A COMMISSION REPORT

GENERAL REVENUE SHARING:
an ACIR re-evaluation

Advisory Commission on Intergovernmental Relations

WASHINGTON, D.C. 20575 • OCTOBER 1974

A-48

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PREFACE

The concept of Federal revenue sharing has long been a subject of interest to the Advisory Commission on Intergovernmental Relations. In adopting its 1967 report *Fiscal Balance in the American Federal System,* the Commission urged the adoption of general revenue sharing as an element of a three part Federal aid system which would also incorporate functional block and categorical grants. Late in 1970, the Commission published its information report *Revenue Sharing — An Idea Whose Time Has Come* describing the case for revenue sharing.

Prompted by the President's request, the Commission began to monitor and evaluate the general revenue sharing program from the date of its enactment. The Commission has held four hearings in various parts of the country, conducted opinion surveys, monitored the activities of governmental, public interest, and scholarly groups and individuals, and undertaken extensive staff research in order to prepare this study.

The study and policy recommendations were considered and adopted at the 51st meeting of ACIR on September 26, 1974.

Robert E. Merriam
Chairman

ACKNOWLEDGEMENTS

This report is the result of extensive monitoring conducted on behalf of the Commission by its staff under the general guidance of John Shannon, assistant director for tax and finance subjects. Will S. Myers, senior analyst, assisted by John Gambill and Jack P. Suyderhoud, shouldered the major research responsibility. John H. Bowman, L. Richard Gabler and Michael Veseth were also involved in preparing the report submitted for Commission consideration. The summaries of ACIR revenue sharing hearings were compiled and edited by Rochelle L. Stanfield and originally appeared as ACIR *Information Bulletins*. The secretarial-clerical duties were capably handled by Phyllis Evans, Rita Peruzzi and Marinda Davis.

Due to the complexity of the general revenue sharing program and the wide spread interest it has generated, the Commission and staff sought the advice and opinions of a large, diverse group of concerned individuals and organizations at various stages of development of the study. We acknowledge the benefit of these "critics" including: Albert J. Abrams, Seth A. Armen, Samuel H. Beer, F. G. Bennett, Gerald J. Boyle, George F. Break, Jesse Burkhead, R. M. Burns, Douglas Clark, Edward Clark, Billy D. Cook, Maudine Cooper, Donald J. Curran, Bruce Davie, John M. DeGrove, Paul R. Dommel, Richard Dunham, L. Laszlo Ecker-Racz, Pablo Eisenberg, Daniel Elazar, Jane Fenderson, Andrew Fischel, Glenn W. Fisher, Delphis C. Goldberg, Thomas F. Hady, Albert M. Hair, Jr., Harold Himmelman, James E. Hoben, Tim Honey, Harold Hovey, Judson L. James, Jacob M. Jaffe, Sally Knack, John F. Laezza, Robert D. Lee, Jr., Donald W. Lief, Trudi Lucas, Allen D. Manvel, Julius Margolis, James Martin, James A. Maxwell, Jerry Miller, Victor Miller, Charles Mohan, Kenneth E. Quindry, Robert W. Rafuse, Robert D. Reischauer, Harold Riehm, Jim Savarese, Frank W. Schiff, Morton Sklar, David Spurgin, Charles M. Stephenson, Robert P. Strauss, Lawrence Susskind, Marjorie L. Taylor, William L. Taylor, Richard Thompson, Orba Traylor, Ben Tryck, Dorothy J. Walker, John T. Walsh, Ray D. Whitman, and Richard Worden.

The Commission is also indebted to the persons who found time in their busy schedules to give ACIR the benefit of their experience with the revenue sharing program at four hearings. These individuals are identified in each of the reports on the hearings which are reproduced as an appendix to this study.

The Commission benefitted greatly from the cooperation and information supplied by Graham Watt, director of the Office of Revenue Sharing, and his ORS colleagues. The staff extends a special note of thanks to John Parker for his incisive comments throughout the preparation of this report.

As always, full responsibility for the content and accuracy of this report rests with the Commission and staff.

Wayne F. Anderson
Executive Director

F. John Shannon
Assistant Director

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Part I

FINDINGS

The enactment of Federal general revenue sharing in October 1972 marked both a new experiment in fiscal federalism and a potential new source of intergovernmental tension. The Advisory Commission on Intergovernmental Relations recognized from the earliest debate over general revenue sharing that it would want to maintain a continuing interest in the development and implementation of the program.

On four occasions Commission members have assembled to hear views on the impact of general revenue sharing from persons representing governmental and organizational interests. The staff has kept abreast of progress in numerous revenue sharing monitoring programs currently underway including those of the Office of Revenue Sharing (ORS) in the Department of the Treasury, the General Accounting Office, and the Senate Intergovernmental Relations Subcommittee. The Commission has prepared and published two public opinion surveys on revenue sharing and, at the request of the House Subcommittee on Intergovernmental Relations, the ACIR staff helped conduct a survey of Congressional attitudes on selected aspects of general revenue sharing.

On the basis of the direct participation of many Commission members in the general revenue sharing program, the Commission's hearings on the program, and the staff's research, the Commission sets out the following 16 findings.

1 Despite the presence of certain Federal conditions on the use of revenue sharing funds, state and local policymakers have enjoyed wide discretion in the use of the dollars. In addition to setting out certain fiscal and accounting requirements, Congress attached nine conditions to the general revenue sharing program. These conditions left the program in a slightly ambivalent position — neither clearly Federal aid to achieve national objectives in designated, broad functional areas, nor pure revenue sharing designed to permit complete expenditure discretion by the state and local recipients.

These Federal *strings* can be summarized as follows:

Local governments may spend revenue sharing funds for all types of capital outlays or for operating and maintenance expenses in eligible categories of functions, called priority expenditures. While these categories are broad, they exclude education, cash payments to welfare recipients, and general administration (activities such as the city manager's office or voter registration so broad in nature as not to be assignable to any of the designated functions).

- Recipients must not use revenue sharing directly or *indirectly* as the non-Federal matching share under a Federal grant.

- Each state must maintain the amount of aid to local units at a level not less than the amount of aid given by the state in fiscal year 1972, except where the state strengthens the revenue raising capability of local government or assumes responsibility for local expenditures.

- Reports on the planned use and actual use of revenue sharing must be filed with ORS and published in newspapers.

- Recipients must provide for the expenditure of revenue sharing funds only in accordance with the laws and procedures applicable to the expenditure of their own revenue.

- Recipients must not discriminate in employment and in the provision of services financed from revenue sharing funds.

- Recipients must require contractors or subcontractors on projects financed at least 25 percent by revenue sharing funds to pay laborers and mechanics wage rates no less than those determined by the Secretary of Labor under the Davis-Bacon act.

- Recipients must pay individuals, whose wages are paid by revenue sharing funds, wages which are not lower than the prevailing rates of pay for its other employees in similar occupational categories where 25 percent or more of the wages of all employees in the occupational categories are paid from revenue sharing funds.

- Recipients must use revenue sharing funds within a reasonable period of time as provided by regulation (within 24 months of the end of the entitlement period).

Notwithstanding these strings, governors, legislators, mayors, county officials, and city managers who appeared at Commission hearings have testified that they have experienced little or no difficulty in getting the money to where their government most needed it.

State and local officials enjoy this latitude in budgeting for three reasons. First, state and local budgetary discretion is enhanced by the lack of revenue and expenditure maintenance requirements and the virtual impossibility of distinguishing revenue sharing dollars — or any other Federal dollars — from state or local dollars once officials transfer the revenue sharing dollars out of the required trust fund.

Second, Congress clearly intended to provide wide discretion in the use of revenue sharing dollars. The states have no categorical expenditure constraints and the high priority expenditure requirements imposed on local general governments include the lion's share of their activities.

Third, state and local governments have received various assurances that, in the administration of the law, states and localities would not be told how to spend the money. President Nixon said at the time the act was signed:

> States and cities will not have to worry about filing complicated plans, filling out endless forms, meeting lots of bureaucratic controls. When we say no strings we mean no strings. This program will mean both a new source of revenue for state and local governments and a new sense of responsibility.

Table 1

Fiscal Capacity Equalization Tendencies

States Ranked By Per Capita Personal Income	Revenue Sharing Allocation (EP 4)* Per $1,000 Personal Income		
	Median	Unweighted Average	Population Weighted Average
Highest Income State (Conn.)		4.15	
10 States with Highest Income	4.97	5.48	5.49
Second 10 States	5.27	5.29	5.29
Third 10 States	5.73	5.58	5.58
Fourth 10 States	7.24	6.33	6.35
10 States with Lowest Income	8.41	8.46	8.50
Lowest Income State (Miss.)		12.70	

*Entitlement Period 4, July 1, 1973 to June 30, 1974.

2 **General revenue sharing tends to equalize fiscal capacities of rich and poor states.** The distributional formulas for the revenue sharing allocations reflect Congressional recognition that governmental units vary in terms of need and fiscal capacity and that low fiscal capacity governments (those with low per capita personal income) should be allocated relatively more than those with high fiscal capacity (high per capita personal income). ACIR computations show a small, statistically significant relationship between state area per capita revenue sharing entitlements and state per capita personal income, an indicator of fiscal capacity. On the average for each $1,000 increase (decrease) in per capita personal income the per capita state area allocation will decrease (increase) by $3.40. At the extremes, Connecticut, with a 1973 per capita income of $5,889, received a per capita revenue sharing allocation of $24.39 or $4.15 per $1,000 of personal income for the fourth entitlement period while Mississippi, with per capita income of $3,448, received $44.12 per capita of $12.70 per $1,000 of personal income.

Table 1 further illustrates this modest fiscal capacity equalization tendency.

It is useful to compare the results reported in *Table 1* with a revenue sharing program designed to return a percentage of Federal income tax collections amounting to $6.2-billion to the states of origin. In sharp contrast to the present program, Federal revenue sharing on a strictly origin basis would have no interstate redistribution effect, the rich would get richer. Thus, Connecticut residents, on the average, would receive 2.5 times as much per capita as residents of Mississippi ($42.30 versus $15.44).

3 **General revenue sharing provides far more financial aid to the nation's major central cities than to rich suburban communities.** When the per capita revenue sharing amounts to cities in the same county are compared, the central city gets 3-to-7 times as much as its affluent suburban neighbor *(Figure 1)*.

Similarly, when the per capita entitlement of the central city is compared to the estimated average per capita entitlement for all outlying cities in the same county, the central city gets 1.5-to-3 times as much as its suburban cities, as *Figure 1* shows.

Two notes of caution are warranted on the interpretation of the equalizing effect of revenue sharing as between central cities and suburbs. First, some critics will contend that the range of responsibilites borne by central cities is so much greater than that carried by many affluent suburbs that the dollar differences suggest an equalization impact that is far more apparent than real. Second, some central cities may have suffered a heavier financial setback than their suburban cities because of the cutbacks in certain Federal categorical aid that occurred at the time general revenue sharing began.

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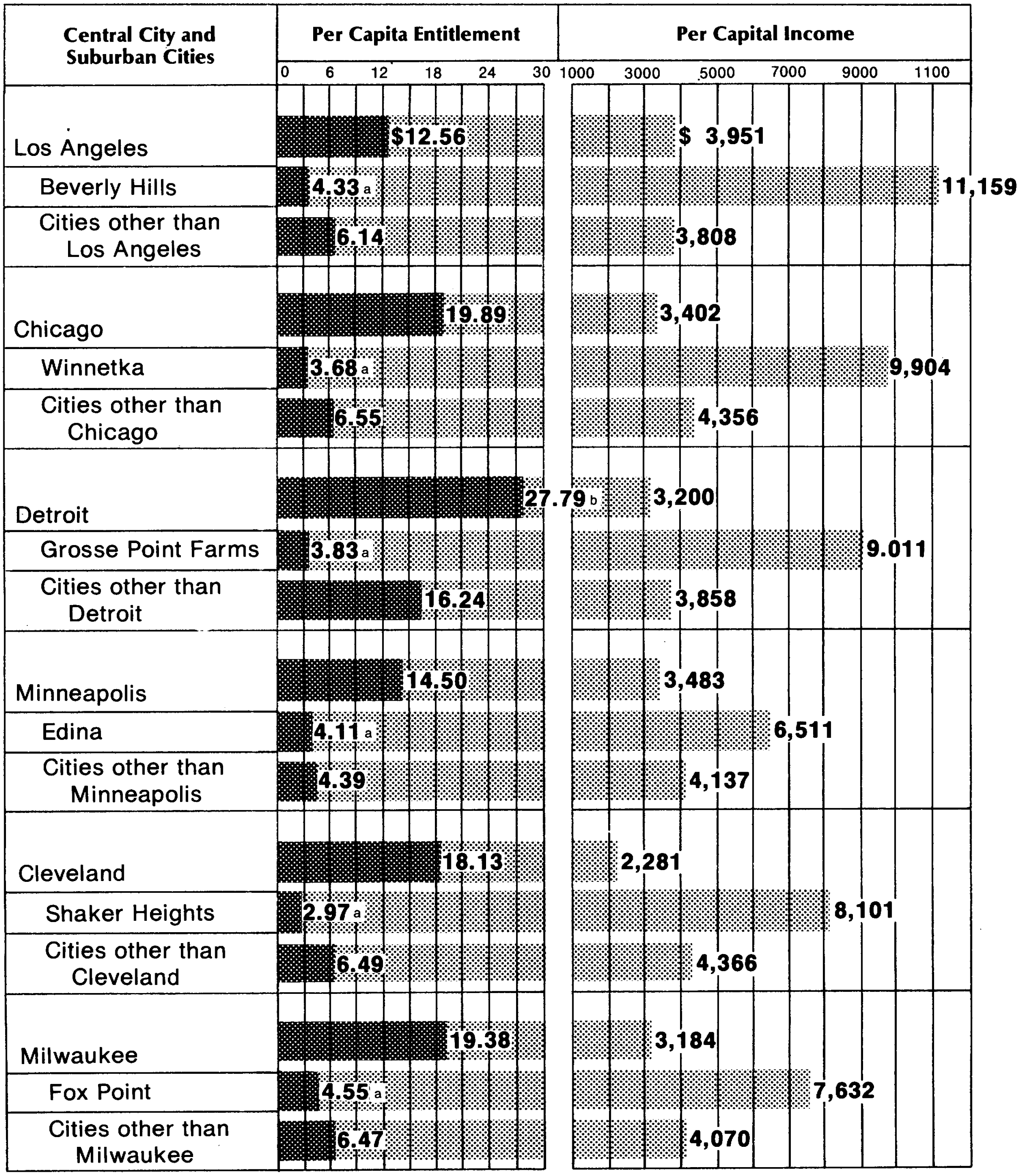
Figure 1

Per Capita Revenue Sharing Entitlements in Selected Central Cities and Their Suburbs



[a] Larger than formula would have provided in the absence of the requirement that no local government receive less than 20% of the statewide average per capital local entitlement.

[b] Smaller than formula would have provided in the absence of the requirement that no local government receive more than 145% of the statewide average per capita local entitlement.

4 **The equalizing thrust of the revenue sharing allocation formula is blunted by the provision that no county area* or municipal or township government shall receive less than 20 percent nor more than 145 percent of the average local per capita entitlement.** Revenue sharing's capacity to reduce fiscal disparities in metropolitan areas would have been greater had Congress not limited the equalizing thrust of the formula by superimposing maximum and minimum limits on payments to local governments. Detroit would have received about $4.8-million or 10 percent more than it did if it had not bumped against the 145 percent payment ceiling and Grosse Point Farms would have received about $10,000 or 25 percent less than it did if it had not been protected by the 20 percent floor.

Table 2 shows, on a state by state basis, the number of governments directly affected by the 20 percent floor and the 145 percent ceiling. Nearly 30 percent, or 11,348, of 38,873 local governments had their Entitlement Period 4 allocation raised or lowered by the minimum and maximum limitations in the formula.

According to a special tabulation by the Office of Revenue Sharing made available to the ACIR staff, total removal of the 145 percent limitation would substantially increase revenue sharing allotments to selected large cities as follows:

City	**Percent Increase**
Baltimore	25
Boston	41
Detroit	12
St. Louis	68
Cincinnati	13
Philadelphia	57

It should be noted that in most cases, the removal of the 145 percent limitation will result in major shifts in allocations. The big city gains will cause reductions in revenue sharing payments to most other local governments in the state. For example, the 145 percent limitation shifts so much of the entitlement in Pennsylvania and Missouri that even major cities such as Pittsburgh and Kansas City have their entitlements drawn down by Philadelphia and St. Louis. In order to give Baltimore a 25 percent larger revenue sharing payment, other local governments in Maryland, except those subject to the 20 percent floor, would have to take a cut of 16 percent. The percentage reductions in entitlement that would have to be borne by all local governments not subject to the 145 percent or 20 percent limits are shown for selected states in the following table:

Local Governments	**Percent Reduction**
Maryland	16
Massachusetts	10
Michigan	8
Missouri	19
Ohio	2
Pennsylvania	19

At the other extreme, equalization is blunted by the limitation that all local governments are entitled to receive an allocation no less than 20 percent of the statewide average local per capita entitlement (subject to the further limitation that no local government's allocation can exceed 50 percent of its adjusted taxes plus intergovernmental transfers). As is seen in *Table 2*, approximately 3,300 municipalities and 6,700 townships have their allocations raised to the 20 percent floor. Because the limitation applies mainly to governments with a small population and a narrow range of functional responsibilities, revenue sharing allocations shifted by the 20 percent rule are smaller than those shifted by the 145 percent rule.

5 **General revenue sharing is gradually being eroded by inflation.** General revenue sharing expands at the rate of 2.5 percent per year whereas the GNP price deflator index for the state and local government sector recently has been rising at a rate in excess of 6 percent annually.

Revenue sharing that Congress intended to be worth $6.05-billion for fiscal year 1974, when corrected by the GNP price deflator, is now worth only $5.5-billion annually (see *Table 3*).

According to one viewpoint, the use of the GNP price deflator fails to reflect the full effect of double digit inflation on the cost of goods purchased by state and local governments and their rising personnel costs. Because of the large personnel component in the public sector and the difficulty of achieving significant improvements in public sector productivity, no adequate indicator of prices paid by state and local governments exists.

*County areas should not be confused with county governments. County areas serve as intermediate points in the allocation process and are not recipients of revenue sharing funds.

Table 2

Number of Local Governments Subject to the Limits* on Local Revenue Sharing Allocations, by State and Type of Local Government

State	County Governments	County Areas** Total	County Areas** Subject to 20 percent rule	County Areas** Subject to 145 percent rule	Municipalities Total	Municipalities Subject to 20 percent rule	Municipalities Subject to 145 percent rule	Townships Total	Townships Subject to 20 percent rule	Townships Subject to 145 percent rule	Tribes	Total GRS Recipients**
Alabama	67	67	–	3	406	33	77	–	–	–	–	473
Alaska	8	29	5	8	119	63	41	–	–	–	18	145
Arizona	14	14	1	2	65	9	3	–	–	–	8	87
Arkansas	75	75	–	7	460	99	9	–	–	–	–	535
California	57	58	–	13	409	56	10	–	–	–	21	487
Colorado	62	63	–	22	258	43	6	–	–	–	2	322
Connecticut	–	8	–	–	34	4	6	149	–	6	–	183
Delaware	3	3	–	1	54	7	15	–	–	–	–	57
Dist. of Columbia	–	1	–	–	1	–	–	–	–	–	–	1
Florida	66	67	–	9	384	38	62	–	–	–	2	452
Georgia	158	159	1	22	526	141	31	–	–	–	–	684
Hawaii	3	4	–	1	1	–	–	–	–	–	–	4
Idaho	44	44	–	12	198	28	4	–	–	–	5	247
Illinois	102	102	–	5	1,270	253	13	1,436	391	24	–	2,808
Indiana	91	92	–	2	562	164	5	1,008	960	1	–	1,661
Iowa	99	99	–	6	953	166	5	–	–	–	1	1,053
Kansas	105	105	–	44	627	27	4	1,498	647	14	2	2,232
Kentucky	120	120	–	13	397	58	54	–	–	–	–	517
Louisiana	62	64	–	11	295	54	24	–	–	–	1	358
Maine	16	16	–	–	22	–	1	474	1	85	2	514
Maryland	23	24	–	4	151	41	4	–	–	–	–	174

Massachusetts	12	14	–	3	39	–	2	312	–	19	–	363
Michigan	83	83	–	16	531	51	40	1,247	912	19	5	1,866
Minnesota	87	87	–	20	854	186	17	1,800	899	5	7	2,748
Mississippi	82	82	–	12	277	35	12	–	–	–	1	360
Missouri	114	115	1	8	906	223	26	343	54	6	–	1,363
Montana	56	56	1	22	126	10	–	–	–	–	6	188
Nebraska	93	93	–	28	534	155	11	479	197	1	3	1,109
Nevada	16	17	–	4	17	–	–	–	–	–	11	44
New Hampshire	10	10	–	–	13	–	1	222	14	28	–	245
New Jersey	21	21	–	4	335	14	21	232	5	14	–	588
New Mexico	32	32	1	4	91	14	2	–	–	–	8	131
New York	57	62	–	1	619	167	6	930	272	20	7	1,613
North Carolina	100	100	–	17	456	36	107	–	–	–	1	557
North Dakota	53	53	–	13	359	63	6	1,368	80	22	5	1,785
Ohio	88	88	–	–	935	89	23	1,320	875	8	–	2,343
Oklahoma	77	77	–	2	561	202	34	–	–	–	15	653
Oregon	36	36	–	7	235	33	23	–	–	–	4	275
Pennsylvania	66	67	–	2	1,013	98	15	1,550	246	10	1	2,630
Rhode Island	–	5	–	–	8	–	2	31	–	3	–	39
South Carolina	46	46	–	7	262	41	77	–	–	–	–	308
South Dakota	67	67	–	25	309	50	4	1,031	365	7	9	1,416
Tennessee	94	95	–	7	320	64	34	–	–	–	–	414
Texas	254	254	–	77	1,022	211	23	–	–	–	2	1,278
Utah	29	29	–	2	215	42	7	–	–	–	4	248
Vermont	14	14	–	–	60	11	2	237	2	58	–	311
Virginia	95	100	–	32	232	15	26	–	–	–	1	328
Washington	39	39	–	6	266	20	17	39	5	–	16	360
West Virginia	55	55	–	4	227	11	37	–	–	–	–	282
Wisconsin	72	72	–	9	572	148	10	1,270	815	7	9	1,923
Wyoming	23	23	–	6	87	21	2	–	–	–	1	111
U.S. Total	3,046	3,106	10	529	18,673	3,294	959	16,976	6,740	355	178	38,873

*The revenue sharing act provides that no county area, municipal government, or township government will receive less than 20 percent nor more than 145 percent of the average per capita local amount given to the state as a whole.

**County areas serve as intermediate points in the allocation process and are not recipients of revenue sharing funds.

Source: ACIR staff compilation based on ORS printout of Entitlement Period Four data.

Table 3

Total Revenue Sharing Funds by Entitlement Period: Current and Constant Dollars (amounts in billions)

Entitlement Period	Current Dollars	Constant Dollars*	Constant as Percent of Current dollars
Jan. 1 - June 30, 1972	$ 2.650	$ 2.650	100.0
July 1 - Dec. 31, 1972	2.650	2.587	97.6
Jan. 1 - July 30, 1973	2.9875	2.8163	94.3
July 1, 1973 - June 30, 1974	6.050	5.449	90.1

* Based on Implicit Price Deflators for state and local government in the gross national product account.

6 General revenue sharing appears to be gaining public support. In the most recent poll conducted on behalf of ACIR, the revenue sharing program was supported by public opinion and by a larger margin than last year. Moreover, a smaller percentage of respondents indicated no opinion in the most recent poll. Both in May 1973 and April 1974 the public was asked:

> *In addition to providing certain monies to state and local governments for specific purposes, the National government also gives a form of Federal aid called revenue sharing. Under this program, state and local governments receive about $6-billion a year to use as they think best. Do you favor or oppose this revenue sharing form of Federal aid?*

	Percent of Total U. S. Public	
	May 1973	April 1974
Favor	56	65
Oppose	18	13
No Opinion	26	22

Polling results, however, have sometimes been shown to be less than conclusive. In the ACIR poll conducted in 1973, more of the respondents favored Federal grants for specific purposes than Federal grants that state and local governments could spend as they think best.

There is no doubt, however, about the favorable attitude of elected state and local officials toward general revenue sharing. Through their national organizations, governors, mayors, and elected county officials have consistently supported the concept of general revenue sharing.

7 Since the enactment of the revenue sharing program, total Federal aid outlays have continued to increase in absolute terms but have declined somewhat in relation to total state and local expenditures. In its *Special Analysis N* of the budget for the fiscal year 1975, OMB traced the growth of Federal aid flows.

It should be noted that the OMB statistics in *Table 4* tend to understate the full dimension of Federal aid for the fiscal years 1974 and 1975.

> The 1974 and 1975 totals tend to understate the amount of Federal aid compared to previous years. Supplemental Security Income, the public assistance program for the aged, blind, and disabled, changed on January 1, 1974, from a Federal grant program to a program administered by the Social Security Administration. This shift, which results in direct Federal benefit pay-

ments to individuals, reduces the amount of Federal assistance provided in the form of grants by $900-million in 1974 and $1.6-billion in 1975 without decreasing (and often increasing) benefits. The shift also results in significant savings for many states, since the state matching share, new benefit liberalizations, and former state administrative costs will now be borne by the Federal government.[1]

Some critics of the revenue sharing program argue that the enactment of Federal revenue sharing was responsible for the relative slow down in Federal aid flows. On the other hand, it can also be pointed out that it is naive to expect the Federal government to constantly increase its aid in relation to total state-local expenditures – that a day of reckoning had to take place and that it simply coincided with the enactment of revenue sharing.

It must be conceded, however, that certain jurisdictions chose to use their general revenue sharing dollars to fill the fiscal gaps created by the Administration's decision to impound certain aid funds and to cut back many categorical programs.

8 **While there is no legal mandate calling for citizen participation in decisions on the use of revenue sharing funds, the publicity attending the enactment of the program and the distribution of the funds along with the requirement that recipients publish Planned Use and**

Table 4

Federal Aid Flows

		Federal aid As a Percent of–		
Fiscal Year	Amount (millions)	Total Federal Outlays	Domestic Federal Outlays	State-Local Expenditures
1959	$ 6,669	7.2	15.9	13.9
1960	7,040	7.6	16.4	13.5
1961	7,112	7.3	15.4	12.6
1962	7,893	7.4	15.8	13.2
1963	8,634	7.8	16.5	13.3
1964	10,141	8.6	17.9	14.6
1965	10,904	9.2	18.4	14.6
1966	12,960	9.7	19.2	15.6
1967	15,240	9.6	19.5	16.3
1968	18,599	10.4	20.9	18.2
1969	20,255	11.0	21.3	17.4
1970	23,954	12.2	21.9	18.3
1971	29,844	14.1	23.5	19.8
1972	35,940	15.5	24.5	21.5
1973	43,963	17.8	26.8	23.5
1974 estimate	48,293*	17.5	25.8	23.3
1975 estimate	51,732*	17.0	24.7	22.4

*On the basis of more current data, the ACIR staff estimates that total Federal aid outlays for fiscal year 1974 were $46.5 billion and for fiscal year 1975 will be $50.5 billion.

Actual Use Reports[2] stimulated some additional citizen participation and concern in determining local budget priorities. Some governments have an established pattern for citizen involvement in decision making processes on budgets while others do not. In many of those communities where citizen participation has always had a significant impact on local budget priorities, general revenue sharing appears to have stimulated greater citizen participation. Where citizen participation is minimal or non-existent in determining local budget needs and priorities, the advent of general revenue sharing did not necessarily herald a change in the governmental process. Indeed, one of the criticisms leveled against the revenue sharing program is that neither Congress nor many state and local governments have chosen to use it to institutionalize ongoing citizen involvement in the state and local budget process.

The General Accounting Office (GAO) reported that in the opinion of knowledgeable local officials in about one-third of 250 major local governments it has surveyed, citizen participation in planning the uses of revenue sharing was more than is normal in regular budgetary processes. The GAO survey noted that increased participation was more frequent in larger rather than in smaller cities.

Witnesses at the ACIR revenue sharing hearings presented a mixed picture of the extent of citizen participation. Mayor Hatcher of Gary, Indiana, described his city's successful effort to involve citizens in planning for the use of revenue sharing funds. Frank Harris, of the Detroit United Way organization, reported various citizen participation experiences in Michigan ranging from none in financially hard pressed Detroit, where the funds were budgeted before the act was passed, to a fair amount in Battle Creek. Frederick Stocker, revenue sharing monitor for the Brookings Institution, has found no evidence of any significant increase in relatively low level citizen involvement in the two cities and two counties in Ohio that he studies.

As revenue sharing becomes a recurring item in state and local budgets, its novelty and hence its visibility will diminish. With this development, the program is apt to lose most of its ability to generate citizen participation in the state and local budgetary processes.

9 **Because revenue sharing dollars can be substituted for equal amounts of state and local revenue from their own sources, many of the conditions on the use of revenue sharing funds are largely cosmetic in character, and the Planned Use and Actual Use Reports are of little value for analysis of the ultimate impact of the program.** By exercising a minimum of care, recipient governments can arrange their use of revenue sharing funds to conform to the letter, if not the spirit, of all existing requirements. For example, a recipient government can allocate revenue sharing funds for expenditure in the public safety area with the effect of freeing an equal amount of local funds for use in the non-priority areas or to provide tax relief. Similarly, the Davis-Bacon and public employee prevailing wage requirements can be avoided by making sure that revenue sharing funding, where these conditions apply, does not reach the 25 percent threshold.

This fiscal fact of life – fungibility – prompted the General Accounting Office to conclude:

> Except for a potential restriction on the direct or *indirect* use of the funds to meet matching requirements of other Federal programs, the act and regulations do not restrict using local funds freed by revenue sharing. Therefore, except for the matching prohibition, compliance with the restrictions and requirements by local governments can be largely a budgeting and accounting exercise with little effect.[3]

10 **At this time it is virtually impossible to determine on an aggregate basis how revenue sharing funds have been spent.** Despite widespread curiosity, and the fact that general revenue sharing is approaching the halfway mark in the distribution of the $30.2-billion, there is a paucity of hard, comparable data on which to judge the effects of the program.

The data problem results in part from the normal lag in reporting government financial statistics through such established channels as the Bureau of the Census publications, but more importantly the lack of hard data stems from the fungibility of revenue sharing and other state and local funds from their own sources.

To obtain additional information on how revenue sharing funds have been used, the National Science Foundation's Division of Research Applied to National Needs (RANN) is actively solicting research proposals, but these efforts will not yield fruit until late in 1974 and early in 1975.

The Brookings Institution has been monitoring the program in a representative group of state and local governments since early 1973 and will soon release a report. The National Revenue Sharing Project also has been monitoring the program in various communities for approximately a year and its report is still in preparation. Perhaps the most intensive effort to trace the effects of the use of revenue sharing dollars is being undertaken by Congress' own watchdog agency, the General Accounting Office. GAO expects to study in selected cities, counties and townships such issues as the effects of general revenue sharing on local government structure, the impact of the program on taxes and tax rates, the extent to which the general revenue sharing funds have replaced cutbacks in categorical programs, who benefitted from revenue sharing expenditures, the relative importance of general revenue sharing in the total budget, the extent to which the program encouraged citizen participation, and other policy questions.

Yet, due to the fact of fungibility, it remains questionable whether it will ever be possible to fully assess the ultimate impact of revenue sharing on state and local expenditure decisions and priorities.

11 **Although revenue sharing has come under fire for *shortchanging the poor* there is no way to prove or disprove this allegation because the requisite data do not exist.** At ACIR's revenue sharing hearing, Rev. Jesse Jackson of Operation PUSH deplored the minimal use of revenue sharing funds for the poor or aged and recommended "that steps be taken to assure greater encouragement for state and local government units to use Federal revenue sharing monies for needed social services." Rev. Jackson's statement reflects a view widely held by the leaders of minority groups.

Revenue sharing's alleged antipoor bias can be traced to two contentions:

1. Most statehouses, county courthouses, and city halls are dominated by the more advantaged sectors of the body politic.

2. Revenue sharing funds, in contrast to certain categorical aids targeted on the poor as a group, do not flow in sufficient quantities to help those local governments, particularly the major central cities, with extraordinary concentrations of poor people.

In view of the fungibility of revenue sharing dollars, it is virtually impossible for any researcher to state authoritatively that revenue sharing dollars were or were not used for programs benefitting disadvantaged people.

Precisely for this reason – the inability to target Federal revenue sharing funds into a specific area – Congress would choose almost any type of other aid program over revenue sharing if it had intended to rifle aid into poor households. In short, revenue sharing was never designed to be anything but general aid to state and local governments on the assumption that these jurisdictions would then be responsive to their diverse and most urgent needs.

12 **The use of Federal general revenue sharing to stabilize or to reduce state and local taxes precipitated a debate at the beginning of the program over the propriety of tax stabilization action but now that the adjustments have been made this issue has become moot.** Recipients of revenue sharing had the opportunity to use the funds for tax relief purposes in several ways. They could use revenue sharing to free up local funds which in turn could be used to reduce taxes or to halt or slow down tax increases.

According to information supplied by recipients to ORS, about 45 percent of general revenue sharing funds were used to reduce or prevent a tax increase.[4] The General Accounting Office audit of 250 major local governments reported that, in the opinion of knowledgeable local officials, three-fourths of these governments were using their funds in some manner expected to reduce local tax pressure.[5] While the fungibility of Federal revenue sharing dollars makes it difficult to be too precise about this impact on state government, the budget policies set forth in recent governors' messages and statements of local officials all tend to substantiate the relief or reduction aspect on state and local taxes from own sources, if not the magnitude of the effect.

State and local policymakers received conflicting signals from Washington on the question of using revenue sharing for tax relief. The Administration made no bones about the propriety of this use of the funds for tax relief while the Congress was somewhat divided on the subject. A poll prepared by the House Intergovernmental Relations Subcommittee and published in April 1974 asked members of the House and Senate a number of questions.

As seen in *Table 5,* a majority of those responding in the House and in each geographic area considered tax relief a desirable use of revenue sharing funds, but a majority of Democrats deemed it undesirable for recipients to use revenue sharing for tax relief.

At the local level, citizens can be of two minds on whether revenue sharing should provide property tax relief. Carl Holman, president of the National Urban Coalition, told the Senate Intergovernmental Relations Subcommittee that revenue sharing tends to be divisive,

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Table 5

Should Revenue Sharing Funds be Used to Reduce Taxes?

(A Congressional Survey)

The initial reports on the uses of revenue sharing funds indicate that the payments have enabled some recipient governments to reduce taxes (or avoid tax increases) as permitted under this legislation. Do you regard this as a desirable use of revenue sharing funds?

	Number of Responses*			
	Desirable	**Undesirable**	**No Opinion**	**No Response**
Total	**106**	**72**	**8**	**22**
House	90	58	8	14
Senate	15	15	0	7
Democrats	40	50	7	12
Republicans	65	22	1	9
Northeast	23	7	1	1
South	29	27	4	11
North Central	33	19	2	5
West	20	19	1	4

*Total for each category does not add to total responses because two members did not identify themselves.

pitting the homeowners who want tax relief against minority groups who desire improved governmental services.

The subject of using revenue sharing for tax relief is now largely moot except where revenue sharing funds were used for non-recurring items or where the revenue sharing payment is increased. As Harold Hovey, chief budget officer of Illinois, has observed:

> The jurisdictions that used revenue sharing for this purpose (tax reduction) have completed their adjustment in tax structure. As a result they are now in the same position as a jurisdiction that used revenue sharing to expand spending and/or to avoid tax increases that might otherwise be necessary. In each of these cases the current revenue and expenditure patterns presumably balance, and the impact of discontinuing revenue sharing would be to require increases in taxes. The taxes that would increase would not necessarily be those that were lowered as a result of revenue sharing.[6]

13 Revenue sharing tends to prop up certain duplicative, obsolete, and/or defunct units of local government. Revenue sharing is allocated among local governments according to a three factor formula that uses population, general tax effort, and relative income. Every unit of local general government, regardless of fiscal activity or population size, is an eligible recipient unless it is entitled to less than $200 on an annual basis.

The act works in two ways to prop up obsolete local governments. First, all general purpose governments as defined by the Bureau of the Census are eligible for general revenue sharing funds thereby permitting such limited governments as many midwest townships and some, principally New England, counties to receive revenue sharing allocations. Second, provisions in the law raise the allocation to every township and municipality, no matter how inactive, to an amount equal to the lesser of (a) 20 percent of the statewide average local per capita entitlement or (b) 50 percent of the recipient government's total taxes plus intergovernmental transfers. These provisions benefit local governments that exert little tax effort because they either have few services to perform or possess abundant fiscal capacity as indicated by relatively high per capita income of their residents.

Midwest township governments except in North Dakota obtain a significantly larger share of revenue sharing funds than they would receive if their allocations depended solely on their relative share of adjusted taxes *(Table 6).* In Illinois, Indiana, Missouri, and Wisconsin, because of the 20 percent rule, the township governments on the average get twice as large a share of revenue sharing entitlements as their share of adjusted taxes would indicate. In most instances the gain for townships is at the expense of municipal governments.

The provision of the law that limits local revenue sharing allocations of county areas,* cities, and townships to 145 percent of the statewide average local per capita entitlement also has a "propping up" effect. Certain counties that score rather poorly on a tax activity basis, particularly in New England, benefit from the redistribution of funds taken from high effort cities and townships.

Thus, general revenue sharing may have checked the gradual decline of certain obsolete and duplicative local governments.

14 **A basic conflict arises as to the means of reconciling *no strings* Federal aid with Federal enforcement of the antidiscriminatory provision of the revenue sharing law. Thus, while the inclusion of the nondiscrimination provision in the general revenue sharing law has extended the ability of the Federal government to combat discrimination in the state-local sector, the Office of Revenue Sharing does not possess sufficient staff to launch a vigorous affirmative action program.** Extension of the Federal ability to combat discrimination has come about in several ways.

General revenue sharing goes to all 39,000 general purpose governments, many of which have never before received Federal aid.

General revenue sharing is the first Federal aid program to apply the prohibition against discrimination both to the distribution of the expenditure benefits and to employment in programs financed in whole or in part by shared revenues. Further, general revenue sharing enlarges the prohibition to include discrimination on the basis of sex.

• General revenue sharing funds may be used in program areas not specifically funded by Federal categorical grants, thereby extending the prohibition against discrimination to new program areas.

• The exchange of information between Federal civil rights compliance officers in all Federal departments and agencies when coupled with the ultimate threat of withholding a government's revenue sharing allocation because of non-compliance with the antidiscrimination provision of the revenue sharing law substantially increases the Federal leverage to obtain voluntary civil rights compliance from state and local officials.

• The threat of a loss of Federal revenue sharing funds has strengthened the hands of those state and local public officials urging compliance with the antidiscrimination provision in their own jurisdictions.

• The antidiscrimination provision taken in conjunction with other provisions of the revenue sharing law, notably the audits of state and local governments by ORS personnel, state and local audit officials, and private auditors, extends the means of detection of civil rights violations.

The Office of Revenue Sharing is stepping up its efforts to inform the public about discrimination provisions. It has published and widely distributed a booklet, *Getting Involved,* which describes for the public the steps involved in filing a civil rights or other complaint. It has in draft a booklet, *Revenue Sharing and Civil Rights,* for general public circulation to help assure that the money will be spent in a nondiscriminatory manner. This booklet contains case histories describing patterns of discrimination and the action required to correct the violation. One such case study is cited below:

After a $600,000 appropriation had been made to build a new facility for a volunteer fire department, the local chapter of the NAACP alleged discrimination because the

*County areas serve as intermediate points in the allocation process and are not recipients of revenue sharing funds.

Table 6

Relative Fiscal Activity in 1972 and Revenue Sharing Entitlement for 1974:
by State and Type of Local Government

State	County Government Ratios		Municipal Government Ratios		Township Government Ratios	
	Adjusted Taxes to Total Local Adjusted Taxes	Entitlement to Total Local Entitlement	Adjusted Taxes to Total Local Adjusted Taxes	Entitlement to Total Local Entitlement	Adjusted Taxes to Total Local Adjusted Taxes	Entitlement to Total Local Entitlement
Alabama	0.358	0.385	0.642	0.615		
Alaska	0.382	0.418	0.618	0.582		
Arizona	0.399	0.421	0.601	0.579		
Arkansas	0.498	0.355	0.502	0.645		
California	0.588	0.612	0.412	0.388		
Colorado	0.290	0.352	0.710	0.648		
Connecticut	–	–	0.560	0.526	0.440	0.474
Delaware	0.416	0.603	0.584	0.397		
Dist. of Columbia	–	–	–	–		
Florida	0.433	0.448	0.567	0.552		
Georgia	0.562	0.572	0.437	0.428		
Hawaii*	0.196	0.252	0.804	0.748		
Idaho	0.560	0.581	0.440	0.419		
Illinois	0.232	0.232	0.702	0.634	0.066	0.134
Indiana	0.343	0.350	0.603	0.524	0.054	0.126
Iowa	0.557	0.582	0.443	0.418		
Kansas	0.503	0.501	0.457	0.442	0.040	0.057
Kentucky	0.380	0.471	0.620	0.529		
Louisiana	0.356	0.414	0.644	0.586		
Maine	0.063	0.071	0.433	0.413	0.504	0.516
Maryland	0.614	0.584	0.386	0.416		
Massachusetts	0.052	0.055	0.564	0.558	0.384	0.387

Michigan	0.264	0.290	0.684	0.624	0.052	0.086
Minnesota	0.507	0.530	0.460	0.411	0.033	0.059
Mississippi	0.583	0.635	0.417	0.375		
Missouri	0.282	0.327	0.708	0.652	0.010	0.021
Montana	0.678	0.683	0.322	0.317		
Nebraska	0.455	0.497	0.524	0.472	0.021	0.031
Nevada	0.627	0.633	0.373	0.367		
New Hampshi,	0.127	0.131	0.489	0.485	0.384	0.384
New Jersey	0.329	0.340	0.462	0.447	0.209	0.213
New Mexico	0.417	0.443	0.583	0.557		
New York	0.348	0.207	0.505	0.688	0.147	0.105
North Carolina	0.475	0.539	0.525	0.461		
North Dakota	0.504	0.239	0.363	0.629	0.129	0.132
Ohio	0.327	0.327	0.624	0.577	0.049	0.096
Oklahoma	0.325	0.362	0.675	0.638		
Oregon	0.390	0.389	0.610	0.611		
Pennsylvania	0.225	0.279	0.638	0.562	0.137	0.159
Rhode Island	–	–	0.709	0.707	0.291	0.293
South Carolina	0.456	0.530	0.544	0.470		
South Dakota	0.579	0.595	0.362	0.332	0.059	0.073
Tennessee	0.362	0.427	0.638	0.573		
Texas	0.316	0.358	0.684	0.642		
Utah	0.515	0.506	0.485	0.494		
Vermont	0.009	0.011	0.362	0.352	0.629	0.637
Virginia	0.335	0.366	0.665	0.634		
Washington	0.431	0.453	0.569	0.547		
West Virginia	0.412	0.458	0.588	0.542		
Wisconsin	0.518	0.513	0.448	0.414	0.034	0.073
Wyoming	0.737	0.728	0.263	0.272		

*Hawaii's unique local government structure does not permit inference on the basis of city versus county entitlements.

Source: ACIR staff computations from ORS data.

volunteer fire department was all white. ORS conducted an investigation as a result of which the fire department amended its constitution and bylaws to eliminate the appearance of discrimination conveyed by certain sections. Minorities have since been admitted to membership in the fire company. ORS took jurisdiction in this case even though the only expenditure for the fire department had been the payment of fees to the architect who designed the new facility.

Out of 41 civil rights complaints handled by ORS between October 1972 and June 1, 1974, 18 had been resolved, 22 were in the process of negotiation, and one case was in court. As these statistics demonstrate, the Office of Revenue Sharing has tended to emphasize mediation and conciliation in the resolution of allegations of discrimination.

The Office of Revenue Sharing has not been entirely successful in securing appropriations from Congress to meet its perceived compliance requirements. For the last two years Congress has filled only a portion of ORS's request for 51 compliance positions. Funds have been provided for 30 compliance positions.

Certain civil rights spokemen favor a far more aggressive ORS discovery program and a tougher approach involving the administration of the law so as to apply more expeditiously the deferral of payment as a tool of enforcing civil rights compliance. In the view of these spokesmen, the sanction of withholding payment is the most effective method of both deterring and promptly curbing discriminatory practices, and the Office of Revenue Sharing should be prepared to use it whenever it has reason to believe that a state or local government has discriminated in the use of its revenue sharing funds. At the opening of a recent hearing on revenue sharing, Senator Muskie, chairman of the Senate Subcommittee on Intergovernmental Relations, characterized the agency's use of its deferral power as a "very cautious, very restrained and very inhibited" exercise of its responsibility.[7]

15 **The long lead time required to update local population and per capita money income data delayed realization of the Congressional intent to distribute funds to local general purpose governments on the basis of current need and effort.** With each passing entitlement period, local population and per capita money income data drawn from the 1970 decennial census become less representative of each community's true demographic and economic situation.

If all local government recipients of revenue sharing experienced the same rate of change in population, per capita money income, and tax collections, the *aging* of these formula elements would be no problem. There is, however, great variation in local population and income growth rates especially between newer suburbs and central cities. Because the local distribution formula is heavily weighted to favor those governments whose population has below average income, the aging data tends progressively to understate the needs factor of governments with relatively slow growth in per capita money income.

At the present time the Federal government is using Congressionally authorized procedures to update population and per capita income estimates. These data are nearly complete and if they pass the evaluation tests, they could be available to the Office of Revenue Sharing for use in 1975 to calculate fiscal year 1976 revenue sharing allocations.

16 **To date, the incentives for greater state use of the personal income tax have not proved strong enough to accomplish their objective.** Two income tax incentives are evident in the fiscal assistance act:

1. Interstate allocations of revenue sharing funds were maximized for several states that make heavy use of the personal income tax by the adoption of the compromise that each state area's allocation would be the larger of the amount calculated under a House approved and a Senate approved formula. Under the House formula, 17 percent of the state area allocation depends upon a state's individual income tax collections, within specified limits.

2. Another title of the act provides for Federal piggyback collection of a state's personal income tax under specified conditions.

The incentives have lost a great degree of their effectiveness as a result of the release of fiscal pressure on the states since the enactment of P.L. 92-512. Revenue sharing gave the states an infusion of funds. In addition, by the time revenue sharing became law, most states had equipped themselves with powerful state-local revenue generating systems that respond to wage and price inflation.

Meanwhile, state expenditures, based in many instances on biennial budgets, continued to lag temporarily behind the rise in revenues, thereby generating budget surpluses. The improvement in state fiscal health became evident when the 1974 state legislative sessions took up fewer tax increase measures than in any recent year.

The complexity of the interstate allocation formulas make it difficult for state policymakers to determine what the incentive would mean in larger revenue sharing payments. Actually, only 16 states and the District of Columbia could obtain a larger revenue sharing allocation if they increased income tax collections. The table below shows the amounts by which these states' allotments could be increased if the state increased income tax collections by $100 but kept total tax effort constant, and no other state changed its elements in the formula:

State	Gain in GRS allocation for $100 Increase in Income Tax Collections
Alaska	$ 6.67
California	5.70
Colorado	6.60
Delaware	6.65
District of Columbia	6.63
Hawaii	6.63
Illinois	6.31
Maryland	6.47
Massachusetts	6.31
Michigan	6.29
Missouri	6.57
New York	5.34
Ohio	6.57
Oregon	6.57
Pennsylvania	6.20
Rhode Island	6.66
Virginia	6.51

It should be noted that only one-third of the additional revenue sharing allocation a state might anticipate from making greater use of the personal income tax would flow to the state government where the political responsibility for the tax decision would rest.

Regardless of the fiscal condition of the states, governors and legislators are reluctant to arouse the natural opposition to any change in the state tax structure. Thus, the income tax incentive built into the revenue sharing act apparently would have to be substantially larger to trigger state action on the income tax front.

The lack of apparent state interest in taking advantage of the Federal piggyback income tax option may be attributed to several factors:

1. The piggybacking proposal would restrict state tax policy discretion. States may only collect taxes on non-resident wage and other business income generated within the state if such income is greater than 25 percent of the non-resident's total wage and other business income; no circuit breakers operating *via* income tax credits could be granted; and states would have to enact new income tax laws to be eligible.

2. State fiscal ease stemming from revenue sharing's enactment probably delayed further the adoption of the state income tax in such non-income tax states as New Jersey, Texas, and Connecticut, prime candidates for taking advantage of the piggybacking opportunity.

3. The Treasury Department has yet to promulgate the regulations governing piggyback arrangements. In addition, the Commissioner of Internal Revenue told state tax administrators that the Administration was giving serious consideration to asking Congress to amend the law to provide for state reimbursement of the Federal cost of administering a piggyback state income tax. The issue of reimbursement remains unresolved within the Administration.

FOOTNOTES

[1]Office of Management and Budget, Executive Office of the President, *Special Analyses, Budget of the United States Government – Fiscal Year 1975*, Washington, D.C., p. 203.

[2]The law requires that each state government and unit of local government that receives revenue sharing funds submit a report to the Secretary (1) before each entitlement period on the *planned use* of the funds and (2) after each entitlement period on the *actual use* of the funds. The Secretary of the Treasury prescribes the form and detail required on the reports. The reports must also be published locally.

[3] Comptroller General of the United States, *Revenue Sharing: Its Use By and Impact on Local Governments*, April 1974, p. 29.

[4] Department of the Treasury, Office of Revenue Sharing, *General Revenue Sharing – the First Actual Use Reports, March 1,* 1974, p. 16.

[5] Comptroller General of the United States, *op. cit.*

[6] Personal correspondence.

[7] *New York Times*, August 27, 1974, p. 1.

Part II

POLICY RECOMMENDATIONS AND ISSUES

Now that the original revenue sharing program has crossed the halfway mark of its five year initial life, Congress and the nation will soon be engaged in the debate over the renewal of this program. Moreover, any consideration of the renewal issue will also trigger a discussion as to the desirability of substantive changes in the present program.

There are at least six basic questions raised by any proposal to extend the life of the revenue sharing program.

1. **The Renewal Issue.** Is the basic rationale underpinning the revenue sharing idea – fiscal imbalance and the desirability of decentralized decision making – still valid for our federal system?

2. **The Appropriations Issue.** If the answer to the first question is yes, how are we to strike a balance between the state and local desire for funding certainty and the Federal desire for budgetary flexibility?

3. **The Distribution Issue.** Should the distribution formula be altered in order to give this program greater fiscal rationality and greater fiscal capacity equalization power?

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4. The Discrimination Issue. To what extent should the Office of Revenue Sharing become more aggressively involved in combatting discrimination in the state-local sector in view of the prohibition against discrimination on the grounds of race, color, national origin, and sex in the use of revenue sharing dollars?

5. The Federal Control Issue. The present program includes certain elements of Federal direction and accountability – the requirement that local expenditures for operating and maintenance purposes be in designated high priority areas and the requirement that recipient governments publish Planned Use and Actual Use Reports and file copies with the Secretary of the Treasury. Should these requirements be eliminated in the interest of giving state and local governments full discretion for the decisions on the use of revenue sharing dollars?

6. The Leverage Issue. Should the Federal revenue sharing program be used as a lever for accelerating reform in certain state and local government policies and practices in the budgetmaking process and for encouraging more intensive state use of the personal income tax?

The Commission considered staff findings in all of these areas but concentrated its recommendations in those areas it deemed most essential to the continuation of the program; namely, should the concept of revenue sharing be extended, for how long, and at what level?

The Renewal Issue

Congress should give favorable consideration to an extension of revenue sharing because the evidence to date clearly indicates that the program has strengthened our federal system in four important ways. First, it has tended to redress the fiscal imbalance within our federal system by using Federal dollars to bolster the revenue position of the weaker partners – state and local governments. Second, revenue sharing dollars move in the right equalization direction by providing greater per capita allocations to poor states than rich states and far more help to financially hard pressed central cities than to their affluent suburban neighbors. Third, this program has added a needed element of flexibility to the Federal aid system by enabling state and local officials to use Federal grant funds to underwrite their own diverse expenditure priorities. Thus, Federal revenue sharing dollars help to fill in the chinks and cracks around the Federal conditional grant programs. Fourth, it must be emphasized that revenue sharing has also introduced a needed, albeit small, element of progressivity into the rather regressive state-local revenue system; state and local governments would have had to make greater use of regressive property and sales taxes had they not been helped with Federal revenue sharing funds drawn largely from the progressive Federal income tax.

The Commission concludes that the general revenue sharing program has strengthened our federal system by increasing the decision making powers of state and local governments and that its discontinuance would cause a severe shock to the state-local fiscal system in general and to local governments in particular. The Commission further concludes that there remains an imbalance in fiscal resources within our federal system – an imbalance that clearly favors the Federal government. The Commission recommends that Congress give early and favorable consideration to the extension of the revenue sharing program with states and local governments along the general lines of the present program.*

The Congress should give early consideration to the renewal of the revenue sharing program because state and local governments must have sufficient lead time to make sound budgetary decisions. To be more specific, Congress should take action on this issue in 1975. If the revenue sharing program were to be discontinued at the end of 1976 or even replaced with a completely different form of Federal aid program, such action would cause severe shock to the state-local fiscal system in general and to local governments in particular. The Federal revenue sharing grants have become an integral part of the state-local revenue system. As a result, any decision to eliminate this program would force state and local governments to take fairly drastic action. In order to close the annual $6-billion gap, these jurisdictions would have to raise taxes substantially or cut, stretch out, or defer programs and capital projects.

It should also be noted that it is practically impossible for the Federal government to construct an alternative method of Federal aid – new or expanded categorical aids or a new system of tax credits – that would even come close to replicating the type of fiscal

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* Congressman Fountain stated that he "favors the concept of general revenue sharing but wishes to reserve judgment on specific conclusions and recommendations until Congress has fully studied this matter."

support now received by the 39,000 recipients of Federal revenue sharing funds.

The Fiscal Issue— State "Surplus" Situation

The improved fiscal condition of many states has prompted some observers of our federal system to question the advisability of continuing to make Federal revenue sharing payments to the states. In a statement issued to the press on August 8, 1974, Congressman Wilbur D. Mills announced the introduction of a bill (H.R. 16330) that would, among other things, remove the states from the program effective January 1, 1975, and make available to cities, counties, towns and local eligible governmental units the funds that would have otherwise gone to the states. In his press statement, Mr. Mills noted that:

> . . .in general, state governments are now in much better fiscal condition than our cities, counties, towns and local governmental units. In this connection, in fiscal 1973, on the basis of such information as can be obtained, nearly all of the State governments enjoyed budget surpluses in contrast to a series of heavy deficits recently experienced by the Federal government and by a number of cities and local governmental units. In 1974, it appears that only one state was in a deficit position. This emphasizes the need to shift these general revenue sharing funds to those units of government most critically in need.

In the judgment of this Commission, Congress would be ill-advised to remove the states from the program for four reasons. First, despite the fact that many states are now experiencing a degree of relative fiscal ease, there is still validity in the basic rationale that underpins the revenue sharing program – it is needed to help redress the continuing fiscal imbalance within our federal system that stems from the fact that the National government enjoys a clear cut revenue raising advantage over the 50 states.

The National government still dominates the most responsive and equitable tax – the personal income levy. Last year the Federal government accounted for 86 percent of total personal income tax collections and *just the growth alone in the Federal income tax – a $15.6-billion increase between 1973 and 1974 – was equivalent to total state personal income tax collections in 1973.*

It should also be noted that in sharp contrast to the state-local situation, the Federal government is not hobbled by the fear of intergovernmental tax competition. Moreover, and again in sharp contrast to the typical state-local situation, the National government can borrow funds to cover its operating deficits when the Congress decides it is necessary to do so.

Second, there is reason to believe that the present degree of relative fiscal ease experienced by many states is temporary at best. Because states operate on a balanced budget basis, it is not surprising that these jurisdictions chalk up a revenue surplus during the first stages of an economic upturn or period of inflation. With the passage of time the expenditure demands begin to catch up with the revenue as employees successfully demand higher wages and as the suppliers of goods raise their prices. The states are also under unremitting pressure from local governments seeking to obtain greater state support for general aid, property tax relief, and the schools.

Third, the proponents of revenue sharing may interpret any move to cut out the states as a divisive action calculated to put an end to revenue sharing. For example, the states are not without friends in the Congress and could conceivably halt any effort to report out a revenue sharing bill that removes them from the list of eligible recipients. Thus, local governments run the lively risk of losing far more than they would gain from any attempt to remove states from the revenue sharing program.

Finally, there is also a basic philosophical objection to any attempt to remove the states from the revenue sharing program – the states stand as an indispensable political and fiscal element in our federal system. This year, state aid to local governments will approximate $50-billion. Moreover, a good share of the states' revenue sharing entitlement has been spent to reduce local fiscal tensions – either directly with state financed property tax relief programs or indirectly as states picked up a larger share of local school costs. Thus, it would be standing logic on its head to endorse a proposal that purports to strengthen our decentralized system of government while bypassing the states.

The Social Reform Issue

The second major criticism of revenue sharing is to be found in the claim that this program shortchanges the poor. These critics contend that the Federal government has a far better track record when it comes to protecting and promoting the rights of the poor and minority groups than do most state and local governments. Thus, these critics charge that the revenue sharing program that takes money from the Federal treasury and gives it to state and local governments with virtually no strings attached represents a rather sinister method for turning back the humanitarian advances of the last three decades.

If these critics could repeal the revenue sharing program, they would do it on the grounds that Federal funds can be spent far more effectively in behalf of the less advantaged groups when the Federal government assumes direct responsibility for the expenditure of the funds. As a fall back position, they favor the tightening up of the expenditure strings on the revenue sharing program, greater efforts to encourage citizen participation in the state and local budgetary processes, and vigorous ORS enforcement of the antidiscriminatory provisions in the general revenue sharing legislation.

The friends of the revenue sharing program contend that some expenditures of general revenue sharing funds have helped the poor both directly and indirectly. They also respond to this *antipoor* criticism by noting that revenue sharing was never designed to be either pro-poor or antipoor – just pro-state and local government. If Congress wanted to strengthen its programs for the poor, it certainly would not have selected the revenue sharing program to promote that objective.

It should also be noted that any effort to tighten the expenditure requirements or to insist upon the introduction of revenue and expenditure maintenance provisions runs counter to the spirit of the revenue sharing program – to give states and localities the widest discretion in the selection of their budgetary priorities in order to meet their diverse needs. It would, in effect, turn revenue sharing into another categorical aid program.

Both proponents and opponents of the present revenue sharing program should recognize, however, that the fungibility of Federal revenue sharing funds makes it virtually impossible to measure the aggregate effect of the revenue sharing program on the poverty issue.

Other Objections to Revenue Sharing

The issue of renewing this program can also be expected to revive the claim that revenue sharing encourages fiscal irresponsibility because it divorces the pleasure of expenditure from the pain of taxation. We will once again be warned that there is no free lunch at the intergovernmental fiscal table – that under constant pressure from various reform groups, a responsive Congress will attach more and more strings to the revenue sharing program. Thus, revenue sharing will become a snare and a delusion. Instead of liberating state and local governments, it will place them under more and more Federal controls.

It must be conceded that this warning has some basis in fact. Those who are social reformers will attempt to tilt the program more definitely in favor of the poor and minority groups, while the "good government" reform interests will attempt to use revenue sharing leverage to encourage a wide variety of reforms – greater state use of the personal income tax, more active citizen participation in the budgetary process, the modernization of local government structures, and the promotion of regional governmental entities.

The only real defense that the supporters of revenue sharing can advance is that of vigilance – strong and persistent opposition to those proposals that would constrict the wide latitude that state and local governments now enjoy in the expenditure of Federal revenue sharing funds.

The Commission has consistently held the view that general revenue sharing is no panacea for all of the ills of fiscal federalism. In the last analysis, the current development of strong state tax systems is the best guarantee of the independence of our 50 state-local systems. However, general revenue sharing stands out as one of the three indispensable elements of a rational Federal aid system. In 1967, this Commission called for a three part Federal aid mix consisting of:

- A reformed system of categorical grants-in-aid to stimulate and support programs in specific areas of national interest (such as air and water pollution abatement) and to promote experimentation and demonstration where the national interest dictates.

- Block grants, through both the consolidation of existing categories and through starting initially in appropriate new fields, to give state and localities greater flexibility in meeting needs in broad functional areas of national interest.

- General support payments (no strings general revenue sharing) to equalize fiscal resources and to allow states and localities to devise their own priorities to help solve their own unique and most crucial problems.

The Appropriations Issue

Establishing the amount and duration of appropriations for general revenue sharing involves the balancing of two competing objectives. On the one hand, state and local jurisdictions relying on general revenue sharing have a legitimate need to know several years in advance not only that the program will continue, but also approximately how much aid will be forthcoming. If certainty is lacking, state and local governments that use revenue sharing for recurrent expenditures face the possibility of making substantial program cuts or tax increases. Many have chosen, therefore, to use general revenue sharing for construction of capital facilities and other one shot uses – even though higher priorities may lie elsewhere. Thus, there is a need for certainty to promote effective and efficient use of revenue sharing monies.

On the other hand, if Congress and the President are locked into a firm revenue sharing commitment several years ahead and this part of the Federal budget is not evaluated in relation to competing demands for the same funds, changing Federal government priorities cannot easily be accommodated. To isolate revenue sharing in this manner from annual scrutiny runs counter to the spirit of the new *Congressional Budget and Impoundment Control Act of 1974* (budget act). This act requires that *all* Federal expenditures be under the jurisdiction of the appropriations committees; exemption of general revenue sharing is possible, but requires that the bill to extend revenue sharing have specific language to activate the exemption language in the budget act.

The question essentially comes down to this: *How far should Congress go in restricting its own appropriations committees and the President in the exercise of their traditional budgetary prerogatives in order to accommodate state and local governments' need for certainty?*

State-local certainty and Federal flexibility – two sides of the same coin – can be separated into two issues. One concerns the duration of the revenue sharing commitment, or the period of time for which Congress makes an appropriation. The other concerns the amount appropriated for each year. These issues are discussed below.

The Appropriations Period

The choices available to Congress range from annual appropriations for general revenue sharing through an indefinite appropriation, with an intermediate position being an advanced appropriation for a specified number of years. Most of the Federal budget, including most Federal aids to state and local governments, operate on an annual appropriations cycle.

Annual budgetary review would be in keeping with the spirit and needs of the 1974 budget act. It would enable Congress to maintain control over expenditure of Federal revenues and to have the flexibility to resolve annually the competing claims on Federal resources. With annual review of revenue sharing, if national needs indicated a cut in spending to be necessary as an anti-inflation measure, for example, Congress would not be in the position of being accused of breaking faith with state and local governments in order to make a cut in revenue sharing.

At the same time, the state-local need for certainty remains strong. From the time general revenue sharing was first proposed, however, it has been recognized that an annual appropriation for revenue sharing would not be consistent with full integration of revenue sharing funds into state and local budgets. If revenue sharing is to be virtually indistinguishable from state and local own source funds, then these levels of government must be able to plan ahead with certainty that the revenue sharing funds will be available.

P.L. 92-512 established a five year advanced appropriation and trust fund for general revenue sharing. The five year period was a compromise between the need for certainty and Congress' desire to try out this new approach to intergovernmental aid before making a permanent commitment to it. As noted earlier, many governments have allocated much of their revenue sharing entitlements to capital outlays or other nonrecurring expenditures, at least in part because of the desire to avoid becoming dependent upon a temporary or uncertain source of funding for ongoing operations. When Congress takes up the question of reenactment of general revenue sharing, therefore, it seems probable that at least a five year commitment will again be contemplated.

Establishment of revenue sharing amounts five years into the future, with these appropriations outside traditional annual budgetary scrutiny, represents a sizeable Federal concession to the state-local need for certainty. Moreover, if the program is extended beyond the initial five year *experimental* period, state and local governments should feel more secure about the continuation of revenue sharing and therefore should have less hesitancy about committing themselves to ongoing programs funded at least in part from general revenue sharing receipts.

The maximum feasible assurance of the continuation of the revenue sharing program would result from establishment of general revenue sharing as a permanent program funded from a permanent trust fund, not automatically subject to annual review by Congress and the President. Assured of the continued flow of general revenue sharing monies, state and local governments could allocate them to the programs having the highest priorities; capital construction programs would not receive undue emphasis if state and local officials were not afraid that an ongoing program with recurrent expenditure needs would have to be curtailed (or funded through a tax increase) because of a curtailment in revenue sharing.

The primary argument against permanent funding of revenue sharing outside regular budgetary channels is that this would remove revenue sharing from periodic scrutiny and evaluation relative to other possible uses of the same funds. With permanent funding, revenue sharing would tend to be "uncontrollable" and hamper the reordering of priorities through the budgetary process. Over time, revenue sharing could become too large (or too small) by the standards of some future period if funding were effectively locked in for all time by the next session of Congress.

Realistically, a permanent trust fund outside the budgetary process cannot make revenue sharing – or any other program – truly uncontrollable. Anything Congress can do, Congress can undo. The 1974 budget act attests to Congress' seriousness about subjecting all expenditures to annual review. Regardless of any guarantees by the 94th Congress, that Congress or any subsequent Congress could change the revenue sharing program if it so decides. Nevertheless, establishing the principle of a permanent revenue sharing trust fund certainly would make future reduction of revenue sharing more difficult than it would otherwise be.

In the final analysis, then, establishment of a permanent trust fund for general revenue sharing would accomplish the major objective of signaling Congress' commitment to the principle of general revenue sharing and giving state and local governments the maximum possible assurance of the continuation of this source of funds, but still would not so completely tie the hands of the Federal government if later circumstances should require a change in the level of revenue sharing.

The Appropriations Level

In approaching the question of how much money should be distributed to state and local governments in the form of general revenue sharing in any given period, Congress can, in lieu of annual appropriations, choose one of two alternatives: (a) advance appropriations for a multiyear period of specific amounts for each year, or (b) advance appropriations of an unspecified dollar amount equal to some percentage of Federal revenue or revenue base. P.L. 92-512 followed the former course, establishing legislatively determined, stair step increases of approximately 2.25 percent per year over the five year life of the revenue sharing act. The accompanying table *(Table 7)* compares these approaches.

Predetermined, stair step increases in general revenue sharing entitlements offer greater certainty to state and local governments – and the Federal government – than setting these entitlements equal to a percentage of, say, the Federal income tax base (adjusted gross income, AGI). While the trend of AGI is clearly upward, the rate of change varies and can decline. Moreover, predetermined entitlements do not have to mean small precentage increases from year to year. This approach is flexible enough to accommodate anything that is politically feasible, whether that be 2-to-3 percent annual increases, such as those in P.L. 92-512, or increases of 10 percent or more.

Making the amount of revenue sharing assistance available to state and local governments a constant percentage of the Federal personal income tax base might be criticized on the basis that it would erode the concept of fiscal responsibility further than is now the case. Whereas under P.L. 92-512, Congress had to vote to spend a particular amount of Federal revenues for revenue sharing, the amount of expenditure being authorized would not be known in advance if revenue sharing were tied directly to the Federal tax base. Moreover, this latter course might imply that state and local governments have a superior claim on Federal revenues – that a certain percentage of the Federal tax (base) belongs to state and local governments as a matter of right and the Federal government's needs must take second place. If setting revenue sharing equal to a percentage of income tax collections were viewed as a bad precedent, setting it equal to a percentage of the *base* would compound the problem.

These arguments notwithstanding, a strong case can be made for tying the amount of revenue sharing directly to Federal personal income tax collections or to the Federal personal income tax base. First, setting general revenue sharing appropriations or entitlements equal to a fixed percentage of the Federal personal income tax (base) would provide the important tie to this major Federal revenue source that is desirable for a true *revenue sharing* program. In addition to this symbolism, tying revenue sharing to the Federal income tax would help keep revenue sharing aid in line with the growth of the economy and with the upward push of inflation. Whereas the annual growth in revenue sharing entitlements over the period covered by P.L. 92-512 is just a little over 2 percent, the annual growth of Federal AGI has hovered near 10 percent in the last few years.

Finally, if revenue sharing is to be funded from a permanent trust fund, it would be adminstratively simpler to determine the amount of revenue sharing funds for an indefinite period by providing for automatic growth in relation to the Federal revenue structure than to periodically adopt specific appropriations for several years into the future.

While revenue sharing could be tied to the income tax most directly by setting the appropriations for general revenue sharing at a precentage of Federal personal income tax collections, use of AGI seems preferable. AGI provides a clear linkage between the income tax and revenue sharing without subjecting the trust fund appropriation to fluctuations that would accompany discretionary tax changes by Congress (there have been several tax cuts since the Korean War). By the same token, use of AGI rather than tax collections as the basis for determining revenue sharing entitlements avoids giving state and local governments a vested interest in seeing that Federal taxes are never cut, thereby leaving

Table 7

Revenue Sharing Entitlements Under P.L. 92-512 Related to Federal Personal Income Tax Collections and Federal AGI
(Billions of Dollars)

Entitlement Period	Present Law Entitlement	0.68 Percent of Estimated Federal Adjusted Gross Income	5.169 Percent of Estimated Federal Net Individual Income Tax Receipts
1) Jan. 1 – June 30, 1972	2.650	2.650	2.650
2) July 1 – Dec. 31, 1972	2.650	2.645	2.645
3) Jan. 1 – July 30, 1973	2.9875	3.062	3.148
4) July 1, 1973 – June 30, 1974	6.050	5.985	6.100
5) July 1, 1974 – June 30, 1975	6.200	6.605	6.825
6) July 1, 1975 – June 30, 1976	6.350	7.500	7.730
7) July 1, 1976 – Dec. 31, 1976	3.325	3.785	4.370
Total	30.2125	32.232	33.468

Source: ACIR staff estimates based on Internal Revenue Service, *Statistics of Income, Individual Income Tax Actions;* and U.S. Department of Commerce, Office of Business Economics, *Survey of Current Business.*

the Federal government greater freedom in using the income tax for contracyclical purposes or altering the tax rate for other legitimate national considerations.*

In summary, while setting revenue sharing entitlements according to a predetermined schedule of specific dollar amounts is perhaps the ultimate in certainty, there are some disadvantages to this approach. These disadvantages are removed by setting revenue sharing entitlements equal to a fixed percentage of the Federal personal income tax base. This latter course would assure that revenue sharing growth would neither fall behind nor outpace the growth of the economy, and would also provide the important symbolic link between aid to state and local governments and the major and most dynamic element of the Federal revenue structure.

The Commission concludes that the fundamental rationale for general revenue sharing dictates that the state-local need for revenue certainty and growth must have greater priority. The revenue sharing program embodied in P.L 92-512 incorporates several deficiencies that must be corrected: the five year appropriations period is too short to permit effective and efficient budgeting by state and local governments; the scheduled stairstep increases in funds in successive entitlement periods have failed to establish the income tax connection that is desirable in a true revenue sharing program; and these stairstep increases have failed to maintain the real level of assistance intended by Congress because they have fallen so far short of inflation. The Commission therefore recommends that Congress, in extending general revenue sharing beyond the initial five year period, change the program to provide: –

–permanent trust fund financing; and

–funding at a constant percentage of the Federal personal income tax base (adjusted gross income, AGI).**

The Distribution Issue

Several aspects of the revenue sharing distribution formula appear arbitrary when related to existing state-local fiscal patterns and as a result have led to suggestions to change the maximum and minimum revenue allocations to townships and cities and the division of revenue sharing dollars between state government and its local governments.

The Commission considered the following three proposals for introducing greater fiscal rationality into the revenue sharing program:

1. Develop a practical formula for giving recognition to the actual division of state-local fiscal responsibilities.

2. Remove the 20 percent floor on county area (not county government), township and municipal revenue sharing allocations.

3. Remove the 145 percent ceiling on county area (not county government), township and municipal revenue sharing allocations.

State-Local Fiscal Division

*It is conceded that AGI could decrease due to either a prolonged recession or a decision to cut the tax base, thereby reducing the size of the revenue sharing trust fund. Such a decrease in revenue sharing funding could be avoided by a save harmless clause that provided that in no case would the amount of the revenue sharing trust fund be allowed to fall below a specified percentage of the previous year's amount.

** Congressman Fountain dissented from this recommendation on the grounds that it is undesirable to tie general revenue sharing to a rigid formula or to remove it from effective Federal budgetary control.

The following statement of dissent was submitted by Senator Muskie:

Revenue sharing is a desirable and important Federal initiative to provide fiscal assistance to state and local governments. Like other priority Federal programs, however, revenue sharing must be subject to continuous scrutiny by the Congress. The current five year appropriations period assures Congressional review and for that reason it is desirable.

In addition, revenue sharing must be subject to the annual Congressional review of the budget. Among the objectives of the new budget procedure Congress enacted this year is to increase the "controllable" portion of the Federal budget so that Congress has more flexibility to make budgetary decisions in line with national economic needs. To remove revenue sharing or any other program from that annual budgetary review process would reduce the flexibility and would make more of the budget "uncontrollable." It is unrealistic to assume that Congress would be willing to consider revenue sharing outside the annual budget process, and it should not be asked to do so.

I supported the compromise the authors of the budget reform bill worked out, in consultation with representatives of the public interest groups, to exempt revenue sharing from controls governing other entitlement programs. Other entitlements that exceed the amount that the Congressional budget initially targets for them must be re-referred to the Appropriations Committee for 15 days. Revenue sharing is exempted from that re-referral process, and that exemption will continue if the bill reauthorizing revenue sharing provides for it.

The present division of revenue sharing funds between states and localities — one-third (state), two-thirds (local) — has the signal merit of placing the major share of the funds at the level of government most in need of fiscal assistance. Local governments generally are in a far poorer revenue raising position than the states. A bias toward giving local governments a large slice of revenue sharing is therefore appropriate.

In relation to the wide diversity that actually exists in the division of responsibilities between the 50 states and their localities, the one-third, two-thirds division nevertheless appears to some observers as unduly prejudicial to state interests. On the average, state governments collect 55 percent of state-local tax revenue; yet, New Mexico's state government accounts for 80 percent while New Jersey's accounts for 40 percent.

It is possible to modify the state-local division in a way that would reflect the fact that the fiscal work is not evenly divided in most states without deviating significantly from the present division. For example, a program could be designed to divide the state area share on a one-third, two-thirds basis in a state which reflects the average state-local division of responsibilities, but in states where the local share deviates from the average state-local division, subtract or add the deviation to the two-thirds local share.

In a state where the local share in the provision of public services is 50 percent, 5 percentage points above the national average, the local share would be 71-2/3 (that is 66-2/3 + 5) and the state share 28-1/3 percent (that is 33-1/3 - 5), assuming the average state-local split is 55 state, 45 local *(Figure 2)*. Because local governments are called upon to assume a greater than average fiscal role in this state, they are awarded 5 extra percentage points — the amount by which they exceed the nationwide local share — over the two-thirds share they would receive if the present division was extended.

It can be argued that this proposal would avoid the arbitrariness of the present rule and allow a state government such as New Mexico, which finances 80 percent of the state-local sector, to obtain a commensurately larger percentage of the state area entitlement. Moreover, this basis of dividing revenue sharing funds would minimize whatever bias may now exist against transferring fiscal responsibilities between a state and its localities since this transfer would be at least partially reflected in the state-local split of the state area entitlement.

Although this approach would more adequately reflect the greater revenue needs and lesser revenue options available to local governments, the question must be raised whether this issue is sufficiently significant to warrant endangering the revenue sharing alliance that has been forged in support of the entire revenue sharing program.

Supporters of the existing state-local division point out a lack of evidence to indicate that the states have failed to accept additional expenditure obligations. Moreover, they point out that there has been no outcry from any of the revenue sharing participants that the division between the states and localities is unfair and must be altered. They add that the incorporation of a state-local division formula would complicate even more a program already difficult to understand.

The Commission recognized that the state-local division in its present form is arbitrary, and altering it to reflect fiscal realities more accurately would be at least an academically appealing alternative. The Commission, however, taking a practitioner's view, is reluctant to increase the complexity of the distribution formula when there is no apparent demand to do so and when the suggestion to do so could well threaten the coalition required to obtain reenactment of the program.

Removal of the 20 Percent Floor and 145 Percent Ceiling

The Congress provided that all general purpose local governments are eligible recipients of revenue sharing funds unless their entitlement comes to less than $200 annually. In addition, Congress provided that county areas (not county governments), townships and municipal governments are entitled to a revenue sharing allocation of no less than 20 percent nor more than 145 percent of the statewide average local per capita entitlement. These provisions assure all but a few local governments of a revenue sharing payment and they also operate, as noted in the findings, to blunt the equalizing thrust of the revenue sharing distribution formula. The provisions, moreover, have such potentially adverse side effects as propping up certain outmoded, obsolete, or duplicative general purpose governments.

In major metropolitan areas, the floor under local revenue sharing allocations undermines the equalizing tendency of revenue sharing's local distribution formula; it tilts the revenue sharing program in favor of the suburbs. In the case of each of the suburban cities covered in the findings, its local per capita entitlement was increased as a result of the 20 percent floor on local payments. Every major city in the listing lost part of its allocation in order to permit its suburban neighbor to be brought up to the 20 percent floor.

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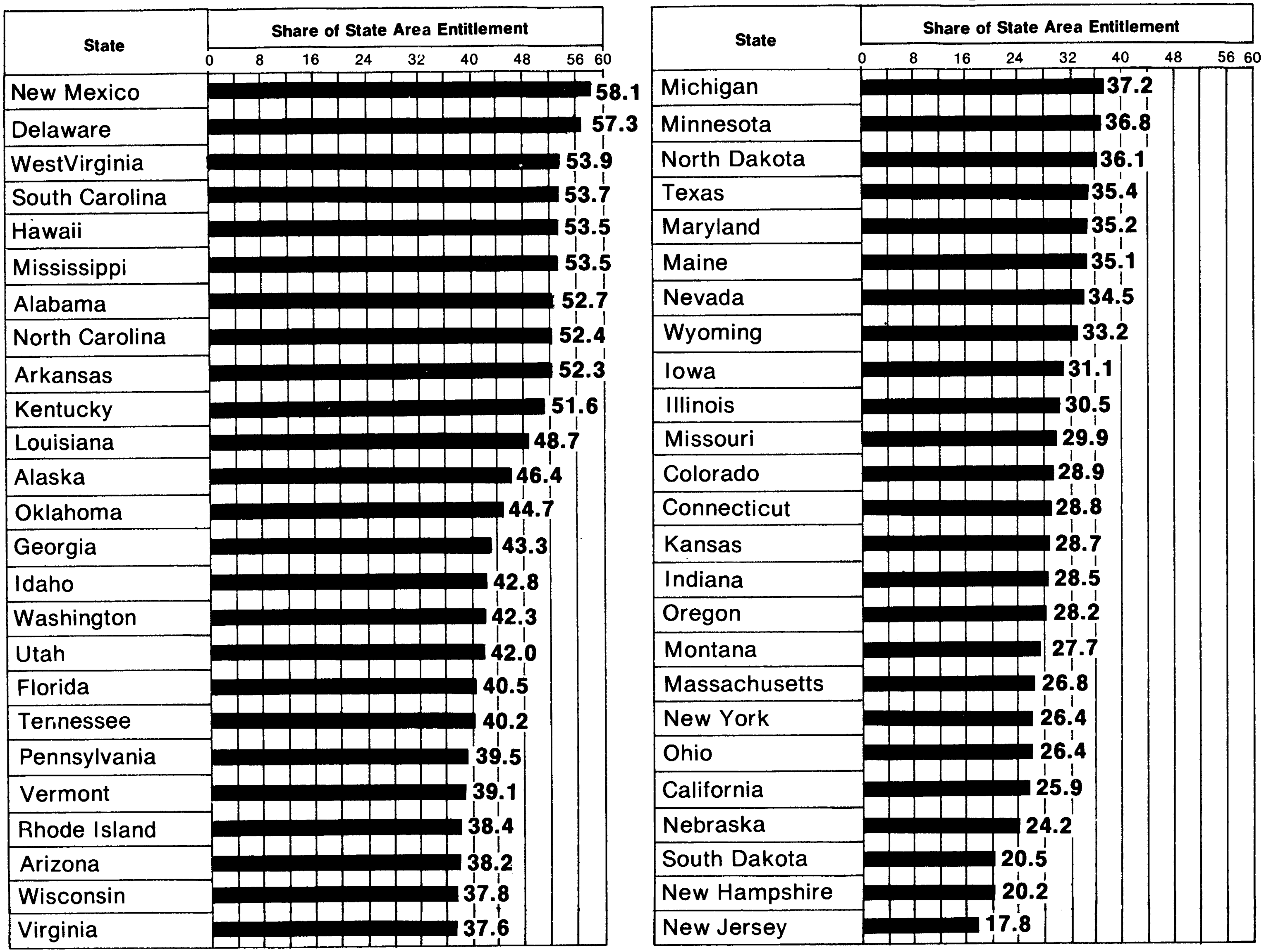
Figure II

State Government Share of State Area Entitlement Where the State Share is Adjusted by 1 Percent for Each 1 Percent That a State's Tax Collection Varies from the U.S. Average of 55.3 Percent



Source: ACIR computation based on U.S. Bureau of the Census, *Government Finances* in 1971-72.

In both metropolitan and non-metropolitan areas, the present floor on local revenue sharing tends to prop up existing units of government regardless of the amount of governmental acitvity they perform. *Table 6* of Part I (see page 00) demonstrates this situation by showing aggregate revenue sharing allocations and aggregate taxes by class of local government by state. It can be inferred from the data in that table that, in many states, a large number of township governments benefit excessively in revenue sharing allocations relative to their need as measured by tax effort.

About 10,000 governments have their allocations increased as a result of the application of the 20 percent floor *(Table 2)*. The governments affected by the rule exceed 1,000 in a few states, and number more than 100 in 17 states, and at least a few exist in almost every state. To raise entitlements for some governments to 20 percent of the statewide local per capita average, revenue sharing allocations have to be reduced for other governments that may be serving people with lower per capita income who pay higher taxes.

In the metropolitan setting, the inclusion of the floor and ceiling in the general revenue sharing formula perpetuates fiscal disparities. The 20 percent floor undermines the equalizing tendency by rewarding governments that, according to the formula factors, do not need revenue sharing dollars.

If the 20 percent minimum local per capita allocation were eliminated, some local governments now qualifying for revenue sharing might be allocated less than $200 and therefore might no longer receive a payment. In this case, the revenue sharing allocation would automatically accrue to the overlying county government unless the county government's allocation came to exceed 50 percent of its adjusted taxes plus intergovernmental revenue, in which case the state government would receive the excess. Thus, the elimination of the 20 percent minimum local per capita allocation would go a long way toward neutralizing the influence of general revenue sharing on local government structure and tone up the equalizing tendency of the present local distribution formula.

The 145 percent payment ceiling has acted to reduce revenue sharing allocations of approximately 1,200 townships and cities and particularly to a number of major cities *(Table 6)*. These reductions have been quite dramatic in some cases, as can be seen in *Table 8*.

Doing away with the 145 percent limit would serve to channel more revenue sharing funds into big cities where the need for these funds is great.

It is important to note, however, that the revenue sharing intrastate distribution formula based on the three factors of population modified for per capita income and tax effort tends to overstate the tax effort on residents in those communities that possess extraordinary ability to export, either directly or indirectly, their tax burdens to non-residents. The 145 percent rule has the merit of preventing enrichment of such jurisdictions commonly identified as industrial enclaves and resort communities.

The introduction of a population cutoff of say 350,000 for the major city and its overlying county area, taken in conjunction with the removal of the 145 percent limitation, would permit more funds to be channeled to major cities without distributing substantial sums to such resort cities as Atlantic City, New Jersey, and Ocean City, Maryland, or to such industrial and commercial enclaves as Cuyahoga Heights, Ohio, and

Table 8

Allocation Reductions Due to 145 Percent Ceiling, Selected Major Cities

City	Amount of Reduction	Percent of Actual Allocation
Baltimore, Maryland	$ 6.6-million	25
Cincinnati, Ohio	1.1	13
Detroit, Michigan	4.8	12
Philadelphia, Pennsylvania	28.3	57
St. Louis, Missouri	9.7	68

Commerce, California. A population cutoff would, however, restrict the revenue sharing distribution to numerous "deserving" smaller cities primarily in the southern states.

The elimination of the maximum limit, when taken in conjunction with the elimination of the 20 percent floor, would enhance the equalization impact of the program in major metropolitan areas, as noted above.

Although the Commission recognized the existence of fiscal aberrations resulting from the 20 percent floor and the 145 percent ceiling on local revenue sharing allocations, it took the view that these factors were not of sufficient magnitude to warrant departing from the exsisting allocation process.

The Commission concludes that the present distribution formula does provide a significant degree of intergovernmental fiscal equalization. The Commission, therefore, urges that the present distribution formula be retained.

The Commission notes that the elimination of the 20 percent floor on local allocations has several practical disadvantages. The amount of general revenue sharing funds made available by the elimination of the 20 percent floor on local allocations is modest at best. Governments benefitting from the application of the floor on payments obviously neither serve many people nor perform many functions. Thus, the amount of money that would go to other governments would be small and therefore not significantly equalizing. In addition, the law prohibits any local government from receiving an allocation greater than 50 percent of its adjusted taxes plus intergovernmental transfers. This further limit on the local allocation represents a line of defense to prevent any local government from getting an extraordinary, favorable benefit from the 20 percent rule.

It can be argued further that the 20 percent rule is the product of sound, political judgment. It has the distinct merit of spreading a modest portion of revenue sharing funds around thereby generating wider political support for the program. Moreover, it can be argued, revenue sharing should not be expected to be the vehicle for restructuring local government — it has one central objective, to redress fiscal imbalance within our Federal system. In addition, there is no assurance that cutting off Federal aid funds will do the job of restructuring local government, a responsibility that lies ultimately with state government.

Again, certain practical and political disadvantages weigh against the suggestion to remove the 145 percent limitation on local revenue sharing allocations. Because the total revenue sharing allotment for a state in any given year is a fixed amount, any increase in the allocations to big cities must come at the expense of allocations to other units of local government within the state. Indeed, some cities, like Philadelphia and St. Louis, loom so large in the local government picture in their states that the removal of the 145 percent ceiling would result in a reduction in allocations to almost every government in the state including Pittsburgh and Kansas City in this example.

It is appropriate to limit the "Robin Hood" effect of revenue sharing. After all, Detroit receives a per capita allocation of over $27.00 under the current program while nearby Grosse Point Farms receives just $3.83. The 145 percent ceiling has the earmarks of being the appropriate "trade off" to assure continuation of the alliance of forces needed to obtain renewal of the program.

The Discrimination Issue

The present law clearly directs the Secretary of the Treasury to insure that revenue sharing dollars are not used to perpetuate discrimination on the basis of race, color, national origin or sex. This raises the question of (a) whether the Office of Revenue Sharing should be staffed to vigorously enforce the non-discrimination provisions of the revenue sharing law or (b) whether compliance with the provisions of the revenue sharing law can be integrated with civil rights compliance activities of other existing government agencies.

No one would argue seriously that the concept of no strings Federal aid abrogates the constitutional mandate for equal rights, a national commitment. The revenue sharing concept cannot work unless it works for all the people. In relation to the overall Federal task of enforcing compliance with the civil rights mandate, it is argued that the present Federal effort could be usefully augmented through the revenue sharing program. Thus, it has been suggested that the Office of Revenue Sharing should be provided with sufficient staff to assure compliance with the antidiscrimination provisions of the law.

At the present time, the Office of Revenue Sharing has the authorization and funds to support 30 positions for its compliance effort — a minuscule staff in relation to the 39,000 governments that receive revenue sharing funds. In view of the variety of compliance tasks in addition to policing the prohibition against discrimination, the staff is also small in relation to whatever discrimination exists at the state and local level. The prohibition against discrimination in the revenue sharing law goes beyond the usual elements of race, color, and national origin to include the prohibition against discrimination on the basis of sex.

It is further alleged that from a political standpoint it makes good sense for the friends of revenue sharing to create a confidence building civil rights enforcement program and thereby spike one of the major guns now trained on the program by its ideological foes.

On the other hand, the friends of the revenue sharing program must be constantly on their guard against those who would subvert the essential purpose of revenue sharing – to redress the fiscal imbalance within our federal system. The Office of Revenue Sharing should remain a very small agency dedicated to getting the checks out on time, yet staffed adequately both to follow up expeditiously on all complaints and audit findings concerning discrimination and to promote citizen and public official awareness of the need for selfpolicing of the prohibition against discrimination. ORS should not be equipped and staffed to be the principal instrument for ridding the state-local sector of discrimination in all of its forms.

The National government now has agencies engaged in combatting discriminatory practices. The Equal Employment Opportunity Commission has approximately 2,500 employees investigating discriminatory employment practices in private industry and in government. The present charter of the EEOC permits that agency to investigate complaints for all governments with 15 or more employees. In addition, there is the large civil rights division of the Department of Justice and the civil rights enforcement capability of HEW and other Federal agencies administering Federal grant programs.

In time, state and local governments can be expected to increase their effectiveness in combatting discrimination. Human rights agencies have been established in 40 states and the District of Columbia. At the local level in 34 states, approximately 400 such agencies exist. Although these agencies usually direct their effort to eliminating discrimination in the fields of housing and employment, some have broader authority. Many of the agencies still have not been granted a wide range of enforcement tools to stop discrimination. Yet, by referring cases of alleged discrimination to other agencies with such powers, including now the Office of Revenue Sharing with its enforcement powers, the local agencies are far from powerless to combat discrimination.

Because the general revenue sharing program is based on the philosophy of returning power to the grassroots, the electorate and the elected officials of recipient governments should be given the widest latitude in handling complaints of discrimination and the Office of Revenue Sharing should not be converted into the *avenging angel* envisioned by some civil rights spokesmen.

The Commission recommends that the Office of Revenue Sharing conclude arrangements with appropriate existing Federal, state, and local government agencies to carry out the civil rights responsibilities under the revenue sharing act.*

*Senator Edmund S. Muskie separately commented:

As written by Congress, the revenue sharing law imposes an unequivocal prohibition against the discriminatory use of revenue sharing funds by state and local governments. This prohibition is part of our national commitment to use the full powers and machinery of the Federal government to help eliminate discrimination.

Unfortunately, however, the record of the Office of Revenue Sharing to date is less than satisfactory in three areas – in prompt investigation of charges of discrimination, in vigorous enforcement of the law in cases where those charges have been substantiated, and in monitoring local compliance efforts where voluntary agreements have been reached. It is true that the compliance division of the Office of Revenue Sharing has been hampered by lack of staff, and that Congress has failed to authorize a sufficient number of civil rights specialist positions, as requested by ORS. Nonetheless, the basic philosophy of the Office of Revenue Sharing with respect to civil rights enforcement can only be described as extremely cautious.

The ACIR recommendation that the Office of Revenue Sharing conclude arrangements to carry out civil rights responsibilities with existing Federal, state and local government agencies is desirable as far as it goes, and should help to facilitate investigations of civil rights complaints. However, as the Federal agency responsible for distributing some $6-billion a year to state and local governments, the Office of Revenue Sharing should play a more aggressive, highly visible role in Federal civil rights enforcement activities. This role should include a vigorous monitoring program undertaken by a substantially augmented civil rights compliance staff. To enable ORS to meet its responsibilities Congress should authorize additional personnel. Anything less would be an abdication of the basic Federal commitment to end discrimination.

In making this recommendation, the Commission does not contemplate that ORS would abdicate its responsibility or authority for enforcing the non-discrimination provisions of the revenue sharing law nor slacken in any way the program it is now implementing. The Commission intends rather by its recommendation to suggest a way to maximize compliance effort while minimizing the number of compliance positions in the ORS. By concluding arrangements with appropriate existing Federal, state, and local agencies, ORS should be able to enforce effectively the antidiscrimination provisions of the law while avoiding duplication of enforcement effort. This recommendation accords with the limited Federal involvement embodied in the revenue sharing concept.

The Federal Control Issue

Congress introduced an element of ambiguity as to its intent in the present revenue sharing program. On the one hand, Congress clearly designed the program to strengthen decentralized decision making. On the other hand, Congress included certain vestiges of Federal direction over the state and local use of the funds because of the belief by many legislators that they will be held accountable for the proper use of these Federal funds. Two of the more obvious examples of Federal direction in the present law are (1) the local priority expenditure categories and (2) the Planned Use and Actual Use Reports and publication requirements.

Revenue sharing purists consider these vestiges of Federal direction as unnecessary, complicating, misleading and at least slightly wasteful. They call for the elimination of local priority expenditure requirements because they are largely cosmetic in character. They seek the elimination of the Planned Use and Actual Use Reports on the grounds that they provide little or no insight into the impact of the program on state and local governments in particular and on the federal system in general.

The Local Priority Expenditure Requirement

Revenue sharing purists argue that the local priority expenditure requirement should be removed because it serves only a "cosmetic" purpose – it creates an impression of Federal direction that is far more apparent than real.

Those with a practical bent note that local officials enjoy wide latitude in budgeting revenue sharing dollars because this program lacks revenue and expenditure maintenance requirements. Moreover, it is virtually impossible to distinguish revenue sharing dollars from state or local dollars once local officials transfer revenue sharing funds out of the required trust fund. They also note that the so called *high priority* categories cover a large part of the spectrum of local activity – public safety, environmental protection, public transportation, health, recreation, libraries, social services for the poor or aged, and financial administration.

Political pragmatists argue that the friends of revenue sharing might be well advised to leave this "cosmetic" provision alone because any attempt to remove it could prove counter productive. Many Congressmen might resent any overt attempt to strip this program of all evidence of Federal direction. There is a real danger in allowing the revenue sharing purists to push their logic to the extreme, in this case, asking Federal policymakers to repeal a provision that is not causing state and local officials much trouble but does have considerable support in Congress.

Planned and Actual Use Reports

The Congress provided for two reports in the revenue sharing law as a means of securing accountability and public interest in the use of the funds.

The Planned Use Report, required at the outset of each entitlement period, alerts the public to the fact that a specified amount of revenue sharing dollars will soon become available to the governmental unit and that the officials responsible for spending the money intend to use it in ways specified in the Planned Use Report.

The Actual Use Report, prepared and published at the end of each entitlement period, is designed to serve two purposes. First, to reveal the financial flows into and out of each state and local government's revenue sharing trust fund. Second, it is intended to be a report to the public on the use of the funds.

For state governments and most local governments, the portion of the Actual Use Report devoted to telling where the funds were spent may be little more than a bookkeeping exercise. The actual uses provided on the forms are so broadly categorized as to obscure the effect of revenue sharing funds on the government's budget and activities. Moreover, revenue sharing funds can be used to free up local funds for non-priority expenditure categories and therefore a report on the actual use of revenue sharing funds may not disclose their effect on expenditure patterns. This raises two questions. Should Congress eliminate the public reporting requirements of the present revenue sharing act? Can the present reporting requirement on actual use be strengthened in a meaningful way?

Recognizing that the Planned Use and Actual Use Reports that are now required fall short of giving the public and the Congress a fully accurate indication of the role that revenue sharing dollars play in state and local budgetary decision, some thought is being given to the development of more informative reports. One idea that may attract some adherents is based on the premise that the state and local budget process usually has its greatest meaning at the margin where programs are either added or deleted depending upon the availability of funds. This *marginal impact* concept suggests that one way of obtaining a better appraisal of the actual use of revenue sharing dollars would be to ask state and local officials to identify the programs that would be sacrificed if revenue sharing were not available. The Actual Use Report now suffers from the failure to disclose the displacement effects. If the local expenditure priority expenditure restrictions are removed, the case for this marginal impact report becomes stronger. It is a way of obtaining needed information for Federal policymakers without impinging on state and local discretion. Its effectiveness would rest on the requirement that a state of local official bears responsibility for its preparation and accuracy.

In opposition to this proposal it can be argued that the fungibility of revenue sharing dollars and state and local own source dollars makes all attempts to draft meaningful reporting requirements an exercise bordering on futility. Moreover, from the viewpoint of the revenue sharing purist, Congress should not demand an accounting for use of funds that should be regarded as *discretionary* state and local revenue.

From the technical standpoint, the marginal impact type report is subject to the criticism that it would encourage state and local officials to write very self-serving statements about their budget priorities, or transient, quick, careless judgements that could not be refuted. If the marginal impact report were taken seriously, it would require the same careful preparation required to develop the government's budget in the first place and therefore might end up being an excessive administrative burden.

In view of the difficulty of developing a new type of report and the apparent lack of difficulty with the present system, the Commission decided that the existing reporting requirements are responsive to the Congressional desire for at least a modicum of Federal accountability and direction. The Commission therefore made no recommendation with respect to reports nor with respect to the elimination of the local priority expenditure requirement although it was the sense of the Commission's deliberations that Congress and the Administration should be constantly seeking more useful reporting techniques if Congress insists on requiring reports from revenue sharing recipients.

The Leverage Issue

Congress will be under relentless pressure to use revenue sharing to promote *good government* reforms such as citizen participation in the state and local budgetary process, more intensive state use of the personal income tax, and regional government cooperation and many others.

Citizen Participation

Many local governments have active programs to involve citizens in the budget formulation process. Some local governments lack a process for obtaining citizen input. Still others have procedures but allegedly do not give serious consideration to citizen suggestions about spending priorities. As noted in **Finding 8,** the required publication of the Planned Use and Actual Use Reports has done relatively little to alter the usual local practices with respect to citizen participation. The true believers in citizen participation argue that unless the public has an assured method of making its views on state and local budgets known to their elected officials, revenue sharing will fail to fulfill its promise of making state and local governments more responsive.

They further contend that Congress has the right to expect state and local governments to allocate revenue sharing funds through a process that encourages citizen awareness and involves citizen participation. The essential features of such a process usually include:

> a hearing on the total budget of the recipient government, including anticipated receipts and expenditures of revenue sharing funds,
>
> advance notice of the hearing either by newspaper or other suitable method of reaching the general public, and
>
> availability of budget summaries and narrative highlights at the principal office of the government in advance of the hearings.

State and local officials seldom quarrel with the idea of citizen participation but nevertheless argue that the inclusion of a requirement calling for state and local governments to have an open budget process is inconsistent with the purpose of general revenue sharing. They argue that this is one more manifestation of the desire to use the revenue sharing program to lay down a uniform national pattern of governmental practice. State and local governments in their view, should not be coerced through Federal general purpose aid to change practices that they have found suited to their varying needs. Numerous state laws and local ordinances already provide sufficient opportunity for citizen participation in the budget process; where this is not so, it is up to the citizens to secure their rights.

The State Personal Income Tax Incentive

Congress intended to encourage increased state utilization of personal income taxation by adopting the House five factor formula as an alternative method of determining the interstate distribution of revenue sharing funds and by providing for optional Federal collection of state personal income taxes. As **Finding 11** clearly shows, under the present system these incentives are minimal. Only 16 states plus the District of Columbia have an incentive to shift from non-income taxes to income taxes. Even for these states the incentives are small, and it is obvious that political constraints outweigh any benefits provided by general revenue sharing.

The piggybacking provisions allowing for the Federal collection of state personal income taxes also was intended to provide an incentive for states to increase utilization of this tax or to introduce it as a new element of their tax structure. The requirement for strict conformance with the Federal tax, the failure of the U.S. Treasury Department to promulgate regulations, and the apparent intention to require state reimbursement of Federal cost have kept states from entering into piggybacking agreements with the Federal government.

This Commission has long urged the states to make effective use of individual income taxes as part of a well balanced state-local revenue system. Moreover, in the ACIR study, *Federal-State Personal Income Tax Coordination,* the Commission said,

> It is clear to us that no comprehensive study of the ways in which the Federal government can use its resources in aiding State and local governments can override the hard logic that the States should be encouraged to exploit their own tax resources before Congress considers the introduction of large scale general purpose aid programs.

As long as ten states still do not impose a broad based personal income tax the Federal revenue sharing program will be the lightning rod that attracts proposals for encouraging state use of a prime tax source. Income tax advocates note with gratification its many advantages. For example, reliance on a broad based personal income tax can improve the fairness of state and local taxation by allowing for various exemptions as well as for adequate revenues at a low rate. The income tax also provides states with a source of revenue that grows as the economy grows whether due to real causes or to inflation.

This Commission has been in the vanguard of those advocating increased utilization of the state personal income tax. But the Commission foresees certain disadvantages in adding an explicit incentive for this purpose to the revenue sharing program. The more objectives that are added to the general revenue sharing program, no matter how worthy, the less likely it is to succeed because multiple goals may tend to conflict with each other. If the Congress is convinced that states should adopt or increase personal income taxation it can legislate a program dealing specifically with that issue.

* * * * *

Summing up the views of the Commission on revenue sharing, individual aspects of this program can be faulted for not conforming to all the nuances of our highly complex state and local fiscal system. For example, the present program does not go as far as some would urge in equalizing fiscal capacity between rich and poor states. Nor does the present program completely compensate for the great fiscal disparities between the nation's major central cities and their affluent suburban neighbors. But, taking the distribution of revenue sharing funds as a whole and bearing in mind the diverse interests that had to be reconciled in creating this program, its fiscal equalization results are impressive.

By the same token, some of the advocates of *pure* revenue sharing fault the Congress for attaching certain expenditure *strings* and imposing certain reporting requirements on state and local governments. Yet, our findings reveal that despite these conditions, state and local governments enjoy wide discretion in the use of this added resource; while, at the same time, the conditions provide at least a modicum of Federal guidance for this program.

A long time student of our federal system, James Maxwell, has observed,

. . . .federalism is, in any case, essentially pragmatic: It is conceived and born in compromise which often falls short of the golden mean; it accepts less than the best to achieve viability; it can be changed only slowly. *

Clearly, the renewal of the revenue sharing program reflects this pragmatic character of federalism where accommodation to various interests must be made to insure that the continuing quest to improve the program does not undermine the support for an already essentially good one.

FOOTNOTE

[1] James Maxwell and Charles E. McLure, Jr., "Comment and Reply: Revenue Sharing," *Public Policy,* Vol. XX (Winter, 1972) No. 1, p. 158.

Appendix

ACIR REVENUE SHARING HEARING SUMMARIES

June 21, 1973

ACIR REVENUE SHARING HEARING

ACIR held a field hearing on the implementation of revenue sharing, June 21 in San Francisco. Officials and civic group leaders from western states reported on how their states and cities were spending revenue sharing funds, citizen participation in the allocation decisions and the effect — that can be determined at this early stage — of revenue sharing on intergovernmental relations. Several common threads emerged from the wideranging testimony of the witnesses. Because of the information gathered at this pilot hearing, the Commission decided to hold a national hearing on revenue sharing in the fall in Washington, D.C.

Several common themes emerged from testimony at a western field hearing on revenue sharing conducted June 21 in San Francisco by the Advisory Commission on Intergovernmental Relations:

- In general, cities are using revenue sharing funds more for one time capital projects and states for tax relief and social programs.

- But, it is still to early to get an accurate picture of how revenue sharing fits into the overall scheme of intergovernmental fiscal systems — and far too early to evaluate its impact.

- The lack of hard and fast rules — the ambiguity of the "strings" — on the one hand, but the temporary nature of the five year authorization for revenue sharing on the other hand, creates a dilemma for local officials who want to use the money for locally determined priorities but feel the need to "second guess" the program's Federal auditors.

The Hearing

When the President signed the revenue sharing act last fall, he asked ACIR to monitor this innovative program's impact on intergovernmental relations. The Commission accepted the task and decided to hold a hearing in the west to test this method of gathering such information.

A public hearing was held on June 21 in San Francisco. Six witnesses appeared before 14 members of the Commission.

The six witnesses, from state and local government and civic organizations, were *Alan Post,* legislative analyst, State of California; *M. D. Tarshes,* county manager, San Mateo County, California; *Don Benninghoven,* executive director, League of California Cities; *Hugh McKinley,* city manager, Eugene, Oregon; *Mrs. Kenneth Kaplan,* president, California League of Women Voters; and *Robert Brown,* executive vice president, California Taxpayers Association.

The 14 Commission members present at the hearing were *Robert E. Merriam,* chairman and *Robert H. Finch,* private citizens; *Kenneth R. Cole, Jr.,* executive director of the Domestic Council, member of the Federal Executive Branch; Governors *Daniel J. Evans* of Washington and *Robert D. Ray* of Iowa; Mayors *C. Beverly Briley,* Nashville-Davidson County, Tennessee; *Richard G. Lugar,* vice chairman, Indianapolis, Indiana; *Jack D. Maltester,* San Leandro, California; and *John D. Driggs,* Phoenix, Arizona; State Senators *B. Mahlon Brown* of Nevada and *Robert P. Knowles* of Wisconsin; and *Judge Conrad M. Fowler,* Shelby County, Alabama; *Edwin G. Michaelian,* Westchester County, New York; and *Lawrence K. Roos,* St. Louis County, Missouri, county officials.

Deciding on How to Use the Funds

General revenue sharing comes to California at a time of a substantial State surplus, said Alan Post, state legislative analyst, and the decisions on how to use revenue sharing are being made in this context. He noted two major plans have been advanced, the governor's plan and the assembly Democartic program. In essence, both would use the $235-million in fiscal 1973 revenue sharing money for tax relief. Disposition of fiscal 1974 funds is less clear, but he suggested the $223-million would probably be used both for new school financing programs and for tax reductions.

California cities received $164.6-million in Federal revenue sharing in fiscal 1973 and $156.3-million for fiscal 1974; county governments got $305.6-million in fiscal 1973 and $290.2-million for fiscal 1974.

The results of a telephone survey, Post explained, show tentative expenditures;

> include everything from fire alarm boxes to community action programs. However, the majority of the jurisdictions surveyed planned to use the funds for one kind of capital improvement program or another. Parks, flood control projects, libraries, and city and county buildings were given top priority. The purchase of fire equipment, police vehicles, hospital equipment, and other equipment was next in line. The trend is against funding ongoing programs because of a fear that the revenue sharing program will end in five years and that the local government will be left programs which it will have to continue to support on its own.

Don Benninghoven of the California League of Cities reported that California cities "have chosen to include general revenue sharing expenditure decisions in the same process as the decisions relating to other general fund monies," in large part because of long experience with a type of state revenue sharing program. He also said the cities would use the funds for capital expenditures "undoubtedly because of the reluctance to initiate ongoing programs when there is no guarantee that Federal funds will continue past 1976."

He cited two examples from local Planned Use Reports on how cities arrived at intended use of their revenue sharing funds: the City of Riverdale arbitrarily proposed using 63.1 percent for capital improvements; 36.9 percent for operating and maintenance. On the other hand, the City of Santa Cruz developed a three point guideline for spending the money: to benefit the overall city rather than to be allocated to specific areas or special interest groups; that it not be used for a one lump sum project; and that citizen input and response be solicited by questionnaire before any final decisions are reached.

Another example of local decision making techniques in allocating the funds was given by Mrs. Kenneth

Kaplan, president of the California League of Women Voters:

> Orange County which adopted a policy for the expenditure of revenue sharing funds that 50 percent of said funds shall be for tax reductions, 25 percent for parks, recreation and open space, and 25 percent for social programs. . . In essence, a *shopping list* of possible uses was developed by the county administrative officer from department requests and public hearings; with the help of an advisory committee from the various county departments, he presented a full list of *proposed projects* and *projects not recommended at this time* to the supervisors; and most recently a citizens advisory *Social Project Review Committee* has been added. To our knowledge, no other county or city has approached the allocation of revenue sharing funds with nearly this much careful planning.
>
> Elsewhere, first come, first served seems to be the rule. The League of Women Voters of Davis reported that almost all project requests were granted in Yolo County, although they expect that next time around there will be many more requests submitted as more groups of citizens become aware that funds are being allocated. It appears that very little advance planning is going into allocation of funds. In San Francisco, the budget analyst pointed out to the board of supervisors that if they appropriated all of the funds for projects that they had promised they would exceed the amount of available revenue sharing funds by some $600,000 by the end of June 1974.

Planning Problems

Another witness, Hugh McKinley, city manager of Eugene, Oregon, cited this lack of ability to plan and make decisions on spending the new money as a basic problem with implementing revenue sharing:

> The advent of revenue sharing, limited as it is to a minor percentage of a total budget, has provided a new source of revenue which makes possible the achievement of some long deferred needs. And since it can in no way meet a majority of the long deferred needs it necessitates a systematic process of priority setting and decision making. This can be both painful and enjoyable. In many instances it has thrown policymaking bodies into a virtual tizzy because of the opportunity for the first time to really make some decisions about the levels of service and varieties of functions to be performed. Added to this is the complication created by the sudden discovery of multitudes of interested public groups, each with its own set of priorities and its conviction of selfimportance. If nothing else, revenue sharing may have pointed up the fact that some of our budget making procedures are obsolete, ineffective, cumbersome, and in need of thorough revision. So long as there were no decisions to make because of the shortage of funds this probably was not important. Now we are finding our policy bodies split between the factions who would hold the line and reduce taxes, the groups who see an opportunity for building long deferred capital projects, and groups who see an opportunity for building long deferred capital projects, and groups who see the first opportunity for local governments to expand and enhance their programs to meet human needs through social service activities.

Most of the witnesses expressed disappointment at cutbacks in Federal categorical aid which followed on the heels of revenue sharing.

Despite this disappointment and the early date, M. D. Tarshes of San Mateo noted,

> I seem to sense some real benefits that can come from shifting the decision making on these programs from the Federal bureaucracy to the local level. Immediately apparent is the potential for less duplication and for more integration and coordination. In San Mateo County and other cities and counties there has already been some actual shifting in the way money is being spent. Revenue sharing is giving elected members of our city councils and boards of supervisors an opportunity to weigh programs that have been supported by the Federal government in the past against other community problems. What it is doing in effect is creating a broader priority base and allowing local officials to make decisions about com-

pleting programs and about shifting funds from existing programs to unmet needs. This will also give the local agencies an opportunity to evaluate results of individual programs — if they will accept the opportunity to do this, they can do it much more effectively than a remote Federal agency.

Information and Coordination

Several witnesses discussed the difficulty of obtaining current information and the need for better information to monitor and evaluate revenue sharing.

Benninghoven discounted the value of the pro-forma publication of the Planned Use Report required in the law. He said,

> Not only does this create unnecessary publishing costs, but in addition the forms are not meaningful to the general public. For example, the planned use form has a category for public safety operating expenditures. From the information on the report form, the public could not ascertain whether the money was to be used for additional retirement benefits for public safety employees, for the activation of a new unit in the fire department, for additional police patrol services, for additional drug enforcement services, etc. In short, there needs to be a more concise, meaningful method for informing the public instead of requiring cities to publish the report forms in their entirety.

Post discussed this problem from the perspective of intergovernmental fiscal coordination in California.

Federally required Planned Use Reports are not adequate for state monitoring he said, in part because they,

> do not put the use of revenue sharing funds in the context of local expenditure for other purposes. Government expenditures can be understood only when reviewed as a whole. It will do little good for us to know that 85 percent of revenue sharing funds are used for public safety capital outlay, 10 percent for health services, and 5 percent for debt repayment, unless we know what other changes occurred in the pattern of local expenditures.
>
> The state's need to have more information about the pattern of local expenditures arises from the interrelationships of Federal, state and local spending. This need has existed and been growing for many years, but recent events have accelerated the problem. A law enacted last session, *Chapter 1406*, better known as *SB 90*, requires the state to reimburse local government for new state programs or increases in the level of service. To meet this requirement intelligently the state will have to monitor local spending patterns.
>
> Federal budget cutbacks and revenue sharing further add to the state's need for information about local government. The state will be a major participant in the realignment of programs and priorities which is associated with these shifts and, as such, it will be calling upon local government to justify their requests and recommendations.
>
> The tenor of future discussions was illustrated by a recent hearing in the senate finance committee in which the committee was being asked to appropriate state revenue for the continuation of the Federally funded Public Employment Program (PEP). The line of questions revealed the thought that, if the state is being asked to spend its revenue sharing money for this purpose, then local government should also be willing to devote its own share to replace cutbacks in Federally funded programs.
>
> I do not know how this problem can or will be resolved, but I am certain that as the legislature considers additional bills to replace Federal cutbacks in the next several months there will be intensified concern expressed over local application of its share of the revenue sharing money.

Tarshes also noted that state policy has a profound impact on local use of revenue sharing funds. Viewing the same situation from the local point of view, he said:

> In California, recently enacted legislation, as well as an important bill now under consideration in Sacramento, will have substantial effects on the manner in which revenue sharing funds are utilized in our state. In the first instance, *Senate Bill 90*, enacted in December 1972, places a quite inflexible tax rate ceiling on all of the California counties and cities. This will

inevitably force our local governments into utilizing revenue sharing funds to maintain operating programs when the service levels in such programs are threatened because the property tax base does not grow as rapidly as work load and inflationary increases. This, by the way, creates some schizophrenic pressures since the temporary nature of the revenue sharing program tends to motivate local officials to use it for non-repetitive items such as capital improvements.

The legislation under consideration at the present time involves the implementation in our state of the provisions of HR 1 — the Federal bill enacted last year under which the Federal government assumes the responsibility for the basic grant and for the administration in adult public assistance programs. If, for example, the implementation of this legislation in our state places a substantial financial burden upon the counties to assist in financing the supplemental payments over the basic grants to adult recipients, the pressures will increase to utilize revenue sharing funds to support the operating budgets of the counties.

In Oregon, McKinley saw buck passing resulting from revenue sharing:

> . . . the availability of the general revenue sharing programs seems to have mesmerized a good many of the members of the state legislature into believing that cities are now in a position to assume all of the distasteful tasks which the state no longer wants to accomplish. There is a rather large amount of buck passing taking place whereby petitioners at the state level have been told to go back to the city halls and get help there. There seems to be an effort to use the availability of revenue sharing funds at the city and county level as one method of bailing the state out of some financial obligations.

And Robert C. Brown of the California Taxpayers' Association — which has opposed general revenue sharing, but supported special revenue sharing — expressed considerable fear at what revenue sharing would do to Federal-state-local relations:

> There will be some major changes in the budgeting process, particularly regarding the allocation of local funds. This is not due totally to revenue sharing, but also due to tax reform in California which has placed limits upon access to property taxes with increased state revenues allocated to local government. Revenue sharing and tax reform will place boards of supervisors and city councils increasingly at the mercy of state and Federal legislative action. Since most of the local budgets are formulated and often adopted prior to action at the Federal level, I see greater uncertainty than ever in the budgeting process.

New Functions

Tarshes saw general revenue sharing as broadening the scope of local government functions, he noted:

> Much of the initial revenue sharing publicity emphasized that the program was designed for correction of *urban problems.* It should be of particular importance to your commission, however, that the funds have been apportioned by the Federal government without any apparent attention to the differences in allocation of governmental responsibilities within the 50 states. The funds have been apportioned in accordance with political boundaries and have not been channeled in accordance with the need to resolve urban problems or with the existing legal responsibility and ability of agencies to respond to such needs. One example we can see in California is that the cities have received a lot of revenue sharing money at the same time that the OEO programs are being cut back. This has put a lot of pressure on the cities to support many of these programs but the cities have not been familiar with the programs because, in California, they have very little if any responsibility for these types of social services. I am sure that in some instances the city officials' lack of familiarity with these programs has made them an easy target for the pressures that have been developed.

McKinley noted that the wide latitude for local expenditures coupled with reduction in Federal service programs "has created a remarkable increase in requests for local grants to fill the social service voids in areas hitherto unrecognized as big city responsibilities."

Goals

Considerable discussion – particularly in the dialogues between the witnesses and the Commission members – dealt with the problem of defining goals. Revenue sharing is designed to bolster local priority setting, and therefore Federally enunciated goals deliberately have been kept at a minimum. But many witnesses expressed the fear that Congress and the Federal auditors would take local governments to task for the way they spent the money in the absence of well defined guidelines.

Tarshes clearly articulated the problem:

> This leads back to the basic problem that I see ahead for the revenue sharing program as a result of inadequate definition of goals. In the absence of some generally understood national goals for this program, we will inevitably see the development of local goals without any logical pattern and we will be unable to rationally evaluate the effectiveness of the program. I suppose that what we will be left with in each locality is the ability to historically describe what we have done – which of course opens the field for all the Monday morning quarterbacks to tell us how we should have done it differently.

Reorganization

Linked to the problem of goals is the question of whether revenue sharing could be counter productive in discouraging cities and counties from reorganizing or consolidating.

Brown saw it as a definite danger:

> First of all, by giving unneeded money to some cities, the Federal government has forestalled the day when these cities might be concerned about reorganizing. It remains our belief that the major way government costs can be controlled and reduced is by reassigning responsibilities. Lacking fiscal pressures, the smaller units of local government are not likely to show much interest in this. As long as there are sufficient funds without any tax pressures, government needs expand to use up all resources.

Benninghoven noted that the problem might be with the definition of tax effort under revenue sharing. He said,

> Many cities in California are concerned with the definition of local tax effort as specified in the revenue sharing legislation. In fact, at the present time there are three bills before the state legislature on this subject. The basic problem is that the use of the term *tax effort* is really a misnomer since the definition takes into account the total amount of locally raised revenues rather than the actual property tax rate or degree of effort. As a result, those cities with extraordinarily high sales or property tax bases benefit under the revenue sharing formula, even though their property tax rate may be much lower than in neighboring cities.
>
> A related problem is that the tax effort of independent special districts has not been taken into account at the local level. Many city councils have determined that it is more efficient and effective to have fire service provided by an independent special district covering numerous cities rather than to have each city provide its own fire service. Unfortunately, these cities are penalized under the revenue sharing formula because the tax revenues of independent special districts are not taken into consideration for the intrastate allocations.

McKinley saw revenue sharing as a minor factor in a very broad problem:

> There are so many factors involved in governmental reorganization or governmental boundary changes that are more dominant than revenue sharing fund availability that it would be difficult to attribute any significant effect on such occurrences to general revenue sharing. Political pressures and prejudices, land values, geographical concern, transportation facilities, and many other factors all have a much greater impact on these questions than I would anticipate would occur from the availability of revenue sharing funds.

And Tarshes saw the danger, but suggested a remedy:

> It seems to me that the decision to apportion Federal revenue sharing funds to all cities regardless of size tends to perpetuate the many ineffective and limited purpose cities we have in this country. Perhaps the same can be said of some counties since it seems apparent at times that there are too many counties in some of our urban areas – and a question can certainly be raised as to the necessity of apportioning revenue sharing funds to many rural counties. The revenue sharing program, although apparently not intended to do so, can certainly act as a barrier to any logical reorganization of local government – and I don't have to tell you that we already have enough barriers. Speaking of goals, why not give state and local officials the opportunity to utilize the power of Federal financing to help reshape our local government structure to more effectively meet the needs of the last quarter of the 20th century? To accomplish this, these officials could be given a substantial voice in determining the method of apportioning the revenue sharing funds. This approach would not be without its problems, but it might be preferable to the present apparent assumption that problems do not vary much from state to state or community to community.

Citizen Participation

Revenue sharing has been sold as a device to get government closer to the people. The Commission was interested in the amount of citizen participation in the program.

Mrs. Kaplan of the League of Women Voters found it disturbingly absent:

> Our third question, relating to citizen participation, reveals that very little effort has been made by city and county government to involve citizens in making decisions on where to spend their revenue sharing funds. In most cases, the government has made public its proposal for use of the funds, as required by law and only then does the citizen, if he makes the effort, have an opportunity to react to the proposals. . . .
>
> To the League, this represents a major problem area in revenue sharing in action so far. League members have stated repeatedly that the Federal government bears a major responsibility, not only to provide funds which are not available at the state or local level or from state and local sources, but also to set firm guidelines about how they are spent. . . . There is a need for guidelines that will help local governments to plan for spending their revenue sharing funds wisely and to involve citizens in the establishing of the priorities in their own communities.

Several Commission members suggested that improving citizen participation was a state and local – rather than Federal – responsibility.

Benninghoven noted, however, that one reason that California cities "include general revenue sharing funds as a part of their budgeting process is the very stringent open meeting laws *(Ralph Brown Act)* which has resulted, as any mayor or councilman can testify, in full public participation. Including general revenue sharing as part of the budget process does not mean to say that a great many cities did not have special hearings on the general revenue sharing portion of their funds." He also noted that with enactment of that law, the burden for citizen participation rested with the citizens.

Conclusion

The witnesses generally agreed that it is still too early to evaluate revenue sharing, that data are inadequate and perspective is absent. But, while criticizing particulars about revenue sharing, several witnesses expressed confidence in the general program. For instance, Benninghoven said, "But despite these minor problems we feel that the Federal revenue sharing program is working extremely well in California."

At its regular meeting following the hearing, the Commission found the observations of the witnesses to be valuable in giving a preliminary picture of how revenue sharing is fairing. Thus, they decided to hold a national hearing on the subject in conjunction with ACIR's October meeting in Washington.

GENERAL REVENUE SHARING AFTER ONE YEAR:

"More Money with Greater Certainty"

At an ACIR national hearing on general revenue sharing, five panels of state, county and city officials discussed how they see revenue sharing affecting their governments and the federal system. Everyone supported the concept of general revenue sharing; most officials, however, criticized the lack of certainty in all Federal aid; several of them questioned the auditing requirements; and some, the allocation formulas.

The Advisory Commission on Intergovernmental Relations held a national hearing on general revenue sharing in October 1973, the anniversary month of the signing of the historic *State and Local Fiscal Assistance Act of 1972.*

The Commission asked five panels of state, county and city officials their views of the impact of general revenue sharing on their governments and on federalism. The 19 officials that made up the panels, without exception, supported the concept of general revenue sharing. With very few exceptions, however, they also expressed disappointment that proposed reductions in Federal categorical aid followed closely on the heels of the program's enactment.

Other major points included:

- Revenue sharing is very welcome as a new program, but categorical grants should be continued unabated as a form of Federal aid.

- Local governments are increasingly using revenue sharing funds for operating programs not merely for capital improvements, but the uncertainty factor still causes the smaller localities to prefer non-recurring types of expenditure.

- Revenue sharing should be made permanent, or at least renewed in the third or fourth year of the five year act to increase certainty about the availability of the funds and flexibility in the use of the money.

- Controversy remains among officials at various levels of government as to the urgency of need, proportion of services performed and, therefore, the allocation of revenue sharing monies.

- The exclusion of user charges from the fiscal effort calculation presents a festering problem. Many local governments that are subject to property tax rate limitations turn to service charges as the sole alternative means of financing. They assert that such charges represent local fiscal effort comparable to taxes, the exclusive measure now used in allocating revenue sharing funds.

- Most restrictions placed on the use of revenue sharing provide few problems to state, county and city officials, but audit requirements in the view of some officials could become onerous.

- All witnesses agreed that citizens should participate in decisions on the use of revenue sharing, but several urban officials indicated that because revenue sharing must be used just to maintain existing city services the potential for citizen participation is limited.

- Restructuring of local government to eliminate non-viable units is necessary, but revenue sharing is not seen as the likely tool to accomplish it.

Background of Hearing

When President Nixon signed P.L. 92-512, *The State and Local Fiscal Assistance Act of 1972,* into law on October 20, 1972, he asked the Advisory Commission on Intergovernmental Relations to monitor the impact of the measure on intergovernmental relations and the federal system. ACIR agreed and the staff has conducted both surveys of officials and polls of the general public during the first year of implementation. To discover the value of the hearing in reviewing the program, the Commission conducted a hearing of western officials and public interest groups in June in San Francisco. Encouraged by the results, the Commission planned a national hearing to come near the conclusion of the first year of operations under the act.

The hearing was not planned as a formal taking of testimony; it was designed to elicit informal, candid reactions from a broad range of state, county and local officials from urban and rural areas. Therefore, each witness was asked to talk informally for a few minutes and then participate in a dialogue with the Commission.

Five panels participated in the day long hearing. The morning featured two panels from individual states: Georgia, represented by its governor, a mayor and a county commissioner; and West Virginia, represented by its governor and a member of his cabinet, a state legislative leader, a mayor and a county commissioner.

The afternoon session consisted of panels from three major general government groups: the National League of Cities-U.S. Conference of Mayors, represented by three mayors; the National Association of Counties, represented by three county officials; and the Council of State Governments, represented by five state fiscal officers. In addition, the National League of Cities submitted a formal statement for the record and the National Association of Counties submitted the results of a survey of county officials across the country.

The Concept of Revenue Sharing

Every witness supported the concept of revenue sharing — the transfer of unrestricted funds from Federal to state and local governments.

County Executive Louis V. Mills of Orange County, New York, said:

> I don't think this legislation should be looked at as some sort of dole from the Federal government to local levels of government. The whole theory of new federalism is that many of these services can be terminated at the Federal level and picked up at the local level. . . . I think we should look at revenue sharing as a continuing, permanent form of conduit for money from the Federal income tax to the level of government that performs these services.

Mayor Roman Gribbs of Detroit commented, "I believe that general revenue sharing was formulated in response to a vital and immediate need in the nation's cities and that given the realities of political compromise, general revenue sharing has performed its task admirably. This is high praise considering the immensity and the complexity of the problem it was developed to combat."

Others acknowledged how grateful they were to have this new source of revenues, calling general revenue sharing: "manna from heaven" and "Santa Claus four times a year."

The witness most critical of revenue sharing was Governor Jimmy Carter of Georgia, who told the Commission "among the 50 governors, I was probably the only one who did not support general revenue sharing to begin with." Governor Carter went on to say that "the concept of revenue sharing is good, but the application unfortunately has been devastating in some instances." He was referring primarily to the reduction in categorical programs that has accompanied the enactment of revenue sharing.

Uncertainty of Funding

All the witnesses commented on cutbacks in Federal categorical grants that followed closely the enactment of revenue sharing.

Governor Carter explained his feelings,

> Although the concept of revenue sharing was very good, I had great concern that there was no additional revenue to share. Despite the fact that the President and then Secretary of the Treasury Connally assured the Congress and the public that existing funds would not be used to finance revenue sharing, I was fearful that this would be the case, and indeed it has turned out to be the case.

A member of the governor's Georgia panel, Commissioner Gil Barrett of Dougherty County, who also serves as president of the National Association of Counties, countered: "It is unfair to link general revenue sharing directly to proposed cutbacks in Federal aid programs. There is no direct cause and effect. It seems likely these cuts in the Federal budget would have been proposed even if revenue sharing had not been enacted. But these cutbacks were directly related to the Administration's concern about inflation and the National debt."

Governor Arch Moore of West Virginia took a different position: "We did not choose to use these dollars as substitution for any programs that existed heretofore in West Virginia, either categorical or block grants. We took the view that these were new dollars and we should put them to work in delivery of services in such a way as to bring about the most dramatic results."

As the hearing progressed, witnesses and Commission members indicated that the biggest disappointment probably was linked with Title III of the revenue sharing act which placed a $2.5-billion ceiling on funds distributed to states for social service programs through Title IVA of the *Social Security Act.* The *1970 Social Security Amendments* had provided for open ended grants for state social service programs. At first, few states were aware of this practically unrestricted source of money and only a few took advantage of it. But, by mid-1972, word had gotten out and so many states were applying for Title IVA money that estimated total requests reached upwards of $7.5-billion. At this point, Congress established the ceiling, tying it to the revenue sharing act for obvious political reasons.

Governor Moore explained the situation:

> In 1970, the greatest invasion of the Federal treasury took place through the back door method of Title IVA of the *Social Security Act.* When the message started getting out to the country, then each state began to expand its social service categories and many of the delivery systems that had not been adequately supported by state funds in the past. In fact, when we presented Federal revenue sharing as a concept to the Senate Finance Committee, one of the most revealing observations was that one state desired to increase its Title IVA application for dollars by over 400,000 percent. Well, now, everybody saw the opportunity to come in through the back door. Congress had no control over this. It was only a matter of time before the Congress was alerted to the fact that this invasion of the Social Security trust fund was going to have to be brought under control. The fact that it was brought rather abruptly under control has put the shoe rather tightly on some of these states.

Governor Daniel Evans, a member of ACIR, added: "I think those states that are complaining so bitterly of how much they are losing are in reality talking about how much less than they anticipated they were going to get that year. They are getting, in most cases, more than they were getting in the past."

Keep Categorical Grants

Most of the witnesses saw revenue sharing as a new dimension in intergovernmnetal fiscal relations, not as a replacement for categorical grants, regardless of the sums involved.

The prepared statement submitted by the National League of Cities-U.S. Conference of Mayors put this in clear terms:

> As a key element of our intergovernmental fiscal system, the Federal government must strive to develop an adequately funded and properly balanced assistance program to municipal governments. General revenue sharing, block grants and categoricals are the essential parts of that system – they must not be viewed in conflict with one another. Although each represents a markedly different approach to Federal assistance, they are integrally tied together at the local level. Working together, these forms of assistance can maximize the impact of Federal resources at the local level on our urban problems.

Governor Carter suggested the need very candidly:

> Categorical grants have been designed as contracts between the Federal government and the state or local government with a clearly understood, predictable sharing responsibility for meeting needs that were identified to be unmet by state and local programs. . . . When these funds are taken away from the poor and put into general revenue sharing or block grants, even the most enlightened legislature is not going to take these funds and put them back exclusively into programs that benefit the poor. They are going to spread them uniformly among all the citizens.

Use of the Funds

The witnesses suggested two general factors that influenced decisions on how to use revenue sharing money: for operating or for capital expenditure and allocating it among the various priorities. One set of factors centered on need and certainty of the money continuing beyond five years. The other set focused on the audit requirements, discussed in the section on audit trails.

A recurring debate since the first revenue sharing checks went out was centered on whether to use the money for recurring or non-recurring expenses.

The statement of the National League of Cities-U.S. Conference of Mayors included a revealing breakout of revenue sharing data by population groupings of cities:

Cities	Operating and Maintenance	Capital Expenditures
500,000 and over	88%	12%
250,000 – 499,999	80	39
100,000 – 249,999	49	51
25,000 – 99,999	38	60
10,000 – 24,999	29	70

Testimony of the local witnesses bore out these statistics. Officials of large cities indicated that revenue sharing was used to meet the enormous budget deficits suffered annually by inner cities.

Mayor Alfred Del Bello of Yonkers, New York, noted that "those funds have been flowed into general revenue before they were even received in order to pay for essential services" and that "absorption of new sources of revenue is so quick that we don't have the freedom to look at supplemental funding for improved services."

The City of Yonkers allocated its revenue sharing: 42 percent to fire fighting, 34 percent to the uniform police patrol force, 11 percent to refuse collection, 5 percent to refuse disposal, and 8 percent to recreation and playgrounds.

Mayor Del Bello said,

> Unlike so many of the towns and villages which have received proportionately much greater amounts considering their size, responsibilities and population, major urban areas can hardly afford to spend their money freely on *luxury* capital improvements such as swimming pools, golf courses, and the like. Every available dollar in urban areas must be pumped into maintaining what is at best an adequate operating level of basic services.

Mayor Gribbs, noting the precarious fiscal position of Detroit and other large cities, echoed those sentiments.

Other witnesses, including Mayor Wes Wise of

Dallas, voiced the argument that with the uncertainty of revenue sharing continuing beyond its initial five year period, it would be fiscally irresponsible to use the money for recurring expenditures. Mayor Wise said if revenue sharing were more certain he would spearhead the campaign to use it for more *people oriented* programs.

Mayor-President W. W. "Woody" Dumas of East Baton Rouge Parish, Louisiana, articulated the fiscal responsibility argument:

> It is wrong to use these funds for recurring items, based on the possibility it was going to go only for a five year period. To me, to use general revenue sharing for recurring items is fiscal irresponsibility. You cannot have deficit spending and, yet, if anyone in the cities or the 28-million people we represent in county government take these funds and obligate themselves and commit their community to a deficit three or four years from now, they are wrong. They are doing their people an injustice.

West Virginia Innovation

In West Virginia, Governor Moore proposed an innovative use of the state's revenue sharing allocation as incentive grants for local government improvements. Governor Moore explained the proposal:

> We took the arbitrary position that since these were new dollars, we did not want to encourage the local governments to spend it as a great windfall on all the things they had wanted to do without regard to priorities. We indicated that the state wanted to use state revenue sharing dollars as an incentive to local government. If they would follow an established system of priorities, which we would arbitrarily set by legislation, we would match every local revenue sharing dollar put into this particular area or avenue of approach to a problem. We would match it dollar for dollar.
>
> The matching projects included: the paving of city and county streets, bridges and roads; the construction of sidewalks, recreational facilities, and libraries; the purchase and construction of street lighting equipment, police and firefighting equipment; the purchase of land and equipment for solid waste management; the purchase of equipment for urban and rural mass transportation; the purchase of equipment for emergency health needs; the improvement of local administrative, financial, and revenue collection systems; the construction and improvement of county and city facilities; and the support of social delivery systems within the county. Over a five year period, the state of West Virginia would have $285-million. We felt that this was the best opportunity to make a complete transition of the body politic, particularly when a number of required services of which the citizens were desirous but which heretofore – by reason of limited taxation – had not been permitted to share in. We did suggest the mode of establishment of a state fiscal assistance act using the residue of Federal revenue sharing funds as inducements to local units of government to take their local revenue sharing dollars and do certain things with them.
>
> We were successful in getting it through one house of the legislature, but the other house wanted to study it for several months. We anticipate the implementation of that legislation in the next session of the West Virginia legislature.

Permanency – or At Least Early Renewal

The principle of certainty in revenue sharing is very important to all of the witnesses. Even the present five year certainty built into the program through a five year advance appropriation is far better than the normal year to year worry about whether Federal aid appropriations will be reduced or terminated, they indicated. A permanent program would be so desirable as to be almost out of the realm of belief of many of the witnesses, they said.

Eugene Farnum, legislative analyst for the State of Michigan, discussed the uncertainties:

> You say to yourself, "Perhaps it will be like other Federal programs and end at the end of five years." You have built in costs at that point. What do you do? Cancel the program? Or do you try in the system of budget priorities to find the necessary funds to continue that program? I would suggest that

> perhaps the Congress should consider the possibility of making it a permanent piece of legislation as a basic statute. Or at least, it should consider the extension of revenue sharing well before the last year. In other words, get an early start. It would help us in our planning.

In discussing the certainty issue, Mayor Gribbs described the typical situation now: "We are accustomed to living under the knife of cuts in funding. We are extremely dependent on grants any one of which can be cut at anytime. So we have become accustomed to planning our future on an annual basis, doing all that we can. Five years for revenue sharing is a luxury. Most times we don't have even that. We accept any kind of a guarantee for the future."

And Mayor James M. Beck of Valdosta, Georgia, commented on the general issue:

> What happens after 1976? We need to know soon. If we had to take one or the other (kind of aid), I'd certainly prefer to take general revenue sharing – but I would like to know if that's the route we're going to follow and not be playing one against the other or offering a little of this and a little of that. A great deal of our problem in local government is that we don't know from day to day or year to year what's going to be available to us the following year.

Other witnesses asked about renewal, urged that Congress consider extension of revenue sharing in the third or fourth year of the act.

Needs and Allocations

When revenue sharing was still pending before Congress, the states, counties and cities showed remarkable solidarity in fighting for adoption. But with implementation of revenue sharing, it was inevitable that parochial interest would resurface. Therefore, it could be expected that representatives from each level of governement would argue that their level should be given a greater allocation because of greater needs or fewer resources.

The state witnesses pointed out that the states have been taking over many local government expenditures and functions and therefore they should be getting more revenue sharing dollars. Local officials, in general, pointed out that their resources are restricted (while the states' are not) and therefore they should be getting a portion of the state allocation (some states point out that they are, indirectly). County officials suggest that governments are taking on new functions altogether – and the level at which they are being performed is inevitably the county. The mayors insist that the big cities have the most onerous burden, the greatest need, the most exhausted resources, and should be getting bigger portions of the allocation.

Several Commission members voiced these concerns for their levels of government.

Governor Richard F. Kneip of South Dakota suggested that all revenue sharing money should pass through the state to enable better planning and more efficient use of the funds.

County Executive Edwin G. Michaelian of Westchester County, New York, suggested that the allocation formula be weighted to reflect the portion of services and functions performed by an individual unit of government.

Mayor Del Bello of Yonkers pointed up one of the effects of overlapping city and county governments. His city's revenue sharing allocation is adversely affected by Westchester County's high income relative to other New York counties. Yonkers relative income is not as high as Westchester County's income, thus Yonkers needs are not truly reflected in its entitlement. The Mayor suggested that the general revenue sharing formula provide for an independent calculation of entitlement for cities of population in excess of 125,000. The influence of an overlying affluent county could thereby be eliminated in determining a major city's revenue sharing payments.

A state witness, John Murray, the budget officer of Rhode Island, suggested that where the state government is responsible for a great deal more than half of the expenditures in the state, perhaps it should receive more than one-third of the funds.

Limits on Local Resources

Local government officials gave as a major reason behind the need for larger allocations, limitations on their resources. The definition of tax effort to exclude user and service charges was also seen as a problem.

Commissioner Dewey E. S. Kuhns of Kanawha County, West Virginia, said, "Our only avenue of income is the property tax. Because of the tax limitation amendment in West Virginia, we are locked in. Revenue sharing brought to our county new money that made it possible to do things we could not do with our own resources."

Mayor Del Bello described the situation in Yonkers:

> It is a city which has the full range of urban conditions from a decaying inner city to prosperous fringe neighborhoods. It is also a city which, like so many of America's urban areas, is financially overburdened and restricted both in its operating costs and in its available revenue. Our already overburdened property tax is effectively exhausted, and while we have done much to control our rising operating costs and create new sources of revenue from special user charges and available state and Federal sources, we still must face the major burden of financing over 75 percent of all the educational costs in the city and the single largest portion of the city's operating expenses from a limited and diminishing set of local alternatives. It is axiomatic in local government that only the state and the Federal governments have the revenue generating capabilities to effectively support the ever increasing cost of local government. Yet each new legislative session brings with it further mandated costs and further restrictions on local governments' revenue raising capabilities.

Several local witnesses explained that they have instituted user charges and service fees to get around the limits on tax resources while keeping property tax within reason. The revenue sharing act uses as a measure of relative effort the U.S. Census Bureau definition of taxes, which excludes user charges and service fees.

Mayor Wise said:

> We have tried some very innovative fund raising programs to keep the property tax down. As one, we imposed a sanitation fee. This is not figured into the revenue sharing allocation for the City of Dallas. Similar fees in other cities also are not figured in. This represents some difficulty because user charges are not characterized as tax effort. It discriminates against cities that in recent years have had to develop these unique sources of revenue to alleviate an overburdening of the property tax.

Restrictions and Requirements

States are forbidden from using revenue sharing funds to fulfill the matching requirements of other Federal aid programs and are required to assure that projects using revenue sharing money are in compliance with civil rights and fair labor standards. Governor Carter criticized the restriction on using revenue sharing to match Federal funds. But Governor Moore countered with:

> I am not tortured by the present restrictions. I can see that the Congress is never going to give the states these \$5-to-\$6-billion and permit the states to use these dollars as the local participating share in some program that requires 20 percent participation by "x" unit of government. Revenue sharing gives you one thing: incentive to local people to see the carrot — to see that they can actually accomplish something in their communities.

A few of the witnesses said that the requirement to meet the Davis-Bacon labor law raised the price of many construction projects.

Revenue sharing restrictions on local government are greater, permitting use of the money only for eight broad "priority areas." These general restrictions do not raise problems for most of the officials. However, several witnesses did complain about the audit requirements that direct recipient units to follow each dollar to its ultimate use.

To simplify meeting this directive, many jurisdictions plowed all their revenue sharing into a few places, freeing up general budget money to be used elsewhere. Considerable discussion centered on this practice throughout the hearing.

For instance, Mayor Gribbs explained:

> By directing Detroit's general revenue sharing monies to three major departments, police, fire and sanitation, we have merely simplified our task of proving to Federal auditors that our general revenue sharing monies have been expended in areas of permissable use. General fund money that would otherwise have been used to operate these departments is freed for other uses.

Commissioner Kuhns said:

> I have to agree that the ultimate step in revenue sharing should be that the money intermingles with regular money raised by taxes because, after all, you've got a pretty

> strict audit procedure under the state tax commissioner. Those records are pretty carefully audited. Under revenue sharing, you have duplication in your accounting procedures at the county level. You almost have to keep two sets of books: for revenue sharing and for regular expenditures.

Governor Moore sharply denounced "playing games" with revenue sharing money by using it indirectly to substitute for tax effort.

> I have taken this mental position. I read that law and it says "directly or indirectly." What they are essentially saying to me is "we are not going to let you play games with this." And we have tried to educate our people, local units of governments. They (the Federal people) may come in sometime in the future and say: "Now look. The law says directly or indirectly. You withdrew all your support for firemen and you used those dollars for something outside of revenue sharing and you used Federal revenue sharing to support the fire department, which is a legitimate support program, but indirectly you are doing what the law says you can't do directly. And thereby you are in trouble."

Farnum explained the procedures in Michigan:

> About the only restriction we really have is that you can't match Federal funds. This is very logical and very reasonable. The thing that is bothering us, however, is the reporting requirements when we have to track the revenue sharing funds all the way down to their final destination. Rather than create a large bureaucracy, we in the state of Michigan have looked for the easiest place that we can – within our $2.6-billion general budget – place the money so that it is most easily identifiable for Federal requirements without a large tracking system or accounting system problem. We therefore placed it in our school fund and from there into our retirement fund. So when we make our report, it doesn't really identify how we use the money. The money goes into our general fund and then goes out.

Leigh Grosenick, Minnesota's Federal-state relations director, offered an alternative approach: "Unlike Michigan which directed its fund to one specific purpose that could easily be trailed in an audit, we worked out, with the U.S. General Accounting Office and the Office of Revenue Sharing, legislative action for revenue sharing moneys to be distributed throughout the general functional duties of state government."

Governor Robert D. Ray of Iowa, a Commission member, queried whether it is a fiction to try to trace general revenue sharing funds to their ultimate use since one dollar is a perfect substitute for another dollar.

Citizen Participation

The witnesses favored the maximum amount of citizen participation possible in determining the uses for revenue sharing. However, the urgency with which revenue sharing was incorporated into the budget of at least one city cut down on citizen participation.

Mayor Gribbs noted:

> In Detroit, no item in our budget is approved without a public hearing first being held. In addition to this hearing, we also scheduled a specific public hearing on the allocation of revenue sharing funds. Since 1943, we in Detroit have had our own community relations commission, a $600,000 a year operation, to enforce all types of antidiscrimination provisions in city practices in hiring and resource allocation.

Commissioner Kuhns said: "We went to the grass roots. We held seminars – town hall meetings – and called the people in and told them 'we would like to hear from you what your community's number one priority is'. Out of the meetings we arrived at a program of priorties."

But Mayor Del Bello acknowledged, "Citizen participation is encouraged but limited because of the necessity of using funds for critical service areas. We don't have too much privilege to debate their application. So therefore, a certain amount of citizen input is automatically denied. We are disappointed by that."

Restructuring Local Government

One problem voiced with the final Congressional compromise on revenue sharing was that because there would be no population cutoff for receiving aid, the act might indirectly prop up non-viable units of local government that otherwise would be merged into larger units. The witnesses agreed that many small units of government should not be kept alive by artificial means, but they doubted that revenue sharing was the tool to effect reorganization or restructuring.

Mayor Gribbs explained:

> It has been alleged that general revenue sharing merely prolongs the life of inefficient local governments and inhibits regionalism and that too much of the revenue sharing money is flowing into wealthy suburban communities who put it to luxury uses. In some cases this criticism is valid. However, these uses of funds intended to save the nation's major cities are a direct result of the political compromise needed to get general revenue sharing passed.
>
> Every Congressman had to make sure there was something for his constituents in the bill before he could justify voting for it. Because of this, it is true that some wealthy suburbs and some towns providing few services do receive funds, but it is also true that by far the largest portion of funds has gone to combat one of the largest of our national problems, the decay of our cities.

Governor Moore said: "I think that restructuring of governmental identities is a matter of necessity. But whether we can use this as a tool or instrument to bring it about remains to be seen. There are awfully strong feelings on this subject. We in West Virginia look forward to bringing about government on a regional basis. But it is an evolutionary thing. Now is not the right time, but we see it coming."

Revenue Sharing in Perspective

Several witnesses placed revenue sharing in the perspective of fiscal federalism and the American political system.

First of all, the state fiscal officials each noted that while Federal general revenue sharing is a new step, state revenue sharing with localities is a practice at least a generation old. Also, that while the monies are very welcome, even essential, they comprise merely 1.5-to-2 percent of an average state budget and maybe 5-to-10 percent of a local budget.

As to the political and historical perspective, the formal statement submitted for the record by the National League of Cities-U.S. Conference of Mayors said:

> The public debate over revenue sharing is already in high gear. Perhaps the greatest danger in evaluating general revenue sharing is to view the program in an historical vacuum – to judge the program only in light of the political battles of the day. When this is done, the program tends to become the symbol for all that is *right* or all that is *wrong* with the present Administration's domestic policies. Revenue sharing has been caught in this political crossfire. Its accomplishments and difficiencies have been exaggerated beyond recognition.
>
> On the one hand, the enactment of revenue sharing has surely not ushered out the *crisis of the cities.* It has not ushered in the second American revolution. It is a mistake to think than an increase of 3 percent in a city's budget is going to alleviate dramatically the problems facing that city. Nor is it going to change dramatically the way in which that particular city government operates.
>
> On the other hand, it is just as fallacious to claim that revenue sharing is going to dismantle and eliminate the entire Federal categorical grant-in-aid system that has been so carefully constructed over the past two decades. Many categorical grants have been cut, but revenue sharing should not be held responsible. The critics would like to argue that if general revenue sharing is eliminated, then the categoricals will be restored. However, the categoricals were cut, not because of general revenue sharing, but because they were deemed ineffective and in some instances, ideologically objectionable to the President. If revenue sharing is terminated, the only replacement will be a $20-billion deficit in municipal budgets.
>
> Revenue sharing must be lifted from this political crossfire and less passionately addressed. It must be placed in an historical context that focuses upon the development of our intergovernmental fiscal system. We must remind ourselves of the evolution of that system and must project into the future the type of system we are working to create.

Witnesses at the October 11 hearing on general revenue sharing were *Gil Barrett,* commissioner, Albany County, Georgia; *James M. Beck,* mayor, Valdosta, Georgia; *Alfred Del Bello,* mayor, Yonkers, New York; *Governor Jimmy Carter,* Atlanta, Georgia; *W. W. "Woody" Dumas,* mayor-president, Baton Rouge, Louisiana; *Eugene Farnham,* fiscal analyst, Lansing, Michigan; *John J. Feeney,* deputy comptroller, Albany, New York; *Roman Gribbs,* mayor, Detroit, Michigan; *Leigh Grosenick,* Federal-state relations, Minnesota; *Dewey E. S. Kuhns,* commissioner, Charleston, West Virginia; *Daniel Lynch,* commissioner, Omaha, Nebraska; *Louis V. Mills,* county executive, Goshen, New York; *Governor Arch A. Moore, Jr.,* Charleston, West Virginia; *John Murray,* budget officer, Providence, Rhode Island; *William Nicely,* mayor, Parkersburg, West Virginia; *Ron Pearson,* commissioner of administration, Charleston, West Virginia; *George H. Seibert,* delegate, minority leader, Wheeling, West Virginia; *Lewis Stettler,* director of fiscal planning, Maryland; *Wes Wise,* mayor, Dallas, Texas.

ACIR REVENUE SHARING HEARING III

Witnesses at ACIR's third hearing on revenue sharing focused on such concerns as: citizen involvement and participation in the use of revenue sharing funds particularly in the social services fields; allocation formulas and the shape and character of governments receiving funds, particularly the midwestern townships; and on the degree to which revenue sharing undercuts the movement to insure civil rights. The hearing was held in Chicago on March 26, 1974.

The third hearing on revenue sharing – *The State and Local Fiscal Assitance Act of 1972* – conducted by the Advisory Commission on Intergovernmental Relations differed from the two previous dialogues both in subject-area focus and in the witnesses heard. The hearing concentrated on controversial topics: citizen participation, use of general revenue sharing funds to support social service type programs and the formulas for distributing funds to local government; and it heard primarily from observers outside of government – some of whom have criticized the program from the outset.

The perspective and the goals of the witnesses differed, but the generalizations were much the same as that of earlier testimony: everyone sees room for improvement, but few if any seek abolition of revenue sharing.

Frank Harris, a United Way official from Detroit, stated plainly that although many improvements are necessary, "We do not want to see general revenue sharing abolished."

Mayor Richard G. Hatcher of Gary, set a similar tone: "Although I have problems with the game, I will do what I can to improve the rules. I realize we are dealing with what may eventually become the only game in town."

And Rev. Jesse Jackson, a Chicago civil rights leader, said he viewed revenue sharing "with mixed emotions." He favors the local decision making fostered by revenue sharing but is concerned that minority interests will not receive the deserved degree of attention from local officials that they do from National officials.

The Hearing

Seventeen witnesses appeared before a panel of three Commission members – Chairman Robert E. Merriam; Rep. Charles F. Kurfess, minority leader of the Ohio House of Representatives; and Judge Conrad M. Fowler, Alabama county official – at the day long hearing.

Eight of the witnesses were government officials, including one mayor, three city managers, two city administration officials and two members of a state advisory commission on intergovernmental relations.

Nine of the witnesses appeared as observers from outside the government. They included a civil rights leader and four executives of United Way, the major association of volunteer organizations. In addition, four Brookings associates appeared as a panel. They are part of a major project that is monitoring revenue sharing using a field research sample of 65 jurisdictions – eight states, 29 municipalities, 21 counties, six townships and one Indian tribe. The Brookings' study is expected to result in a report later this year.

The witnesses were Chicago officials *Edward Bedore,* budget director and *Clark Burrus,* comptroller: a panel of city managers made up of *Edward H. Potthoff,* Saginaw, Michigan; *Robert Morris,* Glencoe, Illinois; *Richard Wilkey,* Des Moines, Iowa: *Rev. Jesse Jackson,* Operation PUSH, Chicago: *Mayor Richard G. Hatcher,* Gary, Indiana: the Kansas Advisory Commission on Intergovernmental Relations represented by *Marjorie L. Taylor,* chairman and *Harold Riehm,* executive director: a panel of Brookings associates consisting of *Richard P. Nathan,* Washington, D.C.; *Frederick D. Stocker,* Ohio; *John Lattimer,* Illinois; *W. O. Farber,* South Dakota: and United Way directors *John P. Walsh,* Chicago; *Walter Tarpley,* Columbus, Ohio; *John L. Darcy,* Aurora, Illinois; and *Frank Harris,* Detroit, Michigan.

Citizen Participation

The amount and kind of citizen participation in deciding how to use revenue sharing funds varies across the board, according to the witnesses. From their accounts of individual areas, no pattern emerged for large central cities, smaller communities, or rural areas. Citizen input appears to be highly localized.

Mayor Hatcher described extensive efforts to involve the citizens of Gary in planning for revenue sharing use:

> That is one aspect of revenue sharing of which we are justifiably proud. Each time we allocated revenue sharing funds, we urged citizens to add any recommendations or suggestions, and to communicate those suggestions to my office. We extensively advertised a public hearing that was not part of our local budgetary procedure, but that was called by the mayor's office. We invited anyone and everyone in the community to present proposals and assured them that they would be given serious consideration. At that hearing, the turnout was excellent. A subsequent screening process produced about seven sound proposals that had come from the general public. In the final proposal that was submitted to the city council, we incorporated six of those. Then the city council held another hearing. The public was invited to come in and participate. We feel we have done just about everything we could to include the public in determining how the revenue sharing funds should be expended – and the response from the public has been excellent.

Harold Riehm of the Kansas ACIR commented:

> . . . revenue sharing has produced a new degree of citizen participation. . . .We feel the advent of revenue sharing has created a new factor which now finds people integrating not only with these special (community action) programs but with general units of local government, if for no other reason than out of sheer recognition that revenue sharing funds must at some point be pumped into human resources development.

In contrast, Rev. Jackson criticized the revenue sharing program:

> There are still no provisions for

> citizens to petition the preliminary use of revenue sharing funds. Nor are there adequate provisions in the regulations permitting citizen input for the planning phase of fund use. . . .It is questionable to allow state and local units of government to utilize freely some $30-billion over a five year period without qualified *citizen* audits.

The first two of eight recommendations submitted by his organization, Operation PUSH, dealt with citizen participation:

> 1. That a citizen audit and citizen advisory council be established and mandated in the regulations and guidelines for Federal revenue sharing administration.
>
> 2. That local and state governmental units be required to report planned expenditures in a document separate from the announcements in the legal notices of the press and that they be required to distribute such reports to the general public.

Richard Wilkey, city manager of Des Moines, Iowa, noted that, "In terms of broad citizen participation, it is not as broad as it has been in the model city planned variations program" in which "a regular structure of neighbors and neighborhood boards" exists.

One of the Brookings associates monitoring two cities and two counties in Ohio, Fred Stocker, professor of business research at Ohio State University, said, "I looked in vain for evidence of increased citizen participation and my inquiries give me no evidence that there has been any significant increase in relatively low level citizen involvement."

The experience of the volunteer organizations has been just as mixed, according to the United Way directors. Walter Tarpley, of Columbus, Ohio, and John Darcy of Aurora, Illinois. Both reported a high degree of involvement in the local government planning process.

In the Columbus case, members of a citizens' planning council helped to draw up guidelines on the use of revenue sharing money which included provision for certain social services. In Aurora, Darcy conducted a survey of community needs and problems in 1972, and developed a list of nine problem areas in the community. These were submitted to the city council which, on the advice of their own citizens' review committee, funded all proposed projects.

Harris of Detroit reported various experiences in Michigan: "There's been little citizen participation. In Detroit it was impossible; it was already budgeted (before the act was passed). Battle Creek has had a fair amount of citizen participation. On the state level, that decision (on using revenue sharing) was made by the governor – not even by the legislature. It was in the governor's budget that he presented."

Capital Improvements

Operating Programs

Since the signing of the revenue sharing act, considerable discussion has centered on priority use of the money – for capital improvements versus operating expenses, and within that broad category, for social service programs.

A frequent argument for using the funds for once only capital programs was that it would be a hedge against the discontinuance of revenue sharing after the initial five years.

Harold Riehm, of the Kansas ACIR, explained a new strategy on that front:

> Initially, revenue sharing was used for long neglected capital projects. Now more is going into operating costs. Initially it was put into capital improvements for fear the program would not be extended beyond five years. Now, the idea is to present Congress with some sort of *fait accompli* – that, if we impress upon them the percentage they (revenue sharing funds) constitute of our expenditures for operations, it would be very difficult for Congress to consider dropping the program.

Bedore of Chicago said, "not one cent went for capital improvements" in Chicago, "we couldn't afford that luxury."

Others who had used revenue sharing for capital improvements are switching to operating programs out of necessity. Wilkey of Des Moines noted, "I don't see that we will be able to use our future entitlements for capital improvements even though we had planned to do so. We will have to use it for operating expense because of the increase in the cost of living."

Stocker illustrated how differing financial pressures on cities and counties accounted for how the money was used in two cities and two counties in Ohio:

> The counties used revenue sharing for capital

> outlays in both instances. They took capital programs off the shelf, programs that probably would have been funded from local sources within a two or three or four year period. But they advanced them in time. . . . On the other hand, the two cities are under considerably more financial pressure. And while there is no doubt in my mind that these cities would have liked to spend the revenue sharing money largely for capital expenditures, they found it necessary, because of the financial pressure, to use the money to restore items that had been pared from the budget or to incrementally expand their service delivery.

Social Services

Within the operating category, the use of the money for social programs rather than public safety or tax relief is a matter of continuing controversy.

Rev. Jackson deplored the minimal use of revenue sharing funds in this area and recommended "that steps be taken to assure greater encouragement for state and local governmental units to use Federal revenue sharing monies for needed social services."

Harris suggested that the citizens themselves are not in agreement with that idea: "General revenue sharing funds at the level at which they have been available, are not the answer to providing human service needs. They were tacked on as the last three of eight or nine priorities. If you take the same survey as was taken in Aurora – in Detroit – you will get police as number one because crime is considered to be a major priority."

Walsh noted, "From reports we have seen, there has been a dearth of investment of these new dollars coming into the community for these social service programs, in general, particularly when large city complexes are involved."

In Gary, Indiana, a large percent of revenue sharing was plowed into social programs – an unprecedented 65 percent – and many complaints were registered from a variety of quarters. Mayor Hatcher explained:

> We have had some criticism. Some of the criticism has come locally – from the Chamber of Commerce and from the League of Women Voters. There has been some concern about putting more money into sewer tap lines and capital improvements. The Chamber thought we should use more of the funds to reduce local taxes. We were ciriticized at the state level. When our proposal was reviewed at the state level, many of our social programs were rejected, basically on the grounds that we're just using too much money for social programs.

Inflation

Wilkey noted that inflation has caused considerable rethinking of the use of revenue sharing. The pressure to maintain current operations in the teeth of rising costs would force governments to use every available resource including revenue sharing funds. Most of the government officials testifying, mentioned the toll taken by inflation and the cost of living increases.

Darcy of Aurora described how in the first year and a half of revenue sharing, much of the money went for social programs. "We were able to get $300,000 of new program off the ground. That's the good news. There has been considerable controversy this week. The city fathers have difficulty balancing the budget and what they have decided to do is take the balance of the revenue sharing money. That demonstrates a dilemma. As an advocate of human service needs, it is disappointing that an alternative cannot be found."

Edward Potthoff, the city manager of Saginaw, Michigan, explained that his city is extremely sensitive to the variations in economic conditions, "all the more so because our local economy is dependent upon the automobile industry." He continued, "We anticipate that the slowdown of manufacturing large autos combined with the effect of the current rate of inflation will mean that revenue sharing must support our entire public improvement program. Revenue sharing must also finance the maintenance of Federal categorical programs for which Federal funds are being phased out."

Discrimination and Undercount

Two major types of complaints lodged against the implementation of revenue sharing have been; the alleged lack of compliance with the civil rights laws in programs for which the money is used, and the undercount of blacks and Spanish-speaking people in the 1970 census upon which allocations are based.

On the first point, Rev. Jackson alluded to the efforts of the Afro-American Patrolmen's League and the NAACP to enjoin distribution of revenue sharing funds earmarked for the Chicago police department on grounds of discriminatory practices. A formal administrative complaint was filed with the U.S. Treasury

Department and the Office of Revenue Sharing in September 1973, asking that ORS make a determination of discrimination, notify the governor of Illinois and request his assistance in achieving compliance, and temporarily defer revenue sharing payments to Chicago until compliance with the act's non-discrimination requirements has been accomplished.

Mayor Hatcher related his frustrating experience with regulations and bureaucracy in this area. The Lake County government in Indiana used $1-million of revenue sharing funds to help build a county court house complex.

> The entire complex was constructed without the use of any minority contractors or subcontractors. As a matter of fact, we have not been able to determine that any minority contractors were even allowed to bid on the job. We contacted HUD and asked if they would hold up construction of the project since revenue sharing had been used. After several weeks, HUD finally got back to us and said that it's not within their jurisdiction and referred us to HEW. We went to HEW and after a similar time, HEW advised us it was not within their jurisdiction and suggested that we contact the Labor Department. Labor said "yes," they thought it was within their jurisdiction, but they had not completed the regulations for enforcement of the non-discriminatory provisions. So we are a little confused, because someone finally tells us that it is really the Office of Revenue Sharing that we should be addressing ourselves to. I think if there is any reevaluation of this legislation that there should be an effort made to clarify that subject.

On the subject of undercount, Bedore explained that the Census Bureau has admitted an undercount of 7.7 percent of black, Spanish-speaking, and poor people in the 197C census of population. He said that amounted to 104,000 people that were not counted in Chicago – who contribute to the tax base but were not included in the revenue sharing allocation.

Rev. Jackson elaborated on the point:

> A lot of the census takers were young college students working on stipend – and there were areas they would not go into. State Street in Taylor Homes, for instance, has 28,000 people in six blocks, we know by rough estimate. Multiply that kind of thing across the nation. Many of the census takers would not go in where they felt they didn't have the right kind of protection; many of them would not go into those areas at night and many of the people are out working in the daytime; their children are at school. There must be some kind of method like the one that the draft system uses. It finds where the people are. The tax people find where the people are. It seems to me inconsistent for the census takers to use a system any less scientific than the draft or the tax people. Needless to say, as a result of that undercount, the cities suffer overall.

Allocation Formula

Revenue sharing is allocated among local governments according to a three factor formula based on population, general tax effort, and relative income. There is no population cutoff, but if a local government is so small that it is entitled to less than $200, it receives nothing. Nathan of Brookings noted that half the jurisdictions that get revenue sharing are under 1,000 population and 80 percent are under 5,000 population.

The allocation formula and its impact on local governments with citizens of varying income levels has been an area of controversy.

Professor William Farber of South Dakota, one of the Brookings observers, described the fiscal disparities in his state: "Counties have not needed the money. Most of them are very wealthy. The median population is 6,500, yet the median figure for their savings is $688,000. Many have over $1-million on deposit. That doesn't mean that South Dakota doesn't have needs. It means that we have commissioners who don't want to spend any money. This is not true of cities. That's why, in our opinion, the formula is a bad one."

Bedore illustrated the fiscal disparities in Chicago. The city, with a median family income of $10,242 spends $9.10 per capita on health and $93.45 on police and fire, by far the largest amounts. The suburb of Arlington Heights, on the other hand, with a median income of $17,034, spends $1.69 per capita on health and $39.60 on police and fire.

Mayor Hatcher cited similar statistics:

> I think that the major problem with the formula is that the element of need is just minimal. Almost two-thirds of the poor

> people in Lake County live in Gary, and our need is so much greater than most of the communities in that county, but under the revenue sharing formula we did not gain any particular advantage. So I think this is a point that should be reevaluated, especially in light of our experience. Also, the formula really does not take into account the fact that some communities in the past have been more aggressive in seeking Federal assistance, Federal funds. And again the result is that in many instances, you find yourself worse off as a result of the revenue sharing program than prior to its institution.

The revenue sharing act permits the state legislatures to change the local allocation formula. However, only one state – Kansas – has brought a proposed change to the point of a vote.

Riehm explained that the proposal to change the formula was prompted by the wide range of per capita entitlements: from \$3.05 to \$13.06 for counties and from \$1.69 to \$9.05 for cities. Various alternatives were investigated with an eye to bringing each jurisdiction toward the middle. However, under the proposed new formula that emerged, 84 counties would have lost money and only 22 would have gained. The bill went to the legislature – and lost.

The other side of this picture was represented by Robert Morris, the city manager of Glencoe, Illinois, who testified from the standpoint of the small city. He mentioned that "revenue sharing came just in the nick of time for the small city. Inflation, demands for local services, and limited sources of revenue have really crippled the small city government in recent years. If it were not for revenue sharing, there would be dire financial crises affecting small government throughout the country." ACIR Chairman Merriam asked him whether states would extend additional assistance to small cities if they were not included under revenue sharing, Morris pointedly said, "I think it would be very doubtful."

Townships

One large aspect of the allocation problem has been the township governments, particularly in the midwest. The revenue sharing act provides money to all general purpose units of government – and depends upon the census definition of general purpose government. Census includes townships in that definition.

Nathan explained the problem:

> It is a striking fact that one-third of the 38,000 local governments that receive revenue sharing funds are midwestern township governments. Most of those governments do very little but repair and operate local – not state and not county but local – roads. In effect, many of these so-called general governments are really special districts for roads. The answer is not simple. Because in New England and New York, township government is indeed very important and, in New England, county governments do not exist. Even within midwestern states, it is not possible to say that all townships are limited function, highway focused governments. Some are not.

Witnesses from South Dakota and Kansas confirmed that many townships in their states are in effect special districts – but others perform the functions of general purpose governments.

John Lattimer, the director of the Illinois Commission on Intergovernmental Relations, described the complex legal problems resulting from Illinois townships' efforts to expend their revenue sharing money:

> Townships in Illinois have essentially three purposes: roads, general assistance, and assessment. Because townships are receiving a great deal of money and have limited statutory authority for expenditures, they have been coming to the legislature and asking for increased authority to expend their revenue sharing money. Last session, a bill passed by the legislature and signed by the governor authorized townships to spend revenue sharing funds – but not their own funds – for priority purposes established in the fiscal assistance act. If you are familiar with Federal law, that is illegal, because you have to be able to spend your own funds to be able to spend revenue sharing funds. Consequently, our commission asked for an attorney general's opinion. . . that said, in effect, they could not spend revenue sharing funds for purposes that they could not attorneys are saying, "you have got to get that money back, and this is causing all kinds of problems." In addition, the League of Women Voters in Illinois has gone so far as to write a letter to the Secretary of the

Treasury saying, in effect, that not only are townships spending revenue sharing money illegally, but they should not get revenue sharing funds at all because they are not general purpose units of government.

Requirements

Most of the public officials who testified said they had no trouble complying with the technical requirements for recordkeeping.

In fact, Morris of Glencoe said, "Most local governments feel there should be Federal compliance requirements to assure that local governments use these monies in accordance with Federal law. We believe that these compliance requirements have been minimal and yet they are essential."

Clark Burrus, comptroller of Chicago (the first city to be audited by the Office of Revenue Sharing), called the accounting requirements "more of a nuisance than anything else" and recommended that "they ought to be repealed or have teeth put in them." He suggested that they "do not serve a constructive purpose" and the required reports are not useful to the citizens.

Mayor Hatcher noted the difficulties some cities may have in making effective use of revenue sharing funds because of restrictive state statutes.

> Local governments are hamstrung by their required adherence to state regulation and restrictions. For instance, in Indiana, local governments are not permitted to use revenue sharing funds for library construction among other general purposes. Additional unnecessary and arbitrary state barriers to the exercise of local government powers could be raised by legislative amendments and thereby impair the effectiveness of the *State and Local Fiscal Assistance Act of 1972*. I feel the method of appropriating general revenue sharing funds (at state and local levels) is at present far too cumbersome. At last count, there were four official steps that had to be taken before a penny could be spent. There were also innumerable substeps that were costly in terms of time spent by the planners and city officials. We believe this (state and local) process could and should be streamlined.

Further testimony brought out that the State of Indiana is one of perhaps three or four states that closely supervises and restricts the local budgetary process.

Access to Federal Data

Some state and local officials have reported difficulty in obtaining raw data on revenue sharing that they need to make studies of how the program is working in their own states.

Riehm stated that for the Kansas study that led to the proposal for a change in formula, the Office of Revenue Sharing was very cooperative.

Nathan commented, "Treasury is always being badgered to give all sorts of help and the reports are always 'they didn't give us this' and 'they didn't give us that.' I think the record should show that in the case of Kansas, you were successful."

Lattimer, on the other hand, said,

> Legislative agencies find it very difficult to get any help at all from the Federal government, the Office of Revenue Sharing included. We are trying to do a major study of use in Illinois. We are going to have to do it ourselves because the cost of doing the survey ourselves would be less than going to ORS – and I think we would get better results from a better questionnaire. We would like to have been able to get the use reports for Illinois from the Office of Revenue Sharing. The only way they would make them available is if we would go up there and look at their microfilms – and then I think they were going to charge us for that.

Cooperative Use of Funds

Because the revenue sharing act provides money to relatively small jurisdictions, the question has been raised whether it serves to help or hinder intergovernmental cooperation – or whether it is even a factor in that situation.

Farber suggested it was a hindering force in South Dakota: "Towns and cities have less need to cooperate with each other and so the net effect has been that the process of promoting intergovernmental cooperation, that in 1970-72 seemed to be accelerating, seems to have stopped. Whether or not it is a long run effect it may be something else – certainly it is something that needs to be very carefully watched."

On the other hand, Nathan, cited "a number of cases where revenue sharing has been a catalyst for intergovernmental acitivity. We can also cite cases of jurisdictions that now are disposed to go it alone. But there are a number of cases in which city-county consolidation in specific program areas has been facilitated – housing programs, water works, public safety facilities, to cite a few."

Certainty

Nearly every witness inside and outside of government has urged early extension of revenue sharing to facilitate planning. At this hearing, all the witnesses but one reaffirmed this belief. Rev. Jackson called for annual appropriations – rather than the five year authorization – to assure greater accountability on the part of local officials.

Conclusion

When the President signed the *State and Local Fiscal Assistance Act of 1972*, he asked ACIR to monitor the intergovernmental impact of this new department in fiscal federalism. ACIR so far has conducted three hearings as part of that obligation.

Each hearing has produced different specific responses to the program – some criticisms, some recommendations, some plaudits. In general, almost all observers wish to see the program perpetuated and improved. Most observers agree that in the past the categorical route has been over used; for the future, many would like to see greater emphasis on block grants; but nearly all see a place for revenue sharing.

As Bedore of Chicago stated at the last hearing, "With all its faults, we love it still."

REVENUE SHARING HEARING IV

At its fourth hearing on general revenue sharing, ACIR heard the views of the National Clearinghouse on Revenue Sharing — a consortium of citizens' groups monitoring the program — and of two local school board organizations. Clearinghouse representatives focused on citizen participation and non-discrimination in the use of revenue sharing; the school board representatives discussed the position of education in the act.

The Advisory Commission on Intergovernmental Relations held its fourth hearing on general revenue sharing — implementing the *State and Local Fiscal Assistance Act of 1972* — on May 15, in Washington, D.C. Topics discussed included the work of the National Clearinghouse on Revenue Sharing, citizen participation and non-discrimination in deciding how revenue sharing funds are to be used, and the use of the funds for elementary and secondary education.

Five witnesses testified informally before a panel of six Commission members. The witnesses from the National Clearinghouse on Revenue Sharing were *Donald Lief*, director; *Morton Sklar*, Center for National Policy Review; and *Linda Brown*, League of Women Voters' Education Fund. The school boards were represented by *Michael Resnick*, National School Boards Association and *Carl Pforzheimer, Jr.*, National Association of State Boards of Education.

Representatives of the National Association of Towns and Townships were also invited to appear but were unable to do so. They did submit a short statement.

Members of the Commission participating were *Robert E. Merriam*, chairman; *U.S. Rep. L. H. Fountain*, North Carolina; *Mayor Jack Maltester*, San Leandro, California; *Commissioner John H. Brewer*, Kent County, Michigan; *Judge Conrad M. Fowler*, Shelby County, Alabama; and *Robert H. Finch*, Los Angeles, California.

National Clearinghouse on Revenue Sharing

The National Clearinghouse on Revenue Sharing is a citizen based revenue sharing monitoring effort mounted by the League of Women Voters, National Urban Coalition, Center for Community Change, and the Center for National Policy Review. It is supported by two foundation grants.

Lief described the clearinghouse's aim as putting the revenue sharing rhetoric to the test of whether it has in fact performed to the benefit of the citizens. The public and citizen organizations, he said, are becoming aware of the fact that what they once considered firm national commitments can be undercut by the distribution of *no strings* money to states and localities.

He listed five principal tasks of the clearinghouse: collecting data to develop criteria to guide decisions about local spending priorities; encouraging citizen participation in deciding both revenue sharing and general government policies; examining the Federal administration of the act to ensure enforcement of non-discrimination and other Federal laws; examining the effect of the distribution of funds on the status of local income groups; and disseminating findings and providing technical assistance to policymakers and citizen groups.

To further these objectives, the clearinghouse is addressing itself to seven specific questions:

- What are the priorities of state and local governments?

- To what extent has general revenue sharing served to replace categorical aids?

- What is the impact of general revenue sharing on the distribution of income by various classes?

- What mechanisms exist for citizen participation?

- Has revenue sharing led to any increase in discrimination against individuals on the bases of age, sex, race, or ethnicity?

- Has revenue sharing helped governments address matters of regional concern?

- What role does the planning process play in deciding how revenue sharing funds will be spent?

Lief pointed out that the clearinghouse effort intends to show what general revenue sharing can and cannot accomplish. General revenue sharing's shortcomings, if any, in dealing with matters of major public concern should be known and recognized as the public debate proceeds on other issues. Presumably, decision makers will then choose the public policy instrument best suited to deal with the problem at hand.

Graham Watt, director of the Office of Revenue Sharing, noted that general revenue sharing was part of an integrated package of Administration proposals to deal with a wide range of public issues. General revenue sharing was not intended to provide a solution to problems that some critics are now loading on it, he stressed.

Revenue Sharing Issues

Civil Rights

Sklar suggested that there was no inconsistency between the concept of no strings Federal aid and the enforcement of compliance with civil rights mandates, a national commitment. The revenue sharing concept cannot work unless it works for all people, he said, and urged that the Office of Revenue Sharing be provided with sufficient staff to assure compliance with the civil rights provisions of the law.

He said the clearinghouse is concerned over the 1970 Census undercount of minorities which can work to the detriment of the inner cities in the allocation of revenue sharing funds. He also described two forms of discrimination – in employment and in the delivery of services. Sklar gave as an example for the first, Chicago's police force case which is now in litigation; and as an example for the second, questions raised about the use of revenue sharing funds in Ouachita Parish, Louisiana; Beaumont, Texas; and Mobile, Alabama.

Citizen Participation.

Commissioner Brewer noted that two types of citizen participation exist in his county: citizens are involved in setting overall budget priorities for county government; and many county functions are under the direction of citizen boards.

Sklar complimented the Office of Revenue Sharing for its publication *Getting Involved* to stimulate citizen participation. He encouraged ORS also to prepare a handbook for local officials offering helpful hints for encouraging citizen involvement.

Human Service

Reported actual uses of revenue sharing through June 1973, indicate that county government tended to put its money into brick and mortar, large cities tended to use their money in operating programs, and small cities invested in equipment. Judge Fowler suggested that a survey might reveal that after the initial local interest in reviving capital investment that had been shelved for lack of funds, local governments would begin to spend revenue sharing funds on human service programs.

But Commissioner Brewer suggested that revenue sharing was intended by Congress to deal with matters that had been neglected while many categorical programs were being created in the social welfare field.

The Schools and Revenue Sharing

Under the revenue sharing act, schools do not directly receive revenue sharing. The state's share of revenue sharing funds may be spent for school operation and maintenance; local revenue sharing can only be spent for capital outlay of benefit to education. Nonetheless, the Actual Use Reports indicated about 65 percent of expended state and local revenue sharing funds going for education.

Resnick discounted that percentage, saying much of it was expended for higher education, for reducing property taxes — substitute rather than new money — and for manpower training, and adult education. He suggested perhaps 10 or 15 percent of revenue sharing funds found their way into additional support for elementary and secondary education. Pforzheimer — in urging greater support for education — noted that education in total commands more resources and manpower than any other governmental acitivity, absent a shooting war.

Resnick claimed schools were put at a distinct disadvantage by not having direct access to revenue sharing resources. Local schools have to go to the local electorate for more taxes while general governments are not asking for increases or are cutting taxes. Local schools have been separated from other governments in terms of access to revenue sources (general revenue sharing in this instance) at a time of rising governmental costs.

He indicated that his organization — the National School Boards Association — would support the continuation of revenue sharing if schools were included as recipients. Both witnesses agreed with the concept of general revenue sharing and grant consolidation in the field of education — but refrained from specifying which proposals their organizations would support.

Congressman Fountain expressed apprehension about the Federal government getting involved with an increasing number of governmental entities in revenue sharing. Pforzheimer, also noting the problem of dependent school districts that do not levy their own taxes, suggested working revenue sharing for education through the state boards of education and the state legislatures. Resnick suggested formula grants as an approach. Pforzheimer said states were an appropriate vessel for carrying out broad national policies. He also called for full and adequate advanced funding and simplification of Federal regulations and controls as part of any revenue sharing or grant consolidation program.

Conclusion

While the problems of revenue sharing are not associated exclusively with that program, they often point to general symptoms of conflicts in our federal system.

Lief alluded to the difficulties in communications between local officials and citizen groups. He described two parallel monologues going in opposite directions. In one monologue, local officials have to avoid making a long term commitment because they lack assurance of continued revenue sharing funding. In the other monologue, local and national interest groups withhold support for revenue sharing because they lack confidence that local officials still undertake meaningful long term program commitments. Result: misunderstanding and suspicion.

Flexibility in the use of funds and devolution of power present both a danger and opportunity for national policy, Lief suggested.

The danger stems from the possibility that local officials will not take full account of the views of their various constituencies, especially the poor and the black and other ethnic minorities. The opportunity lies in enhancing involvement of citizens in spending and other decision making at the state and local level.

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After selecting specific intergovernmental issues for investigation, ACIR follows a multi-step procedure that assures review and comment by representatives of all points of view, all affected levels of government, technical experts and interested groups. The Commission then debates each issue and formulates its policy positions. Commission findings and recommendations are published and draft bills and executive orders are developed to assist in implementing ACIR policies.