Office of State-Based Initiatives

Annual Report 2016

The increased influence of the federal government in state matters is correlated with the increase in federal grants and the strings attached to them. States hold the key to solving many of the nation's financial problems. Decreasing federal regulations and allowing flexibility in federal grants will result in the innovation needed for Indiana to better serve Hoosiers.

Executive Director,
Luke Kenworthy

Executive Summary

Indiana Governor Mike Pence first formed the Office of State-Based Initiatives (OSBI) in 2013 to restore American federalism and ensure Indiana's strong financial health and independence. States are supposed to be beacons of experimentation. Just as Silicon Valley sees vast flexibility of investments and experimentation to find the solutions for consumers, States must have the flexibility and freedom of innovation to better and more efficiently serve the public. That is American federalism.

Today, the public may ask: "How much federalism is the right balance?" meaning how much authority should the federal government have over states? But as Michael Greve points out in *Federalism and the Constitution: Competition versus Cartels*, this is the wrong question because the constitution doesn't outline "how much" authority, but rather "what" the federal government has authority over.[1] While the federal government had supreme power, it was limited to exclusive roles. It was given specific authority set by the constitution, all else was exclusively reserved to states.

Americans question the "balance of federalism" because American federalism has been transformed and turned on its head for the past century. The federal government saw a significant expansion beyond its "exclusive" role during the twentieth century. The federal government started new programs and states were willing to trade both power and responsibility for federal dollars.

This self-reinforcing relationship exploded, with federal grants growing from 132 in 1960 to 530 in 1970, and over 1,100 today; the federal government promulgating its authority in each one.[2] The federal government has passed laws and regulations that limit innovation in states, with myriad requirements dictating how states are to run programs supported with federal dollars. We are quickly moving to a system of centralized government with a cooperative, decentralized administration – the states.

This is why Indiana Governor Mike Pence created the Office of State-Based Initiatives (OSBI). The Governor and OSBI have successfully fought for flexibility since OSBI's creation. The administration gained a 15 percent set-aside under the Workforce Innovation and Opportunity Act (WIOA), and received waivers to the Affordable Care Act to expand Hoosiers' access to consumer-driven health care through the Healthy Indiana Plan (HIP) 2.0.

In January 2015, Governor Pence set the tone, leading 24 governors in a letter to Speaker John Boehner and Majority Leader Mitch McConnell urging the Congress to work states to provide greater flexibility and control over issues such as health care, education, and infrastructure.

OSBI is leading this charge for more federalism. It continues to carefully consider every federal grant the state receives, while pushing for block grants and increased flexibility to increase the

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[1] Greve, Michael S. *Federalism and the Constitution: Competition versus Cartels.* Arlington: Mercatus Center, George Mason University, 2015, p.1.

[2] Ibid, p.33.

performance of its services. The following contains a breakdown of Indiana's current funding levels and a summary of the block grant contingency plans as reported by state agencies that receive federal funds.

Federal Fiscal Year (FFY) 2015 Recap

Indiana's budget totaled $19.1 billion for State Fiscal Year (SFY) 2015 ($15.4 billion in General Funds and $3.7 billion in Dedicated Funds) while maintaining reserves of nearly $2 billion. In addition, Indiana spent $11 billion in federal grants, making up 37 percent of government funding in Federal Fiscal Year (FFY) 2015.

Federal functions become 49 percent of Indiana's budgetary functions, if the required $3.7 billion state-match requirements for federal grants are included.

FFY 2015 Budget (billions)		Federal/State Functions	
State General Fund	$15.4	- $3.7 State Match	$11.7
State Dedicated Funds	$3.7		$3.7
Federal Funds	$11	+ $3.7 State Match	$14.7
Total	$30.1		$30.1
Percentage Federal	37%		49%

For perspective, Indiana's Family and Social Services Administration (FSSA), which administers Medicaid, makes up approximately $7.2 billion of total federal funding and $3.6 billion in state matching funds. If we combine the FSSA's federal funding and the state match ($10.8 billion), FSSA's federal functions amount to 36% of Indiana's spending.

This is why HIP 2.0 is so important for Indiana. Since Medicaid plays such a large role in government services, the waivers to the Affordable Care Act were a significant achievement. These waivers enabled Indiana to adopt consumer-driven health care, through HIP 2.0, tailoring benefits to the needs of Hoosiers rather than a one-size-fits-all plan from the federal government.

Federal dollars from the Highway Trust Fund ($906.8 million) and the Supplemental Nutrition Assistance Program (SNAP ~$1.26 billion) make up other significantly-funded federal programs. However, these funds are not managed by the OSBI, as they are direct appropriations from Congress. FSSA receives federal funds for administrative costs, but Indiana does not actually distribute SNAP benefits. SNAP beneficiaries receive funds directly from the federal government.

Of the 325 federal grants requested by state agencies, 315 were approved and received. The remaining 10 federal grant requests were retracted by the federal agency, retracted by the state agency, or denied by OSBI.

Indiana FFY 2015 Federal Grants Chart. 1 (October 1, 2014 – September 30, 2015)								
Agency	**Requests**	**Approved**	**Withdrawn**	**Amount Approved**	**% of total**	**State Match**	**Match %**	**% of total**
FSSA	39	36	3	$7,223,973,098.60	81.88%	$3,563,267,864.03	49.3%	95.94%
DOE	19	19	0	$699,549,557.00	7.93%	$494,000.00	0.1%	0.01%
DCS	14	14	0	$318,484,970.00	3.61%	$76,493,516.05	24.0%	2.06%
ISDH	65	64	1	$215,986,755.60	2.45%	$9,842,425.00	4.6%	0.27%
CJI	13	13	0	$67,890,389.33	0.77%	$13,243,731.15	19.5%	0.36%
IDEM	14	14	0	$59,551,161.00	0.68%	$23,452,504.00	39.4%	0.63%
DWD	9	9	0	$54,522,134.00	0.62%	$2,283,193.40	4.2%	0.06%
AGO	22	22	0	$48,739,013.00	0.55%	$5,019,776.00	10.3%	0.14%
DNR	72	70	2	$44,018,263.23	0.50%	$9,944,684.02	22.6%	0.27%
OCRA	1	1	0	$28,023,644.00	0.32%	$560,472.00	2.0%	0.02%
INDOT	3	3	0	$18,841,278.00	0.21%	$18,400.00	0.1%	0.00%
ISP	13	10	3	$10,458,824.01	0.12%	$1,390,286.20	13.3%	0.04%
IDHS	6	6	0	$8,682,848.86	0.10%	$1,131,753.22	13.0%	0.03%
CHE	2	2	0	$3,292,501.00	0.04%	$1,133,645.00	34.4%	0.03%
DOL	3	3	0	$3,236,548.00	0.04%	$1,271,714.00	39.3%	0.03%
ISL	1	1	0	$3,123,514.00	0.04%	$1,061,994.76	34.0%	0.03%
IODD	1	1	0	$3,000,000.00	0.03%	$306,388.00	10.2%	0.01%
OSBE	2	2	0	$2,614,711.00	0.03%	$1,000,000.00	38.2%	0.03%
DOC	6	6	0	$1,934,363.00	0.02%	$52,543.00	2.7%	0.00%
IURC	5	5	0	$1,709,000.00	0.02%	$376,000.00	22.0%	0.01%
BOAH	1	1	0	$1,687,106.00	0.02%	$843,553.00	50.0%	0.02%
ISDA	4	3	1	$1,065,438.00	0.01%	$0.00	0.0%	0.00%
IPAS	8	8	0	$1,005,205.00	0.01%	$0.00	0.0%	0.00%
IAC	1	1	0	$757,400.00	0.01%	$757,400.00	100.0%	0.02%
AG	1	1	0	$34,238.00	0.00%	$0.00	0.0%	0.00%
HTF**				$906,758,066.00				
SNAP**				~$1,260,000,000.00				
Totals	**325**	**315**	**10**	**$10,988,940,026.63**	**100%**	**$3,713,945,842.83**	**33.80%**	**100%**

Block Grant Contingency Plan Review

According to IC 4-3-24-6, state agencies that receive federal funding must submit a Block Grant Contingency Plan (BGCP) to OSBI by November 1, 2015, and every other year thereafter.

Every agency has different levels of federal funding and different levels of regulations surrounding them. The following constraints are the most commonly identified by agencies:

1) **Administrative regulations:** Administrative regulations include restrictions on how, when, or where money is spent, time constraints on when funds must be obligated, and limited flexibility of purpose within a project.

   Proposed Action: Federal funding programs should become block grants to allow agencies flexibility on spending the funds, while maintaining agency accountability. This will ensure greater innovation and efficiency for local needs.

2) **Process:** Reporting requirements, financial processes, and regulatory sources are uncoordinated and inconsistent. This lack of coordination is partially due to how federal agencies work in silos; however, often issues exist within a single agency. Regardless, time spent managing funds and the accompanying reporting requirements is the most easily-identified burden among all of Indiana's state agencies that receive federal funding.

   Proposed Action: Though there are some websites that consolidate available grant listings, the process is insufficient. There should be a comprehensive audit of what federal grants exist, followed by a consolidation and standardization of application processes, reporting, and financial management into one source.

3) **Match Requirements:** State match requirements within Indiana's state agencies are either too high, resulting in insufficient state funding to comply with federal requirements, or lacking consistency among similar grants, resulting in confusion and difficulty planning for the future.

   Proposed Action: Consolidating programs of similar purpose into block grants would eliminate inconsistent match requirements and allow agencies to better plan their finances.

The Burdens of Federal Grants

When states spend federal grants, there are two degrees of separation from the original owner of the money (the state is spending money from the federal government, who got the money from taxpayers). While federal agencies are accountable to taxpayers through Congress, states are actually held accountable by federal agencies rather than taxpayers. The incentives for federal grants are misaligned.

Each federal grant comes from different federal agencies, with different legal authority, different application processes, different payment systems, and different and changing regulations. Indiana's Block Grant Contingency Plans are required to outline the major federal mandates and regulations that inhibit program performance, including the many strings attached to federal grants. These strings include:

- State Match Requirements
- Administrative Regulations
- Public Policy
- Collateral Costs
- Long-term Liabilities
- Opportunity Cost

State Match Requirements

Most federal programs require the state to match a certain percentage of the federal grant. For example, the Indiana State Police receive $4.7 million for the Motor Carrier Safety Assistance Program. The match requirement is 80/20, meaning the state must contribute 20 percent, or $1.2 million.

The top three agencies who have the highest state-match requirements are FSSA, the Department of Child Services (DCS), and the Indiana Department of Environmental Management (IDEM). Of these, FSSA has the greatest contribution of 49.3 percent, or $3.6 billion in state-match funding.

There are several issues with how matching requirements work. Sometimes the match requirement is too high. For example, Indiana's Motor Carrier Service (MCS) receives a $1 million grant with a 50 percent matching requirement. The match requirement for MCS is very high considering that most of the work must be performed by contractors, requiring additional state funds. The Indiana Arts Commission (IAC) receives a grant with the highest percentage match requirement of 100% for the National Endowment for the Arts (NEA) for $750,000.

Another issue with matching requirements is inconsistency between similar programs. The Department of Natural Resources (DNR), for example, receives more than 70 grants a year, most of which are programmatically similar. Having multiple arbitrary matching requirements for each grant hinders DNR's financial process and makes it more difficult for the Indiana General Assembly to budget for DNR's state matches.

Formula grants are similar to matching requirements, and have a percentage or formula for how much a state must contribute to a program. This is generally based on measures such as participation in the program and previous year spending. This is most notable for FSSA's formula for Medicaid, called the Federal Match Assistance Percentage (FMAP), which is 33.3 percent in FY 2016. This formula is different from the Children's Health Insurance Program.

Administrative Regulations

There are many different types of administrative requirements and regulations when accepting federal grants. These are the largest burdens on the state and prevent the innovation necessary to improve these programs.

One of those regulations is on how the money can or cannot be spent. The Indiana State Library, for example, receives funds to digitize and modernize library resources. However, there are restrictions, mostly on construction, that prevent renovating libraries (many of which were built before 1915) to be compliant with the Americans With Disabilities Act (ADA), which minimizes the Library's service to underserved populations.

The Indiana Department of Homeland Security (IDHS) is required to provide 80 percent of its State Homeland Security Program (SHSP) funding and 25 percent of its Urban Area Security Initiative (USAI) funding to local governments and law enforcement. This complicates the coordination of state-wide needs and is difficult to provide law enforcement with equipment due to restrictions on equipment purchases.

Additionally, with SHSP, IDHS must obligate funding within 45 days, despite the contracting timeline of a minimum of 65 days. Similarly, Indiana Department of Correction must spend Prison Rape Elimination Act (PREA) funding within a specific period of time even if unnecessary or not part of long-term plans.

In terms of financial management restrictions, sometimes DNR receives grants that are primarily for another agency. However, because DNR receives the award, they must do all of the reporting and financial management instead of the agency that actually uses the grant.

Then there are general regulations, both associated and not associated with the grant itself. When it comes to the Hazard Mitigation Grant (HMGP), IDHS spends more time on documentation than programmatic work. In fact, this work used to be done by the federal government, but has since been transferred by the federal government to the states.

FSSA must submit plans to the Center for Medicare and Medicaid Services (CMS). If Indiana wants to amend its plans – innovate – it must receive approval from CMS. This used to take 90 days. Today, the process is so extensive that it may take a full year to implement a new policy. By then, FSSA is ready to apply for the next grant period.

On May 26, 2015, CMS released 635 pages of regulations on Medicaid oversight. These regulations are very onerous and severely impede any ability for the state to innovate.

Lastly, sometimes agencies have to spend time and resources just to comply with indirectly-related federal regulations. For example, Indiana's Army National Guard (INANG) is the fourth largest in the United States. With such a large force, Indiana must have an entire office, the Environmental Management Branch, with 21 employees dedicated solely to compliance with federal and state environmental regulations.

Public Policy

In many cases, Indiana also loses its independence to make policy decisions. For example, Indiana is hypothetically allowed to determine the providers that qualify to participate in Medicaid. However, in practice, CMS has used broad interpretation of a "free choice" clause to restrict Indiana. When Indiana banned abortion providers from receiving state and federal funds, CMS rejected this qualification for Medicaid. Therefore, Indiana's attempt to prevent taxpayer funds to abortion providers cannot be fully implemented.

Collateral Costs

Most grants also have collateral costs that add up over time. These costs can include building facilities in order for a program to work or out-of-state staff training paid for by the state in order to run a program. While these costs are often smaller, indirect costs that may be missed when analyzing the cost-benefit of a program.

Long-Term Liability

One ramification of federal programs is long-term liability. When the state applies for a new grant, it is important to consider over the long-term if the state is prepared to take financial responsibility for a program if it no longer receives federal funding.

Perhaps it is a program that will hire a hundred Hoosiers. That might be a great thing in the short-term, but the state did not have to convince the public to start this program, and did not have new revenue to pay for it. Therefore, if the federal government ends funding for this program, the state is in a tight financial position. Either they must fund new revenue to pay for it, or Hoosiers may lose their jobs.

When the economy is struggling, states tend to rely more heavily on the federal government. When the economy improves, the increased involvement becomes the new standard and states have little incentive to revert back. Therefore, it is absolutely necessary that Indiana takes seriously any long-term consideration of such opportunities before accepting federal funding.

Opportunity Cost

Opportunity cost essentially means that resources are not used more efficiently. The "cost" is the difference in what could have been gained with an alternative, more efficient use of resources. For federal grants, the opportunity cost is accepting the one-size-fits-all approach of a federal program versus a more efficient state-based program.

When a state accepts a federal program, it has no incentive to find tax revenue to create its own program on top of the federal program. Therefore, the state will either accept the one-size-fits-all approach of the federal government, or spend its time and resources fighting for flexibility within the parameters of the federal program.

Additionally, the existence of a federal program assumes that those services are not already being provided by another state program. Therefore, the opportunity cost might actually be spending more of taxpayers' money on new programs for services already provided; resulting in duplicative programs.

States would be better positioned to tackle complex problems if the programs were more coordinated at the enterprise level. For example, Governor Pence created the Governor's Task Force on Drug Enforcement, Treatment, and Prevention to address the scourge of drug abuse affecting Hoosiers. While there are other state programs aimed at combating certain aspects of drug abuse, the Task Force brings together Indiana experts from a variety of specialties to evaluate the growing national drug problem as a whole and its effects on Indiana.

Conclusion

Block grants would provide Indiana with greater opportunity to innovate and flexibility to meet the needs of Hoosiers as efficiently as possible. Reducing the authority of the federal government and freeing Indiana from myriad restrictions imposed on federal grants will save the autonomy of state programs and protect Indiana's future fiscal health.

Federalism, as intended by the constitution, must be restored. Indiana will continue to work for more flexibility on a program-by-program basis, and OSBI encourages Congress to do its part to return authority back to the states, and allow Indiana to make decisions that are best for Hoosiers.