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Local government and old-age support in the New Deal

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A B S T R A C T

A key question in the design of public assistance to the needy is how allocation of responsibility for funding and decision-making across different levels of government influences the level and type of assistance provided. The New Deal era was a period in which this allocation changed significantly in the United States, as provision of public assistance shifted from local governments to states and the federal government, accompanied by a large increase in government transfer payments. Focusing on assistance to the elderly and using variation in state laws governing the division of funding between local and state governments for the Old Age Assistance (OAA) Program, this paper investigates the responsiveness of OAA payments and recipiency to local government funding shares. Payments per elderly resident were significantly lower in states with higher local funding shares, driven largely by reductions in recipiency. The baseline results suggest that had local governments needed to fund half of OAA payments in 1939, on the lower end of local funding shares prior to the New Deal, the share of the elderly receiving OAA would have been 5 percent rather than 22 percent, and perhaps even lower. More speculative results suggest that greater local funding led to lower representation of blacks among OAA recipients relative to their share of the population, particularly in the South.

1. Introduction

A key question in the design of public assistance to the needy is how allocation of responsibility for funding and decision-making across different levels of government influences the level and type of assistance provided. Theoretical work, such as Brown and Oates (1987), has investigated some of the efficiency properties of providing assistance at the state or local level, as opposed to the national level.[2] Economists have explored this question empirically in modern contexts such as the welfare reform of the 1990s, which, Ziliak (2015) suggests, may have contributed to declining levels of cash assistance after the reform by raising the marginal cost to states of providing cash assistance.[3] This question is particularly topical given recent proposals to convert many assistance programs into block grants to states (Ryan, 2014). In this paper, I investigate this question in the context of government assistance to the elderly during the New Deal era.

A large literature has investigated fiscal federalism in the New Deal (see, e.g., Fishback and Wallis, 2012). The New Deal marked

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[2] Oates (1999) discusses this literature more broadly.

[3] Specifically, the 1990 s welfare reform shifted welfare from open-ended matching grants for states under Aid to Family with Dependent Children (AFDC) to block grants under Temporary Assistance to Needy Families (TANF). Relevant also is the literature on the flypaper effect, the observation that block grants tend to increase expenditure on their stated purpose more than non-grant income (Inman (2008) provides a relatively recent review). As Moffitt (1984) emphasizes, here it is important to consider the difference between matching grants, whose effects are not due to 'flypaper' effects, and block grants. Recent work, such as Singhal (2008) and Knight (2002), emphasizes the importance of political considerations in the analysis of flypaper effects.

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not only a dramatic increase in governmental transfers to the elderly, but also a shift from local provision of old-age support to increased federal and state involvement, as part of the broader shift of government expenditures from the local to national level (Wallis, 1984, 1991). Prior to 1933, assistance to the needy elderly, and to poor in general, was almost entirely a local affair in both funding and decision making (Wallis and Oates, 1998). State governments had gradually begun to take on a greater role in the 1920s, but even in 1934, when 26 states had passed laws providing for some state role in old-age assistance, in only 6 states did counties fund less than a quarter of payments. The role of states changed dramatically after the passage of the Social Security Act, which provided federal matching funds for state old-age support programs through the Old Age Assistance Program (OAA) and encouraged a shift of responsibility from local to state governments. By 1939, four years after the passage of the Social Security Act, all states had passed laws and in more than half of them, the county share of OAA payments was zero percent.

The main empirical analysis investigates what role reduced local funding shares played in the observed increase in the level of old-age support. Facilitating the analysis is the fact that even in 1939, there was considerable variation across states in the degree of local involvement in funding OAA. The main empirical estimates use this cross-state policy variation to investigate the relationship between statutory local funding shares and the amount of OAA provided in 1939. Because state policies were correlated with levels of need, and levels of need also influenced the level of relief provided, the empirical strategy follows Fetter and Lockwood (2016) in focusing on comparisons across state borders in order to control flexibly for differences in aggregate shocks and population characteristics. The estimates indicate an economically and statistically significant negative relationship between local funding shares and OAA payments per person, driven primarily by a reduction in the share of the elderly receiving OAA and, to a much lesser extent, by reductions in payments per OAA recipient. The magnitude of the results is substantial, suggesting that the reduction in local funding was an essential part of the growth of government old-age support. Under the Social Security Act, the national government funded 50 percent of old-age assistance payments (up to a cap), and the remainder was funded by states or localities. The baseline specification suggests that had counties been required to fund the other half of old-age assistance payments, the OAA recipiency rate in 1939 – measured as the share of those 65 and above receiving OAA – would have been 5 percent, rather than the observed level of 22 percent.

Several pieces of evidence support the interpretation of these estimates as the causal effect of local funding shares. Once comparisons are made only across state borders, other observable policy characteristics do not explain the negative relationship between local funding shares and recipiency or payments, and if anything conditioning on observable policy variables tends to magnify the results. Moreover, changes in local funding shares between 1937 and 1939 are associated with changes in recipiency and payments that are nearly identical to those estimated from the 1939 cross-section.

Closely related to the shift away from local funding of old-age assistance was a shift in decision-making from the local level to the state level. I document that the responsiveness of OAA payments to local funding shares was most pronounced in states in which local governments, rather than states, had the final say in determining whether to provide assistance to a given case.[4] The greater responsiveness to local funding requirements in states where localities had more influence on decision-making accords with the interpretation of the main estimates as the effect of local funding. Moreover, allowing this flexibility is important for understanding the effects of changing both local funding requirements and the level at which decisions were made. Allowing this flexibility yields results that suggest that had all decisions been made by local governments that funded 50 percent, the OAA recipiency rate would have been 1 percent rather than 22 percent.

To the extent that local funding reduced OAA recipiency, a natural extension is to ask how it influenced the composition of recipients. I focus on one dimension of this question: how local funding influenced blacks' receipt of OAA. The basic difficulty in answering this question is that there is no large source of microdata from this period that directly measures OAA receipt. However, in a spirit similar to Fetter and Lockwood (2016), I show that the 1940 Census question on receipt of non-wage income can be used to construct a reasonable proxy for OAA recipiency at the county level, using the complete-count Census data for 1940 (Ruggles et al., 2015). After validating this measure, I use it to investigate the relationship between local funding and the representation of blacks among OAA recipients relative to their share in the population. I find suggestive evidence that in the country as a whole, local funding was associated with greater underrepresentation of blacks among OAA recipients relative to their share of the population. While somewhat sensitive to specification, the evidence is also suggestive that this relationship is significantly larger in the South, both economically and statistically. These findings, while necessarily speculative given that they are based not on observation of OAA receipt but rather receipt of any non-wage income, suggest that the shift away from local funding may have improved access of blacks to old-age support.

This paper relates most closely to the literature on fiscal federalism in the New Deal: for example, Wallis (1984), Wallis (1991), and Wallis (2000), in addition to Fishback and Wallis (2012). In large part this literature has focused on explaining the decline of local government expenditures relative to state and national government expenditures by measuring the responses of state and local spending to shifts in national spending.[5] It has not, however, directly measured the responsiveness of spending to changes in the marginal cost to local or state governments of providing assistance, in the spirit of the broader literature on the responsiveness of lower-level governments to changes in intergovernmental matching grants (e.g., Baicker, 2005). One reason this question has been difficult to address is that while most New Deal programs required some state or local funding, in many programs there was no

[4] Wallis (1981) provides a model of local relief budgets in his analysis of relief earlier in the New Deal, under the Federal Emergency Relief Administration, and discusses the importance of accounting for which level of government actually makes relief decisions.

[5] Other work documents similar shifts in regulatory functions of government over this period: Knittel (2006), for example, discusses the shift of electricity regulation away from local governments to state governments. Fishback and Wallis (2012) note the tendency of regulatory programs during the New Deal to be national programs.