and the environment. Finally, in the twenty-first century, the federal government sent unprecedented amounts of money to the states with the passage of the COVID-19 relief bills during the 116th and 117th Congresses.

Under the Articles of Confederation and Perpetual Union, America's first governing document, the Confederation Congress possessed limited powers. Consequently, federal grants of any kind were few and far between. The most notable exceptions from this period were the Land Ordinance of 1785<sup>5</sup> and the Northwest Ordinance of 1787.<sup>6</sup> Both pieces of legislation gave land to new territories and states. In what later became a common feature of grants, the ordinances placed limited conditions on the use of select parcels of land. The Land Ordinance, for example, required new townships to set aside a portion of land "for the maintenance of public schools." These conditions allowed the national government to exercise limited control over the use of some land in the territories and the states.

Over time, the minimal national government of the Articles of Confederation proved untenable. To resolve the problems of a weak central government, delegates from the states proposed a new Constitution with a stronger national government. In his argument for the then-unratified Constitution of 1787, James Madison laid out the relationship between the states and the federal government under the proposed system. In his response to fears that the new constitution would lead to the repression of the states by the national government, Madison assured critics that the new government would be "neither wholly national, nor wholly federal."<sup>7</sup>

Instead, the Constitution created a system in which the national government and state governments operated with their own respective spheres with limited interference from the other. Whereas the states maintained control over actions entirely within their borders, the federal government possessed authority over the national matters laid out in Article 1, Section 8 of the Constitution.

During the Republic's early decades, the national government rarely provided funds directly to the states. The most notable example of a direct allocation to the states is the Deposit Act of 1836. After using a federal budget surplus to retire the national debt in 1835, Congress elected to allocate the remaining surplus funds to the states through a one-time grant. In doing so, legislators rejected a proposal by Kentucky Senator Henry Clay that all surplus funds from "land sales should be permanently earmarked for the distribution of the states for" the expansion

---

<sup>5</sup> Land Ordinance of 1785, Documents from the Continental Congress and the Constitutional Convention, 1774-1789, Library of Congress, [http://memory.loc.gov/cgi-bin/query/r?ammem/bdsdcc:@field\(DOCID+@lit\(bdsdcc13201\)\)](http://memory.loc.gov/cgi-bin/query/r?ammem/bdsdcc:@field(DOCID+@lit(bdsdcc13201))).

<sup>6</sup> Northwest Ordinance, Journals of the Continental Congress, *A Century of Lawmaking for a New Nation: U.S. Congressional Documents and Debates, 1774-1875*, Library of Congress, <https://memory.loc.gov/cgi-bin/ampage?collId=lljc&fileName=032/lljc032.db&recNum=343>.

<sup>7</sup> Alexander Hamilton, John Jay, and James Madison, "No. 39," *The Federalist*, edited by George W. Carey and James McClellan 2001, Liberty Fund, Indianapolis, Indiana, p. 199.

## Federalism and Federal Grants

of “both the transportation network and their public school systems.”<sup>8</sup> Outside of the occasional land grant to the states, the federal government did not provide any assistance or funds to the states during this period.

Even in financial crises, the federal government declined to provide aid to the states. When the Panic of 1837 set off a multi-year depression, the federal government left each state to its own devices and offered no assistance. As the crisis worsened, historian Daniel Walker Howe wrote, “The federal government not only refused to bail out the states but did not even come to the rescue of the Florida Territory.”<sup>9</sup> The lack of support bolstered the argument that federalism required a strict separation of federal and state finances and powers.

While that that view did not prevail in the decades following the Civil War as grants to the states began to increase, their use remained limited until the 1930s. After the collapse of the stock market on October 29, 1929, and the onset of the Great Depression, calls for increased federal aid to the states grew.

In his 1932 veto of the Emergency Relief and Construction Bill, President Hebert Hoover expressed concerns that the legislation would add to the national debt, fail to accomplish its desired purpose, and allow recipients to shift their financial burdens to the federal government. The legislation, he warned, created the potential for the “16,000 municipalities and the different States that have failed courageously to meet their own responsibilities and problems and to balance their own budgets” to “dump their financial liabilities and problems upon the Federal Government.”<sup>10</sup> Although Hoover eventually signed a watered-down version of the bill, his veto message marked a notable effort to constrain the use of federal grants to the states during the Great Depression.

The election of President Franklin D. Roosevelt in 1932 led to the adoption of a robust system of federal grants to the states. Roosevelt’s New Deal completed the shift in American intergovernmental relations from a “dual federalism,” in which the states and federal government have separate responsibilities to “cooperative federalism,” in which the states and federal government share responsibilities. Notable pieces of legislation from the New Deal include the Federal Emergency Relief Act of 1933,<sup>11</sup> the National Industrial Recovery Act,<sup>12</sup> and the National Housing Act of 1934.<sup>13</sup>

Designed “to respond to the nationwide unemployment and attendant poverty,” these bills created new federal programs and expanded federal ventures into areas historically controlled by

---

<sup>8</sup> Daniel Walker Howe, *What Hath God Wrought: The Transformation of America, 1815-1848*, Oxford University Press, 2007, Oxford, p. 499.

<sup>9</sup> *Ibid.*, p. 508.

<sup>10</sup> Herbert Hoover, “Veto of the Emergency Relief and Construction Bill,” July 11, 1932, <https://www.presidency.ucsb.edu/documents/veto-the-emergency-relief-and-construction-bill>.

<sup>11</sup> Federal Emergency Relief Act of 1933, 15 U.S.C. §§ 721-728 (1934), <https://tile.loc.gov/storage-services/service/ll/uscode/uscode1934-00101/uscode1934-001015016/uscode1934-001015016.pdf>.

<sup>12</sup> Industrial Recovery, 15 U.S.C. §§ 701-712 (1934), <https://tile.loc.gov/storage-services/service/ll/uscode/uscode1934-00101/uscode1934-001015015/uscode1934-001015015.pdf>.

<sup>13</sup> National Housing, 12 U.S.C. §§ 1701-1732 (1934), <https://tile.loc.gov/storage-services/service/ll/uscode/uscode1934-00101/uscode1934-001012013/uscode1934-001012013.pdf>.

## Federalism and Federal Grants

the states.<sup>14</sup> From the Great Depression onward, the system of divided powers between the states and the federal government ended and an era of federal intervention in and management of state affairs began.

In the 1960s, President Lyndon Johnson led the shift from Roosevelt's cooperative federalism to a system of "coercive federalism." Johnson's Great Society built upon the New Deal by using federal grants to force states to fund his administration's policy priorities. The establishment of Medicare and Medicaid combined with the expansion of federal housing programs increased the role of the federal government and allowed it to make further inroads into state affairs. Targeted categorical grants allowed the federal government to distribute funds to the states to ensure they would be spent on specific individuals and groups.

In many cases, federal funds supplemented state spending in health care, infrastructure, education, and economic development, allowing, and in many cases forcing, states to expand how much they spent in these areas. "States continued to function" as independent governments, but "they were kept in line by threats that the federal government would cut off their funds if they strayed."<sup>15</sup>

The twenty-first century brought about a significant expansion of federal grants. In response to the Great Recession, on February 17, 2009, President Barack Obama signed into law the American Recovery and Reinvestment Act (ARRA).<sup>16</sup> Like Roosevelt's massive spending programs in the New Deal, the ARRA operated on the belief that public spending could offset private revenue lost during economic downturns and fuel an economic recovery.

Between FY 2009 and FY 2014, state and local governments received "\$274.7 billion in grants, contracts, and loans combined" from the ARRA.<sup>17</sup> The legislation required the establishment of a centralized database to track the expenditures, which became [recovery.gov](http://recovery.gov), and was overseen by the Recovery Accountability and Transparency Board's (Recovery Board) Recovery Operations Center (ROC). While there were many examples of wasteful spending from the ARRA, the use of the funds may have been the most transparent of any large spending bill.<sup>18</sup>

During the six years in which the Recovery Board operated the website until it was shut down in 2015, the GAO recommended that Congress consider reconstituting the "essential capabilities of the ROC to help ensure federal spending accountability."<sup>19</sup> In addition, the report stated, the secretary of the Treasury may want to consider transferring some of the knowledge and documentation gained through the operation of the ROC to help reduce improper payments.

---

<sup>14</sup> Bruce J. Casino, "Federal Grants-in-Aid: Evolution, Crisis, and Future," *The Urban Lawyer* Vol. 20, No. 1 (Winter 1988), p. 31, <https://www.jstor.org/stable/27894544>.

<sup>15</sup> Forrest McDonald, *States' Rights and the Union: Imperium in Imperio, 1776-1876*, 2000, University Press of Kansas, Lawrence, Kansas, p. 231.

<sup>16</sup> American Recovery and Reinvestment Act, H.R. 1, 111th Congress (2009), <https://www.congress.gov/bill/111th-congress/house-bill/1?r=1&s=9>.

<sup>17</sup> Dilger, p. 4.

<sup>18</sup> Senator Tom Coburn, "100 Stimulus Projects: A Second Opinion," <http://lcweb2.loc.gov/master/gdc/coburn/2014500030.pdf>.

<sup>19</sup> Government Accountability Office, "Federal Spending Accountability: Preserving Capabilities of Recovery Operations Center Could Help Sustain Oversight of Federal Expenditures," GAO-15-814, September 14, 2015, <https://www.gao.gov/products/gao-15-814>.

## Federalism and Federal Grants

The COVID-19 pandemic and ensuing economic downturn led to the largest expansion of grants to the states in American history. Between March 2020 and May 2021, Congress passed legislation that provided a total of \$4.6 trillion.<sup>20</sup> The Coronavirus Aid, Relief, and Economic Security (CARES) Act,<sup>21</sup> the Health and Economic Recovery Omnibus Emergency Solutions (HEROES) Act,<sup>22</sup> the Coronavirus Response and Relief Supplemental Appropriations Act (CRRSA),<sup>23</sup> and the American Rescue Plan Act (ARPA)<sup>24</sup> allotted \$1.23 trillion in federal aid to the states.<sup>25</sup>

President Joe Biden added to this flood of money to the states when he signed into law the \$1.2 trillion Infrastructure Investment and Jobs Act (IIJA) on November 15, 2021.<sup>26</sup> Over the next 10 years, the legislation will provide more than \$300 billion in formula grant funds to the states for roads, bridges, electric vehicle charging stations, airports, transit, resiliency, and water infrastructure.<sup>27</sup> The law's promise of rebuilding American infrastructure includes plans to use the states to fund programs designed to "advance environmental justice" and create "good-paying union jobs."<sup>28</sup>

Several states have expressed their concerns about insufficient flexibility and unrelated requirements attached to the IIJA grants. On January 20, 2022, 16 Republican governors sent a letter to President Biden requesting that the "Office of Management and Budget (OMB), along with the respective federal agencies charged with implementation, draft regulations and guidance that defer to the states and confer maximum regulatory flexibility."<sup>29</sup>

The letter also noted that "states have to be partners with the federal government. It is critical that your administration consider how simplicity, flexibility, and finality will drastically improve states' ability to develop and implement plans" and that the "administration should not attempt to push a social agenda through hard infrastructure investments and instead should consider economically sound principles that align with state priorities."<sup>30</sup> New Hampshire Governor Chris Sununu (R) pointed out that, unlike the Biden administration, the Trump administration let the states lead the way with funding under the CARES Act, understanding that

---

<sup>20</sup> "The Federal Response to COVID-19," USASpending.gov, <https://www.usaspending.gov/disaster/covid-19?publicLaw=all>.

<sup>21</sup> Coronavirus Aid, Relief, and Economic Security Act, H.R. 748, 116th Congress, (2020), <https://www.congress.gov/bill/116th-congress/house-bill/748?r=2&s=2>.

<sup>22</sup> Health and Economic Recovery Omnibus Emergency Solutions Act, H.R. 6800, 116th Congress, (2020), <https://www.congress.gov/bill/116th-congress/house-bill/6800/text>.

<sup>23</sup> Coronavirus Response and Relief Supplemental Appropriations Act, H.R. 6074, 116th Congress (2020), <https://www.congress.gov/bill/116th-congress/house-bill/6074?r=1&s=2>.

<sup>24</sup> American Rescue Plan Act of 2021, H.R. 1319, 117th Congress, (2021), <https://www.congress.gov/bill/117th-congress/house-bill/1319?r=1&s=1>.

<sup>25</sup> Committee for a Responsible Federal Budget, "COVID Money Tracker," <https://www.covidmoneytracker.org/>.

<sup>26</sup> Infrastructure Investment and Jobs Act, H.R. 3684, 117th Congress, (2021), <https://www.congress.gov/bill/117th-congress/house-bill/3684>.

<sup>27</sup> Justin Badlam, Tony D'Emidio, Rob Dunn, Adi Kumar, and Sara O'Rourke, "The US Infrastructure Investment and Jobs Act: Breaking it down," McKinsey and Company, November 12, 2021, <https://www.mckinsey.com/industries/public-and-social-sector/our-insights/the-us-infrastructure-investment-and-jobs-act-breaking-it-down>.

<sup>28</sup> The White House, "Fact Sheet: The Bipartisan Infrastructure Deal," November 6, 2021, <https://www.whitehouse.gov/briefing-room/statements-releases/2021/11/06/fact-sheet-the-bipartisan-infrastructure-deal/>.

<sup>29</sup> Joseph Choi, "GOP governors press Biden administration for control of infrastructure implementation," *The Hill*, January 19, 2022, <https://thehill.com/homenews/state-watch/590430-gop-governors-press-biden-administration-for-control-of-infrastructure>.

<sup>30</sup> Ibid.

## Federalism and Federal Grants

states like Arizona, California, Massachusetts, and New Hampshire have different priorities and needs.<sup>31</sup>

### *The Problems with Federal Grants to the States*

The expansion of federal grants to the states and the replacement of the Constitution's system of divided powers with one of coercive federalism has had a detrimental impact on the states. Grant programs not only erode the division of powers between the states and the federal government established by the Constitution, but also fuel wasteful practices and unsustainable spending.

The most significant problem with federal grants is their impact on the federalist system. Roosevelt's New Deal and Johnson's Great Society led the shift to cooperative and then coercive federalism. Thanks in part to the expansion of federal grants, American intergovernmental relations no longer resemble James Madison's vision of how powers should be divided between the federal government and the states. The expansion of federal power allows for greater control from a centralized government. Central control, in turn, undercuts the protections provided by a decentralized system and the ability of states and localities to make decisions best suited to their circumstances.

Restrictive grants to the states allow the federal government to set and execute policy priorities that are inconsistent and contradictory from one administration to another. In 1987, the Supreme Court ruled that Congress could attach conditions related "to the federal interests in particular national projects or programs" to federal funds in order to implement preferred policies.<sup>32</sup> Congress and federal agencies have increasingly expanded this approach in recent years. For example, the evaluation criteria for the U.S. Department of Agriculture's ReConnect Loan and Grant broadband expansion program gives preference to applicants "who commit to net neutrality" principles, a policy priority of the Biden administration that was in place during the Obama administration and then eliminated by the FCC during the Trump administration.<sup>33</sup> Initial guidelines for ARPA spending stipulated that state and local governments could not use any of those funds to reduce taxes.

The impact of coercive grants on state sovereignty fuels other issues. Most notably, as grant money moves further away from the issuing agency, spending becomes harder to track. In cases "where the Federal Government compels States to regulate," Justice Sandra Day O'Connor wrote in *New York v. United States*, "the accountability of both state and federal officials is diminished."<sup>34</sup> This problem is exacerbated by the lack of a uniform reporting standard for the states and federal agencies.

For example, the Community Development Block Grant-Disaster Recovery (CDBG-DR) program was established in 1993 to provide long-term recovery aid to areas hit hard by natural

---

<sup>31</sup> Kelsey Koberg, "New Hampshire GOP governor pushes Biden for flexibility: 'They've got to deliver,'" Fox News, February 3, 2022, <https://www.foxnews.com/media/new-hampshire-gop-governor-biden-flexibility>.

<sup>32</sup> *South Dakota v. Dole*, 483 U.S. 207 (1987), <https://www.loc.gov/item/usrep483203/>.

<sup>33</sup> U.S. Department of Agriculture, "Evaluation Criteria," <https://www.usda.gov/reconnect/evaluation-criteria>.

<sup>34</sup> *New York v. United States*, 505 U.S. 168 (1992), <https://www.loc.gov/item/usrep505144/>.

## Federalism and Federal Grants

disasters. Since that time, the program has struggled with funding delays and wasteful spending. A January 2021 Urban Institute report “found that CDBG-DR grants took an average of 4.7 years to complete.”<sup>35</sup> A May 2021 Government Accountability Office (GAO) report found that the constant transfer of funds through different entities before it reaches recipients made the program ripe for abuse.<sup>36</sup>

Despite the risk and concerns that federal oversight becomes more difficult once funds reach the states, the Department of Housing and Urban Development has doled out \$40 billion to states and localities in response to disasters since 2017, nearly half of the \$90 billion distributed since the inception of CDBG-DR.<sup>37</sup> This increased spending has expanded involvement federal control over what were once considered state and local emergencies.

When federal grants dry up, states must find other ways to offset the lost funding either through increasing revenue or eliminating the programs. After the passage of the ARRA in 2009, for example, many states used federal grant funds to support the establishment of new programs or prop up existing programs that would normally be cut. Within a few years, the funds provided by the federal government expired, and the states found themselves unable to continue the programs.

A May 11, 2020, Reason Foundation report examined the implementation of state education funds received under the ARRA in light of calls for aid to the states in the early stages of the COVID-19 pandemic. The report found that several states spent federal education funding on projects unrelated to the legislation’s intent. Texas placed its education money in a fund that disproportionately benefited higher-income school districts that were less impacted by the Great Recession than schools in low-income areas. North Carolina spent money “via mechanisms that aren’t directly based on overall student counts or needs,” leading to federal relief money being spent on programs “like professional development, driver training for ninth-graders, and gifted and talented education.”<sup>38</sup> Strict regulation of federal funds, on the other hand, increases federal control over the states and risks violating state sovereignty.

Just as Hoover predicted in 1932, state and local governments have learned to rely on the federal government to provide a bailout during times of economic downturn. When states fail to prepare, it allows them to shift the burden to the federal government and other states. The Mercatus Center’s Veronique de Rugy and Tad DeHaven noted that “it is fair to ask...why taxpayers in states like New Mexico should be responsible for covering for the insufficient

---

<sup>35</sup> National Low Income Housing Coalition, “Disaster Recovery Timelines are Shortening, but Challenges Remain for the CDBG-DR Program,” February 1, 2021, <https://nlihc.org/resource/disaster-recovery-timelines-are-shortening-challenges-remain-cdbg-dr-program>.

<sup>36</sup> Government Accountability Office, “HUD Should Take Additional Action to Assess Community Development Block Grant Fraud Risks,” May 2021, <https://www.gao.gov/assets/gao-21-177.pdf>.

<sup>37</sup> Ranking Member Pat Toomey (R-Pa.), “Opening Statement Full Committee Hearing: Disaster Recovery Assistance - Authorization of the Community Development Block Grant – Disaster Recovery Program,” <https://www.banking.senate.gov/imo/media/doc/Toomey%20Statement%202012-15-21.pdf>.

<sup>38</sup> Aaron Garth Smith and Christina Barnard, “Evaluating the Effectiveness of the Federal K-12 Education Stimulus Spending of 2009,” *Reason*, Reason Foundation, May 11, 2020, <https://reason.org/commentary/evaluating-the-effectiveness-of-the-federal-k-12-education-stimulus-spending-of-2009/>.

## Federalism and Federal Grants

planning of states like Pennsylvania.”<sup>39</sup> Relief grants allow poorly prepared states to benefit from the stability of other states and their taxpayers. As more states recognize that they do not need to prepare for future downturns or spend money that they set aside for emergencies, they will continue to take steps to maximize federal assistance.

After the Great Recession, most states took steps to prepare for an economic downturn. A “stress test” of the states performed by Moody’s Analytics in 2019 found that 28 states held enough cash on hand to weather a moderate recession without turning to tax hikes or spending cuts.<sup>40</sup> Of the remaining 22 states, 12 were “within striking distance” of the goal and the remaining 10 were “significantly underprepared” for even a moderate downturn. In the end, the federal response to the pandemic demonstrated that states did not need to take steps to prepare for downturns because the federal government was standing by to bail them out. To help offset projected budget shortfalls, the federal government pumped trillions of dollars into all the states to offset revenue loss, even if they were running surpluses. In the end, the states were left with far more money than they needed to break even. Federal grants allowed every state, both those that had prepared well and those that hadn’t prepared at all, to expand funding into a wide variety of programs they could not afford to establish before.

One year after the declaration of the COVID-19 national emergency, the data showed that only 15 states experienced a decrease in their rainy-day funds. Of the remaining 35 states, all but two “reported higher balances” than before the pandemic.<sup>41</sup> The influx of federal funds allowed states to increase spending without tapping into their reserves.

States have also learned to rely on federal funding to respond to natural disasters. Programs like the CDBG-DR allow states to defer costs and responsibilities to the federal government. Federal disaster relief programs force states in the interior of the country to provide additional funding to coastal states typically hit hardest by natural disasters. When states rely extensively on federal funds and shift their own spending elsewhere, citizens in other states pay the price.

State reliance on and use of federal funds creates a system of dependency and increases the opportunity for waste, fraud, and abuse of government programs. When states become flush with federal money, the opportunities for individuals to take advantage of the funds increases dramatically.

Reporting on the first tranche of ARPA grants uncovered a wide array of wasteful projects unrelated to economic recovery.<sup>42</sup> In one of the most egregious examples, Wisconsin’s

---

<sup>39</sup> Veronique de Rugy and Tad DeHaven, “No More State and Local Government Bailouts,” Mercatus Center, George Mason University, May 26, 2020, p. 2, [https://www.mercatus.org/system/files/de\\_rugy\\_and\\_dehaven\\_-\\_policy\\_brief\\_-\\_cfi\\_series\\_-\\_no\\_more\\_state\\_and\\_local\\_government\\_bailouts\\_-\\_v1.pdf](https://www.mercatus.org/system/files/de_rugy_and_dehaven_-_policy_brief_-_cfi_series_-_no_more_state_and_local_government_bailouts_-_v1.pdf).

<sup>40</sup> Sarah Crane and Colin Seitz, “Stress-Testing the States 2019,” Moody’s Analytics, October 2019, <https://www.moodysanalytics.com/-/media/article/2019/stress-testing-states-2019.pdf>.

<sup>41</sup> National Association of State Budget Officers, “The Fiscal Survey of States, Spring 2021,” p. 67, [https://higherlogicdownload.s3.amazonaws.com/NASBO/9d2d2db1-c943-4f1b-b750-0fca152d64c2/UploadedImages/Fiscal%20Survey/NASBO\\_Fall\\_2021\\_Fiscal\\_Survey\\_of\\_States\\_S.pdf](https://higherlogicdownload.s3.amazonaws.com/NASBO/9d2d2db1-c943-4f1b-b750-0fca152d64c2/UploadedImages/Fiscal%20Survey/NASBO_Fall_2021_Fiscal_Survey_of_States_S.pdf).

<sup>42</sup> Ryan Lanier, “States Must Use Caution When Spending ARPA Funds to Avoid Waste,” *The Waste Watcher*, Citizens Against Government Waste, October 14, 2021, <https://www.cagw.org/thewastewatcher/states-must-use-caution-when-spending-arpa-funds-avoid-waste>.

## Federalism and Federal Grants

Whitewater Independent School District (ISD) school board voted to allocate 80 percent of the District's ARPA funds to the construction of synthetic turf fields for baseball, softball, and football. The district possessed a rare opportunity to improve their facilities, Whitewater High School Athletic Director Robert Crandall told the board as the district was not one "that would go to a referendum for turf fields."<sup>43</sup>

Unfortunately, Whitewater ISD was not alone in its decision to take advantage of federal funds. School districts across the nation poured funds into projects that were tangential at best to the pandemic and education.<sup>44</sup> Presented with the opportunity, state and local governments often use federal relief funds to expand existing programs or establish new ones without a full consideration of their long-term impact.

The various impacts and consequences of the federal grant regime underscore the need for dramatic reform. Without serious changes, the problematic impacts of federal grants on the states will continue to magnify. The Build Back Better Act, which passed the House of Representatives on November 19, 2021, and currently awaits a vote in the Senate, takes each of these concerns to the next level.<sup>45</sup> The legislation includes requirements that states prioritize programs that "expand equitable outdoor access" on non-Federal land for "underserved groups" in addition to a variety of other conditions, which allows the federal government to dictate policy to the states.<sup>46</sup> The rise of coercive federalism made possible by the expansion of federal grants makes the states accessories to the waste, fraud, and abuse prevalent in these programs while they undercut the authority and power of the states to make independent decisions.

### *Three State-based Reforms*

Federal grant reforms require changes from the bottom up. It is unreasonable to expect Congress and federal agencies to willingly cede the power they now hold. A state-based approach will allow for a localized response to problems and provide states the opportunity to reestablish their proper role in America's federalist system.

First, states should decline federal funds when the costs outweigh the benefits or there are policy requirements that prevent the money from being spent effectively. Such an effort is not unprecedented. In 2010 and 2011, states turned away billions in federal funds in part because "the commitments or policy changes necessary to receive federal money were far more costly and/or long term than the amount or duration of the award."<sup>47</sup>

ARPA provided \$19.5 billion in aid to cities and towns with fewer than 50,000 residents in an effort to reach every community across the country. The National League of Cities found

---

<sup>43</sup> Collin Binkley and Ryan J. Foley, "Flush with COVID-19 aid, schools steer funding to sports," *AP News*, October 6, 2021, <https://apnews.com/article/coronavirus-pandemic-school-funding-sports-5b468b260ebd2593e53f03f9104d9bca>.

<sup>44</sup> Ryan Lanier, "School Districts are wasting COVID relief funds," *The Hill*, November 7, 2021, <https://thehill.com/blogs/congress-blog/education/580477-school-districts-are-wasting-covid-relief-funds>.

<sup>45</sup> Ryan Lanier, "Build Back Better is bad for the states," *The Hill*, December 6, 2021, <https://thehill.com/blogs/congress-blog/politics/584591-build-back-better-is-bad-for-the-states>.

<sup>46</sup> Build Back Better Act, H.R. 5376, 117th Congress (2021), <https://www.congress.gov/bill/117th-congress/house-bill/5376>.

<sup>47</sup> Sean Nicholson-Crotty, "Leaving Money on the Table: Learning from Recent Refusals of Federal Grants in the American States," *Publius: The Journal of Federalism* 42, no. 3 (Summer 2012): 450.

## Federalism and Federal Grants

that in the 14 states where information on the expenditures was available, 171 communities rejected the funds. In one case, the federal government sent \$1,988 to the New Jersey borough S.N.P.J., which consists of 18 people who run a recreation center founded by Slovenian immigrants. Some towns had no use for the grants, while others rejected the funds because local leaders thought the government was already wasting too much money. Algoma Township Supervisor Kevin Green in western Michigan said, “The main reason we said ‘no’ as a board is because our country is going \$29 trillion in debt, and we wanted to do our part to say: Hey, enough’s enough.”<sup>48</sup>

There were many other communities that found the funding limitations did not meet their needs and the reporting requirements were beyond their capability without outside assistance. While rare, these instances of fiscal responsibility provide a model for governors and state legislators to follow to reestablish state sovereignty and protect the interests of their constituents. When states place themselves on firm financial footing absent federal support, they place themselves and the country as a whole in a better position for the future.

Second, states should reclaim sole authority over activities that occur exclusively within their borders. Re-establishing control over state issues works hand-in-hand with declining federal grants. Federal intrusion into issues best left to the states, like education, which many argue was more effective and productive prior to the establishment of the Department of Education in 1977, has created a system of dependency and inefficiency. States should take it upon themselves to create the best conditions possible for their citizens and to ensure efficient and effective government. When states are left to their own devices, the opportunities for waste, fraud, and abuse endemic to federal grants will decline.

Finally, states should take steps to prepare for future economic downturns. Lack of preparedness at the state level opened the door for the expansion of the federal grants system in the early twentieth century. Every state should take steps to increase its rainy day or emergency fund to prepare for the next pandemic, recession, depression, or other event that creates economic hardship. Since the states are being handed more money than ever from the COVID-19 relief bills, they should spend those funds as required and set aside the surpluses that were generated despite the pandemic for future emergencies.

If states implement the first two reforms and prepare for future economic crises by increasing their emergency funds, they will be able to both stabilize their finances and reduce the need for federal assistance. States should take heed of the lessons gleaned from the Great Depression, the Great Recession, and the COVID-19 pandemic. In each case, federal power expanded, and states were left on the hook to pay for federal programs once funding expired.

---

<sup>48</sup> Sophie Quinton, “Why some small towns are turning down federal COVID relief funds during the pandemic,” *USA Today*, September 28, 2021, <https://www.usatoday.com/story/news/nation/2021/09/28/some-small-towns-rejecting-federal-covid-19-relief-funds/5901531001/>.

## Federalism and Federal Grants

### *Conclusion*

The evolution and expansion of federal grants demonstrate the need for drastic reforms to not only cut down on waste, fraud, and abuse, but also to re-establish a limited federal government. The centralization of power in the hands of the federal government, aided in part by coercive grants to the states, undermines policy making at all levels of government. Decentralization “is critical to restoring trust, competence, and effectiveness in government programs.”<sup>49</sup>

Enacting reforms to the federal grant-making process will provide an opportunity to restore fiscal responsibility and improve intergovernmental relations. Most notably, the decentralization of federal grants would reduce the financial burdens of both the states and the federal government. There should be greater accountability, transparency, and efficiency in federal spending practices, since it is harder to keep track of such spending the further away it goes from Washington, D.C. State leaders could likewise allocate their tax revenue on programs that are unique to the needs of taxpayers in their state. Together, these reforms allow for the potential for increased efficiency and effectiveness at every level of government.

States should begin to take steps to reassert their position and authority under the Constitution by placing themselves on a firm financial footing, reduce waste, fraud, and abuse, and easing the burden on taxpayers. Reforms to federal grants to restore a proper balance of power between the states and the federal government will allow states to “try novel social and economic experiments” that establish sound, transparent, and effective government.<sup>50</sup>

---

<sup>49</sup> Michael Lucci, “America Needs a Great Decentralization,” *National Review*, November 26, 2021, <https://www.nationalreview.com/2021/11/america-needs-a-great-decentralization/>.

<sup>50</sup> *New State Ice Co.*, 311.