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FUTURE DIRECTIONS OF STATES IN ECONOMIC GROWTH

Back in 1978, a top official of the U.S. energy department took exception to the oft-voiced complaint that the United States has no coherent energy policy. On the contrary, he replied, the country did in fact have such a policy. It was a policy which encouraged consumption and discouraged production. It placed the greatest demand on fuels which are in the most scarce supply (oil and natural gas) while discouraging consumption of the most plentiful forms of energy (coal and nuclear). And, to make up the resultant fuel shortages, it relied upon foreign imports of oil.

The flawed national energy policy of the 1970's was costing U.S. industry $500 million a year to administer and the federal government $200 million per year to enforce. It caused gas lines to extend from California to Delaware, it sapped our nation's economic vitality, it inflated our economy, it undermined the value of our dollar and it put thousands of people out of work. In short, the failure to enact a sensible energy program disrupted our economy, pitted American against American, and yet failed to deliver a single additional BTU of energy to the American people.

A similar problem has confronted us in regard to our economic policies. Until President Reagan began to address the fundamental problems of our economy, our nation's leaders seemed content with economic policies that produced 11 consecutive budget deficits, inflation rates arching towards 15%, a national debt of close to a trillion dollars costing taxpayers $120,000 a minute in interest, unemployment in the millions, and the lowest rate of productivity growth in the Western world. Our national economic policy pitted region against region, the young against the old, students, housewives, businessmen and families against each other in an annual battle for a larger slice of a shrinking federal economic pie. It is clear that our policies produced no substantial economic improvement for any segment of the nation, let alone for the nation as a whole.

Behind these observations regarding energy and economic policy lies a decade of misunderstanding, of confusion between our economic goals and our social goals, of weakness in our institutions, of demagoguery in our political process, of uncertainty in our fundamental beliefs and of a lack of resolve of our people and our leaders. As a result, we have been unable to forge the consensus which is necessary to respond to policies which threaten our standard of living and even our ultimate existence.

It is against this background of inability on the part of the federal government to manage effectively our economic problems, that a dramatic change has occurred in the nature of American federalism: state and local governments have become substantially involved in formulating and executing economic policy. At least since the depression of the 1930's, and perhaps longer economic policy-making has generally been left to the federal government. But in the last half dozen years a revolutionary change has occurred as state and local governments have suddenly become economic planners, economic stimulators, economic innovators.

Of course in Washington this winter things have changed, and for the first time government policy is being formulated with a clear understanding of the problem. President Reagan has embarked upon a bold new economic course - a fundamental change in federal economic policy. His budgetary reductions are well conceived and critically important in reducing inflation. Regulatory changes will help as well. Tax reduction is a vital part of the program, for as one of your speakers recently pointed out, with only a 10% annual inflation rate, all taxpayers making $15,000 or more today will be pushed into the 50% marginal tax bracket by 1986 - just five years from now.

I believe the President has set forth a sound and workable economic program - one that will help solve our economic woes and one which I hope the Congress will support. I do not mean to suggest that the program will be easy for any of us, for the budget cuts will affect programs at every level of government. Nevertheless, decisive action to cut spending and taxes is essential if we are to reverse a decade of inflation, unemployment, stagnation, and confusion, and set America on a corrected economic course. We have already begun to correct our energy policy; we must correct our economic policy as well.

So President Reagan's economic program is a welcome and vital change in federal policy. But the road to an effective national economic policy is long and arduous, and while we in state government are supportive and aggressive participants in the national effort to improve our economic fortunes, we cannot afford to stand and wait the outcome of the great federal debate. We must take what actions we can to protect and further our own economic interests.

And so, the states, suffering as they have from years of befuddled federal policies, are beginning to assert themselves to protect their economic equilibrium. Our reasons are manyfold, partly the result of a desire for self-preservation, for after all, the states are on the front lines of taxpayer dissatisfaction with national economic failures. Also, the failure of national economic stabilization policies and the resultant boom-bust cycles have played havoc with state revenues and consequently with our ability to provide the level of services demanded by our constituents as a result of these same policies.

There are other reasons as well. The states and their leaders many of them former Washington officials like myself, have resolved not to repeat the errors of the past, and instead have looked within their own borders for economic stability and innovation rather than depending upon the federal government. Many of those federal programs designed to help with local problems have had the opposite effect, and have actually destabilized local economies and subverted local initiatives.

Finally, there is widespread agreement that this nation has become too diverse and the population centers have become so spread out that a highly centralized government no longer responds effectively to local needs. The states, acting singly or in concert can achieve many of the social and economic goals sought by Washington, in many instances more quickly and less expensively.

Consequently, the states' in recent years have become more aggressive and sophisticated in shaping our own economic destinies. Dozens of states, including my own Delaware, have straightened out their finances and enacted spending or taxing limitations in an attempt to hold down the cost of government. We realized long ago that unbalanced budgets make poor economics as well as poor politics. We have sought a loosening of the strings on federal grants so we can spend the

monies more efficiently. We are using our taxing authority less, to encourage more economic growth. We, as individual states, are initiating job training programs in the private sector to lessen the load on the taxpayers. And we have become more aggressive in the area of international trade. Half of our states today have one or more foreign offices boosting international trade.

But in our effort to accelerate economic growth and improve our own opportunities, we have often run afoul of federal policies. Some matters, such as education, corrections, and law enforcement are clearly of local concern, and should be handled at the local level. In many cases the federal government has sought to set guidelines or protect against injustice. But federal involvement has gone far beyond such objectives. For example, there are over 500 specific categorical grants provided by the federal government for particular purposes. These grants often by-pass the plans and policies of the states; they force the states to commit resources to areas of lesser concern and thus narrow the state's prerogative to implement effective local programs.

In my home state, we sought to rebuild a bridge for a key highway artery at a cost of $7 million. The federal government would provide us with the bulk of the funds, but only if the bridge cost $10 million or more. Other highway funds available to Delaware were restricted and could not be used. Seemingly the only way to obtain funding was to promise to pave the bridge in gold. Ultimately, a change in federal law was enacted by the Congress so we could rebuild this vital bridge. This example, as extreme as it might be, symbolizes the frustration felt by governors, mayors, and townspeople in dealing with the maze of government regulations and mandated expenditures of federal funds. A better solution -- and one being proposed by the Reagan Administration -- is to combine those 500 categorical grants into block grants to allow local autonomy in deciding where to commit resources.

On the other hand, increased federal assistance is appropriate in some areas, especially if the problems are the result of federal policies. If education, corrections and law enforcement are of local concern; welfare, unemployment, and income support programs are clearly of federal concern, because the problems they address are problems largely caused by national economic policies.

For example, federally-mandated programs such as unemployment compensation should receive substantial federal support in those regions where there is a disproportionate level of unemployment. The major cause of the high level of U.S. unemployment (7.4 percent - January) is the lack of real growth in the productive sector of the economy. The federal government's destabilization policies -- erratic money supply shifts, ballooning federal deficits, and regulations and restrictions on the actions of the private sector, have successfully prevented a national business climate which would be conducive to steady real growth and greater employment.

Seventeen states, including Delaware, have had to borrow heavily from the federal government to cover unemployment compensation payments. For example, every time an automobile assembly plant lays off a worker for 2 1/2 weeks in Delaware, that worker exhausts the total pay-in by his company to cover the benefits to which he's entitled. Benefits for the remaining 23 1/2 weeks of unemployment benefits are paid for by drawing down upon the payments made by other employers and borrowing from the federal government. This imposes heavy costs on the firms within the states which maintain consistently high employment levels, and on all firms in the long run as the federal government imposes penalty taxes on states with extended deficits. States with relatively high levels of unemployment will face increasingly heavy business tax burdens, which will further discourage employment opportunities within those states. Certainly this is an area where increased federal responsibility is appropriate and necessary, and can give a real boost to economic development efforts within states and regions.

But state and local governments cannot sit back and await the conclusions of a national debate about federalism. While we are participating in that debate, aggressively and with some passion, we are simultaneously moving rapidly on many fronts to improve our own economic opportunities.

The states are becoming much more effective than the federal government in removing deterrents to development. By improving state finances, balancing budgets and cutting taxes, states have not only cut the growth of government, but the burden as well. This helps local economies to flourish. Delaware cut the personal income tax 9% in 1979 (we have no sales tax). We lopped off the top three tax brackets. We enacted two constitutional amendments to contain the growth of government spending. The theory behind tax and expenditure limitations

within our state has been both to contain the growth of government and to provide a stable and competitive financial climate for encouraging private investment.

We are developing the economic tools necessary for economic growth. We are enacting tax incentive laws to encourage medium sized companies to grow and expand. With eight out of every ten new jobs created as the result of local business expansion, local incentives are essential if we are to increase the number of private sector jobs and reduce reliance upon public sector employment.

Tax-exempt financing, improved permit processes and special incentives to specific industries also play an important role in the new assertiveness by state economic development programs. Long ago, Louisiana developed a program to draw the off-shore oil industry to its shores. Several years ago, Pennsylvania put

together a package of incentives, including tax breaks, new highway construction, and low-cost financing for a new Volkswagen assembly plant near Pittsburgh. Ohio did the same for the Honda Motor Company and a new automobile plant will rise near an existing motorcycle plant (built with the same incentives), in the central part of that state. All three programs have or will create hundreds, if not thousands, of jobs for the residents of the states.

In Delaware, last month, we enacted a series of changes in our banking laws to encourage large bank holding companies to create subsidiaries in our state to take advantage of attractive regulations and tax rates. Many banks have expressed an interest in establishing operations in Delaware. Two have already committed.

The passage of the legislation was the result of a community wide effort for economic expansion, especially in industries which are growth oriented, which are non- polluting and which pay good wages. All segments of our community worked together to enact this legislation.

Delaware saw that the banking industry is changing. With the dawn of new electronics and telecommunication technologies, expanded services are now offered by financial institutions. At the same time, federal regulations are becoming obsolete and inter-state banking is going to become commonplace. In Delaware we saw the opportunity to bring some diversity to our economy and at the same time

insulate ourselves against erratic federal policies and changes in the nation's economy.

(At the same time, we are endeavoring to build for the future by providing our young people with the opportunity to secure a job immediately upon graduation from high school. In Delaware we've started a program to help place those high school seniors who would not ordinarily enter post secondary education programs to find a job in the private sector. Called Jobs for Delaware Graduates, it has proven to be enormously successful, placing some 85% of the students enrolled in the program in meaningful private sector jobs, with the support of business, labor, community, government and education leaders.) The result of these state initiatives in Delaware and elsewhere in the nation is to provide an additional competitive factor in the national economy. Businesses now can seek additional opportunity for economic growth which may have not been present before. For example, banks, which were captive of cities and states because of federal and state laws, can now seek additional growth in other areas which may have not been financially or legally possible before.

Secondly, this competition fostered by states is healthy because it will force states to promote efficiency in the delivery of government services at the risk of placing too great a burden upon both individual taxpayers and local businesses.

Finally, sophisticated state economic development programs are the seeds of innovation and can be the tester in the soil of state programs before they are transferred in practice to other states or the federal government. If the program works, it can be adopted for other states; if not, it won't become a burden shared by all of the states.

The tremendous national diversity and the spread of population centers have created a situation such that a highly centralized government no longer responds effectively to certain local needs. That is why we believe the individual states, acting singly or in concert, can achieve many of the social and economic goals sought by Washington, more quickly and less expensively. We are putting our beliefs to the test, involving ourselves in economic innovation, in economic planning, in economic progress. That in itself is a revolutionary concept in state and local government. While the national debate rages on, about inflation, about

tax cuts, about the re-industrialization of America, with barely a press notice federalism has been reborn. State and local governments with the support of concerned community groups ranging from the AFL- CIO to the Business Round Table, have taken matters into their own hands, determined to reinvigorate their own economies with their own initiatives and their own resources. Two decades of federal economic planning have not served us well; we are determined to do better.

Fiscal reforms, stimulative tax cuts, constitutional limits upon the growth of the public sector, tax incentive packages, target industry recruitment programs, private sector involvement in public sector programs - these are the initial results of the rebirth of federalism. These are the tools and techniques that Governors, Mayors, and community leaders are using to take control of the economic future of our own constituencies.

We believe such activities are good economics and good politics, good for the nation and good for the several states. But perhaps most significantly, they point the way to new opportunities for the private sector. You now have the opportunity, if you will use it, to become involved in the decision making process on a wide variety of issues - from local economic incentives, to workmen's compensation reform; from unemployment insurance and job training programs to tax reform. And that opportunity is perhaps the most significant aspect of our newly reborn federalism, for it is a return to the compact that was the intellectual basis of the ratification of our constitution two hundred years ago; that there are three full partners in the governance of our republic, the federal government, the state governments, and we the people of the United States of America.