

# CATO SYMPOSIUM ON THE NEW FEDERALISM AND URBAN OPPORTUNITIES

## INTRODUCTION

*We must not overlook the fact that the market has, on the whole, guided the evolution of cities more successfully, though imperfectly, than is commonly realized and that most of the proposals to improve upon this, not by making it work better, but by superimposing a system of central direction, show little awareness of what such a system would have to accomplish, even to equal the market in effectiveness.*

*Indeed, when we look at the haphazard manner in which governments, with seemingly no clear conception of the forces that determined the development of cities, have generally dealt with these difficult problems, we wonder that the evils are not greater than they are. Many of the policies intended to combat particular evils have actually made them worse.*

—Friedrich A. Hayek<sup>1</sup>

The persistence of high unemployment, small business failures, a large core of disadvantaged persons, and other problems in our center cities, as well as a need to improve the federal structure, has prompted the Reagan administration to propose a new urban policy: the “New Federalism.” This policy consists of three major elements.

1. Enterprise zones are to be created in depressed urban areas to provide tax and regulatory relief. According to President Reagan, such zones are intended to “remove government barriers, freeing

<sup>1</sup>*The Constitution of Liberty* (Chicago: Henry Regnery Co., 1972), p.342.

individuals to create, produce and earn their own wages and profits.”<sup>2</sup>

2. Numerous programs are to be returned to the states and localities, including Aid to Families with Dependent Children (AFDC), while the federal government is to acquire full responsibility for Medicaid.

3. Categorical state and local grants are to be consolidated into “block grants.” This is intended to give state and local officials more discretion in allocating tax dollars. It is believed that this will increase efficiency by directing resources to those uses deemed most valuable by concerned citizens rather than by federal bureaucrats.

The architects of this new urban policy perceive the city as a place of opportunity, if only market forces are released from the grip of government. The city can then become a dynamic center of economic activity and growth. At least that is the rhetoric.

Given certain basic economic principles, like the law of demand (individuals will undertake more of any action at a low than at a high price), combined with an understanding of the effect of private versus public ownership on incentives, we can gain some useful insights into the New Federalism. For instance, if state and local officials perceive that lobbying time is now better spent trying to obtain the right from Washington to create urban enterprise zones, the New Federalism could spur competition for deregulation. This would certainly be a reversal of the past competition for ever larger federal handouts.

On the other hand, decentralization of programs and grant consolidation will not in themselves reduce the size and power of the public sector. As long as *government* officials are in charge, the perverse incentives that operate at the federal level will be duplicated at the state and local levels. Thus, what is needed is a radical decentralization, one that moves activities to the private sector rather than to another level of government. The Reagan proposal for a new urban policy is not entirely lacking in this respect—it does recommend lower taxes, deregulation, and the privatization of certain public services—but it does not present us with a clear, consistent free-market agenda. By failing to achieve this, the Enterprise Zone proposal (which does not eliminate one of the major causes of unemployment among disadvantaged, low-productivity workers—the minimum wage), and other parts of the New Federalism package may become so politicized that the end result could be highly undesirable, good intentions aside.

<sup>2</sup>President Ronald Reagan, quoted in Stuart Butler, “The Enterprise Zone Tax Act of 1982: The Administration’s Plan,” Heritage Foundation *Issue Bulletin* No. 80, March 29, 1982, p.2.

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In order to carefully examine the implications of a restructured urban policy, the Cato Institute sponsored a major conference on "The New Federalism and Urban Opportunities." The Political Economy Research Institute in Richardson, Texas, helped organize this conference, which was held last May in Santa Fe, New Mexico. The conference proceedings constitute one of the few systematic analyses of the Reagan administration's policy shift, and should help improve our understanding of the complexity of modern urban areas, as well as the problems involved in moving toward a truly free economy. The following papers from the conference explore the nature of cities, their problems, and their future under alternative policy agendas.

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