

Intergovernmental

Winter 1988, Vol. 14, No. 1

PERSPECTIVE

Federalism Becomes Finance



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ACIR Begins Search for Executive Director—
see page 4 for details.

In This Issue . . .

Federalism Becomes Finance is the theme of this issue of *Intergovernmental Perspective*. ACIR Communications and Publications Director Robert Gleason wraps up developments of the last two years in "Federalism 1986-87: Signals of a New Era." As a tribute on the occasion of his retirement, "The Faces of Fiscal Federalism" presents a selection of Executive Director John Shannon's wit and wisdom on the subject of intergovernmental finance during this decade. In "The 'State' of State-Local Relations: How Officials See It," Paul D. Moore and Karen A. Scheer of the New York Legislative Commission on State-Local Relations report on a first effort to measure the impact of state policy on local governments. A **Special Report** highlights ACIR's preemption recommendations. The **Intergovernmental Focus** is on the Connecticut Advisory Commission on Intergovernmental Relations.

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Intergovernmental Perspective
(ISSN 0362-8507) is published
four times a year by the
U.S. Advisory Commission
on Intergovernmental Relations,
Washington, DC 20575
202-653-5540

SOUTHWESTERN UNIV.
LAW LIBRARY

FEB 02 1988

GOVT DOCUMENTS 508

The Chairman of the Advisory Commission on Intergovernmental Relations has determined that the publication of this periodical is necessary in the transaction of the public business required by law of this Commission. Use of funds for printing this document has been approved by the Director of the Office of Management and Budget.

John Shannon Retires

The Commission has accepted the resignation of John Shannon as ACIR Executive Director, effective January 1, 1988—the occasion of his 65th birthday. He has been director since 1985.

Shannon has devoted nearly 24 years of service to ACIR, including 18 years as assistant director for taxation and finance. He was named ACIR's first Kestnbaum Fellow in 1984. A nationally recognized authority on public finance and intergovernmental relations, he has supervised the development and publication of nearly 100 policy reports, and authored numerous professional articles and working papers. He will continue to put his talents to work as a senior advisor and consultant for The Urban Institute, concentrating

on public finance and federal-state-local relations.

At the quarterly meeting on December 4, at which Shannon's retirement was formally announced, the Commission adopted the following resolution:

WHEREAS, John Shannon has served the United States Advisory Commission on Intergovernmental Relations for nearly 24 years (June 1964 to January 1988) with dedication and distinction as Senior Analyst, Assistant Director for Taxation and Finance, Executive Director, and Kestnbaum Fellow;

WHEREAS, John Shannon has brought to these assignments an encyclopedic knowledge of intergovernmental relations, federalism, and public finance and

ACIR Research Director John Kincaid assumed the position of Acting Executive Director on January 1, 1988.

taxation, as well as an extraordinary ability to discern and predict trends and developments in American intergovernmental relations;

WHEREAS, John Shannon's devotion to duty, standards of integrity, perseverance in the face of adversity, boundless enthusiasm, and institutional loyalty have contributed substantially to the influence, esteem, and well-being of the Commission;

WHEREAS, John Shannon has generously shared his knowl-

ACIR Begins Search For Executive Director

At the Commission meeting on December 4 in Washington, DC, Chairman Robert B. Hawkins, Jr., nominated and the Commission approved eight members to serve as a search committee for a new executive director.

North Dakota State Senator David E. Nething, past president of the National Conference of State Legislatures, is chairing the committee. The other members are: U.S. Senator David Durenberger (Minnesota); U.S. Representative Ted Weiss (New York); Montana Governor Ted Schwinden; Colorado Springs Mayor Robert M. Isaac; Tennessee State Representative John T. Bragg; Dougherty County, Georgia, Commissioner Gilbert Barrett; and Temple University Professor Daniel J. Elazar.

The Executive Director manages the staff in carrying out the directions of the Commission and the Chairman; represents the Commission before a variety of audiences, including the Congress and its committees; the Executive Office of the President and

other federal agencies; national and state associations of state and local officials; state and local governments; the media; schools and universities; and the general public; and undertakes and directs such other activities as the Executive Director and Chairman may deem in the best interests of improved intergovernmental relations.

Requirements for the position include "hands on" experience in running an organization or major operation, demonstrated communications ability, and a thorough grasp of the theory and practice of federalism as evidenced by writings and practical exposure. Other desirable qualifications include conduct and supervision of public policy research, and experience in obtaining outside funding.

Persons interested in being considered for the position should send a resume and references to Esther Fried, Personnel Officer, ACIR, 1111 20th Street, NW, Suite 2000, Washington, DC 20575, by February 15.

edge with others, given freely of his friendship, and shown great sensitivity to the personal and professional needs of his staff and associates so that they willingly marshaled their best abilities to do more with less;

WHEREAS, John Shannon has tirelessly carried and conveyed the Commission's messages to citizens throughout the United States and even to audiences elsewhere in the world;

WHEREAS, John Shannon's fine Irish wit, turn-of-phrase, and vivid prose have enlivened many a speech, article, and meeting:

BE IT THEREFORE RESOLVED, That, the Advisory Commission on Intergovernmental Relations extends to John Shannon its most sincere gratitude and deepest appreciation for the outstanding services he has rendered, and expresses its genuine sense of loss on the occasion of his retirement, and

BE IT FURTHER RESOLVED, That, the Advisory Commission on Intergovernmental Relations wishes him a happy retirement, many years of family pleasure, and a long life to enjoy the esteem he has earned from his many friends and associates.

Grants Catalog Update

ACIR's recent publication *A Catalog of Federal Grant-in-Aid Programs to State and Local Governments: Grants Funded FY 1987* reported that, of 422 grant programs funded on January 1, 1987, 73 were added since January 1, 1984. After allowing for the number of programs that lost funding in the 1984-87 triennium, the net addition was 30—73 added, 43 dropped.

Subsequent to publication of the Catalog, it was suggested that some of the added programs may not have been new, but, for example, may have been existing programs appearing in a new guise or being refunded after a period of non-funding. ACIR, therefore, undertook further research on

the 73 added programs, examining the historical data in the OMB-GSA *Catalog of Federal Domestic Assistance* (CFDA), which is the basic information source on program funding, and interviewing by telephone federal officials responsible for administering the programs.

The research indicates that, indeed, 27 of the 73 programs were not newly authorized and funded in the 1984-87 triennium. Five programs existed earlier than 1984 but were part of other programs or were temporarily unfunded in 1984.

CFDA

- 11.803 Minority Business Development: State and Local Government Program
- 12.607 Military Base Reuse Studies and Community Planning Assistance
- 13.125 Mental Health Planning and Demonstration Projects
- 66.701 Toxic Substance Compliance Monitoring
- 81.086 Conservation Research and Development

Three programs started before January 1, 1984, but at that time did not include state and/or local governments as eligible recipients.

CFDA

- 15.221 Cooperative Agreements for Research in Public Lands Management
- 15.308 Mining and Mineral Resources and Research Institutes
- 81.079 Biofuels and Municipal Waste Technology and Regional Programs

Seven programs were funded prior to January 1, 1984, but for various reasons were not reported in the CFDA until after that date.

CFDA

- 13.669 Administration for Children, Youth, and Families: Child Abuse and Neglect: State Grants
- 13.670 Administration for Children, Youth, and Families: Child Abuse and Neglect: Discretionary Activities

- 13.888 Home Health Services and Training
- 81.089 Fossil Energy Research and Development
- 81.090 State Heating Oil
- 83.519 Hazard Mitigation Assistance
- 84.173 Handicapped: Preschool Incentive Grants

Twelve programs were funded before January 1, 1984, but were not picked up in ACIR's 1984 catalog, which, therefore, undercounted the number of grants funded at that time.

CFDA

- 10.206 Agricultural Research: Competitive Research Grants
- 10.567 Needy Family Program: Administrative Costs
- 13.118 Acquired Immunodeficiency Syndrome (AIDS) Activity
- 13.262 Occupational Safety and Health: Research
- 13.273 Alcohol Research Programs
- 13.279 Drug Abuse Research Programs
- 13.886 Physician Assistant Training Program
- 14.174 Housing Development Grants
- 20.205 Federal Aid Highways: Interstate System: Highway Substitution
- 20.205 Federal Aid Highways: Interstate System: Resurfacing, Restoring, Rehabilitating, constructing
- 45.129 Promotion of the Humanities: State Programs
- 83.515 Emergency Broadcast System Guidance and Assistance

Intergovernmental FOCUS

Spotlight on the Connecticut ACIR

David W. Russell
Executive Director

The Connecticut ACIR was born out of the need for an agency to study "system" issues surrounding the relationship between the state and its municipalities. The truly positive element was—and remains—a recognition on the part of most participants in the process that state and local government actions form essentially one system. While the system has some predominantly state aspects and some that are predominantly local, most actions of one level necessarily have an impact on the other. This recognition provides a solid base of self-interest as well as public interest for all participants.

The Setting

In organizing a state-local cooperative effort, Connecticut has the advantage of having relatively few local government entities (169) and essentially only one level of substate government (towns). There are no counties, and all towns have the statutory right to the same powers.

Connecticut does not lack for local government advocacy organizations, with a strong municipal league (Connecticut Conference of Municipalities) and an active small town group (Council of Small Towns). Planning regions are also organized at the state level, as are local boards of education.

In forming the state ACIR, all of these groups were brought together through the efforts of the Speaker of the State House of Representatives. Speaker Irving J. Stolberg introduced the ACIR bill and shepherded it through the legislative process with the active assistance of the local gov-

ernment groups and the state's Office of Policy and Management (the policy agency for the executive).

ACIR Legislation

The statute creating the Commission closely follows in membership and goals the model legislation proposed by the U.S. ACIR. All affected parties were closely involved in the agency's design and operations. Commission membership is a blend of state legislative and executive, local government and general public interests. None of these interests dominates, nor does any single appointing authority.

The Commission has 25 members: five representing the general public, six legislators, three state executives, and 11 local government representatives. While this distribution seems weighted toward local government and away from the state executive branch, the appointment authority for the positions provides a compensating balance. Five of the members are statutory (four legislative and one state executive), 12 are appointed by the Governor, six by the legislature, and two by local government organizations.

The statute provides that membership include the Senate President Pro Tempore, the Speaker of the House and the minority leaders of both houses of the General Assembly, providing an automatic direct link to the legislative leadership. Access to the executive branch is assured with the statutory membership of the head of the Office of Policy and Management and two gubernatorial appointments of state executives. Local

government leadership involvement is achieved by having the Connecticut Conference of Municipalities (CCM) nominate to the Governor two officials from municipalities over 60,000 population and two officials from municipalities between 20,000 and 60,000. The Council of Small Towns (COST) nominates two officials from municipalities under 20,000 population. The Connecticut Association of Boards of Education, the Connecticut Association of School Administrators and the Regional Planning Association of Connecticut each nominate one member.

The Commission membership is completed by appointment of one senator and one representative by their respective leaders, one "public" member by each of the legislative leaders and the Governor, and one member each directly by CCM and COST.

The ACIR operates as a semi-independent body within the state government, but is part of the legislative branch for administrative purposes. Its proposed budgets are considered along with legislative staff agencies and cannot be reduced by the executive branch. Its first-year budget was \$74,000, including one professional staff members. For 1987-88, the budget is \$98,000, including a two-person staff and allocations for outside consultation. The entire budget is funded by state General Fund appropriation, although activities have been supplemented by time contributions from universities and law firms. Contrary to the suggestions in the national model, no fi-

nancial commitment is asked of the local government sector for the Commission. To date, there has been no attempt to secure outside grant funds either, although the enabling act specifically authorizes it.

The ACIR chairman and two vice chairmen are chosen by the Commission itself. The chairman is University of Connecticut Professor David B. Walker, a former senior staff member with the U.S. ACIR. The vice chairmen are Rep. Alice Meyer, a former chairperson of the legislature's local government oversight committee, and Rep. Geri Langlois, who has the dual hats of state representative and local chief executive.

In order to accomplish its initial work program, the Commission has met virtually monthly since its organization. It plans ultimately to meet somewhat less often to avoid conflicts with members' schedules, and a committee arrangement is being worked out.

Charge to Commission

The statutory goals of the ACIR are to: (1) serve as a forum for consultation among state officials, administrators and legislators and local government officials; (2) conduct research on intergovernmental issues; (3) encourage and coordinate studies of intergovernmental issues by universities, research and consulting or-

ganizations and others; and (4) initiate policy development and make recommendations for consideration by all levels and branches of government.

Commission Activities

Since its organization in early 1986 and staffing in the fall of 1986, the ACIR has completed two major projects and initiated a number of others.

Immediately after organizing, the Commission began a process of evaluation of potential "first projects." Its goal was to tackle one or two issues which were important to a variety of its constituencies but

Connecticut ACIR Membership		
Name	Position	Appointing Authority
Legislative		
Hon. John B. Larson	Senate President Pro Tempore	Statute
Hon. Irving J. Stolberg	Speaker of the House	Statute
Hon. Reginald J. Smith	Senate Minority Leader	Statute
Hon. Robert G. Jaekle	House Minority Leader	Statute
Hon. Alice V. Meyer	Representative, 135th District	Speaker
State Executive		
Hon. Anthony V. Milano	Secretary, State Office of Policy and Management	Statute
Edwin V. Selden	Office of Policy and Management	Governor
Local Government		
Hon. Thirman L. Milner	Mayor, City of Hartford	Governor/CCM
Hon. Sebastian J. Garafalo	Mayor, City of Middletown	Governor/CCM
Hon. Paul S. Timpanelli	First Selectman, Town of Trumbull	Governor/CCM
Hon. Elizabeth A. Adams	First Selectman, Town of Woodbury	Governor/CCM
Hon. Geri W. Langlois	First Selectman, Town of Thompson	Governor/CCM
Local Association		
Joel Cogen	Connecticut Conference of Municipalities	CCM
Donald J. LaChance	Council of Small Towns	COST
Margaret W. Becker	Connecticut Association of Boards of Education	Governor/CABE
Lee R. Burne	Regional Planning Association of Connecticut	Governor/RPAC
Gerald R. Leblanc	Connecticut Association of School Administrators	Governor/CASA
Public Members		
Marie T. Larson	Public Member	President Pro Tempore
Hugh I. Manke	Public Member	House Minority Leader
Richard Miller	Public Member	Speaker
Patrick Spalluto	Public Member	Senate Minority Leader
David B. Walker	Public Member	Governor

which were not so controversial as to threaten the building of a sense of unity within the Commission and between the Commission and its constituent members.

Each member developed his or her own priority projects which were blended together to form one Commission list. There was remarkable agreement on top priorities, and a work program was about to be adopted when reality struck, with the General Assembly and the Governor both asking the Commission to undertake projects. While the specific projects may not have been what the Commission planned, the interest demonstrated by top state leaders was gratifying and valuable. The 1986 session of the General Assembly formally assigned the ACIR to study the status of home rule and make recommendations by January 1987. With very active Commission involvement and outside expertise provided by universities and a major Hartford law firm, the staff completed the report and it was adopted by the Commission and forwarded to the General Assembly on time.

The net effect of its recommendations has been to generate three additional projects representing efforts to implement the changes which the Commission found necessary. Over the next several years, the Commission will be heavily involved with the General Assembly, proposing both substantive legislation and staff processes for evaluation of legislation affecting local governments.

Concurrently, the Governor requested the ACIR to make recommendations to improve the timing of state-aid-to-local government decisions in relation to local budget cycles. Again with a very involved Commission, the report was adopted in December. The recommendations contained in this report are oriented largely toward adjustments in local government budget cycles, with some assistance from the state.

The Commission is now turning its attention to additional areas of concern:

1. A reorganization or reindex-

ing of state statutes dealing with local government.

2. Testing a process for analysis of proposed state legislation as it affects the authority of local governments (so-called "municipal powers" impact analyses).

3. Development of a research network of professionals performing intergovernmental research in Connecticut.

4. Creation of an intergovernmental fiscal data base to provide information on local and state finances as they interrelate, particularly the impact of state aid programs on local tax rates and spending patterns.

Other areas which are potentially in the Commission's near future are analyses of the status of substate districts and the distribution and impact of property tax exemptions in Connecticut.

Conclusion

The Connecticut ACIR, with its emphasis on system studies, fills an important niche in improving the delivery of public services in the state. It is the only setting in which all of the involved parties sit down together in a noncrisis atmosphere and discuss potential improvements in intergovernmental relations. In its membership, its work program, and its recommendations, the Commission continually strives for a balanced approach. While balance is a thin line, often difficult to find, it is well worth striving for, and the degree to which the ACIR achieves a balance that is valuable to the parties and the issues of intergovernmental relations will be the measure of its relevance and the determinant of its future.

Federalism 1986-87: Signals of a New Era

Robert Gleason

Although federalism developments during the early Reagan years—the block grants and regulatory relief of 1981, and the 1982 New Federalism Initiative—received far more media coverage, future historians may well view the 1986-87 biennium as the culmination of this Administration’s legacy to intergovernmental relations.

Both substantively and symbolically, two events in 1986 and responses to them in 1987 signaled a new era in federal-state-local fiscal arrangements: the *Tax Reform Act* altered the environment in which state tax systems operate by intensifying interstate competition; and the termination of General Revenue Sharing (GRS) ended the direct fiscal relationship that the majority of localities had with Washington.

Yet, 1986-87 also offered a constancy. It was a time frame in which a full measure could be taken of the evolution in intergovernmental relations over the past decade. As ACIR Research Director John Kincaid has noted: “If fiscal affluence helped drive Lyndon Johnson’s Creative Federalism and Richard Nixon’s New Federalism, fiscal conflict and rising debt have helped to drive Ronald Reagan’s New Federalism.”¹

Beginning in 1978, and accelerating in the 1980s, federal budget priorities underwent a double shift. A macro shift occurred in overall budget priorities, with a general slowdown in discretionary (nonentitlement) domestic spending, and a micro shift occurred within domestic spending priorities. Both produced a substantially restructured intergovernmental grant system.

Chasing the Almighty Dollar

Even when adjusted for inflation, both federal receipts and outlays have grown sharply during this decade. Real revenues in FY 1987 were 17% higher than in FY 1980, and expenditures were 23% higher. However, of the increased expenditures, 35% was consumed by national defense, 34% by federal payments for older Americans (social security, medicare, and other retirement), and 20% by interest on the national debt—for a combined 89% “consumption” of all the increase in expenditures. These are the federal government’s “big ticket” items which ACIR Executive Director John Shannon refers to as the three Ds: defense, deficits (interest payments), and demographics (an aging population). Indeed, in FY 1987 these three expenditure items accounted for almost three-quarters of the budget—up roughly 10% from 1980.

With some domestic programs, such as farm subsidies, also growing, other discretionary spending was squeezed, and aid to state and local governments took the first and hardest hit. Whereas grants had amounted to \$105.9 billion (1982 constant dollars) in FY 1980, in FY 1987 they amounted to \$90.2 billion—a 15% decline. Of more importance was the change in the percentage of grants earmarked for payments to individuals (primarily AFDC and Medicaid). In 1980 they accounted for 35%; in 1987 they accounted for almost 50%. Thus, beyond an overall decline in grants, those that are spent directly by state and local governments—as opposed to being passed through to individuals—declined even further. Calculated in this manner, federal dollars spent on grants-in-

¹*Publius*, Center for the Study of Federalism, Temple University and North Texas State University, Summer 1987, p. 8.

aid for "governing" functions declined by 34% in real terms between 1980 and 1987.

The inevitable result of this federal retrenchment was that state and local governments became more self-reliant during the Reagan years. Whereas in 1980 federal grants in aid accounted for 26.5% of spending by state and localities, in 1987 it was 19.1%. State-local expenditure from their own sources rose from \$266.9 billion to \$505.9 billion during this time, and in constant (1982) dollars, their per capita own-source spending grew by approximately 26%. In contrast, federal per capita spending grew by approximately 15% during the 1980s, and in FY 1987 recorded the first post-Great Society one-year decline (from \$3,744 to \$3,709e).

Of conspicuous note is the imbalance of the federal government's revenue-expenditure ratio in comparison to states and localities. While in FY 1987 the federal government spent about \$1.20 for every dollar of receipts, the 50 state-local systems had about \$1.10 in receipts for every dollar spent. In the aggregate, state and local revenues exceeded expenditures by approximately \$60 billion. Although these revenues cannot properly be considered surpluses (the vast majority went into public employee pension funds), the contrast is striking. At the same time that the federal government is obligating future interest payments, state and local governments are covering future obligations.

Born Again States and Stillborn Proposals

In light of this glaring disparity, the emergence of states and localities as more prominent actors in the federal system was inevitable. Fred C. Doolittle of Princeton University has observed that with many states in relatively good financial health at the same time that Washington is deficit ridden, "many lobbyists are finding their way back to the state capitol." In areas like economic development, individual rights, and education, states have launched bold initiatives and enacted legislative remedies. These developments have likewise attracted the notice of interest groups.

However, equally noteworthy during 1986-87 was what didn't happen. A central concept of the Reagan New Federalism—the idea of federal-state "swaps" of programs and fiscal responsibilities—seemed to lose political momentum after having spawned several alternative proposals. In some cases, states and localities had always resisted the idea. What continued to maintain a foothold in fiscal debates, though, was the concept of fiscal neutrality, namely, the idea that new domestic commitments should not result in a net increase in federal expenditures. In addition, states and localities intensified their call for federal reimbursements when federal mandates necessitate expenditures.

In another intergovernmental domain, judicial decisions and federal preemption of state laws continued to frustrate state and local policymakers. Some raised the possibility that in the aftermath of the Supreme Court's decision in *Garcia v. San Antonio Metropolitan Transit Authority* constitutional reform might be necessary to

correct a breakdown in restraint by the national government. Others disagreed that the states have been emasculated. Both sides were debated at a roundtable discussion convened by ACIR in September 1987. On one side, for example, Stuart Eizenstat, former Domestic Policy Advisor to President Jimmy Carter, said: "It seems to me that it is somewhat ironic for dramatic notions of constitutional amendments to surface at a time when states are, more clearly than at any point in the last 50 years, the centers of innovation and creativity, while policymaking in Washington is an utter shambles."² Conversely, New Hampshire Governor John Sununu, ACIR Vice Chairman and National Governors' Association Chairman, said: "Right now, post-*Garcia*, it is clear that there is nothing that the federal government cannot do willy nilly that would—in any case, in any way, shape or form—be deemed by the federal courts to be an intrusion on the rights of the states. It is that swing of the pendulum, well past the extreme, that must be corrected."³

So it is against this backdrop that federal tax reform and the termination of General Revenue Sharing transformed federalism. Surely, though, it is fair to ask why these two actions—the former not even an intergovernmental action per se, the latter just one of 400+ intergovernmental programs—together became a culmination after so much that had gone before. Why can turning on just one more appliance cause a circuit breaker to trip? The cumulative effects of budget retrenchment set the stage for the realization that the course of intergovernmental relations had been permanently altered.

Taxing the Federal System

Though the federalism aspects of tax reform were well debated in the 1986 package, the saga really commenced with the income tax revisions of 1981. For in that act the top marginal rate was reduced from 70% to 50%, thus beginning the process of diminishing the value of deductibility of state and local taxes from federal income taxes, particularly for high-income taxpayers. Then, in the 1986 act, the top marginal rate was reduced to 28%, further reducing the value of deductibility, and intensifying interstate tax competition. In essence, over a five-year period, deductibility lost 60% of its value to the highest income, itemizing taxpayers—from 70 cents on the dollar to 28 cents. While this is true of all deductions (e.g., home mortgages), it is the ability of high-income taxpayers to move to lower-tax jurisdictions that gives tax reform intergovernmental import.

Still, the tax competition aspect of deductibility was intertwined with two other important ramifications of the 1986 tax reform act: the "windfall" issue, and the outright elimination of deductibility of sales taxes.

For 33 of the 43 states and the District of Columbia

²Is Constitutional Reform Necessary to Reinvigorate Federalism? A Roundtable Discussion (M-154). ACIR, p. 13.

³Ibid, p. 5.

which have an income tax,⁴ federal tax reform legislation had the potential of producing larger revenues if states did not alter their own tax codes. Since many states conform or "couple" in some way to the federal income tax structure, the base broadening in the 1986 legislation meant that states would be applying their marginal rates to higher adjusted gross incomes. According to ACIR staff estimates, the additional income tax revenues would have ranged from less than 1% in Massachusetts and Idaho to a high of 27.9% in Louisiana, and would have averaged 11.9% in the 33 states. In the aggregate, the potential additional revenue was estimated to be \$5.2 billion. In the state legislatures, therefore, a major issue became what to do with the windfall.

Perhaps prompted by the memory of the taxpayers' revolt, and perhaps more keenly aware of heightened interstate tax competition, or both, approximately 80% of the windfall revenues were returned to the taxpayers under a wide variety of turnback strategies. As might be expected, the states hardest hit by the agricultural slump and/or the drop in energy revenues were most likely to keep all or some of the personal income tax windfall.

The Disposition of the "Windfall" from Federal Income Tax Reform

States Which Returned All of the Windfall

Arizona	Maine	Ohio
California	Massachusetts	Virginia
Connecticut	Minnesota	West Virginia
Georgia	New York	Wisconsin
Hawaii		

States Which Kept Part of the Windfall

Colorado	Iowa	Oregon
Delaware	Maryland	

States Which Kept All of the Windfall

Alabama	Kansas	Montana
Arkansas	Kentucky	New Mexico
Idaho	Louisiana	North Carolina
Illinois	Mississippi	Oklahoma
Indiana	Missouri	

Of more lasting significance, however, is the fact that ten states took the occasion of federal tax reform to fashion major restructuring of their own individual income tax codes.⁵ In varying combinations, they cut top rates, reduced the number of brackets, and removed low-income filers from the tax rolls. Not surprisingly, the ma-

majority of the states cutting rates and curtailing progressivity were those sharing borders with lower income tax jurisdictions and/or situated in highly competitive regions. New York, for example, cut its top rate almost in half, from 13% to 7%, and reduced the number of brackets from 13 to two over four years. In the upper-Midwest, both Minnesota and Wisconsin cut top rates and reduced brackets. Yet, even California—a state somewhat protected from interstate tax competition because of geography—cut its top rate and reduced brackets. Interestingly, most of these states took a leaf from the federal tax reform book at the other end of the income spectrum by removing low-income taxpayers from the base.

While innumerable local considerations contributed to tax revisions in the various states, five primary national trends stand out: (1) the "windfall" revenues from federal tax reform provided financial maneuverability; (2) because of ease of administration and taxpayer convenience, state lawmakers feel compelled to conform the major provisions of their tax code to federal provisions; (3) because of competition for high-income taxpayers and their investment dollars, it is becoming increasingly risky for states to use a highly graduated rate structure to accomplish income redistribution; (4) considerations of tax fairness are forcing states to grant more generous personal exemptions and standard deductions; and (5) a coalition of conservatives and liberals is changing state income tax policy, with less emphasis being placed on soak the rich and more on protecting the poor.

Nevertheless, in another response to federal tax reform, conventional wisdom did not prevail. It had been argued that total elimination of the deductibility of sales taxes would cause states to reduce their reliance on sales taxes and rely more heavily on income or other taxes. Not only have many states receded from income taxation, in 1987 alone six states increased sales taxes—either through rate increases, extending temporary rate increases, or base broadening. Indeed, since 1982, 23 states have increased sales tax rates, and the national median rate has climbed a full percentage point, from 4% to 5%. In retrospect, the deductibility thesis may have long ago been discounted by political practitioners. As ACIR Commissioner State Senator Ross Doyen has said: "In my 28 years in the Kansas legislature, never once have I heard someone get up on the floor and say it was OK to raise taxes because they're deductible."

**Revenue Sharing:
Brother Can You Spare \$4.6 Billion?**

During its 14-year life span, General Revenue Sharing disbursed over \$83.5 billion to state and local governments, reaching a high of \$6.8 billion in 1978, 1979 and 1980. The centerpiece of Richard Nixon's New Federalism, GRS was terminated for state governments in 1980, and the annual appropriation for local governments was \$4.6 billion when authorization expired in 1986. Though always controversial, as long as fiscal affluence prevailed in Washington, GRS was able to maintain a majority coalition for support. With the rise of the deficits, however,

⁴Connecticut, New Hampshire, and Tennessee tax income only from interest and dividends.

⁵State with major income tax rate reductions were California, Colorado, Delaware, Washington, DC, Iowa, Minnesota, New York, Oregon, West Virginia, and Wisconsin.

the balance gradually tipped. A dominant coalition emerged of conservatives in Congress who had long objected to GRS "handouts" and liberals who had long disliked the idea of giving highly discretionary funding to states and localities because of concern that the money would not be used to help the poor. Perhaps more importantly, the very thing that made GRS so popular with state and local officials made it one of the easiest (as distinct from easy) programs to terminate: because they were discretionary dollars to be spent by other units of government, Congress had difficulty taking credit for what the money was spent on.

At its inception, GRS was an uneasy mix of economics and ideology, and a marriage of convenience for liberals and conservatives. In the early and mid-1960s, some economists were predicting that the federal income tax would soon be generating revenues at such capacity that the federal treasury would have huge surpluses, and that this would be a drag on the economy. Thus, it was argued, an effective mechanism was needed to dispose of money.

Politically, in the late 1960s and early 1970s, Revenue Sharing was a means of giving both liberals and conservatives something they wanted. For liberals, the money would not be spent by Washington to achieve centralization, but at least it would be raised by the progressive income tax, and kept in the public sector; for conservatives, the anticipated surpluses would not be used for tax cuts as they might have preferred, but at least GRS would engender more decentralized spending decisions, and perhaps state and local tax reductions.

Obviously, the ensuing years were to prove that the national government was never in danger of being unable to spend its revenues. In some quarters, Revenue Sharing gained a new moniker: Deficit Sharing. A particularly salient criticism, however, arose from the very design of the program to be universal—that GRS provided funds not just for poor communities, but for rich ones as well. Some critics argued that a fiscally strapped federal government redistributing wealth to affluent communities was perverse.

Given that GRS payments to states were stopped in 1980, the full expiration of GRS has had its greatest effects on the nearly 39,000 local governments that received it, especially the governments of many small and/or poor localities. Although, on average nationwide, GRS funds constituted less than 3% of local government expenditures, GRS accounted for as much as one-fourth to nearly two-thirds of total tax revenues for some small and poor local governments. Furthermore, GRS was the only direct federal aid received by many small localities. The National Association of Towns and Townships estimated that about 78% of the 36,000 communities having a population of less than 25,000 would no longer receive any direct federal aid with the expiration of GRS.

While various interest groups and members of Congress have proposed revising revenue sharing in some form, mainly as a more targeted program for fiscally strapped communities, whether Congress can enact a program that will benefit only some communities is

questionable. Drawing a line between localities that are marginally affected and severely affected by the loss of GRS funds is politically difficult. Probably less than 30% of local governments can be considered severely affected, and they constitute a small portion of the population.

Meanwhile, other major programs for local governments, such as Urban Development Action Grants and the Community Development Block Grants, continue to be targets of proposed elimination. Indeed, of the 435 grants-in-aid funded in 1987, only 16 were strictly for local governments, while 177 were strictly for state governments. Forty-five flowed to both state and local governments, while the remainder were channeled to some combination of governmental and other organizations.

Hence, a dramatic change has occurred from the thrust of the Great Society years and Nixon's New Federalism. Whereas the direct fiscal relationship between the national government and localities had been growing, it has now contracted—to none at all for the majority of the nation's localities which previously had received only General Revenue Sharing.

Free Demonstrations and Negative Pork Barrel

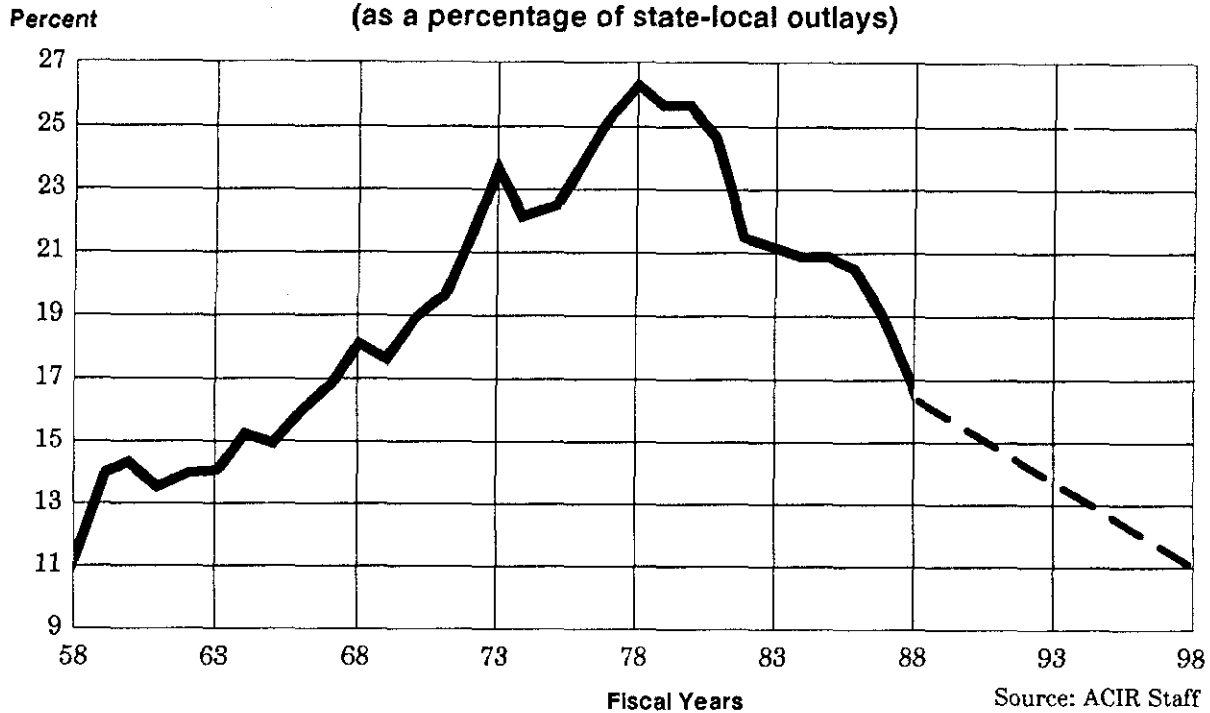
In terms of precedent, the 1987 highway reauthorization bill may be the most significant event of the past two years. Included in the bill were 120 "demonstration" projects for specific undertakings. This had the effect of dictating priorities for certain roads and bridges, and superseding the discretion of state highway administrators. In essence, this is a new way for members of Congress to get credit for their spending. In any given congressional district, the project becomes not the state's or Governor Smith's road, but Congressman Jones' road—a subtle distinction of particular importance when it's time to cut the ribbon. To some degree, Congress is looking for a replacement for the old Rivers and Harbors program in which well-placed individual members could bring home dollars for their district. And, using the highway precedent, project-specific funding can be extended to many other areas such as housing and economic development.

Yet another device that cropped up in 1987 was that of "negative pork barrel"—the withholding of federal funds to settle local disputes. For example, specific amendments were adopted prohibiting the use of federal funds for demolishing certain public housing projects in Dallas and Houston; a hold was put on federal funds until Burbank, California, airport authorities adopted new noise-reduction takeoff and landing patterns; and federal funds were halted for the construction of an expanded Atlantic City, New Jersey, airport in an effort to force competing local interests to reach compromises.

From an intergovernmental perspective, these developments are a dramatic departure from the decentralizing thrust of the 1981 block grants, and certainly from General Revenue Sharing. They go beyond even the restrictive categorical grant approach, because these federal grant policies are project specific. In cumulative fashion, they could become an even more powerful way for Congress to micromanage state-local priorities.

Exhibit 1

The Rise and Decline of Federal Aid, 1958-88 — and 1998?
(as a percentage of state-local outlays)



Federalism Futures

In an effort to put an end to state-local micro-management by executive officials, President Reagan issued Executive Order 12612 on Federalism on October 26, 1987. In general, the provisions call for federal action to permit maximum state discretion in developing policies and administering federal programs within the scope of clear constitutional authority; refraining from establishing uniform national standards for programs; preempting state law only when provided or implied in statute; and directing executive departments and agencies to refrain from submitting legislation that would interfere with the independence of the states, or to attach conditions to grants that are not directly related to the purpose of the grant.

Each federal department and agency was also directed to designate an official to be responsible for ensuring the implementation of the order. Among their responsibilities are to prepare a "federalism assessment" for policy recommendations and proposals submitted to the Office of Management and Budget, including an estimation of the extent to which the policy imposes additional costs or burdens on the states. This assessment would include the likely source of funding for the states and their ability to fulfill the purposes of the policy.

Federalism Becomes Finance

Whatever one thinks of President Reagan's federalism record heading into the final year of his Administration, it must be noted that of all the post-war presidents

he arguably got the most of what he wanted. In his first Inaugural Address he said it was his intention "to curb the size and growth of the federal establishment, and to demand recognition of the distinction between the powers granted to the federal government and those reserved to the states or to the people." He did not accomplish all he wanted, and especially not the way he wanted. Nevertheless, from a financial standpoint, the division of responsibilities among the levels of government has been more clearly defined.

Like other post-war Presidents, Reagan's successes had philosophical underpinnings, but were fiscally driven. As John Shannon has noted: "The federal budgetary realities of the 1980s would have made it difficult for even a President Lyndon Johnson to maintain—let alone expand—the federal fiscal presence on the state-local front."⁶ Yet, as also noted by Shannon, "The American brand of federalism is marked by diversity, competitiveness, and resiliency, and the Reagan Administration's contribution boils down to this—it has helped give our pre-Great Society brand of fend-for-yourself federalism a new lease on life."⁷

Accordingly, many observers looking to the future predict more of the same. In the absence of a major new revenue source, such as a value added tax or a general sales tax, Washington will not be able to reverse the re-

⁶Address to the American Political Science Association, Chicago, Illinois, September 5, 1987.

⁷Ibid.

cent devolution of domestic policymaking to states and localities.

What, then, might intergovernmental grant-in-aid funding look like if the trends of the past decade continue for another ten years? Since 1978 (the "high water mark" for grant funding), federal grants have declined by approximately one-third, from 27% of state and local spending to an estimated 17.1% in 1988. While it is conjecture, should that decline continue over the next decade, federal grants would amount to about 11% of state-local spending in 1998—roughly the same as during the second Eisenhower Administration.

In 1957, President Dwight D. Eisenhower noted the federal government's fiscal dominance over the states, and told the Governors' Conference that, "if present trends continue, the states are sure to degenerate into powerless satellites of the national government in Washington." The graph on page 13 is a reprint from John Shannon's Fiscal Note in the last issue of *Intergovernmental Perspective*, but with the above projection added.

If present trends continue

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Robert Gleason is ACIR's Director of Communications and Publications

The Faces of Fiscal Federalism

John Shannon

Editor's Note: In a resolution honoring John Shannon for his many years of service to ACIR, the Commission noted his "encyclopedic knowledge of intergovernmental relations, federalism, and public finance, as well as an extraordinary ability to discern and predict trends and developments," along with his "fine Irish wit, turn of phrase, and vivid prose." Here, as another tribute to John, we present "Shannon by Shannon," a selection of his predictions and prognostications culled from the pages of *Intergovernmental Perspective*, 1980-87.

The Fiscal Trump Cards

1980 marked the end of a fiscal era: "In retrospect, the 1954-79 period may well go down in history as the golden fiscal era for the federal government . . . in which [it] could repeatedly cut personal income taxes while more than doubling its real presence on the domestic expenditure front Why did the federal government move so much farther, faster, and more safely than did the states and localities into the domestic public sector . . . ? The answer—federal policymakers held several fiscal trump cards [income tax, defense, social security, and federal aid] which enabled them to expand rapidly in the domestic public sector at little political risk In addition, they could finesse revenue shortfalls with deficit financing." None of these cards could continue to be played as easily or with the same flourish as in previous decades, indeed, critics contended that the federal aid card had been badly overplayed. The prognosis was for a period of sustained fiscal stress for the federal government, with federal policymakers being forced to make "higher and higher expenditure bids with fewer top revenue cards." Any fairly quick rebound would take an "extraordinary luck of the draw—a dramatic reduction in international tensions, a rapid and sustained economic recovery, a sharp drop in energy prices, the enactment of a 'popular' new federal tax, and/or renewed public toleration of heavy deficits."

Austerity Equals Decentralization

For 1981 intergovernmental finance was seen as "moving from bit player to star billing in the theater of national public policy." At the national level, "major tax and expenditure cutbacks were enacted, with federal aid programs to state and local governments particularly hard hit. At the same time, there was a continuation of the slow retreat of state-local spending that started several years previously." The slowdown in state-local spending stood in contrast to the continuing rise in federal spending spurred again by sharp increases in defense spending, social security, and interest payments on the national debt. The implications of these developments for the federal system? "First, an era of scarce resources will sharpen the debate over which level of government should finance what—a pressing issue for our mishmash system of federalism. Second, no matter how the debate turns out, federal aid is likely to decline as a percentage of state-local own-source revenue." The fiscal trump cards? They "have been played out."

The fiscal prognosis was for continued austerity: "Fiscal pressures at the federal level and the legacy of the tax revolt at the state-local level will serve as powerful constraints on state and local governments." The intergovernmental prognosis was for less federal influence: "Fiscal austerity will both stimulate a sharp debate about federalism—who should do what—and change the contours of the intergovernmental fiscal landscape." The political prognosis was for no consensus: "There are two sharply opposing interpretations of just what fiscal aus-

terity means for America over the next several years. While labels are sometimes demeaning and often deceiving, major thrusts of current public opinion can be explained in considerable measure through contrasting liberal and conservative viewpoints Because of their equity concerns . . . , when the domestic public sector reaches high tide and then begins to recede, [liberals] predict that the ships of the poor and the disadvantaged will be the first to crash against the rocks of fiscal austerity Because of their efficiency and private market concerns, conservatives view the great slowdown in state-local spending as a most welcome development that was long overdue. They argue that the domestic public sector has steadily gained weight for decades and that now it will have to stop gaining and hopefully slim down a little." Future observers of the federal system may well point to 1981 as the beginning of the "do-it-yourself" era of intergovernmental relations, with fiscal austerity and budgetary cutbacks at the federal level forcing a decentralization of the intergovernmental system.

Spenders Go Their Separate Ways

1982 was the year of the "big revenue shortfall," when the most severe economic downturn since the Great Depression cut federal, state, and local tax receipts and forced painful fiscal responses at all levels of government. 1982 also provided decisive evidence that the contours of the intergovernmental landscape were being changed by a significant trend—expenditure acceleration at the federal level and deceleration at the state-local level. The growing gap since 1978 contrasted boldly with earlier experience.

What caused the great state-local slowdown? For the first time since the end of World War II, it became much easier for most state and locally elected officials to say "no" rather than "yes" to proposals calling for true expenditure increases because of the restraint dictated by the three Rs—*revolt* of the taxpayers (1978-80), *reduced* federal aid flows (1979-82), and *recessionary* pressures. "These fiscal shocks came in fairly rapid succession and powerfully strengthened the backbones of elected officials in most state and local jurisdictions."

On the other hand, the sharp rise in federal spending was attributable to the three Ds—*deficit* financing, *defense*, and *demographics* (social security and medicare). A combination of electoral politics and Keynesian economics had created "a magnificent federal spending machine with a hair-trigger accelerator and a powerful recession turbo-charger, but no brakes. This sporty federal car stands in sharp contrast to the old-fashioned state and local models equipped with balanced budget brakes and a 'speed governor' "—a feature added during the recent tax revolt.

The victory for decentralization might prove more apparent than real, however, if Washington were to pull an increasing amount of resources away from state and local government to underwrite rapidly expanding na-

tional needs. While a major intergovernmental battle for additional tax sources had been avoided in the past by federal reliance on deficit financing and by state-local expenditure restraint, the tax picture was changing rapidly. Growing public concern about runaway deficits was putting the federal government under pressure to reform the tax system, while state and local governments were being forced back into the tax arena to offset losses caused by the recession and the slowdown in federal aid flows. The fundamental problem for the post-Proposition 13 era was going to be "the harsh task of reconciling expenditure priorities with limited tax sources."

A New Fiscal Balance?

For 1983, the issue was dealing with deficits. Was it reasonable to assume the federal policymakers would soon make a substantial reduction in the budget deficit in the absence of a crisis? The quick answer was yes. Why? Because federal policymakers have lost, one by one, "the five political heat shields" that for decades enabled them "to fly so much faster and more safely through the public expenditure skies" than could state and local officials (crises and charisma, 1929-53; federal aid; income tax; social security; the budget deficit). "Federal reentry into the zone of hard budgetary choices is likely to be quite painful for federal policymakers and somewhat painful for state and local officials, but quite beneficial to the nation in general and to our federal system in particular."

Although there was widespread agreement that the federal government had a serious fiscal ailment that must be cured, there was far less agreement on its cause and cure. "The physicians at the right end of the policy spectrum blame the runaway costs of domestic social programs and prescribe a sharp cutback in that sector. The physicians at the other end of the spectrum point to rapidly rising defense spending and recent tax cuts as two primary causes. Their prescription—slow down the defense buildup and raise taxes. Those who occupy the center will likely make the final diagnosis, and their prescription will probably draw from all sides." An added incentive for Congress—the "state shotgun behind the congressional door" (32 states had petitioned the Congress for a limited constitutional convention to draft a balanced federal budget amendment). To put the issue in broader perspective, the "progressive loss of special fiscal privilege by federal officials" might generate "a new equilibrium within our federal system—a new fiscal balance that could drastically slow down, if not check, the centralization of domestic power in Washington."

A World Turned Upside Down

1984—not a good fiscal year for Big Brother—became the vantage point from which to look back over the changes from the end of World War II until 1978 and the subsequent years of de facto new federalism.

Old federalism: was characterized by steadily growing state-local dependence on federal aid and an increasing number of "strings" and conditions designed to alter

state and local budget priorities and to “race state and local engines”; represented a steady advance of the federal government into areas that had been the exclusive province of state and local governments; called on Washington to provide extra aid to stabilize state and local finances during economic recession; and flourished in a political environment that resolved doubts in favor of social equity concerns, national defense containment, and domestic public sector growth.

New federalism: was marked by steadily decreasing state-local reliance on federal aid dollars and the federal government pulling aid funds and tax resources from state and local governments; represents a slow retreat from national government positions staked out during the Great Society era; calls on states to help themselves by setting up “rainy day funds”; and operates in a political environment that emphasizes economic efficiency concerns, national defense expansion, and domestic public sector containment.

Events in 1984 sharply underscored the fact that the national government is afflicted with two serious fiscal ailments—growing budget deficits and a badly flawed income tax—and obscured a badly underrated virtue of contemporary federalism—the remarkable resiliency of state and local jurisdictions. “1984 did not represent an abnormal blip on federalism’s big trend screen.” The fiscal decentralization process that started in 1978 would continue at a fairly good clip, “powered by growing fiscal austerity at the national government level and strong public support for President Ronald Reagan’s conservative policies.” Fortunately for our intergovernmental system, state and local officials have demonstrated “an outstanding ability to adjust quickly to great changes—cyclical changes in the economy, fiscal changes in Washington, and preference changes in the body politic.”

Fend-for-Yourself Federalism: One More Time

In 1987, American states operate “in a fairly harsh and politically risky fend-for-yourself fiscal environment in which the long road to stronger state revenue systems has been paved with the political bones of former governors. The distinctive American brand of federalism is marked by diversity, competitiveness, and resiliency, and the Reagan Administration’s contribution boils down to this—it has helped give our pre-Great Society brand of fend-for-yourself federalism a new lease on life.”

Because all states and most localities must raise most of their revenue, there are great variations in state and local tax and expenditure policies—diversity which provides real choices. Liberals often view these fiscal differences as disparities, and call for equalizing federal and state actions. Most conservatives tend to view these variations as diversities that should not be wiped out by redistributive federal and state actions. “For the supporters of decentralized government, one of the toughest policy issues is this: When does a ‘good diversity’ become a ‘bad disparity’ that necessitates corrective federal and/or state action?” However one views these variations, one

thing is clear—state and local boundaries do make a difference in the federal system. In the United States, “you pays your money and you takes your choice.”

What keeps the 50 state-local systems from becoming too diverse? The quick answer: interjurisdictional competition for economic development plays that stabilizing role, “simultaneously forcing high-tax states to slow down while prompting low-spending states to accelerate on the public service side of the ledger, especially for education and physical infrastructure.” Can the poorest states and localities be competitive without outside help? “This poses a tough equity question for fend-for-yourself federalists. No matter how that question is resolved, one thing appears fairly certain—the competition issue is not likely to go away, in fact is likely to become increasingly fierce.”

Now for the third distinctive, most significant and most underrated, feature of the American federal system—the resiliency of state and local governments that keeps the system going, the demonstrated ability to absorb and then rebound from regional and national shocks. The states and localities are both playing the activist roles in education and welfare reform, and collecting well over one-half-trillion dollars from their own resources, while we have the “spectacle of the federal government mired down deeply in massive budget deficits.”

The creation of a fiscal environment that forces state and local officials to become more self-reliant “stands out as the primary impact the Reagan Administration has had on our federal system . . . The federal budgetary realities of the 1980s would have made it difficult for even a President Lyndon Johnson to maintain, let alone expand, the federal fiscal presence on the state-local front.” While this gradual decentralization is not a neat, orderly, or swift process, “nevertheless, fend-for-yourself federalism is slowly effecting a ‘sorting out of sorts.’”

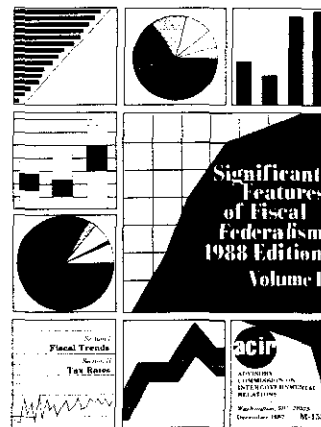
The prognosis for fend-for-yourself federalism? The future will be determined “more by the financial condition of the federal Treasury than by the political philosophy of the next President. Because deep slashes in federal spending appear highly unlikely, the condition of the Treasury will be largely determined by whether or not Washington policymakers gain access to a major new tax—a national sales or value-added levy.” If they don’t, the prospects remain fairly bright for fend-for-yourself. If they do gain access to a major new tax, the prospects for the continuation of fend-for-yourself federalism become cloudy. “In that case, the squeeze on the federal budget will be relaxed and Washington should once again be in a fairly good position to push more funds into the state-local arena—with more federal expenditure strings attached. Why? Because there no longer exist any real political and judicial restraints on federal entry into arenas once considered the exclusive domain of the states. With the withering of all but the fiscal constraint, more than ever federalism is finance.”

Significant Features of Fiscal Federalism, 1988 Edition, Volume I

Report M-155 \$10 December 1987

Significant Features of Fiscal Federalism, 1988 Edition, Volume I contains completely revised and up-to-date information on federal, state and local tax rates and national trends in government expenditures and revenues from 1929 through 1987. *Significant Features* is designed for national, state and local policymakers, their staffs, public finance analysts, and other interested individuals who wish to have ready access to a single source of comparative tax data on all levels of government in the United States.

Among the items included in *Significant Features, 1988 Edition, Volume I*: federal individual income tax rates for 1986, 1987 and 1988; state and local individual income tax rates updated through December 1987; detailed information on standard and itemized deductions, exemptions and exclusions to income for federal and state income taxes; tax rate and base information on social security and unemployment insurance; general sales tax rate and exemptions; data for state and local governments; federal and state tax rates for cigarettes, alcoholic beverages and gasoline; average property tax rates for each state; information on estate, inheritance and gift taxes; state and local property transfer taxes; and fees and taxes on automobiles



Measuring State Fiscal Capacity 1987 Edition

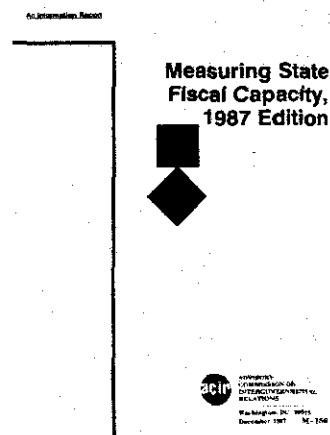
Report M-156 \$10 December 1987

ACIR's *Measuring State Fiscal Capacity, 1987 Edition*, its latest report on the fiscal capacity of the 50 states, contains the 1985 Representative Tax System (RTS) estimates and alternative fiscal capacity indexes.

ACIR developed the RTS in 1962, as a means of measuring the tax base or "tax capacity" of each state. This method of measuring tax capacity examines the ability of the states to raise revenues by applying a uniform set of tax rates to some 26 tax bases including, for example, sales, personal income, and corporate income. Thus, tax capacity would comprise the amount of revenue that each state would realize if a uniform set of rates was applied nationally. RTS also measures "tax effort," or a state's actual tax revenues in relation to its hypothetical tax capacity. In essence, the report endeavors to answer the question: What would be the total revenue and relative rankings of each of the 50 states if every state applied identical tax rates to a number of commonly used taxes?

As in past editions, the report gives graphic representations of state-by-state indices of tax capacity and tax effort based on the RTS method, showing trends for each state and breakdowns on capacity and revenues for seven major categories of state and local taxes.

(see page 22 for order form)



The “State” of State-Local Relations: How Officials See It

Paul D. Moore and Karen A. Scheer

Like it or not, states and their local governments must work in partnership to provide most services. There are 50 such state-local delivery partnerships, each unique, and each assuming greater importance as the federal role in providing and financing public services decreases. In New York, that relationship encompasses an extensive, complex, and interactive system delivering services to almost 18 million people.

It is vital that these relationships function as effectively as possible, and that sources of friction be quickly identified and resolved. Yet, while certain areas of government activity, such as labor and education, have defined ways (e.g., unemployment rates, SAT scores) to measure their respective “states,” there are no parallel indicators for the broader concept of state-local relations. In fact, evaluative information may only exist in the perceptions of state and local officials.

Basic to improving that relationship is the need to measure the impact of state policy on local governments. State and local officials must be sensitive to problems that each other face in delivering programs and services—especially since so many are common or shared problems. To do so, it is important to document how the various levels of government feel about the state of state-local relations and determine specifically where the difficulties lay.

New York’s Legislative Commission on State-Local Relations first proposed to quantify these perceptions in March 1987, through the development of measures assessing the degree of friction in New York’s state-local partnership, and isolating the factors influencing that perception. Encouragement to pursue this research came from other state-local advisory groups and the U.S. Advisory Commission on Intergovernmental Relations (ACIR) during a June 1987 meeting.

The Process

The New York Commission and various local government associations have endowed an annual conference to study issues of importance and concern in the area of state-local relations. The conference is coordinated by the Nelson A. Rockefeller Institute of Government, a research and policy institute in Albany, New York. The theme for the 1987 conference was “What is the ‘State’ of State-Local Relations?”

Commission and Rockefeller Institute staff, in collaboration with the U.S. ACIR, designed a mail survey to measure local officials’ perceptions of state-local relations. In addition to local government officials, questionnaires were sent to nonaligned individuals and agencies with particular expertise or involvement in intergovernmental relations. In all, responses were solicited from counties, cities, towns, villages, school districts, academicians, regional planning agencies, and state executive and legislative agencies involved in state-local policymaking. Within each group, a random sample was drawn.

The survey and samples were designed to include both the state and local levels of New York government, since perceptions of these two groups could reasonably be expected to differ. Local officials focus on their own jurisdictionally defined concerns, while state officials must address issues affecting all jurisdictions.

Drafts of the survey were reviewed by Commission and Institute staff, and by the major local government associations, state officials, and the U.S. ACIR. Their rec-

ommendations were incorporated into the final questionnaire, which was compiled and distributed to the sample in mid-July 1987.

The survey asked respondents to gauge how closely specific aspects of current state-local relations approach an "ideal state" that was defined as:

a framework of state laws, rules and regulations that provide maximum opportunity for local discretion in their implementation coupled with a financial system that provides adequate funding to carry out state imposed directives.

To ascertain whether or not state-local relations have improved or deteriorated, respondents also were asked how they would have answered this question five years ago. In addition, an effort was made to determine what aspects of state involvement in local affairs might be "driving" these responses. For each of 15 specific service relationship areas (e.g., law enforcement, social services, refuse collection, etc.), respondents were asked to rate three aspects of state funding and other means of support, and three aspects of procedural requirements for their closeness to the ideal state. Respondents then were asked to rank their relative level of concern among the 15 service areas. Respondents were also asked to specify the two most persistent sources of friction and the two best examples of cooperation between state and local government. Finally, they were asked for an overall opinion as to whether they are generally satisfied with the current state of state-local relations.

Generally, answers were analyzed by computing a "grade point score" ranging from 0 (farthest from the "ideal state" of state-local relations) to 100 (closest to the ideal).

The Results

As might be expected, state policymakers in New York felt the current state of state-local relations was closer to the ideal (56.2 out of 100) than their local government counterparts (ranging from 43.2 to 50.0). In addition, state officials felt that relationship is now closer to the ideal state than it was five years ago (a gain of 11.2 grade points), but local officials did not think any progress had been made.

School officials gave the state better grades than did the other local representatives, but they also indicated the greatest degree of deterioration in state-local relations over the past five years. This is especially interesting since there have been record increases in the level of financial aid to schools in New York during that period.

The survey sought to determine which service areas were viewed more favorably—or less favorably—than the others. Six major aspects of state involvement were used: three focusing on funding and other types of support, and three dealing with procedural requirements. With respect to funding and other means of support, the three aspects of state involvement were: (1) the dollar amount of assistance, (2) discretion in use of the funds,

and (3) technical assistance. In almost every area, technical assistance was viewed the most favorably—closer to the ideal. The highest rating for technical assistance was in the area of fire prevention (61), and the lowest in solid waste (37).

Looking at procedural requirements, the three aspects of state involvement surveyed were: (1) statutory mandates, (2) rules and regulations, and (3) administrative processing. No one of the three requirements was singled out as being closer to the ideal than either of the others. In most cases, procedural requirements generally were viewed as being closer to the ideal than were the funding and other support aspects.

Results clearly show that concern over refuse collection and disposal, otherwise known as solid waste, is universal. Local governments, school districts, and even state agencies agreed that the state-local relationship was farthest from the ideal in this area. Overall, it was the only area that scored less than 40 out of 100.

Not surprisingly, the need for a good state-local relationship in solid waste was ranked very high. In terms of the priority respondents placed on each of the 15 service areas, counties were most concerned about refuse collection and disposal, and least concerned with recreation and cultural services as a state-local issue. Economic development was at the top of cities' concerns, and planning at the bottom. Both towns and villages gave top priority to highways and refuse collection and disposal, and were least concerned about public transportation. By contrast, state officials felt mental health issues were the priority concern and, like counties, were least concerned about recreation and cultural issues.

Virtually everyone, state and local officials alike, identified unfunded mandates as the most persistent source of friction. Yet, 67% of cities surveyed were more concerned about general purpose state aid. The second greatest source of friction, from a local perspective, was the related concern of a diminishment of local discretionary power. State officials, by contrast, were more concerned with the distribution and local use of categorical aid.

On the positive side, local governments viewed highway aid as the best example of state-local cooperation. Interestingly, state officials and nonaligned experts felt education aid was the best example, yet none of the 80 school district administrators who responded felt it was. In fact, they ranked seven of the 15 service areas as closer to the ideal than education.

The Verdict

Analysis of the survey results identified several differences in perceptions about the current state of state-local relations. The New York Commission will continue to compile these perceptions annually and will, therefore, be able to measure any improvement or deterioration in specific areas of concern.

Although the response rate for this pioneer effort was relatively low, ranging from 14.5% to 31.4% of the

various classes, the sample received was representative of the more than 2,300 units of local government in New York. It also is expected that the response rate will increase with the active participation of the major local government associations.

The conference at the Rockefeller Institute provided good feedback on the questionnaire itself. The basic concept, the definition of the "ideal state" of state-local relations, and the format of the questions were not criticized. Several respondents suggested that more—and more specific—questions should be asked, such as surveying departments within a municipality, including more narrative questions, and asking about specific programs or problem areas. Surprisingly, only one question was criticized as too complex.

Edward C. Farrell, Executive Director of the New York State Conference of Mayors and Other Municipal Officials, provided an overall assessment of the initial survey.

When I think of the "state" of state-local relations, several basic concepts enter my mind. Are we in a state of disrepair, a weakened state, a state of suspended animation, a state of flux, or a state of war? Any one, or a combination, of these could apply.

The recently completed survey by the Rockefeller Institute and the Commission on State-Local Relations is a good start in attempting to measure these concepts and hopefully conclude with a realistic assessment. Although the survey was not perfect, it was an important start and will provide us with a basis for comparison in the future.

Edwin L. Crawford, Executive Director of the New York State Association of Counties, also felt the survey provided important information.

It has occurred to me in the continuing state-local government tug over mandates that it is quite easy for us to lose sight of the "big picture." As is the case with many such issues which tend to polarize parties with different perspectives, the battle frequently takes on greater proportions than the issues themselves.

The surveys generated by the New York Commission on State-Local Relations over the past few years have helped to put such issues into their proper perspective and to prioritize those areas that are the true problem areas as perceived by local governments.

The "Transferability"

Other states may wish to develop similar methods for assessing their state of state-local relations—especially those 24 other states besides New York which have

a state-level agency concerned with intergovernmental relations.

The experience from New York indicates that two steps can be taken which would materially enhance the quality of the results. First, it is vital to include local government associations, both in the planning of the survey and the actual implementation. This would not only improve the response rate but also help in the dissemination and understanding of the results.

Second, careful attention must be given to the use of the results. The average responses obtained from the New York survey were translated into a grade point scale. This invites the obvious comparison to a classroom situation, with 90 to 100 being construed as an "A," 80 to 90 as a "B," and so forth. However, such a tendency could be very misleading because of the relatively low response rate and resulting difficulties in applying more sophisticated statistical tests to determine the significance of the variations identified. Rather, the values should be viewed as a benchmark for comparison to subsequent surveys to note areas of improvement or deterioration.

Finally, the National Conference of State Legislatures' State-Local Task Force has recommended that legislators pay more attention to issues of state-local concern. Certainly the adoption of this kind of annual survey can serve that goal. Further, the survey results provide an opportunity for more extensive follow-up. Specific programs or problem areas can be probed and additional analysis, such as on community size (large versus small) and community character (urban versus rural) can be performed. The National Association of Towns and Townships has already used parts of the survey to ascertain attitudes of its members, with results that parallel those found in New York, and indications are that several other states will initiate a similar annual survey process.

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A Special Report

Federal Preemption of State and Local Authority

In 1985, the Commission authorized a study to focus on "the extent and methods used by the federal government to intervene in the way states structure their relationships with the private sector." The study was concerned with "federal forays into the area of private [sector] regulation, accompanied by corresponding loss of state authority in that area." It became clear that the immediate and basic issue to be addressed was the frequent confusion, often settled in the courts, surrounding whether and the extent to which Congress or a federal agency intended, by statute or administrative ruling, to preempt state authority in a given policy area.

Following are the Commission's findings and the recommendations adopted on March 20, 1987, by the Commission acting as a Committee of the Whole.

Findings

Federal preemption, while a necessary feature in the design of a federal system, ought to be minimized and used only as necessary to secure the effective imple-

mentation of national policy adopted pursuant to the Constitution.

Federal preemption of state law is a necessary feature of the federal system in the United States and is explicitly authorized by the Supremacy Clause of the Constitution. If national laws were unable to preempt state laws, then national laws could in effect be nullified by individual states. Yet, preemption is a complex matter, turning on the detailed requirements of both national law and the laws of the 50 states. The question is always whether a particular provision of national law preempts a particular provision of state law. Frequently the question can be posed as a matter of degree—how far, or to what extent, does national policy preempt state policy in some field of government regulation? Seldom does national policy completely displace all related state policy. The question of what state policy is left standing after Congress has acted is thus a recurrent and necessary legal question in the context of the federal system.

The basic design of federalism in the United States—that the national government exercises only a limited set of powers enumerated in the Constitution, while the states continue to exercise all other powers (not prohibited by the Constitution) as indicated in the "reserved" powers clause of the Tenth Amendment—implies that preemption ought to be exercised in a manner that minimizes national intrusion into the exercise of state authority. To argue otherwise is to contend that a limited national power might properly be implemented in an unlimited manner vis-a-vis the states. Federal preemption is often necessary to secure the effective implementation of a national policy; but preemption should not extend beyond that which is necessary. To do so is to invade those powers reserved to the states by the Tenth Amendment.

A minimalist view of preemption is consistent with an expansive view of national power. That is, one can argue for both a broad construction of the constitutional powers of the national government and a narrow construction of national statutes as these affect the states. That the Supreme Court has historically taken a broad view of the powers that can be exercised by Congress under the Constitution is no obstacle to the adoption of a narrow view of preemption under constitutional statutes. The constitutional issue addresses the policy domain within which Congress is free to act; the statutory issue of preemption is concerned with the implementa-

tion of national policy and what is necessary to reach the end that Congress seeks. A broad construction of the powers of Congress under the Constitution may allow Congress to do what is "necessary and proper" to seek some policy objective; but the Tenth Amendment makes clear that no act of Congress ought to be construed as preempting more state authority than necessary to accomplish a national objective.

The Supreme Court, however, has often confused the constitutional and statutory issues. A judicial conclusion that Congress has "occupied the field" with respect to some policy area may have the effect of completely displacing relevant state law whether preemption is necessary to the attainment of a national policy objective or not. Simply because Congress has decided to legislate in some policy areas does not necessarily mean that all related state policy is inconsistent and ought to be swept aside. The judicial doctrine that Congress implicitly preempts state law solely by virtue of "occupying the field" is inconsistent with the design and proper functioning of a federal system.

In order for a court to conclude properly that Congress has in fact "occupied the field," one of two conditions ought to be met: (1) the test of necessity leads to the same result, i.e., any state legislation in the field conflicts with or undermines national policy; and (2) Congress has explicitly declared an intent to "occupy the field" in order deliberately to exclude state regulation. The latter is appropriate, for example, where Congress seeks to establish deregulation of some portion of interstate commerce as a national policy. In any other case, a conclusion that Congress has "occupied the field" expands the scope of congressional action beyond that which is necessary to the attainment of national policy.

The negative effects of an overextended doctrine of preemption include a dampening of state policy initiative and resultant loss of policy experimentation and diversity. Promising state initiatives can be eliminated and replaced by a stultifying national uniformity at the point when the entire nation has much to learn from individual state policy experimentation. Even more seriously, however, state and local policymakers may be forced to stand on the sidelines as Congress "occupies a field" without having taken full and appropriate action within it. The states are then left powerless to respond to problems even in a way that is complementary to national policy.

Preemption is properly a legislative decision, within appropriate constitutional constraints, and ought not to be exercised by administrative or judicial officers without prior legislative authorization and direction.

A decision to preempt state law, where necessary, is clearly legislative in nature, delegated to Congress by the Constitution. A decision that displaces state law can be no less than an act of lawmaking, and one that is extraordinarily sensitive in a federal system. Although Congress

cannot possibly anticipate all instances of statutory application where preemption may be necessary, and therefore necessarily must leave some detailed determinations to administrative and/or judicial officers, the decision to preempt as deemed necessary is one that ought to be made explicitly by Congress. Only if this decision is clearly lodged with the Congress do the states have an adequate opportunity to influence the decision through the political process. As recognized by the Court in the *Garcia* decision, the national political process is an important avenue by which political constraints inherent in the federal system are maintained. Yet the political process is unavailable to the states with respect to preemption unless Congress explicitly addresses the issue.

Both federal administrative agencies and the federal courts nevertheless routinely make preemption decisions without explicit congressional authorization. Administrative agencies do so by virtue of regulatory authority granted by Congress. The courts frequently find preemption in statutes and regulations where it is not explicitly authorized, as well as infer preemption directly from the Commerce Clause of the Constitution with no statutory basis available. These actions are inconsistent with the legislative nature of the preemption decision and therefore appear to violate the Court's doctrine of nondelegation—the rule, derived from the constitutional separation of powers, that Congress may not delegate its legislative authority.

It is important that Congress not only authorize preemption before it can occur at the behest of administrative agencies or the courts, but also that Congress supply direction as to how the preemption decision is to be made. Without direction from Congress, including limits on the scope of preemption permissible under the law, administrative agencies and the courts are placed in the position of legislators. Statutory direction can take the form of both general and specific criteria and standards to be applied to determine when preemption ought to occur. In order to maintain a rule of law, congressional statutes must establish standards by which administrative agencies act, and courts must review administrative agencies in view of statutory criteria. In this manner, the states and their citizens have an opportunity both to affect the legislative determination on preemption and to enforce the legislative decision in the courts. A more orderly and predictable—and less arbitrary—process would result.

The Administrative Conference of the United States, an advisory body to federal agencies on policies and procedures, has embraced the concept of the desirability of express intent to preempt. It recently called for Congress to "address foreseeable preemption issues clearly and explicitly when it enacts a statute affecting regulation or deregulation of an area . . ." and further calling on each agency to ". . . clearly and explicitly address preemption issues in the course of regulatory decision making."

Recommendations

Recommendation 1:

Expression of Legislative Intent

The Commission recommends that the Congress stipulate by law that no act of Congress shall be construed or interpreted as preempting related state and local authority unless the language of the statute explicitly expresses the intent of Congress to do so, and then only to the extent that state authority directly conflicts with the exercise of federal authority under the federal statute in question.

Recommendation 2:

Legislative Authorization of Administrative Preemption

(a) The Commission recommends that the Congress stipulate by law that no act of Congress authorizing the promulgation of rules and regulations by an administrative agency shall be construed or interpreted as authorizing the preemption of state and local authority unless the language of the statute in authorizing such rules and regulations explicitly authorizes preemption by administrative regulation.

(b) The Commission recommends further that the Congress amend the Administrative Procedures Act in order to: (1) establish general criteria for the preemption of state and local authority by administrative regulation and (2) to direct that all such regulatory preemption of state and local authority be restricted to the minimum level necessary to achieve the objectives of the statute for which the rules and regulations are promulgated.

(c) The Commission also recommends that any time the Congress authorizes the preemption of state and local authority by an administrative agency it enumerate specific criteria and standards in accordance with which the agency is directed to exercise its preemption authority.

(d) The Commission recommends, in conclusion, that the Congress also amend the Administrative Procedures Act to require that no rules or regulations promulgated by an administrative agency of the U.S. Government be construed or interpreted to preempt state and local authority unless the regulation explicitly expresses an intent to preempt.

Recommendation 3:

Judicial Review of Preemption

The Commission recommends that judicial review of preemption be conducted in such a manner as:

(a) to require as a matter of constitutional law that both Congress and administrative agencies must have

explicitly declared an intention to preempt state and local authority before the courts will construe as preemptive any act of the U.S. Government or rules and regulations promulgated under such an act;

(b) to require that the Congress, on the basis of the nondelegation doctrine, must have supplied statutory criteria to govern preemption of state and local authority by administrative action before the courts will judge such action constitutional; and (c) to scrutinize all acts of federal preemption, whether by statute or by administrative action, in order to determine that the extent of the preemption of state and local authority is no greater than necessary to give effect to the operation of the relevant statute enacted pursuant to the Constitution.

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