OVERHAULING THE FEDERAL AID SYSTEM: REDESIGNING GENERAL REVENUE SHARING AND COUNTERCYCLICAL AID PROGRAMS*

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I. INTRODUCTION

As is well known, Federal grants-in-aid have grown steadily in importance in terms of the Federal budget (from 5 percent in 1951 to 15 percent in 1976 of Federal expenditures on an NIA basis) and in terms of overall GNP (from ½ percent in 1951 to 4.5 percent of GNP in 1976). The period of most rapid absolute and relative growth occurred in the late 1960's and thereafter.[1] A related part of this expansion of Federal grants-in-aid has been the provision of relatively unrestricted aid. In part, general revenue sharing, as it is usually called, has been a response to the complexities of regulations, duplication, and red tape that accompanied the growth in Federal aid. Promised as both new money and simplification, recipients still continue to view it as a desirable form of Federal assistance. It currently amounts to 11 percent of all Federal grants-in-aid; block grants (including revenue sharing) constitute over 25 percent of Federal grants-in-aid.

Because the renewal of revenue sharing is partially complete as a result of House action on June 11, 1976, it is of interest to see where it is, and what the final legislation may contain in terms of changes from the original 1972 legislation. Not only is revenue sharing the largest Federal grant-in-aid program, but it is viewed as a major source of innovation in our Federal system. Provisions of this legislation have filtered into other Federal programs as well as into some State aid programs.

I want, therefore, to devote my remarks to a discussion of H.R. 13367 as passed by the House of Representatives, the likely form a final revenue sharing bill might take, a discussion of the related development of "countercyclical" or anti-recession revenue sharing, and, by way of conclusion, some overall discussion of the implications of these trends for our three tier Federal system. Also, I will include a discussion of certain alternatives which were considered but not provided in the final House legislation.

II. THE HOUSE REVENUE SHARING RENEWAL BILL: H.R. 13367

A. *Description*

The final House bill contains six major provisions: [2] (1) the elimination of the 8 high priority expenditure categories and the prohibition on matching other Federal aid programs with revenue sharing funds; (2) the extension of the legislation for 3¾ years at a $6.65 billion annual rate on an entitlement basis; (3) the provision of additional eligibility requirements as of October 1, 1977; (4) additional public hearing and publication requirements; (5) a new civil rights section which provides certain procedures under which the Treasury must enforce nondiscrimination and timetables for compliance on the part of recipients; and (6) a new requirement that recipients perform independent audits.

The elimination of the expenditure categories and matching prohibition are essentially just that, and require no further description; however, the other provisions deserve further comment.

The basic extension is noteworthy in that it provides for no growth in the dollar amount available; current law had increased the aggregate amount available by $150 million/year so that it reached a $6.65 billion annual rate in the last six months of the current law, i.e., July 1, 1976–December 31, 1976. The extension freezes for 3¾

*Responsibility for the views and errors in this paper rests with the author.

[1] *1976 Economic Report of the President*, 1976, Table B–67.

[2] In addition, the bill: (1) updates the base year to FY1976 for the application of the state maintenance of effort provision in current law (sec. 107(b) of the 1972 Act); (2) requires the Secretary of the Treasury to promulgate regulations on timetables by the agency with respect to complaints and obtain compliance reviews; (3) prohibits the use of revenue sharing for lobbying purposes; and (4) except for the new eligibility requirement, takes effect as of January 1, 1977.

years this $6.65 billion amount. More important, however, is that the payments will continue to be made without an application and thus be quite certain as in the past. In order to achieve this in light of the Congressional Budget and Impoundment Control Act of 1974, "entitlement" payments are made within the meaning of sec. 401(b) of the Budget Act. This is the first time since the Budget Act was passed that a significant program has made use of the entitlement concept. I might note here that the manner of funding stirred considerable controversy in 1972, and was the focal point of considerable controversy again in 1976. However, despite the expressed concerns of the Chairmen of the House Budget and Appropriations Committees, this certain method of funding was provided.

While restrictions on use of funds were diminished, the proposed eligibility requirements make it more difficult to receive revenue sharing payments after October 1, 1977. Current law requires that a recipient government be a city, township, or county, an Indian tribe, or an Alaskan native village as defined by the Bureau of the Census. The proposed requirements in effect add that such a unit of local government must spend some funds in at least two of 14 enumerated categories (police protection, courts and corrections, fire protection, health services, social services for the poor or aged, public recreation, public libraries, zoning or land use planning, sewerage disposal or water supply, solid waste disposal, pollution abatement, road or street construction and maintenance, mass transportation, and education).

While intended to improve citizen participation in the budgeting process, the proposed public hearing, notification and reporting requirements are rather complex. The current proposed and actual use reports are retained and expanded to show the relationship of the proposed and actual uses of revenue sharing funds to the entire budget, and to the budgets of the previous two entitlement periods. Areawide organizations are also to receive these reports. In addition, the actual use report must explain how the actual uses differ from the proposed uses and be available to the public.

The public hearing requirements are several. Seven or more days prior to the submission of the proposed use report to the Treasury Department, recipients must have a preliminary hearing on possible uses of revenue sharing. Seven or more days before the adoption of the actual budget, a second hearing must be held. Thirty days before this second hearing, a recipient must publish in a newspaper the proposed use report, a narrative summary of the entire budget, and the time and place of the second hearing. Thirty days after the adoption of the budget, a recipient must publish a narrative summary describing changes in the budget from proposed uses and make it generally available to the public. Finally, the actual use report must be sent to the Treasury.

The civil rights provisions are also quite complex. Essentially, a general prohibition against discrimination is provided and applies to all programs in the recipient's budget; discrimination on the basis of age, religion, and handicapped status are additional forms of discrimination which are prohibited. Also, discrimination is now defined in accordance with titles II, III, IV, VI, and VII of the 1964 Civil Rights Act, title VII of the 1968 Rights Act and title IX of the Educational Amendments of 1972 with respect to discrimination on the basis of race, color, religion, sex or national origin. Current law references only Title VI of the 1964 Civil Rights Act.

Second, an exception to this general prohibition is provided where a recipient can prove by clear and convincing evidence that the program on which discrimination is alleged to take place was not funded in whole or in part, directly or indirectly, with revenue sharing funds.

The third part of the civil rights provision is a series of procedures the Treasury must honor in administering the general prohibition. Without detailing these provisions here,[3] of interest is that: (1) a finding of

[3] There are three basic ways that suspension of a recipi[illegible] revenue sharing payments can occur under the ci[illegible]s section of the bill: (1) if, after notification of an allegation of discrimination and the passage of 90 days, the recipient does not sign a voluntary compliance agreement, and an administrative law judge does not rule that the recipient would prevail in a susbsequent compliance hearing, suspension may occur; (2) if in the above mentioned 90-day period, a locality directly requests a compliance hearing and is found in noncompliance, termination may occur; (3) if the Attorney General brings a civil action against a recipient in which the Attorney General's action prays for suspension or

discrimination by an agency other than the Treasury Department or the Justice Department can "trigger" the notification-compliance process which may culminate in a suspension or termination of revenue sharing funds; (2) a civil action may be brought directly against a recipient by a citizen only after exhaustion of administrative remedies (which is taken to mean a 60-day period). Thus, the passage of certain amounts of time and the concommitant absence of a resolution of an allegation of discrimination (e.g., a finding of nondiscrimination) can result in the suspension of further revenue sharing payments; [4] (3), the Attorney General has essentially concurrent authority with the Secretary of the Treasury in administering the civil rights provisions. This last aspect of the provisions is the most notable.

The auditing provision requires that recipients conduct independent financial audits in accordance with generally accepted audit standards.

B. Discussion

I would like to turn now to a discussion of these provisions in terms primarily of their relation to problems in current law as identified by the committee that developed the legislation.

Overall, I think it is fair to characterize the final House legislation as being supportive of the concept of revenue sharing and quite realistic about the problem of fungibility. That is, without a local maintenance of effort provision requirement, it is virtually impossible to know how the revenue sharing funds were spent. In fact, there seemed to be general agreement that one could not now know from one budget "how" revenue sharing funds have been used, that this was in effect endemic to the general revenue sharing approach, and that one might be able to make some judgments about how such funds were used only by examining *entire* budgets *over time.*[5]

As a result of this view on fungibility, it was thought essential to strengthen certain local control mechanisms to ensure that funds would be spent according to local preferences, without discrimination, and in accordance with general accounting principles. The more stringent public hearing and reporting requirements, civil rights strictures and accounting requirements reflect this. These areas were also strengthened because revenue sharing as administered by the Treasury Department had been faulted for not encouraging local participation and for lax civil rights enforcement.

I think it is fair to point out with respect to citizen participation in State and local government that citizen interest in the budget process has been generally low. Also, in many states open public budget hearings at the local level are not mandated by state law. That participation and general interest in revenue sharing diminished after the first year of the program can therefore come as no surprise to observers of State and local government.[6] It should be also pointed out that media coverage of the local budget process has generally been minimal, although local newspapers do publish the planned and actual use reports.

The public hearing requirements should improve the general level of citizen participation; however, by requiring two hearings and allowing the Secretary of the Treasury broad waiver authority, the proposal may both go too far and not far enough. There is a possible problem of applying this requirement at the state level, for there are usually two (House and Senate) committees that act on the proposed budget rather than the one body contemplated by the House

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termination of payment, and the recipient asks for but does not get preliminary relief within 45 days of initiation of the action, suspension by the Secretary can occur. Also, if in such an action, the recipient does not seek preliminary relief and the matter is not resolved before the court in the 45-day period, suspension can occur.

[4] Payments will be resumed if: (1) a recipient enters into a compliance agreement with the Secretary after the 90-day period; (2) the recipient complies with a Federal or state court order to end the alleged discrimination; (3) the Secretary finds, 120 days after the passage of the initial 90-day period, that compliance has been achieved; (4) after a compliance hearing, the recipient is found to be in compliance; (5) after a final finding of noncompliance by the Secretary, the recipient may appeal the finding to a Federal court which could rule in favor of the recipient.

[5] This congressional awareness of the fungibility problem was well ahead of its costly discovery by revenue sharing researchers who tried to ascertain "how" revenue sharing funds were used. The problem is generally addressed by Gramlich and Galper (1973).

[6] See Juster *et al.* (1976) for a sound statistical survey of attitudes toward general revenue sharing. Also, see Nathan *et al.* (1975) for results of a limited sample of localities.

bill. Also, by keying the various reports to the entitlement period, which will be the new Federal fiscal year (October 1, to September 30 of the following year), the reports may not be as useful to the public as they might otherwise be.

Once fungibility is acknowledged, then the expenditure categories and matching prohibition are essentially unenforceable. It was with this in mind that these requirements were eliminated. The basic form of the civil rights provision also is shaped by the fungibility issue. Note that these provisions do not apply in cases where the recipient can demonstrate that the program or activity was not funded by revenue sharing. This represents an isolation of revenue sharing in the budget from own-source-funded programs. Because of fungibility, there was the possibility that Federal civil rights legislation would apply to all items in the budget. Of interest will be the extent to which recipients can demonstrate that certain programs were not funded by revenue sharing, for they will have to show clearly that such programs were not funded directly or indirectly or in whole or in part by revenue sharing.

In terms of administration of existing civil rights provisions, it is apparent that Treasury has a substantial backlog of civil rights complaints,[7] and that the response time from date of filing to actual action is prolonged.[8] On the other hand, the internal civil rights compliance staff is quite small, and requests for additional personnel have not been met. A related issue is whether civil rights under general revenue sharing are being violated in a manner other or different than under other Federal grants-in-aid. Since the recipients of revenue sharing are generally the same as those of other Federal programs, it seems reasonable to suppose that the extent of discrimination is about the same, and the extent of any relief or diminution of these violations is about the same as in other programs. I say this not, of course, to excuse discrimination, but rather to point out that it would appear unlikely that recipients are discriminating *more* with revenue sharing than they have in the past with their own or other Federal funds.

Perhaps the least noticed but potentially most significant new requirement in the House bill is that independent and complete audits be performed by each recipient. As I noted some time ago,[9] the Treasury imposed through their regulatory authority a rather modest set of audit requirements; this new requirement is far more stringent. It has not been possible to ascertain how many states and local governments do not currently have independent audits of their accounts; however, there are several states which have biennial budgets and for whom such annual audits might be burdensome. It is generally thought that many of the smaller localities have relatively simple accounting systems and probably do not have independent certified public account signoffs each year. Also, there may be large localities which are not audited annually as well; the District of Columbia has recently been faulted for not keeping a coherent set of books. Yet, as we know from the experience of New York City, having an independent comptroller and audit procedure does not ensure that budgets will be accurately, realistically, and informatively kept. Presumably, the purpose of such Federal audit requirements is to force states and localities to manage their funds in a businesslike fashion as well as to ensure that funds are honestly dispensed. However, because such audits can be costly and cause considerable dislocation until certification can be achieved, the requirement may be resisted.

C. Other Areas of Consideration

The final House legislation described did not include three provisions which were recommended by the full Government Operations Committee: changes in the inter and intra state formulas, required modernization plans, and the application of the Davis-Bacon Act[10] to all capital projects funded in whole or in part by revenue sharing. At this point I will, therefore, digress to discuss the options considered in these three areas.

[7] See, for example, General Accounting Office (1976), and Subcommittee on Civil and Constitutional Rights of the Committee on the Judiciary (1975).

[8] Subcommittee, *op. cit.*, p. 15.

[9] See Strauss (1974, pp. 189–90), and Stolz (1974, pp. 105–117).

[10] The Davis-Bacon Act generally requires that wages covered by the application of it be at rates prevailing on similar projects surveyed by the Department of Labor.

1. *Formula Issues*—In examining the formula, three considerations at various times can be now said to have been made: a desire to direct funds increasingly to "needy" local governments; a desire to "hold harmless" any recipients which would be disadvantaged by a change in the formula; and a desire to hold constant the overall size of the program at the $6.65 billion rate of the last six months of current law. Clearly, it is not possible to simultaneously achieve all three goals, for to make certain recipients better off is to make the rest worse off when the amount of funds for distribution is fixed through time. Moreover, with such a fixed amount, there can be no hold-harmless funding available.

While the outcome was to leave the current formulas intact, a rather wide variety of options was considered. First, the Administration proposal to raise the upper limitation on allocations was examined, and rejected because it did not systematically aid older, central cities, and had the disadvantage of allowing the so-called industrial enclaves and resort areas to get larger allocations. Moreover, the ceiling was found to impact primarily small places with aberrant tax effort values. Of the 1,155 units at the 145 percent ceiling,[11] 841 had populations under 3,000; 1,018 had populations under 10,000, and 1,117 have populations under 50,000. Only 5 of the nations 25 biggest cities gained and 17 lost from the higher ceiling.

Second, the relationship between certain lower limitations [12] allocations was examined. Under current law, localities may not receive more than 50 percent of the sum of their taxes and transfers nor less than 20 percent of the average statewide per capita grant. Various lower percentages were examined. Finally, the sequence of application of these rules was examined. Of all the permutations of formula changes which were considered, only the lowering of the 20-percent floor to lower figures actually resulted in more winners than losers, and a rather sensible pattern of allocations to midwest townships. However, the fact that 8,000 or so our of the 39,000 jurisdictions would lose some amount argued against such changes.

Third, there was interest in broadening the tax effort definition at the state and local level to include certain fees and charges which were thought to be more nearly taxes than items of individual consumption. Three related kinds of user fees were considered in various combinations: sanitation fees, water fees, and other sanitation fees. As might be expected, the reallocation which resulted was primarily intra-state; however, there were substantial shifts of funds among types of governments: the shifts were from county governments, which generally do not engage in the sale of such services, to city and township governments. While efficiency and equity arguments can be framed pro and con[13] on the inclusion of these changes in tax effort, the fact that about a quarter of a billion dollars was reallocated argued against accepting this type of change.

Fourth, consideration was given to including in the definition of population certain illegal aliens. Since they use municipal services, it was thought equitable to take them into account when measuring the overall service population size of a jurisdication. However, because the actual data on the number of such aliens by jurisdiction is generally unavailable, and it was felt that including them in the count of population would give some legitimacy to what otherwise is thought to be a problem of illegal migration, the final House legislation did not include this redefinition of population.

Fifth, consideration at various points in the legislative process was given to a formula based on the number of poor persons and families (in lieu of the inverse per capita income factor), and an adjustment of aggregate income in the tax effort factor to reflect essential needs to support a family. When initially considered, this alternative formula was faulted because: it relied on 1969 census data that could not be updated until 1980, it failed to systematically aid the larger jurisdictions (only 82 of the largest 200 were better off under the particular

[11] Under current law, no locality may receive more per capita than 1.45 times the average per capita local grant for the state overall.

[12] Under current law, no locality may receive less than .20 times the average per capita local grant for the state overall, or more than 50 percent of the sum of its taxes plus intergovernmental transfers.

[13] See, for example, General Accounting Office (1975) for the pro argument, and Strauss and Wertz (1976) for the contrary argument with regard to municipal electric profits.

formula considered), 33,231 of the 39,000 plus jurisdictions were worse off and only 2,584 (many of whom were the industrial enclaves) were better off when compared to the current formula at the same funding level, and 28 of 51 states (many were the larger, industrial states) were worse off. In any event, the Government Operations Committee favorably recommended this formula change to the House although without the comparative data just noted. In the final analysis, however, this formula change was deleted.

Perhaps the most persistent criticism of the intra-state allocation formula has been that it fails to provide sufficient funds to "needy" communities. It is sometimes difficult to ascertain what "needy" means. The most common benchmark used by critics is the differential presence of poor families. In this view, a concentration of poor families is prima facie evidence of a greater "need" for revenue sharing. On the other hand, it may also be that the local government (the object of the program) is in sound fiscal health and does not have jurisdiction over welfare and health programs which are more oriented toward the poor. There is the additional question of how redistributive such a general (as compared to a categorical) program of fiscal assistance should be. While the program is usually though to to be somewhat equalizing, as a result of the inverse per capita income factor in the intra-state formula, it is held by some to be sufficient for the purposes of a program of general assistance which goes to all units of government.

In many respects, the issue of how redistributive revenue sharing should be cannot be resolved, either because data on certain factors (e.g., differential service costs) is unavailable, or because the matter is primarily a judgemental one. Of related interest is to compare how revenue sharing impacts jurisdictions vis-à-vis other major grant-in-aid programs.

To make such comparisons, I have taken the ratio of Entitlement Period 6 allocations to the individual income taxes needed to finance nationally the program for several city county governments. Two such ratios are computed: the first assumes financing as a surcharge to Federal liabilities, the second assumes financing via a simple flat tax on AGI. When the ratio is greater than one, the area is a "winner"—that is, it gets more in revenue sharing than it implicitly pays to finance the program. When it is less than one, the area is a loser—it pays in more than it gets back. Analagous ratios have been computed for 19 other Federal aid programs under the same financing assumptions.

Several caveats to this net fiscal incidence analysis should be stressed: the data refer to just a few county areas and not just cities. Another limitation is that the Federal tax data refer to 1972, and are preliminary. Finally, the other 19 Federal program data is based on the OEO 1972 Federal outlay surveys which in turn have certain limitations.

With these limitations in mind, let us look at the results of this analysis (Table 1). Under either financing assumption, 4 of 6 are net fiscal "winners" under revenue sharing. For example, Philadelphia receives 9 percent more than it "pays in" on a surcharge basis and 1 percent more a percent of liability basis. Viewed in isolation for these few observations, revenue sharing is redistributive, if we take that to mean that big cities should get more than they implicitly pay in through Federal individual income taxes.

When we compare revenue sharing to other Federal programs, the comparison for these few observations is less favorable, although there is a fair amount of variation.

2. *Modernization Report*—A second, less controversial proposal was to require the states to file plans for modernizing state and local government and the progress through time in achieving it. However, since modernization is an illusive concept to operationalize, and there was little sentiment for making the reports meaningful, e.g., defer funds to those who failed to provide or achieve stated plans for modernization, it became apparent that the resultant paperwork might not be justified.

3. *Broadening Davis-Bacon Requirements*—Current law requires that the Davis-Bacon Act be applied to capital projects funded by 25 percent or more with revenue sharing funds. At one point in the development of the legislation, it was though that eliminating the percentage test might help improve the construction industry. On the other hand, such a requirement might materially reduce the ability to smal-

Table 1

Net Fiscal Incidence of Grant-in-Aid Payments[1/] to Selected City-County Governments

Incidence Index[2/]

Federal Grant-in-Aid Program[3/] in 1972	PHILADELPHIA COL.A 4/	PHILADELPHIA COL.B 5/	WASHINGTON, D.C. COL.A 4/	WASHINGTON, D.C. COL.B 5/	ST. LOUIS COL.A 4/	ST. LOUIS COL.B 5/
1. School Lunch Program	.67	.62	1.52	1.76	.99	.92
2. Food Stamp Bonus Coupons	1.53	1.42	2.25	2.60	.73	.68
3. Educ. Deprived Children	2.06	1.91	1.40	1.62	.42	.39
4. SAFA (P.L. 874)	.79	.73	1.67	1.94	.02	.01
5. Grants: Dependent Children	3.58	3.32	1.66	1.92	.46	.43
6. Grants: Old Age	1.13	1.05	.75	.87	.81	.76
7. Grants: Social Services	1.59	1.48	1.28	1.48	.18	.17
8. Medical Assistance	1.64	1.52	1.48	1.71	.16	.15
9. OASI	1.53	1.42	.78	.90	2.05	1.92
10. Urban Renewal	2.42	2.25	2.84	3.29	.43	.40
11. Low Rent Housing	6.74	6.25	3.82	4.42	.00	.00
12. Model Cities	4.53	4.21	4.58	5.30	.00	.00
13. Grants: LEA	.16	.15	8.75	10.12	.07	.06
14. MDTA-Training	1.25	1.16	5.54	6.41	.43	.40
15. Neighborhood Youth Corps	1.53	1.42	5.08	5.87	.00	.00
16. Public Employment Program	2.54	2.36	1.11	1.29	.79	.74
17. Urban Mass Transit	9.93	9.22	5.73	6.62	.00	.00
18. Hwy. Planning & Construction	1.00	.93	.60	.69	1.05	.98
19. Grants: Wastewater Treatment	.00	.00	4.39	5.08	.03	.03
20. General Revenue Sharing	1.09	1.01	.98	1.13	1.04	.98
Rank of GRS with respect to I-19	(15)	(15)	(17)	(17)	(3)	(3)

Notes: Source: Tabulations of preliminary 1972 Small Area Statistics of Income

1/ Refers to Entitlement Period 6 Allocation.
2/ Ratio of Grant-in-aid allocation to portion of 1972 Federal individual income taxes needed to finance the program nationally.
3/ Based on 1972 Federal Outlays by State and County Area.
4/ Financing assumption is surcharge on 1972 tax liabilities.
5/ Financing assumption is tax on adjusted gross income.

Table 1 (Cont'd.)

Net Fiscal Incidence of Grant-in-Aid Payments[1/] to Selected City-County Governments

Incidence Index[2/]

Federal Grant-in-Aid Program[3/] in 1972	BALTIMORE COL.A 4/	BALTIMORE COL.B 5/	NEW ORLEANS COL.A 4/	NEW ORLEANS COL.B 5/	NEW YORK COL.A 4/	NEW YORK COL.B 5/
1. School Lunch Program	2.48	2.37	.00	.00	1.21	1.27
2. Food Stamp Bonus Coupons	3.34	3.19	4.64	5.17	.97	1.02
3. Educ. Deprived Children	2.00	1.91	1.22	1.36	2.10	2.21
4. SAFA (P.L. 874)	.58	.56	.30	.34	.17	.18
5. Grants: Dependent Children	.10	.10	1.31	1.46	2.48	2.61
6. Grants: Old Age	.08	.07	3.01	3.35	.91	.96
7. Grants: Social Services	.07	.07	.55	.61	4.61	4.85
8. Medical Assistance	.18	.17	.60	.67	3.21	3.37
9. OASI	1.22	1.16	1.10	1.22	1.21	1.27
10. Urban Renewal	3.69	3.53	1.20	1.33	.24	.25
11. Low Rent Housing	4.15	3.97	7.58	8.43	2.74	2.88
12. Model Cities	4.57	4.37	.00	.00	2.38	2.50
13. Grants: LEA	4.56	4.36	.12	.13	1.82	1.91
14. MDTA-Training	2.92	2.79	1.20	1.33	.11	.12
15. Neighborhood Youth Corps	2.92	2.80	1.70	1.89	1.44	1.52
16. Public Employment Program	1.35	1.29	1.95	2.17	.89	.93
17. Urban Mass Transit	.00	.00	.04	.04	.26	.28
18. Hwy. Planning & Construction	1.97	1.88	.21	.24	.12	.13
19. Grants: Wastewater Treatment	.03	.03	.02	.02	.37	.39
20. General Revenue Sharing	1.06	1.01	1.08	1.20	.90	.95
Rank of GRS with respect to 1-19	(13)	(13)	(11)	(11)	(13)	(13)

Notes: Source: Tabulations of preliminary 1972 Small Area Statistics of Income

1/ Refers to Entitlement Period 6 Allocation.
2/ Ratio of Grant-in-aid allocation to portion of 1972 Federal individual income taxes needed to finance the program nationally.
3/ Based on 1972 Federal Outlays by State and County Area.
4/ Financing assumption is surcharge on 1972 tax liabilities.
5/ Financing assumption is tax on adjusted gross income.

ler jurisdications to engage in capital construction projects. After some consideration, the 25 percent test was left in place.

D. *Possible Parameters of Final Bill—*

In certain respects, the major philosophical battles over the renewal of general revenue sharing have been completed. The provision of entitlement funding for 3 and ¾ years in the House bill could well remain. Recognition of fungibility and various procedural requirements as well as expanded civil rights guarantees could well be parts of a final renewal bill; however, it is likely that some of the details of the House bill may be altered (e.g., the public hearing, reporting, and civil rights provisions) to make them both more workable vis-à-vis the diversity of state and local government and more effective in terms of achieving overall goals.

Whether or not the program will in the final analysis be continued for a 3¾-year period and at a fixed or growing dollar figure is difficult to predict. However, it would appear at this juncture that the formulas of current law, which were examined rather carefully in the House, will not be changed in any substantial fashion. Not only do apparently small modifications affect many jurisdictions, they generally do so in surprising and unintended ways.

III. ANTI-RECESSION OR COUNTERCYCLICAL REVENUE SHARING

A. *General*

While the Congress has been considering general revenue sharing, there has been a parallel consideration of anti-recession or countercyclical revenue sharing as part of a package of fiscal stimulus. The justification for such grants is based on the following.[14] In periods of declining GNP, state governments, and to some extent, local governments find revenues either dropping off or not growing adequately to meet expenditure needs. As a result, the state-local sector tends to raise tax rates and/or cut expenditures to balance their budgets at the same time the Federal government is doing the reverse to stimulate aggregate demand. Overall, public fiscal policy tends to be more neutral than countercyclical in nature, and has led to the suggestion that periodic Federal grants be made which would be based on the business cycle.

In this section, I would like to discuss alternative approaches to providing such assistance. I should note parenthetically that all of them make anti-recession payments, but none obtains repayments or tax collections in periods of excessive economic growth.

B. *Unemployment Triggered Assistance*

The two versions of countercyclical revenue sharing that have received active consideration rely on unemployment rate levels to indicate whether or not such assistance should be provided. In particular, funds become available for distribution to state and local government when the national unemployment rate exceeds 6 percent for two consecutive quarters. The amount available per quarter for allocation is \$125 million plus \$62.5 million times each one-half percentage point of unemployment in excess of 6 percent. The first version of the countercyclical formula then allocates funds to state and local government if their unemployment rates exceeded certain base period unemployment rates observed over 1966–69; one-third of the initial national amount would be available for state governments and two-thirds of the initial amount would be available for local governments. In both instances allocation for eligible units (e.g., those with unemployment rates in excess of the base period) would be based on the excess unemployment rate weighted by nonschool taxes.

The second version of the countercyclical revenue sharing formula would follow the one-third, two-thirds division of available funds; however, allocation to each state area would be based on the excess unemployment rate (but using a fixed 4.5 percent base point) times the general revenue sharing allocation. Essentially, the general revenue sharing allocation replaces taxes in the formulas.

There are, however, several pratical and conceptual difficulties with both of these. Perhaps the most difficult issue to resolve is whether one is seeking to achieve fiscal

[14] See Sunley (1976) for a further discussion of counter-cyclical revenue sharing.

coordination with such a program of assistance (and, therefore, eliminate the fiscal perversity noted earlier), or one is seeking to provide a form of job creation assistance in those areas worst hit by a recession. This is not to suggest that the two goals are contradictory, but rather that emphasis on ensuring fiscal coordination may result in something other than an unemployment rate triggered program.

A second conceptual issue involves the pattern of lags in the economy. Generally, adverse developments in the labor market follow declines in production (and thus declines in certain income conditioned tax revenues such as sales and individual income taxes). Providing aid based on labor market conditions may result in making payments quite late in the recession and well into the recovery. More desirable might be assistance which occurred early in the recession so that it would be more countercyclical.

There are several practical considerations beyond these general matters. The most difficult aspect of an unemployment based formula is that there is very little unemployment data by jurisdiction, and that data available is subject to rather large sampling error—unofficial BLS guess-estimates put the standard error of estimate at 20 percent or higher. While there are such data for only 1,200 potential recipients, these are the major population and economic centers. However, I must confess some unease at the prospect of allocating over a billion dollars on the basis of data which will not stand up well under scrutiny. There has been some rather extensive litigation over similar data used to administer the Comprehensive Employment Training Act.

C. *Assistance Triggered by Declines in Real Wages*

An alternative approach to the unemployment rate trigger is to compensate state areas directly for taxes foregone due to a recession in that state. Under this approach, there is no national trigger, but rather state specific triggers based on whether or not private real wages in each state have declined for two consecutive quarters. By looking at private wages (rather than GNP) at the state level, one isolates activity which contributes to tax collections from various Federal transfers (e.g., welfare payments) and built-in-stabilizers. In a sense, a decline in real wages by state is a definition of a recession and a primary indicator that there will be a fiscal coordination problem.

Allocations could be equal to the tax effort of the state area multiplied times the decline in real wages; this is in effect the amount of taxes foregone as a result of the recession. Diagram 1 displays the pattern of timing of this type program of assistance. The entry of a "1" means real wages have declined in that quarter compared to the previous quarter; back-to-back "1's" means a payment would be triggered. Especially interesting is the variation among states in the pattern of the 1949, 1954, 1957–8, 1960, 1970, and 1974–5 recessions. For the industrial states, the recessions were generally earlier, and lasted longer. Table 2 indicates the quarterly and annual total costs of such a program over the period 1960–1975. Of interest is that the costs would have exceeded \$1 billion/year in 1974 and 1975; in 1975, the costs would have exceeded \$6 billion a year.

While the state-level trigger has certain attractions in that it better reflects the timing of a recession and its location, it has certain disadvantages. For example, there may be circumstances when a state will in the aggregate be economically healthy, but have certain depressed or declining areas, (e.g., the State of Maryland and the City of Baltimore). Also, with 51 separate "triggers," there is less predictability in required Federal payments and thus an increase in the uncontrollability of the program vis-à-vis one based on a single national trigger.

With respect to the allocation of funds within each state area, there are several possible allocation formulas. For example, one could use the current intra-state revenue sharing formula, although it is primarily a general fiscal assistance formula rather than one aimed at achieving fiscal coordination. Variants of the unemployment rate approaches discussed earlier might be used, although the inavailability and unreliability of data would seem to be an intractable problem. Most desirable, of course, would be to allocate intra-state on the same basis as inter-state—that is, on the basis of foregone tax revenues. Unfor-

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Diagram I

Pattern of Real Wage
Declines:1948–75

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YEAR                48  49  50  51  52  53  54  55  56  57  58  59  60  61  62  63  64  65  66  67  68  69  70  71  72  73  74  75
QUARTER             1234123412341234123412341234123412341234123412341234123412341234123412341234123412341234123412341234123412341234
STATE

ALABAMA                 1111                   1 1 11 1 1111                 11 1 11  11 111 1  1           11 1              1 1111
ALASKA                     1       1 111 111111                1 11 1 11 111 1        1 1111     1         111    11    1
ARIZONA                  11  1                         1 1 1     1 11   1  1   1         1      1 11         11               111111
ARKANSAS                1 1     1   1 11 111          11   1 1    1 1 1                        1          1  1                1 1111
CALIFORNIA               11               1 1                    11111  1                       1         1 1111 11        1 1111111
COLORADO                11        1       111         1    111    1           1      111                    1  1              1 1111
CONNECTICUT             111     1 1       1111                  11111  11                1         1   1   111111 1       1 1111111
DELAWARE                1 1  1            1111        1 111 11    11 1 11  1                 1 1         1  1 11 11          11 11
D.C.                     11  111 1 1 11   11  1   1 11 1111   111   1 11 111 1 1      1          1    1 1 1 11 11  1         1111111
FLORIDA                  11                                         1 1 1                                     1              1 11111
GEORGIA                  1     1           1 1        1 111111        11                                    111              111111
HAWAII                  111  1       1 1 1 1 1      1                     1 1 1 1            1                1 111     11 1111 11
IDAHO                    1    1 1 1 1 1 11                      1 1 1   1  11   111 1 1     11             1 1 11             1  1 1
ILLINOIS                1111 1 1 1        1111        1 11111     1 1111      1                           111 1  1   1    1 1111111
INDIANA                 11 1   11 11      11111     11 11 111    11 1111      1              1 1         111 1  1           11 111
IOWA                     1      1 11 1111           1 1 1111        1 11 1      .                           11 11  1            1111
KANSAS                  1         1       11 1   1    1 11 11 1   1 1 1 1 1       1    1        1      1  1111 1              1 111
KENTUCKY                111     11 111111             1    111 1 11 111                                1 1  1            1 1 11 1
LOUISIANA               11   1             1 11                 1111 11 111 1                     1       11111 1             1 1 11
MAINE                   111     1 1       11          1 11111     1 1 1       11       1            1   1 1 111              111111
MARYLAND                1111    1 1       111         1 1111      1 1 1                                1     1 1            1 1 1111
MASSACHUSETTS           111    1 111      1111        1 11111       1 1 1 11           1                  11 1 1 1          11111111
MICHIGAN                11 1   1 11  1    11111     111 111111 1 11 1111                  1  1  1         1 11  1           1 11 11
MINNESOTA                11    1 1 1      11 1        1    1 1    1   1        1                            1 1    1     11 11111
MISSISSIPPI              1     1 1 1      111 1                 1 11  11  11               1  1             1 1          1 1 11 1
MISSOURI                 1     1  1        1 111               1 11 111  1   11 1                      1    1 1 1 1  1    111111
MONTANA                   1 1 1 1   1 11 11                    111 1111  11  111  1 11 11   1 1 11 1   1111 1  1   1  1   1   1 1 1
NEBRASKA                               1 11     1 1 11 11            1    11       1        1  1        1 1 1           1 11111
NEVADA                  1 1   1           11       11111 111      1 1    1          1 1  11 111 1           11    1         1 1111 1
NEW HAMPSHIRE           11     11 1 1 11           111 11111 1    1           1   1                    1  11111              111111
NEW JERSEY               11    11         111         1 11111         11                               1  1 1 1 1        11 1111111
NEW MEXICO               1     1          111 1                   1 11        11 1     1 1111 11         1 111 1         1  111
NEW YORK                1111   1111 1     1 1                   1111  1 1 1   1     1                     1111 111 1     11111111 1
NORTH CAROLINA           1     11         11 1        1 11111         111                                   1 1              111111
NORTH DAKOTA            1 1 1 1 1 1  1 1 111          1 1 11      11 1 1 1    11       1 1111  1 11           1           1     1
OHIO                    1111    11        11111       1 11111     1 1111      11              1           11 1 1         1 111111
OKLAHOMA                1 1  1            11  1       1 11 111    1 111                                   1 1 1 1              111
OREGON                  1 1 1  1 1 1 111 11  1        111 1111        1111 1   1       1     1 1          111 1              1 1 111
PENNSYLVANIA            1111   11 11      1111        1 11111     1 1111      111            1           11 1  1        11 111111
RHODE ISLAND            11      1         1 111      11 11111         111         1 1     1          1 1 1 1 1 1 1         111111111
SOUTH CAROLINA           1                111111    1 11111           111                     1             11                1 111
SOUTH DAKOTA            1 1 11 11 1  1    1 11     11 11 11           1        11 1111     11   1   1    1  1                 1   11
TENNESSEE                11    11          1 1                   11111  11                                 11 1               1 11
TEXAS                    11    1          111                   1 111  1  11  1                            1111 11             111
UTAH                      11      1        111        1    111    11  1       1 1 1 1 1          111   1    1 1 1             1 1111
VERMONT                 111    11 1       11111                 11111  111     1  1              1 1        1 1 1  1         1 11111
VIRGINIA                111               1111                  1 1111  11                             1 1                   111111
WASHINGTON              1 11      1       1 1 1 1 1             1111  11      1 11 1            1         111111 11       1 11 1111
WEST VIRGINIA           1111    1 1 1      1111       1    111    1 1111     111       1   1  11 1 1 1 1          1 1    1 1 11 1
WISCONSIN               11        1       1111       1 111111       1 1111    1                  11         1 1 1        1 1 1111
WYOMING                 111 1  1 11       11111 1     11  11 1    1   1111 1 111  1    111 1 11             1 11              11  11
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Source: tabulations of Bureau of Economic Analysis data tape.

Table 2

Total U.S. Allocations under Countercyclical

Revenue Sharing Formula Based on Decline in Private Real Wages*

($ millions)

Year	Quarter 1	2	3	4	Annual Total
1960	88.9	0.0	0.0	138.5	225.4
1961	389.9	359.3	2.1	1.0	762.4
1962	.6	0.0	0.0	14.2	14.8
1963	29.8	2.2	3.7	10.7	48.4
1964	2.0	0.0	.8	1.9	4.7
1965	2.1	0.0	1.0	1.4	4.5
1966	1.3	1.8	3.1	4.0	10.0
1967	7.9	1.0	6.1	8.0	23.0
1968	9.8	0.0	0.0	0.0	9.7
1969	.3	0.0	0.0	.3	.6
1970	4.9	78.7	494.0	289.4	866.9
1971	633.0	27.1	6.9	146.9	813.7
1972	98.3	0.0	1.4	0.0	99.7
1973	0.0	0.0	0.0	141.8	141.8
1974	125.0	211.9	873.5	558	1768.5
1975	1486.3	2772.3	1447.6	335.7	6041.9

*Note: Quarterly totals reflect the sum across 50 States and the District of Columbia of tax effort times the decline in real wages per State. Tax effort is as measured by the Census Bureau in annual numbers of Governmental Finances; real private wages refer to private wages by State deflated by the Consumer Price Index. Table entries reflect data lags.

tunately, data by jurisdiction on wages is not frequently available.

Another approach to the intra-state allocation of funds would be to make such payments proportional to the net taxes of state government and adjusted taxes of local government.[15] (See tables 3 and 4.) In this view the fiscal coordination problem is dealt with quite neutrally. To make the intra-state allocation more redistributive, one could adjust the formula for tax effort and inverse per capita income on the grounds that localities sacrificing a larger percentage of income have a more serious fiscal coordination problem as do those with lower per capita incomes, e.g., abilities to pay.[16]

[15] Algebraically, the grant, G, for the j'th unit of government in a state would be:

$$G_j = \frac{FT_j}{\sum_j T_j}$$

where F is the aggregate state area amount.
The ratio of F to $\sum_j T_j$ is the percentage of taxes each locality will receive.

[16] More specifically, one might create a local share on the basis of taxes, and then allocate in a series of geographic tiers as in the general revenue sharing formula. The basic algebraic statement would then be:

$$G = \frac{F\ T\ \frac{T}{Y}\ \frac{1}{PCY}}{\Sigma\ T\ \frac{T}{Y}\ \frac{1}{PCY}}$$

Table 3
1975 Countercyclical Grant Under ($ Millions)
Decline in Real Wage Formula

	Total 1/ Local Taxes	Total State 2/ Taxes	Total Taxes	Total 1975 Countercyclical Grant 3/	Grant as Percent o Total Tax
Alabama	259.047	1017.4	1276.447	63.928	5.0
Alaska	50.068	205.9	255.468	0	-
Arizona	217.389	1253.6	1470.989	90.983	6.2
Arkansas	64.665	605.4	670.065	42.689	6.4
California	4047.337	7971.7	12019.037	641.271	5.3
Colorado	305.983	797.6	1103.583	68.138	6.2
Connecticut	436.550	1092.9	1529.450	182.468	11.9
Delaware	37.091	308.1	345.191	24.478	7.1
D. C.	-	-	-	9.706	-
Florida	796.961	2786.6	3583.561	443.259	12.4
Georgia	452.807	1514.9	1967.707	169.500	8.6
Hawaii	148.611	494.9	643.511	4.848	.8
Idaho	50.340	256.2	306.54	0	-
Illinois	1459.596	4083.0	5542.596	634.212	11.4
Indiana	523.420	1674.2	2197.62	199.776	9.1
Iowa	302.332	1005.1	1307.432	20.588	1.6
Kansas	246.976	702.7	949.676	12.072	1.3
Kentucky	186.005	1106.1	1292.105	11.259	9.8
Louisiana	318.336	1319.5	1637.836	23.619	1.4
Maine	107.164	336.3	443.464	30.690	6.9
Maryland	556.050	1578.2	2134.25	85.055	4.0
Massachusetts	1319.956	2204.7	3524.656	215.561	6.1
Michigan	1057.707	3681.2	4738.907	324.813	6.9
Minnesota	436.509	1843.1	2279.609	125.699	5.5
Mississippi	137.508	746.5	884.008	19.491	2.2
Missouri	523.117	1300.4	1823.517	83.897	4.6
Montana	84.181	220.0	304.181	0	-

Because central cities generally have higher per capita taxes, tax effort, and lower per capita income than other jurisdictions, such a formula would substantially concentrate funds to them. For example, New York City would get 28 percent more under this approach than under the general revenue sharing formula (with identical state area amounts available for local distribution).

where Y is total money income and PCY is per capita income.
With respect to the matters of the 20 percent floor, the 145 percent ceiling, and the sequence of constraints, one might eliminate the floor and the ceiling except for those units with aberrant tax effort values.

TABLE 3 (cont'd.)

Nebraska	167.804	405.6	573.404	11.107	1.9
Nevada	112.046	251.6	363.646	9.322	2.6
New Hampshire	86.381	165.1	251.491	22.877	9.1
New Jersey	1429.017	2056.3	3485.317	370.498	10.6
New Mexico	49.530	437.7	487.23	8.533	1.8
New York	5434.393	8516.4	13951.094	668.995	4.8
North Carolina	419.694	1806.4	2226.094	59.457	2.7
North Dakota	47.190	218.7	265.89	0	-
Ohio	1081.396	2788.9	3870.296	372.661	9.6
Oklahoma	184.365	777.5	961.865	16.229	1.7
Oregon	158.096	701.5	859.596	42.463	4.9
Pennsylvania	1213.548	4609.1	5822.648	427.461	7.3
Rhode Island	96.517	333.7	430.217	33.842	7.9
South Carolina	116.881	901.5	1018.381	88.039	8.6
South Dakota	78.570	165.6	244.17	2.190	.9
Tennessee	353.519	1092.4	1445.919	67.840	4.7
Texas	1202.493	3287.9	4490.393	32.873	.7
Utah	85.421	363.1	448.524	12.789	2.9
Vermont	40.829	179.6	220.429	14.728	6.7
Virginia	567.875	1507.9	2075.775	101.936	4.9
Washington	327.548	1359.7	1687.248	27.549	1.6
West Virginia	85.682	610.1	695.782	9.648	1.4
Wisconsin	446.878	2032.2	2479.078	108.921	4.4
Wyoming	23.886	124.2	148.086	4.036	2.7

1/ Source: Staff tabulations of Entitlement Period 6 revenue sharing tape

2/ Table 17, Governmental Finances in 1973-4, U.S. Bureau of the Census

3/ $6,041 billion U.S. total

IV. IMPLICATIONS FOR THE FEDERAL SYSTEM

The renewal of general revenue sharing and the likely passage and funding of a program of countercyclical assistance do not in and of themselves constitute a trend from which one can generalize. Also, it is not likely that both will occur without substantial opposition. On the other hand, revenue sharing has been with us since 1972, and appears to be a relative fixture; the block grant approach is also becoming more important in terms of overall Federal grants-in-aid.

There are several noteworthy characteristics of the two programs reviewed here that may spread to other programs of Federal assistance: (i) direct, formula allocation of fixed amounts of Federal funds to local governments, (ii) provision of assistance to general governmental units rather than special districts or multi-district entities, (iii) reliance on strong Federal procedural requirements (e.g., civil rights, citizen participation, and auditing and accounting). In fact the renewal of general revenue sharing involves primarily changes in these procedural requirements, rather than in the universe of recipients, the formula, definitions of data etc.

This direct allocation to localities represents a Federal recognition of a three tier Federal system. It has historically been argued that because localities are the constitutional creatures of the states that there really is only a two tier system. With a possible Federal takeover in certain state responsibilities, notably welfare, the question arises what sort of role the states will play in the future. While procedural requirements on the state and local governments may increase over time, and funds will be provided on the basis of Federal defined, nonmatching formulas, it is interesting to note that certain basic organizational problems in state and local government have so far been unaddressed. The matters of overlapping jurisdictions, outdated allocations of functional responsibilities, and annexation and zoning powers are usually not thought to be the proper concern of the Federal government. Yet, as resources increasingly are spent at the local level to deliver services, these matters of organization and boundary will become increasingly important.

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