Occasional Paper
3

Decentralization or Concentration of Power?

The Paradox of Revenue Sharing

M A Haskell

Centre for Research on Federal Financial Relations
The Australian National University

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PREFACE

This is the third of a series of occasional papers which the Centre is publishing on selected topics in federalism. The papers take the form of a discussion of policy issues supported by statistical or other data intended to throw light on the questions being discussed.

The paper was originally presented to the Centre's Fiscal Federalism Seminar in Canberra in September 1975. Professor M.A. Haskell is Professor of Urban Affairs, University of Delaware. During 1975 he was sponsored by the Australian-American Educational Foundation as Visiting Professor, Department of Politics in the University of New England.

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April 1976

R.L. Mathews
Director

DECENTRALIZATION OR CONCENTRATION OF POWER? THE PARADOX OF REVENUE SHARING

CONTENTS

DECENTRALIZATION OR CONCENTRATION OF POWER ? THE PARADOX OF REVENUE SHARING

The State and Local Government Fiscal Assistance Act of 1972 has been called "....... in many ways...... the most significant domestic legislation obtained by former President Nixon". [1] This judgement is widely made, not because the sums involved are large or because any significant influence on state and local budgets or budgetary processes has been discernible, but because revenue sharing is widely viewed as a watershed; as a turning back from centralism, from big government and impersonal bureaucracies toward a revitalization of the federal system. This revitalization is said to ultimately involve a large scale rearrangement of governmental functions largely in favour of state and local governments. It was, claimed the so-called "Father" of the Nixon Administration's revenue sharing proposals, "....... a deliberate and conscious effort to transfer a greater share of that authority (decision-making power) to states and localities". [2] By doing so, it was assumed that the real political power of individual citizens would be enhanced.

Although the term "The New American Revolution" [3] (which encompassed revenue sharing) may be viewed as an example of the overblown rhetoric so common to the Nixon Administration, and although it was finally replaced by the more modest term "New Federalism", it provides some flavour of the vast changes that were to be achieved through general revenue sharing and its related measures.[4]

THE POLITICAL DEBATE ON REVENUE SHARING

Revenue sharing has been an important part of the public agenda since the early 1960s, placed there mainly through the efforts of Walter Heller, Chairman of President Kennedy's Council of Economic Advisors. In the ensuing years, it gained wide support of a bi-partisan nature. But it was not until late in the first term of the Nixon Administration that it became a priority item for legislative action. After three years of intense debate within the Administration, a plan was presented to Congress in February 1971. Although modified considerably by Congress in the course of two sessions, the major purpose of the Administration bill was achieved - that is to transfer federal funds to state and local general purpose governments with a minimum of "strings".

The wide support for revenue sharing was activated for a number of reasons, not all of them philosophical. Nonetheless, it cannot be denied that, even among Democratic Congressmen, there was a strong feeling that the tide of centralism needed to be revised and that the position of governmental generalists at the state and local level needed to be strengthened *vis-a-vis* that of program specialists in federal agencies and their counterparts in states and localities. The system of categorical grants which had grown immensely during the sixties was widely viewed as cumbersome and as increasingly ineffective.

Even if this is granted, the overall record of the Nixon Administration leads to questions about its real dedication to a philosophical principle. Because revenue sharing was one of its more important programs, if not its most important, one can reasonably assume that whatever that Administration's overall thrust, it was carried over into the quest for a "New Federalism".

That thrust has been best characterized by Jonathan Schell, as one which threatened constitutional government by persistently undermining and attacking the powerful institutions of American life.[5] Specifically this consisted of attempting to subjugate the press, the Supreme Court, Congress and the federal bureaucracy. The ultimate aim was to remove "all the restraints on his (Nixon's) power which had so deeply frustrated him in his first term....". The attacks on the press, Supreme Court and Congress have received widespread coverage; those on the bureaucracy are less well known, but more relevant to the subject of this paper. The aim of that campaign was, first, ".... to turn the White House into an autonomous bureaucracy that duplicated the functions of the established bureaucracy". The next step was to "disperse the loyalists in the White House into the old bureaucracy and to assume control over it".

The aim of all this was essentially pragmatic - to use the Federal Government as "....a machine for punishing and rewarding the American people". This differs from the ordinary partisan actions of an Administration primarily in its totality and secondarily in the generosity of its rewards and the vindictiveness of its punishments.

Revenue sharing, though more prosaic than Watergate, the Pentagon Papers, international "destabilization" efforts and domestic spying nonetheless had an important role to play in the overall design. It can be seen as part of the attempt to break the power of the civil rights-poverty constituency and the symbiotic social welfare bureaucracy which both nourished it and received support from it. The weakening of this coalition would solidify the support of the Nixonian power base, the middle income-middle class surburbanites, the states of the deep south which had, after almost 100 years, moved into the Republican columns in national elections and millions of other Americans, potential Wallace supporters increasingly receptive to the notion that welfare and bussing for school integration were the principal threats to their pocketbooks and to their freedom.

The attack on social welfare took other forms. Having denoted most of the programs of the nineteen sixties as "massive failures", Nixon singled out the Department of Health, Education and Welfare and the Department of Housing and Urban Development as the prime candidates for cutbacks. The Office of Economic Opportunity was not to escape with mere cutbacks; it was scheduled for total liquidation. In Nixon's view, there had been an undesirable trend toward "permissiveness" in law enforcement and in welfare - "the tendency to give people things for nothing and not to punish them enough." [6]

It has been argued that revenue sharing, in addition to strengthening and enlarging his natural power base, gave the President an opportunity to develop an entirely new constituency comprising the elected officials of large cities and states, a constitutency which had, at least since the New Deal, been much closer to the Democratic Party. If revenue sharing alone could not be the cause of a fundamental change in political loyalities, it could at least influence those mayors and governors to lessen their opposition to other Nixonian policies and programs.[7]

The principal hypothesis of this paper is that revenue sharing was the most important domestic element of a broader strategy which was designed to concentrate federal power in the White House, to strengthen an existing political constituency and to punish severely those groups which were anti-Nixon and had been since his dramatic entrance into national politics 25 years ago. In particular, revenue sharing can be regarded as an attempt at restructuring the control of government in the interest of property-owning classes, both at a national level and in local communities. This hypothesis contrasts sharply with other explanations which centre around the need for decentralization in government in the interest of efficiency and grass-roots democracy. The "paradox of revenue sharing" lies in the fact that decentralization in the form specified by the State and Local Fiscal Assistance Act of 1972 led not to the extension of grass roots democracy, but to enhanced political power for local elites. Nominal decentralization of expenditure functions, viewed in class terms, has led instead to a concentration of governmental decision-making power.

This hypothesis can be demonstrated by reviewing the principal effects of revenue sharing after four years of operation. In brief, this paper concludes that social welfare programs have been the principal victims of revenue sharing and that property-related expenditures have been the principal beneficiaries. Social welfare programs have been affected in two ways.

(1) The enactment of revenue sharing was used as an occasion to make severe cuts in categorical grant programs, in violation of a pledge by the President that revenue sharing would constitute "new money".

(2) State and local governments have shown little or no inclination to use revenue-sharing funds for additional social welfare spending. Further, it is concluded that, when needs and fiscal capacity are taken into consideration, there is little equalization in favour of the most hard pressed urban areas with the largest black and Spanish speaking populations. With respect to civil rights, the evidence seems to suggest that the Nixon and Ford Administrations have been, at best, passive in enforcement of the non-discrimination provisions and, more likely, unconcerned. It is also clear that the loyalty to the program of almost all state and local officials has been secured and that the Advisory Commission on Intergovernmental Relations (ACIR) has been transformed from a body created to "monitor the operation of the American federal system and to recommend improvements" to an uncritical advocate for the program in its original form.

The reduced use of the federal government by poor people and minority groups has been balanced by increased access by other groups - particularly middle class property owners - to state and local governments. What was seen initially by many disinterested observers as the diffusion of the power of government became a restructuring of the control of government. The program which was billed as one which would make government "more responsive" became one which in the aggregate allowed or may allow governments to become less responsive to larger numbers of citizens.

These conclusions provide the major explanations for the virtual collapse of the liberal-conservative consensus which supplied the necessary support for passage of the revenue-sharing program. On one hand, most mayors and governors who have testified at ACIR and Congressional hearings urge renewal of the program in its basic form, as does ACIR itself. [8] On the other, an increasing number of critics including leaders of civil rights organizations, organizations representing the poor, many Democratic Congressmen and the Comptroller General urge either drastic changes or replacement with an enlarged program of categorical or block grants. Senator Edmund Muskie, Chairman of the Subcommittee on Intergovernmental Relations of the U.S. Senate Committee on Government Operations has stated that revenue sharing is in "political trouble" as a result of various Administration actions and a distribution formula which provides funds to jurisdictions that do not need them or cannot provide use for them. The Administration actions he refers to are the cutbacks in social programs that accompanied revenue sharing, and the failure to "enforce vigorously" the non-discrimination provisions of the law. Muskie is also critical of the widespread use of revenue-sharing funds to reduce property taxes or prevent increases in them which would have otherwise occurred.[9]

The Ford Administration has taken a middle position, in that it would strengthen the Treasury Department's civil rights enforcement powers and would require a procedure for "citizen participation" in the allocation of funds by recipient governments. But the Administration does not propose substantive changes in the distribution formula, nor does it propose that state and local governments be further restricted in the allocation of funds between programs or be restrained in using them for tax relief.[10]

Prior to the passage of the Act, there was a remarkable consensus among liberal and conservative voices on the desirability of such a program. Joining Walter Heller in his advocacy was another important liberal voice, that of Joseph Pechman of the Brookings Institution and a one-time Treasury Department official.

While Heller. Pechman and others spelled out in great detail the extent of state-local fiscal pressures and the availability of surplus federal funds which could alleviate them, their argument was more than the pragmatic one of revenue-responsibility imbalance. The issue, Heller said, "touches on the very essence of federalism in both a political and socio-economic sense", [11] and "will have a profound effect on the future course and strength of our federalism". [12] He argued that revenue sharing would reduce inequalities in tax burdens and service levels, increase "diversity.....dissent and innovation" in government, and aid pluralism and decentralization of power. In short, "revenue sharing would serve the ends of both political and economic democracy". [13]

Undoubtedly, some of Heller's strong advocacy for revenue sharing stemmed from his belief that rising federal revenues and surpluses would otherwise go toward federal tax reduction. Given his liberal belief in the need for increased public spending, a new program of revenue sharing (i.e. increased spending by state and local governments) appeared as the only possible use for those surpluses which would receive widespread support. Some of the fortuitous convergence of support is said to be due to the fear of conservatives that, if surpluses did occur, tax reduction was not as likely as increased federal spending on categorical programs. Given this belief, it was preferable for them to support increased state and local spending, i.e. decentralization. Prior to passage of the Revenue Sharing Act in 1972, Michael Reagan summed up the matter when he stated that "the single greatest appeal of revenue sharing is that on the surface it appears to combine the liberal desire for an enlarged public sector and the conservative desire to avoid further enlargement of the federal government". [14]

An ironic note to this whole debate is that the predicted federal surplus was one of many victims of the Vietnam War; it simply failed to make its appearance. In spite of that, revenue sharing became an accomplished fact and its extension is a real possibility, despite the largest federal deficits in history. Such success is testimony to the genuine political and ideological support it obtained on both sides of the political spectrum, aided by a President determined to weaken the bureaucracy and the Congress and to reward his supporters quite generously.

There were, of course, opponents - conservatives who favoured tax cuts and thought them a possibility and liberals who, distrusting state and local governments, favoured a deepening and broadening of federal programs.

Thus revenue sharing was "criticized from one side as too conservative and from the other as too liberal." [15] Heller turned these arguments on their heads by arguing that "they combine the sound conservative principle of preserving the decentralization of power and intellectual diversity that are essential to a workable federalism with the compassionate liberal principle of promoting equality of opportunity among different income groups and regions of the United States". [16] This was not an argument that made much impression on confirmed centralists who questioned that revenue sharing would promote "equality of opportunity". Heller had further to argue that state and local governments were not incompetent, corrupt and insensitive as so often had been charged and could be trusted to revitalize themselves, "to release their creative and innovative agencies" if they were given the substance "to fulfil their intended role as strong and resilient partners of our federalism".[17] Further he had to reassure liberals that revenue sharing would help reduce the large differences among states in social service expenditures and that it would not be funded at the expense of the existing federal categorical programs, particularly those concerned with social welfare and urban assistance. Not anticipating Richard Nixon, he did so reassure them. [18]

That conservative ideology merged with liberal ideology is seen when Heller's language is juxtaposed with that of President Nixon. In his 1969 message on revenue sharing, Nixon stated that "a majority of Americans no longer support the continued expansion of Federal services. The momentum for Federal expansion has passed its peak; a process of deceleration is setting in". He argued that many federal efforts in the sixties had failed and he viewed the expanded grants-in-aid programs of that decade as "a gathering of the reigns of power in Washington". This, he stated, was "a radical departure from the vision of Federal-State relations the nation's founders had in mind". He pledged his administration to work towards a decentralization of power in favour of state and local governments. [19]

No doubt some of Nixon's enthusiasm stemmed from the possibility that federal domestic spending could be substantially reduced if revenue sharing became a reality. In fact, just at the time revenue sharing went into effect, the Administration did announce deep cuts in Federal spending for fiscal 1973. In his 1972 budget message, the President recommended a $6.5 million decrease in spending on categorical aid programs, of which almost half was to come from the Department of Health, Education and Welfare alone. Although not all of these cuts were implemented, social welfare programs suffered greatly. [20] In addition, as part of the Act, a $2.5 billion ceiling was placed on Federal matching for social services under programs of aid to the aged, blind, disabled and families with dependent children, effective fiscal year 1973. Each state was limited to a share of Federal matching funds based on its proportion of total U.S. population.

Another provision of the Revenue Sharing Act (Title III, Section 301 (a)) limited the eligibility for social services under public assistance programs. According to this provision, "not more than 10 per cent" of the Federal matching dollars could be spent on clients of other than current welfare recipients. Prior to this amendment, social service programs funded under the Social Security Act could provide services without regard to the tenure of clients. As a result of the new 90/10 eligibility requirements, many providers of service were cut off from funding by State social welfare departments.

Moreover, on 16 February 1973 the Department of Health, Education and Welfare's Social and Rehabilitation Service issued proposed regulations which explained how the law should be interpreted and implemented by state welfare agencies. The effect was to curtail further social service programs, and further limit the number of persons eligible. However, as a result of numerous objections to these new regulations, they were amended and then postponed until 31 December 1974, retroactive to 1 November 1973. (HR 11333). Needless to say, the timing and effect of these actions gave rise to a widespread belief that revenue-sharing funds were intended to substitute and did substitute for some social welfare programs.

Perhaps the most pragmatic political force behind the revenue-sharing concept was and continues to be the Advisory Commission on Intergovernmental Relations. While it is formally a "bipartisan body representing the executive and legislative branches of Federal, State and local government and the public", an analysis of its pronouncements on revenue sharing provides strong evidence that, at least with respect to that issue, it has become a pressure group representing the interests of state and local governments. Even on the basis of sheer numbers, the majority of its 26 members are elected state or local officials including governors, state legislators, mayors and county officials. The pamphlet, which was published in 1970, *Revenue Sharing-An Idea Whose Time Has Come*, sets forth its views quite directly. Its case for revenue sharing is based not only on state and local need but ideologically on maintaining "balance" within the federal system. "We are still receptive to the idea of 'leaning against the wind', of resisting those tendencies and forces in our system that if unchecked would result in lodging a disproportionate amount of political power at one level of government", namely the federal. Among other things, this was said to involve "progressive loss of freedom of choice" as the price that is paid for categorical aid programs. On a more pragmatic level, the Commission cited a Gallup Poll which revealed that revenue sharing enjoyed the support of "71 per cent of the American people", pointed out that the Nixon Administration assigned high priority to it and that about 160 members of Congress had either introduced or co-sponsored revenue-sharing bills.

As an adjunct to its revenue-sharing plan, ACIR had called for the Federal government to assume all costs of public welfare and medicaid (aid to the "medically indigent"). Thus, in a very positive way it attemped to ensure the construction of a more adequate and universal social welfare system. Of course, the pragmatic interest of state and local governments in reducing their own burdens and securing the support of social welfare interest groups was obvious. In addition, the Commission was sceptical of the notion that revenue sharing would undermine existing categorical aid programs. To that challenge it responded that "the allegation that general support assistance would drive out categorical grants is a faulty assessment of Congressional and bureaucratic interest in specific programs. There is no reason to believe that having once enacted revenue sharing Congress would then preside over the liquidation of the categorical aid system thereby renouncing its influence over so many of the great domestic programs operated by State and local governments". It is true that there was no danger of "driving out" categorical aid or of Congress "liquidating the system", but that of course overstated the concern. The question was always whether national concerns, particularly those in the area of social welfare, would suffer as a result of revenue sharing. There is no longer any question that such has been the case.

Another strand of thought in the debate concerned the proliferation of categorical grants during the sixties and the bureaucratic complexity that was engendered. Here again, liberal and conservative views tended to merge. Heller, for example, cited the growth in all federal aid (loans, revenue sharing and grants) from \$4 billion in 1957 to \$14.5 billion in 1967. In that year they represented more than 15 per cent of state-local revenues, having grown from about 3 per cent during the nineteen-twenties. By 1970 they provided over 18 per cent of state-local revenue. While not questioning that these grants served an important and necessary national purpose, Heller nonetheless felt that their drawbacks were increasing. He argued that state personnel and finance were being siphoned away from non-aid programs, that poorer states suffered unduly from matching provisions and that the growing "web of particularism, complexity, and Federal direction" would "significantly inhibit.......... freedom of movement".[21]

Dealing with the same theme, Nixon focused on the piecemeal nature of the grant system which had grown from 160 separate programs in 1962 to more than 500 in 1970. While formula grants levelled off at about 100 in 1965, project grants, which give federal bureaucrats greater discretion, grew at an exceptionally fast rate. By 1971, the total value of all categorical grants had reached \$29 billion.[22] Nixon commented that the system "has grown up over the years in a piecemeal fashion with little concern for how each new program would fit in with existing old ones. The result has been a great deal of overlap and very little co-ordination".[23] Similarly, ACIR commented "State and local governments cannot readily absorb such a large number of diverse programs over restricted periods of time. The sheer number of these Federal incentives, each designed to accomplish a different objective has produced managerial apoplexy if not financial exhaustion for those jurisdictions not able to devote the time and resources necessary to track down and match every available Federal dollar."[24]

Beyond administrative complexity, after the debacle of the "War on Poverty" some liberals had become convinced, or at least were willing to entertain the suggestion, that the bulk of federal efforts to alleviate or end poverty were doomed to futility. In addition, the success of some community groups like the National Welfare Rights Organization and Saul Alinsky's community groups on the local level gave rise to the belief among liberals that decentralization efforts held substantial possibilities.

Conservatives of course had always believed that, given the nature of the poor, social welfare efforts would necessarily fail. One result of the "War on Poverty" was the appearance of a full scale exposition of that thesis in the context of the cities, namely Edward Banfield's *The Unheavenly City*.[25] Perhaps at no time since poverty and equality had been a social issue in the United States was there such a convergence of liberal and conservative views.

This is not to say that there were not important dissenters among the more conventional liberals. Michael Reagan, for example, concluded that revenue sharing would cause neglect of the nation's most pressing local needs- those of the cities- in that it would "return power to state-local officials for whom racial discrimination is still a wholly acceptable premise of public policy". More generally, it would be an abandonment of national purpose and a betrayal of federal responsibility. It would substitute amateur administration for professional and replace an "enlightened conception of social needs" with "exclusive, status quo dominated pressure systems". In short, the power of the "major anti-popular interest groups" would be enhanced. Reagan noted with telling effect that existing grant programs in fiscal 1970 were not being funded up to authorized levels and that what might have been spent on revenue sharing constituted funds that could have been used for categorical grants under existing legislation. There would, he stated, "be more enthusiasm for revenue sharing and much less opposition on the part of supporters of particular grant programs......if the latter programs were being funded up to authorized levels".[26]

THE "PROPER" ROLE OF GOVERNMENT

That opposition based on such an analysis was substantial is evidenced by ACIR's attempt to provide reassurance that revenue sharing would not undermine categorical aid programs.[27]

The controversy around the fate of social welfare programs and urban aid goes to the very heart of revenue sharing. It raises the theoretical question of what kinds of public sector decisions are legitimate and the pragmatic question of the capacity or incapacity of state and local governments. With respect to the former, Secretary of the Treasury William Simon has expressed what might be called a market-oriented view of public sector decision-making. Testifying at the 1974 Senate revenue-sharing hearings, he stated that "revenue sharing is helping the people most by letting them decide what needs take priority in their communities. There is no way that the Federal government can spend this money more wisely than the local governments that see and feel the needs of their citizens daily".[28] This is more than a statement that there is a role for local government; it implies that higher level governments are in some sense non-representative and that their functions, if any, should be limited to areas where local provision is technologically difficult or impossible. Conversely, the statement assumes that local governments are truly representative of the interests of their citizens and are capable of responding to their needs. This is not an uncontroversial view. Critics of revenue sharing, both before and after 1972, argued and still argue that the status-quo conservatism of most local governments would cause them to by-pass the needs of minorities, of the poor, of the ill-housed, the ill-schooled and the exploited.

In a sense the supporters and the critics are talking past each other. The response of some revenue-sharing supporters would undoubtedly be that such may be the case, but revenue sharing is not the instrument to reform local governments or to press certain concerns upon them. Thus the appropriateness of the term "market-oriented" Defenders of the market system argue somewhat circularly that whatever the market provides must be optimal, otherwise it would not have been provided. As these defenders overlook the market power of producers as well as the skewed income distribution of consumers, so the revenue-sharing "marketeers" overlook local power elites and the deficiencies of electoral politics. When these considerations are held outside the frame of analysis, the conclusion logically follows from the premises!

While not widely representative, two other strains of conservative thought should be mentioned here; both oppose revenue sharing. One argues that when state or local officials are not required to raise funds, they tend to be irresponsible in spending them. While it is no doubt true that the level of state and local spending would be lower if officials had to raise the revenue for all programs locally, it does not follow that once federal funds are in hand they will be spent any less responsibly than other funds. A second position argues that revenue sharing is not necessary at all: a more efficient way to accomplish the same ends would be for the federal government to reduce taxes by the amount of revenue it wished to share. State and local governments could then choose to increase taxes out of the increased pool of income or do nothing at all, thus allowing constituents to use their increased "take-home pay" as they wish.[29] Several problems arise here. First, there is no possibility of equalization - of income transfers from wealthy to poor states. Second, there is no guarantee that increased state revenue due to a tax increase will be passed through to local governments. Third, because of the factor of tax competition for industry, it would be difficult for any state, particularly one of the poorer ones, to increase taxes even if this was otherwise considered desirable. Finally, so long as a revenue-sharing program allows recipient governments to reduce (or stabilize) their own taxes, it effectively accomplishes the major ends of federal tax reduction and avoids the pitfalls noted above.

Some of the critics of revenue sharing focused on the alleged incompetence of state and local governments, rather than their ill will toward the needy, in performing the business of government. Reagan argued, for example, that: "State governments are structurally inadequate and politically weak even when not actually corrupt".[30] These charges cover much ground including "archaic jurisdictions and practices", undertrained staff, part-time and underpaid legislators, lack of an independent and critical press in most jurisdictions and excessive influence by lobbyists. Taking note of this, both Senator Hubert Humphrey and Representative Henry Reuss introduced bills making the receipt of revenue-sharing funds conditional on governmental reform. Governors would have been required to submit a plan and timetable for "modernizing and revitalizing state and local governments". The plan was required to cover an extraordinarily wide range of items including constitutional change, reallocation of functions, electoral practices, executive and legislative reform, fiscal and personnel systems, home rule, property tax reform, regionalization, annexation and many others.[31] The bills were never taken seriously by Congress with the result that revenue sharing has had an effect on governmental structure only indirectly, through the distribution formula.[32]

Prior to the passage of the Act, ACIR responded to the problem of modernization and restructuring by stating that "it would be a disservice to the cause of balanced federalism to insist that every State put its structural house in perfect order before the principle of revenue sharing is enacted".[33] Thus, in 1974 ACIR argued straightforwardly that "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".[34] Its present position remains unaltered with respect to reform. In addition, it urges retention of the existing distribution formula, even though it is widely acknowledged that the formula is prolonging the life of certain moribund units of government.[35]

On the issue of state and local capability and responsibility Daniel Elazar takes a position diametrically opposed to that of Reagan. In his view, the allegation of state and local government incompetence and corruption is "one of the great myths of American politics....used to justify further centralization of power in Washington or efforts to bypass the states to give special aid to central cities". He argues that a "transformation of state and local governments....has been going on virtually unnoticed and certainly unsung since the end of World War II". This "quiet revolution" has transformed state and local governments into instrumentalities capable of dealing with the "new tasks confronting government in the contemporary United States". Elazar believes that most criticisms of state and local capability, responsibility and honesty were myths from the start and the rest, "whatever their original value, have long since become obsolete reflections of the time lag that separates actual government performance from public perceptions of that performance". [36]

Perhaps this issue can never be settled in an objective way, since evaluations of state and local governments are never unrelated to the programs that emanate from them. As long as it is widely perceived that state legislatures are not receptive to social welfare and urban needs for example, or it is believed that for many local officials racial discrimination in provision of services and in employment remains wholly acceptable, the question of capability cannot be empirically separated from performance. Elazar grants that "the extension of greater local responsibility.....will lead to results in some quarters that are not satisfying to liberals or progressives....", but argues that that does not provide "reason to plead that there are intrinsic reasons why the states and localities are less able to do the job required of them than the federal government." [37] That begs the question somewhat, for perhaps the most important question for governments is what is the job they are required to do ?

What can the operation of the revenue-sharing act over a four year period tell us about these issues? On one hand, there have been a number of favourable statements regarding the operation of revenue sharing which draw optimistic conclusions concerning the possibilities of extension. On the other hand, there have been a large number of devastating criticisms. In between, there have been some measured evaluations, notably the recently published Brookings study.[38]

An example of the former is an article by John Shannon of ACIR entitled "Federal Revenue Sharing - Time for Renewal". Its theme is that "two key compromises" give revenue sharing a strength and general popularity that is not widely acknowledged. The first is the "wide discretion granted to state and local authorities with the retention of "a definite element of federal accountability". The second is its "universal coverage" which gives the program extensive political support balanced with differential grants which "funnel revenue sharing dollars to those jurisdictions experiencing greatest fiscal tensions". [39] While it may be accepted that the program has wide support among state and local officials, [40] it should be emphasized that its support in the U.S. Congress and among those most concerned with the particular problems of urban areas is more problematic. This asymmetry in support is no doubt due to the very asymmetry in the so-called compromises. The phrase "a definite element of federal accountability" is a vast overstatement about the situation. Four of the five "features of federal direction" cited are mere statements of the official restrictions on use of funds. That they are largely ineffective is the common conclusion of virtually all of the studies of the effects of revenue sharing. The fifth feature - the fact that the appropriation has a limited time span - certainly does not impinge directly on state and local autonomy within that time span.

While granting that the areas are broad, Shannon thinks it significant that state and local governments are limited to specific priority areas in the expenditure of revenue-sharing funds and that they must file and publish "planned use" and "actual use" reports. Nonetheless, says ACIR, "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". In the Commission's view, this is due to the fact that recipient governments are not required to maintain previous tax levels or previous levels of expenditures, hence the possibilities of substitution and use of revenue-sharing funds in prohibited areas are virtually without limit. In short, revenue-sharing dollars cannot be distinguished from any other dollars. [41] The word "fungibility" is used to describe this phenomenon .

Similarly, the General Accounting Office study of 250 local governments found that the effect of the priority expenditure regulations were "illusory". They study concluded that "except for a potential restriction 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 effects". [42] And while the detailed Brookings study of 65 state and local governments did not focus on illegal uses of funds, its principal purpose was to go beyond the official reports on use of funds to find the "real, or net fiscal effects". The findings, the study states, "provide many illustrations of substitution effects that have caused a marked divergence between the officially designated uses of shared revenue and the real effects of its availability on the finances of particular jurisdictions". "Caution", states the study, "overreliance on publicly reported data on the uses of revenue sharing can be dangerous to your health".[43]

EQUALIZATION

With respect to equalization , the situation is much more complex. While there is certainly a negative correlation between per capita incomes of recipient units and per capita grants, it is no easy matter to evaluate the significance of this correlation. While Shannon calls it "impressive", ACIR citing the same data terms the correlation (with respect to states) "a small statistically significant relationship" providing "modest fiscal capacity equalization....". Lest the words "significant" and "modest" appear to be contradictory, it should be pointed out that "statistically significant" means only that such a relationship is not likely to have occurred by chance. As all students of statistics understand, everything depends on which data are chosen and which analytical methods are used. ACIR cites the fact that "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", and the fact that the poorest state received $44.12 per capita or $12.70 per $1,000 of personal income in the fourth entitlement period while the richest received $24.39 per capita and $4.15 per $1,000 of personal income. But note the following; the ten highest income states received population weighted average $5.49 per $1,000 of personal income, the next ten received less ($5.29) and the third ten states $5.58. Not much equalization there! All of it was in the lowest quintile, with the fourth group of ten states getting $6.35 and the poorest ten $8.50 per $1,000 of personal income.[44]

But that is not the end of the story. If we look at per capita allocations by states, we find that ".... during fiscal 1973, the ten wealthiest states received $33.72 per capita...., fully 95 percent of the $35.49 received by the 10 poorest states. The 30 states in the middle received lower per capita allotments than either the top or bottom groups".[45]

With respect to equalization between central cities and surrounding surburbs, ACIR provides no regression estimates, but simply cites the fact that central cities receive three to seven times as much per capita as their most affluent suburbs and, on the average, "1.5 to 3 times as much as....their suburban cities".[46] While these are raw facts and not controvertible, Shannon seems to infer some close correlation when he states that those jurisdictions "experiencing the greatest fiscal tensions" are provided with the greatest amount of aid. The term "fiscal tensions" or "fiscal pressure" contains an element of relative need and the per capita income factor in the distribution formula does not adequately measure that need. Some hint of this is provided in the ACIR study, where it is conceded that the "greater range of responsibilities borne by central cities" than by suburbs leads to an overstatement of the equalization effect of revenue sharing, as does the fact that "some central cities may have suffered" more from cutbacks in Federal categorical aid than did their neighbours".[47] But the issue goes even beyond a greater range of responsibilities. Melville Ulmer has pointed out that "...underlying the assumption about leveling disparities is the further one that the revenue shares in general would be used conscientiously to satisfy the most pressing social needs".[48] It follows from this that to measure equalization in traditional statistical terms is inadequate. Rather, those jurisdictions with the most severe social problems should be favoured, regardless of what their average incomes turn out to be.

Further, Nathan and associates have pointed out in the Brookings study that the per capita income factor in the distribution formula does not measure relative fiscal capacity very well either. Since counties and lower level units of government depend heavily or almost exclusively on the property tax, they argue quite logically that taxable property values would provide a more accurate measure of fiscal capacity.

In an explicit attempt to deal with the question of local fiscal capacity *and* local need, Gerald Auten has computed a measure called "fiscal resource gap" for 102 communities in New York State.[49] The "gap" is the difference between a standardized measure of public expenditure needs based on "aggregate consumption function theory" and a standardized measure of capacity based on "the ability of a community to generate revenues for public services with a normal amount of effort relative to economic resources".[50] Auten finds that although revenue-sharing funds correlate positively with estimated expenditure needs, they are negatively correlated with the resource gaps. The gaps themselves are positively correlated with size, the "Big Five" cities - New York, Buffalo, Rochester, Syracuse and Albany - having the largest absolute gaps. [51] These results are, in the opinion of the author, due to the fact that the revenue-sharing formula does not accurately measure local fiscal capacity, the same view held by Nathan and associates. Local governments in New York, as in most other states, depend on property and to a lesser extent on sales taxes, rather than on taxes which are levied directly against income. Auten comments that "communities with the same level of per capita income may differ greatly in their abilities to generate revenues for local public services because of differing abilities to shift part of the burden of taxes onto non-residents through sales and property taxes". [52]

What is important for the equalization controversy here is that Auten's study implies that no infrastate equalization at all results from the revenue-sharing program, if equalization is viewed in terms of needs and resources instead of as merely a correlation between per capita grants and per capita income. The population factor in the distribution formula infers that needs are equal per capita and the measure of capacity, per capita income, is deficient at the local level. It follows that the degree of "equalization" which would satisfy some of the critics of the program could not be achieved without a drastic overhaul of the formula, something that is not favoured by the vast majority of local officials nor their representatives, nor the ACIR.

THE MINIMA AND MAXIMA

It has been widely noted that the distribution formula would provide far more equalization within states were it not for the provision that no local government may receive less than 20 per cent nor more than 145 per cent of its "per capita entitlement". [53] The 145 per cent limitation affected more than 1,200 municipalities, the most serious impact being on the largest of them. Ten cities of over 300,000 population, representing almost 21 per cent of that group, were affected by the limitation. This represented the highest proportion of any population group affected. The next highest, the 100,000 to 300,000 group, had only 10 per cent of its units affected. Removal of the 145 per cent limitation would have increased the shares of St. Louis, Baltimore and Philadelphia by 78 per cent, 51 per cent and 47 per cent respectively. [54] Another calculation has Boston falling short of its formula amount by 41 per cent, Cincinnati by 13 and Detroit by 12 per cent. [55] Since any excess above the 145 per cent limitation is shared only with other governments in the same category, practically every other municipality in states such as Pennsylvania and Missouri receive amounts larger than the formula justifies. ACIR points out that the removal of the limitation would require all local governments in Pennsylvania not subject to the 145 per cent ceiling or the 20 per cent floor to take cuts averaging 19 per cent. Similarly the reduction would be 19 per cent in Missouri, 16 per cent in Maryland, 10 per cent in Massachusetts and 8 per cent in Michigan. [56]

The 20 per cent floor affected far more units of government than the ceiling, over 9,000 benefiting from this provision. These were, by and large, much smaller units than those affected by the ceiling. For example, over 27 per cent of townships had their allocations increased. More than half of all of these units had populations under 1,000 and only 75 had more than 50,000 residents. Although, nationwide, the amount of revenue transferred by the floor is relatively minor, the effect is serious in a number of states. In Indiana and Ohio, for example, the application of the floor led to striking differences in per capita grants between townships on one hand and counties and municipalities on the other. [57] However, whether the effect was equalizing or de-equalizing is not easy to determine. Most likely it was the former, but the effect was certainly not comparable to the major impact of the ceiling on central cities *vis-a-vis* their suburbs.

Nathan and his associates see little reason for retention of either of the limitations. Eliminating the ceiling would, they state, "increase the amounts going to more than a score of the nation's hardest-pressed municipalities; additional funds also would go to a much larger number of smaller local governments in low-income areas". The removal of the floor would, in their opinion, "reduce the strong tendency of the law to bolster marginally useful jurisdictions". [58]

The Brookings study provides an extensive analysis of "net redistribution effects", both between states and within states. One attempt to measure interstate redistribution makes the assumption that revenue sharing is financed by states in proportion to their estimated contributions to all federal receipts. It then becomes possible to compute net gains and losses for each state. Concentrating on the ten biggest gainers and the ten biggest losers, the authors find that "all of the ten largest-gain states rank relatively low in per capita income, whereas nearly all of the largest-loss states rank relatively high on this score". [59] But it also turns out that six of the big losers -

Connecticut, New Jersey, Ohio, Delaware, Illinois and Missouri - are among the most urbanized states in the nation. Their high per capita incomes do not reflect the fact that there are huge pockets of low-income residents in their cities. Hence, there is interstate equalization in a very gross sense, but insofar as there urbanized areas are concerned the revenue-sharing process is very much a de-equalizing one.

ACIR applies this technique by stating that if the actual degree of equalization under revenue sharing were replaced with a program "....designed to return a percentage of Federal income tax collections.... to states of origin", there would be "no interstate equalization effect, the rich would get richer".[60] It is a truism that such a program would result in no statistical equalization, but the statement ignores the actual state of income distribution in the high income states, particularly within the large central cities which contain such a large proportion of their populations.

However, it is a more trenchent criticism of the ACIR attempt to show "relative equalization" to point out that a program of revenue sharing designed to return funds in proportion to tax contributions was never a viable alternative to the legislation as passed by Congress. As it turns out the *de facto* alternative was a higher level of categorical grants, particularly in the social welfare area. Allen Manvel points out that "there is considerably less variation among the states in shared revenue per capita than in other federal grants per capita. Hence, the new program has tended to lessen relative interstate differences in federal intergovernmental aid".[61]

On the local level, Nathan and associates concentrate on the "fiscal impact" of the program as most "meaningfully measured.....by relating shared revenue to the scale of governmental finances ....".[62] On this measure, the 72 largest Standard Metropolitan Statistical Areas (SMSAs) fare slightly worse than the rest of the nation and the largest among the 72 fare worse than the smallest. The first result is attributed to the higher per capita incomes in the large SMSAs despite the high incidence of poverty within them, and the second to the higher scale of per capita government finance in the largest and hardest pressed SMSAs coupled with approximately equal per capita revenue sharing.[63]

When large cities are viewed alone, however, the revenue-sharing program does appear to alleviate fiscal pressures. In 18 of the 25 largest cities, per capita grants are higher than the national average for local governments; in 22 they are higher than the statewide average. And in every one of the 23 instances where the city is part of a larger SMSA, per capita revenue-sharing grants are larger in the city than in the remainder of the SMSA. In nine of these cases, per capita grants for the cities are at least double the average amount received in the rest of the metropolitan area.[64]

The conclusions drawn from these computations are reinforced by another set of data which indicate that the fiscal inequality between cities and suburbs is reduced by revenue sharing. Thus, shared revenue as a percentage of local tax revenue was greater for all 19 of the 25 largest cities for which data were available than for the rest of the SMSAs in which they were located. The average difference in ratios was 45 per cent, with New York City's ratio topping the list of 2.26 times the average of its SMSA.[65]

Another interesting set of data refers to various characteristics of all 3,118 county areas and how these characteristics relate to per capita revenue sharing grants. To a considerable extent, these findings modify and even challenge some of the conclusions that might be drawn from the data for large cities and their SMSAs. The key findings are:

(1) That non-metropolitan counties received slightly larger per capita grants than metropolitan counties.

(2) That metropolitan area counties received only $5.06 per $1,000 of personal income versus $7.25 for non-metropolitan counties. This negative correlation was consistent throughout the size distribution of counties, except at the very top. Similar results held with the population density as with population size.

(3) That there was an even stronger negative relationship between the ratio of shared revenue to local nonschool taxes and population size and density. Small counties with 10,000 to 25,000 population had 213 per cent of the all county average while the 20 counties of more than 1 million had only 66 per cent of that average.The exception here was the

group of smallest counties, of less than 10,000 population, which had 185 per cent of the U.S. average.

The authors attributed these county variations "in large part to differences in income level. Mainly as they affect the local-allocation stage of the distribution formula, these differences work to the severe disadvantage of the most populous and densely settled county areas". [66]

The authors' reconciliation of some of these apparently contradictory findings is best quoted in detail:

> **' The foregoing sections have shown that amounts of local shared revenue per capita for 1972 generally average:**
> **- Considerably more for large metropolitan central cities than for their suburban hinterlands;**
> **- More for local governments in relatively populous and densely populated counties than for those in other counties ;**
> **- More for large-population municipalities than for corresponding smaller units; and**
> **- About the same, overall, for local governments within and outside metropolitan areas.**
>
> **If, however, the basis of analysis is shifted to compare amounts of local shared revenue for 1972 with the pre-existing financial scale of local government , a quite different picture emerges. In these terms, large metropolitan central cities again are found to benefit more than suburbia, though far less significantly than the per capita comparisons indicated. But the program's benefits as so measured generally are less for local governments in metropolitan areas for those in large and densely populated counties, and for large-population municipalities than for the appropriate counterpart groups of jurisdictions. Thus, the distribution of shared revenue can be expected, by and large, to permit relatively more easing of local taxes (or more expansion of local government expenditure) in thinly populated areas whose per capita income levels of taxation and financing are below average than in more urbanized, higher-cost areas - with the exception of large metropolitan central cities, whose capacity for fiscal competition with suburbia appears to be enhanced somewhat by the revenue sharing program.**
> **When amounts of locally shared revenue are compared with resident income, metropolitan areas, large and densely populated counties, and large population municipalities again are found to fare less well than the appropriate counterpart groups of jurisdictions'.** [67]

It should be pointed out that in all of this discussion the authors avoid the concept of need, except implicitly when they measure per capita grants against "the scale of governmental finances", i.e. per capita taxes or expenditures. This is, of course, a crude measure of need; one could as well argue that those who spend most are least needy ! To do the argument justice, we know by experience that the largest cities have the greatest responsibilities. Some of these are, of course, voluntary, New York City's municipal colleges being one example. Many others are not, and those cities such as New York which are required under federal and state law to pick up a massive share of welfare payments are clearly very needy. There are hosts of other poverty related payments and services which these cities must also provide. It is a reasonable conclusion that the larger scale of services provided by the large cities are in no sense "consumer goods" reflecting individual "tastes". They more likely reflect the urgent needs of a large low-income population.

USE OF FUNDS

Perhaps the most bitter criticism of the revenue-sharing program has concerned the use of funds by state and local governments. Three related issues involving outcome and process can be extracted from these critiques. The first deals with the actual uses of funds - functional uses and/or tax cuts or tax stabilization. The second deals with alleged violations of the discrimination provisions of the Act and the third with the extent of community participation in the determination of fund allocation. Each of these issues will be dealt with separately.

ACTUAL USES

The criticism which comes mainly from representatives of the poor and minority groups concerns the alleged failure of state and local officials to channel sufficient funds into social welfare programs. This criticism has been accentuated by the fact that many existing categorical aid programs were cut down or ended when the revenue-sharing law was enacted in 1972. These cutbacks took place despite the fact that the President had portrayed revenue-sharing funds as "new money" in his 1971 revenue-sharing message. "All of this", he said, "would be 'new' money - taken from the increases in our revenues which result from a growing economy. It would not require new taxes nor would it be transferred from existing programs". [68] In some instances, state and local officials have used revenue-sharing funds to replace categorical aid funding, but in others no replacement has occurred. In any case, "new" social welfare spending is rare. M. Carl Holman, President of the National Urban Coalition, highlighted the conflict inherent in revenue sharing when he stated that ".....general revenue sharing occurs in a void left by impoundments and left by the failures to get some substitute sources of funding. So, therefore, people with a need for newer services are pitted against homeowners who think they have and do have heavy tax burdens". [69]

That social welfare expenditures would suffer is not a conclusion that would surprise early critics of the program like Michael Reagan. Such critics saw state and local governments as bastions of conservative and business interests which would attempt to delay or obstruct socially progressive programs. An interesting parallel point of view was presented as a workshop conclusion at the National Planning Association conference on Revenue Sharing Research. The members agreed that: "General revenue sharing is not a social program. The logic of this statement rests on three assumptions. First, a social program must be undertaken throughout the whole country if it is to be successful. Second, no locality will attempt an innovative social program on its own. Finally, a mix of localized social programs is inferior to a single nationwide social program". [70] It should be pointed out that such reasoning understates the ability of local governments to operate social welfare programs. A distinction should be drawn between transfer payments which best operate on a national basis and social service programs which better lend themselves to local administration. But whatever the reasons, it does seem clear that revenue-sharing funds have neither replaced cuts in categorical aid nor added substantially to other types of social welfare spending, if at all.

In fact, all the systematic studies of revenue sharing conclude that only about half of revenue sharing funds were used for "new" spending of any kind. And of this "new" spending, a substantial proportion went to capital expenditure. Thus, Nathan and associates estimate that 42.5 per cent of local government and 64.3 per cent of state government revenue-sharing funds were used for purposes of "substitution". In the methodology of the researchers, substitution includes using revenue-sharing funds for tax reduction, tax stabilization, avoidance of borrowing, replacement of reduced federal aid and the maintenance of existing programs, i.e. budget balancing. Of those categories, the important items for states are program maintenance and tax reduction; and for local governments they are tax stabilization, program maintenance and avoidance of borrowing. For states only three per cent of funds were used for restoration of federal aid and for local governments only 0.3 percent. [71]

Substantial substitution effects are verified by the other studies. The Subcommittee on Intergovernmental Relations survey of 14 states and 31 other jurisdictions concluded that "of the 45 governments contacted, 29 responded that general revenue sharing had either prevented a tax increase, reduced the rate of a tax increase or lowered taxes". With respect to program maintenance and restoration of federal aid, the Subcommittee reported that "....the wide variety of ways State and local governments have elected to treat their revenue sharing funds negates the original promise that they would be "new" money. Among the forty-five governments surveyed, only a majority of the counties looked on general revenue sharing as new money, or as a combination of new funding and money to replace certain Federal cutbacks". [72]

Similarly, in a survey of revenue-sharing decisions for fiscal 1974 in 106 cities of over 50,000 population, David Caputo and Richard Cole found that 63 per cent of respondents had used revenue-sharing funds for a tax reduction, prevention of a tax increase or a diminution in the increase that would have otherwise occurred. [73]

The General Accounting Office (GAO) report on State government use of 1972 revenue-sharing funds is not very precise on substitution effects, but does contain the information that officials of 48 states indicated some effect on taxes or end-year balances. In 18 states, officials expected "some form of tax relief"; in 16 it was anticipated "that the funds would postpone future tax increases" and in 14 there was the expectation that unobligated funds at the end of the year would be increased. [74]

GAO's later study of local governments, which deals with funds distributed through June 30, 1973, provides comparable detail for 250 local governments. [75] Of all the governments 167, i.e. almost 70 per cent, indicated that receipt of revenue-sharing funds "had either reduced taxes, had halted a planned or possible tax increase, had slowed or would slow the rate of tax increases, or had a combination of these effects". The percentages at each level of government did not vary significantly. Further, an additional 27 governmental units stated that revenue-sharing funds would allow the establishment of cash reserves or an increase in such reserves. [76]

A different type of substitution estimate is provided by the Bureau of Economic Analysis of the Department of Commerce, on the basis of interviews with a large number of state and local officials representing governments which had received about 30 per cent of local government funds and approximately 45 per cent of state revenue-sharing funds. Instead of calculating proportions of *governments* engaging in tax substitution, the study made estimates of the actual amount of *funds* which had been used for tax relief. The estimates were that nearly 25 per cent of all funds received by December 1973 had been used for tax relief. Another 25 per cent had gone into increased end-of-year fund balances. [77]

Finally, the Office of Revenue Sharing's summary of the Actual Use Reports submitted by all recipient governments provides corroborating evidence of widespread tax substitution. Almost 45 per cent of all governments reported that revenue-sharing funds had allowed a reduction in taxes or prevented a tax increase. These 16,000 governments represented over 62 per cent of all governments willing to express an opinion at that point. A large number, 10, 124 or 28 per cent of all governments, indicated that it was "too soon to predict". Among the 16,000 governments which had reported a tax decrease or the prevention of an increase were 58 per cent of counties, 43 per cent each of cities and townships and 30 per cent of states. Further, almost 33 per cent of all governments said that revenue-sharing funds had allowed them to avoid or lessen an increase in debt. Among these, counties were also the best represented group.[78]

Prior to passage of the Revenue Sharing Act, the questio. . the propriety of tax reduction or, stabilization was a controversial one. Although ACIR has declared that the "issue has become moot" as a result of such a widespread practice, it is perhaps not quite dead. ACIR cites a House Intergovernmental Relations Subcommittee survey of Congressmen, which although showing a majority approving of the use of revenue-sharing funds for tax relief also showed that a majority of Democrats responding found that practice "undesirable". In addition, the Senators who took part in the poll were evenly divided, for and against. [79] Congressman Henry Reuss, who has been outspoken against the use of revenue-sharing funds for property tax relief, has objected on the ground that revenue-sharing was justified in large part because local governments argued that they were unlikely to provide essential services with their existing revenue base. He believes that if Congress did want to provide tax relief, it would not have singled out property owners as beneficiaries, neglecting sales-tax paying consumers and "poor and moderate income citizens". [80]

Perhaps the chief objectors to tax relief are those who feel that social welfare programs are being shortchanged and that tax relief, like capital expenditure for golf courses, tennis courts and other non-essentials, represents a lower priority use of limited funds. Carl Holman's statement quoted earlier dramatically expresses the divisive effect of the availibility of tax relief as a legitimate use for revenue-sharing funds. [81]

While no two of the studies mentioned above use comparable data, it is clear from all of them that "new" spending represents only a bare majority in the use of revenue-sharing funds. Of this new spending, the Brookings study reported that 46 per cent of it went into capital expenditure for local governments; in the case of state governments the comparable figure was 21.6 per cent.[82] Caputo and Cole found 48 per cent of all funds used for capital expenditure in their survey of 106 cities of over 50,000 population, [83] while the GAO study of 250 local governments showed that 33 per cent of all funds had been used for capital outlay. However, there was considerable variation among types of governments. While cities used only 22.3 per cent of revenue-sharing funds for capital expenditure, townships used 53 per cent and counties 57.3 per cent. Among cities, proportions of capital expenditure varied inversely with size. While cities with over 1 million population had allocated only 1.3 per cent of revenue-sharing funds for capital outlay, those smaller than 50,000 population had authorized 80.3 per cent.[84]

In its study, the Bureau of Economic Analysis (BEA) of the Department of Commerce estimated that through late 1973, almost 40 per cent of new spending in the states and localities studied would go to capital outlay. There was some expectation that this proportion would increase because of the time lag involved in undertaking construction projects after revenue-sharing funds were received. Because this study used national income accounts rather than state and local expenditure accounts, it estimated that the rest of new expenditure (60 per cent) went into employee compensation. [85]

The Office of Revenue Sharing (ORS) Actual Use Reports for expenditures through June 30 show local governments using 49 per cent of all allocated funds for capital outlays, but state governments only slightly more than 6 per cent. The apparent explanation for this low proportion is that state governments were not prohibited from using funds for education. [86] Consequently, they used 65 per cent of their revenue-sharing funds for this purpose, 97 per cent of which was for operating and maintenance purposes. Among the local governments, cities spent the smallest proportion of funds on capital outlay (44 per cent) with townships at 48 per cent and counties at 56 per cent. [87]

In general, it can be observed that the larger units of local governments, notably the larger cities, have spent the highest proportions of their allocations on current spending; i.e. operations and maintenance. In this context, the difference between the GAO estimate of 33 per cent for capital outlays as compared to the ORS figure of 49 per cent seems to be due to the presence of a much larger proportion of large local governments in the GAO study. This tendency no doubt reflects the more precarious financial positions of the large cities, whose officials have had the least freedom to undertake new projects or new programs.

Nonetheless, in the case of local governments a significant proportion of revenue-sharing funds has been spent on capital projects in all but exceptional cases. To a considerable extent, the large proportion can be accounted for by the uncertainty in the minds of many officials over the question whether the program will be continued beyond its initial five years. Where funds were not needed to replace federal cuts or to fund on-going programs, there seems to have been a tendency for governments to avoid new program commitments and the consequent future financial responsibility. Aside from the normal political attractiveness of capital spending, such projects could be completed during the life of the Act, with continuing maintenance expenditures a relatively minor consideration. [88] This is not to deny that many relatively affluent communities, even with future funding certain, would continue to use substantial amounts of revenue-sharing money for otherwise low priority capital expenditures. [89]

Clearly, when one takes account of tax substitution, replacement effects and the wholesale use of revenue-sharing funds for capital expenditure purposes, only small amounts are available for current expenditures and only very much smaller sums for new social welfare spending. [90] This point has not been missed by spokesmen for urban areas and for the poor. Senator Muskie, for example, in questioning whether funds get "to those communities that need it most", noted that states and counties surveyed by the Subcommittee on Intergovernmental Relations were "in either good or stable fiscal shape". But "50 per cent of the cities the staff contacted said they were in fiscal distress. Boston, for example, had a $40 million gap between what it formerly received in categorical funds, and what it now receives in revenue sharing". He went on to cite New York, Phoenix and Seattle as other cities with serious fiscal problems. [91] During the same hearings, Carl Holman pointed out that in Detroit, Department of Labor funding alone had been cut by $56 million between 1972 and 1973, and that in Minneapolis urban renewal funds had been reduced from $10.4 to $2.4 million. In his view, the program was in many ways retrograde "in terms of some of the things we have had in the past", leaving "great gaps in the filling of critical human needs...." He went on to say that "in urban areas this major deficiency has made the phrase 'returning power to the people' a mockery for the poor, minority, and working class residents of our cities". [92] Vernon Jordan, Executive Director of the National Urban League goes even further. Speaking before the National League of Cities, he charged the city officials present with an "apparent inability to spend the funds to aid the poor". He continued, "if that aid does not benefit the people who need it most, then it is very clear the nation would be better off putting those scarce resources into federally administered programs of job creation, health, transit and housing". The New York Times article which reported Jordan's speech also reported that : "Earlier in the week a National League of Cities committee.....overwhelmingly rejected a proposed policy plank offered by black elected city officials requiring that 'a substantial portion of revenue sharing funds be used for social programs to meet pressing human needs' ". [93] These concerns, as well as concerns about racial discrimination, have led the National Association for the Advancement of Colored People (NAACP) to take a stand against continuation of the program beyond 1976 and to urge Congress to replace it with an expanded program of categorical grants. [94]

The operation of the program has reinforced the beliefs of such critics that federal funds will benefit the poor and minority groups much more if the federal government assumes responsibility for the spending of them. At the minimum, they urge that more restrictions be placed on state and local governments with respect to permitted uses.

ACIR responded in 1974 that the allegation that the poor were being "shortchanged" cannot be proved or disproved, "because the requisite data do not exist". The Commission stated that "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 benefiting disadvantaged people". [95] This statement contains the remarkable inference that some state and local officials may have been hiding expenditure on social welfare by reporting other uses for revenue-sharing funds. This completely misses the point about fungibility, which is that state and local governments can easily use funds for prohibited purposes. It is extraordinarily difficult to understand why governments would not want to reveal the fact that they were spending their revenue-sharing allocation for the provision of social services. Whatever the use of funds may be, however, ACIR's philosophical position is that "revenue sharing was never designed to be either pro-poor or anti-poor - just pro-state and local government", and that if Congress had "intended to rifle aid into poor households", it would have chosen "almost any type of other aid program over revenue sharing.....". In short the Commission says that "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". [96] This line of argument begs the question of just how responsive jurisdictions are to different groups and different classes of people. ACIR no doubt believes they are very responsive and that allowing them the widest discretion in the use of funds best enables them to meet their real needs. Representatives of the poor, on the other hand, do not see state houses, county court houses and city halls as operating in such a responsive fashion.

There can be no doubt that the use of revenue-sharing funds for social welfare purposes has been minimal, even when replacement for categorical aid is included. When it is not, social welfare spending is best described as miniscule.

Thus the Brookings study reports that after substitutions, new capital spending, increased pay and benefits and "unallocated" items are subtracted from the shared revenue allocations of the 65 jurisdictions studied, only 2.9 per cent of the total remained for local government spending on expanded operations and only 4.4 per cent for state governments. [97]

While the Brookings study does not provide a detailed breakdown among functions which were able to expand operations, it is clear that where funds were being used for such purposes the major beneficiaries were transportation and public safety. Among the ten units which devoted 20 per cent or more of their allocations to expanded operations, 25 per cent went to the former and 16 per cent to the latter. Five of the ten units spent some amounts for social services and health but, except for the City of Cincinnati, the proportions and amounts were small. [98]

Without taking into account substitution or replacement, the GAO study of local governments reveals that of $1.374 billion actually allocated by the 250 governments, only $33 million went for social services for the poor or aged and $70 million for health. These two items together account for only 7.5 per cent of the total and a substantial proportion of that, perhaps a majority, went towards replacement of federal aid. [99] In the study of state governments, slightly less than 7 per cent was estimated to be allocated for comparable functions, again without taking tax substitution or federal-aid replacement effects into account. [100]

Similar proportions are found in other studies and surveys. The 106 cities of over 50,000 persons studied by Caputo and Cole spent only 5.1 per cent of their funds for social and health services, including capital expenditure. Operating expenditure alone amounted to 60 per cent of that total or 3.6 per cent of all revenue-sharing funds inclusive of tax substitution and federal aid replacement. [101] The ORS summary of the first Actual Use Reports for 32,665 units of government includes estimates of proportions of expended funds used to support existing services and proportions representing new spending. For all governments, only 20 per cent of all operating and maintenance expenditure represented new or expanded services. States were able to devote 28 per cent of non-capital expenditures for such purposes. Comparable proportions are not presented for local units of government, but obviously as a group they averaged considerably less than 20 per cent. [102]

By function, 70 per cent of all funds used for operations and maintenance were used for education, public safety and public transportation, with 17 per cent of that total representing new expenditure. [103] By contrast, spending on social services for the poor or aged and on health represented 10 per cent of all operating and maintenance spending, but only about 10 per cent of this new spending. Thus about $19 million out of nearly $1.9 billion accounted for as having been expended in the operating and maintenance categories of the first Actual Use Reports went for new social services, broadly conceived. [104] This was slightly more than one per cent of the total. [105]

CIVIL RIGHTS VIOLATIONS

Perhaps the most contentious of all revenue-sharing issues has been the allegation that there have been numerous violations of the provision of the Act prohibiting discrimination in the use of funds on the basis of "race, color, sex or national origin" [106] and that ORS has not been vigilant in applying the sanctions of the law where such discrimination has taken place. Fears that such would be the case were expressed by many critics of the program before its passage. These fears were a product of the fact that the proposed civil rights provisions appeared to be less stringent than those in most categorical grant programs and of the widespread doubt that the Nixon Administration was serious about enforcement.

The bare record shows that up to 1 June 1974 there were only 41 discrimination complaints of which 18 were resolved through negotiation. Twenty-two were in the process of resolution and only one (the Chicago Police Department case) had been referred to the Attorney General for court action, the last step in the enforcement process. [107]

To the critics, the mere citing of the record misses the most important point about discrimination which is that the very broad prohibition in the law is inadequate to the task and that too much responsibility is put on state and local officials for monitoring and enforcement. In the view of the Joint Center for Political Studies, [108] there is the possibility that without the detailed laws and administrative enforcement procedures applicable under other Federal civil rights laws, such as the Fair Housing Act and the Equal Employment Opportunities Act, "states and localities will be unwilling or unable to avoid racial discrimination where revenue sharing funds are involved". The unwillingness or inability of states and localities to enforce the laws is said to stem from "fewer laws, less effective enforcement mechanisms, and in some cases a lack of will to avoid racial discrimination". The Center points out that racial discrimination in the use of funds can be subtle. As well as outright discrimination in employment, in wage and salary levels, or in provision of services under a specific program, "discrimination can be accomplished by the nature of fund use" itself. For example, a recreational facility used heavily or exclusively by whites may receive preference over a program whose beneficiaries are principally black. Further, revenue-sharing funds applied in a non-discriminatory way can be used to free funds to be used in a discriminatory way. [109]

Senator Muskie gives credence to the views of such critics. He has stated that ".... 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". In his view, ".... the basic philosophy of the ORS can only be described as extremely cautious". It should, he goes on, ".... 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". [110] Muskie's criticism is mild compared to that of some organizations representing minority groups. Carl Holman, for example, speaks of "....the shocking disregard for established Federal civil rights safeguards which have been permitted". [111]

A good deal of criticism centres around the fact that ORS has only 30 compliance officers for 39,000 jurisdictions, only two of whom are specifically charged with enforcement of the discrimination provisions. Although ORS had asked for 20 more officers in 1974, its expressed philosophy is a preference for working through state and local agencies because "this makes best management sense, makes maximum use of existing agencies and is most efficient in the use of tax money" [112] This theme has been used consistently by Graham Watt and other Treasury officials. William Simon, Secretary of the Treasury told the Muskie Subcommittee that: "We seek voluntary compliance wherever possible, and have been very successful in achieving voluntary compliance. Where we do not receive this voluntary compliance - as a recent example with the city of Chicago - we turned the case over to the Justice Department for prosecution and adjudication." [113] What Simon does not mention here is that ORS was under heavy fire for not taking administrative action to cut off funds to Chicago while the case was in the Courts. Having found evidence of discrimination, ORS had the authority to "defer payment of revenue sharing funds pursuant to an administrative proceeding". [114] Under questioning by Senator Muskie on that case and on the general attitude of ORS on discrimination, Watt can be said to have hedged considerably. Responding to a Subcommittee staff analysis which characterized the ORS attitude as being passive, he countered with the statement that "I think it is a very active and very aggressive role...." But the most obvious hedge is his attempt to rationalize the ORS lack of action in withholding funds:

> "....When you talk about withholding funds, you are talking about withholding funds prospectively, and these are presumably funds for which the city of Chicago has not yet made a decision as to their use. Now we don't know that funds to be paid to Chicago in October, for the next year, are going to be spent in the police department, or that they are going to be spent in any activity in which any question of discrimination may arise. The funds at issue are the funds which they already have and have spent, and those are the funds upon which we must base our action. We cannot withhold these funds. They already have them. They already have spent them. If we find there has been a violation in their use, we must seek to recover them".

When challenged on this explanation, Watt retreated to his original position: "I can only say sir, considering carefully and thoroughly the two options available here, it was our conclusion that the interest of the revenue sharing program and the early resolution of the discrimination complaint in the *Chicago* case would best be served by following the course of action which I took." Perhaps feeling that he had gone too far in recommending a judicial procedure as more expeditious than an administrative one, he continued by saying that "....the Chicago case has unique features....This does not mean that in every case in the future we will select the referral-to-Justice option as opposed to the administrative procedure option". [115] To all of this it should be added that Harold Himmelman, Director of the Revenue Sharing Project of the Lawyer's Committee for Civil Rights Under Law, has argued that the law permits payments to be deferred prior to an administrative hearing. He pointed out that the Department of Health, Education and Welfare has often done this after making a finding of discrimination and that ORS itself has deferred payments when governments have failed to file reports required under the Act. As a result of this view, a case was filed in Federal court in February 1974 alleging that the Secretary of the Treasury and the Director of ORS "had failed to take adequate steps to enforce the civil rights requirements of the Revenue Sharing Act..". [116]

After this recital of the basic facts of the issue, it is very difficult to disagree with the members of the workshop concerned with nondiscrimination provisions at the National Planning Association Conference on Revenue Sharing Research. During this conference, it was reported that "most workshop members expressed doubt that the Administration was serious about enforcement" of the nondiscrimination clause. Several reasons were advanced:

(1) "... the limited size of the auditing and compliance section of the Office of Revenue Sharing signified to group members, at worst, a possible lack of concern on the part of the Office with regard to enforcement from above, and, at best, excessive confidence in the informal monitoring activities of civil rights organizations and concerned citizen groups at the local level".

(2) "....in lieu of establishment at the federal level of a viable auditing and compliance mechanism, the failure of the Office of Revenue Sharing officially to entrust the responsibility for

enforcement to groups with suitable mechanisms, previous experience and proven competence convinced workshop members that the Administration was not sufficiently concerned with variations of the nondiscrimination provision of the Act".[117]

Certainly Himmelman's point that the federal government had found it necessary to move into the area of civil rights legislation precisely because state and local governments did not meet their responsibilities is much to the point in the debate over discrimination. In his view, little has changed since 1964; hence "the federal presence is mandatory" for adequate civil rights protection.[118]

The strongest supporter of ORS on the question of how the anti-discrimination provisions are enforced is ACIR. The Commission warns "against those who would subvert the essential purpose of revenue sharing - to redress the fiscal imbalance within our federal system". ORS should be, in the view of the Commission, "a very small agency dedicated to getting the checks out on time...... It should not be equipped and staffed to be the principal instrument for ridding the state-local sector of discrimination in all of its forms." ACIR cites the fact that the Equal Employment Opportunity Commission and the Civil Rights Division of the Department of Justice have large staffs and have considerable latitude in investigating complaints about discrimination in governmental programs. Further, "in time, state and local governments can be expected to increase their effectiveness in combating discrimination". Such governments and their own agencies "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 civil rights spokesmen".[119]

Not untypically, ACIR overstates its case by the use of language such as "avenging angel" and "ridding the state-local sector of discrimination in all of its forms ". In this, as in some other matters, ACIR appears to be acting as an apologist for state and local governments which naturally prefer full freedom of action. The concept of revenue sharing would be better defended if allegations of civil rights violations were not so widespread. And they need not be if ORS did not take such a passive stance. Senator Muskie agrees that "....the administration is undermining the credibility of the revenue sharing program when it fails to enforce vigorously the antidiscrimination provisions of the revenue-sharing law".[120] The essence of the matter is that all but a handful of states have the will and capacity to successfully combat discrimination by local governments. There is no question that Treasury and ORS have chosen a "minimalist" interpretation of Section 122 of the Revenue Sharing Act. Where the law states that the Secretary of the Treasury shall take certain actions whenever he (she) "determines that a State government or unit of local government has failed to comply", it begs the question of how that determination is made. ORS has chosen to rely entirely on complaint actions from aggrieved parties, interested citizens or groups. It has consciously chosen not to have its own staff which would vigorously monitor and enforce the anti-discrimination provisions.

In the second area where ORS appears to have some option, its philosophical position is not so clear, since only one case has gone beyond the negotiation stage. In that situation a Governor failed to secure compliance and ORS chose a civil action through the Attorney General, without taking the simultaneous administrative actions that were available to it. Nonetheless, in that case ORS took minimal action and has defended its position against strong attacks and in the face of a civil action against it. There is almost nothing in the expressed attitudes or actions of ORS which would indicate that it considers Section 122 anything but a low priority area. In this, ORS acts in a way consistent with the attitudes of the Administration, which sponsored revenue sharing as a device to moderate the liberal economic and civil rights tendencies of the federal bureaucracy.

COMMUNITY PARTICIPATION

The Revenue Sharing Act does not require that any special budgetary process be used for the allocation of revenue-sharing funds. This reflected, states David Caputo, "...a philosophical position emphasizing the responsibility and legitimacy of elected officials...".[121] Nonetheless, during the debate over revenue sharing widespread expectation arose that substantial citizen participation would be stimulated leading to a greater degree of responsiveness on the part of state and local officials. This expectation was, in part, the result of a great deal of rhetoric about how the law would enhance community participation and the political influence of the average citizen. Phrases used often by President Nixon such as returning "power to the people" contained that implication.'[122] In addition, civil rights and social welfare organizations were determined to work at the grass roots level to ensure strict enforcement of the nondiscrimination provisions and the use of funds to benefit the poor and minority groups. Also the requirement that planned and actual use reports be published in local newspapers was seen as a further spur to citizen involvement. As a result, the budgetary process itself, as distinct from actual use of funds, has become a widely used criterion for evaluation of the entire program.

There is, of course,a great difference of opinion about whether or not a signficant amount of citizen participation has been achieved and whether or not it is desirable for the federal government to mandate some required process to achieve it.

On the first point, Richard Nathan, in testimony before the Subcommittee on Intergovernmental Relations, stated that " there are significant indications that revenue sharing has increased the competitiveness and prominence of local budgetary process". This statement was, however, immediately made subject to three qualifications: (1) that such an effect has been spotty; (2) because of the early "bunching" of payments and cuts in categorical aid, "there is reason to believe the changes....may not have a sustained effect"; and (3) these changes were neither "deeply important" nor "pervasive in terms of their overall national impact". [123]

However, in the study which appeared about a year later after those remarks the word "significant" is not used. Instead, the concluding statement simply says that "in about one-third of the cases, some degree of separate handling of revenue sharing took place that involved increased public and interest group participation in the budgetary process" and that "evidence exists that revenue sharing has caused many nationwide interest groups to turn their attention increasingly to local decisionmaking processes". However, only in five of the 65 jurisdictions studied were special procedures such as hearings or advisory boards instituted for the purpose of increasing public participation. Thirteen other jurisdictions handled revenue-sharing funds through a supplemental appropriation process, but this process did not necessarily involve citizen participation beyond that which normally occurs. This approach was adopted only to deal with the "bunching effect" in the early months of the program and to avoid a budget bulge by spreading shared revenue over two budgets. That is to say, the supplemental appropriation process was primarily an accounting procedure, not one meant to increase public input into the budget process. And to counter the five jurisdictions which attempted to increase public participation, there were three which had special procedures which decreased such opportunities. [124]

Other studies reached roughly similar conclusions. The GAO local government survey also found that about one-third of the 250 governments had had greater citizen participation "than is normal in their budgetary process". In cities, such participation increased with size. Fifty per cent of cities over 500,000 claimed an increase; of those between 50,000 and 500,000, 40 per cent reported an increase and of those under 50,000 persons only 22 per cent did so. However, in counties the increased participation rate was inverse to size, except in the smallest counties which had the least. Townships in general showed a very low rate of increased citizen participation.[125]

The Subcommittee on Intergovernmental Relations survey of 45 jurisdictions found that 11 of them held special hearings. However, none of the 15 states included in the sample did so. When they are eliminated, the proportion is again near one-third. In addition, it was found that the program alone generated additional citizen interest and participation, even where special procedures were not initiated to induce it.[126]

Finally Caputo and Cole come up with roughly similar findings. In a study limited to cities of 50,000 or more they found that about half held public hearings regarding the disposition of revenue-sharing funds. Another 37 per cent indicated that they planned to hold such hearings in the future. However, the number of cases where this constituted a change from the normal budget process, i.e. an increase in the possibilities for citizen participation, remains unclear. [127]

The raw figures of course do not tell us very much about the actual effect of increased participation on decision-making. Some of the critics of revenue sharing are convinced that they mean very little. The Joint Center for Political Studies, for example, charges that "some states and localities intentionally minimize citizen participation". They "circumvent the law by using obscure publications and fine print (in publishing planned and actual use reports); some may ignore the law entirely. There are still cases where citizens are told they may not attend city council meetings." [128]

The Revenue Sharing Task Force, a study project sponsored by the National Urban Coalition, the Center for National Policy Review, the Education Committee of the League of Women Voters and the Center for Community Change is similarly sceptical. In monitoring the use of revenue-sharing funds in 64 communities, they found in their preliminary report that the principal failure of the program was the lack of involvement by poor persons and minority groups in expenditure decisions. Even where "watchdog" groups had been formed, their performance was judged ineffective. That conclusion followed from the fact that "the watchdog groups were usually called in after the budgets had been put in order." The idea that public hearings are a charade - that they...."just give citizens a chance to yell" [129] is also held by Pablo Eisenberg of the National Urban Coalition. Excluding some notable exceptions, he argues that "in most communities, local governments continue to function as they always have. Their budget processes.....remain alien to most people and closed to meaningful citizen involvement. Public hearings, where they are held, are merely the frosting of a cake shaped and baked almost entirely by government officials in the executive branch". [130]

Other individuals and groups are equally critical. Vernon Jordan of the National Urban League has stated that "the expected citizen participation in decision making has not occurred", and that "local governments have not proved themselves more responsive to the needs of all citizens...." [131]

Clearly these individuals and groups are critical of the opportunities for citizen participation and the quality of participation when the opportunities exist. What is desired is summed up well by Carl Holman: "what is needed is not just a citizen's day or week. but a continuous planning and accountability system which ensures citizen participation as a regular everyday part of the operations of city government. Citizens should have an opportunity to help establish priorities for their city -not merely react passively to the plans developed by municipal bureaucrats".[132]
Eight specific recommendations were put forth by Jesse Jackson of Operation PUSH at an ACIR hearing regarding citizen input and audit. The first stated "that a citizen audit and citizen advisory council be established and mandated in the regulations and guidelines for Federal revenue sharing administration". The second urged "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". [133] ACIR characterizes the essential features of a program designed to encourage citizen awareness and increase citizen participation as:

- 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'.[134]

Whatever the specific method proposed, however, ACIR appears sceptical of the validity of any mandatory citizen participation process. The advocates of such a process are demeaningly called "the true believers in citizen participation". The opposite point of view held by most state and local officials,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", seems more suited to ACIR's general orientation. State and local governments in the view of these officials "should not be coerced....to change practices that they have found suited to their varying needs". [135] One cannot resist inquiring just what these needs are that require secrecy and exclusivism in budget construction in so many jurisdictions.

From the standpoint of Congress, it must certainly appear too monumental a task to attempt to reform states and local governments using $30 billion over a five-year period as the carrot. There is also the question whether or not any set of requirements could accomplish the task, given the enforcement effort that might be required and the difficulty of determining whether or not grass roots views had in fact been taken into account in any decision or series of decisions.

Nonetheless, the same type of argument was used with respect to Federal protection of the civil rights of blacks in the areas of voting, schools and a host of others. General Eisenhower didn't believe that laws could change the "hearts and minds" of people, but the mere Federal involvement, aside from its enforcement effort, certainly acted as a moral force. The real question is, is it right? If so, the Federal government does have an obligation to act, whether or not it can guarantee perfect results. In the case of civil rights, the Federal government was legally obligated to act in places where states and local governments failed to do so. There is, of course, no clearly defined comparable legal requirement with respect to the budget process; certainly there is no comparable demand on the the part of the abused that the Federal government enforce their constitutional guarantees.

All this considered, however, if one of the major justifications of the revenue-sharing Act was to make the entire governmental process more responsive, it appears totally inconsistent for the Administration and state and local government officials to continue to resist the inclusion in the law of some mandatory requirements respecting dissemination of information and public hearings. Those who resist such requirements lay themselves open to serious question about whether their stated commitments to governmental responsiveness are genuine.

CONCLUSION

It is the thesis of this paper that most such stated commitments are, in fact, not genuine. This conclusion covers the Nixon Administration which used federalist principles to conceal its desire to weaken the power of the Federal social welfare bureaucracy and the latter's clients, the poor and minority groups which it has attempted to serve since the New Deal. It also covers the more pragmatic state and local government officials who welcome all the Federal money they can get, especially if there are no strings attached to it. These officials especially resent any requirement which would force them to serve groups other than those they identify as their natural constituencies or those groups which possess real power in their communities. Local elites are, of course, no figment of paranoid imaginations. Sociological and political science research has documented their existence and power. Beyond that, we are well aware that our rapidly growing suburban communities operate largely in the interest of a relatively homogeneous middle class; the poor, the black and the elderly are under-represented in these communities and the needs of those of them who do find themselves in suburbia are systematically neglected. The under-representation in itself is partly a product of zoning and related land-use policies.

Revenue sharing has done little or nothing to change these situations; on the contrary it has reinforced them. While the Office of Revenue Sharing "gets the checks out on time" and no doubt efficiently. there is considerable doubt whether enough money is getting to those jurisdictions under the greatest fiscal pressure. We have seen that when need is taken into account and when a more realistic index of tax capacity is substituted for per capita income, it becomes doubtful that very much, if any, equalization results from either the three or five factor formulas now in use. Similarly, when we consider shared revenue as a proportion of locally raised taxes or as a proportion of expenditures, the equalization picture appears very mixed - certainly very modest at best. When consideration is taken of the fact that "....the administration broke its longstanding promise that revenue sharing would be new money" [136] by making massive cuts in categorical aid programs at the time revenue sharing was inaugurated, we get an even more negative picture of equalization. The effect on central cities has been such that Michael Reagan is moved to comment that "clearly there is something wrong when a central city has absolutely no maneuverability and its revenue sharing funds disappear in the desperate attempt to maintain existing inadequate levels of basic services, while adjoining suburbs solicit ideas for the spending of money that is beyond need or expectations". [137]

The categorical cuts and political pressure from property owners have been the major factors responsible for the fact that the major share of revenue-sharing funds has been channelled into substitution. That is, they have been used to hold down or cut taxes by supporting existing programs or to replace Federal funds no longer forthcoming. Where revenue-sharing funds have been used for new programs, they have gone heavily into property-oriented expenditures, in particular expanded police and fire services, much being capital expenditure. New social welfare programs have been exceedingly rare, because the larger units of government have little to spend on new programs of any kind.

The Treasury Department's continued refusal to monitor the use of funds so as to enforce the nondiscrimination provision of the Act can be said to be one of the influences on the pattern of fund use. This is because it is exceedingly difficult to prove that funds have been used in any way that is intrinsically discriminatory. Another influence in the same direction has been the view that mandatory structures for community participation violate the spirit of revenue sharing. The laissez faire attitude encompassed in both of these perspectives means that the exclusionist structures which have prevailed for so long in many states and localities will continue to prevail and to direct the use of revenue-sharing funds.

The modest achievements of revenue sharing in transferring Federal funds to more than 38,000 state and local units of government efficiently and at low cost are vastly outweighed by the failures of the program. The principal philosophical justification of the program was that it would enlarge the sphere of democratic decision-making. From this standpoint it has been a dismal failure, for greater democracy in decision-making cannot be judged soley by the fact that a higher proportion of public funds is being allocated by state and local governments. It is the quality of those decisions that is crucial; in particular whether or not they are being made in the interests of a cross section of the population rather than in the interests of America's middle class political majority.

We earlier noted the disintegration and possible break-up of the liberal-conservative coalition which was primarily responsible for the passage of the Revenue Sharing Act in 1972. But now the program seems to be in political difficulty in spite of the fact that support for the program on the part of state and local officials is truly massive. It is questionable whether that support alone will permit extension of the law in a relatively unmodified form, since the opposition to such an extension has increased immeasurably since 1972. Also, as Deil S. Wright has commented, that support lacks ..." a unifying ideology, policy focus or constituency (apart from more dollars)...".[138]

Predictions are hazardous, particularly predictions respecting decisions to be made in a presidential election year. Nonetheless, it does not seem likely that an overwhelmingly Democratic Congress will be content to accept the view that it should continue to dispense six to ten billion dollars anually to states and local governments without some guarantees that a broader range of interests will be served. It seems inconceivable that the program as operated during the years 1972-1977 will be the prototype of future federal-state-local fiscal relations. Congressman Reuss asks:" do we really want to shift a large share of scarce federal dollars into police equipment, road maintenance, once only capital expenditures, and property tax reduction, thereby leaving health care, social services, housing and community development to fend for themselves ?"[139]

To alter that situation will require, at the minimum, substantial changes in the program. These include changes in the distribution formula, elimination of the 20 per cent and 145 per cent minima and maxima, elimination of the "moribund" units of government from the program, a new list of priority expenditures and total exclusion of some expenditures, more realistic accounting procedures on the part of ORS, some restrictions on tax substitution, more meaningful publication requirements, mandatory hearing requirements and a serious civil rights enforcement program. The alternative to such reforms is most likely the federalization of social welfare payments and a comprehensive program of block grants to ensure that federal priorities are served. For many Congressmen, these alternatives are clearly preferable to a continuation of general revenue sharing, a fact of which its supporters are aware. While the spectre of the federal bureaucracy will no doubt be raised to oppose a proposed tightening-up of the program, Congress may no longer be willing to sanction what a growing number of critics regard as substantial excesses and abuses, if not outright illegalities, in the program as it has operated in the past four years.

FOOTNOTES

1. David A. Caputo, "General Revenue Sharing and American Federalism: Toward the year 2000", in David A. Caputo, ed., *General Revenue Sharing and Federalism,* The Annals of the American Academy of Political and Social Science, Vol. 419, May 1975, p. 140.
2. Murray L. Weidenbaum, "Strengthing the Federal System Through Revenue Sharing", *Politics 1972,* East Carolina University, 1972, p. 43.
3. Upon signing the Revenue Sharing Act in 1972, President Nixon declared that "the new American Revolution is truly under way".
4. The other components of the "New Federalism" are listed by Caputo as welfare centralization and reform, special revenue sharing, decentralization of federal agencies to the regional level and executive reorganization. Caputo, *op. cit.,* p. 131.
5. Jonathan Schell, "The Nixon Years", *The New Yorker,* 2 June - 7 July, 1975.
6. *Ibid.,* 30 June, 1975, p. 58.
7. Robert W. Rafuse, Jr., *Proceedings of the Conference on Revenue Sharing Research,* National Planning Association, Washington, D.C., July 1974, p. 40.
8. The only significant change proposed by the the ACIR is the introduction of permanent trust fund financing which is, of course, highly desirable from the standpoint of state and local governments.
9. Hearings before the *Subcommittee on Intergovernmental Relations of the Committee on Government Operations, U.S. Senate,* 93rd Congress, 2nd Session, Part 1, 4; 5, 11, and 12 June, 1974, U.S. Government Printing Office, Washington, D.C., 1974, pp. 515-516.
10. Advisory Commission on Intergovernmental Relations, *Information Bulletin,* No. 75 - 4, Washington, D.C., July 1975, p. 3.
11. *Saturday Review,* 22 March, 1969, pp.26-29.
12. Walter W. Heller, *New Dimensions of Political Economy,* Harvard University Press, Cambridge, 1966, p. 119.
13. *Ibid.,* pp. 121-124, 151.
14. Michael D. Reagan, *The New Federalism,* Oxford University Press, New York, 1972, p. 98.
15. Heller, *op. cit.,* pp. 169-170.
16. *Ibid.,* p. 170.
17. *Ibid.,* p. 169.
18. *Ibid.,* p. 163.
19. Quoted in Reagan, *op. cit.,* p. 97.
20. Henry S. Reuss, "Should we Abandon Revenue Sharing?" in D.A. Caputo, ed.,., *General Revenue Sharing and Federalism, op. cit.,* p. 94.
21. Heller, *op. cit.,* pp. 139, 142-143.
22. Advisory Commission on Intergovernmental Relations, *Revenue Sharing - An Idea Whose Time Has Come,* U.S. Government Printing Office, Washington, December 1970, pp. 7-8; and Deil S. Wright, "Policy Control: The Hidden Issue in Revenue Sharing", *Politics,* 1972, *op. cit.,* p. 49.
23. Quoted in Reagan, *op. cit.,* p. 99.
24. ACIR, *op. cit.,* pp. 7-9.
25. Little Brown and Co., Boston 1970. Much in the same vein, but less orthodox and with more focus on the role of the (misguided) intellectual in policy making was Daniel Patrick Moynihan's *Maximum Feasible Misunderstanding,* Free Press, New York, 1969.
26. Reagan, *op. cit.,* pp. 121, 126-130, 132.
27. Supra., pp. 11 - 12
28. Hearings before the Subcommittee on Intergovernmental Relations, *op. cit.,* p. 4.
29. Reagan quotes Harley Lutz on this point. Lutz goes on to add that tax sharing increases the dependence of state and local governments on the federal government, as the latter has the inherent right to end the program. Reagan, *op. cit.,* pp. 102-103.
30. *Ibid.,* p. 111.
31. Carl W. Stenberg, "Revenue Sharing and Governmental Reform" in D.A. Caputo, ed., *General Revenue Sharing and Federalism, op. cit.,* pp. 53-54

32 Richard P. Nathan, Allen D. Manvel, Susannah E. Calkins and Associates, *Monitoring Revenue Sharing,* Brookings Institution, Washington, D.C., 1975, pp. 4, 281-282.

33 ACIR, *Revenue Sharing - An Idea Whose Time Has Come, op. cit.*, p. 19.

34 ACIR, *General Revenue Sharing: An ACIR Re-evaluation,* Washington, D.C., October 1974, p. 70

35 Namely New England counties and 13,000 townships in 11 midwestern states. See Nathan, et al., *op. cit.*, pp. 285 ff.

36 Daniel J. Elazar, *Revenue Sharing: Are The States and Localities Responsible ?,* Centre for the Study of Federalism, Temple University, Philadelphia, n.d., pp. 1-4.

37 *Ibid.*, p. 24.

38 Nathan et al., *op. cit.*

39 *National Tax Journal,* Vol. XXVII, No. 4, December 1974, p. 495.

40 Michael Reagan believes (1975) that "the strongest single argument" for renewal and perhaps the only one still valid ".... is the bread-and-butter political one: Governors, mayors, city councils, and the appointed officials who help spend money all enjoy receiving the quarterly checks". "The Pro and Con Arguments" in D.A. Caputo, ed., *General Revenue Sharing and Federalism, op. cit.*, p. 24.

41 ACIR, *General Revenue Sharing, op. cit.*, pp. 3-4.

42 Comptroller General of the United States, *Revenue Sharing: Its Use By And Impact on Local Governments,* U.S. General Accounting Office, Department of the Treasury, Washington, D.C., 25 April 1974, pp. 29-30.

43 Nathan et al., *op. cit., p. 234.*

44 ACIR, *General Revenue Sharing, op. cit.*, p. 5.

45 Henry S. Reuss, "Should We Abandon Revenue Sharing ?", in D.A. Caputo ed., *General Revenue Sharing and Federalism, op.cit.*, p. 91.

46 ACIR, *General Revenue Sharing, op.cit., p. 6*.

47 *Ibid.*, pp. 7-8.

48 Melville J. Ulmer, "The Limitations of Revenue Sharing", in Melvin K. Whiteleather, ed., *Seven Polarizing Issues in America Today,* The Annals of the American Academy of Political and Social Science, Vol. 397, September, 1971, p. 53.

49 Gerald E. Auten, "The Distribution of Revenue Sharing Funds and Local Public Expenditure Needs", *Public Finance Quarterly,* Vol. 2, No. 3, July 1974, pp. 352-375.

50 *Ibid.*, pp. 359-363, 370.

51 *Ibid.*, p. 369.

52 *Ibid.*, p. 370.

53 "Per capita entitlement" is established for each governmental unit by dividing the State allocation by the population of the State and multiplying by the population of the unit. It is, in effect, a hypothetical equal per capita distribution.

54 Nathan et al., *op. cit.*, pp. 156-160.

55 ACIR, *General Revenue Sharing, op. cit.*, p. 9.

56 *Ibid.*, p. 12.

57 Nathan et al., *op. cit.*, pp. 160-162.

58 *Ibid.*, p. 162.

59 Nathan et al., *op. cit.*, pp. 71-72.

60 ACIR, *General Revenue Sharing, op.cit* p. 6

61 Allen D. Manvel, "The Fiscal Impact of Revenue Sharing", in D.A. Caputo, ed., *General Revenue Sharing and Federalism, op. cit.*, p. 45.

62 Nathan et al., *op. cit.*, p. 98.

63 *Ibid.*, pp. 100-101.

64 *Ibid.*, pp. 106-108. In these computations, Nathan and associates add to the actual city grants an estimated share of the grants of outlying county governments. The crucial assumption here is that county grants are distributed between central cities and suburbs on the basis of population. To the extent that this assumption is not accurate (and there is no reason to believe that it is in fact representative in any single case), the computations may seriously overstate or understate the fiscal advantage of the cities.

65 *Ibid.*, pp. 108-110.

66 *Ibid.*, pp. 117-128.

67 *Ibid.*, p. 133.

68 U.S. President, *Message. General Revenue Sharing.* 92nd Congress, 1st session, House Document 92-44, 4 February 1971.

69 Hearings before the Subcommittee on Intergovernmental Relations, *op. cit.*, p. 619.

70 Robert W. Rafuse, Jr., ed., *Proceedings of the Conference on Revenue Sharing Research,* National Planning Association, Washington, 1974, p.41.

71 Nathan et al., *op. cit.*, pp. 192-193. The data are unweighted means for the 65 government sample. The authors comment (p. 192) that "proportions shown on an unweighted-mean basis can be regarded as accounting for revenue-sharing decisions rather than revenue-sharing dollars".

72 Subcommittee on Intergovernmental Relations of the Committee on Government Operations, U.S. Senate, *How 45 Selected Jurisdictions View Revenue Sharing,* 93rd Congress, 2nd Session, U.S. Government Printing Office, Washington, 1974, pp.1, vi.

73 Cited in hearings before the Subcommittee on Intergovernmental Relations, *op. cit.*, p.15.

74 Comptroller General of the United States, *Revenue Sharing: Its Use By And Impact on State Governments,* U.S. General Accounting Office, Washington, 2 August, 1973, pp. 2-3.

75 The 250 are made up of the 50 Cities and 50 counties receiving the largest 1972 revenue-sharing payments: the city and county receiving the largest payment in each state and two local governments in each state, selected at random from among those receiving more than $10,000 during the first 12 months of the program.

76 Comptroller General of the United States, *Revenue Sharing: Its Uses By and Impact on Local Governments,* U.S. General Accounting Office, Washington, 15 April 1974, pp. 21-23.

77 Data from Nathan et al., *op. cit., pp. 251-252.*

78 David A. Caputo and Richard L. Cole, *Revenue Sharing: The First Actual Use Reports,* Office of Revenue Sharing, Department of the Treasury, 1 March, 1974, pp. 15-18.

79 ACIR, *General Revenue Sharing, op. cit.*, pp. 23-24.

80 Reuss in D.A. Caputo, ed., *Revenue Sharing and Federalism, op.cit.*, pp. 93-94.

81 Hearings before the Subcommittee on Intergovernmental Relations, *op. cit.*, p. 619.

82 Nathan et al., *op. cit.*, p. 193.

83 Hearings before the Subcommittee on Intergovernmental Relations, *op. cit.*, p. 14.

84 *Revenue Sharing: Its Use By and Impact On Local Governments, op. cit.*, pp. i, 15.

85 Nathan et al., *op. cit.*, p. 252 and Manvel, *op. cit.*, p. 40.

86 State governments are not limited to expenditure on the priority categories.

87 *Revenue Sharing: The First Actual Use Reports, op. cit.*, pp. 7-13.

88 *Revenue Sharing: Its Use By and Impact on Local Governments, op. cit.*, p. 16. A report on the use of revenue-sharing funds in Delaware contains the paradoxical suggestion that some local officials preferred to use funds "for secondary and somewhat less worthwhile projects which will not vitally affect the community if discontinued due to lack of funds....." (Delaware Association for Public Administration, *Revenue Sharing: The Delaware Experience,* January 1974, p. 6)

89 Henry Reuss cites the "extreme"cases of Aurora, California which spent over $500,000 to build a golf course, Corpus Christi, Texas which used $100,000 to landscape an existing one and Fairfield, Connecticut which used its allocation to improve a bridle path. "Should We Abandon Revenue Sharing?" in D.A. Caputo, ed., *General Revenue Sharing and Federalism, op. cit.*, p. 93.

90 Graham Watt, Director of the Office of Revenue Sharing makes the somewhat disingenuous claim that: "All of the categories, including capital expenditures, lend themselves to use by the poor or aged"..."Also, many capital expenditure items are necessary to the operation of a service for the needy; in fact, there might be no service program without a capital purchase (no meals on wheels without a delivery van)". Hearings before the Subcommittee on Intergovernmental Relations, *op. cit.*, p. 48.

91 *Ibid.*, p. 46.

92 *Ibid.*, pp. 615-618.

93 *New York Times,* 5 December, 1974.

94 Advisory Commission on Intergovernmental Relations, *Information Bulletin,* No. 75-4, July 1975, p.3.

95 ACIR, *General Revenue Sharing, op. cit.*, pp. 21-22.

96 *Ibid.*, pp. 45, 22.

97 Nathan et al., *op. cit.*, Table 8-3, p. 199. These are the aggregate dollar proportions. When calculated by mean percentages, the comparable figures are 10.8 and 11.6 per cent. The former figures are dominated by the large jurisdictions which appear to have had almost nothing available for expanded operations.

98 *Ibid.*, pp. 206-208.

99 *Revenue Sharing: Its Use By and Impact on Local Governments, op. cit.*, p. ii

100 *Revenue Sharing: Its Use By and Impact on State Governments, op. cit.*, p. 2.

101 Hearings before the Subcommittee on Intergovernmental Relations, *op. cit.*, p. 14.

102 Nathan and associates point out that the proportions shown in the ORS report are "actually unweighted means of the percentages reported by individual jurisdictions..." and hence cannot be used to compute aggregate dollar amounts used for new spending. "The catch is that equal weight has been given to each reporting unit regardless of the amount of spending involved. If, as seems likely the new spending proportion differs materially between large and small jurisdictions, actual total dollar relations may be quite different from those suggested by the Treasury presentation. All that can reasonably be concluded is that, except for educational spending by state governments (most of it for aid to local governments and most of it reported as new spending), recipient governments use the overwhelming bulk of those shared-revenue funds applied to current operations to maintain existing services rather than to finance new or expanded services." Nathan et al., *op. cit.*, p. 243.

103 Almost all the expenditure on education was accounted for by State governments. Local governments spent 72 per cent of all funds devoted to operations and maintenance on public safety and transportation.

104 Clearly, some substantial proportion of expenditures in the "health" category benefited the "non-poor". There was also $66.5 million of capital expenditure for health purposes. Probably even a larger proportion of those expenditures benefited persons other than the poor or elderly.

105 *Revenue Sharing: The First Actual Use Reports, op. cit.*, p. 3-9. See footnote 102 regarding the accuracy of the estimates for new services.

106 *Public Law 92-512*, Section 122. The law prohibits discrimination in both services and in employment resulting from use of revenue sharing funds.

107 Hearings before the Subcommittee on Intergovernmental Relations, *op. cit.*, p. 23.

108 An organization funded by the Ford Foundation providing "research, information, education and supportive services for black and other minority group elected officials" and for others representing minority group interests.

109 Joint Center for Political Studies, *The Minority Community and Revenue Sharing*, Second Edition, Washington, June 1973, p. 10. ORS has reported that about two thirds of the complaints filed with it concern employment policies and the rest deal with discrimination in the provision of services under a specific program *(New York Times*, 4 November, 1974).

110 ACIR, *General Revenue Sharing, op. cit.*, p. 74a.

111 Hearings before the Subcommittee on Intergovernmental Relations, *op. cit.*, p. 616.

112 Statement by ORS Director, Graham Watt in the *New York Times*, 4 November, 1974.

113 Hearings before the Subcommittee on Intergovernmental Relations, *op. cit.*, p. 7.

114 *Ibid.*, p. 29.

115 *Ibid.*, pp. 40-41. The courts evidently did not agree that withholding of funds was an inappropriate remedy. They have been frozen since December 1974. On January 6, 1976, District Court Judge P.H. Marshall continued the impoundment as an "economic sanction to end the sexual and racial discrimination". His order required the Chicago Police Department to adhere to quotas in the hiring of police officers(*New York Times*, 6 January, 1976).

116 *Ibid.*, pp. 62-63.

117 National Planning Association, *op. cit.*, p. 21

118 Hearings before the Subcommittee on Intergovernmental Relations, *op. cit.*, pp. 88-89.

119 ACIR, *General Revenue Sharing, op. cit.*, pp. 71-74.

120 Hearings before the Subcommittee on Intergovernmental Relations, *op. cit.*, p. 516.

121 Caputo in D.A. Caputo, ed., *Revenue Sharing and Federalism, op. cit.*, p. 135.

122 *New York Times*, 25 December, 1974.

123 Hearings before the Subcommittee on Intergovernmental Relations, *op. cit.*, pp. 426-427.

124 Nathan et al., *op. cit.*, pp. 271-278.

125 *Revenue Sharing: Its Use By and Impact on Local Governments, op. cit.*, pp. 24-25.

126 Subcommittee on Intergovernmental Relations, *How 45 Selected Jurisdictions View Revenue Sharing, op. cit.*, p. 2.

127 Data from Maureen McBreen, "Criticisms Voiced Against General Revenue Sharing And Some Recommendations For Reform", Library of Congress, Congressional Research Service, Washington, 25 September, 1974, p. 21.

128 *The Minority Community and Revenue Sharing, op. cit.*, pp. 26-27.

129 *New York Times*, 10 December, 1974.

130 Pablo Eisenberg, "Citizen Action and General Revenue Sharing", *Viewpoint*, October 1974, p. 9. (Wilmington, De., Model Cities Organization).

131 *New York Times*, 5 December, 1974.

132 Hearings before the Subcommittee on Intergovernmental Relations, *op. cit.*, p. 623.

133 ACIR, *General Revenue Sharing, op. cit.*, p. A29.

134 *Ibid.*, pp. 81-82.

135 *Loc.cit.*

136 Senator Muskie at the Hearings of the Subcommittee on Intergovernmental Relations, *op. cit.*, p.515.

137 Reagan in D.A. Caputo, ed., *General Revenue Sharing and Federalism, op. cit.*, p. 30.

138 Deil S. Wright, "Revenue Sharing and Structural Features of American Federalism", in D.A. Caputo, ed., *General Revenue Sharing and Federalism, op. cit.*, p. 115.

139 Reuss in D.A. Caputo, *ibid.*, p. 94.

APPENDIX A

GENERAL EXPLANATION OF THE STATE AND LOCAL FISCAL ASSISTANCE ACT AND THE FEDERAL-STATE COLLECTION ACT OF 1972. PREPARED BY THE STAFF OF THE JOINT COMMITTEE ON INTERNAL REVENUE TAXATION, FEBRUARY 12, 1973. *

SUMMARY

The State and Local Fiscal Assistance Act of 1972 (H.R. 14370) represents a landmark in Federal-State-local fiscal relations. [1]

This legislation is designed to help our sorely pressed State and local governments to meet their heavy financial problems and to keep them financially sound. If our Federal system of government is to continue to operate effectively, the State and local governments must be financially sound. However, after extensive study, the Congress concluded that many localities face severe financial crises. In part, this stems from the increasing demand for public services resulting from the substantial increase in urbanization occuring in recent years. Closely related to this is the problem arising from the limited jurisdictions of many local governments: they often are called upon to provide many services for persons who do not live in their taxing jurisdictions. At the same time, those within their taxing jurisdictions are often poor and unable to pay for their share of the services demanded. This financial problem for local governments has been significantly worsened by rising costs resulting from inflation. It has also been accentuated in the recent past by the lower than normal increase in revenues resulting from stagnant economic conditions.

Although their financial problems are generally less grave than those of the local governments the States also face severe financial problems. In the case of the States, limited jurisdiction is a less significant factor. Nevertheless, the difficulty in obtaining adequate financing, in part because of the nature of their tax structures, has presented the States with problems not only in meeting their own financing needs but also in their increasing role in assisting local governments.

The State and Local Fiscal Assistance Act of 1972 makes a substantial contribution toward resolving these problems by providing a new and fundamentally different kind of aid to State and local governments. The Federal Government provided very substantial aid to State and local governments in the past. However, this has been in the form of categorical aid which generally must be spent for rather narrowly prescribed purposes and which does not give the State and local governments much flexibility as to how the funds may be used. Accordingly, the Congress concluded that there was need for a new aid program to give the State and local governments the flexibility that they need to use the funds for the most vital purposes in their particular circumstances. The Act fulfills this need.

The fiscal assistance provided by this Act differs in several fundamental respects from other proposals which have been made for the sharing of funds by the Federal Government with the States and localities.

First, the local governments, although given very considerable latitude in the use of the aid funds, are also provided with general guidance to give assurance that the funds will be spent for priority items.

Second, the Act provides for the distribution of specific dollar amounts of fiscal assistance rather than a percentage of Federal revenues. This means that the Federal Government is not adding a new expenditure category which will grow at an uncontrollable rate.

Third, the Act provides the fiscal assistance for a limited 5-year period. This assures a review of the financial problems of State and local governments after a period of time with the result that provision can be made for needed changes as they develop. At the same time it gives assurance that

1 Public Law 92-512, H.R. 14370, "An Act to provide fiscal assistance to State and local governments to authorize Federal collection of State individual income taxes, and for other purposes" contains three titles. Title 1 is cited as the "State and Local Fiscal Assistance Act of 1972" and Title II is cited as the "Federal-State Tax Collection Act of 1972". The term "Act" is used to designate the overall Act and Titles I and II. The usage is clear from the context.

* U.S. Government Printing Office, Washington, 1973.

these funds will be available to States and localities during the current period when, because of economic and other problems, the need for this assistance may well be at a peak level.

And fourth, the formulas for distributing the funds are designed to encourage State governments as well as local governments to meet their revenue needs to the greatest extent possible out of their own tax sources, either by greater use of income taxes or other revenue sources. In other words, the Act helps the States as well as the localities, who help themselves.

More specifically, the Act appropriates $30.2 billion for aid to State and local governments covering the period from January 1, 1972, through December 31, 1976. The payments start at an annual rate of $5.3 billion for calendar year 1972 and increase annually until they reach $6.5 billion in calendar year 1976.

The following tabulation shows the amounts of aid appropriated for distribution to State and local governments by fiscal years:

Period	Amount of aid (millions)
January 1, 1972, through June 30, 1972	$2,652
Fiscal year beginning July 1, 1972	5,642
Fiscal year beginning July 1, 1973	6,055
Fiscal year beginning July 1, 1974	6,205
Fiscal year beginning July 1, 1975	6,355
July 1, 1976, through December 31, 1976	3,327
Total	30,236

These aid funds are distributed among the States and the localities on the basis of formulas which are designed to recognize the widely varying circumstances of particular State and localities throughout the country and "to put the money where the needs are".

Two thirds of the total amount appropriated each year is to be distributed to local governments throughout the country and the remaining one-third is to be distributed to the States. This division of funds is provided because it is believed that local governments generally have more pressing financial problems than the States and also because approximately two-thirds of total State and local expenditures are made by local governments.

Table 1 shows the estimated distribution among the States of the aid funds for the States and for localities in the first year of the program. This distribution differs from the previous estimate because of data error corrections and the use of fiscal year 1971 State and local tax data rather than fiscal year 1970 as was previously used (see note 1 to table 1).

The Act uses two different formulas in determining the allocations shown in table 1 for State areas (which include in each case both the State and its localities). The actual payment going to each State area is computed on whichever of the two formulas yields the higher payment. [2]

The first formula (which was developed by the House) in part is based on the need of the States and localities and in part is an incentive device to encourage them to meet their own needs. Under this formula, the need of States and their localities is measured by taking into account population, the extent of urbanization and the extent of relative poverty (measured by population inversely weighted by relative per capita income). The incentive feature also included in the formula is designed to encourage tax effort generally in a State and also to encourage greater use of State individual income taxes. In the distribution, the three items in this formula designed to measure need are each given a weight of about 22 per cent (giving the three items a combined weight of two-thirds

2 However, the allocation to each State area on the basis of the particular formula which produces the higher amount is scaled up or down proportionately to make the total allocation for the year equal to the total amount appropriated for that year. In 1972, the first year of the program, this involves scaling down the higher of the two formulas by 8.4 per cent to keep the total distribution within the bounds of the $5.3 billion appropriated for that year (see table 3 and accompanying text).

TABLE 1. – DISTRIBUTION OF AID FUNDS TO STATE AND LOCAL GOVERNMENTS UNDER THE STATE AND LOCAL FISCAL ASSISTANCE ACT OF 1972, FOR CALENDAR YEAR 1972
(In millions of dollars)

States	Total[1]	State share[2]	Local share[2]
United States, total	5,301.3	1,766.9	3,534.4
Alabama	90.6	30.2	60.4
Alaska	6.6	2.2	4.4
Arizona	50.2	16.7	33.5
Arkansas	54.5	18.1	36.4
California	560.3	186.8	373.5
Colorado	54.5	18.2	36.3
Connecticut	67.2	22.4	44.8
Delaware	16.1	5.4	10.7
District of Columbia	23.9	8.0	15.9
Florida	146.7	48.9	97.8
Georgia	109.6	36.5	73.1
Hawaii	23.7	7.9	15.8
Idaho	21.3	7.1	14.2
Illinois	274.0	91.3	182.7
Indiana	113.8	37.9	75.9
Iowa	75.5	25.2	50.3
Kansas	52.4	17.4	35.0
Kentucky	87.0	29.0	58.0
Louisiana	122.5	40.8	81.7
Maine	31.0	10.3	20.7
Maryland	107.1	35.7	71.4
Massachusetts	165.1	55.0	110.1
Michigan	224.4	74.8	149.6
Minnesota	106.4	35.4	71.0
Mississippi	88.4	29.4	59.0
Missouri	98.2	32.7	65.5
Montana	20.5	6.8	13.7
Nebraska	38.9	13.0	25.9
Nevada	11.5	3.8	7.7
New Hampshire	16.6	5.5	11.1
New Jersey	166.6	55.5	111.1
New Mexico	33.0	11.0	22.0
New York	589.0	196.3	392.7
North Carolina	136.0	45.3	90.7
North Dakota	22.2	7.4	14.8
Ohio	213.9	71.3	142.6
Oklahoma	58.9	19.6	39.3
Oregon	53.0	17.7	35.3
Pennsylvania	278.0	92.7	185.3
Rhode Island	24.2	8.1	16.1
South Carolina	72.1	24.0	48.1
South Dakota	24.1	8.0	16.1
Tennessee	98.9	33.0	65.9
Texas	247.9	82.6	165.3
Utah	30.6	10.2	20.4
Vermont	14.7	4.9	9.8
Virginia	106.3	35.4	70.9
Washington	78.0	26.0	52.0
West Virginia	52.0	17.4	34.6
Wisconsin	133.3	44.5	88.8
Wyoming	10.0	3.4	6.6

1. This distribution differs from the previous estimate (shown in the volume "State and Local Fiscal Assistance Act of 1972; Supplemental Report Showing Distribution of Funds as agreed to by the Conferees", prepared by the Staff of the Joint Committee on Internal Revenue Taxation, September 27, 1972) because of correction of data errors and updating of tax data to fiscal year 1971 from 1970. The amounts allocated to local governments shown in that volume were based on tax data for fiscal year 1966 obtained from the 1967 Census of Governments. The actual amounts allocated (as shown in table 5 for the 100 largest cities) are based on fiscal year 1971 tax data. The difference in tax data results, in many cases, in a significant difference between the amounts shown in the above volume and the amounts actually distributed. See also footnote 12 in Part III, General Explanation.

2. Total funds to a State are divided one-third to the State government and two-thirds to local governments.

of the total) while the two incentive factors are each given a weight of about 17 per cent (and together a weight of about one-third of the total). [3]

In determining the distribution of the aid based on income tax collections, the Act provides that 15 per cent of the individual income tax collections of each State is taken into consideration. However, to prevent particular States from securing either an unduly large or unduly low allocation as a result of this factor, the amount of such income taxes actually taken into consideration may not exceed 6 per cent of the Federal individual income tax liabilities attributable to the State or fall below one per cent of these Federal income tax liabilities. The latter one per cent floor is especially helpful to States which do not impose individual income taxes.

The second formula (which was developed by the Senate) distributes the funds to the State areas on the basis of population weighted by general tax effort and weighted still further by inverse relative income. This formula is designed to place more emphasis (than the House formula) on need as measured by inverse income levels. Also, in measuring tax effort, it differs from the House formula in that it does not place any special emphasis on the use of State income taxes as distinguished from other taxes. Finally, this formula instead of taking urbanization into account, uses general tax effort as a means of increasing distributions to those States in which larger cities are located.

The 3-factor (Senate) formula is also generally used to allocate the total share of the aid set aside for the local governments in each State area (two-thirds of the total State area allocation) among specific local governments. Additional flexibility in this latter respect is provided by allowing the States to choose by law to have the aid funds distributed among their local governments on the basis of an alternative formula instead of on the basis of the standard three-factor formula. Thus, a State may elect to have the distribution to local governments made on the basis of population weighted by general tax effort factor or population weighted by inverse relative income levels factor or on the basis of any combination of these two factors.

The funds distributed to the local governments may be used only for certain priority purposes. In the case of maintenance and operating expenditures, the funds may be spent for public safety, environmental protection, public transportation, health, recreation, libraries, social services for the poor or aged and financial administration. In addition, these funds may be used for capital expenditures authorized by law. All of the categories of expenditures listed above are limited in that the expenditures must be for ordinary and necessary purposes.

In general, the States are given complete flexibility in regard to expenditures of the aid funds. However, to receive their full allocation, the States must generally maintain their assistance to their local governments at the levels existing in fiscal year 1972. In determining the assistance provided by a State to its localities for this purpose, adjustments are made where the State provides additional tax sources to its localities or assumes financial responsibility for programs previously financed by its localities.

In addition to the limitations set out above, the aid funds may not be used by a State or local government in a way which discriminates because of race, color, sex or national origin. A further restriction prevents the aid funds from being used to pyramid Federal aid to State and local governments by prohibiting the use of funds to match Federal funds under programs which make Federal aid contingent on a contribution by the State or local government. Finally, provision is made under certain circumstances to give individuals whose wages are paid out of the aid funds the protection of prevailing wage rates, including the Davis-Bacon Act.

State and local governments receiving aid funds must also submit reports to the Treasury Department on now thay have used such funds in past periods as well as how (for periods beginning after December 31, 1972) they plan to use future aid funds. Copies of these reports must be published in the press and made available to the news media so that the electorate can be kept fully informed.

3 In the House version of the bill, the three main items in the formula designed to measure need determined the amount distributed to the local governments. The two factors designed to provide an incentive accounted for the distribution in the State governments. However in the conference agreement a single formula was used which took into account (under the House formula) the "need" and the "incentive" factors in determining the distributions both to the State and to the local governments.

To facilitate compliance with State individual income taxes, States are also given the option to request Federal collection of their State individual income taxes under a "piggyback" arrangement whereby the State tax is collected in conjunction with the Federal tax if the State tax generally conforms to the Federal tax. This is to be available only for 1974 and later years, and only at such time as two or more States (representing 5 per cent or more of individual income tax returns) have requested the Federal Government to collect these taxes for them.[4]

4 The Act also places a limit on the previously open-ended Federal matching grants for social services under public assistance programs but as indicated in the letter of transmittal this subject is not discussed in this general explanation.

APPENDIX B

EXTRACTS FROM ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS REPORT ON GENERAL REVENUE SHARING: AN ACIR RE-EVALUATION, OCTOBER 1974 *

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.

2 General revenue sharing tends to equalize fiscal capacities of rich and poor states.

3 General revenue sharing provides far more financial aid to the nation's major central cities than to rich suburban communities.

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 per cent nor more than 145 per cent of the average local per capita entitlement.

5 General revenue sharing is gradually being eroded by inflation.

6 General revenue sharing appears to be gaining public support.

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.

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 Actual Use Reports stimulated some additional citizen participation and concern in determining local budget priorities.

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.

10 At this time it is virtually impossible to determine on an aggregate basis how revenue sharing funds have been spent.

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.

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.

13 Revenue sharing tends to prop up certain duplicative, obsolete, and/or defunct units of local government.

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 non-discrimination 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.

15 The long lead time required to update 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.

16 To date the incentives for greater state use of the personal income tax have not proved strong enough to accomplish their objective.

*Advisory Commission on Intergovernmental Relations, Washington, 1974.

Policy Recommendations and Issues

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 Appropriation 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?

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 those 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

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 Appropriation Issue

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 Public Law 92-512 incorporates several deficiencies that must be corrected: the five period 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

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 Discrimination Issue

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.

The Federal Control Issue

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

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 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.

Summary

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 .