Introduction: The Basic Purpose

While I was chairman of the Administration's Committee on Revenue Sharing and attempting to develop support for the program, I made literally hundreds of presentations to state and local government officials and civic groups throughout the nation. Let me read a short excerpt of the standard part of every talk I gave, whether it was to a professional group of economists or to a local Rotary:

"Before getting into the details, one fundamental point needs to be made. We are not recommending just another program of sending Federal dollars around the country; there certainly is not shortage of ways of doing that already.

"We are proposing a shift of decision-making power to state and local governments. Revenue sharing is unlike any existing grant-in-aid program. Under revenue sharing, the money that state and local governments obtain from the U.S. Treasury becomes in good measure their money. For example, revenue sharing money can go into a county's general fund, and it is up to the county council to decide how to spend it."

Historical Perspective: Republican Version

The general concept of revenue sharing, that is, sharing the revenues of the federal government with the other parts of the federal system, goes back to the earliest days of the Republic. In his second inaugural address in 1805, President Thomas Jefferson urged that federal revenue be utilized for a "just repartition...among the States...applied...to rivers, canals, roads, arts, manufactures, education, and other great objects within each state."

In 1836 the Congress actually did endorse a form of revenue sharing when it voted to distribute surplus federal funds to state governments. The amount actually distributed in 1837 was almost equal to the total of direct federal expenditures for the year. That magnificent sum of $28 million was used for a variety of purposes, ranging from capitalizing the state banks to local debt repayment to public works construction. The
greater part of the distribution was devoted to what we now call investments in human resources, notably education.

Modern-day interest in unconditional sharing of federal tax revenues with the states dates back to 1960 when the concept began to emerge again in academic circles. Soon, political leaders were giving it their attention as well. In 1958, then Congressmen Melvin Laird introduced a revenue sharing bill. Much of the credit for bringing the concept to more widespread public attention is owed to Professor Walter Heller of the University of Minnesota, who, as Chairman of the President's Council of Economic Advisers in the early 1960's, proposed a detailed revenue sharing plan. The plan was developed in cooperation with Dr. Joseph Pechman of the Brookings Institution, who headed a task force to develop more fully the specific outlines of a proposal. The result was often called the Heller-Pechman Plan.

The Heller-Pechman Plan was never proposed by the Johnson Administration. Yet interest in the idea continued. In 1968, support had grown to the point that both party platforms contained specific revenue sharing proposals. During the campaign, candidate Richard Nixon pledged, "I plan a streamlined Federal system with a return to the states, cities, and communities of decision-making power rightfully theirs." In April 1969, while outlining his first legislative program, President Nixon called for "...a new sharing of Federal revenues--the revenues of the Federal Government, so that other levels of government...will not be caught in a constant fiscal crisis." You will note a duality of justifications which continues to this day: the political science version with the all-conquering power of the people, and the closely related concern of the economists over the adequacy of the financial base for state and local government.

The next important step occurred in July 1969. The President called to the White House a representative and bipartisan group of Governors and county officials to assist the Administration in developing a specific approach to revenue sharing. We reached agreement on the basic principles:
1. An automatic distribution each year of a designated portion of the federal income tax base, based on objective criteria spelled out in law.
2. An equitable sharing of the money among State and local governments, as also spelled out in clear formulas in the federal law.
3. No "strings" or restrictions on the use of the money.
4. Inclusion of all general-purpose local governments, regardless of size or location.

The fourth point represented new ground in the development of revenue sharing—the inclusion of counties, cities, towns and other "general-purpose" local governments. Most of the earlier approaches were limited to state governments. The July 1969 agreement was a fundamental political compromise between the respective demands of states and localities. Their joining forces on the subject of revenue sharing was to provide the reassurance in the political struggle among the congressional considerations of revenue sharing legislation.

In September 1969, the Administration's first revenue sharing bill was introduced in Congress. In the Senate, the bill was sponsored by Senator Howard Baker of Tennessee in cooperation with Senator Fred Harris of Kentucky. In the House of Representatives, it was introduced by Representative Jackson Bettts of Ohio and 75 of his colleagues. Despite the relatively large number of sponsors and the growing public support, the Congressional committees were impressed and held no hearings on them. That the public support was substantial and growing was evident. In May 1969, the Gallup Poll showed 71 percent in favor of having a percentage of federal income taxes returned to state and local governments for use as they saw fit. A Gallup survey conducted in January 1971 found that support had grown to 77 percent. Favorable reaction cut across party lines, with large majorities of Democrats (77 percent), Republicans (81 percent), and Independents (73 percent) all in favor of the plan.

In February 1971, Senator Baker and 38 cosponsors introduced the General Revenue Sharing Act of 1971. The House version was introduced by 140 cosponsors. We had worked out the details of the new and more generous proposal carefully with representatives of the major national associations of State and local officials, including the National Governors Conference, the National Legislative Conference, the U.S. Conference of Mayors, the National League of Cities, the National Association of Counties, and the International City Management Association.

The precise formulas contained in the 1969 bills were modified to provide a larger share to local governments, and to take into account the great diversity among the states. That is, in states--notably Hawaii--the state government bears the burden of financing and carrying out the great bulk of the government functions, ranging from welfare to education--the state governments would receive a below-average share of the revenue sharing funds distributed to that state. Ignoring the wide variations in the allocation of responsibilities between individual states and their local sectors, the congressional version of revenue sharing loses a good deal of the equity embodied in the earlier version.

A five-year fixed dollar amount was substituted for the earlier plan to disburse permanently and automatically a pre-designated share of the personal income tax base. During a five-year period, the Congress should have adequate opportunity to review the wisdom of its actions. Also, it was argued that such a reasonably long period--in contrast to the typical 12-month appropriation enacted by Congress--would enable the states to make realistic long-range plans for the use of the revenue sharing funds. Because the legislation is both an authorization and appropriation act, it provides considerably more assurance to the recipients than the annually-appropriated grant-in-aid.

It does seem, however, that the five-year limitation has restrained localities in making their allocation of funds. A recent survey of Southwestern states, for example, reveals that a large portion of the local funds is being used for capital projects. Apparently, localities are reluctant to incorporate the revenue-sharing funds into their long-range operating budgets because of their uncertainty over the continuation of the program beyond 1976.

A survey of local officials in the spring of 1973 by the Advisory Commission on Intergovernmental Relations revealed another relation that they asked was, "Did uncertainty about the future of revenue sharing have an important bearing on the way your government decided to spend its revenue sharing funds?" Approximately half of the local officials replying stated that the uncertainty did have an important bearing on the way in which they spent the money. This is borne out by a follow-up question as to whether the uncertainty influenced the local officials to use the money for capital outlays and other non-recurring expenses. The answer in this case was "yes." Perhaps the most unfortunate change is the requirement that the local share only be used for designated "priority" areas, which notably exclude welfare and education. The areas "blessed" by the Congress comprise public safety, environmental protection, public transportation, health, recreation, libraries, social services, and capital outlays. That change is undesirable on both conceptual and practical grounds. Conceptually, the program's "strings" violate the basic notion of putting the responsibility for allocating and spending the funds right on the local governments receiving the money. If the citizens do not like how the revenue sharing money is being spent, they know exactly how their government is spending it and hold accountable--and defeat, if they wish, at the next election.

At the practical level, limiting the local two-thirds of the revenue sharing money to specific priority areas, no matter how well those areas are defined, multiplies the unproductive overhead and paper shuffling that the sharing is designed to cut down. Each locality is having to set up an accounting system to show the inevitable federal auditors that the revenue sharing money is being spent for parks or sewers or some other designated purpose. In addition, the fact that the national legislature has ruled to be a priority in every locality. Woe unto the unfortunate local government who is caught using a penny of the money for what by default Congress must consider low priorities of local government--such as the public schools.

What is Revenue Sharing for Municipalities? As it has been true for some time since the first revenue sharing payments were made, it is obviously premature to attempt any definitive evaluation of the program. Nevertheless, I would like to speculate on some of the more likely results.

As I see it, the Congress was exclusively interested in fostering the attainment of its basic objective, to increase the relative importance of the state and local share of the public sector of the United States at the expense of the federal. In the words of the Advisory Commission on Intergovernmental Relations (ACIR): "The relative importance of state and local governments will have occurred in a qualitative as well as quantitative sense. More of those expenditure decisions will be made by state and local officials rather than by the Congress in voting grants-in-aid or by federal personnel administering the aid programs."

To some degree, the state-and-the-art does not enable us to calibrate the precisely-direct federal employment, purchases and other outlays will be less than they likely would have been in the absence of revenue sharing. Conversely, the employment, procurements, and other expenditures by state and local governments will be larger than they otherwise would have been. As a result, the intergovernmental balance of fiscal federalism, away from centralization making and toward matching needs and resources at the State and local levels.

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grants-in-aid and general revenue sharing is that the former works through both the "income" and the "price" effects, while the latter works only through the "income" effects. That means that grants-in-aid provide a double incentive to increase spending by state and local governments. First and similar to revenue sharing, they increase the revenues or income of these governmental units, thus enabling them to spend more. But grants-in-aid have a second effect—they lower the price of certain categories of public goods.

For example, a 50-50 matching grant on a $5 million library means that it only costs the county or city $2½ million to build the library. At the lower price, the demand is higher. Few can resist the argument that our city will "lose" the federal stimulus if we do not match it with local funds. The effect is to reduce the price of the aided public goods thus reduced in relation to other public undertakings, but in relation to private goods. Thus, grants-in-aid tend to encourage a greater amount of purchases of public goods (and hence a larger public sector) by altering the relative prices of public and private goods.

Revenue sharing does not have that "price" effect. If a county wants to build a $5 million library, it will have to pay the full $5 million. Even if the $5 million is all taken out of the revenue sharing fund, there will be full citizen knowledge that the most marginal spending has been funded for another purpose, and perhaps foregoing the need for a tax increase.

Also, grants-in-aid—again unlike revenue sharing—tend to encourage wasteful or low yield undertakings, because of the federal government's willingness to pay. To an economist, that's a cost-benefit ratio in favor of the grants instead of a tax reduction. However, a budget analyst will likely argue that the shift of funds from states to counties will have a significant effect on the budget deficit and the price of federal goods. It also tends to reduce the gap between the price levels of public and private goods.

The realistic answer is that it depends—it depends on who gets the benefits and who pays the costs, and of course on who makes the decisions. If in our hypothetical example, a 50 percent matching grant available from a federal agency, the locality may find that the pertinent benefit/cost ratio for it is quite low. But the city government may find that they can gain the $800 in benefits but only have to pay one-half of the $1,000 of costs, the pertinent benefit/cost ratio for local decision-makers is not an unfavorable 0.8 but a rather attractive 1.6 ($800 of benefits to $500 of local costs). It is not surprising, hence, that local interests continue to push so strongly for federal projects in their area, even quite marginal ones, so long as the national taxpayer will subsidize them. Again, revenue sharing is an attractive alternative to that unhappy state of affairs.

It should be noted that the recent discussion of state and local surpluses seems to have been overblown. Over half of the surplus in 1972 was earned by state and local retirement funds, money which is not available for general expenditures. The cyclical recovery in the national economy and the initial large retroactive increases in revenue sharing certainly contributed to this.

In these temporary surpluses are likely to be reduced in favor of a combination of higher state and local disbursements and lower taxes. Fundamentally, the question is whether the society prefers its tax reductions and expenditure increases to occur at the state and local or the national level.

Perhaps one of the most important impacts of revenue sharing will be the influence on the structure of decision-making in state and local government, especially to strengthen the position of elected officials. Under the grants-in-aid system, typically the program department of the state, city, or county looks to its counterpart in the federal bureaucracy for guidance and leadership. Where the federal agency provides the larger share of the funds, such federal influence or control may be very substantial.

Thus, in effect, a state Roads Commission may find itself more beholden to the Federal Bureau of Public Roads from which it receives 90 percent of the cost of interstate highways—than to the governor or state legislature, which provide the remaining 10 percent. To a lesser extent, similar relationships exist between state education departments and the U.S. Office of Education, between local health offices and the U.S. Public Health Service, etc.

The revenue sharing funds, in contrast, are administered by popularly elected officials. It is the legislature that will decide the uses to which the state government's share will be put. Similarly, the city councils and the county commissioners will exercise the decision-making power over the local shares. Thus, an important shift of power from executive to legislative branches may well occur, paralleling the shift from federal to state-local decision-making.

As a result of the decision-making and hence action is shifted to the states and their subdivisions, they will be more capable of attracting high calibre personnel and thus become more effective at carrying out their functions and programs. The greater financial resources should help in both recruitment and retention of good people. I believe that we have seen our most talented students interested in government service all go to Washington. State or local government was generally dismissed as irrelevant. Revenue sharing will be no panacea, but it should help to improve the situation and enhance the economic development of the states. Thus far, the Congress has not approved either the special revenue sharing proposals or the plans to merge the cabinet departments into four new ones organized around major functional purposes of government: community development, human development, natural resources development, and law enforcement.

Other efforts related to revenue sharing include the Administration's attempts to streamline the administration of federal programs by consolidating many of the old-line special-interest departments into four new ones organized around four major functional purposes of government: community development, human development, natural resources development, and law enforcement. Thus far, the Congress has not approved either the special revenue sharing proposals or the plans to merge the cabinet departments into four new ones organized around major functional purposes of government: community development, human development, natural resources development, and law enforcement.

Instead, the area of major debate appears to have shifted, at least for the moment, to the question of tax reduction. The most dramatic aspect of the new struggle is the subject of Presidential impoundments of Congressional appropriations. Many Presidents have refused to spend all the funds that Congress has voted and there is some legislative authority for exercising such discretion. Nevertheless, the scale of the impoundments has been exceptionally large and the public statements accompanying them unnecessarily challenging to congressional prerogatives.

Although the impoundments have upset the supporters of the proposals, the proposals themselves have been viewed as an aspect of fiscal policy. In this period of substantial inflationary pressures, restraint on government spending seems to be an appropriate response. Ideally, opinions will differ
on which programs should be cut back, but that is the continual struggle over national priorities. It is unfortunate that the debate has clouded the introduction of general revenue sharing. But as stated earlier, over the years the operation of revenue sharing is likely to mean a slower rate of growth in other federal spending than would otherwise be the case. And despite the talk about slashes in civilian programs, the reality is only a modest slowdown in what has been an extremely rapid rate of growth.

A Look Ahead

The modern public sector which is emerging in advanced nations is a variety of mechanisms and organizations in order to carry out national policies. Excessive reliance on any single mechanism—whether it be contracts to government-oriented corporations or grants-in-aid to state and local government—often tends to weaken the mechanism or to dilute the effectiveness of public policy. Seen in this light, revenue sharing is a useful addition to the mechanisms which the modern state, particularly a federal one, can utilize in conducting the public business.

Whether revenue sharing is a onetime experiment or a continuing commitment will depend, in very large measure, on how the nation evaluates the effectiveness of the revenue sharing money and perhaps even some real "horror stories" of actual graft and corruption. Unfortunately, honesty and good faith in the use of revenue sharing will depend on the wisdom of program choices and on the effectiveness of program execution on the part of the states and localities using the money.

Although it can be hoped that the examples will be few and far between, for so long as there will be reports of some stupid or wasteful instances in the use of revenue sharing money and perhaps even some real "horror stories" of actual graft and corruption. Unfortunately, honesty and good faith in the use of revenue sharing will depend on the wisdom of program choices and on the effectiveness of program execution on the part of the states and localities using the money.

To be sure, it is incumbent upon state and local officials to avoid what has been called "FTC expenditure"—funds going for frivolity, thriftlessness and cheating. But it will take more than that to make the revenue sharing experiment a success. It will be necessary to show the citizenry that the $30 billion of federal tax revenue that will be allocated to state and local governments over the five-year period, by and large, will be more wisely spent than the $12 billion or $14 billion that is currently allocated to the budgets of federal agencies. That is a clear challenge to the ability of state, city, and county government throughout the nation and it is likely to require some positive action. The state of Texas is an example of one of the few areas that is developing a comprehensive approach to this important question.

In late 1972 Texas established a Revenue Sharing Council to promote state and local cooperation in the revenue sharing program. The Governor serves as chairman of the Council; the other members are three city officials, three county officials, the Lieutenant Governor, the Speaker of the House of Representatives, and the State Comptroller.

The Council does not have the authority to allocate the revenue sharing money. Rather, it is assisting those who do. Early in its operations, the Council requested the State Department of Community Affairs to set in motion a program to assist local governments in providing statistical information to federal agencies as well as in answering the inevitable questions that are likely to arise. The result is a State Office of Revenue Sharing Assistance.

As the Executive Director of the Texas ACIR put it, "We want very much to avoid a stream of Texas officials going to Washington seeking answers, because the more questions we ask of Washington, the more written responses they will give, many of which will find their way into the Federal guidelines."

The Texas approach may not be necessarily desirable or workable in other regions. But in general, the "extra mile" that state and local officials may walk in carrying out the spirit as well as the letter of revenue sharing is likely to be a very good investment. It should be recalled that many members of the Congress had and continue to hold an aagnostic view of the desirability of requiring the states to allocate a portion—albeit a modest part—of federal revenues to another level of government. Hence efforts to reduce the flexibility and discretion available to state and local officials in carrying out the revenue sharing experiment can be expected from time to time. The legislation itself contains restrictions that do violence to the basic concept, notably the limitation of local expenditures to designated priority areas. The U.S. Advisory Commission on Intergovernmental Relations anticipates that the Appropriations Committees will make another effort to convert revenue sharing to an minor, from eliminating the five-year assurance.

To put it simply but accurately, unless state and local governments, and their citizens, and their associations, take great pains to minimize waste and inefficiency in the revenue sharing disbursements, more rather than fewer restrictions can be expected to be written into the legislation in the future. Despite impressions to the contrary, the Congress has been known to cut back and on occasion even to eliminate federal spending programs that lose public support.

But I want to end on an optimistic note. For the next five years, the Nation will be witnessing not only the disbursement of $30 billion, but also one of the most important efforts to strengthen the institutions of the American society. If there is any lesson to be learned from the past, including the very recent past, it is the need for a free and strong national government, with a variety of centers of power, resources, and discretion in the formulation and execution of public policy. Revenue Sharing may well turn out to be a vital contributor to the development of that more decentralized structure of the public sector which will enable our society to continue to cope with a great variety of external pressures and domestic stresses. Revenue sharing is, after all, one of the few programs in American history which is overtly designed to help achieve the often neglected portion of the preamble to the Constitution, that stirring part referring to "forming a more perfect Union.""
Of particular interest in Table 1 is how people of different income and education levels rank the expenditure categories. Those with incomes below $8,000 indicated social services for the aged and poor as the highest expenditure priority. In contrast, those with incomes from $8,000 to $12,000 indicated public safety as most important and those with incomes above $12,000 indicated transportation as most important. A similar pattern was found by education levels. Those with less than 12 years of education considered social services for the aged and poor to be most important; those with 12 years of education considered public safety most important; and those with more than 12 years of education placed the greatest importance on

Conclusions

Results of this survey should provide local government with some positive guidelines for allocating revenue sharing funds. The timing of this survey (i.e., the survey was conducted after the energy crisis became well publicized) undoubtedly affected the views that people have in particular towards environmental protection and public transportation expenditures. Since attitudes do change there is a definite need for periodic assessments to be made of community opinion toward local government expenditure policy. This, in the final analysis, should lead to an improvement in both the effectiveness and responsiveness of the elected in carrying out the expressed needs of the community at large.

Footnotes:
1 The author wishes to acknowledge the help from Dr. Paul S.T. Lee of the Center who provided the statistical computations upon which analysis was made. Appreciation is also extended to the graduate research assistants working at the Center who were responsible for carrying out the interviews.
2 The computed $X^2$ value for the three most frequently mentioned most important expenditure categories was 2.5685 (2 d.f.). The results indicate no significant difference in ranking of public transportation, public safety and social services for the aged and poor (95% confidence).
3 The computed $X^2$ values were 14.1730 (14 d.f.), 24.2163 (14 d.f.), 30.3734 (14 d.f.), 28.3947 (14 d.f.) and 7.7279 (7 d.f.) by area of residence, age, educational level, income and sex, respectively. $X^2$ values associated with income and educational levels are significant at the 5% significance level. All other $X^2$ values are not significant.