

JUNE 1955

*Local
Government*

SUBMITTED TO THE
COMMISSION ON INTERGOVERNMENTAL RELATIONS

AN ADVISORY COMMITTEE REPORT ON

*Local
Government*



**SUBMITTED TO THE
COMMISSION ON INTERGOVERNMENTAL RELATIONS
BY THE
ADVISORY COMMITTEE ON LOCAL GOVERNMENT**

JUNE 1955

COMMISSION ON INTERGOVERNMENTAL RELATIONS

THE ADVISORY COMMITTEE ON LOCAL GOVERNMENT

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LETTER OF TRANSMITTAL

COMMISSION ON INTERGOVERNMENTAL RELATIONS,
WASHINGTON, D. C., *June 20, 1955.*

DEAR MR. PRESIDENT:

The Commission on Intergovernmental Relations has submitted its report to you separately.

In carrying out its work, the Commission established a number of study and advisory committees to develop suggestions about specific programs. One of these was its Advisory Committee on Local Government.

These committees were made up of public spirited citizens selected with the idea of obtaining the benefit of varied experience and differing views on the subjects examined. The Commission is indebted to the committees for their willingness to undertake their difficult assignments within the limited time available to them.

The Commission has carefully considered the reports of the study and advisory committees, and has obtained valuable assistance from them. It has also had the benefit of recommendations and information from organizations interested in the respective programs, and from a wide variety of other sources.

The Commission, however, arrived at its own findings and recommendations which are confined to those appearing in its own report. The Commission's views do not in every case coincide with those of its study and advisory committees, although the committee reports contain much valuable information and many detailed recommendations that deserve careful consideration.

Recognizing the great interest in the subjects of its inquiries, the Commission has brought together material ancillary to its own report. The report of the Advisory Committee on Local Government, submitted herewith, is part of this material.

Respectfully,



MEYER KESTNBAUM,
Chairman.

THE PRESIDENT,
THE WHITE HOUSE.

LETTER OF SUBMISSION

COMMISSION ON INTERGOVERNMENTAL RELATIONS,
WASHINGTON, D. C., *September 25, 1954.*

The Honorable MEYER KESTNBAUM,
Chairman, Commission on Intergovernmental Relations.

DEAR MR. KESTNBAUM :

Several months ago you appointed an Advisory Committee on Local Government and charged it with certain responsibilities. A comprehensive report has been prepared and is submitted to you herewith.

The Advisory Committee was exceptional in many respects. Nearly every member attended every meeting. The entire membership of the Committee read every word of both the preliminary draft and the final draft of the report. The decisions of the Committee, with the exception of a single instance, were unanimous.

May I direct your attention to the fact that the official positions of some of the members of the Committee may have changed since their appointment. Nevertheless, they were still competent to consider the relations between the national and local governments and to give us their advice on this subject. The members of the Advisory Committee deserve our commendation for the thoroughness of their consideration and their willingness to study the report of the group so thoroughly before its submission to you.

Respectfully yours,

SAM H. JONES,
Chairman,
Advisory Committee on Local Government

CONTENTS

	Page
Advisory Committee Membership.....	ii
Letter of Transmittal.....	iii
Letter of Submission.....	v
Chapter 1. Summary of Recommendations and Conclusions.....	1
Recommendations.....	1
Major Conclusions.....	6
2. The Role of Local Government.....	9
3. Relation of Federal and Local Activities.....	15
The Pattern of Governmental Activity.....	17
Overlapping Activities.....	19
Opinions on Federal-Local Relations.....	20
Proposed Structural Changes.....	23
4. Intergovernmental Relations and Metropolitan Areas.....	24
5. The Role of the States in Federal-Local Relations.....	27
Decentralization Goes Two Ways.....	29
Dealing Directly or Through the States.....	29
What the States Can Do.....	30
Conclusion.....	32
6. Grants-in-Aid.....	33
Purposes and Origin.....	34
Fiscal Importance.....	37
General Opinions on Grants.....	37
Major Problems.....	38
Alternatives to Grants-in-Aid.....	41
Recommendations on Specific Grant-in-Aid Programs.....	41
7. Intergovernmental Revenue Problems.....	45
Exemptions and Immunities From Taxes.....	48
Other Considerations.....	50
Conclusions and Recommendations.....	52
8. Debt and Borrowing.....	54
9. Some Observations.....	58
Appendix—Federal Services to Local Governments.....	60

Chapter 1

SUMMARY OF RECOMMENDATIONS AND CONCLUSIONS

Recommendations

1. In any proposal for changing Federal-State grants, the ultimate effects upon State-local relationships and the continuance of State grants to localities should be considered. It seems apparent from all available data and from the political questions involved that the State grants to localities for a variety of purposes would be drastically altered by changes in Federal-State fiscal relations.

2. One of the guiding principles to be followed is that, if decentralization of government is an objective to be attained, it is by no means won when decentralized to the States, but only when as many powers and financial resources as possible are returned to the local governments where every citizen has a chance to exercise his will directly.

3. From the standpoint of ultimate results, this Committee would advise that there be studied carefully the extent to, and the means by, which Federal programs adopted in the national interest by Congress are subject to partial nullification by State action or inaction. The States can nullify or modify some programs by failure to provide matching funds, by refusing to pass the necessary enabling legislation, or by administrative inaction. A necessary national program should not be set up in such a manner that State indifference or inaction can defeat it.

4. In general the larger metropolitan governments (cities, counties, and special districts) do not like the prospect of being excluded from direct dealing with the National Government. They fear that decentralization from the National Government to the States will be at the expense of the urban areas. However, consideration of these changing relations should not be thought of in a combative or antagonistic manner. Rather an effort should be made to reconcile differences and find a solution.

5. Attention should be focused upon grants for broader purposes, e. g., for general welfare or health purposes instead of particular categories or diseases. This fundamental shift in the basis of some Federal grants would serve three major purposes:

a. Less distortion of public services would result because it would no longer be necessary to divert funds from a balanced program of services to match grants for limited purposes or to meet inflexible Federal standards.

b. Local governing bodies would be in a stronger position to harmonize the demands of functional pressure groups with the overall interests of the communities which they represent.

c. The number of Federal administrative employees would be reduced. However, the perfection of a Federal formula for general purposes or for block grants to the States may be frustrated in considerable part were the present secondary distribution systems within States to continue without modification.

6. Consideration should be given to improvements in the administration of Federal grants:

a. If Federal regional or district offices, and the State offices underneath them, could be given greater discretion, national programs could be better adjusted to local conditions. Inability by such offices to make discretionary decisions limits their usefulness and causes much of the State and local criticism of Federal programs. Federal rules are established to obtain national uniformity. Complete uniformity is not necessary to accomplish the purposes of the Federal grants. It would appear better to permit variations within the general objective in order to stimulate experimentation and competition.

b. To the extent that Federal grants-in-aid are channeled through the States, the latter should take the lead in working out a system so that local governments may know earlier and more certainly, for budget purposes, the amount of Federal and State funds they will receive during the year.

c. Wherever feasible, Federal grant-in-aid programs should be designed so that payments will be made through the regular budgets of the recipient governments, rather than directly to a functional department or agency. This will permit more effective budgetary control by the chief executive and his staff, and review by the governing body. This single change in some of the aid programs would strengthen the administration of these programs, put an end to much splintering of administrative loyalties and diffusion of administrative responsibilities, and reduce the distortion caused by the necessity of matching appropriations which are partially the result of functional autocracies.

d. In the implementation of several of the national housing programs, the appropriate Federal housing agencies should be encouraged to give more consideration to the policies and programs of the local governments where the housing is, or is to be, located. Federal aid should not be used to override local planning and zoning regulations. Similarly, in the disposal of surplus housing by Federal agencies,

local governments should be consulted and given first choice if the property is needed for local governmental purposes.

7. Recommendations on specific grant-in-aid programs:

a. Airport Construction and Operation.—Continue Federal aid to airports which are part of a national system of airports, or are necessary to national security. The National Government must also continue to regulate air traffic by financing control towers and control devices.

b. Civil Defense.—Since civil defense is part of national defense, Federal aid should continue for property, equipment, operations, and administration which are required for civil defense.

c. Federally Impacted Areas.—Until provision is made for payments-in-lieu of taxes on Federal property, the National Government should assume the special burdens placed on local governments by unusual Federal activity in any geographic area.

d. Health Grants.—Public health grants should be combined into a single general health grant.

e. Hospital Construction.—The Hill-Burton program should continue.

f. Public Housing.—Capital grants only should be made in the future so that the National Government can accomplish its purpose and leave administration and supervision to local agencies.

g. Public Education.—The recommendation is left to other Commission study groups. However, the National Government should assume its responsibility in federally impacted areas either by grants-in-aid or payments-in-lieu of taxes.

h. Highways.—Federal aid should be continued for a national system of highways. Local and State officials should be given greater discretionary powers. Areas inside and outside cities should be treated alike.

i. Vocational Education and Vocational Rehabilitation.—Return them to the States for financing and administration except where they apply to veterans.

j. Public Welfare Assistance.—Local welfare boards should have greater discretion regarding eligibility for, and standards of assistance. Local governments should have some financial responsibility for relief in order that they may have a stake in economical management. Categorical aids and general assistance should be replaced by a general welfare grant.

k. Disaster Aid.—The National Government should be prepared to help in case of natural disasters with which the State and local governments cannot cope.

8. From the standpoint of cities and urban counties, any study of intergovernmental relations would not be complete if it did not include recommendations as to Federal responsibility, vis-a-vis the

States, in preparing for serious recessions or depressions. This Committee advises at least three steps:

a. The National Government should be prepared to purchase legally authorized and economically sound issues of local government bonds which cannot be sold immediately in the public market at reasonable rates. This procedure would lessen the pressure for direct Federal financing of local public works and, when properly administered, would result eventually in no ultimate cost to the National Government.

b. To the extent that the National Government considers it desirable to have local governments speed up local construction projects as an antidote to unemployment, the National Government should encourage the advance planning of local public works through repayable advances in order that a shelf of public works be available.

c. The National Government, in cooperation with State and local officials, should immediately develop a policy for taking care of general assistance if and when widespread unemployment ever again becomes an issue. If this is not done then the National Government, and the States as well, will again be faced without plans to meet a great human catastrophe.

9. The Ways and Means Committee of the House of Representatives might appropriately give the State and local governments a chance to be heard on matters which affect State and local revenues either directly or indirectly. This has already been done in some cases. The practice could be extended and formalized.

10. The Congress of the United States—and not a department or agency of the National Government—should control the exemption from taxation of property. The components of the Department of Defense should not be permitted, by forms of contract or other devices, to extend the nature and range of tax exemptions as they have in recent years. Payments-in-lieu of general property taxes on federally owned property should be made to many local governments on many classes of property. The purpose is to eliminate discriminatory burdens on some localities and to increase local revenues to those units which have been unjustly deprived of them. All agencies of the National Government need to know what property they own in order that proper payments may be made to the local governments where the property is located. In federally impacted areas, payments-in-lieu of taxes would reduce the necessity for Federal grants.

11. The National Government should, without further equivocation or delay, pay special assessments for local improvements benefiting Federal properties on the same basis as private property owners.

12. The National Government should stay away from the general retail sales tax, or its equivalent, which States use so widely, because, if the National Government were to impair State revenues from the

general sales tax, the States would have to curtail their payments to local governments.

13. The admissions and amusement taxes can be administered by local governments as effectively as they can by either the National or State Governments. Furthermore, since the local costs of servicing places of entertainment and amusement are high, the National Government is urged either to abandon the tax on admissions or to allow credit for local admissions taxes against the Federal levy.

14. The interest on local government bonds should in no event be subject to Federal income taxes. This exemption and the resultant lower rates of interest permit local governments to do many things for themselves that would otherwise have to be financed by either the States or the National Government.

15. The National and State Governments should seek more effective coordination of such of their programs as are conducted at the county level by encouraging county governments to have an office responsible to the elective head or chief executive of each county, such office to provide information and guidance to citizens having business with the Federal, State, and county agencies; to facilitate cooperation and coordination among agencies carrying out related programs; and to assist in planning programs with a view of adapting them as far as possible to the peculiar needs and conditions of the county.

16. If the county is to continue as the agent for carrying out Federal programs at the local level, the State governments as the sponsors and protectors of their local subdivisions should take steps to simplify and streamline county and other local government, or at least to permit and encourage the counties to strengthen their own administrative structures.

17. It is to be hoped that the Commission on Intergovernmental Relations, in its final report, will recommend the necessity for strengthening within the National Government the machinery and the appropriations, for various types of technical service, assistance and advice of great value to the local governments, as well as to the States; especially the work of the Governments Division of the Bureau of the Census.

18. Since no final solution, good for all times, can be found to all the issues involved in the relations between governments, this Committee favors the establishment of a continuing Commission on Intergovernmental Relations with duties generally comparable to those set forth in Public Law 109. Periodic or continuous studies are needed to search out and compromise the points of conflict between the National Government on the one hand, the States and their local governments on the other.

19. Local governments should be permitted to deal directly with appropriate Federal agencies on Federal programs although they are

generally satisfied with present arrangements for administration of the Federal Aid Highway Act and old age and survivors' insurance.

Major Conclusions

1. The Committee recognizes that intergovernmental fiscal relations in a Federal system have never been, nor can remain, static. A neat allocation of functions to be performed exclusively by each level, a complete separation of revenue sources by levels of government, and a dedication of particular revenue sources to the financing of particular governmental activities—these are no longer workable approaches, even though logically appealing. In their stead must be adopted a new theory of parallel interest, a parallelism in both revenue sources used and in functions performed. Some governmental activities, once local, are now tinged with a strong State and Federal interest; and some revenue sources, or the proceeds therefrom, which were once the property of only one level have now become common property. This more flexible approach permits collection of revenues by those governments better able to collect certain revenues, and transmission of portions of the receipts to governments better able to carry out the governmental activities, but with changing concepts of which governments are "better able" in both areas.

2a. The strategic role of the States in Federal-local relations appears throughout this discussion of intergovernmental relations, particularly with reference to grants-in-aid and the needs of metropolitan governments. The States' part in Federal-local relations has been stressed because the States can implement or refuse to implement those matters affecting local governments which Congress has decided are in the national interest. The policies of the States also determine the extent to which local governments are impelled to seek financial aid from the National Government.

b. A strictly legalistic view of intergovernmental fiscal relations cannot be taken because (1) court decisions change with the times; (2) questions must be considered on their practical merits; and (3) there is little in the Federal Constitution to govern the fiscal relations between the National, State, and local governments.

3. There is little duplication between activities performed by the National Government and by the local governments; in a few categories they both render similar services, but only occasional Federal-local conflicts are found in local functions. With changing economic and social conditions there is a growing State and National interest in some local activities. Here State and Federal grants-in-aid have become important. Direct Federal grants to local governments constitute only one part of Federal aid to localities. The Federal grants

to States when analyzed, reveal that some of this money also is passed on to local governments and in many jurisdictions is supplemented by State grants. Local public officials are concerned lest reduction of Federal grants to States adversely affect State grants to their localities, and that in any readjustment of this secondary distribution urban governments would fare worse than rural governments.

4. Overlapping or duplications of revenue sources between the National Government and the local governments have not reached serious proportions, being concentrated in the excise and income tax fields. And even here the overlapping is not serious. But the intrusion of the National Government into the general sales tax field would indirectly, but very substantially, damage local revenues by impairing the States' ability to continue their present payments to local governments. The overriding consideration in Federal-local tax relations is that local revenue sources are difficult to expand because of the sheer weight of Federal taxation.

5. Although some Federal-aid programs, in their administrative aspects, cause no serious hardships to local governments, in others the story is different. Several types of difficulties arise:

a. In some Federal agencies, despite the existence of regional, district and/or State offices, it is impossible for responsible local officials to get clean-cut decisions without going to Washington. Frequently, the local officials must deal with Federal officials at each level, with resultant duplication of effort, serious delays, and even conflicting advice and rulings.

b. Vertical functional autocracies, composed of functional specialists at two or more governmental levels, have had, in some cases, an injurious influence on Federal-aid programs. Appropriations directly to functional departments have been encouraged or dictated with the result that general administrative and budgetary controls have been bypassed; and strings and conditions have been attached, the meeting of which distort local budgets and divert monies which, taking an overall view of community needs, should be spent elsewhere.

c. So-called stimulating grants turn out, at times, to be not aids but real burdens, pushing the local governments, under functional prodding, into areas which have not been recognized as local functions and are not ready for local government support.

6. There are no basic inconsistencies between cities and counties asking for State or Federal grants-in-aid (or shares in State or federally collected taxes) on the one hand, and on the other, seeking wider home rule powers for themselves. For some of the more lucrative revenue sources, the States and the National Government, because of their wider geographical areas and constitutional powers, are better revenue collectors than even the large cities or counties. On the other hand, the local governments are in many instances the best governments for

direct administration of programs affecting the daily lives of people. They are at "home base" where the local differences, nonuniformities, and special needs can best be weighed and understood. The power to collect is but one task in a division of labor. It should not give the collector the right to tie strings and dominate the other partners in the business of government. The receipt of grants and shares from the States and the National Government enables the local governments to preserve home rule and continue to perform functions which otherwise they would have to give up and turn over to other levels with greater revenue-collecting powers.

7. In periods of long-sustained prosperity there seems to be a tendency to ignore the advance planning and preparation for emergency changes in intergovernmental fiscal relations which may be required during times of serious and sustained economic depressions. No clear Federal-State-local plan for handling widespread unemployment relief now exists. Unless some plan is formulated, the States and local governments will be forced to turn to the Federal Government for immediate aid and the intensity of Federal-State-local relations will return again as it did from 1932-37. For the sake of humanity and democracy, some plan is imperative.

Chapter 2

THE ROLE OF LOCAL GOVERNMENT

The Advisory Committee on Local Government devotes this report primarily to Federal grants-in-aid and Federal activities as they affect local governments, the relation of Federal to local revenues, and the connection between Federal decisions and local debts. The Committee was established by the Commission to implement the objectives laid down by Congress in the act to establish a Commission on Intergovernmental Relations (Public Law 109, 83d Cong.) :

(1) “* * * it is necessary to study the proper role of the Federal Government in relation to the States *and their political subdivisions*,¹ with respect to such fields [which, under our constitutional system, may be the primary interest and obligation of the several States and the subdivisions thereof], to the end that these relations may be clearly defined and the functions concerned may be allocated to their proper jurisdiction * * *” (sec. 1).

(2) “The Commission shall study and investigate all of the present activities in which Federal aid is extended to State *and local governments*,¹ the interrelationships of the financing of this aid, and the sources of the financing of governmental programs * * *” (sec. 3b).

In addition to direct Federal impacts the Committee found that some attention must be given to Federal-State and State-local relations because both have a great effect on Federal-local relations.

A study of intergovernmental relations without adequate attention to local government would be as invalid as a physical examination by a doctor who examined only the exterior of the body and the limbs and assumed that the tissues and the muscles had no bearing on the body as a whole. Local governments are to total government what basic tissues are to the human body. Without them, government would have no vitality. The counties, cities, towns, villages, and boroughs serve as training schools for the leaders of government, and in the affairs of local government are tried those who aspire to State and National office. More important still is the use of local government to soften the impact of arbitrary State and National laws and regulations and to modify them to fit a population quite diverse in its cultural, economic, geographic, and political elements.

Many other committees have been established by the Commission. This report, however, may differ from the others because its primary

¹ Italics supplied.

purpose is to bring together the opinions of the Committee members with respect to certain relations between the National and local governments, based on the practical experience and observation of its members, rather than upon an intensive, detached study. In formulating these opinions, it was necessary to consider also the place of State governments in the scheme of Federal-local relations because the action or inaction of the States has a great bearing upon whether local governments actually derive any benefits or services from a Federal-aid program.

Despite the variety of local governments in the United States, the Committee has attempted to consider local governments "in general." Admittedly because of the marked differences between local governments in various States, generalizations must frequently be qualified when applied to a particular State or one of its local governments. Different connotations of the term "local government," and differing opinions about local government, are well illustrated by the poem, "The Blind Men and the Elephant": Six blind men went to see an elephant. The first man, feeling its side, thought it was a wall; the second, feeling its tusk, declared the elephant was like a spear; while the third, happening to take the trunk, declared it was a snake. The fourth blind man, as he grasped the knee, was certain he held a tree; the fifth, touching only the ear, thought the elephant resembled a fan; and the sixth, holding the tail, decided the animal was very like a rope.

"And so these men of Indostan disputed loud and long,
Each in his opinion exceeding stiff and strong,
Though each was partly in the right,
And all were in the wrong."²

This also illustrates the necessity of seeing government as a whole and not examining only the National, only the State, or only the local point of view.

At particular points in the report special stress has been placed upon metropolitan cities and counties where some 56 percent of the population of the United States is concentrated. This emphasis is warranted because these areas have the most frequent contacts with the National Government and the greatest stakes in any changes in Federal-State and Federal-local relations. The interests of cities and of urban counties must, in general, be considered parallel and without basic conflicts. In only one or two places in the report (or in the Committee discussions) has it been necessary to differentiate between these two types of local government. On the other hand, the report has had to recognize that in some States the urban areas have been partially disenfranchised and suffer at the hands of unfriendly legis-

² John G. Saxe, "The Blind Men and the Elephant," in *A Treasury of the Familiar*, Ralph L. Woods, ed., MacMillan, New York, 1945.

latures. In these jurisdictions the Committee finds the greatest concern over possible changes in the Federal-aid pattern.

At first, attention was concentrated upon direct Federal aid to local governments in accordance with Public Law 109, Eighty-third Congress. If one factor stands out more sharply than others, it is the need for a clearer understanding about so-called grants-in-aid. They need to be more clearly defined and their justification seen more sharply. Probably "State grants-in-aid" is more of a misnomer and "catchall" name for a large group of dissimilar payments than "Federal grants-in-aid." The so-called Federal grants were initiated by the National Government and justified by the courts under the general welfare clause of the Constitution. In a State, a charge previously collected by local governments for their own use, then later collected by the State for the local governments and returned to them, cannot be properly called a grant-in-aid. Neither can the money paid to a city to maintain a State highway within the city. Money spent to build or maintain a State highway *outside* a city is classified as a "State highway expenditure" but frequently money spent on the same road but *inside* the corporate limits is called a grant-in-aid. Since much of the talk about intergovernmental relations centers around grants-in-aid there ought to be a far clearer understanding of the limitations of the oft-quoted financial and other statistical data, important as they are.

Next the Committee found that attention could not be limited to direct Federal aids to local governments, because one fundamental characteristic of Federal-State relations is that many of them turn out to be Federal-State-local relations, that is, the final impact of the grant-in-aid is upon a county, city, town or other local government. Thus where the National Government gives money to the States for highways, health, social welfare programs, vocational education, and other purposes, the ultimate effects of the national programs must be studied at the local level, the real point of impact.

One of the major conclusions of this report, therefore, will have been implemented if, in its deliberations, the Commission on Intergovernmental Relations constantly looks behind every proposed change in Federal-State relations to see what "chain reaction" will be transmitted to local governments. If new burdens or new benefits are to be passed on to the States, the legitimate question is, "To what extent can the avowed objectives be blocked or materially altered by State action or inaction, or by adjustments in State-local relations?"

Since the Commission is directed by law to "* * * study and investigate * * * the sources of financing of governmental programs," the Committee has given its views on the extent of Federal-local tax conflicts and the extent to which State laws and procedures influence Federal-local revenue relationships.

The report includes a few summary tables. But it is well to remember that cold statistics do not always reveal the basic issues. The struggles for school and highway funds, for new sources of revenue, for greater shares in revenues collected by other governments, and the never-ending struggles within certain communities to solve their basic traffic and high-accident rate problems, crime, juvenile delinquency, blighted areas, and numbers of other critical problems are in essence basic struggles for progress, equity, human rights, and even the right not-to-be-killed-unnecessarily in a highly mechanized world. It matters not that the contests are clothed in more mundane terms such as taxes, functions, public administration, fire protection, and so forth.³ Even more confusing in understanding the basic struggles is the frequent concurrence of conflicting and sometimes even converging currents created by individuals, pressure groups, or organizations in quest of ambition, power, or authority.

To understand the relations between governments requires first a knowledge of the number and nature of such governments. While there are more than 100,000 units of local government in the United States—there were 116,694 of them in 1952—it must be noted that 67,346 of these were school districts. This leaves 49,348 other units made up of 3,049 counties; 16,778 municipalities; 17,202 towns and townships; and 12,319 special districts. The following table shows the number of governmental units in the United States in 1952 and an index of their relative fiscal importance.

TABLE 1.—*Number of Local Governments in United States* ^a

Type of local government	Number of units, 1952	Percent of 1952 local government totals		
		Number of units	Tax revenue	Expenditure
Counties.....	3, 049	2. 6	20. 3	19. 4
Municipalities.....	16, 778	14. 4	44. 2	41. 4
Townships.....	17, 202	14. 7	5. 7	4. 5
School districts.....	67, 346	57. 7	28. 0	26. 7
Special districts.....	12, 319	10. 6	1. 8	8. 1
Total.....	116, 694	100. 0	100. 0	100. 0

^aPrepared by the Governments Division, Bureau of the Census, for the Advisory Committee.

Tremendous differences exist between various parts of the country in the number, size, and responsibilities of local governments. In part, these differences arise because States deal in a variety of ways with particular governmental functions—in some instances themselves

³See H. F. Alderfer, *Battlegrounds of Local and State Government in Pennsylvania*, a talk given at LaFayette College, Easton, Pa., Dec. 2, 1953.

performing services which in other States are handled by local governments with or without State financial assistance. Another important reason for marked differences in the pattern and role of local governments is the wide variation in the extent of urbanization. Census figures show that the fraction of all State and local government employment accounted for by primarily urban-type services (water supply, fire protection, sanitation, and the like) ranges from about one-twelfth in some States up to around one-third in others.

There are important differences also in the relative importance of different types of local governments in various areas. The county is an extremely important unit except in New England where the county's role is quite limited but town or township governments have extensive responsibilities. In the Midwest, however, most townships have limited functions, and there are no such local governments at all in 26 States. Again, no independent school districts are to be found in five States which provide local school facilities and services entirely through other governments such as the counties, cities, or townships. Independent local school districts are to be found throughout 26 States and in some areas of 17 others.

Local government transactions are a significant segment of total governmental finance in the United States. At the turn of the century local government revenues and expenditures about equalled the combined State and national figures. The last 50 years have changed all that due primarily to the increased volume of State and National fiscal activity. The important role of local governments is shown, in part, by the following tables:

*Tax Revenues—1953*⁴

	<i>Millions</i>
National.....	\$62, 411
State.....	10, 542
Local (1952).....	9, 466
	<hr/>
Total.....	82, 419

But the expenditures of each level, due in part to grants-in-aid and in part to borrowing, were in quite different proportions:

*Governmental Expenditures—1952*⁵

	<i>Millions</i>
National.....	\$70, 568
State.....	10, 790
Local.....	20, 093
	<hr/>
Total.....	101, 451

⁴ *Overlapping Taxes in the United States*, prepared for the Commission on Intergovernmental Relations by the Analysis Staff, Tax Division, U. S. Treasury Department, January 1, 1954.

⁵ *Summary of Government Finance in 1952*, Governments Division, Bureau of the Census, November 1953.

Capital outlays have an important part in the gross national product. Here the local governments in 1952 played a more important role than the states:

Capital Outlays—1952⁵

	<i>Millions</i>
National.....	\$17, 437
State.....	2, 658
Local.....	4, 778
	<hr/>
Total.....	24, 873

With respect to numbers of employees and payroll payments, the local governments are even more significant because they have as many civilian employees as the state and national governments combined and their payroll payments are slightly less than half of the combined total.

Employment and Payrolls, January 1954⁶

	<i>Number of employees</i>	<i>Monthly payroll (Millions)</i>
Federal civilian.....	2, 360, 000	\$762. 8
State—including schools.....	1, 133, 000	292. 8
(Schools—state).....	(346, 000)	(82. 2)
All local—including schools.....	3, 519, 000	933. 6
(Schools—local).....	(1, 635, 000)	(475. 0)
	<hr/>	<hr/>
Total.....	7, 012, 000	1, 988. 2

The data indicate that no consideration of governmental affairs is complete without serious attention to local governments.

No final solution can be found to the issues involved in the relations between governments. But this is neither a tragedy nor an excuse for inaction. Society is not static. The functions, activities, and revenue sources of government are always undergoing a change or a shift in emphasis. The views of this Committee, therefore, have been expressed insofar as they pertain to the need for adjustments at the present time and in the foreseeable future. The *Summary of Recommendations and Conclusions* in this report stresses the need for periodic or continuing studies which will search out and compromise the points of conflict among the component parts of the Federal system.

⁵ *Summary of Government Finance in 1952*, Government Division, Bureau of the Census, November 1953.

⁶ *Public Employment in January, 1954*, Governments Division, Bureau of the Census, April 1954.

Chapter 3

RELATION OF FEDERAL AND LOCAL ACTIVITIES

Federal-local contacts are numerous in many areas of governmental activity due primarily to the National Government's interest. A listing of these activities runs a wide gamut:

1. Street and highway construction.
2. Flood control and prevention.
3. Improvement of rivers, harbors, and waterways.
4. Water-pollution control.
5. Control of communicable diseases including tuberculosis and venereal.
6. Services to crippled children.
7. Health centers and clinics.
8. Disaster relief.
9. Civil defense.
10. Housing, slum clearance, and urban redevelopment.
11. School-lunch program.
12. Special problems of federally impacted areas.
13. Airports and air terminals.
14. Distribution of electricity.
15. Old age and survivors' insurance for local government employees.
16. Hospital planning and construction.
17. Suppression of crime.
18. General welfare assistance.
19. Categorical assistance under the Social Security Act.
20. Vocational education.
21. Vocational rehabilitation.
22. Agricultural extension services.
23. Soil conservation.

The National Government uses three different devices to assist in the financing of these activities.

1. *Direct grants to local governments, with the local governments carrying out the activity.*—Disaster relief, slum clearance and urban redevelopment, and aids to local airports and air terminals would be illustrative.

2. *Performance of an activity directly by the National Government in such a way that it constitutes an indirect aid to the local government.*—Sometimes the work is done in consultation with local government. As illustrations, flood control and prevention, and improvement of rivers, harbors, and waterways are perhaps the best known.

3. *Federal assistance which although classified as Federal grants to States is ultimately channeled, in whole or in part, by the States*

to the local governments and is spent at the local level.—Good examples are hospital planning and construction, health centers and clinics, and the school-lunch program.

Despite the terminology used—whether “direct Federal grants to local governments,” “Federal aid to States,” or “direct Federal expenditures” to implement a national program—the end result, that is, Federal financing of the activity may be substantially the same.

Any attempt to approach this whole area of Federal-local relations statistically meets with real obstacles. Direct Federal expenditures within local areas are, of course, not reported as aids. The term “Federal grants-in-aid” has not been so interpreted. Federal grants to States and to local units of government are generally reported together. In many categories it is difficult to separate the two with any degree of accuracy. The best that can be done is exhibited in table 2.

TABLE 2.—Major Programs of Federal Grants to State and Local Governments

[Federal Payments for Year Ending June 30, 1953 ^a]

Primarily for local governments:	
Low-rent public housing.....	\$20,464,005
Slum clearance and urban redevelopment.....	7,817,758
Airports.....	26,990,836
Urban highway funds.....	106,174,952
School-lunch program.....	81,665,047
School construction—Federally impacted areas.....	118,308,139
School operation—Federally impacted areas.....	65,994,669
Donations of surplus agricultural commodities.....	66,024,948
Defense communities facilities and services.....	2,433,638
Total	495,873,992
Combined State and local programs:	
Public health.....	33,291,736
Hospital construction.....	109,302,421
Civil defense.....	13,863,140
Natural disaster relief.....	4,656,731
Vocational education.....	25,420,754
Vocational rehabilitation.....	22,244,093
Agricultural extension.....	31,915,396
Water pollution studies.....	1,113,416
Highway construction—exclusive of urban.....	^b 409,269,588
Total	651,077,275

^a Annual Report of the Secretary of the Treasury on the State of the Finances, 1953, page 576, et seq.

^b The U. S. Treasury report for fiscal year 1953 shows total highway payments of \$515,444,540. The “urban highway” figure of \$106,174,952 for this period came from the Bureau of Public Roads. The difference has been listed as “Highway construction—exclusive of urban.”

TABLE 2.—Major Programs of Federal Grants to State and Local Governments—Continued

State programs (minor local participation, if any) :	
Employment security administration-----	\$197, 779, 364
Agricultural research and marketing-----	13, 083, 507
Fish and wildlife restoration-----	12, 474, 131
Forestry cooperation-----	10, 275, 566
Support of land-grant colleges-----	5, 030, 000
Homes for disabled soldiers and sailors-----	3, 722, 190
Supervision of on-the-job training for veterans-----	1, 890, 574
Total -----	244, 255, 332
<hr/>	
Federal welfare programs—State and locally administered :	
Public assistance—categorical relief-----	1, 329, 933, 470
Child welfare-----	6, 388, 437
Crippled children's services-----	11, 814, 776
Maternal and child health services-----	13, 299, 919
Total -----	1, 361, 436, 602
<hr/>	
Grand total-----	2, 752, 643, 201

^c The total includes \$2,743,483,383 payments for fiscal year 1953 and payments for four smaller programs—water pollution studies, defense community facilities and services, homes for disabled soldiers and sailors, and supervisors of on-the-job training for veterans totaling \$9,159,818. Shared taxes are omitted.

Table 2 contains abundant evidence that many Federal-State activities have a great bearing on local governments. What in theory is a Federal-State relationship, and classified statistically as a Federal-State grant, often turns out to be an indirect aid to local government. The figures indicate too that half of the money from Federal grants is paid out for social-welfare programs which had their origin in Federal laws.

The Pattern of Governmental Activity

The whole pattern of Federal-State-local governmental activity is closely intermingled. The problem is more than one of statistical reporting. Only a relatively few categories of governmental activities in the United States are wholly performed and entirely financed by a single level of government. This results in part from the inherent nature of federalism, in part from the growing economic interdependence of all geographic areas in this country, and in part from a convenient division of labor between levels of government. A partial list of governmental activities has been made and is part of this report:

THE PATTERN OF GOVERNMENTAL ACTIVITY ⁷

A. *Federal Activities—Federally Financed and Administered:*

1. National defense except the National Guard and some parts of civil defense.
2. Conduct of foreign relations.
3. Insurance—bank deposits, life insurance for members of armed services.
4. Aids to navigation such as the Coast Guard, lighthouses, astronomical observations, hydrographic surveys, navigational information, shipping regulations, use of navigable streams.
5. Weather information and time observation.
6. Coinage and regulation of money.
7. Granting copyrights, patents and trademarks.
8. Regulation of commodity exchanges.
9. Control of foreign trade.
10. Subsidization of agricultural commodities.
11. Establishing standards for biological products.
12. Old age and survivors' insurance.
13. Guarantee and purchase of mortgages.
14. The postal service.

B. *State Activities—State Financed and State Administered:*

1. Incorporation, inspection and control of the insurance business.
2. Administration of workmen's compensation insurance.
3. Industrial hygiene.
4. Training schools for the deaf, dumb, and blind.
5. Unemployment compensation insurance.
6. Licensing certain professions such as dentistry, medicine, pharmacy, law, engineering, and architecture.
7. Supervision of horse and dog racing.
8. Production of petroleum.
9. Public higher education.
10. Incorporation of businesses generally.

C. *Local Activities—Locally Financed and Locally Administered:*

1. Registration of voters and conduct of elections.
2. Fire fighting.
3. Protective inspections including building inspection, plumbing inspection, electrical inspection, gas inspection, boiler inspection, elevator inspection, and smoke inspection.
4. Construction and maintenance of local streets and highways except those that are part of the State highway system.
5. Sewers and sewage disposal (except a few State agencies).
6. Street cleaning.
7. Garbage and waste collection and disposal.
8. Health inspections including dairy farms and milk plants, food handlers, housing, local abattoirs, and water supply.
9. Publicly owned, public-service enterprises, including abattoirs, buslines, street railways, gas plants, water works, terminals, markets, cemeteries, and telephone systems.

⁷ Adapted from Carl H. Chatters and Marjorie Leonard, *An Inventory of Governmental Activities in the United States*, published by Municipal Finance Officers Association, Chicago, 1947.

D. *Activities in Which the Federal and State Governments Are Both Engaged:*

1. The regulation of business and industry including banking, sale of securities, railroads, trucks and busses, water carriers, air transportation, transmission and sale of electricity and gas, petroleum extraction, telephone and telegraph.
2. Standards of weights and measures.
3. Services to agriculture including agricultural research; dissemination of information; experimentation with crops, farms and animals; plant experimentation, disease control and quarantine; marketing statistics, reports, agreements; agricultural advisory services, and soil conservation.
4. Fish, shellfish, and wildlife conservation and restoration.
5. Petroleum—regulation of leases.
6. Enforcing food and drug laws.
7. Services to veterans including hospitals, homes, credit facilities, and reemployment.
8. Forestry and reforestation.

E. *Activities divided between Federal, State and Local Governments with each government paying directly its own costs:*

1. Police protection and law enforcement including
 - a. Police records and statistics including identification.
 - b. Detention and custody of prisoners.
 - c. Police communications.
 - d. Prevention and investigation of crimes.
 - e. Probation and parole of prisoners.
 - f. Control of prostitution, liquor, and narcotics.
 - g. Fish and game protection.
2. Maintenance of hospitals.
 - a. General hospitals.
3. General libraries.
4. Recreation facilities.
 - a. Forest parks and camps.
 - b. Monuments and historical sites.

F. *Overlap in Federal, State, Local Research, Planning, and Records:*

1. Police records and statistics.
2. Highway engineering and research.
3. Water conservation and utilization.
4. Pollution of lakes and streams.
5. Health—in many phases.
6. Educational research and statistics.

G. *Federal-Local Contacts in Activities Due Primarily to Federal Financial Interest in an Activity.*

(See the 23 activities listed in the opening paragraph of this chapter).

Overlapping Activities

Certain facts affecting local government stand out from the above listings:

1. In four important functional areas all levels of government operate with little if any sharing of costs and with each government pay-

ing its own costs. These are: Police protection and law enforcement, maintenance of hospitals, general libraries, and the provision of recreation facilities.

2. There is much done by all levels of government in research, planning, statistics, and records in several functions although this does not necessarily imply duplication or unnecessary work.

3. While the State governments spend their own money plus related Federal aid mainly for highways, health, social welfare programs, and education, there are only a few instances where the State alone both finances and carries out these functions directly by its own employees. Much of State expenditures is channeled through local political subdivisions—the local units functioning as spending and administrative agents of the State. The States themselves have a surprisingly small number of activity categories which are wholly financed and carried out by them. These include: The licensing of professions, public higher education, the supervision of horseracing, workmen's compensation insurance, unemployment compensation insurance, incorporation of businesses generally, and the supervision of the private insurance business.

4. Local governments consisting of counties, cities, towns, townships, boroughs, and special districts perform and finance alone many very important activities primarily related to the daily life of the individual citizen in the community where he lives. Such activities include the registration of voters and the conduct of elections, fire protection and fire fighting, protective inspections, construction and maintenance of local roads and streets, sewers and sewage disposal, street cleaning, garbage and waste collection and disposal, and many public service enterprises such as publicly owned gas, light and water plants, buslines and street railways.

Opinions on Federal-Local Relations

From the local government viewpoint there is little feeling or little evidence either that the Federal Government has taken over some services belonging to local governments, or that the Federal Government is duplicating the services of local government. When the question is put, "Can the performance or domination of local activities by the National Government be considered as a basis for Federal-local conflicts?" the answer based on the evidence must be "No." The predominant local activities are elections, police, fire, education, local public works, and local public utilities. There may be some questions on the fringe of educational activity such as vocational training, the school-lunch program, and federally impacted areas. No questions of conflict arise over elections, fire fighting, local public works, or local

public utilities. Some mutterings are heard about conflicts in police jurisdiction but the local police are still free from domination by State or Federal authorities. This contrasts sharply with the situation in other countries throughout the world. The activities which can be considered as strictly "local activities" are being narrowed in number and scope by the financial limitations on small areas, by the mobility of persons and things, and by speed and ease of communication. Local control of some activities must be kept to fortify the concept of a democratic government. These essentials are primarily elections, schools, local courts, and the police. Most other activities must be conceived on a broader geographic base.

The chief areas where some difficulties arise in Federal-local relations are:

1. The Federal domination of policy through strings attached to grants-in-aid. These strings are sometimes dictated or encouraged by "functional autocracies" made up of the functional specialists at two or more levels of government. Specialists have tended to build up proprietary and "professional" interests in their own functions with administrative loyalties running vertically rather than remaining with their own level of government. For example, county and State public or social welfare officials sometimes have stronger loyalties vertically than horizontally. This results in even a desire for "strings attached." Another result has been a new competition between functional interests, e. g., between welfare and highways, so that the struggle in the welfare field is not always between Federal, State, and local forces but sometimes between welfare groups and other interest groups at all levels. There is also a conflict between the generalists (staff people, such as budget and finance officers) and the functional specialists who are supported by their counterparts at all levels. The specialists and technicians with a functional interest want to be free from popular control and from the necessity of harmonizing their specialized interests with the overall interests of the communities they represent. Part of the antidote for this serious situation is to give grants for broader purposes and to require Federal and State grants to go through the State or local budgetary process of the receiving government.

2. The standards imposed by the Federal Government as a condition for receiving grants-in-aid. The examples and standards set by both the Federal and State Governments tend to greatly affect local matters pertaining to finance, personnel, and quantity and quality of many local services. One particularly sore point is salaries. Federal salary levels are higher than the prevailing rates for many positions in many geographic areas. This forces the salary costs of local government and private business upward and deprives them of ca-

pable employees in those sections of the country where salaries and living costs are relatively low.

Standards in categorical public assistance also present a problem. If local boards of public welfare were given wider latitude in determining who is eligible for public assistance and the amount each should receive, the cost of categorical aid could be lessened.

3. Dislocation or distortion of local services by diverting local funds to those activities for which Federal aid is conditionally available. The money diverted to federally aided services either to meet Federal standards or to obtain matching funds tends to distort local public services. This is particularly true in the case of health and welfare grants. A highly desirable remedy would be to make grants for broader purposes, e. g., for general health purposes instead of particular diseases.

4. Approval of some federally aided activities by some geographic areas of the country and disapproval or lack of interest by other areas. Some areas of the country are more interested than others in housing, slum clearance, and urban redevelopment. Rapidly growing industrial areas and federally impacted areas are most interested in these programs. Federally aided highways are most sought by the heavily populated areas which have little complaint about the program except that construction standards may bring unnecessary costs. Civil defense concerns the eastern, northern, and western cities more than the southern. But the impact of most federally aided programs is spotty with the most widespread geographic interest in health and welfare services, including general clinics, hospital construction, and categorical assistance.

5. Conflicts between Federal and local administrative officials over administrative decisions. Conflicts over administrative decisions are bound to appear in federally aided programs. The judgment of one person must frequently overrule that of another. When Federal assistance, for instance, is denied to an airport, the local authorities question the decision in that case. Sometimes a request of this kind is denied because funds are exhausted, because of ineligibility under the terms of the law, because of local financial and engineering deficiencies, or because of legal inadequacies. Delay in making decisions by Federal agencies in Washington or regional offices may sometimes aggravate the misunderstanding. In the Federal housing field, decisions as to location of public housing or new mortgage-insured multiple-family units, or as to disposal of surplus housing, have sometimes proved irritating to local government officials, especially when they have run contra to local planning or zoning regulations.

In general, however, the administrative conflicts, while frustrating in an individual situation, are of secondary importance in the whole Federal-local relationship.

Proposed Structural Changes

The States should take steps to simplify and streamline county and other local governments, or at least pass permissive legislation which would encourage local action. As counties assume more and more responsibility for carrying out programs for the State government, or for the National-State Governments, the need for improved county government becomes more urgent.

The National and State Governments should seek more effective coordination of such of their programs as are conducted at the county level by encouraging county governments to set up an office responsible to the elective head or chief executive officer of each county, such office to provide information and guidance to citizens having business with the Federal, State, and county agencies; to facilitate cooperation and coordination among agencies carrying out related programs; and to assist in planning programs with a view of adapting them as far as possible to the peculiar needs and conditions of the county.

Chapter 4

INTERGOVERNMENTAL RELATIONS AND METROPOLITAN AREAS

The metropolitan areas of the United States are the most important focal points for intergovernmental relations. Just as the importance of a railroad center or an air terminal is determined by the number of lines running into it and the number of passengers carried, so also are the metropolitan areas of primary concern as the places where great numbers of governments, people, and industries come together. In the metropolitan areas, the relations between the Federal and local governments are numerous and intense. Here, too, not only the counties and cities are involved with the Federal Government, but also the school districts and hosts of highly important special districts and authorities whose interests may revolve around Federal more than State relations.

In 1950, there were 84,671,000 persons in 168 metropolitan areas of the United States.¹ This was 56 percent of the total population. Each of the 168 areas centers about and includes a city of 50,000 or more inhabitants. There were 14² areas with more than 1 million population and 19³ others with more than 500,000 population. The 135 smaller metropolitan areas had problems similar to the 33 largest ones and on a scale relatively as great and complex.

The metropolitan areas have a special significance in the study of intergovernmental relations. They are more concerned than other areas about the broad range of Federal and State grants-in-aid. There is much reason to believe that most of the problems of intergovernmental relations would disappear if it were possible for the metropolitan areas to finance their activities from the resources they possess but cannot tax for legal or economic reasons. And within the circle of each metropolitan area there is a maldistribution of resources and responsibilities. In some cases the central city may have

¹ Bureau of the Census, *Local Government in Metropolitan Areas*, Washington, D. C., April 1954.

² Includes Baltimore, Boston, Buffalo, Chicago, Cleveland, Detroit, Los Angeles, Minneapolis-St. Paul, New York-Northeastern New Jersey, Philadelphia, Pittsburgh, St. Louis, San Francisco-Oakland, and Washington, D. C.

³ Includes Albany-Schenectady-Troy, Atlanta, Birmingham, Cincinnati, Columbus, Dallas-Denver, Houston, Indianapolis, Kansas City, Louisville, Milwaukee, New Orleans, Portland (Oreg.), Providence, San Antonio, San Diego, Seattle, and Youngstown.

adequate funds while the suburban areas are tax hungry. In many cases substantial portions of the total taxable wealth lie outside the central city in a small community or in unincorporated areas. The metropolitan areas are the great reservoirs of wealth and population but they are the simultaneous builders of slums and possessors of needy persons—a Dr. Jekyll in wealth, a Mr. Hyde in needs.

Take three or four large metropolitan areas and observe the Federal interest. In the Chicago-Cook County area 5.5 million persons were living in 1950. This area includes Lake County, Ind. Lake County contains many of the great steel industries which feed on the resources of the entire area, contribute to its transportation and welfare problems, but escape taxation in Chicago and Illinois. Chicago has three airports in which the Federal Government is interested. Its Midway Airport is the world's most active. The Federal Government contributed heavily to its development and now has 33 full-time employees at the airport for traffic control purposes. O'Hare Field was started as a Chicago project, taken over by the Federal Government for defense purposes, and is now being extended for civilian use and partial return to the city of Chicago. Meigs Field, the lake-front airport, is also active. The Chicago Housing Authority with its widespread operations contacts the Federal far more closely than the State government. The Chicago Park District remade the lake-front with substantial Federal aid in the days of WPA. Now Uncle Sam uses some of these large park areas as sites for anti-aircraft batteries. The Chicago Sanitary District is limited by Federal action in diverting much needed water from Lake Michigan. Chicago's waterborne traffic is dependent on the decisions of the Corps of Engineers and other Federal agencies. The Federal programs affecting other counties apply to Cook County, even to the county agent. The research program of the Atomic Energy Commission has taken over large physical properties in the metropolitan area and draws heavily on its educational institutions for research personnel. The Chicago Medical Center has a great number of projects financed by Federal grants through the United States Public Health Service. Large-scale programs of slum clearance and urban redevelopment were stimulated by Federal funds and Federal legislation. Finally, Chicago as a city cannot tax much of the great industry, popularly thought of as being in Chicago, because it lies in unincorporated areas, in suburban towns, in counties other than Cook, or in the State of Indiana. Whatever tax money Chicago receives from these industries results primarily from a distribution of Federal grants-in-aid collected through corporate income taxes.

Other large metropolitan areas have the same problems as well as some peculiar to their location or needs. Los Angeles is concerned with Federal relations regarding the Metropolitan Water District,

the Housing Authority, the Los Angeles County Flood Control District, the municipal airport, the city's harbor facilities and many others. The Federal Government has an unusual concern for the Los Angeles area as the center of aircraft production for the armed forces. San Francisco has its vehicular bridges across the Golden Gate and across the bay to Oakland. Construction of the bridges was dependent on approval of the Corps of Engineers and other Federal agencies.

Lest it seem that only the larger and more industrialized areas are involved, take a look at some problems of Bismarck, N. Dak., a city of slightly over 19,000 population in 1950, whose former mayor is a member of this Advisory Committee. Bismarck and its surrounding area were badly flooded every spring. Money for flood-control works was advanced from Federal funds. The city engineers and the local representative of the Bureau of Public Roads work together on local segments of federally aided highways. Both the Corps of Engineers and the United States Public Health Service are telling the city what to do about sewage treatment since one large Federal dam is north of the city and another just south of it. They give conflicting advice. Federal grants for public health come to the city through the State under conditions which have not always been satisfactory. Civil defense for Bismarck, of course, covers its entire adjoining area. Inflexible Federal rules regarding stockpiling of medical supplies kept Bismarck from participating. The federally financed school-lunch program is used and approved but the uncertainty of funds has caused some school budget difficulties. The Federal airport program affects Bismarck, too. After its airport had been built according to Federal specifications, the control tower was not manned at Federal expense as earlier promised. Other Federal programs affect Bismarck and its hinterland.

The people and the governments of the metropolitan areas cannot solve their problems with the governmental and private devices now available. The central city usually guarantees services such as hospitals, transportation, fire protection, and utility services for the entire area but it (the central city) lacks the authority to collect for its services and sometimes is forced to serve without compensation. In other cases the metropolitan counties have taken over a function, such as health or welfare, and relieved the central city of the financing and administration. No one has yet been able to develop a method to establish areawide policies on matters affecting a metropolitan area. The area itself does not exist as a legal entity which can act. The very size of the metropolitan areas makes their cities and sometimes their counties more inclined to look to the National than the State governments. The situation is further intensified where the State government and the government of its large cities are not in harmony. The metropolitan governments must surely be a major concern in any reshaping of the relations between the Federal, State and local governments.

Chapter 5

THE ROLE OF THE STATES IN FEDERAL-LOCAL RELATIONS

The position of the State governments must be considered in any attempt to understand or improve the relations between the United States Government and the local governments of this country. Why? Because the State governments occupy a strategic position in our democratic Federal Republic. They control the switches which can put local government on the tracks that lead to Washington or to the State capitals. The States can take positive action that will tend to prevent undesirable centralization or, by either inaction or hostile action, they can force their local units to look to the Federal rather than their State governments. Historically, the most compelling single factor in changing Federal-local relations was the inability of the State governments to act when unemployment relief became the most critical public issue in the early 1930's. That event is symptomatic of some other shifts to direct Federal-local relations.

But the consideration of these changing relations should not be thought of in a combative or antagonistic manner. Rather an effort should be made to reconcile differences and find a solution. A representative of county governments has stated the need very well by writing:

Separation of the so-called "levels of government" has been overemphasized. Overemphasis of the separation has led to confusion, antagonism, and conflict in many instances in an area where cooperation and interdependence should have been the dominant factors. We have frequently acted as if we were independent governments rather than separate arms of the same general system of government which, in turn, is merely our citizen expression of self-control. We are the same people motivated by the same ultimate desires and purposes, whether we exert our self-control through the city halls, the county courthouses, the State capitals or the National Government. A shifting of emphasis in this area would eliminate many troublesome brickbats, such as accusations that local governments are bent on raiding the Treasury; or that bureaucrats in Washington are bent on destruction of local governments.¹

The key position of the States is also emphasized by the recent policy statement of the American Municipal Association. It reads:

¹ Keith L. Seegmiller, executive secretary, National Association of County Officials, in a letter dated June 30, 1954.

Neither Congress nor this Commission (on Intergovernmental Relations) can consider problems of taxation, grants-in-aid, and public services as if they were solely Federal-State matters. What affects the activities and revenues of the States is bound to be reflected in the affairs of the cities * * *²

This statement is equally applicable to urban counties and, in part, to other political subdivisions.

The States are important factors both in preventing concentration of power in the National Government and encouraging strength or weakness in local government. The States can exercise their own inherent powers more fully in relation to the Federal Government and assume greater financial and administrative responsibility. On the other hand, they can encourage or compel local governments to decide purely local matters at home. The States, however, must do two things if they wish to keep their cities from strengthening Federal-city ties.

First, the States must not avoid responsibility for financing and administering activities that can appropriately be carried on by joint State-local action. In a crisis, such as that in relief in the 1930's, the local governments would be compelled, for reasons of humanity and public safety, to seek Federal help. In no State except New York have definite plans been made for the sharing of unemployment relief costs.

Second, the States should not weaken their own financial powers nor the strength of the local governments. They should be strong enough to minimize the need for Federal financial aid except under acute depression conditions. The States should not adopt constitutional amendments that freeze the financial powers of the State and its local governments. Such restrictions as already exist in many States with respect to tax limitations, debt limits, and prohibition of certain kinds of taxes should be reviewed.

Neither should the States adopt a "dog-in-the-manger" attitude toward their local governments in Federal-State-local relations. In some matters of the common welfare there is no agency except the National Government that can get nationwide action when necessity requires it.

The States can nullify or modify some national programs by failure to provide matching funds, by refusing to pass the necessary enabling legislation, or by administrative inaction. For example, some States have not obtained Federal highway funds for city purposes because no matching money was provided; civil defense costs are being matched more heavily by the cities than by the States although the latter are designated by Federal law as the channel of cooperation; and a State official in one State refused to make Federal old-age and survivors' in-

² *Municipal Objectives in Intergovernmental Relations*, a statement officially adopted by the American Municipal Association at New Orleans on December 2, 1953.

insurance available to local employees after Federal and State legislation was passed.

Local officials have long felt that national programs adopted in the National interest by Congress should not be subject to nullification by State action or inaction. Once a program, civil defense for instance, has been adopted by Congress as a necessary National program it should be carried out as such.

Again, a few States encourage what some call unnecessary Federal-State-local relations because State legislatures are unrepresentative, unsympathetic or inactive as far as their local governments are concerned. The larger cities and counties particularly feel that they receive more considerate treatment in Washington than they do in Harrisburg, Springfield, or Albany. But on this point of representation in the State legislatures it should be noted that the complaints and grievances of the large cities are greater than those of the counties.

Decentralization Goes Two Ways

The local governments want the same consideration from the States as the States do from the National Government. Just as the States want to be freed, as far as possible, from Federal dictation and domination, so do the localities want the freedom to handle their own affairs. The States want to retain or have returned to them certain powers, activities, and revenues. Just so, the local governments have the same innate wish. The Governors of the States want the prestige that comes from meeting annually with the President—and rightly so. But the mayors, councilmen, and county commissioners want no less from their Governors.³ In the whole process of shifting revenues and activities, the purpose should be to strengthen all levels of government and to weaken none.

If decentralization of government is an objective to be attained, then it is not won when decentralized to the State, but only when as many powers and financial resources as possible are returned to the local governments where every citizen has a chance to exercise his will directly.

Dealing Directly or Through the States

The question arises as to whether cities and counties should deal directly with the Federal Government, or through the States, on matters involving Federal-local relations. Local officials do not like to

³ Some Governors have a policy of meeting regularly with their local officials and invite them to the State capital for that purpose.

be excluded from direct dealing with the Federal Government.⁴ This feeling comes, in part, because some State legislatures will not implement Federal acts by legislative and administrative action. In other cases, such as airport construction, the local governments feel that the State governments should not intervene because the latter neither operate airports of their own nor contribute (in most States) to local airport construction costs. The local governments of the United States are generally satisfied with the excellent administration of the Federal Aid Highway Act through the State highway departments, that is, they are satisfied with the arrangement that the money be channeled through these State agencies. The same is true of local participation in the old age and survivors' insurance program. However, on most other Federal programs affecting local governments there is a general feeling that the local governments should be permitted to deal directly with the appropriate Federal agency.

Many aspects of the States' part in Federal-State-local relations are related to opinions on so-called grants-in-aid and attempts to equalize the quantity and quality of services among all people in the country. People who believe strongly in a uniform quantity and quality of public services at all levels of government will tend to favor Federal in preference to State grants. This naturally follows in matters of common welfare because there is no agency except the National Government that can bring about anything approaching uniform national action. The problem then is to decide what uniform national action is required or desired in order to obtain at least a minimum national standard. When a minimum national standard is required in a service affecting directly and personally a large proportion of the total population, it is necessary to have national standards administered through the State and local governments under Federal supervision and control.

*What the States Can Do*⁵

The States can do many things to improve both Federal-local and State-local relations. They can do some things to minimize the pressure for greater centralization or greater Federal participation in State and local affairs. Some desirable State actions are listed below.

1. Representation in the State legislatures should be on a fair and equitable basis. One house of the State legislature should be apportioned on the basis of population. While the other house may give due

⁴ Act 117, Louisiana Laws of 1954, sets up a Commission on Federal Grants, with local government representation, to advise and consult with all State departments, boards or agencies on any program expending Federal grants, if for local government purposes or related to local problems and situations.

⁵ This section draws heavily on the statements of policy adopted by the American Municipal Association on December 2, 1953.

consideration to both population and geographic distribution, there are many States in which the geographic element is now over-weighted.⁶

2. States should not hamper their own normal operations nor the ability to aid their own local governments by putting into their State constitutions undue limitations on their own rights to levy and distribute revenue.

3. State legislation should make available to local governments the widest possible range of revenue sources consistent with sound fiscal policies and the needs of the State and local governments.

4. The States must recognize the changes in the national economy, the reasons for more highly centralized tax collections, and the necessity for State redistribution to local governments of a substantial portion of the revenue they (the States) collect. The growth of private business into larger units has made it necessary to collect a greater percentage of the total public revenue at the State and National levels and a lesser proportion at the local level. This makes it essential to return part of these funds to State and local governments. State governments need to understand better their position as logical collectors but not necessarily the logical spenders. The conditions under which these returns of funds, frequently mislabeled grants-in-aid, are made from one level of government to another constitute one of the greatest problems in intergovernmental relations.

5. If the States could improve or expand their own revenue systems, drawing more heavily upon revenue sources released by the National Government, they could finance either directly or through aids to their local governments, many activities now federally aided. Through this change, the requirements for Federal grants would be reduced, and because of savings through equalization at a level closer to expenditures, a lower total tax burden from all sources would be achieved. Equalization at the State level, with adequate minimum standards consistent with the national interest, would be less expensive than equalization in a uniform manner throughout the Nation. This follows primarily because, in actual practice, equalization not only equalizes (if it actually accomplishes that end) but also increases the expenditures for all units. In other words, "equalization" grants tend not only to set a minimum standard in the "below-level" units but they also increase the amount of spending by the units for which equalization is not needed. Equalization at the State level would also reduce the cost of aided programs because each State would make payments based on its relative cost level whereas now there is generally assumed a uniform national cost level. The measurement of need requires more attention. If need could be more accurately ascertained, more grants could be given solely for equalization instead of raising

⁶ One member of the Committee, Mayor Robinson, did not approve this paragraph.

the level of spending everywhere. Equalization of State-aided programs could also be reduced in cost if the local governments with greater than average need were given the authority to raise revenue to meet these needs. This can be done, of course, only in those places which have adequate resources, now untaxed. If equalization or the need for grants-in-aid could be confined to the fewest possible subjects at the National level and left predominantly to the States, then the overall costs would be less because the people of a State, spending their own tax money, would watch expenditures more carefully because they would have the political responsibility for raising the taxes used for equalization.

6. To the extent that Federal grants-in-aid are channeled through the States, the latter should take the lead in working out a system so that local governments may know as early and as accurately as possible, for budget purposes, the amount of Federal and State funds they will receive during any year.

7. State governments should recognize the joint Federal-State-local interest in matters before Congress which affect local governments. The local governments are entitled to the active support of the States on Federal actions affecting local government, such as defense-impacted areas, airports, housing, and payments-in-lieu of taxes. State governments have usually been silent on Federal matters affecting local governments.

8. State and local governments, acting jointly with the Federal Department of Health, Education, and Welfare, should develop a plan to finance unemployment relief on a large scale if this should be a major issue again.

9. State governments should recognize the pressing metropolitan problems not only in their central cities but also in the emerging urban communities in the unincorporated fringe areas and in the suburban cities. There is need for new legislation which will permit counties, townships, and other local jurisdictions to deal with these problems and legislation which will also permit the composition of new metropolitan governments or new metropolitan working arrangements.

Conclusion

The strategic role of the States in Federal-local relations appears throughout this discussion of intergovernmental relations, particularly in the area of grants-in-aid and the needs of metropolitan governments. The States' part in Federal-local relations has been stressed because the States can implement or refuse to implement those matters affecting local governments which Congress has decided are in the national interest. The policies of the States also determine the extent to which local governments are impelled to seek financial aid from the National Government.

Chapter 6

GRANTS-IN-AID

The term "grants-in-aid" is misunderstood. Basically it means monetary payments by one government to another. "Intergovernmental payments" might be a more expressive, and scientifically more objective, term because of the erroneous connotation attached to each part of the term "grants-in-aid." A "grant" implies a gift, a certain benevolence on the part of the paying government, and casts the grantor in the role of "lady bountiful," and the recipient in the role of the needy, the receiver of a gift or windfall. Addition of the term "in-aid" strengthens this connotation because the implication is that the payment is in aid of the program of the recipient government. Actually, a substantial portion of so-called "grants-in-aid" are transfers in order that the recipient, as an agent, may carry out the grantor's program. Instead of the grantor aiding the recipient, the opposite is true—the recipient is aiding the grantor by implementing the latter's program, receiving only reimbursement for its expenditure outlays. The aid may really be a burden; the function may not be a local responsibility at all but an imposed agency relationship on behalf of the State or National Government. Ironically, in State-local relations the political subdivisions often have no choice; they are mandated to act as agents. Also some of the so-called Federal aids to local governments are really channeled Federal expenditures used to implement Federal programs imposed upon the local units by agreement between the National and State Governments.

The term "grants-in-aid" is also misleading because in financial reporting it is necessarily restricted to direct monetary payments. To illustrate. If the State gives a city or county some cash from the gasoline tax to build a city street or county highway such payment is called a "grant-in-aid." But, if the State takes the same amount of money from the same pocket and spends it directly to build the identical road or street in the same city or county, this is treated as a State expenditure for highways and not a grant or an intergovernmental payment. For this reason, comparisons between States as to grants-in-aid lose some validity just as the total expenditure and revenue figures do. Since the arguments for and against grants-in-aid

center around the amounts involved, still more refined statistical work is needed to obtain a clear picture of the facts.

The local officials want a clearer understanding of this whole area of intergovernmental relations. The difficulty is that assistance can be given by one government to another in several ways. The first is through the payment of cash which is labeled a "grant." Help can also be given, as seen above, by direct expenditures of the State or National Governments through their own employees. Technical assistance in the form of loans of expert personnel and the supplying of free information and technical advice is a common form of Federal nonmonetary assistance to State and local governments.¹ Aid can also be extended by giving assistance in a variety of ways to the private industries of a city or county, such as placing war orders in an area of unemployment, thereby indirectly relieving the local government of some of its welfare relief burden. In the case of the National Government, aid may also come from monetary, fiscal, or other broad policies.² But only the direct, monetary payments are now labeled as grants.

So far the inherent difficulties in the term "grants-in-aid" have not been surmounted. Few writers have been willing to switch to "intergovernmental transfers" or "intergovernmental payments," which admittedly are colorless words. Yet the term "grants-in-aid," probably ill-chosen in the first instance, has now become so burdened with semantic barnacles that the very use of the term distorts our thinking. Despite all warnings to the contrary, the word "aid" is more often than not construed literally. Even high-ranking public officials at all levels of government often place in their thinking all grants in one category and fail to distinguish between true aids and other types of transfer payments.

Purposes and Origin

Grants-in-aid are made for a variety of purposes some of which directly contradict the others. These purposes are not always mutually exclusive; it happens that one type of aid program may comprise a complex of objectives. A list of purposes would include the following:

Equalization.—If the grants are true fiscal aids to the recipient government, an attempt is made to apportion funds in accordance with need and the ability to support the program. Payments, therefore, constitute a geographic redistribution of wealth for a particular pur-

¹ See the *Appendix* of this report.

² B. C. Bracewell, "Financial Policies in Intergovernmental Relations," *Municipal Finance*, August 1954, p. 15.

pose and a transfer of revenue from an area with an above-average income to one with a below-average income.

Stabilization.—The grant-in-aid device can be used to stabilize local revenues. When receipts from local taxes and public-service earnings fluctuate due to changes in the cycle of business activity, the State or National Government with a broader economic base can, by increasing or decreasing grants, stabilize the total revenue receipts of the local governments. With fairly constant and recurring expenditure burdens, local governments require some stability in their revenues.

Assistance in Periods of Serious Depressions.—While akin to the preceding purpose, the difference in degree seems to warrant a separate purpose category. The objective is to absorb the shock of extraordinary depression expenditures. In depression periods, State and local financial powers could be extremely limited so that an actual breakdown in State and local government might occur unless the Federal Government came to its financial rescue. Some important grant programs have been started to cope with a national crisis which neither the States nor localities could finance. The prime example was Federal financial assistance for taking care of unemployment relief in the 1930's.

Distribution of Tax Proceeds by the Government Best Able To Collect Such Tax Revenues.—This is a device for utilizing the superior fiscal capacity of the National or State Government while at the same time preserving local government autonomy and administration. So-called "higher governments" often have a greater ability for efficient collection of taxes than they do for performing certain services and handling the expenditures therefor.

Some so-called State grants to local governments exist solely because the State government has taken over collection of certain taxes previously collected at the local level. This is illustrated by the California procedure of returning the personal property tax on motor vehicles to the local governments. The latter collected the tax until it was discovered that better results could be obtained by State collection. And yet the present return of the collections from this tax to local governments is labeled as a grant-in-aid. The significant thing to be noted here is that changes in State and local economies have made it desirable from the standpoint of administrative convenience and fiscal expediency to transfer collection of certain revenues to higher levels. Yet the higher levels have no greater proprietary rights to the revenues than they did when the lower governments collected them.

Stimulation.—Grants are sometimes given to start new types of services or activities. For example, the National and State Governments have started new programs in the fields of social welfare and health. These programs originated through pressure on the Federal and State legislative bodies by some groups of enthusiasts. As a means of get-

ting a program started, the Federal or State Governments offered part or all of the money to accomplish a specified purpose. Such grants are generally classified as stimulating or promotional. The recipient government is induced by this method to enter fields not formerly a part of its governmental services. The offer of a new aid stimulates a matching appropriation lest the proffered funds be "lost." The danger is that once the new program becomes established the grants will be reduced or withdrawn. Citizens generally will not permit a reduction in scope of the new program to fit funds available, nor are they willing to finance the growing deficit through additional local taxation. The local government is "in the middle" and may have to reduce appropriations to other services below the desirable median with the result that the entire service program suffers. An example illustrative of this is the Federal grant to Kansas City, Mo., used to pay salaries of personnel in venereal disease, industrial hygiene, and convalescent home inspection. In 1952 this grant totaled \$42,000, and in 1953 it was reduced to \$24,000. Not only must the city itself finance the \$18,000 reduction, using funds previously budgeted for other equally necessary activities, but ironically the industrial hygiene and convalescent home inspection employees enforce State health division regulations and not local ordinances.

Support of a Minimum Program in a Field in Which the Granting Government Has an Interest.—The objective in establishing a minimum program is usually to raise the standard of performance. This has been true of some of the public health and public welfare grants.

Support of a Program in Which the Grantor Has the Major Interest.—For example, Federal grants have been given to accomplish a national need common to all or most of the States, or for the construction of facilities crossing State lines or existing in most individual States. Thus the National Government came to aid highways as part of a national highway system for purposes of national defense and national convenience. The airport program exists because only the National Government can properly control air traffic. There is the further justification of national defense.

Although only a few of the Federal grant programs which affect local governments originated through pressure from the local governments, once the programs were started local officials have generally supported them.

As between the States and the localities, most of the grants are made either because the State has legal or moral responsibility for a function such as education or because the State is better able than the local governments to collect revenue.

Fiscal Importance

Grants-in-aid are an important revenue source to States and local governments. Federal grants constituted 17.3 percent of State revenues in 1952. For the same year local governments received 26.1 percent of their revenues from State payments. Of great significance is the fact that the States, in 1952, received from the National Government \$2,329 millions in grants-in-aid which was 17.3 percent of State revenues but the States made grants to local governments totalling \$5,044 millions which was 31.9 percent of all State payments. Although it appears that local governments as a whole received 26.1 percent of their revenues in the form of State payments, this figure will be misunderstood and misinterpreted unless it is known that public welfare, education, and highways received \$4,229 million of the \$5,044 million State payments to local governments. To complete this picture, it should be noted that \$1,855 million out of \$2,329 million Federal grants in 1952 were made for public welfare, education, and highways. Thus it appears that Federal aid and State aid are not so much "aid to local governments" as they are "aids to selected functional activities" in which the granting governments have a major interest.

TABLE 3.—*Importance of Grants-in-Aid in the Revenue and Expenditures of the States and in the Revenues of Local Governments*^a

[In millions].

Total general State revenue.....	\$13, 429
Total Federal grants to the States.....	\$2, 329
Percent of State revenue from Federal grants.....	17.3
Total State expenditures.....	\$15, 834
Total State payments to local governments.....	\$5, 044
Percent of State expenditures as grants-in-aid.....	31.9
Total local revenues.....	\$19, 336
Local revenue from State grants.....	\$5, 044
Percent of local revenue from State grants.....	26.1

^a Data on State revenues, expenditures, and grants to and from the States are from *State Government Finances in 1953*, Governments Division, Bureau of the Census. Total local revenues for 1952 were derived from figures in the Census Bureau's *Summary of Governmental Finances, 1952*. No total figure was reported. The total given here for "Total Local Revenues" (in millions) includes: Counties, \$4,045; cities, \$8,278; towns and townships, \$862; schools, \$5,097; and special districts, \$1,054.

General Opinions on Grants

Already in defining "grants-in-aid" certain implications in the minds of the public have been pointed out. There is a tendency to regard such moneys, collected over a broader area, as a windfall or gift which cannot be passed up and which need not be spent very carefully because it "did not cost anything." On the other side of the coin, the

strings attached to the grants, the conditions to be met and the red tape of conforming to standards and of accounting and reporting have made grants-in-aid seem a real threat to home rule and a symbol of centralization. The degree of truth or falsehood in these opinions is beside the point. The existence of these opinions is itself a potent fact.

With a variety of grants and with multiple objectives, it is understandable that public attitudes toward grants is divided. The use of a common term to designate so many different types of payments does not make for clarity. In addition some programs start with one avowed purpose but continue under an entirely different philosophy. The school-lunch program, for instance, started as a means of disposing of surplus agricultural commodities. The program now continues with cash payments by the National Government on the theory that all school children should be well nourished.

Much of the opposition to grants-in-aid arises from the failure of so-called equalization grants to achieve their purpose. Frequently, the grants appear to have made more money available for a service in all areas instead of equalizing opportunity or establishing a desirable minimum level of service in all places. Probably this accounts for the attitude of most of those who protest strongly against grants-in-aid.

Others are really not as much opposed to grants-in-aid as they are opposed to government spending generally. These opponents of grants-in-aid feel that if the grant is eliminated and the next lower government must support the service alone, then the activity formerly supported will be greatly reduced in scope and the total public expenditure will be far less. This last idea should be assigned considerable weight in evaluating the opposition to grants-in-aid.

Major Problems

Much of the difficulty with Federal grants-in-aid arises from one or more problems which have not been properly resolved :

1. Some Federal grants are inherently arbitrary because the laws upon which they are based make arbitrary requirements necessary.

2. Lack of coordination in the administration of the various types of grants. It is understandable that Federal grants-in-aid lack cohesion and consistency because almost all of the 40 grants were created separately, are being administered separately, and are appropriated for separately, whether or not they are related programs or could be better administered collectively.

3. Administration has not been fully decentralized to Federal offices close to the point of actual expenditures. District offices of Federal agencies, and State offices beneath them, could be of greater help in bringing the national programs down to the State and local level if

they were given wider discretion in adjusting the programs to local conditions. Their inability to make discretionary decisions limits their usefulness and causes much of the State and local friction in the Federal programs. Inflexible national rules are established to obtain national uniformity. Such uniformity is not necessary to accomplish the purpose of the Federal grants. It would appear better to permit variations within a general objective in order to stimulate experimentation and competition.

4. Grants-in-aid are sometimes used for indoctrination of State and local officials with ideas originated by Federal officials. This has been true particularly in the health field where Federal funds have been spent upon the training costs of State and Territorial health departments.³

5. Functional autocracies have grown up in certain of the grant areas, which has resulted in functional pressures and functional loyalties. This problem has already been stressed in chapter 3 of this report.

6. The bases for distributing Federal grants need reexamination. It may well be that a number of grants for specific purposes could be consolidated into more general purpose grants based on a combined index of need and ability. Some modification of the British block grant might be the proper approach. The block grant resembles sharing in that it leaves local governments free to spend at their own discretion. It differs in not returning revenues to the place of collection.⁴ Grants for broader purposes might not immediately reduce the amount of Federal grants, but this shift would simplify administration, reduce the number of administrative employees and likewise reduce the impact of pressure groups which now support many of the highly specialized grants.

7. The requirement of matching sometimes defeats the equalization objective. Most Federal aid programs require the benefited local government to match the Federal grant according to a percentage sometimes as high as 100 percent. Too frequently, the size of the grant depends almost entirely on the local government's ability to raise matching funds. The more the local unit has, the more it can get. This may result in one of two conditions, neither of them favorable. The local government may be unable to produce local revenues for matching purposes and thereby lose a program or facility which is greatly needed, or it may secure its matching funds by reducing the budgets of other vital municipal services: police, fire, recreation, etc. If Federal funds are to be used to equalize opportunities, new formulae should be developed which recognize local needs as well as local ability to pay.

³ Public Health Service Publication No. 184, 1950, p. 63.

⁴ See, *Federal, State, and Local Government Fiscal Relations*, S. Doc. 69, 78th Cong., 1st sess., p. 167.

8. Rulings by Federal agencies often add to the cost of capital projects. Several examples from Kansas City, Mo., will illustrate:

The Civil Aeronautics Administration, which administers Federal airport aid, requires that before a project is advertised for bids, labor rates, as predetermined by the Secretary of Labor for all classes of labor likely to be required, be included in the specifications. These rates may not be more than 90 days old. Kansas City recently forwarded to the Civil Aeronautics Administration for approval specifications for a project when 60 days validity remained on the labor rate list used. Approval was granted on the 91st day and new rates were required. This delayed the project 6 or 7 weeks and the new rates were identical with the old.

The Federal Bureau of Public Roads agreed to participate in the right-of-way costs for a new expressway. The city was to be permitted to purchase property by negotiation based on a real estate board appraisal before resorting to condemnation. The appraisal was made in 1950, but the flood in 1951 placed a premium on all available rental space and caused a general increase in property values. As a result the appraisal was out of date. Although the city asked permission to make a new appraisal, the Federal administrators adhered rigidly to their original decision that property could not be purchased for more than its 1950 value. They did agree, however, that Federal grants would be paid on the basis of condemnation awards. The city was required, therefore, to condemn much property which could have been purchased at a small increase over the 1950 appraised values. The condemnation awards were considerably higher than the cost of the properties if they had been acquired by negotiation.

In preparing plans for the replacement of portions of a concrete airport apron, the Civil Aeronautics Administration insisted on use of a rock subbase, although local engineers stated such a base was neither practical nor necessary. During construction, after watching an abortive attempt to place the rock subbase, Civil Aeronautics Administration officials reluctantly agreed that this was an impossible requirement and that a sand base should be used. Although the apron rested on river sand, the Civil Aeronautics Administration inspectors required that 4 inches of sand be dug out and replaced with 4 inches of sand, which was hauled to the job. It is estimated that the cost of the unnecessary pavement base amounted to 10 percent of the total cost of the project.

Certainly, some control is needed to assure the Federal authorities that Federal grants are used honestly and for the purpose intended. But sometimes unnecessary costs are injected, particularly in engineering and construction projects.

Alternatives to Grants-in-Aid

The extension of local taxing powers is one alternative to grants-in-aid. The larger cities and counties which have larger per capita operating expenses but which also have large resources which they cannot now tax locally would profit from such a change. The granting of such powers would do away with raising revenue from all to serve a few and, in some cases, from a few to serve all. Even though these larger cities and counties were to levy the same kind of taxes as the State or National Governments, the total tax burden would probably be less if the larger cities and counties which appear to have the greatest present needs could raise directly a greater portion of their own revenue.

Another alternative to grants-in-aid is the transfer of activities or functions from the local level to the State or National Governments. This has already been done with respect to some activities in some States. While this may be the most simple alternative and while it may be the least expensive method of operation, it is not entirely consistent with the theory of federalism in the United States nor consistent with local responsible democracy. Perhaps the transfer of functions and the improvements of the revenue system could be accomplished simultaneously by enlarging the areas of government and/or the areas of taxation so that there would be less need of equalization by providing larger areas with greater breadth of taxation.

Greater State and local shares in federally collected revenues is another possible approach but one restricted in applicability. The difficulty with this alternative is that the point of collection of revenues does not always constitute the proper basis for the distribution of funds. Many of the purposes of grants-in-aid would be defeated by the use of this basis. Too often also the collecting government attaches to shared revenues the requirement that the receipts be earmarked for particular purposes when they should go into the general fund subject to unrestricted uses by the local government.

In some cases a better integration of the revenue system would help under a plan whereby the National and State Governments would collect a surcharge imposed on a Federal or State tax by a State or local government. The money collected would then be collected as the property of the government which imposed the surcharge and would be its own revenue to dispose of according to its own wishes.

Recommendations on Specific Grant-in-Aid Programs

Airport Construction and Operation.—*a.* Continue Federal aid for construction to airports which are part of a national system of air-

ports and which are necessary to national security. No discrimination should be made against airports or particular parts thereof which may support themselves by outside revenues such as concessions. Such discrimination places a penalty instead of a premium on foresight and initiative. *b.* The National Government must continue to finance whatever services are necessary, such as control towers and control devices, to regulate air traffic. Only national standards, applied with rigid uniformity, are adequate for the protection of life and property.

Civil Defense.—Since civil defense is part of national defense Federal aid should continue for property, equipment, operations, and administration. To date, the States through which Federal funds must be channeled, have been gradually withdrawing financial support from this program and transferring the burden to local governments.

Disaster Aid.—In the interest of humanity and because of the necessity for quick and effective action, this aid program should be continued. However, careful definitions should be framed as to what constitutes a natural disaster with which the State and local governments cannot be expected to cope.

Advance Planning of Public Works.—Repayable advances for planning of public works should be made by the National Government because the presence of a large volume of planned public works assures the ability to expedite public works as an offset to unemployment in private construction or in other segments of the national economy. Conditions surrounding the grants must assure their use for a desirable national purpose, e. g., offsetting unemployment.

Federally Impacted Areas.—The National Government should assume the ascertainable and special financial burdens it places on counties, cities, townships, schools, and special districts by reason of unusual Federal activity in a particular geographic area. This is true with respect to both construction and operation. The ability of the local government to finance such construction or operation has no bearing on Federal responsibility for meeting the burdens placed on the local governments. The kind of areas referred to are illustrated by Norfolk, Va.; the Aiken-Augusta, S. C., area; the Portsmouth, Ohio area; San Diego, Calif., area; and other locations of large Army, Navy, and Air Force installations.

Health Grants.—Public health grants, now given for a variety of highly specialized services, should be consolidated into a single general health grant to permit each State to achieve maximum results in terms of local needs and to reduce the intensity of Federal and State direction of local health activities. The Federal agencies should concentrate on research, consultation, and interstate problems.

Hospital Construction.—The program has been successful and should be continued. Since any program of capital grants to stimulate local action must eventually terminate when the initial construction needs have been substantially accomplished, a Federal survey should soon disclose the nature and extent of the future need. Furthermore, it is assumed that the National Government will provide the means of meeting problems of hospitalization created in a relatively few communities by unusual Federal activities.

Public Housing.—The National Government can best meet its financial responsibility to local governments by making one-time capital grants and then freeing the local governments from all further Federal control and supervision. The National Government should assist with planning and with capital grants. After that, it should get out of the local housing and not participate in the operation of the housing projects.

Public Education.—This subject is left to other study groups appointed by the Commission. However, this Advisory Committee feels that the National Government should assume its share of the financial responsibility for school construction and operation in so-called “federally impacted areas.” Local areas cannot be expected to assume the entire financial burden of school construction and operation when they are confronted by a sudden influx of pupils through a Federal activity which does not provide the tax resources to expand school revenues.

Highways.—Federal aid for a national system of highways should be continued. Areas inside and outside cities should be treated alike. The criterion on which funds should be distributed is whether or not a highway serves the national interest and is part of the national highway system. Greater discretion should be left to State and local officials in carrying out construction according to Federal standards. This could be helped by giving greater latitude to the State and regional offices of the Bureau of Public Roads.

Public Welfare Assistance.—Categorical aids should be replaced by a general welfare grant based upon a combined index of need and ability of the state and its political subdivisions to support the welfare programs. Further, in order that inflexible uniformities be removed from applications of the programs to local conditions, greater discretion should be granted the local welfare boards in applying rules of eligibility for, and standards of, assistance. It must be remembered that our local governments for over 250 years had full responsibility for relief of the indigent and the destitute. There is still a real contribution which local officials and local citizen groups could make. They are the people who know local needs, and how aid could most effectively be given. They could also harness the local facilities which otherwise would be idle.⁵

⁵ See H. F. Alderfer cited above, pp. 7-8.

Vocational Education and Vocational Rehabilitation.—Except as these programs apply to veterans they should be returned to the states for financing and administration. Where they do apply to veterans, the National Government should assume full financial responsibility.

General Recommendations.—A review of all the specific types of grants, and some of the major problems involved, prompts a number of general recommendations:

a. The detailed supervision and control exercised by many Federal agencies over the spending of money granted to States and local governments could be curtailed by: (i) greater discretion to regional and State offices of Federal agencies, (ii) grants for broader purposes, and (iii) substitution of performance and financial audits for detailed construction and operating supervision.

b. Careful thought should be given to the provision for some machinery whereby local and State officials could appeal from decisions made by Federal officials in administering Federal aid programs.

c. When localities call on Federal or State Governments for financial assistance, they should be prepared to do their own part. Local governments are expected to carry their share of the financial burdens in grant programs.

d. Consideration should be given to a coordinating agency in the National Government which could attempt without coercion to coordinate the purposes, standards, and conditions under which the separate grants are made.

e. From the viewpoint of local officials, the Commission on Intergovernmental Relations is urged to consider the relationship between Federal grants to the States and the continuance of State grants to localities. It seems perfectly apparent from all available data and from the political questions involved that the State grants to localities for a variety of purposes would be drastically altered by changes in Federal-State fiscal relations.

Chapter 7

INTERGOVERNMENTAL REVENUE PROBLEMS

Local government revenues come predominantly from the local property tax and State distributed funds. They overlap National Government sources only with respect to a few excise taxes and a more limited number of local income taxes. But the entry of the National Government into the general sales tax field would indirectly, but very substantially, damage local revenues by impairing the States' ability to continue their present payments to local governments. The principal troubles with the local revenue system are its competition with the National Government for the total tax dollar, some conflict with the States over revenue sources and taxing authority, and the inflexibility and limitations of the local property tax. Federal grants-in-aid are not a large proportion of total local revenues but they appear to cause dislocations and misunderstandings out of proportion to their relative fiscal importance. Finally, the revenue situation in local governments has been tremendously affected by the maturing economy of this country attended by the concentration of private business into larger units that make local taxing more difficult.

Simeon Leland after studying the financial and economic data for the period from 1932 to 1952 stated that four facts stood out:¹

1. The increased magnitude of governmental fiscal operations;
2. The fiscal dominance of the Federal Government;
3. The growth of the States as tax collecting units;
4. The importance of intergovernmental transfers to local governments.

He further concluded that these facts are closely interrelated.

Both economics and law restrict the total taxation in our Nation. Constitutions, statutes, and charters impose some limitations. But the barriers growing out of economic, political, and social causes are even more imposing. In the report cited above Leland notes that, "On the one hand, sources of revenue are limited; on the other, the costs are continuously expandable." The New York State Temporary Commission on the Fiscal Affairs of State Government said in its report of

¹ Simeon E. Leland, *Needed—New Municipal Revenues*. The United States Conference of Mayors, Washington, September 1953.

February 15, 1954, "The tax resources of the Nation are limited. At the present high level of overall taxation, any increase in Federal taxes necessarily reduces the potential tax-raising ability of the States and their subdivisions." The overriding consideration, then, in Federal-local tax relations, is that local revenues are difficult to expand because of the sheer weight of Federal taxation.

In a democracy the will of the people also imposes limits. By referendum, they can authorize or approve many tax levies, or spending programs that will ultimately result in taxation. By direct pressure on National, State, and local legislators they encourage or discourage many tax proposals. And when sufficiently aroused the people elect to office or defeat at elections those who support or fail to support tax or spending programs in which there is a great popular interest.

The National Government and the States have control of the most productive and most easily administered tax sources. They also possess the tax sources which expand as prices and profits rise and as the country grows in population and wealth. The growth of private business into larger units has also made it necessary for the larger private businesses to be taxed by the National and State Governments instead of the local governments since the properties and income of such private companies could not be adequately reached by any single local government or combination of local governments. The National Government and the States rely primarily on net income taxes and excises or sales taxes while the local governments generally depend on the local property tax, so-called grants-in-aid, and licenses sometimes based on the volume of business. Perhaps one illustration at this point is desirable. The personal property tax—on both tangible and intangible property—was once an important source of local revenue. This tax is becoming obsolete because of the mobility of personal property, the use of small local inventories by companies doing a large volume of business, and the complaints of small independent merchants who see their larger competitors paying taxes on relatively small stocks of goods. Intangible property is free to seek the most favorable tax situs, to move temporarily during the assessable period, or to follow the movement of the principal office of a business. Thus the city of Highland Park, Mich., lost 25 percent or more of its assessed valuation two decades ago when the Ford Motor Company moved its offices from Highland Park to Dearborn, Mich. Thus, too, the bank deposits of Illinois businesses and individuals, taxable as personal property, take an annual journey to New York just as individuals go to favorable climates to escape hay fever. Since the personal property tax has become ineffective and difficult to apply, it is threatened with general extinction following its constitutional prohibition in New York State.

Tax relationships between the parts of a Federal system of government influence very strongly the nature of that system and the real

strength of each of its parts. No better example could be found than Germany, prior to World War II, when the Reich government had emasculated the German states and provinces fiscally and taken administrative control of the local governments. In a document as yet unpublished, Roy Blough has expressed very well the position of the local governments in a Federal state. He said:

The simple model of federalism breaks down on the tax side not only because the most productive forms of taxation in the modern economy are the most difficult to allocate equitably among taxing jurisdictions, but also because these taxes generally speaking are difficult for local jurisdictions, and even for States, to impose and administer effectively. This is a crucial point with respect to local finance since income taxes, corporation taxes, death taxes, taxes on intangible personal property, and even sales taxes and taxes on some kinds of tangible personal property are difficult and expensive, if not virtually impossible, for localities to use successfully. Even the States find some of these taxes, for example, the tax on corporation profits, difficult and expensive to administer. Both States and localities also face the necessity of using such taxes, if at all, at relatively low and unproductive rates because of the mobility of many tax bases. High rates may drive taxpayers out of the jurisdiction, and even when there is little danger of this happening, the argument is a politically powerful restraint on legislative action.”²

Blough also says in this same paper that

* * * as tax sources have become increasingly based on an increasingly complicated national economy it is less and less possible to say with assurance upon whom the burden of any particular tax really falls. The difficulty is greatest with respect to local taxes but has significance and validity also with respect to State taxes.

He cites as examples the taxation of utilities with generating facilities in several States and principal distributing facilities in others; corporations with a principal office in one State, drawing raw materials from several others, having factories in several States, and possessing stockholders throughout the Nation.

So much for the effect of national economics and politics on local taxes. Now look at the extent of tax overlapping between the National and local governments. Taken in the aggregate the overlapping, measured in dollars, and as a proportion of the National Government's income, is not great. But the elimination of this duplication of tax sources would be a fatal blow to some cities such as Philadelphia which receives 31 percent of its total income from the local payroll or income tax, the cities of New York and New Orleans with nearly 30 percent of their tax revenue from local sales taxes, and all Florida cities recently saved from tax starvation by the cigarette tax. Neither would extension of the local income or payroll taxes to more cities greatly interfere with the Federal income tax because the local taxes tap the income generally exempt from Federal taxes.

² Roy Blough, *Fiscal Aspects of Federalism*, a paper prepared for Columbia University's Bicentennial Conference on Federalism, January 11-14, 1954.

The direct Federal-local tax overlapping is set forth in a report³ prepared for the Commission on Intergovernmental Relations by the United States Treasury Department. From this report are derived the following conclusions about direct tax conflicts between the national and local governments:

1. The local *income tax* is levied by only a few cities. In Pennsylvania 286 units, including Philadelphia, Scranton, and Johnstown use it; also 10 cities in Ohio, 4 in Kentucky and the city of St. Louis.

2. In four Kentucky cities and St. Louis the local income tax overlaps the Federal and State income taxes.

3. Local *cigarette taxes* are imposed in 11 States, with Florida, Alabama, and Missouri leading. The municipal rates range from 1 cent to 5 cents per package. Florida collects 5 cents per package and all is returned to the city of origin except 2.5 percent of the total kept by the State for administration.

4. Local *liquor taxes* give a fairly substantial return where used.

5. *Motor fuel taxes* are imposed by local governments in 7 States (Alabama, Florida, Mississippi, Missouri, Nevada, New Mexico, and Wyoming) and by more than 300 cities. Rates range from $\frac{1}{2}$ cent to 3 cents per gallon. Included in the users are 180 Alabama cities, 75 Missouri cities and 43 New Mexico cities.

6. *Admissions taxes* are levied by cities in at least 11 States. Most rates are from 1 percent to 3 percent of admission price. But in Pennsylvania where 350 local governments use it, the rate is usually 1 cent on each 10 cents of admission.

7. *Sales taxes*. Outside of California, where they are almost universal, only a few large cities have a general retail sales tax. But it is a substantial part of the local revenue where used as indicated by the fact that from this source New York derives 29.9 percent of its revenue, New Orleans, 29.2 percent, and Denver 8.5 percent.

Exemptions and Immunities From Taxes

Tax exemptions and immunities are significant in any study of Federal-local relations both because of the amounts involved and the peculiar burden placed on some communities by the exemption from taxation of Federal property. Many constitutional questions bearing on the nature of federalism are also involved.

Local governments are exempt from the payment of most Federal excise taxes. They are subject to the Federal Insurance Contributions Act (old-age and survivors' insurance) only when the States and/or local governments assent to such payments. The income from local

³ *Overlapping Taxes in the United States*, prepared for the Commission on Intergovernmental Relations by the Analysis Staff, Tax Division, U. S. Treasury Department, January 1, 1954.

Government bonds and other forms of debt are immune from Federal income taxation even in the hands of private owners. The so-called proprietary enterprises of local government are not subject to Federal taxes imposed on comparable private corporations engaged in similar enterprises.

The National Government does not pay local taxes on its properties except in a few cases and to a very limited extent. Some properties at the time they were owned by Government corporations such as the Defense Plant Corporation and the Reconstruction Finance Corporation did pay local taxes. But these properties, deeded in recent years to the National Government, arbitrarily ceased to pay local taxes. Thus some of the largest industrial plants in the United States are tax free although they receive the same services and cause the same local government problems as other plants. The continuing removal of existing properties from local tax rolls by the National Government presents a very general problem. But the exemption of Federal properties is even a greater injustice to local governments in those areas where Federal properties are concentrated.

The greatest Federal tax injustice for which there is no possible excuse except the legal superiority of the National Government is the Government's refusal to pay special assessments for local improvements such as pavements, sidewalks, and sewers. The National Government itself, for income tax purposes, considers such charges as additions to capital and therefore not deductible for income tax purposes as current taxes, and yet it refuses to make such payments even though a pavement is constructed on a street surrounding a postoffice or a pavement is laid primarily or solely to serve an airfield. Ordinarily when a pavement or sidewalk or other improvement benefiting a limited area is constructed, the cost is assessed against the abutting property or the benefited property in the adjacent area. If there is federally owned property which does not pay its share, this part of the cost must frequently be borne by the other property owners in the limited special assessment district or paid from the general funds of the local government. The principle involved here is far different from pay-in-lieu of general property taxes, and this change could be made pending settlement of a more general pay-in-lieu policy.

This Advisory Committee notes that payments-in-lieu of taxes are suggested for federally impacted areas, for other areas containing more than the normal proportion of Federal owned property, and for other Federal properties. The Committee recognizes that Federal grants-in-aid, either present or proposed, could be appropriately reduced or even eliminated in federally impacted areas, and other areas with abnormal concentrations of Federal property, if payments-in-lieu of taxes were made in these areas. The Committee feels that other types of Federal property should make equitable payments-in-lieu of

taxes although it leaves the detailed recommendations to the study committee appointed by the Commission on Intergovernmental Relations for that purpose. But this Advisory Committee feels that if the National Government paid its taxes and special assessments and left with the local governments certain revenues which they can readily administer—and if the States would do the same—the need for grants-in-aid would be greatly reduced.

The National Government does not threaten in any way, now or in the future, to interfere with the local property tax or the revenue from local licenses. There are, however, spasmodic efforts to tax the income from some types of municipal bonds and perhaps some proprietary enterprises. These efforts may be expected to continue.

Local government revenues are controlled primarily by the States. In order to present a well-rounded view it may be well to note here that the States control local revenue measures by the following devices:

1. Tax rate limitations in constitutions and statutes.
2. State controlled exemption of State-owned property.
3. State enacted exemptions of veterans' property.
4. State enacted exemptions of homestead property.
5. Other exemptions and limitations.
6. State enacted laws which grant or withhold authority to local governments to levy or not such taxes or sources of revenue as the States see fit.

In the aggregate these controls by the State exercised through limitations, exemptions, and authorizations have more bearing on local revenues than any other legal factors.

Other Considerations

Several other observations about the local revenue system are necessary to an understanding of Federal-State-local tax relations.

While revenues at all levels of government have greatly increased, the proportionate increase has been less for local governments than for the National or State Governments. Of equal or greater significance is the unequal and sometimes seemingly illogical distribution of the new revenues between functions or activities of government and between different kinds of governments such as counties, townships, towns, cities, schools, and special purpose districts. The maldistribution of new revenues is due in part to the influence of Federal and State grants-in-aid and in part to organized pressures.

Closely related to the above thought is the observation that some local government activities financed by special or segregated funds, or by new self-supporting authorities, prosper and have sufficient funds

for their needs while the "regular" units of government lack sufficient income to do their assigned tasks. Compare, for instance, the excellent financial situation of the Port of New York Authority with the always critical finances of the city of New York. Responsibility for this can be attributed to the National Government only to the extent that it drains the resources which the city of New York could tax or to the degree that it fails to support in the New York area governmental functions which have a national interest.

Another important phenomenon should be recorded because of its bearing on the need and nature of grants-in-aid. Financial data show conclusively that the per capita operating cost of government is greater in large cities than small ones, probably varying in a ratio of 6 to 1 between the cities over 1 million in population and those approximating 5,000 population. The causes are determinable and understandable. Despite this great variation in per capita costs, most grants-in-aid are distributed according to formulas whose single or primary element is population. New York is the only State to recognize the varying needs of different sized communities. This is done roughly through different per capita grants to towns, cities, and villages under the so-called Moore plan.

The lack of local revenues has been offset in some local governments by the transfer of one or more activities to a higher or different level of government. Several cities transferred responsibility for all phases of public welfare, including general assistance, to their counties. Under the stimulus of Federal grants city and county health departments are being consolidated usually under county administration. In some States the county has become the smallest unit for highway purposes and in others, such as North Carolina and Virginia, the State virtually controls all highway construction and maintenance except for some city streets and rural roads. The movement has this clear significance: If the lack of local revenue continues, the local governments ultimately will be forced to surrender the control and actual performance of many activities to the State and National Governments.

The other alternatives which will follow a continuing inadequacy of local revenues are (1) poor services and public facilities, (2) greater State grants and controls, (3) greater Federal grants and controls, and (4) a hodgepodge local revenue system which is both illogical and inadequate.

The question may be raised, "Why is the National Government concerned about inadequate local revenues due primarily to State action or inaction?" At least two answers are apparent. The inadequacy of local revenues may prevent many local governments from carrying out activities or services in a quantity or quality sufficient to meet the national interest. Also, if local government revenues are

insufficient, greater pressures will be exerted for Federal financial assistance.

Grants-in-aid, although a part of the revenue question, are discussed in a separate section because of their relative importance.

Conclusions and Recommendations

The National Government has an important influence on local revenues. Nevertheless, the major hope of improving local income rests with the States and local governments. The States need to improve their own tax systems, to remove present barriers to a well-rounded State and local tax system, and to share equitably with the local governments the revenues which they (the States) are best able to administer. As a basis for an improved State and local revenue system which will distribute tax burdens more equitably and give greater local taxing powers where appropriate, many of the States should make state-wide studies of their taxable resources and the extent to which these resources are now utilized. Unless such studies are made many tax resources may not be adequately used either at the State level or the local level. To the extent that tax resources at the local level can be utilized more fully, the need for State grants-in-aid will be diminished.

The States can also improve their own schemes of local government grants by recognizing the diverse needs of various types and sizes of governmental units. At the same time the States can, by grants or other devices, encourage the formation of government units large enough to solve part of the problem caused by the unequal distribution of taxable assets among governments geographically adjacent to each other.

The States can expand local revenue sources by removing unnecessary limitations on local taxing power as to rate, amount, and source. The larger counties and cities generally need one good single substantial revenue source in addition to the property tax. The State should authorize such a revenue source designed, where necessary, to draw revenue from the stream of current income at the local level either through a tax on income or sales. This may be done without creating any great Federal-local tax conflict since such taxes would usually be at low, nonprogressive rates and without exemptions.

The National Government should stay away from the general retail sales tax or its equivalent which States use so widely because, if the National Government were to impair State use of the retail sales tax, the States would immediately have to curtail their payments to local government.

With the same thought in mind, before the National Government decides to relinquish any present Federal tax sources to the States,

it should determine what effect such action will have on local government revenue.

The National Government should, without further equivocation or delay, pay special assessments for local improvements benefiting Federal properties. The payments should be made on the same basis as by private property owners.

The admissions and amusement taxes can be administered by local government as effectively as they can by either the National or State Governments. Furthermore, since the local costs of servicing places of entertainment and amusement are high, the National Government is urged either to abandon the tax on admission or allow credit for local admissions taxes against the Federal levy. The success of this plan is further dependent on State enabling acts in some States, and the withdrawal of other States from this revenue source. Other present Federal taxes susceptible to good local administration are utility excise taxes, stamp taxes on documents, and taxes on safe deposit boxes.

The separation of tax sources as a solution to Federal-local tax relations offers little help to local governments except as to the admissions tax and other levies noted above and to the extent the National Government does not use sales or excise taxes which will further cut down the yield of State sales taxes.

The Ways and Means Committee of the House of Representatives might give the State and local governments a chance to be heard on matters affecting State and local revenues. This has already been done in some cases. The practice could be extended and formalized.

The Congress of the United States—and not a department or agency of the National Government—should control the exemption of Federal property from taxation. The components of the Department of Defense should not be permitted by forms of contract or other devices to extend the nature and range of tax exemptions as they have in recent years.

Chapter 8

DEBT AND BORROWING

National economic and political action, as well as Federal laws, have had a profound effect on local government debt. Depression and prosperity, war and preparation for war, and taxation for public welfare and national security—all beyond the control of the cities and counties of the United States, have nevertheless been a major factor in determining the amount of local debt, the time such obligations were incurred, and the interest costs thereon. The use of local debt to finance local public works is looked upon as one means of stabilizing the national economy.

The outstanding gross debt of local governments doubled in each decade from 1902 to 1932 going from \$1,942 million in 1902 to \$16,680 million in 1932. There it was stabilized for about 10 years due first to the depression and then the preparation for war accompanied by a shortage of labor and material. More drastic curtailments due to World War II brought a reduction for several years until local debts in 1946 reached \$13,847 million. Since then the trend has been upward so that local debts are estimated at \$28,000 million on September 1, 1954. Interest costs on municipal debt, based on the most commonly used index of bond yields, have ranged in this century from a low of 1.29 percent in 1946 to a high of 5.69 percent in 1933.

The National Government has exhibited a direct concern for local government debt matters by the following:

1. Loans to local governments through the Reconstruction Finance Corporation and through the Federal Emergency Administration of Public Works in the 1930's.
2. Passage of the so-called Federal Municipal Bankruptcy Act.
3. Continuing efforts to tax the income from local government bonds.
4. Studies and recommendations of the Federal Deposit Insurance Corporation and the Controller of the Currency with respect to local debts as bank investments.
5. Exclusion of municipal debt from control of the Securities and Exchange Commission.
6. Legislation which prohibits member banks of the Federal Reserve System from underwriting and dealing in local government revenue bonds.

But national events such as wars, depressions, and inflation or deflation which were not consciously aimed at local debts may have had the greatest Federal influence on them.

The relationship between local government debt and the activities of the National Government is shown in several ways:

1. Trends in the yearly volume of new local government debt incurred since 1930 have been controlled primarily by (a) the depression of the 1930's, (b) the restrictions on labor and materials incident to the preparations for World War II, (c) the shortages of labor and materials and the restrictions on their use during World War II, and (d) the restrictions on credit, labor, and materials incident to the Korean War. This combination of restrictions has kept down local government debts and local construction to the point where a vast volume of local public needs has accumulated.

2. The National Government—and not the States and local governments—incurred the debt to care for the unemployed during the depression of the 1930's. Local governments, except in New York State, do not know whether the National Government or the States, or neither of them, will care for the unemployed if there should be calamitous unemployment again.

3. The amount of local government debt is dependent in part on the level of construction costs. These costs are related directly to national economic conditions and Federal monetary policies. As costs rise, the local governments and their citizens will either have larger debts, higher taxes, or less improvements.

4. The interest rate on new issues of municipal bonds generally follows the curve of interest rates on United States Government securities. When Federal interest rates go up, local government interest costs go up. The reverse is also true. This phenomenon was best illustrated by the sharp rise in municipal bond costs when the Federal Reserve System withdrew its support of the government bond market in 1948. While the local governments can neither blame the National Government for the rise in interest rates on local bonds nor credit it for lower costs, the relationship is direct and important.

5. The interest rates on municipal bonds (due to the immunity of their interest from Federal income taxes), are appreciably lower than they would be if this interest were taxable. The value of this exemption to municipalities becomes greater when Federal income tax rates are increased. But this exemption and the resulting lower rates of interest permit local governments to do many things for themselves that would otherwise have to be financed by either the States or the National Government.

6. The debts of many local governments have been greatly increased to meet the requirements of expanding National Government activities. Army, Navy, and Air Force installations have brought large

numbers of uniformed personnel into some areas; in others war production facilities were located in such a way that large labor forces were imported, and in still others atomic and hydrogen bomb developments made a cataclysmic impression.

In table 4 are shown historical data regarding local debt outstanding, municipal bond yields, corporate bond yields, and the annual volume of new issues of State and local bonds for selected periods from 1902 to 1953. These data show that local debts remained constant during the depression years, actually declined during World War II, and are now rising rapidly due to the availability of materials and labor. Municipal bond yield data compared with corporate bond yields show that the price trends of municipal and corporate bonds moved generally in the same directions. The total annual volume of new issues is shown because it is a significant factor in the national economy and gives some indication of the relative amount of public construction from year to year.

The following recommendations are made with respect to Federal relations on matters pertaining to local government debt:

1. The National Government and all its agencies—legislative, administrative, and regulatory—should give due consideration to the effects of national policies and actions on local government debts.

2. The interest on local government bonds should in no event be subjected to Federal income taxes.

3. In times of severe unemployment, the National Government should be prepared to purchase legally authorized, economically sound, issues of local government bonds which cannot be sold in the public market at reasonable rates. This procedure would lessen the pressure for direct Federal financing of local public works and when properly administered would result eventually in no ultimate cost to the National Government. The States obviously have limited ability to assist with the purchase of local securities since they cannot do deficit financing. But it should be understood that the Federal or State purchase of securities to finance local public works is not a substitute for State and Federal aid for general assistance in case of serious unemployment.

4. To the extent that the National Government considers it desirable to have local governments speed up local construction projects as an antidote to unemployment, the National Government should encourage the advance planning of local public works through repayable advances for such planning.

5. The issuance of municipal bonds should continue to be free from the regulation of the Securities and Exchange Commission. Other Federal agencies that directly or indirectly influence the issuance of local government bonds should help to create the widest possible

market for such bonds and should remove any present restrictions that limit the market or competition for them.

6. The National Government should assume the cost of local facilities constructed to meet the requirements of the National Government, particularly the Armed Services, to the end that a relatively few local governments may not be unduly and inequitably burdened by debt incurred in the interests of the National Government.

TABLE 4.—*Municipal Debt Statistics*

	Local debt ¹ outstanding	Municipal bond yields ²	Corporate bond yield index ³	New issues, ⁴ State and local tax exempt bonds
	<i>In millions</i>	<i>Percent</i>	<i>Percent</i>	<i>In millions</i>
1902-----	\$1, 924	3. 25 (1900)	-----	-----
1912-----	4, 075	4. 01	-----	\$339
1922-----	9, 093	4. 38	6. 35	1, 279
1932-----	16, 680	4. 87	7. 26	936
1940-----	16, 720	2. 59	3. 64	1, 498
1942-----	16, 479	2. 24	3. 39	576
1947-----	13, 847	1. 85	2. 81	2, 354
1948-----	⁵ 14, 980	2. 36	3. 16	2, 990
1949-----	16, 851	2. 19	3. 06	2, 995
1950-----	18, 830	2. 07	2. 84	3, 694
1951-----	20, 667	1. 66	2. 87	3, 278
1952-----	23, 236	2. 11	3. 27	4, 401
1953-----	⁶ 25, 500	2. 40	-----	5, 551
1954-----	-----	2. 26	-----	3, 706
		(Aug 5)		(6 mos.)

¹ Years 1902-47. U. S. Bureau of the Census, *Summary of Governmental Debt in 1947*.

² At January 2 of each year. *The Bond Buyer's Index* based on 20 bonds.

³ Moody's Index. For 1932 and subsequent years the yields are for the first trading day in January.

⁴ Annual volume derived from tables in *The Bond Buyer*.

⁵ Years 1948-52. Bureau of the Census, *Summary of Governmental Finances in 1952*, series G-GF52, table 6.

⁶ Estimated.

Chapter 9

SOME OBSERVATIONS

Although the Advisory Committee is composed predominantly of representatives of local government, it did not in its deliberations take a biased view but rather tried to think through what was best, not for the local governments as such, but for the people who live within the jurisdiction of these local governments. The aim was a well-balanced solution which would take into account the ultimate impact of changes at a level where sentiment and attitudes of people toward government are molded and where the ultimate decisions of what is good and desirable in intergovernmental relations will be weighed in the balance. If at particular points in this report the needs of urban metropolitan areas were stressed, it was because in these areas there reside a majority of the people of the United States.

The very nature of this Committee's assignment required that whatever Federal-local conflicts exist, and whatever faults are now found with grants-in-aid, they be delineated in this report sharply and accurately. This report therefore must be read in that context. It must also be understood that only by searching out what is wrong can any improvements be made. But this necessary emphasis should not overshadow, nor detract from, the great areas of cooperation between the agencies of the National Government and local governments. In the vast majority of cases, all three levels of government work together harmoniously and in a cooperative spirit, and in many areas—such as highways, health, welfare, and education—the local governments look to the National Government for advice, technical assistance, and an interchange of ideas. In all these areas of common interest and cooperation, the goal of any work for improved relations must be to make adjustment which will leave all governments better strengthened in their administrative structures, the ability to meet their responsibilities and in the resources at hand to accomplish their proper objectives.

As this Committee progressed in its deliberations, it was greatly impressed with the necessity of tracing the probable chain reaction of any changes in Federal grants to the States, especially the ultimate impact of such changes upon the revenues and functions of the local governments. Since some Federal grants to the States are actually

indirect aids to the localities or to local government programs in which the Federal Government has a major interest, and since State grants to localities are strongly influenced by Federal grants to the States, it follows that any reductions or withdrawals (or other adjustments) in Federal grants to the States are bound to affect the secondary distribution, from the States to the localities, of both the Federal money and the States' own contributions.

Because of the dynamics of this problem of intergovernmental relations, it has not seemed feasible to suggest final solutions to all problems nor to propose precise formulas. From the experience and observations of its members it seemed better to the Committee to concentrate upon practical and politically feasible solutions which at least work in the right direction. In some areas of Federal-local conflicts much can be accomplished by a change in the form and attendant procedures without altering the substance. In others the conflicts run deeper. But in every case it is essential to work toward the future. Attempts have been made in the past, and without marked success, to work out between the three levels of government a precise separation of tax sources and an overall realignment of functions. It is difficult to see how much could be gained by a return to this approach. There seems more merit in working within the framework of one of the strong elements of our Federal system, namely its adjustability to new conditions and its flexibility. The latter is needed in order that when a problem cannot be resolved at one level of government there still remains the possibility of its resolution, or some workable compromise, at another level. With our economic and social life growing in complexity, it seems no longer wise to attempt to place intergovernmental relations in a logical but rigid mold, nor to attempt to return government to its original simplicity. In intergovernmental relations, as in time, we cannot turn the clock back to yesterday, or to the "good old days."

APPENDIX

Federal Services to Local Governments

The National Government assists local governments in hundreds of instances by advice, consultation, publications, loans, emergency or temporary services, loan or exchange of property, and in many other ways. The specific services were described by Robert H. Blundred and Donoh W. Hanks, Jr., in a booklet "Federal Services to Cities and Towns," published by the American Municipal Association in 1950. From this book have been extracted samples of Federal services available to local governments at that time and the Federal agencies from which they were available. They reveal a vast area of actual and potential cooperation:

- AIRPORTS.** Advice and consultation on every phase of airport construction and operation. Civil Aeronautics Administration.
- ARMED SERVICES PARTICIPATION IN CIVIL EVENTS.** Participation of personnel and materiel. Air Force, Army, Coast Guard, and Navy.
- ARMED SERVICES POLICING.** Emergency policing. Continuing policing in certain areas. Air Force, Army, Coast Guard, and Navy.
- ARMORIES.** Rented or donated for municipal use. National Guard unit commander.
- BEACH EROSION.** Consultation on problems and solution. Corps of Engineers.
- CIVIL SERVICE.** Information on examination methods. Copies of rules and regulations. Civil Service Commission.
- COAL MINE FIRE CONTROL.** In coal deposits. Share cost with State or municipality. Bureau of Mines.
- COLLUSIVE BIDDING.** Investigation of use of mails to defraud, or alleged violation of Sherman Antitrust Act. Department of Justice.
- CREDIT UNIONS.** Advice on organization. Bureau of Federal Credit Unions.
- CRIMINAL EVIDENCE IDENTIFICATION.** Examination and identification of ashes, paper, stains, wood, metal, poisons, bullets, checks, and other items of evidence. FBI personnel will testify. Federal Bureau of Investigation.
- DENTAL HEALTH.** Through State health departments, assistance to municipalities to establish dental health plans. Public Health Service.
- DISEASES.** Advisory services, field investigations, demonstrations. Assistance in epidemics or disasters. Public Health Service.
- DRUGS.** Investigation of promiscuous sale of restricted drugs. Food and Drug Administration.
- EMPLOYMENT SERVICE.** Assistance in selecting and placing workers for municipal employment. Studies of jobs and job requirements. Bureau of Employment Security.
- EXPLOSIVES.** Information on hazards from combustible gases and vapors as well as from dust and mineral explosives. Will investigate causes and recommend safe practices. Bureau of Mines.

FARMERS' MARKETS. Consultation on establishment and operation. Department of Agriculture.

FIRE PROTECTION OF WATERSHEDS AND MUNICIPAL FORESTS. Will contract with local government for protection service. Forest Service, Department of Agriculture.

FLOOD CONTROL. Advice and assistance to protect against floods. Advice on reclamation of riverside areas for new uses. Corps of Engineers.

FOLK SONGS AND MUSIC. Sound records of American folk songs and poetry. For purchase only. Library of Congress.

FOOD. Grading at nominal cost for municipal purchasing agents. Production and Marketing Administration.

GEOGRAPHIC POSITIONS. Evaluation and description of stations and bench marks. Coast and Geodetic Survey.

HARBOR POLLUTION. Coast guard has power to arrest violators of Federal oil pollution and anti-dumping statutes. Coast Guard.

HOSPITAL PLANNING. Advice on construction and utilization of hospital facilities. Public Health Service.

INSECT CONTROL. Consultation and advice on combating mosquitoes and other insects. Assistance in identifying insects. Bureau of Entomology and Plant Quarantine.

LABOR MEDIATION AND CONCILIATION. Consultation with local groups to bring about better industrial and labor relations. Federal Mediation and Conciliation Service.

LAND EXCHANGE. Exchange of Federal lands for lands owned by local governments. Forest Service, and Bureau of Land Management of Department of Interior.

LIBRARIES. Abstracts. Information. Catalogs and catalog cards for sale. Duplicate materials exchanged. Photoduplicates at nominal cost. Library of Congress.

MAPS AND CHARTS. Loan and sale of maps. Geological data on foundation conditions. Topographic maps. Geological Survey.

POLICE TRAINING. Law enforcement units of Treasury Department will instruct in police schools. Treasury Department.

———. FBI. National Academy trains local police officers. Federal Bureau of Investigation.

———. Army Provost Marshal. School may be attended by police personnel. Provost Marshal Section. Army Area Headquarters.

PRISONS. Information on management, design and construction. Survey of municipal prisons. Information on rehabilitation practices. Bureau of Prisons.

RADIO. Advice on operation of municipal radio services. Federal Communications Commission.

RECORDS MANAGEMENT. Information on records maintenance, retirement, destruction, and reproduction. National Archives and Records Service, General Services Administration.

RECREATION AREA DEVELOPMENT. Use of Federal land. Farm Credit Administration; General Services Administration; Forest Service; Bureau of Land Management, Department of the Interior.

RODENT CONTROL. Information on methods. Agricultural Extension Service.

———. Help in organizing and conducting rat control programs. Fish and Wildlife Service, Department of the Interior.

SANITATION. Information, publications, consultation on sanitation of milk and food establishments, water supplies, sewage disposal and schools. Specialized technical assistance. Public Health Service.

SCHOOL ADMINISTRATION. Advice on every phase of school organization, finance, public relations, teacher training, records, and teaching aids. Office of Education.

SMOKE ABATEMENT. Model ordinance. Information, advice and technical publications. Bureau of Mines.

SURPLUS FEDERAL PROPERTY. Donations and sales. General Services Administration; Office of Education; Farm Credit Administration.

UTILITIES REGULATION. Expert consultation and witnesses. Federal Power Commission.

VENEREAL DISEASE. Cash and materials grants. Consultation on local problems. Laboratory assistance. Advance training in serology of syphilis. Public Health Service.

VIBRATION CHARACTERISTICS. Buildings, towers, dams and other construction tested at local government expense. Coast and Geodetic Survey.

WATER RESOURCES. Investigations of underground supply. Geologic examinations. Cost sharing basis. Geological Survey.

WEIGHTS AND MEASURES. Advice and information. Specifications and regulations. National Bureau of Standards.

ZOO ADMINISTRATION. Advice and information on general administration; care, treatment and housing of specimens. National Zoological Gardens.

