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REVENUE SHARING AND THE LESSONS OF THE NEW FEDERALISM

LAWRENCE SUSSKIND*

Over the past few years Congress has taken steps to check the rapid proliferation of categorical grants-in-aid.¹ While the overall level of federal support to state and local governments has continued to rise, recent legislative efforts have been aimed at minimizing the restrictions placed on federal funds channeled through to state and local governments.² Minimizing the number of restrictions imposed on the use of federal funds is the central objective of the "New Federalism." In October 1972 Congress passed the State and Local Fiscal Assistance Act (General Revenue Sharing) which promised to return more than 30 billion dollars in federal tax revenue to state and local governments over a five-year period.³ In 1973 and 1974 Congress moved closer to

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1. Between 1962 and 1966 the number of categorical grant programs increased from 160 to 349 and by 1969 the total exceeded 400. 1972 was the second year in a row, however, in which virtually no growth occurred in the number of federal categorical grant programs.

2. In dollar terms, federal disbursements for grants-in-aid showed a slowing of what had been remarkable growth in the past few years; but the total did not decrease. From a total of 35.9 billion dollars in fiscal 1972, outlays rose to an estimated 38.2 billion dollars in fiscal 1973 and are projected to reach 38.8 billion dollars in 1974. SPECIAL ANALYSIS, BUDGET OF THE UNITED STATES GOVERNMENT: FISCAL YEAR 1974, at 224 (1973).

3. In October 1972 Public Law 92-512, known as General Revenue Sharing, was passed by the Congress and signed into law by President Nixon. State and Local Fiscal Assistance Act of 1972, 31 U.S.C. §§ 1221-63 (Supp. II, 1972). General Revenue Sharing provides for approximately 30.2 billion dollars to be distributed to the more than 38,000 state and local governments over a five year period. The state and local units will receive their revenue sharing checks in seven installments beginning January 1, 1972, and ending December 31, 1976.

enacting several of President Nixon's "special" revenue sharing proposals aimed at consolidating more than 100 categorical grants-in-aid and providing as much as 10 billion dollars a year for urban community development, rural community development, manpower training, law enforcement, transportation and education.⁴

Federal aid to state and local governments has traditionally taken one of several forms: (1) categorical grants-in-aid involving nationally defined programs (often operated on a matching basis) that are designed to cope with high priority problems; (2) block grants that are designed to consolidate narrow categorical grants or to redistribute federal surpluses; and (3) intergovernmental loans. Categorical grants

4. On March 15, 1973, then Attorney General Richard Kleindienst appeared before a Subcommittee of the House Judiciary Committee to introduce the Law Enforcement Revenue Sharing Act of 1973. H.R. 5613, 93d Cong., 1st Sess. (1973); S. 1234, 93d Cong., 1st Sess. (1973). The proposal for special revenue sharing in this area was viewed as an extension of the block grant component of the Omnibus Crime Control and Safe Streets Act of 1968 (LEAA). 18 U.S.C. §§ 921 *et seq.*, 1201 *et seq.* (app.), 2501 *et seq.* 1970; 42 U.S.C. § 3701 *et seq.* (1970). Also, in March 1973 HEW Secretary Weinberger testified before the General Education Subcommittee of the House Education and Labor Committee and presented the Administration's Better Schools Act of 1973. This bill would have consolidated more than 30 categorical grant programs for education. Both bills were killed by Congress in 1973.

The Administration's transportation initiative calls for the establishment of a Unified Transportation Assistance Program (UTAP) that would eventually consolidate highway and mass transit funds into a single transportation grant program. H.R. 12859, 93d Cong., 2d Sess. (1974); S. 3035, 93d Cong., 2d Sess. (1974). Funds would be distributed on the basis of population and UTAP would mean the demise of the Highway Trust Fund. The Economic Adjustment Assistance Act of 1974, H.R. 12942, 93d Cong., 2d Sess. (1974); S. 3041, 93d Cong., 2d Sess. (1974), the Administration's revised rural development proposal, would provide for a one year extension of the present Economic Development Program in the Department of Commerce. Both bills are under review by congressional committees in 1974.

In March 1974 the Senate passed the Housing and Community Development Act of 1974, a vastly modified version of the Nixon Administration's proposed Better Communities Act (special urban development revenue sharing). Unlike General Revenue Sharing, governments seeking community development funds would be required to submit detailed plans and applications. A compromise version of the President's manpower special revenue sharing bill was signed into law on December 28, 1973. The measure, known as the Comprehensive Employment and Training Act of 1973, Pub. L. No. 93-203, 87 Stat. 839, brings to an end nearly a year of intensive debate between the Administration and Congress over the direction of federal manpower activities. Enactment of the bill gives the Nixon Administration its first special revenue sharing victory. For up-dated reports on special and general revenue sharing see REVENUE SHARING BULLETIN published monthly by the Revenue Sharing Advisory Service in Washington, D.C., from which many of the comments presented here are drawn.

have been by far the most important source of intergovernmental fiscal aid in the United States. Federal assistance to state and local governments grew from seven billion dollars in 1960 to nearly 45 billion dollars in 1973. The national government now contributes more than 25% of all state and local revenues. In 1973 categorical grants accounted for more than 95% of all intergovernmental transfers.

Prior to the enactment of General Revenue Sharing, a few attempts had been made to distribute open-ended federal grants. These included the Mineral Leasing Act, the National Forest Fund, Land Grant Payments to counties in California and Oregon, and a unique distribution of an embarrassing 27 million dollar federal surplus in 1837.⁵ In the 1960's several additional block grant programs were initiated, but these were not entirely open-ended. The Manpower Development and Training Act, the Partnership for Health Program, the Elementary and Secondary Education Act, and the Safe Streets Act were all designed to consolidate categorical grants in broad program areas. Federal restrictions on the use of these funds, although not quite as stringent as those typically imposed upon categorical grants, distinguished consolidated block grants from the totally open-ended formula grants.

Although intergovernmental loan programs involving substantial amounts of money have flourished in the United States, they have been limited almost exclusively to federal housing programs. In 1973 the federal government loaned 1.8 billion dollars to state and local governments; grants from the Department of Housing and Urban Development comprised 80% of this amount.

The shift from categorical grants to general revenue sharing and block grants as the form of intergovernmental transfer represents an important turning point in the evolution of the American federal system. What factors account for this shift? What forces propel such changes in the balance of power? And how will our intergovernmental system work when and if the New Federalism displaces the federal domestic aid strategy that has evolved over the past forty years?

I. ASSUMPTIONS OF THE NEW FEDERALISM

The basic thrust of the New Federalism, exemplified by the domestic assistance proposals of the Nixon Administration, is to reduce the federal government's impact on state and local policy-making. The

5. W. GRAVES, *AMERICAN INTERGOVERNMENTAL RELATIONS* 489-90 (1964).

principal tactic for achieving this reform will not be the withdrawal of federal support for key domestic programs; rather a concerted effort will be made to decategorize and broaden federal grants-in-aid. Although some inconsistencies are apparent (*e.g.*, the President's attempts to further centralize income support and welfare programs and to impound certain funds appropriated by Congress), the fundamental characteristic of the New Federalism has been its emphasis on decentralization.⁶

Many arguments are made in favor of decentralization. By minimizing the federal government's size, the advocates of decentralization expect: (1) to reduce the concentration of power at the top; (2) to permit greater flexibility in problem-solving; (3) to acknowledge the different needs of each community; (4) to encourage innovation by allowing similarly situated communities to experiment with different solutions to public problems; and (5) to encourage the development of political subsystems that allow for widespread participation.⁷ To the extent that supporters of the New Federalism espouse a consistent philosophy, these arguments in behalf of decentralization provide a relatively firm ideological base. Their arguments are most often accompanied by the firm belief that the national government is not inherently more "liberal" on domestic issues than are states and localities.

The New Federalism represents more than a philosophy of government; it constitutes a distinct political strategy as well. Three important assumptions underlie current shifts in grant-in-aid policy. The first, aimed at winning the support of fiscal conservatives, suggests that state and local governments are suffering severe financial strains that are caused in part by the federal government's efforts over the past thirty years to preempt the most productive sources of tax revenue. The second assumption, that states and localities are more qualified to define and address themselves to municipal needs than the national government, is designed to attract the support of the decentralists. This same group points to constitutional limitations that they claim prohibit the federal government from interfering in certain areas of domestic concern. The third, and most politically potent assumption, suggests that categorical grants-in-aid serve primarily to

6. See Nathan, *Essay on Special Revenue Sharing* (a paper presented at the Conference on Approaches to Accountability in Post-Categorical Programs, Stanford Research Institute, Aug. 20, 1973).

7. *Id.* at 10.

support an inefficient and self-indulgent bureaucracy in Washington. This last assumption appeals broadly to the belief held by both rural and suburban interests that the centralized administration of grant programs not only favors major urban areas and minority groups, but also strengthens the hand of non-elected groups at the expense of duly elected officials in city hall.

These assumptions are indeed appealing, especially to the groups that formed the backbone of the 1968 Republican majority. The question is are they valid. Political support for the New Federalism will certainly erode if evidence emerges to suggest that a shift away from categorical grants-in-aid will not accomplish these objectives.

II. SOLVING STATE AND LOCAL FISCAL PROBLEMS

One of the arguments put forward in the 1960's in support of revenue sharing was that it offered an efficient means of solving the country's long-term budgetary problems. A steadily rising full-employment, a federal surplus, and widespread fiscal deficiencies at the state and local level were anticipated. Walter Heller, one of the originators of the revenue sharing concept, recommended "unrestricted federal grants to the states" as a method of reducing fiscal drag.⁸ Heller and others predicted that after the cessation of hostilities in Vietnam the nation would realize a "peace dividend" followed by several years of federal budget surpluses. It seemed logical that federal revenues derived from existing tax sources would increase more rapidly than expenditures for domestic programs since federal revenues are based primarily on the rapidly growing and generally progressive income tax. The transfer of federal revenue to states and localities appeared a more effective method of transition to a peace time economy than a tax reduction. At the same time, federal funds would be available to meet a wide range of state and local needs. To expedite enactment and minimize opposition, Heller proposed revenue sharing in its simplest possible form—distribution to the states on a population basis, without strings or pass-through requirements.⁹

By the late 1960's state and local officials were predicting a "revenue

8. W. HELLER, *NEW DIMENSIONS OF POLITICAL ECONOMY* 132 (1966).

9. Musgrave & Polinsky, *Revenue Sharing—A Critical View*, in *FINANCING STATE AND LOCAL GOVERNMENTS* 17-52 (1970).

gap" of serious proportions.¹⁰ They pointed to the rising costs of state and local services (most notably in the areas of education and welfare), which they claimed were increasing more rapidly than available revenues. The estimates were indeed alarming. In January 1967 the National League of Cities commissioned TEMPO, General Electric's Center for Advanced Studies, to prepare a study of the revenue gap. TEMPO predicted that the cities would face a staggering 262 billion dollar revenue gap in the 10 year period from 1966 - 1975.¹¹ On the strength of these and similar projections by other organizations, the decentralists began building support for the revenue sharing concept. Many big-city mayors claimed that without some form of federal revenue sharing they would be forced to curtail vital services or even to declare their cities bankrupt.

In 1972 the Department of Commerce first reported a reversal in the aggregate financial position of state and local governments.¹² In fact, a surplus appeared. This was explained in part by recently introduced personal and corporate taxes that were both more progres-

10. Robinson, *Financing State and Local Government: The Outlook for 1975* (an undated occasional paper prepared by the Council of State Governments based on the work of the State and Local Finance Project headed by Dr. Selma Mushkin).

An analysis published by Brookings economists Allen Manvel and Robert Reischauer concluded:

If state and local tax rates remain unchanged and federal grants-in-aid continue . . . (with no new programs but with an expansion in existing programs to take account of price and workload increases), total revenues of state and local governments may be expected to rise to about \$251.7 billion by 1976. If the quality and scope of state and local services increase at roughly the rate observed between 1965 and 1969, then total expenditures may be expected to rise to about \$261.1 billion by 1976. . . . [T]he most rapid increases will be in higher education and welfare (assuming that the federal government does not substantially increase its contribution) and general administration.

Manvel & Reischauer, *General Revenue Sharing*, in *SETTING NATIONAL PRIORITIES, THE 1972 BUDGET* 134, 140 (C. Shultze, E. Fried, A. Rivlin & N. Teeters eds. 1971).

11. NATIONAL LEAGUE OF CITIES, U.S. CONFERENCE OF MAYORS & INTERNATIONAL CITY MANAGEMENT ASS'N, *THE FISCAL PLIGHT OF AMERICAN CITIES* (1971). This report concluded that the causes of the fiscal pressures on cities were as follows: (1) nearsighted federal programs; (2) neglect by state governments; (3) demands for more municipal services by the public coupled with a demand for increased pay by municipal employees; and (4) the difficulty of raising revenue.

12. 52 *SURVEY OF CURRENT BUS.*, No. 10, at 1 (Oct. 1972).

sive and more sensitive to economic growth.¹³ In 1970 state and local surpluses reached a postwar high of 3.8 billion dollars, which after a brief decline, rose to the remarkable level of 19.5 billion dollars in the fourth quarter of 1972.¹⁴ The unexpected surplus caused some to wonder whether the federal government was "impoverishing" itself while putting state and local governments in a position of relative fiscal affluence.¹⁵ Recent projections for the second half of the 1970's are even more encouraging. The American Enterprise Institute (AEI) and the Brookings Institution have predicted that state and local revenues will continue to exceed expenditures.¹⁶ The AEI study suggests that aggregate reserves could rise to 2.6 billion dollars by 1980, although predicted surpluses could disappear if national financial conditions change or if municipalities are called upon to absorb new costs for equalization of educational facilities, pollution control, or mass transit. If the surpluses persist they will certainly have an adverse effect on efforts to renew general revenue sharing when the present authorization expires.

13. The federal government has literally cornered the income tax market. In 1969 it collected 91.1% of all income tax, state governments collected 7.9% and local governments 1.0%. In comparison to all other taxes, the income tax is the most effective money raiser. For every one per cent of growth in the nation's economy, individual income tax receipts rise by about 1.5%. In 1960, 19 states were imposing both general sales and personal income taxes. Within a few years the number had increased to 33. During the same period, state and local tax collections outpaced national economic growth. State and local taxes rose from the equivalent of 7.3% of the GNP in 1960 to 8.6% by 1970. More than 53% of the growth was spurred by legislation that raised existing taxes and introduced new ones. ADVISORY COMM'N ON INTERGOVERNMENTAL REGULATIONS, FINAL REPORT: REVENUE SHARING—AN IDEA WHOSE TIME HAS COME 4 (1970).

In 1971 there were 64 tax rate increases throughout the country including 13 corporation income tax increases. In addition, three new personal income taxes and two new corporate income taxes were enacted. ADVISORY COMM'N ON INTERGOVERNMENTAL RELATIONS, STATE-LOCAL FINANCES: SIGNIFICANT FEATURES AND SUGGESTED LEGISLATION 176 (1972).

14. Gramlich & Galper, *State and Local Fiscal Behavior and Federal Grant Policy*, in *BROOKINGS PAPERS ON ECONOMIC ACTIVITY* 15-66 (A. Okun & G. Perry eds. 1973). The authors do point out that the 19 billion dollar figure is a "soft" surplus, explainable in part by the idiosyncrasies of state and local budgeting. *Id.* at 46. Nonetheless, a surplus of some proportion clearly was accumulating. In January 1973, for example, both California and North Carolina amassed multi-million dollar budget surpluses. In both states the governors proposed to return substantial amounts of money to local taxpayers through a tax referral.

15. See D. OTT *et al.*, *NIXON, MCGOVERN AND THE FEDERAL BUDGET* (American Enterprise Institute for Public Policy Research 1972).

16. See E. FRIED, A. RIVLIN, C. SCHULTZE & N. TEETERS, *SETTING NATIONAL PRIORITIES: THE 1974 BUDGET* (1973); D. OTT *et al.*, *PUBLIC CLAIMS ON UNITED STATES OUTPUT* (American Enterprise Institute for Public Policy Research 1973).

When temporary deficits in particular states or localities actually occurred, they were handled in several ways: by raising tax rates, utilizing new tax sources, raising property assessment ratios, or deferring programs. Some of these approaches are merely stop-gap measures. State and local debt ceilings, for example, have constitutionally set limits. Efforts to raise tax rates invariably evoke strong voter resistance and tend to accentuate the problem of interstate competition for new industry.¹⁷

Paradoxically, one effect of revenue sharing has been to reduce the amount of money available to the public sector. A portion of all revenue sharing funds is invariably used to reduce state or local taxes. Revenue sharing thereby inhibits the growth of state and local tax yield. One study estimates that an annual flow of 5.5 billion dollars in general revenue sharing funds will increase state and local expenditures by an average of only two to three billion dollars. The remainder of the money will probably be devoted to tax reductions.¹⁸

Even if one assumes that the cost of municipal services will outdistance the availability of revenues at the state and local level (and this is not likely to occur),¹⁹ it is questionable whether the federal government has the resources to rectify the imbalance. Strong opposition to general revenue sharing appeared when it passed in 1972.²⁰ Many congressmen felt that the federal government did not have surplus revenues to give away. When General Revenue Sharing was signed into law, some congressmen labeled it "deficit sharing" since in that year alone the federal government added an additional 23 billion dollars to the national debt.²¹ Other opponents of the bill argued that state and local governments had not exhausted their own local resources.²² Although methods of measuring fiscal capacity are hard to agree upon, the Advisory Commission on Intergovernmental Relations (ACIR) has constructed an index to predict how much tax revenue would be raised under a representative tax system. Assuming a more equitable and vigorous tax effort throughout the country,

17. M. WEIDENBAUM, PROSPECTS FOR REALLOCATING PUBLIC RESOURCES 3 (1967) [hereinafter cited as WEIDENBAUM].

18. Gramlich & Galper, *supra* note 14, at 50.

19. See text at 12-16 *supra*; text at note 23 *infra*.

20. For a thorough legislative history of General Revenue Sharing see R. THOMPSON, A NEW ERA IN FEDERALISM? (1973).

21. *Id.* at ch. 5.

22. H. REUSS, REVENUE-SHARING 71 (1970).

merely reshuffling existing state and local resources could probably close any fiscal gap between relative expenditure needs and relative expenditure capacities that might arise.²³

Advocates of the New Federalism have suggested that revenue sharing and unconditional block grants will provide a more progressive tax pattern by sharing federal tax dollars, thereby minimizing the need for local reliance on regressive tax sources such as the property tax. Substitution of federal funds for locally generated tax dollars, it is assumed, will enable municipalities to hold down their tax rates. Lower tax rates, it is argued, will help cities retain industry and attract upper-income residents back into the city core, thereby starting a cycle of revival. Local tax increases, however, are not in fact the result of a *revenue gap* at the local level. To the extent that a fiscal crisis exists, it is really on the *expenditure* side of the ledger. Financial difficulties at the local level revolve mostly around the inadequacies of local fiscal planning and management.²⁴

Although municipal budgets have been generously padded to meet patronage demands, city governments have not developed the collective bargaining skills necessary to cope with the demands of public employee unions. Politicians apparently have decided that the political costs of strikes are greater than the economic costs of acceding to union demands for escalator clauses in municipal contracts. In addition, many cities have been forced to accept expensive pension arrangements that will dramatically increase the costs of city government in future years even though the quality of services will probably not improve. Finally, urban politicians have been unable to recoup suburban tax dollars that might be used to underwrite the costs of key city

23. Musgrave & Polinsky, *supra* note 9, at 41. A significant measure of revenue effort is a comparison of revenues raised by state and local governments from their own sources with personal income within each state. The ranking of the states in these terms (special revenue as a percentage of personal income) demonstrates substantial variation, from less than 12% to a high of about 20% in fiscal 1970. The average revenue effort made by all 50 states and the District of Columbia was 14.5% in fiscal 1970. If all states and localities had made a revenue effort equal to the average of the top ten, which was 17.3%, they would have raised nearly 21 billion dollars in additional revenues. These statistics were compiled and computed by the Staff of the Joint Committee on Internal Revenue Taxation. THOMPSON, *supra* note 20, at 13.

24. See RICHMOND STUDY TASK FORCE, THE IMPACT OF FEDERAL GRANTS-IN-AID IN RICHMOND, VIRGINIA (1971) (prepared for the Federal Regional Council in Philadelphia, Pa.); P. Dearborn *et al.*, Fiscal Emergencies in Major American Cities (draft 1973, prepared for the Advisory Comm'n on Intergovernmental Relations).

services enjoyed by all metropolitan residents. For the most part, these are managerial and organizational issues that concern the ways in which costs are allocated and revenues managed. The income from revenue sharing and block grants, especially those with few or no strings attached, will contribute very little to the improvement of fiscal management capabilities at the local level.

III. THE NEW FEDERALISM—CHANGING THE BALANCE OF POWER IN THE FEDERAL SYSTEM

The New Federalists want to change the balance of power in the federal system by strengthening the position of the states vis-à-vis the national government. They look upon revenue sharing as a tool for altering the entire structure of the federal system and providing a more independent and vigorous role for the states.²⁵ The New Federalists are actually making three separate assumptions that need to be examined in light of the first few years' experience with general revenue sharing and block grants. First, they assume that states and localities are closer to the people and are therefore better able to recognize public priorities. Secondly, they suggest that state and local officials can be trusted to use federal funds honestly and efficiently. Lastly, they expect decentralization to encourage innovation and ensure greater respect for the diverse needs and interests of minority groups.

A. State and Local Governments—Are They Closer to the People?

The advocates of the New Federalism suggest that, aside from solving fiscal emergencies at the state and local level, revenue sharing will lead to greater popular control over public spending and governmental decision-making since states and localities are "a lot closer" to the diverse interests and needs of citizens in different communities. They believe that revenue sharing and unrestricted block grants, by placing unencumbered funds at the disposal of smaller governmental units, will guarantee each citizen a larger role in the decision-making process. Furthermore, they argue, if states and localities are required to make difficult decisions about the allocation of large amounts of federal money, citizen participation at state and local levels is likely to increase. The decentralists also argue that if new ideas are not

25. C. GOETZ, *WHAT IS REVENUE SHARING?* 67 (1972).

generated at the local level, the power of the federal government will continue to grow and the bureaucracy will become rigid.²⁶

Our nationwide communications system has allowed national politicians to become better known to their constituents than their state and local counterparts. Yet one observer has suggested that this one-way communication is not an effective indication of how well informed national officials are of the electorate's needs.²⁷ Indeed, there is a substantial "distance" between federal decision-makers in Washington and their local constituents, but this may well be more a matter of priorities than of miles. Throughout the 1960's elected officials in small cities and suburban towns were frustrated in their attempts to obtain federal categorical grants. Is it any wonder they support proposed changes in the grant-in-aid system? A state or local government cannot trade a low priority project for one that it considers more important. They may find it possible to secure a 20 million dollar grant for an unnecessary expressway extension but be refused \$200,000 for a desperately needed sewer treatment plant. Edward Banfield suggests that this involves a double waste; that is, a waste of what is taken (local authorities rarely refuse "free" money) and a waste of the foregone benefits of desirable projects for which grants are unavailable.²⁸ This view ignores two important points. First, many categorical grants require a matching contribution to ensure genuine local interest and in these cases funds are not free. Secondly, projects that are of such high local priority, but not necessarily of pressing national significance, probably should be funded at the local level without federal assistance.

The larger cities employ experts in the art of "grantsmanship" while many smaller communities cannot afford to employ such professionals. Local officials find that they must apply to scores, or even

26. Daniel Elazar writes:

[T]he sheer size of the national bureaucracy creates a degree of remoteness, inefficiency, and waste that rivals that of the least professional state government. . . . Part of the strength of the American political system derives from our understanding that where men are free it is not always necessary to use direct national action to achieve national goals. Often, they can be as effectively achieved through local or state action, and in such cases the results are almost certain to be more enduring because the decisions are more solidly rooted in public opinion.

Elazar, *The New Federalism: Can the States Be Trusted?*, Spring 1974 PUB. INTEREST 89, 101.

27. *Id.* at 101.

28. Banfield, *Revenue Sharing in Theory and Practice*, Spring 1971 PUB. INTEREST 33, 40.

hundreds, of programs, each with its own special requirements and administered by a different bureaucracy.²⁹ The decentralists claim that such inefficiency could be eliminated by wiping out separate categorical grant authorizations and channeling federal funds to local units of government without any spending restrictions. While this may represent a sincere concern for governmental efficiency, a cynical observer might construe such opposition to categorical grants as a politically motivated effort to ensure that federal funds will be more evenly distributed across the nation.

Assuming, *arguendo*, that the issue is in fact a basic disagreement over priorities rather than one of efficiency, local governments are claiming that Congress has been unresponsive to their needs. Local officials are convinced that, with additional federal support, they could respond more capably to local needs. A recent opinion poll undertaken by the ACIR suggests that most people would not support this assertion. In 1972 and again in 1973 a plurality of those surveyed indicated that they had more confidence in the federal government's ability to spend tax dollars wisely than in the ability of a state or local government to do so.³⁰ Even more significant is the evidence of a definite public preference for federal control over local allocation of grants-in-aid. Forty-eight per cent of those interviewed indicated a belief that federal funds are used more efficiently when granted to state and local governments for specific purposes rather than to be used as local officials think best. Only 30% wished to see federal funds passed along to state and local governments with no strings attached.³¹

State and local units of government reported that only 42.5% of the 6.6 billion dollars in revenue sharing funds disbursed had been

29. *Id.* at 41.

30. When asked: "From which level of government do you feel you get the most for your money—federal, state, or local?" the responses were:

	<i>Per cent of Total U.S. Public</i>	
	1973	1972
Federal	35	39
State	18	18
Local	25	26
Don't Know	22	17

ADVISORY COMM'N ON INTERGOVERNMENTAL RELATIONS, REVENUE SHARING AND TAXES [9] (1973) (unpaginated report).

31. *Id.* at [2].

expended by June 30, 1973.³² According to the expenditure reports filed with the federal government, most of these funds were used for education, public safety, public transportation, environmental protection/conservation, and multi-purpose/general governmental concerns. (See Table I.) State governments used 65% of their revenue sharing funds for education alone. Over 44% of all governmental units indicated that revenue sharing funds were used to reduce or avoid tax increases, and nearly one-third indicated that such funds helped either to avoid or lessen debt increases. (See Table II.) Eighty per cent of all general revenue sharing funds went to support existing rather than new programs.³³

Over half of the cities receiving revenue sharing funds did not hold public hearings prior to determining their revenue sharing expenditures.³⁴ City officials may have been reluctant to encourage extensive public involvement since the amount of revenue could not, in most cases, have covered all the uses that would have been suggested. Revenue sharing funds accounted ultimately for less than 10% of most cities' annual income and less than six per cent of annual state revenue collections. When local governments were asked if they planned to hold public hearings in the future, 37.4% said yes, 38.4% said no, and 24.2% were unsure.³⁵ The decentralists would have us believe that the power of the federal government ought to be minimized to achieve the goal of local self-determination. Yet how can there be local involvement and control when few cities are willing to make an effort to encourage citizen participation in the local budgetary process?³⁶

32. D. CAPUTO & R. COLE, *REVENUE SHARING: THE FIRST ACTUAL USE REPORTS 1* (Mar. 1974) (prepared for the Office of Revenue Sharing, U.S. Dep't of the Treasury).

33. *Id.* at 6. There is some doubt about the accuracy of the Planned Use and Actual Use Reports submitted by state and local governments. It is practically impossible to double check the figures contained in these reports because of the substitution and displacement of funds that seems to be occurring.

34. See Caputo & Cole, *Revenue Sharing and Urban Services: A Survey*, 34 *TAX REV.*, No. 10 (Oct. 1973). In March 1973 questionnaires were sent to the chief administrative officials in all cities with 1970 populations of 50,000 or greater. Of the 409 cities sent questionnaires, 212 responded.

35. See *id.*

36. Cannon & Broder, *Nixon's "New Federalism": Struggle to Prove Itself*, *Washington Post*, June 17, 1973, § A, at 1, col. 1; Cannon & Broder, *Revenue Pie Ignores Social Services*, *Washington Post*, June 18, 1973, § A, at 1, col. 5; Cannon & Broder, *The Promise: The Reality*, *Washington Post*, June 19, 1973, § A, at 1, col. 6.

Table I*
 REPORTED ACTUAL USE OF GENERAL REVENUE
 SHARING—ALL UNITS OF GOVERNMENT—1/1/72-6/30/73**

(in millions of dollars)

Category	Operating and Maintenance			Capital		Total Amount Expended	Percent of Total Funds Expended
	Amount Expended	Percent of Category Expended	Percent for New Services	Amount Expended	Percent of Category Expended		
Public Safety	\$ 496.4	76%	8%	\$158.8	24%	\$ 655.2	23%
Environmental Protection/ Conservation	92.5	49%	16%	95.3	51%	187.8	7%
Public Transportation	183.8	44%	12%	233.1	56%	416.9	15%
Health	99.3	60%	8%	66.5	40%	165.8	6%
Recreation/Culture	35.6	31%	28%	81.1	69%	116.7	4%
Libraries	18.5	100%	14%	—	—	18.5	1%
Social Services for the Poor or Aged	88.1	100%	13%	—	—	88.1	3%
Financial Administration	69.9	100%	13%	—	—	69.9	2%
Education	643.0	94%	39%	44.2	6%	687.2	24%
Multi-Purpose/Gen- eral Government	—	—	—	183.7	100%	183.7	6%
Social Development	—	—	—	12.9	100%	12.9	.5%
Housing/Community Development	—	—	—	26.0	100%	26.0	1%
Economic Development	—	—	—	11.6	100%	11.6	.5%
Other	149.8	84%	3%	27.8	16%	177.6	6%
Totals	\$1876.9	67%	20%	\$941.0	33%	\$2817.9	100%***
All Units: Total Amount Disbursed				\$6620.7			
Total Amount Expended				\$2817.9			
Percent Expended				42.5			

*C. CAPUTO & R. COLE, REVENUE SHARING: THE FIRST ACTUAL USE REPORTS 4 (Mar. 1974) (prepared for the Office of Revenue Sharing, U.S. Dep't of the Treasury).

**Note: Totals are calculated on total amounts of revenue sharing funds disbursed and total amounts expended as reported in the analyzed reports. The totals do not include earned interest on revenue sharing disbursements nor do they include estimates for the reports not yet available when these analyses were made. In the tables which follow, totals may not always equal one another due to rounding procedures and errors.

***Percents do not total 100% because of rounding.

A major national study of citizen participation in the budgetary process is currently underway.³⁷ Preliminary findings suggest that

37. The League of Women Voters Education Fund, the National Urban Coalition, and the Center for Community Change are working through their local affiliates to study local budgeting and citizen participation in the allocation of revenue sharing funds in more than 60 municipalities and a dozen states. Support for the project comes from the Edna McConnell Clark Foundation. At a national meeting of local monitoring project directors (Wingspread Conference Center, Racine, Wisconsin, June 26-27, 1974) status reports on each city were presented. A final report will be prepared by the Revenue Sharing Clearinghouse and the Center for National Policy Review in Washington, D.C.

Table II*

IMPACT OF ACTUAL USE OF GENERAL REVENUE SHARING FUNDS ON GOVERNMENTAL TAXES OF THOSE UNITS SPENDING 50 PERCENT OR MORE OF THEIR GENERAL REVENUE SHARING FUNDS

Governmental Unit	Reducing or Preventing Tax Increase Number/Percent		Indicating No Effect Number/Percent		Indicating Too Soon to Predict Number/Percent	
States and District of Columbia	6	35.3%	7	41.2%	4	23.5%
Counties	815	62.9%	260	20.0%	222	17.1%
Cities	4040	48.8%	2336	28.2%	1907	23.0%
Townships	3708	47.0%	2032	25.7%	2156	27.3%
Indian Tribes and Alaskan Native Villages	<u>1</u>	1.8%	<u>43</u>	75.4%	<u>13</u>	22.8%
Total for All Units of Government	8570	48.8%	4678	26.7%	4302	24.5%

*C. CAPUTO & R. COLE, REVENUE SHARING: THE FIRST ACTUAL USE REPORT 46 (Mar. 1974) (prepared for the Office of Revenue Sharing, U.S. Dep't of the Treasury).

without strong pressure from the federal government (such as the requirements for maximum feasible participation enforced in conjunction with grants to Model Cities Agencies or Community Action Programs), state and local officials are not likely to promote citizen participation. In one Massachusetts municipality, the city manager informed a coalition of community groups that "general revenue sharing is for me to use to keep the tax rate down. Special revenue sharing, when and if it passes, is for you to decide how to use."³⁸ Most revenue sharing monitoring projects around the country are likely to underscore the unwillingness of local officials to open up the budgetary process to the public or to urge citizen participation in the allocation of revenue sharing funds.³⁹ It appears that the often re-

38. See L. SUSSKIND, FINAL REPORT OF THE REVENUE SHARING MONITORING PROJECT PILOT STUDY (1973) (prepared for the three public interest groups listed in note 37 *supra*). The quotation is from an interview in August 1973 undertaken as part of a pilot test of the Local Revenue Sharing Monitoring Instruments prepared by the M.I.T./Harvard Joint Center for Urban Studies for the Clark Foundation funded study of General Revenue Sharing. The city and the city manager were promised anonymity as part of the arrangements for the pre-test.

39. One of the larger monitoring studies is a Ford Foundation supported effort under the direction of Richard Nathan at the Brookings Institution. See Nathan

peated hope that revenue sharing would increase citizen involvement in local decision-making is not likely to be realized. One amendment to the revenue sharing law⁴⁰ introduced by Senator Symington, a Missouri Democrat, would require recipient governments to hold public hearings in which interested individuals or groups could participate in decisions about the use of general revenue sharing funds. If the decentralists' assumptions were correct the federal government would not need to mandate citizen participation at the local level.⁴¹ In reality, however, local officials seem more intent on using revenue sharing funds to hold down local tax rates, thus ensuring their own political futures, than on using these funds to meet pressing local needs that would require the expansion of existing services or the creation of new ones.

In connection with the question whether local officials are responsive to pressing local needs, recall that one of the objectives of general revenue sharing is to provide state and local governments with greater flexibility in the use of federal funds. Accordingly, General Revenue Sharing contains only general guidelines delimiting how governmental units may spend their share. A local government may use the funds for any "ordinary and necessary capital expenditure authorized by law."⁴² In addition, funds are to be spent only within specified priority areas, one of which is described as "social services for the poor and aged."⁴³ An analysis of general revenue sharing allocations

& Manvel, *Monitoring Revenue Sharing*, 1 PUB. DATA USE, No. 2, at 12-16 (Apr. 1973).

40. See H.R. 6593, 93d Cong., 1st Sess. (1973). With the start of the 94th Congress reenactment of general revenue sharing will be under consideration. The present program is authorized through the end of 1976, and if it is to be extended Congress must act during the 94th Congress (1975-76).

41. See text accompanying note 26 *supra*.

42. State and Local Fiscal Assistance Act of 1972, 31 U.S.C. § 1222(a)(2) (Supp. II, 1972).

43. The statute reads in part:

(a) In general.

Funds received by units of local government under this subchapter may be used only for priority expenditures. For the purposes of this chapter, the term "priority expenditures" means only—

- (1) ordinary and necessary maintenance and operating expenses for—
 - (A) public safety (including law enforcement, fire protection, and building code enforcement),
 - (B) environmental protection (including sewage disposal, sanitation, and pollution abatement),
 - (C) public transportation (including transit systems and streets and roads),
 - (D) health,

in 250 governments (including the 50 cities and 50 counties that received the largest amounts of revenue sharing funds in 1972) prepared by the Comptroller General of the United States,⁴⁴ indicates a miniscule response on the part of local governments to the needs of the poor and aged. These 250 governments received about 1.66 billion dollars through June 30, 1973, or about 38% of the approximately 4.4 billion dollars distributed to all local governments.⁴⁵ Only 28 of the units studied had authorized the expenditure of part of their revenue sharing funds for programs or activities specifically designed to serve the elderly.⁴⁶ These authorizations totaled about 2.9 million dollars or about two-tenths of one per cent of the total funds authorized for expenditure by 218 of the governments surveyed.⁴⁷ The remaining 32 units had not authorized the expenditure of any of their revenue sharing funds.⁴⁸ These scant expenditures clearly do not indicate responsiveness on the part of local governments to the priority needs of the elderly.

We are also asked to assume that state governments are, by definition, closer to the people than is the federal government. Experience with several precursors of special revenue sharing—the Safe Streets Program and the Partnership for Health Program—suggest that this is not the case.⁴⁹ Under the Law Enforcement Assistance Administrations (LEAA)⁵⁰ block grant program established in 1968, federal aid

-
- (E) recreation,
 - (F) libraries,
 - (G) social services for the poor or aged, and
 - (H) financial administration; and

(2) ordinary and necessary capital expenditures authorized by law.

Id. § 1222.

44. Statement of Elmer B. Staats, Comptroller General of the United States, Hearings on the General Revenue Sharing Program before the Subcomm. on Intergovernmental Relations of the Senate Comm. on Government Operations, 93d Cong., 2d Sess. 4-9 (1974); Letter from the Deputy Comptroller General of the United States to the Honorable Claude Pepper, No. B-14628, undated (copy on file with L. Susskind).

45. *Id.*

46. *Id.*

47. *Id.*

48. *Id.*

49. See L. Susskind, *Decision-making and Resource Allocation in State Government: A New Perspective on Revenue Sharing and Strategies for City Survival* chs. 3 & 4, January 17, 1973 (unpublished thesis in the Rotch Library of the School of Architecture and Planning, M.I.T.).

50. Omnibus Crime Control and Safe Streets Act of 1968 (LEAA), 18 U.S.C. §§921 *et seq.*, 1201 *et seq.* (app.), 2501 *et seq.* (1970); 42 U.S.C. § 3701 *et seq.* (1970).

is distributed among state governments according to a formula based primarily on population. The block grant (or special revenue sharing) aspects of the program end at the state level, since the majority of states have chosen to allocate their funds among local jurisdictions on a project-by-project basis. Most states have replicated the bureaucratic confusion, red tape, and paper work for which the federal government was criticized in its earlier categorical grant programs.⁵¹

State governments have also shown considerable reluctance to distribute LEAA funds. After three years, state agencies had disbursed only one-quarter of the promised funds to sub-units, preferring instead to bank the money or to devote it to state-manned projects.⁵² States are required by statute to distribute LEAA funds to each local government unit in proportion to that local government's expenditures for public safety as compared with such expenditures statewide—the average figure for local governmental expenditures being approximately 72% of statewide expenditures.

Scant attention has been paid to this requirement in at least one state.⁵³ It is also clear that state planning agencies have not followed the federal guidelines, which suggest that large cities and high-crime areas should receive special preference.⁵⁴ Many substate planning units were created in order to minimize the influence of large cities.⁵⁵ As a result of this gerrymandering and of the state-run project selection system, few large cities have received LEAA funds proportionate to their share of either the states' index crimes or expenditures for public safety.⁵⁶

The same insensitivity to big-city needs occurs in the allocation of state block grant funds in other fields as well. The current behavior of state education departments suggests that grouping the dozens of smaller federal school aid programs into a general grant, with state controlled distribution, would only hurt large city school districts.⁵⁷

51. R. Reischauer, *The New Federalism and the Old Cities: The Local Expenditure Implications of Shifting from Categorical to Block Grants*, December 1973 (unpublished manuscript, copy on file with L. Susskind).

52. HOUSE COMM. ON GOVERNMENT OPERATIONS, *BLOCK GRANT PROGRAMS OF THE LAW ENFORCEMENT ASSISTANCE ADMINISTRATION*, H.R. REP. NO. 1072, 92d Cong., 2d Sess. 6 (1972).

53. Susskind, *supra* note 49, at ch. 3.

54. Reischauer, *supra* note 51, at 14.

55. *Id.*

56. *Id.*

57. *Id.*

A cursory review of the allocation formulas built into the Comprehensive Employment and Training Act (special manpower revenue sharing) passed in 1974, as well as the various special community development revenue sharing proposals, clearly indicates that large cities can not expect a larger slice of the federal aid pie under a decategorized grant system even though their needs are clearly more substantial.

States and localities will rely just as heavily on federal aid regardless of its form. Block grants and general revenue sharing will replace a vast array of public programs controlled by the President and Congress, but it is doubtful whether this will check the centralization of power at the top. Block grants as well as continued revenue sharing allocations hinge on congressional appropriations and approval just as do categorical grants. From the local, and particularly the neighborhood perspective, little difference exists between centralizing authority in the hands of the federal government or in the hands of the states—except that the national government has perhaps been more inclined to serve urban areas with proportionately greater needs. Without the federal controls normally associated with categorical grants, states are likely to consume large amounts of money in creating bureaucracies analogous to federal agencies. Citizen participation at the state level is difficult, if not impossible, and without the imposition of matching fund requirements, which apply to categorical but not block grants, it is difficult to develop sufficient legislative support to ensure long-term institutionalization of demonstration or experimental projects. With regard to the pass-through of money, block grant funds that do reach cities and towns are invariably controlled by provider groups and politicians who are connected with decision-makers at the state level. While categorical grant programs can mandate citizen participation, block grants and revenue sharing funds have been used to relieve the pressure on those in political power to involve out-of-power groups in local allocation decisions.⁵⁸

B. Can State and Local Officials Be Trusted to Spend Federal Funds Honestly?

Linked to the question of state and local responsiveness is the issue of trust. Can the states be trusted to serve inner-city residents? Can city officials be trusted to serve the needs of their minority constituents?

58. See L. Susskind, *Decategorization and Emerging Bureaucratic Impediments to Institutional Reform*, March 1974 (unpublished manuscript).

Can either group be trusted to obey the rules set down by the federal government designed to ensure accountability and to avoid discrimination? Revenue sharing funds can be used by local governments for projects or expenses tied to one or more of the eight priority areas mentioned in the General Revenue Sharing Act.⁵⁹ Although local governments are precluded from meeting education expenses with revenue sharing funds, capital expenditures for education are permitted.⁶⁰ No priority restrictions are imposed at the state level.⁶¹ In fact, even the minimal local use restrictions mean very little since a government has great latitude in choosing the projects it indicates have received a portion of revenue sharing funds. The case law on this question is just beginning to develop.⁶²

A surprise ruling by a federal district court prevented the city of Atlanta from using its general revenue sharing funds for tax relief. In *Mathews v. Massell*⁶³ a group of citizens brought a class action suit against the city alleging that the expenditure of revenue sharing funds for tax relief was illegal under the revenue sharing law.⁶⁴ The city had planned a reduction of 4.5 million dollars in water/sewer rates charged to firms and individuals.⁶⁵ The court enjoined the city from executing its plan, finding the city's attempt to use federal funds for tax relief "a sham."⁶⁶ The court order represented a drastic shift in interpretation of the general revenue sharing law. In 1972 the Director of the Office of Revenue Sharing in the Department of the Treasury indicated that "if a community decides to put revenue sharing into policemen's salaries, the other funds that were meant to go into policemen's salaries can be used elsewhere. There is no way we can track that down . . ."⁶⁷

59. See note 43 *supra*.

60. *Id.*

61. A state government is prohibited from using "directly or indirectly, any part of the funds it receives under" the Act as a part of the state's matching fund obligations under other federal grant programs. State and Local Fiscal Assistance Act of 1972, 31 U.S.C. § 1223(a) (Supp. II, 1972).

62. For excellent summaries of the cases discussed below see 1 REVENUE SHARING BULL., No. 5 (March 1973) and 2 REVENUE SHARING BULL., No. 2 (Feb. 1974).

63. 356 F. Supp. 291 (N.D. Ga. 1973).

64. *Id.* at 292-93.

65. *Id.* at 293.

66. *Id.* at 299.

67. 1 REVENUE SHARING BULL., No. 5, at 2 (March 1973) (comment made in December 1972 by Edward Fox, then interim Director of the Office of Revenue Sharing, Dep't of the Treasury).

The *Mathews* holding was unanticipated by Treasury Department attorneys. House Report No. 11950, which served as the original framework for the revenue sharing measure, contained a "local maintenance of effort" provision that would have precluded localities from spending revenue sharing funds indirectly for purposes outside the priority categories. This provision was removed by the House Ways and Means Committee before the bill was enacted. Most attorneys viewed its deletion as rendering the priority categories listed in the Act essentially meaningless.

Mathews, however, suggests otherwise. The court ruled that plaintiffs had a financial interest in the controversy and therefore had standing.⁶⁸ This conclusion was based on a provision of the revenue sharing law that requires any locality to repay the federal government 110% of any revenue sharing funds spent outside the priority categories.⁶⁹ The additional 10% would necessarily come from the taxes paid by local citizens.⁷⁰ Since plaintiffs were local taxpayers, the court concluded that the burden for misspent funds would fall directly upon them.⁷¹

The Mayor of Atlanta and the Board of Aldermen were defendants in *Mathews*.⁷² They argued: (1) that the revenue sharing act imposed no restrictions upon the city's general funds that are "freed-up" by the influx of revenue sharing money;⁷³ (2) that the water/sewer rebate did not conflict with congressional intent as to the use of revenue sharing funds;⁷⁴ (3) that while the matching section of the act specifically prohibits "indirect" use of revenue sharing funds to match other federal programs, the priority expenditure section does not;⁷⁵ and (4) that the Senate committee report admitted that restrictions on the use of funds by localities would be impossible to enforce and were therefore illusory.⁷⁶

Plaintiffs alleged that the City had violated the revenue sharing law since it had not, in effect, spent its revenue sharing money within

68. 356 F. Supp. at 295-96.

69. State and Local Fiscal Assistance Act of 1972, 31 U.S.C. § 1243(a)(3) (Supp. II, 1972).

70. 356 F. Supp. at 296.

71. *Id.*

72. *Id.* at 293.

73. *Id.* at 299.

74. *Id.* at 300.

75. *Id.* at 301.

76. *Id.* at 301-02.

the specific priority categories.⁷⁷ They also maintained that those plaintiffs who did not pay water/sewer fees would be denied equal protection of the law because they would derive no benefit from the rebate.⁷⁸ The court stated:

It is true that the Revenue Sharing Act does not specifically impose any restrictions upon the use of legitimately freed-up funds. Thus the Act seems clearly to have contemplated that the infusion of Revenue Sharing funds into state and local governments would permit future tax relief to the hard-pressed taxpayers of those governments. Further, there is no requirement that a local government maintain at pre-Revenue Sharing levels its spending on "priority expenditures." There is a clear difference, however, between funds which are legitimately freed up by the designation of federal Revenue Sharing funds to provide municipal services which would otherwise have to have been paid for out of general City funds, and funds which are transferred from one account to another simply to avoid the restrictions imposed by § 103 (a) of the Act. The actions [of the city and the statements of the mayor and three members of the Board of Aldermen] show clearly that the steps taken by the defendants were designed to carry out a plan to return \$4.5 million in Revenue Sharing funds to certain taxpayers, the defendants having decided to confer such tax relief by way of rebates on the water/sewer accounts.⁷⁹

Since the court found that the city's action violated the revenue sharing law, it enjoined the City from using 4.5 million dollars in revenue sharing funds in the manner proposed without considering plaintiffs' equal protection arguments.⁸⁰ The decision is not particularly satisfying to critics of revenue sharing who fear that such manipulations will continue. Other cities will simply avoid issuing public declarations that would reveal the kinds of activity found improper in *Mathews*. The decision would have been more gratifying had it achieved the same results based on the equal protection clause of the fourteenth amendment.

The performance of most local and state governments to date suggests that serious enforcement problems may be encountered. In this regard, three additional important federal restrictions are attached to the use of general revenue sharing funds. First, revenue sharing funds may not be used in any manner that does not provide

77. *Id.* at 294.

78. *Id.*

79. *Id.* at 299 (footnotes omitted).

80. *Id.* at 302.

equal benefits to minorities and women.⁸¹ Secondly, a jurisdiction must follow the same budget procedures in selecting projects to receive revenue sharing funds that are used for all other budget decisions.⁸² Thirdly, a copy of each year's "planned" and "actual" use reports must be published in a general circulation newspaper with documentation explaining the use of the funds.⁸³

The sanctions available to the Office of Revenue Sharing in the event of noncompliance by state and local government are deferral of payments, holding up payments, termination of funds, and requiring the repayment of funds.⁸⁴ Deferral can be imposed immediately should a recipient government fail to submit the necessary assurances and report forms.⁸⁵ In October 1973 the Office of Revenue Sharing held up payments to about 4,000 jurisdictions because they failed to file their planned use reports. When funds are used for projects not within one of the eight priority areas, the Secretary of the Treasury, after giving notice and an opportunity for corrective action, can require repayment of 110% of the amount spent.⁸⁶ The repayment

81. State and Local Fiscal Assistance Act of 1972, 31 U.S.C. § 1242 (Supp. II, 1972). Section 1242 is patterned after the nondiscrimination requirements and the fund termination authority of title VI, Civil Rights Act of 1964, 42 U.S.C. § 2000d *et seq.* (1970). Two notable differences exist between the two laws. Section 1242 is broader in scope in that it specifically prohibits discrimination on the basis of sex, and, unlike title VI, it contains no specific exemption from its coverage for certain employment practices.

This discussion of enforcement issues is based on a paper by Morton Sklar. M. Sklar, *The Impact of Revenue Sharing on Minorities and the Poor* 4 (1974) (presented at the OEO-sponsored Legal Services Training Program at College Park, Maryland, January 29, 1974) (copy on file with L. Susskind). On April 30, 1974, the Lawyers' Committee for Civil Rights Under Law filed a civil rights complaint before the United States Treasury Department on behalf of black residents of Ouachita Parish, Louisiana, alleging that the Parish government was guilty of a broad range of discriminatory acts. The complainants requested that the Treasury Department take all necessary steps, including deferment of further revenue sharing payments, until the inequalities in public service delivery are corrected. *Cain v. Ouachita Parish* (complaint filed before the U.S. Treasury Dep't, Office of Revenue Sharing, Apr. 30, 1974).

82. State and Local Fiscal Assistance Act of 1972, 31 U.S.C. § 1243(a) (4) (Supp. II, 1972).

83. *Id.* § 1241(c). Two other requirements of somewhat lesser concern are the anti-matching provision and a stipulation that locally prevailing wage rates must be paid by contractors working on projects receiving more than 25% of their funding via General Revenue Sharing. *Id.* §§ 1223(a), 1243(a) (6).

84. Sklar, *supra* note 81, at 5.

85. State and Local Fiscal Assistance Act of 1972, 31 U.S.C. §§ 1243(a) (5) (C), (b) (Supp. II, 1972).

86. *Id.* § 1243(a) (3).

clause applies only to priority expenditure violations and, unlike the other types of noncompliance, does not require an opportunity for a hearing.

The nondiscrimination provisions require somewhat different procedures before termination.⁸⁷ Notice of noncompliance is given to the governor of the state involved, and he is requested to secure compliance with the Act. If within a "reasonable time" the governor fails or refuses to secure compliance, the Secretary of the Treasury "is authorized (1) to refer the matter to the Attorney General with a recommendation that an appropriate civil action be instituted; (2) to exercise the powers and functions provided by title VI of the Civil Rights Act of 1964; or (3) to take such other actions as may be provided by law."⁸⁸ The meaning of the last alternative is unclear and untested. It might require, for example, filing a lawsuit to compel a recipient to carry out the promises made in its assurance of compliance.⁸⁹

The Atlanta case is not the only indication of local noncompliance with statutory provisions. In September 1973 several minority individuals and civil rights groups filed an administrative petition with the Office of Revenue Sharing charging the Chicago police department with discriminatory employment practices.⁹⁰ Their petition was based in part upon a report of the Justice Department indicating that personnel practices of the Chicago police department adversely affected minority groups. Proceeding under the Civil Rights Act of 1964, the Justice Department had filed suit in August 1973 to compel the police department to change its procedures. In spite of the fact that the police department has received over 50% of Chicago's revenue sharing funds, the Office of Revenue Sharing notified the petitioners that it had no authority to withhold funds from Chicago while the Justice Department suit was being considered by a court.

The Atlanta and Chicago experiences suggest there is good reason to believe that state and local officials will try to ignore rules established to ensure accountability for wrongful use of funds and to prevent discrimination.

87. Sklar, *supra* note 81, at 6.

88. State and Local Fiscal Assistance Act of 1972, 31 U.S.C. § 1242(b) (Supp. II, 1972).

89. *Id.*

90. 2 REVENUE SHARING BULL., No. 5 (Feb. 1974), plus materials supplied to Lawrence Susskind by Harold Himmelman of the Lawyers' Committee for Civil Rights Under Law in Washington, D.C.

One final concern is the extent to which state and local governments possess the management capability necessary to plan for the effective use of unrestricted federal funds. Mayors and their chief budget officers have several options. They can use revenue sharing money to initiate new programs, but unwillingness to do so is widespread since the revenue sharing program may not continue beyond its present authorization. Therefore, localities that use revenue sharing funds to initiate new programs may be forced to absorb the full cost of such programs in the future. A number of communities used their initial revenue sharing checks to underwrite the cost of capital improvement projects that had been held in abeyance for some time. The use of large sums of revenue sharing money for capital construction can minimize a city's long-term indebtedness by avoiding the need for municipal bond issues. Using funds for capital improvements has the additional advantage of not creating new civil service posts that the city might have to fund in the future should revenue sharing end.

City officials can also use revenue sharing to replace those categorical grants reduced by the Nixon Administration. Although General Revenue Sharing was intended to involve only "new" money, the Administration has instead transferred, impounded or arbitrarily cut-off funds already designated for certain domestic programs into revenue sharing accounts.⁹¹ Elected officials may also consider the possibility of placing revenue sharing funds in with their own general revenue accounts. They could then use those funds to cover inflation and salary increases built into public employee contracts. Choosing this option would help to forestall local tax increases. The final option, of course, and perhaps the most attractive, is to use revenue sharing funds to pay the costs of ongoing operations thereby permitting tax reductions.

The fact that more than half of the governments receiving revenue sharing funds failed to allocate any of these funds during the first year or two should not be overlooked. This suggests that not only has the financial squeeze been exaggerated, but also that many communities may be unable to manage large amounts of unrestricted funds on short notice. The reduction in federal administrative requirements brought about by revenue sharing was supposed to achieve both increased

91. See Phillips, *New Federalism Report/Federal Budget Cuts Turn Mayors Against Administration Revenue Sharing Plans*, 5 NAT'L J. REP. 1099, 1102 (1973).

efficiency at the local level and the stabilization of local administrative costs. Instead of monitoring administrative arrangements, it was expected that new city and state employees could devote their time to actual problem-solving. In reality, few if any new personnel were hired with general revenue sharing funds. Moreover, local investments in improved planning and management have not been forthcoming.

*C. Will Decentralization Encourage Innovation and
Serve the Disadvantaged?*

Critics of the categorical grant system have argued that truly creative federalism requires diversity and dissent, which are stifled when rules are imposed from above. Recent experience with block grants, however, suggests that external pressures imposed by Congress and executive agencies are more likely to stimulate innovation, because of intense competition for limited funds, than is a system in which states assume that they are entitled to funds regardless of past performance.⁹²

Decentralists also argue that the strongest impediment to state and local innovation has been a lack of funds. State legislatures and city councils are constantly engaged in a race to find new revenues just to keep already established programs alive. Supporters of the New Federalism would have us believe that this is the major constraint on the innovative tendencies of state and local officials. Such analysis ignores the political pressures that generally oppose innovation and anything but the "tried and true" approach. The issue is not one of innovation for its own sake, but rather of encouraging experimentation aimed at discovering and institutionalizing more effective means to deliver public services. Decategorization, and revenue sharing in particular, work at cross-purposes to this set of objectives. Unrestricted grants do not single out critical problem areas or provide inducements sufficient to overcome the normal inertia at the state and local level as do categorical grants. Eliminating matching provisions and pre-planning requirements minimizes the long-term prospects for institutionalization. Finally, dispensing with the clearing-house function previously performed by federal agencies reduces the likelihood of diffusing new ideas through the maze of state and local governments. Although state governments have initiated important

92. See Susskind, *supra* note 49.

programs such as social security, the list of innovations stimulated by federal matching grants is far more extensive.

Another important consideration is the impact that general revenue sharing is likely to have on the structure of local decision-making and community power. For many years, categorical grants-in-aid have been awarded directly to minority groups, neighborhood boards, non-profit corporations, and private firms willing to meet the stringent requirements imposed by the federal government. For many of these organizations, federal funds provided self-sufficiency and a measure of independence from those in power. Groups without significant leverage at the local level, but with demonstrable needs, found solace and support at the federal level. The switch to general revenue sharing and state-controlled block grants has already threatened the survival of many of these groups. The unwillingness of most city officials to use revenue sharing funds for new social programs or to pick up the cost of projects abandoned during the transition to unrestricted aid provides ample support for the complaints of minority groups who fear the effects of revenue sharing.

IV. CATEGORICAL GRANTS-IN-AID REVISITED

The pros and cons of block grants and categorical grants were being discussed as early as 1961.⁹³ At that time, the ACIR decided to vote against a switch from a categorical grant to a block grant format in the health field and listed ten reasons why it did not recommend the change. All seem equally valid today.

Block grants:

- (1) require larger outlays than categorical aids since they broaden programmatic objectives and increase the number of eligible recipients;
- (2) encompass program areas broader than the sum of the categorical aids thereby widening the area of national standards and increasing national control over state affairs;
- (3) enforce a centralization of state administrative organization in the interest of simplifying national audit and review of program funds;
- (4) impair the application of sanctions for state failure to meet national objectives;
- (5) dilute national objectives sought by the Congress since the grants are not directed toward specific ends;

93. See ADVISORY COMM'N ON INTERGOVERNMENTAL RELATIONS, MODIFICATIONS OF FEDERAL GRANTS-IN-AID FOR PUBLIC HEALTH SERVICES (1961).

(6) reduce the number of appropriation items and may make an appropriation appear large in terms of the vaguely defined needs;

(7) do not, in the end, lessen the need for categorical aids—a specific national problem still requires the introduction of a new categorical program to obtain an immediate allocation of state funds for that purpose;

(8) require, when they replace categorical grants, an increase in federal funds to assure that no state loses any funds and that all states are brought up to a minimum level;

(9) do not ensure or even encourage the uniform development of programs on a nation-wide basis; and

(10) are not likely to stimulate the appropriation of state and local funds for the development of new programs to meet problems of national concern.⁹⁴

There are, of course, arguments on the other side, but these tend to rely more on the deficiencies of the categorical approach than on the advantages of block grants.

In the past, when Congress felt that a problem required the attention of the national government, it created a new categorical program. Problems of continuing concern received support year after year. In other instances, however, problems ceased to be of importance. Currently, for example, concern for air pollution problems is on the upswing while support for tuberculosis control and agricultural training has diminished. Once a federal grant program begins, however, it is very hard to dismantle.⁹⁵ The ebb and flow in the interpretation of national priorities has unfortunately not often prompted efforts to phase out categorical grants that have outlived their usefulness.

Congress has identified several obstacles to the termination or re-direction of categorical grants-in-aid.⁹⁶ Vested interests, both public and private, are created every time a new grant program is initiated. In addition to the normal survival instincts displayed by administrative personnel at all levels, most federal administrators are not notably concerned about the overall problem of intergovernmental fiscal balance or with the proliferation of grants-in-aid. For the most part, they have developed a narrow sense of mission with respect to their particular programs. Given their somewhat partisan point of view, it is not

94. *See id.*

95. SENATE COMM. ON GOVERNMENTAL OPERATIONS, PERIODIC CONGRESSIONAL REASSESSMENT OF FEDERAL GRANTS-IN-AID TO STATE AND LOCAL GOVERNMENTS 10-13 (1967).

96. *See id.*

surprising that they invariably favor the perpetuation and expansion of categorical grants.⁹⁷

Private sector groups (such as professional organizations, suppliers of materials, or providers of services normally purchased with grant funds) are interested in seeing their grant programs continue. They strongly resist all attempts to reduce or eliminate federal appropriations, presumably because they find it easier to lobby for the continuation of an existing national appropriation than to obtain new or increased appropriations from state or local government. Efforts to redirect grant programs toward newer and more urgent problems usually result in an additional appropriation to an existing program rather than a replacement appropriation, or the creation of a new categorical grant rather than the elimination of an old one.

Congress continually initiates new grant-in-aid programs with no real sense of overall purpose. Individual programs and single-function agencies continue to proliferate at the federal and state levels along with local special districts and authorities. While new programs are continually added, existing grants are rarely eliminated. Contributing to the problem, perhaps, is the absence of a single congressional committee responsible for reviewing the whole array of grants-in-aid. Once a particular grant has continued for a number of years, it becomes an integral part of state and local budgets and constitutes one of the assumed sources of revenue in the state or local budgetary process. State and local officials are therefore reluctant to support any grant reduction. Should federal funds be reduced, a greater state or local appropriation would be needed to maintain a particular program at a given level.

97. Comprehensive surveys of federal, state and local officials involved in the administration of grant programs have revealed a number of very disturbing trends. See HOUSE COMM. ON GOVERNMENT OPERATIONS, REPLIES FROM STATE AND LOCAL GOVERNMENTS TO QUESTIONNAIRE ON INTERGOVERNMENTAL RELATIONS, H.R. REP. NO. 575, 85th Cong., 1st Sess. (1957); STAFF OF SUBCOMM. ON INTERGOVERNMENTAL RELATIONS OF THE SENATE COMM. ON GOVERNMENT OPERATIONS, THE FEDERAL SYSTEM AS SEEN BY STATE AND LOCAL OFFICIALS, 88th Cong., 1st Sess. (Comm. Print 1963). A catalogue of "friction points" in the intergovernmental system was prepared for the National Association of State Budget Officers. COUNCIL OF STATE GOVERNMENTS, FEDERAL GRANT-IN-AID REQUIREMENTS IMPEDING STATE ADMINISTRATION (1966). For additional information on the problems of intergovernmental coordination as seen from the point of view of state and local officials see D. WRIGHT & R. McANAW, AMERICAN STATE ADMINISTRATORS (1965); Walker, *Federalism Today*, 53 NAT'L CIVIC REV. 535 (Nov. 1964).

Very little is known about what happens to a federal grant-in-aid program after it is approved by Congress. No one is quite sure whether or to what extent individual grant programs succeed or fail. Delays at the federal level caused by the timing of appropriations and the promulgation of rules and regulations can create a serious gap between a program's approval and its actual initiation. Additional delays are almost always encountered in gearing up the necessary administrative machinery. Frequently state governments are unwilling or unprepared to play their part. When federal funds ultimately filter down to the state and local level, they sometimes fall into the wrong hands. For the most part, communities that do not possess the technical skill, the money to do the requisite pre-planning, or the required matching funds, are left out—although in some cases they may be the communities most in need of assistance. The impact of individual grant programs is, of course, very difficult to measure. By the time a grant program begins to operate smoothly, the particular crisis that prompted its initiation may have already passed. Moreover, since agencies involved in administering grant programs are unlikely to report their own failures and outside information is rarely available, attempts to evaluate programs have been severely handicapped.

Federal departments experience difficulty coordinating programs and services within their own agencies and with other departments and agencies. Responsibility for coordinating the efforts of various bureaus in a given department is, in most cases, fragmented. When responsibility is assigned, staffing arrangements are often inadequate. Various attempts to design new administrative tools for managing the grant application process, auditing accounts, or evaluating the success of particular projects have failed. Interdepartmental coordination at the regional level has accomplished very little. Until very recently, regional office directors were given very little decision-making power. More often than not, they were unable to coordinate their own activities with other federal agencies operating in the same region. In addition, federal departments and their respective bureaus and divisions have done very little to develop favorable relationships with state and local agencies.

V. ALTERNATIVE FORMS OF FEDERAL AID

Alternative forms of federal aid must be examined from a number of perspectives with a view toward their anticipated fiscal impacts and the distribution of power that they imply. It is important, for example,

to understand what impact each form of federal assistance might have on the national economy, what effect each would have on the ability of the federal budget to act as a built-in stabilizer (that is, as a means of offsetting fluctuations in economic activity), and what effect each would have on the progressivity of the overall tax structure or the distribution of personal income. Equally important is the extent to which each form of federal fiscal assistance might help to achieve equalization among high- and low-income states or among various economic strata. Similarly, one must examine the extent to which each form of federal aid would tend to increase national influence over state and local policy-making or to enhance the power of central cities in relation to rural- and suburban-dominated state legislatures.⁹⁸

The choices are limited: categorical grants-in-aid for specific purposes; block grants for use in certain broad areas; federal-state sharing of a fixed portion of federal income tax revenues for unrestricted purposes; federal income tax credits for the payment of state and local taxes; or federal tax cuts that might make future increases in state and local taxes somewhat more palatable.

A. *Categorical Grants-in-Aid*

To be eligible for most categorical grants-in-aid, states usually must match the national contribution at a specified rate. Aid to Families with Dependent Children, for example, requires a state to pay between 35% and 50% of the program cost, depending upon each state's per capita income. While the wealthiest must contribute one dollar from their own funds for each dollar received, the poorest contribute only 54 cents. The interstate highway program, in contrast, requires each state to pay 10% of the total cost regardless of its per capita income. For all categorical grants-in-aid, the states pay an average of one-third the program cost, although there is great diversity among programs as to required matching rates.⁹⁹

It has been suggested that the desire of national politicians to supply conditional grants is more constrained than the desire of state and

98. The perspectives for analysis presented here are a modified version of the criteria that Weidenbaum suggests for evaluating alternative grant-in-aid and federal management strategies. WEIDENBAUM 31.

99. R. WAGNER, *THE FISCAL ORGANIZATION OF AMERICAN FEDERALISM* 25-26 (1971).

local politicians to accept them.¹⁰⁰ Some grants may be virtually free to state and local officials (assuming that the federal government will permit existing operating expenditures to double as matching funds), while national politicians must levy the taxes necessary to finance them. Conditional grants are also a vehicle by which national politicians can secure local votes without violating constitutionally defined governmental responsibilities.

A number of studies suggest that categorical grants can distort the pattern of state and local expenditures:

[Categorical g]rants have been criticized for misdirecting state and local expenditures, for rigidifying state budgetary procedures, for curtailing local autonomy, for undermining state and local incentives both to spend their funds wisely and to raise enough of them from local sources, and for shifting too many public responsibilities to Washington so that political power is unduly centralized and citizens are prevented from participating actively in the choice and administration of governmental programs.¹⁰¹

Nevertheless, greater reliance on conditional grants-in-aid need not adversely affect the progressivity or stabilizing effects of the overall tax system. Moreover, most categorical grant programs have an equalizing effect. Decisions to focus additional funds on certain problem areas have a redistributive impact. This has been true primarily because most allocation formulae have been based, at least in part, on population or per capita levels of income.¹⁰² A possibility always exists that an expansion of federal grants-in-aid might intensify the regressive character of state and local taxes. This would occur, however, only if federal matching requirements created additional pressure for state and local tax increases.

The basic economic justification for functional grants-in-aid is the spill-over of benefits accruing from some of the most important state and local expenditure programs.¹⁰³ Categorical grants also serve as

100. *Id.* at 42. Wagner provides a rather elaborate mathematical analysis of fiscal federalism and the basis for institutional resistance to reforms in intergovernmental relations.

101. G. BREAK, *INTERGOVERNMENTAL FISCAL RELATIONS IN THE UNITED STATES* 83 (1967).

102. See Weidenbaum, *Shifting the Composition of Government Spending: Implications for the Regional Distribution of Income*, 17 *REGIONAL SCI. ASS'N* 163 (1966).

103. BREAK, *supra* note 101, at 105. He refers to Ainsworth, *A Comment on Professor Monypenny's Political Analysis of Federal Grants-in-Aid*, 13 *NAT'L TAX J.* 282 (1960), for a concise presentation of the economic case for federal grants, based primarily on the existence of spillover benefits.

catalysts in situations in which coordinated regional action is needed. For various reasons, however, cities, counties and states have been unable to work together.¹⁰⁴

B. Block Grants

Unrestricted block grants are used extensively in other countries such as Australia, West Germany and Canada.¹⁰⁵ They have a moderately equalizing effect between the high and low income states although they have no effect on the overall progressivity of the tax structure. Such open-ended block grants are ideally suited for offsetting or balancing state or local fiscal deficiencies arising from a high concentration of low-income families (resulting in extraordinary service requirements). This approach, however, is far from ideal for urban areas if grants are channeled through the states. The resulting two-step process tends to exacerbate the difficulties that metropolitan areas typically experience in obtaining a fair share of state funds. Consolidated block grants allocated directly to cities and towns might avoid this problem.

Some observers have urged that only unconditional block grants can compensate for disparities in resources and allow for the attainment of optimum levels of government activity in accord with locally or regionally accepted goals. The unconditional block grant may be the most satisfactory way of bringing about an overall equalization of financial resources.¹⁰⁶ Of course, this assumes a budgetary situation in which, at full employment levels, federal tax receipts expand more rapidly than federal expenditures.

Unlike other forms of federal aid, unconditional grants go directly to the root of the fiscal dilemma allegedly plaguing state and local governments. They provide a new revenue source that grows as rapidly as the national economy expands and income levels rise. Critics such as Wilbur Mills have asserted that unconditional block grants would separate responsibility for collecting taxes from the actual

104. BREAK, *supra* note 101, at 106.

105. For a review of present grant-in-aid policies and practices in Canada, Australia and West Germany see M. LEVY & J. DE TORRES, *FEDERAL REVENUE SHARING WITH THE STATES: PROBLEMS AND PROMISES* 60-78 (1970). See also ADVISORY COMM'N ON INTERGOVERNMENTAL RELATIONS, *IN SEARCH OF BALANCE, CANADA'S INTERGOVERNMENTAL SYSTEM* (1971) (available U.S. Gov't Printing Office).

106. J. DUE, *GOVERNMENT FINANCE: ECONOMICS OF THE PUBLIC SECTOR* 323-25 (4th ed. 1968).

allocation decisions. A number of Democratic leaders have urged that consolidated, as opposed to unconditional, block grants would not force the national government to give up significant leverage. They point out that consolidated block grants in broad functional areas could still be used to induce certain reforms in state and local government.

C. *Tax Sharing*

A third alternative would be for the national government to share a fixed portion of income tax revenues with the states. This approach means that high-income states with above-average federal tax payments would receive the largest share of federal aid. As in the case of unconditional block grants, this approach would diminish the role of the federal government. The states would be free to determine how their shared tax money would be used. Tax sharing is attractive in its simplicity. It promises a large and growing source of revenue and reinforces the progressive distribution of federal, state and local fiscal burdens. Those who are opposed, however, fear that tax sharing will drain funds from higher priority national purposes and that these funds will go into "leaky state purses." Further, several Senators have argued that a generous tax sharing arrangement would lead to a relaxation of state-local fiscal efforts, and that tax sharing would not meet the total needs of local governments, particularly those in central cities and metropolitan areas.¹⁰⁷

D. *Tax Credits*

Tax credits differ from tax sharing in two important ways. Under a tax credit system the imposition, collection and administration of taxes would be handled entirely by state governments.¹⁰⁸ State governments would be free to increase or decrease tax rates on their own. This type of federal assistance would allow federal income taxpayers to write off a generous portion of their state and local taxes. It would also allow them to deduct either their state and local tax payments from taxable income, as they can do now, or a fixed portion of their state and local tax payments from their federal tax bills.

107. HELLER, *supra* note 8, at 148-49.

108. Weidenbaum points out that the tax structure currently provides credits for two types of state taxes: a limited credit for state death taxes against federal estate tax liabilities, and a 90% credit against general payroll levies for payments into state unemployment compensation systems. WEIDENBAUM 39.

The benefits of this approach would accrue to persons in low- and middle-income tax brackets. Persons in higher tax brackets already enjoy a liberal write off through itemization. Federal tax credits would give state and local governments an incentive to place more reliance on income taxes in order to maximize federal tax-saving possibilities. This could help local as well as state governments by softening resistance to increases in state and local taxes. Also, the federal role would be reduced both in the national economy and in relation to state and local governments. The only drawback is that the stabilizing impact and the progressivity of the overall tax structure would tend to be reduced to the extent that progressive and income-elastic federal taxes would be replaced by state and local levies less progressive and less responsive to economic growth.¹⁰⁹

E. Federal Tax Cuts

A federal tax cut is an alternative to categorical grants, unconditional grants, or tax sharing. First, federal tax cuts might stimulate economic expansion. Secondly, in those states that treat federal income tax as a deductible item, federal tax cuts would increase the tax base and thus tax revenues. In discussing these two effects, Walter Heller estimates that an extra three billion dollars a year flowed into state and local coffers from the 1964 tax cut alone, a seven per cent increase for both state and local tax revenues.¹¹⁰ If this estimate is correct, the federal tax cut was responsible for nearly 90% of the 3.5 billion dollar increase in tax revenue enjoyed by state and local governments between 1965 and 1966.¹¹¹

Tax reductions have the advantage of allowing states and localities maximum discretion in choosing whether or not to increase service levels or taxes. Yet in the eyes of some observers, tax cuts would only reduce the federal role in key problem areas without providing guarantees that states and localities would increase their taxes and services. Others point out that a tax cut would not help to equalize interstate fiscal burdens. Whether in fact state and local governments would raise their tax rates under these circumstances is debatable. To forecast what might be done, it is necessary to determine whether present state and local tax rates are held down primarily by inter-

109. *Id.* at 40.

110. HELLER, *supra* note 8, at 140.

111. *Id.*

governmental competition for business and industry or rather by the extent to which the federal government has preempted the revenue field.¹¹² The desirability of tax cuts is heavily influenced by conditions in the national economy:

If strong inflationary pressures were likely as a result of especially rapid increases in consumer and business spending, a surplus in the federal budget, which would permit retiring some of the national debt, would be desirable as an anti-inflationary measure. However, such would not be likely to be the case if the economy were generally characterized by recession-like conditions.¹¹³

F. Categorical Grants Are the Most Effective Alternative

Tax cuts might bring about a decrease in the size of the federal government, but they would only indirectly meet state and local needs. Tax sharing and unconditional block grants would provide for the allocation of public funds among programs selected by state governments presumably more familiar with the needs and desires of their own residents than is the national government. No guarantee can be made, however, that the financial requirements of cities and metropolitan areas would in turn be met under either the unconditional grant format or the tax-cut approach. Moreover, whereas high-income states accrue greater benefit from tax sharing than from other forms of federal aid,¹¹⁴ low-income states benefit most from a grant-in-aid approach that contains some kind of equalization provision.

The objective of equality (formulated in interpersonal terms) can best be served through interstate fiscal equalization. Tax sharing on a per-capita basis is a means to this end. Additionally, a case can be made for unconditional equalizing grants to the states. If the federal government were to assume full financial responsibility for welfare

112. G. Break, *Intergovernmental Fiscal Relations in the United States IV-85, -86* (a background paper prepared for the conference held at the Brookings Institution, Washington, D.C., Nov. 1965).

113. WEIDENBAUM 41.

114. For an attempt to measure the redistribution effects of both federal grants and the taxes that finance them see J. MAXWELL, *FINANCING STATE AND LOCAL GOVERNMENTS* 6-30 (1965). See also *ADVISORY COMM'N ON INTERGOVERNMENTAL RELATIONS, THE ROLE OF EQUALIZATION IN FEDERAL GRANTS* (1964). One additional note: opponents of equalization grants point out that efforts to counterbalance regional poverty with federal grants only worsens the situation by weakening the incentives for residents to move to other locations where they would be more productive. This is a highly controversial and as yet unresolved issue.

costs, or partial responsibility for minimum performance levels in primary and secondary schools, fiscal ills (to the extent that they exist) would be relieved and the chances of achieving a significant redistribution of income would certainly be enhanced.¹¹⁵ Absent such a far-reaching federal program, categorical grants are clearly the most effective means of achieving equalization and of guaranteeing minimum levels of service to target low-income groups. Revenue sharing and block grants can boost the income of governmental units, but only categorical grants (or direct income supplements) can guarantee the provision of sorely needed services to the disadvantaged.

VI. THE LESSONS OF THE NEW FEDERALISM

Presently available evidence suggests that a move away from categorical grants is not likely to achieve the decentralists' desired objectives. State and local officials may believe that they are better attuned to local needs, but the public does not have the confidence in them that it has in the federal government. Political pressures at the local level are such that many decision-makers are forced to select short-term "protectionist" strategies (*e.g.*, tax cuts) rather than endanger their position by supporting expanded social service programs or innovative projects that might not bear fruit during their term of office. The failure of most state and local officials to promote effective citizen participation merely underscores the fact that physical proximity to local groups does not necessarily ensure concern for broadly based community involvement in the decision-making process.

The state and local fiscal crisis forecast in the late 1960's has failed to materialize. Large surpluses in a number of state budgets suggest that their one-third share of general revenue sharing funds is not serving any important purpose. At the municipal level, the budget problem is not financial but managerial, and the switch to block grants and revenue sharing is not likely to improve local management capabilities. Members of Congress who opposed "deficit sharing" in 1972 on the ground that state and local governments had not taxed themselves sufficiently were undoubtedly correct.

Reason exists to believe that states and localities cannot be trusted to abide by federal prohibitions against discriminatory and other inappropriate uses of open-ended grants. Moreover, *Mathews* suggests that Congress probably ought to add an explicit maintenance-of-

115. Musgrave & Polinsky, *supra* note 9, at 37-38.

effort clause to any extension of the general revenue sharing bill. Priority areas expressed in the law need to be tightened considerably and more stringent reporting and auditing procedures must be implemented if Congress desires needy areas to receive benefits in proportion to their requirements.

Centralized approaches to federal fiscal assistance promise the most dramatic redistributive effects. To the extent that Congress is concerned with the problems of people rather than governments, categorical grants-in-aid are the most effective tool for reaching target groups. Categorical grants have additional effects that block grants and general revenue sharing do not. These include stimulating innovative approaches to service delivery, forcing communities to "buy into" projects (thereby enhancing the long-run prospects for institutionalization), and spotlighting certain problems that may have been systematically neglected. A "sliding scale" of matching requirements could ensure that especially needy communities are not prohibited from participating in particularly appropriate categorical grant programs.

An obvious need exists to streamline the categorical grant-in-aid system and to find ways to phase out programs that have outlived their usefulness. Improvements in this area will depend in part on Congress' willingness to set up a joint committee to review the full array of grants-in-aid on a regular basis. Finally, there is evidence suggesting that the states are not likely to be sympathetic to the special needs of big cities. Reapportionment notwithstanding, state legislatures and chief officials are under strong pressure to distribute funds evenly throughout their states. Moreover, they are not likely to allocate disproportionate shares to central city residents in spite of their obviously greater burdens. Only the federal government has proved willing to address the needs of minority groups with special difficulties.

Each of the forces contributing to the shift in federal aid policy is not particularly strong, but together they are powerful enough to effect substantial modifications. There is an obvious quest for greater efficiency in the operation of grant-in-aid programs. It is not clear, however, that to increase efficiency at the expense of other national objectives is worth the price. Equalization and redistribution ought to be of increasing concern to those responsible for the management of our grant-in-aid system. Unfortunately there is no clear-cut agreement as to whether we ought to be aiming for resources equalization among or within states, or among and within socio-economic strata. Reactions

to the changing national economic picture also encourage continued efforts to restructure intergovernmental grants-in-aid, but the recession/inflation cycle is difficult to anticipate. Yesterday's policy aimed at reducing fiscal drag may well be contributing to today's inflationary woes. Attempts to use federal grant-in-aid policy as a tool for national economic planning may well be counterproductive.

A further catalyst for change in our federal domestic aid policy is the emergence and re-emergence of pressing social issues. If our current domestic aid strategy does not allow a rapid and effective response to the "great issues of the day," calls for a restructuring of the grant-in-aid system are sure to be heard in Congress. The shifting configuration of political forces wrought by changes in party control of the White House, the state capitals, and major central cities must also be considered. To the extent that the President or any other elected official is under an obligation to a particular constituency, he will seek to reward that group for its support. If the federal aid system does not provide the flexibility elected officials need, proposals for reform are sure to emerge. This mix of political and ideological considerations is difficult to unravel. No single domestic aid strategy can attract or retain unilateral support; the coalitions involved are too unstable. In assessing alternative grant-in-aid strategies, the single most important rule to keep in mind is that every approach to federal domestic aid represents compromise on a great number of fronts. Currently available evidence suggests that the compromises built into the New Federalism may result in hardships for both central city residents and the poor. Moreover, there is every reason to believe that decategorization of federal grants-in-aid will not achieve the objectives spelled out by those in favor of decentralization.

