

THE STATE AND LOCAL FISCAL ASSISTANCE ACT OF 1972

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CHAPTER 1

THE NEED FOR GENERAL REVENUE SHARING

One of the guiding principles upon which the United States was founded is the wide dispersal of governmental power. This includes a system of checks and balances with authority allocated to all branches and levels of government and with ultimate decision-making pertaining to local public services left in the hands of the state and local governments.¹ The preference for a decentralized government is indicative of a realization that a national government is incapable of curing all the domestic ills within a country. Decentralization emphasizes a flexibility that stimulates an individual response to the various needs and problems on the local level.² Thus the revitalized concern today for strengthening the position of state and local government reflects a resistance to those forces and attitudes in our system that, if remained uncontrolled, would result in a centralization of power and authority in but one level of government.

¹Roger A. Freeman, "The Restoration of Federalism in America," as quoted by Melvin Laird in the Congressional Record, House, 90th Congress, 1st session, (April 10, 1965), Volume 113, Part 7, (hereinafter cited as Freeman, "Federalism") p. 8816.

²U. S., Advisory Commission on Intergovernmental Relations, Revenue Sharing--An Idea Whose Time Has Come, (Washington: Government Printing Office, 1970; hereinafter cited as ACIR, Revenue Sharing), p. 3.

Federal revenue sharing is an attempt to reverse the trend of the Federal government's power to raise revenue. This power has been cause to the creation of an overpowering and awesome, omnipotent national government. An increasingly interdependent economy, a vastly superior jurisdictional authority, and a virtual monopoly of the tax revenues enables the Federal government to raise far more revenue than all state and local governments combined, with far less political risk than state and local government officials can manage.

Within the spheres of state and local government it is extremely difficult to raise taxes in order to meet the growing demands for services. The reasons for this difficulty are several. First, there is the frequently used practice of advertising relatively low tax structures as a means of enticing new businesses and to raise taxes would be to discourage new businesses and industries from locating in the area.³ Second, numerous state and local bond issues and tax increases are successfully blocked by those in opposition to state and local governments because of the ease of organizing and the concentrated area of people necessary to be approached and united.⁴ Third, state and local taxes and expenditures are extremely visible to the taxpayers, thereby affording them easy and direct access to those who

³What Federal Revenue Sharing Means to You, Revenue Sharing Handbook distributed in seminar in Arlington, Virginia, by Consolidated Analysts Center, Inc., March 5-6, 1973, (Washington: 1973, hereinafter cited as CACI, Revenue Sharing) p. 17.

⁴CACI, Revenue Sharing, p. 17.

would attempt to increase either or both categories in general purpose governments.⁵

General purpose governments--states, counties, cities, towns--as well as special purpose governments--school districts, water and sewer districts, fire districts--have all come to realize they no longer are capable of determining completely their own destiny. Their primary consideration is not the concerns and needs of the citizens they serve but their own survival which often depends upon the availability of funds from the Federal government. Consequently, local governments, which increasingly depend upon federal funds, have come to realize that they no longer are capable of developing their own programs. Thus, it often happens that their primary consideration is not the concerns and needs of the citizens they serve but their own survival which frequently depends upon the availability of Federal funds. As a consequence of the local governments' dependence on national funding and since Federal funding is usually tied specifically to a limited single policy objective, local governments have tended to develop distorted budgets which reflect the availability of Federal funds rather than reflect the specific demands and needs of the local community. In effect, therefore, local officials have lost much of their control over local government because the purse strings are held by Federal agencies. When it comes to an act of a Federal agency, the officials are so far removed from the local areas and their needs that

⁵Ibid.

the decisions rendered are generally made without the considerations of local citizens.⁶

The primary reason for the growth in Federal power and the subsequent decline in home rule and local self-government has been the massive development of Federal grants-in-aid. Federal funds are being allocated by the billions for thousands of state and local programs covering virtually all activities conducted by these governmental units.⁷ Conditional categorical grants from the Federal government in 1972 totalled approximately \$38,288 million, an increase from \$6,669 million in 1959.⁸ These allocations are always conditioned upon compliance with Federal requirements and standards on the what, when, and how a program is to be conducted.

With grants-in-aid available in virtually all endeavors undertaken by state and local jurisdictions, Federal administrators are controlling not only the Federal dollar but the local dollar as well through their rights to approve or disapprove grant requests or to require changes before a request can be approved.

The categorical nature of the Federal grant-in-aid program requires approximately 600 separate Federal departments, agencies, bureaus, and offices to administer, develop guidelines for, and monitor the same 600 programs. This procedure has undergone never-ending

⁶Freeman, "Federalism", p. 26.

⁷Ibid.

⁸CACI, Revenue Sharing, p. 17.

attacks for a number of reasons. The proliferation of these limited purpose programs, each with its own set of narrow rules and regulations, has created immeasurable confusion. Developed has been a form of centralization characterized by excessive red tape and delays caused by the need for numerous and different reviews of the applications. Eventually, because of the volume of requests, awards of grants have been made on the basis of grantsmanship rather than need or equity.⁹

The large number of diverse programs, each designed to accomplish a different but specific national objective, made it difficult for many potential recipient governments to avail themselves of the all-powerful Federal dollar. This was due to a lack of the necessary manpower and financial resources to create the required matching funds. Furthermore, many localities would find themselves requesting grant money on a matching basis not where the state or local need actually lay but where the nature of the available money would fund. The categorical grants were too rigid for adequate use by state and local governments. Money awarded on a matching basis for a specific problem would have to be utilized for that program with any excess returned to the Federal government. These forms of inflexibility have led to cries for reform of the system, for the consolidation of grants, a simplification of procedures, and for state and local control over the

⁹Ibid., p. 18.

use of Federal grant money.¹⁰

One common argument developed by the local communities of the categorical grant scheme is that while there is an obvious need for public services, it should be the local officials who make the decisions and establish the priorities for the spending of the grant money. Furthermore, it is argued that given more money state and local governments could escape their fiscal binds without the need for tax increases and more effectively provide the necessary services for their jurisdiction than can the distant Federal administrators.

The urgent need for adequate Federal financial assistance is demonstrated in the decade from 1959 to 1969 as state and local general expenditures increased by 138.7 percent--from \$48.9 billion to \$116.7 billion.¹¹ From 1968 to 1971, local property taxes increased from \$26,835 million to \$36,726 million, an increase of only \$9,891 million; state sales taxes rose from \$20,979 million in 1968 to \$29,590 million in 1971, an increase of only \$8,591 million. During the same period, national income taxes rose from \$68,726 million to \$86,230 million, an increase of \$20,504 million.¹²

¹⁰Ibid., pp. 18-19.

¹¹Maureen McBreen, Congressional Research Service, Federal Revenue Sharing: A Review of Major Proposals and Contending Positions in the 92nd Congress, HJ275A: 71-153E, (Washington: Government Printing Office, June, 1971; hereinafter cited as McBreen, Proposals), pp. 25-26.

¹²CACI, Revenue Sharing, pp. 13-14.

Because of the shortage of funds, the Federal government has, as noted earlier, extended assistance to state and local governments in the form of grants-in-aid for a wide variety of purposes. From 1960 to 1970 direct grants from the Federal government more than tripled-- from \$7.0 billion to \$24.0 billion.¹³ However, most of the Federal aid was categorical thereby denying state and local officials the opportunity to use money if their needs did not fit the categories permitted for expenditure.

In a further attempt to balance state budgets, state legislatures have enacted legislation imposing new taxes or have increased existing taxes. From the period January 1, 1959 to December 15, 1971, state legislatures imposed 58 state personal income tax increases while enacting 12 new personal income taxes. States also increased taxes in all major categories 481 times, while enacting 40 new taxes. As of January 1, 1972, 40 states had adopted individual income taxes, 45 had corporation income taxes, 45 had general sales taxes, and all 50 states imposed both a gasoline and cigarette tax.¹⁴

These new and additional taxes imposed by state and local governments obviously have produced a substantial growth in their total revenues. From 1953 to 1971, local revenues from their own sources increased from \$12,692 million to \$57,491 million, an increase of 352.9 percent. State revenues increased from \$11,750 million to

¹³McBreen, Proposals, p. 26.

¹⁴Ibid., p. 27.

\$61,290 million, an increase of 421.6 percent. Supplementing these revenues was a total of \$26,145.8 million in Federal grants, raising the total general revenue for all states and localities in 1971 to \$144,927.5 million. Additional revenues from utilities, liquor sales, and insurance trust totalled \$21,163.0 million for a total revenue for all state and local governments of \$166,090 million.¹⁵

However, in all probability, the saturation point has been reached in income, property, and sales taxation and the voting public is registering its disapproval at the polls to any additional levies to the existing tax burden. Furthermore, in determining whether to raise the taxation rate or not, state and local officials must weigh the possibility that individuals and business firms will move to other areas where they might find a more advantageous tax situation.¹⁶ Thus, in terms of "tax effort" there is little evidence to support the contention that states do not make the most effective use of the revenue available to them.

Of course, the tax collecting efforts of states should not be generalized. There exist substantial differences in revenue-producing efforts by state and local governments. For example, in 1970 the total general revenue from their own sources represented 14.6 percent of personal income in the United States, up 1.8 percent from 1965. According to the Joint Committee on Internal Revenue Taxation, the

¹⁵CACI, Revenue Sharing, p. 8.

¹⁶Ibid., pp. 7-8.

average of the top ten among the 50 states and the District of Columbia was 17.31 percent of personal income. If all 50 states and their local units of government had made the same efforts, they would have raised approximately \$21 billion in additional revenue in 1970.¹⁷ It was this disparity, in part, which led to greater emphasis for developing the revenue sharing program, whereby those states demonstrating the greater tax effort would benefit by receiving the greater allocation of revenue sharing money. Hopefully, those states with relatively low tax rates would then realize the benefits to be derived by generating more taxes and proceed with the proper enabling legislation.

General revenue sharing, now in its second year, constitutes a major reform of the fiscal relationship between the Federal government and the state and local governments. Revenue sharing is a primary element in President Richard M. Nixon's plan to strengthen and balance fiscal Federalism. The idea behind revenue sharing is to strengthen the fiscal capabilities of the state and local governments by authorizing the Federal government to share a designated portion of the Federal personal income tax revenues with the state and local jurisdictions on virtually a "no strings attached" basis. This would provide the units of general purpose government with the necessary funds to deliver the bulk of domestic public services.¹⁸

¹⁷Ibid., p. 15.

¹⁸ACIR, Revenue Sharing, p. 2.

As designed, the program of revenue sharing can provide immediate help to relieve state and local financial strains. This, in turn, would provide these jurisdictions the funds necessary to afford the public services so much in demand. The plan for general and special revenue sharing is designed to provide state and local governments an annual total of \$16 billion, of which approximately \$6 billion will be money, heretofore, unavailable for state and local use.¹⁹

Basically, it is the intent of Federal revenue sharing to provide unrestricted additional revenues to state and local governments without the usual rigidities and delays. Revenue sharing will eliminate the matching requirements and the narrow limited purposes characteristic of the categorical grants-in-aid program. The additional dollars will permit the spending priorities to be established by those administrators closest to the local problems, thereby allowing for creativity, citizen involvement and public initiative. By providing state and local officials both money and flexibility in determining its use, it is generally felt that the responsibility and responsiveness of local governments toward community problems can be increased.²⁰

Appropriately, Federal revenue sharing will relieve Federal officials from additional details required in the administration of the grant-in-aid programs. More time and energy can now be devoted

¹⁹U. S., Domestic Council, Executive Office of the President, Highlights of Revenue Sharing, (Washington: Government Printing Office, 1971), p. 1.

²⁰Ibid., pp. 1, 23.

to the pressing problems of maintaining the national security, building stronger relationships with our allies abroad, and fulfilling the needs of the American public at home.²¹ Furthermore, reinforcement of the fiscal independence of state and local governments would go a long way toward recreating a balanced form of government. National problems are often state or local problems that should be handled on the state or local level.

The need for fiscal assistance for state and local governments is obvious. The means of assistance at this point is the five-year plan for Federal general revenue sharing with the goal to restore a proper balance of power in the Federal system. Currently, taxes are collected most effectively on the Federal level while spending is done more effectively on the state and local levels where the demands and needs are the greatest. According to President Richard Nixon,

The central advantage of revenue sharing (is) the fact that it combines the advantages of Federal taxation with the advantages of state and local decision-making. There is too much to be done in America today for the Federal government to try to do it all. When we divide up decision-making, then each decision can be made at the place where it has the best chance of being decided in the best way. When we give more people the power to decide, then each decision will receive greater time and attention. This also means that Federal officials will have a greater opportunity to focus on those matters which ought to be handled at the Federal level. . . . let us remember this central point: the purpose of revenue sharing is not to prevent action but rather to promote action. It is not a means of fighting power but a means of focusing power. Our ultimate goal must always be to locate power at

²¹ McBreen, Proposals, p. 30.

that place--public or private--Federal or local--where it can be used most responsibly and most responsively, with the greatest efficiency and with the greatest effectiveness.²²

With a recognized need for some form of fiscal assistance by officials of federal, state, and local governments, what remained was for the Congress of the United States to pass the enabling legislation. For several years revenue sharing had been discussed by economists and legislators in Washington, but not until Richard Nixon announced his program for a "New Federalism" did Congress finally begin to respond.

²²U. S., President (Nixon), "Revenue Sharing--Message from the President of the United States," Congressional Record, House, 92nd Congress, 1st session (February 4, 1971), Volume 117, Part 2, pp. 1715-18.

CHAPTER 2

GENERAL REVENUE SHARING IN THE 91ST AND 92ND CONGRESS

Even before his administration began in January 1969, Richard Nixon was a strong advocate of Federal tax sharing as a means of providing assistance to financially stressed state and local governing units. During his Presidential campaign in 1968, Mr. Nixon stated he felt the "proliferation of specialized federal grants-in-aid" had hampered the effectiveness of state and local governments in meeting the demands and needs of the American people. Rather than continue the extension of this form of federal assistance, Mr. Nixon wanted the federal government to "begin to return tax revenues to states and local communities in the form of bloc grants and thus allow them . . . to determine their own priorities in the allocation of resources . . . and thereby place decision-making in the right hands."¹

On April 21, 1969, three months after becoming President, Richard Nixon delivered a tax reform message to the 91st Congress. In the speech the President announced his intention of submitting a revenue sharing program to Congress within the next several months and that

¹Radio address by Richard M. Nixon broadcast over the CBS radio network, October 25, 1968, as quoted by Maureen McBreen, Congressional Research Service, History of Federal Revenue Sharing Proposals and Enactment of the State and Local Fiscal Assistance Act of 1972, HJ 275A (Washington, Government Printing Office, November, 1972), p. 8.

it would be a high priority committal on behalf of his administration.²

Then, on August 13, 1969, in a special message to Congress, President Nixon submitted the Administration's version of what the revenue sharing legislation should incorporate. In prefacing the details of the proposal, it was the President's belief "a majority of Americans no longer support the continued extension of federal services. The momentum for federal expansion has passed its peak; a process of deceleration is setting in."³ He went on to say that

Ultimately, it is our hope to use this mechanism (of revenue sharing) to so strengthen state and local government that by the end of the coming decade, the political landscape of America will be vastly altered, and states and cities will have a far greater share of power and responsibilities for solving their own problems. The role of the Federal Government will be re-defined and re-directed toward those functions where it proves itself the only of the most suitable instrument.⁴

On September 23, 1969, Senator Howard H. Baker, Jr. (Republican, Tennessee) and 32 co-sponsors introduced this Nixon proposal in the Senate as S. 2948.⁵ In the House of Representatives, the bill was

²U. S., President (Nixon), "Reform of Our Federal Income Tax," Congressional Record, House, 91st Congress, 1st session (April 21, 1969), Volume 115, Part 7, p. 9686.

³U. S., President (Nixon), "Tax Sharing Proposal," Congressional Record, House, 91st Congress, 1st session, (August 13, 1969), Volume 115, Part 18, p. 23834.

⁴Ibid.

⁵U. S., Congress, Senate, Senator Howard Baker, "Introduction of the Revenue Sharing Act of 1969," Congressional Record, 91st Congress, 1st session, (September 23, 1969), Volume 115, Part 20, pp. 26671-26681.

introduced the next day as H. R. 13982 by Representative Jackson E. Betts (Republican, Ohio) and fourteen co-sponsors.⁶

The major elements of these revenue sharing bills were:

1. The size of the fund to be shared was to be equal to 1.3 percent of the personal income tax returns filed for the most recent calendar year for which published data were available. By 1980 there would be an estimated \$10 billion available in revenue sharing funds. To ease the budget impact, the fiscal year 1971 percentage is only 1/6 of one percent (\$500 million).

2. The distribution among states was to be made on the basis of each state's share of national population, adjusted for the states revenue effort. Thus, a state which taxed its citizens more than the national average would receive a proportional bonus.

3. The distribution within states to the general units of local government would be established by a prescribed formula. The portion a state must share with its political subdivision would correspond to the ratio of total local general revenues to the sum of state and total local general revenues in the state. The amount which an individual unit of general local government received would correspond to its share of all local general revenues raised in the state.

4. The only requirements imposed on the states (in addition to the local sharing) were quarterly reporting and accounting, maintenance of existing state aid to localities, and adherence to the existing Federal Civil Rights laws.⁷

Despite the 55 different revenue sharing bills introduced into the first session of the 91st Congress, both Houses adjourned without

⁶U. S., Congress, House, Congressional Record, 91st Congress, 1st session, (September 24, 1969), Volume 115, Part 20, p. 26960.

⁷U. S., Congress, Senate, Senator Howard Baker, "Introduction of the Revenue Sharing Act of 1969," Congressional Record, 91st Congress, 1st session, (September 23, 1969), Volume 115, Part 20, p. 26677.

enacting any of the introduced measures. The only actions related to revenue sharing that did occur were the hearings conducted by the State Government Operations Subcommittee on Intergovernmental Relations on a Muskie-Goodell bill (S.2483), the Intergovernmental Revenue Act of 1969. These hearings recorded testimony from representatives of all levels of government and succeeded in focusing public attention toward the necessity for a revenue sharing program.⁸

When the 92nd Congress convened, President Nixon renewed his quest for a Federal revenue sharing program by submitting an expanded and more detailed proposal than what had been presented before the 91st Congress 18 months earlier. Delivered in his State of the Union Message on January 22, 1971, the proposal was one of Mr. Nixon's "six great goals" offered for Congress and the American people. The fifth goal, revenue sharing called for a \$16 billion Federal investment to renew state and local governments. Approximately \$5 billion of the total would be new and unrestricted funds. The remaining \$11 billion would be provided by allocating \$1 billion in new funds and by converting into revenue sharing funds one-third of the money going to the narrow-purpose Federal grant-in-aid programs.⁹

⁸Richard E. Thompson (ed.) "Revenue Sharing Becomes Law," Revenue Sharing Bulletin, (hereinafter cited as Thompson, "Law," Bulletin), November, 1972, p. 6.

⁹U. S., President (Nixon), "The State of the Union," Congressional Record, House, 92nd Congress, 1st session (January 22, 1971), Volume 117, Part 1, p. 166.

Two weeks later in a special message to Congress, Mr. Nixon outlined in detail the Administration's general revenue sharing proposal, retaining the four basic principles from the legislation submitted to the 91st Congress.¹⁰

However, there was one significant addition to the Administration's latest revenue sharing proposal. Of the total amount of funds to be shared by the Federal government, 90 percent would be distributed directly to the State and local governments. The remaining 10 percent would be appropriated in the form of incentive payments to the states which adopted their own plan for allocating a portion of the State allotment among the local governments in the State. The purpose of this incentive payment was to encourage the States, in cooperation with their local governing bodies, to develop a plan which would incorporate the best interests of their individual needs.¹¹

Five days later, on February 11, 1971, Senator Baker and 37 co-sponsors again introduced the Nixon revenue sharing proposal in the Senate (S.680).¹² The next day Representatives Betts, Harold R. Collier (Republican, Illinois), and Barber B. Conable (Republican, New

¹⁰U. S., President (Nixon), "Revenue Sharing", Congressional Record, House, 92nd Congress, 1st session, (February 4, 1971), Volume 117, Part 1, pp. 1715-1718.

¹¹Ibid.

¹²U. S., Congress, Senate, Senator Howard Baker, "Introduction of the General Revenue Sharing Act of 1971", Congressional Record, 92nd Congress, 1st session (February 9, 1971), Volume 117, Part 1, pp. 2140-2150.

York) introduced the Administration's bill in the House of Representatives (H.R. 4187). Also introduced by these same Representatives were six additional versions for a proposed revenue sharing program (H.R. 4188 to H.R. 4193).¹³

Opposition to the Nixon proposal came quickly in the Senate when immediately after Senator Baker's introduction of the Administration's version of revenue sharing legislation, Senator Vance Hartke (Democrat, Indiana) rose to challenge. Said Hartke:

. . . . The administration's plan, as presently drafted should not and cannot be enacted. Its defects so far outweigh its merits that to pass it in substantially its present form would be to move farther from, rather than nearer to solution of those bitterly intractable social and fiscal problems which the idea of revenue sharing was conceived to meet.¹⁴

Eventually more than 50 different revenue sharing proposals were introduced into both Houses of Congress. Consequently, the House Ways and Means Committee spent the entire month of June, 1971 in hearings on general revenue sharing compiling 1524 pages of testimony and statements from Administration personnel, Treasury officials and governors, mayors, and county officials from all over the United States. The committee then spent the month of July in executive session.

¹³U. S., Congress, House, Representative Jackson Betts, "General Revenue Sharing with State and Local Governments", Congressional Record, 92nd Congress, 1st session (February 10, 1971), Volume 117, Part 1, pp. 2341-2345.

¹⁴U. S., Congress, Senate, Senator Vance Hartke, "Revenue Sharing: The Administration's Proposal and Its Alternatives," Congressional Record, 92nd Congress, 1st session (February 9, 1971), Volume 117, Part 1, p. 2156.

However at the end of two months the Committee was still unable to produce any substantial results or findings on the means through which revenue sharing would be implemented.¹⁵ Perhaps the most significant result to develop from the House Ways and Means Committee was the personal opposition to the Administration's proposal by the Committee Chairman, Representative Wilbur D. Mills (Democrat, Arkansas).

Representative Mills acknowledged that State and local governments needed additional Federal support. Speaking at the opening session of a three day National Tax Association Seminar on July 22, 1971, Mills said he would not be opposed to the Federal government allocating specific funds to cities and counties, but only as a temporary measure in order to allow the local governments the opportunity to work out their own financial problems.¹⁶ However, Mills went on to say the Nixon proposal was not the best way of providing the needed assistance. Consequently, in August, Mills instructed his own staff to begin the preparation of a new revenue sharing proposal for Congressional review and evaluation.¹⁷

Mills had two main objections to the Nixon revenue sharing plan. First, the plan violated the principle that the same level of government that spends the money should have the responsibility for raising it.

¹⁵Thompson, "Law", Bulletin, p. 6.

¹⁶Frank C. Porter, "Mills Hits Revenue Plan, Warns on Taking Credit," Washington Post, (hereinafter as Porter, "Mills", Post), July 23, 1971, A; 2; 3-5.

¹⁷"Law", Bulletin, p. 7.

The second was that the plan, as designed, would distribute the funds indiscriminately. Consequently, state and local governments that did not need the financial assistance, as well as those which did, would benefit from the program. Representative Mills felt financial assistance should be based primarily on governmental need and not distributed randomly without proper evaluation made for the funds intended usage.¹⁸

After Mills publicly announced his opposition to the Nixon revenue sharing proposal many Republicans began indicating their support for the impending Mills proposal. Representative Conable and Betts, co-sponsors of the Administration's proposal, announced the Administration's awareness of the revenue sharing proposal being prepared by Mills and both Representatives stated they would support the proposal when presented on the House floor.¹⁹

During the latter days of October and the early days of November, 1971, a draft of the Mills' proposal was circulated for review and comment to the staff members of national associations of states, cities, and counties across the country. Support for this proposal soon arrived in Washington, D. C. from the Presidents of the National League of Cities, U. S. Conference of Mayors, National Governor's Conference, National Legislative Conference, National Association of

¹⁸Porter, "Mills", Post, A; 2; 3-5.

¹⁹"Law", Bulletin, p. 7.

Counties, and the International City Management Association.²⁰

Finally, on November 30, 1971, Representative Mills and nine co-sponsors, introduced his revenue sharing proposal in the House of Representatives as the Intergovernmental Fiscal Coordination Act of 1971 (H.R. 11950).²¹

Mills viewed his plan not as revenue sharing but as a grant because it authorized a direct grant of \$5.3 billion to State and local governments for each of five fiscal years from 1973 through 1978. Of the \$5.3 billion total, local governments would receive \$3.5 billion for specific high priority programs: (1) maintenance and operating expenses for public safety, environmental protection, public transportation, youth recreation, health and fiscal administration; (2) capital expenditures for sewage collection and treatment, refuse disposal systems and public transportation. The distribution of the \$3.5 billion would be based primarily on need and include elements of total population, urbanized population, the extent of poverty, and adjusted tax revenues. The remaining \$1.8 billion would be distributed to the State governments on the basis of the State's personal income tax collections. For States not having an individual income tax, their share would be the equivalent of one percent of Federal income tax

²⁰Ibid.

²¹U. S., Congress, House, Congressional Record, 92nd Congress, 1st session, (November 30, 1971), Volume 117, Part 33, p. 43442.

liabilities for the year of revenue sharing distribution.²²

After the holiday recess the House Ways and Means Committee reconvened in January, 1972, and once again began extensive executive sessions on revenue sharing in an attempt to work out a compromise version between the Nixon proposal and the Mills alternative. Subsequently, various struggles developed during the first two and one-half months of 1972 to construct a revenue sharing program acceptable to both the Democrats and the Republicans.

One of two major confrontations began and ended on March 13, 1972, when the senior Republican member of the House Ways and Means Committee, John Byrnes (Republican, Wisconsin) offered an amendment to the Mills' proposal that would give a State the final decision as to the amount of the funds allocated to local governments within that State. The amendment passed in the morning session of the Committee by a vote of 12 to 6. However, this vote split the coalition of State and local governmental associations providing support for the bill. The National Governors' Conference favored the action while the associations of local governments were obviously opposed. Consequently, the afternoon session of the Committee included a discussion of this State and local dissention and a subsequent modification in the earlier decision. By the meeting's end the House Ways and Means Committee agreed to limit the States discretion over the allocation of

²²"Mills Offers Own Bill for Local Grants," Washington Post, December 1, 1971, A; 2; 3.

funds to local governments by providing several alternative formulas from which the States could choose.²³

On April 17, 1972, the Committee finally approved a 5-year \$29.5 billion revenue sharing bill incorporating primarily the elements of the Mills' proposal entitled the "State and Local Fiscal Assistance Act of 1972" by a vote of 17 to 7.²⁴ However, a second major fight developed in the House Rules Committee over the parliamentary procedure under which the revenue sharing bill would be considered on the House Floor. As designed, the proposed revenue sharing program had an automatic five-year appropriation for funding which would negate an annual review and authorization of funds by the House Appropriations Committee. The opponents of revenue sharing failed in their attempt to have the revenue sharing program scuttled when, after extensive debate, the Rules Committee on May 23, 1972 voted 8 to 7 to preclude the House Appropriations Committee from gaining control of the program.²⁵

After numerous delays because of non-favorable Democratic "nose-counts," the House of Representatives, under heavy pressure from the White House and the nation's governors and city managers, sustained

²³Peter Milius, "State Run Tax Sharing Is Backed", Washington Post, March 14, 1972, A; 6; 1.

²⁴Peter Milius, "Revenue Sharing Wins Test", Washington Post, April 18, 1972, A; 10; 2.

²⁵Thompson, "Law", Bulletin, p. 7.

the Rules Committee decision by a vote of 223 to 185 on June 21, 1972.²⁶ The next day the House of Representatives voted 274 to 122 to accept the House Ways and Means Committee's version of the revenue sharing bill.²⁷

The Senate Finance Committee then began its revenue sharing hearings on June 29, 1972 and received supportive testimony from Treasury Secretary George Schultz and Under Secretary Charles E. Walker. After the Democratic National Convention, the Committee continued to receive testimony and statements from mayors, governors, state legislators, county officials and other reiterating the State and local governmental need for Federal financial assistance.²⁸

Then, on August 9, 1972, Senator Russell Long (Democrat, Louisiana) announced the approval by the Senate Finance Committee of a revenue sharing bill radically different from the House-passed version.²⁹ Immediately, Senator McClellan (Democrat, Arkansas), Chairman of the Senate Appropriations Committee, demanded that the bill become the jurisdiction of his Committee because of the five-year automatic appropriation provision. However, as happened in the House Ways and Means

²⁶U. S., Congress, House, Congressional Record, 92nd Congress, 2nd session, (June 21, 1972), Volume 118, Number 10k, p. 5877.

²⁷U. S., Congress, House, Congressional Record, 92nd Congress, 2nd session, (June 21, 1972), Volume 118, Number 10l, p. 5989.

²⁸Thompson, "Law", Bulletin, p. 7.

²⁹Peter Braestrup, "Revenue Sharing Shuns Suburbs", Washington Post, August 10, 1972, A; 2; 1-4.

Committee, the supporters of revenue sharing in the Senate Finance Committee rallied to defeat the McClellan move and on September 7, the Senate upheld the Finance Committee decision by a vote of 49 to 34.³⁰ Five days later, on September 12, 1972, the Senate approved a \$33.5 billion revenue sharing program by a vote of 63 to 20.³¹ Because of the differences between the House and Senate versions of the revenue sharing program a Conference Committee began work to produce a compromise revenue sharing bill. The Committee completed its work on September 15 and submitted the new bill to both houses for passage. (See Chapter 3 for a discussion of the compromise.) On October 12, the House of Representatives passed the revenue sharing bill by a vote of 265 to 110.³³ The next day the Senate by a vote of 59 to 19 adopts the same bill and the bill was sent to the White House for President Nixon's signature.³⁴

Thus after four years of debates and controversy in the Nixon Administration, members of Congress, governors, mayors, county

³⁰U. S. Congress, Senate, Congressional Record, 92nd Congress, 2nd session, (September 7, 1972), Volume 118, Number 138, p. 14308.

³¹U. S. Congress, Senate, Congressional Record, 92nd Congress, 2nd session, (September 12, 1972), Volume 118, Number 141, p. 14733.

³²"Congress Expected to Enact Revenue Sharing This Month", Washington Post, September 16, 1972, A; 2; 6-8.

³³U. S., Congress, House, Congressional Record, 92nd Congress, 2nd session, (October 12, 1972), Volume 118, Number 164, p. H-9760.

³⁴U. S., Congress, Senate, Congressional Record, 92nd Congress, 2nd session, (October 13, 1972), p. S-18026.

officials, and other interested governmental officials and organizations gained enough support to obtain passage of a much needed revenue sharing program. The first step in President Nixon's plan for a revitalized Federal governmental system awaited only his signature.

CHAPTER 3

GENERAL REVENUE SHARING IMPLEMENTATION

The "State and Local Fiscal Assistance Act of 1972" (P.L. 92-512) was signed into law by President Richard M. Nixon on October 20, 1972 at Independence Hall in Philadelphia, Pennsylvania.¹

Revenue sharing has become the abbreviated term for describing the Act which provides for the payment of \$30,236,400,000 by the Federal government to the fifty states, the District of Columbia and the more than 38,000 general purpose local governments throughout the United States.² Enacted by Congress on October 13, 1972, the \$30.2 billion is to be distributed over a five-year period beginning, retroactively, with calendar year 1972 and terminating on December 31, 1976 (see Table 1).

The Revenue Sharing Act creates entitlement periods during which time the money is to be disbursed to the state and local governments. Payments made during the entitlement periods are made on a quarterly basis (see Table 2).

¹Richard E. Thompson (ed.), "Revenue Sharing Becomes Law," Revenue Sharing Bulletin, November, 1972, p. 1.

²Public Law 92-512, 92nd Congress, 2nd session, (October 20, 1972; hereinafter cited as P. L. 92-512), State and Local Fiscal Assistance Act of 1972, section 105 (b).

TABLE 1

Revenue Sharing Allocations: Calendar Years

Year	Amount
1972	\$5.300 billion
1973	5.975 billion
1974	6.125 billion
1975	6.275 billion
1976	6.425 billion

Source: Public Law 92-512, 92nd Congress, 2nd Session, (October 20, 1972), State and Local Fiscal Assistance Act, section 105 (b).

TABLE 2
Revenue Sharing Entitlements and Entitlements Periods

Entitlement Period	Term	Appropriation
1	January 1, 1972 - June 30, 1972	\$2,650,000,000
2	July 1, 1972 - December 31, 1972	2,650,000,000
3	January 1, 1973 - June 30, 1973	2,987,500,000
4	July 1, 1973 - June 30, 1974	6,050,000,000
5	July 1, 1974 - June 30, 1975	6,200,000,000
6	July 1, 1972 - June 30, 1976	6,350,000,000
7	July 1, 1976 - December 31, 1976	3,325,000,000

Source: Public Law 92-512, 92nd Congress, 2nd Session (October 20, 1972), State and Local Fiscal Assistance Act of 1972, section 141 (b).

The revenue sharing funds are automatically available for state and local distribution without the requirement of an annual appropriation by Congress. The funding mechanism is a trust fund established by the Department of the Treasury known as the "State and Local Government Fiscal Assistance Trust Fund."³ This is a permanent five year trust fund and consists of monies appropriated to it and deposited in it attributable to the collection of the Federal individual income taxes. The money is not associated with a percentage of the Federal personal income tax base or collection, but is a five year authorization to transfer a specific number of dollars from the general fund of the Treasury into the revenue sharing trust fund.⁴

Of the total money distributed, one-third goes directly to the state governments for their own individual use. The remaining two-thirds is allocated to all general purpose local governments.⁵ All general purpose governments--states, counties, cities, towns, townships, boroughs, villages--are qualified to receive general revenue sharing funds. The amount each jurisdiction receives is based on the need of each state and local government in relationship to the need of all other state and local governments.

Of greatest concern to all jurisdictions in the infant stage of revenue sharing implementation was how each government's allocation

³Ibid., section 105 (a).

⁴Ibid., section 105 (b).

⁵Ibid., sections 107 (a) and 108 (b).

would be determined. The question had been raised earlier by the Congressional debate concerning the distribution of revenue sharing funds. Many formulas were proposed and debated in Congress for more than two years. The bill finally passed by the House of Representatives contained a five-factor formula in which the major elements were population, urbanized population, general tax effort, per capita income, and state income tax effort. This formula resulted in a substantial proportion of the funds to be allocated to populous states--which a majority of the House members represent. The senate version of the bill created a three-factor formula based on population, tax effort, and relative poverty. These elements give greater emphasis to lesser populated areas in low income states. The compromise bill created by the conference committee came somewhat as a surprise as Congress decided that in the division of the state revenue sharing "pot", a state could choose either the House or Senate version of the formula--whichever resulted in the larger allocation.⁶ The one problem created through this compromise was the possibility of exceeding the total dollar amount allocated for each calendar year. Congress settled this problem by having the amount going to each state during the first two entitlement periods scaled down on a pro-rated basis and thereby remaining under the \$5.3 billion ceiling for 1972.

Thus a state may choose the formula to be used for determining the amount of its revenue sharing allocation--obviously favoring that

⁶Richard E. Thompson (ed.), "A Simple Description of Complex Formulas," Revenue Sharing Bulletin, November, 1972, pp. 8-9.

formula affording the state the larger allotment. A choice of the House version results in the utilization of a plan containing two separate formulas. Of the total allocation of \$5.975 billion for calendar year 1973, \$1.992 billion is divided so that 50 percent is distributed on the basis of state income tax collections and the other 50 percent distributed on the basis of state and local general tax effort. More specifically, using this formula, \$996,000,000 was distributed among the states for calendar year 1973. This distribution was determined on a comparative basis of general tax effort, which was measured by comparing the state and local tax collections to the personal income level in one state to the same efforts in other states. The allocation of the second \$996,000,000 was based upon income tax revenue collected by a state compared to the income tax collections of all the other states.

The remaining \$3.983 billion is divided into thirds, with each share distributed among the states on a comparative basis of total population, urbanized population, and relative per capita income (also referred to as the poverty level).

HOUSE FORMULAS⁷

The Formulas:

First Share: Each state's share =

$$\frac{1}{3} (\$3.982 \text{ billion}) \times \frac{\text{Population of state}}{\text{Population of all states}}$$

⁷P. L. 92-512, section 106 (b) (3).

Second Share: Each state's share =

$$1/3 (\$3.982 \text{ billion}) \times \frac{\text{Urban population of state}}{\text{Urban population of all states}}$$

Urban population is the population of any area consisting of a central city or cities of 50,000 or more inhabitants and the metropolitan area surrounding them.

Third Share: Each state's share =

$$1/3 (\$3.982 \text{ billion}) \times \frac{(\text{State population}) \times \frac{(\text{National per Capita Income})}{(\text{State per Capita Income})}}{\text{Sum of the products of} \\ \frac{(\text{State population})(\text{national per capita income})}{(\text{Per capita income of all states})}}$$

Fourth Share: Each state's share =

$$1/2 (\$1.992 \text{ billion}) \times \frac{\text{State income tax}}{\text{All states' income tax}}$$

Fifth Share: Each state's share =

$$1/2 (\$1.992 \text{ billion}) \times \frac{\text{General tax effort of state}}{\text{General tax effort of all states}}$$

The Senate formula (three factors) is somewhat less complex. Revenue allocation is determined by multiplying population by tax effort, by relative income.

SENATE FORMULA⁸

The Formula:

Each state's share =

$$\$5.975 \text{ billion} \times \frac{(\text{Population})(\text{General Tax Effort})(\text{Relative Income})}{\text{Sum of the products of all the states' populations, general tax effort, and relative income}}$$

⁸Ibid., section 106 (b) (2).

In this formula general tax effort is defined as the net state and local taxes collected in a state divided by the aggregate personal income for that state.⁹ Relative income is defined as the per capita income of the United States divided by the per capita income of that state.¹⁰

The thirty-five states which chose the Senate version of the formula were primarily those with small populations and poor, urban localities. The fifteen states and the District of Columbia which chose the House formula were jurisdictions with large urbanized areas, low per capita income, and high tax efforts.¹¹ Virginia's allocation was based upon the House version.

For calendar year 1972, the total allocation for Virginia was \$106,339,828.00.¹² For entitlement period 3, (January 1, 1973 - June 30, 1973), Virginia's allocation totaled \$58,594,441.00. In this third period, one-third, or \$19,531,480.00, was retained by the Virginia State Government, and the remaining two-thirds, or \$39,062,961.00, was distributed to all local governments in the state.

⁹Ibid., section 109 (c).

¹⁰Ibid., section 109 (f).

¹¹What Federal Revenue Sharing Means to You, Revenue Sharing Handbook distributed in seminar in Arlington, Virginia by Consolidated Analysis Centers, Inc., March, 1973, (hereinafter cited as CACI, Revenue Sharing), p. 57.

¹²U. S., Office of Revenue Sharing, Department of the Treasury, 4th Entitlement Period Allocation with Adjustments for Entitlement Periods 1, 2, and 3, (Washington, Government Printing Office, 1973), Virginia, pp. 353, 357.

The procedure for determining the local share of revenue sharing money is somewhat complex. What follows is a step by step procedure for determining a local jurisdiction's allotment:

STEP 1:

The state allocation is divided into two shares: One-third of the state allocation goes to the state government, and two-thirds of the state allocation goes to the eligible local governments.

STEP 2:

The local government amount is distributed to county geographical areas (not governments) based upon the comparison that each county area in the state bears to all county areas in the state according to the formula: county population multiplied by general tax effort multiplied by relative per capita income.¹³

The general tax effort of each county area is determined by dividing the county's total net adjusted tax collections by the total income of the county area residents. Adjusted taxes are the total general purpose taxes enacted by the county government, excluding taxes for schools and other educational purposes.¹⁴ General purpose taxes include property taxes, sales taxes, (including general tax, gasoline, liquor, cigarette and tobacco, and public utilities taxes), and licenses and permits (license and inspection charges on occupation and

¹³P. L. 92-512, section 108 (a) (1).

¹⁴Ibid., section 109, (c) (1) (2) and (d) (1).

businesses, animals, and vehicles), taxes on income, payroll, earnings, motor vehicle licenses, and fees retained from the collections by officials of the county government. General purpose taxes do not include receipts of service charges, special assessments, interest earnings, or fines. School taxes are tax revenues of the government allocated for school purposes. Included are taxes for current capital and debt services purposes, as well as amounts collected for the governmental unit by the county or state acting as a collection agent.¹⁵

In regard to adjusted taxes, the Act does make a provision for certain sales taxes collected by counties on behalf of some or all of the local governments within that county area. This is referred to as the "Memphis Rule".¹⁶ When these tax receipts have been collected and are shared, in part, or totally, with the local units of government, the sales tax received by these local units of governments will be deducted from the tax effort of the county government and credited to the tax effort of the local governments.¹⁷

In the case of those governmental units maintaining dependent school systems, the Revenue Sharing Act establishes a different means of computing the adjusted tax element. General revenue sharing was designed to provide assistance to general purpose governments.

¹⁵Richard E. Thompson (ed.), "Definitions", Revenue Sharing Bulletin, (hereinafter cited as Thompson, "Definitions", Bulletin), March, 1973, p. 5.

¹⁶Richard E. Thompson (ed.), "Memphis Rule Will Affect Allocations in Six States", Revenue Sharing Bulletin, December, 1972, p. 2.

¹⁷P. L. 92-512, section 109 (e) (2) (B).

Consequently, the formulas derived to determine local allotments excluded any activity not conducted by general purpose governments. Educational services were assumed to be a function of special and autonomous school districts in all states and therefore excluded from the revenue sharing formula derivations. However, there are over 450 jurisdictions with dependent school systems, including those in Virginia. The adjusted tax element in these cases would be greater than the Federal government had intended when compared to the adjusted tax level of those general purpose governments with independent school systems. For the Office of Revenue Sharing, the problem arose as to how to distinguish the taxes collected for educational purposes from those taxes raised for general governmental purposes as no distinction is made by the local governmental units themselves. For purposes of general revenue sharing, adjusted taxes are not to include taxes raised for education. The procedure finally derived was the creation of a ratio of tax revenues to total revenues which is then applied to school expenditures to determine the percentage of school expenditures that should be viewed as school taxes. It is this final figure that is subtracted from the total adjusted tax figure for the more than 450 jurisdictions maintaining dependent school systems.¹⁸

STEP 3:

County area 145 percent test: The per capita amount allocated

¹⁸"Fiscal Assistance to State and Local Governments: Entitlement Payments: Proposed Rule Making", Federal Register, Volume 38, number 35, part III (Thursday, February 22, 1973), section 51.21 (b) (2), p. 4920.

to a county area must not exceed 145 percent of the state per capita allotment (state per capita amount is determined by dividing the state aggregate amount by the total state population). Any surplus is shared proportionately by all remaining county areas.¹⁹

STEP 4:

County area 20 percent test: The per capita amount allocated to a county area must not be less than 20 percent of the state per capita allotment. The difference is taken proportionately from all other county areas.²⁰

STEP 5:

The remaining funds in the county area pot are divided up between the different types of local governments, i.e., county governments, townships, and municipalities. For townships and municipalities, the funds are not divided among individual units at this point, only between the two types of local governments.²¹

STEP 6:

The county government allotment is determined on the basis of the ratio of the county government adjusted taxes to the total adjusted taxes of the county.²²

¹⁹P. L. 92-512, section 108 (b) (6).

²⁰Ibid.

²¹Ibid., section 108 (b) (2).

²²Ibid., section 108 (b) (1).

STEP 7:

The township amount is determined upon the basis of the ratio of all townships' adjusted taxes to the total adjusted taxes within the county.²³

STEP 8:

The remaining amount is for municipalities.

STEP 9:

(Because individual townships and municipalities allocations are determined by the same process, only the municipalities' allotment procedure is illustrated here.) Individual municipalities are allocated monies on the basis of the formula, population multiplied by tax effort multiplied by relative income.²⁴

STEP 10:

Each municipality's allocation is subjected to the 145 percent test. If a municipality's allocation is greater than 145 percent of the state's per capita amount, the municipality's allotment is decreased to that level. The excess is added to the adjustment pot.²⁵

STEP 11:

Each municipality's allocation is subjected to the 20 percent test. If a municipality's allocation is less than 20 percent of the

²³Ibid., section 108 (b) (2).

²⁴Ibid., section 108 (b) (2) (A).

²⁵Ibid., section 108 (b) (6) (B).

state's per capita amount, the municipality's allotment is increased to the lower of either the 20 percent level or 50 percent of the sum of the jurisdiction's adjusted taxes and intergovernmental transfers. In either case, the deficiency is drawn from the adjustment pot.²⁶

Intergovernmental transfer of revenues are monies received by a unit of government from other governments for use in performing specific functions or for general financial support.²⁷ This would include grants, shared taxes, contingent loans and reimbursements for tuition costs, hospital care, and construction costs. Intergovernmental transfers of revenue do not include monies received from the sale of property, commodities, or utility services to other governments.²⁸

STEP 12:

If any municipal allocation exceeds 50 percent of its adjusted taxes and intergovernmental transfers, the allocation is reduced to that level and the remainder is given to the county government.²⁹

STEP 13:

If any annual allocation is less than \$200.00 (\$100.00 for six-month entitlement period), or if entitlement is waived, the amount is

²⁶Ibid.

²⁷Ibid., section 109 (a) (6).

²⁸"Definitions," Bulletin, p. 5.

²⁹P. L. 92-512, section 108 (b) (6) (C).

allocated to the county government.³⁰

STEP 14:

The 50 percent test is applied to the county government allotment. If the county government total exceeds 50 percent of the sum of its adjusted taxes and intergovernmental transfers, the allocation is reduced to that amount and the remainder returned to the state government.³¹

STEP 15:

Adjustment Pot -- If the amounts transferred to and from the adjustment pot to meet the 145 percent, 20 percent, and 50 percent test, are not equal, the local government amount in Step 1 is apportionately adjusted and the allocation process from Step 2 through Step 15 is repeated until the adjustment pot is consumed.³²

After the first year the formulas used for the allocation of monies for local governmental units within a state may be changed by an act of that state's Legislature. The alternative formulas for distributing general revenue sharing funds among county areas and local governments is based upon two factors: population multiplied by tax effort of the government or area, or population multiplied by the

³⁰Ibid., section 108 (b) (6) (D) (i).

³¹Ibid., section 108 (b) (6) (C).

³²Ibid., section 108 (B) (7).

relative income factors of the government or area. The change in formula may occur only once.³³

The Revenue Sharing Act includes the provision authorizing a portion of a county area's entitlement to be allotted to any Indian tribe in that county or to an Alaskan native village which has a recognized governing body performing substantial governmental functions. The amount of monies allotted to these tribes or villages is determined on the basis of the population ratio of that tribe or village to the county area population in which it is located.³⁴

The Act also specifies that the distribution of monies to small governmental units (excluding county governments) with a population of 500 people or less and where there is inadequate data for the application of the factor formula, shall be on the basis of population.³⁵

Although the standard formula for determining a local unit of government's allocation involve the elements of population, tax effort, and relative income, not all three factors have the same weight in producing the final product. Simplification of the formula breaks down as follows:³⁶

(1) Population X Tax Effort X Relative Income

(2) Population X $\frac{\text{Adjusted Taxes}}{\text{Aggregate Personal Income}}$ X Relative Income

³³Ibid., section 108 (c) (1).

³⁴Ibid., section 108 (b) (4).

³⁵Ibid., section 108 (b) (5).

³⁶Richard E. Thompson (ed.), "Simplified Calculation," Revenue Sharing Bulletin, January, 1973, pp. 5, 11.

$$\begin{array}{l}
 (3) \quad \cancel{\text{Population}} \times \frac{\cancel{\text{Adjusted Taxes}}}{\cancel{\text{Population}} \times \text{Local Government per Capita Income}} \times \frac{\text{County per Capita Income}}{\text{Local Government per Capita Income}} \\
 \\
 (4) \quad \frac{\text{Local Government Adjusted Taxes per Capita Income}}{\text{Sum of all county areas}} \times \frac{\text{County per Capita Income}}{\text{Adjusted Taxes Local Government per Capita Income}} \times \frac{\text{County per Capita Income}}{\text{County per Capita Income}} \\
 \\
 (5) \quad \frac{\text{Local Government Adjusted Taxes}}{\text{Local Government per Capita Income}} \times \frac{\text{Local Government Adjusted Taxes}}{\text{Local Government per Capita Income}}
 \end{array}$$

Thus the formula reduced to its most simplified form is adjusted taxes divided by the square of the per capita income. From this formula it is obvious the higher the adjusted taxes and the lower the per capita income within a jurisdiction, the higher its revenue sharing allocation will be. The most substantial affect in the formula is the element of per capita income as it is squared in the calculation.³⁷

Population becomes an important element only to those jurisdictions subjected to the 20 percent minimum and 145 percent maximum tests. A governmental unit is likely to be tested by either of these two tests if its 1970 population multiplied by the 20 percent or 145 percent figure of the state per capita amount equals approximately double the

³⁷Richard E. Thompson (ed.), "Which Data Items are Important," Revenue Sharing Bulletin, January, 1973, p. 4.

payment received by the local jurisdiction. If a unit of government is constrained by the minimum 20 percent or maximum 145 percent it may increase its allocation by increasing its population. An increase in population would lessen the per capita amount assuming this additional population gained maintained an income not tremendously greater to or less than the average income of the existing population.³⁸

Intergovernmental transfers are important to those jurisdictions affected by the 50 percent ceiling test. The Act limits the annual allocation to any jurisdiction to 50 percent of the unit's adjusted taxes plus intergovernmental transfers.³⁹ Again, maximumization of adjusted taxes is to the benefit of the local unit of government as well as an increase in governmental transfers.

The data elements used in determining the allocation for each jurisdiction are determined by the Bureau of the Census. Every five years the Bureau conducts a survey "Census of Governments" in which it requests revenue, expenditure and employment information from all governmental units throughout the United States. The most recent census was conducted in 1972. It is the intent of the Office of Revenue Sharing to use the data figures obtained from the 1972 Census of Governments as the elements in the revenue sharing formulas for the fourth entitlement period, beginning July 1, 1973. For each of the

³⁸Ibid., p. 4.

³⁹Ibid.

remaining three entitlement periods the Bureau will update tax data on an annual basis.⁴⁰

The mode of annual update is the Federal Individual Income Tax Return forms. The Revenue Sharing Act provides for the addition of questions pertaining to principal place of residence and the number of dependents residing in the same principal place of residence and not filing separate tax returns of their own. This population data in addition to income data always provided will offer the Treasury Department the most current data available for determining revenue sharing allocations.⁴¹

Once the money has been distributed, the Federal Revenue Sharing Act then creates Federal controls for local government units as to the allotments usage. There are no functional limitations on the use of revenue sharing funds for state governments as long as the purpose is legal under state law.⁴² Therefore, the state government may expend its share of the allocation for any purpose it desires as long as the use is in accordance with its own laws controlling expenditures. The one limitation that does exist is the denial of the use of revenue sharing funds for matching directly or indirectly Federal grant-in-aid

⁴⁰Richard E. Thompson (ed.), "Future Entitlements to be Based on 1972 Census of Governments", Revenue Sharing Bulletin, December, 1972, p. 2.

⁴¹Richard E. Thompson (ed.), "1040 Tax Forms Changed to Aid Distribution of Revenue Sharing", Revenue Sharing Bulletin, January, 1973, p. 3.

⁴²P. L. 92-512, Sections 104, 106-107.

programs. The matching prohibition will be discussed in more detail later.

Local jurisdictions are much more limited to the use of the revenue sharing monies than are the states. Local governments, counties, municipalities, and townships must restrict expenditures of their allocation to "ordinary and necessary" operating and maintenance expenditures in the "high priority" categories as designated in the Revenue Sharing Act:

- (1) 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;
- e) recreation;
- f) libraries;
- g) social services for the poor or aged;
- h) financial administration

(2) Ordinary and necessary capital expenditures authorized by law.⁴³

Public safety includes but is not limited to police protection, fire protection, civil defense and inspection of buildings, plumbing,

⁴³Ibid., section 103 (a).

electrical facilities, gas pipelines, and equipment, boilers, and elevators.⁴⁴

Environmental protection includes but is not limited to sewage, street cleaning, solid waste collection, disposal and recycling activities, environmental health activities such as smoke regulation, inspection of water supply, sanitary engineering, water pollution control, and flood control.⁴⁵

Public transportation includes but is not limited to highways, transit systems, streets, grade crossings, parking services, storage facilities related to public transportation, and snow and ice removal.⁴⁶

Health includes but is not limited to hospital expenditures. Defined by the Bureau of the Census, health includes health and hospital facilities, provision of hospital care, support of other public or private hospitals and conservation and improvement of public health.⁴⁷

⁴⁴U. S., Congress, Joint Committee on Internal Revenue Taxation, General Explanation of the State and Local Fiscal Assistance Act of 1972: HR 14370, 92nd Congress, 1st session, February 12, 1973 (Washington: Government Printing Office, 1973), p. 10.

⁴⁵Ibid.

⁴⁶Ibid.

⁴⁷U. S., Governments Division, Bureau of the Census, Classification Manual, Government Finances, (Washington: Government Printing Office, hereinafter cited as Governments Division, Manual), February, 1971, p. 55.

According to the Bureau of the Census recreation is combined with parks and defined as, but not limited to, the provision by a unit of government of "recreational and cultural--scientific facilities and activities."⁴⁸

Library expenditures include but are not limited to library administration, circulation, cataloging, reference service, acquisitions, bookmobile expenses and special collection, such as art and music.⁴⁹

Financial administration is defined by the Bureau of the Census to include:

Officials and agencies concerned with tax assessment and collection, accounting, auditing, budgeting, purchases, custody of funds and other control finance activities.⁵⁰

Capital expenditures if such expenditures are authorized by the local government's own laws may include but are not limited to multi-purpose and general governmental usage, education, health, transportation, social development, housing and community development, economic development, environmental conservation, public safety and recreation culture.

In an administrative ruling by the Office of Revenue Sharing, revenue sharing monies may be also used to retire debt in one of the

⁴⁸Ibid., pp. 60-61.

⁴⁹National Committee on Governmental Accounting, Governmental Accounting, Auditing and Financial Reporting, Chicago, 1968, pp. 199-200.

⁵⁰Governments Division, Manual, pp. 53-54.

priority categories provided the following limitations are adhered to: revenue sharing monies may not be used to pay any interest incurred because of the debt; the actual expenditure from the indebtedness must have occurred on or after January 1, 1972; and no violation of the Revenue Sharing Act's limitations including Davis-Bacon and the Civil Rights provisions should have occurred during the period of time when the debt was incurred.⁵¹

In addition to the specification of designated areas of expenditures, the Revenue Sharing Act details certain administrative provisions to be adhered to by the state and local governments in order to maintain eligibility for receipt of additional revenue monies after January 1, 1973.

Fiscal procedures require each recipient government to deposit all revenue sharing payments and interest earned from these payments into a trust fund.⁵² This fund may be in any form chosen by the government--either a separate set of accounts or separate bank accounts. In either event, separate accounting entries are required for each cash flow into and out of the fund during each entitlement period. The creation of this fund and the maintenance of individual records for every transaction pertaining to the fund allows the Federal government to track a clear audit trail to the final expenditure of the revenue

⁵¹Richard E. Thompson (ed.), "New Ruling Limits Use of Revenue Sharing for Debt", Revenue Sharing Bulletin, February, 1973, p. 1.

⁵²P. L. 92-512, section 123 (a) (1) (2).

sharing monies and thereby verify that the allotment has not been spent in violation of the stated regulations and limitations. The Act also provides the Treasury Department and the Comptroller General access to the state and local books and records in order to properly evaluate the recipient government's compliance with the stated regulations.⁵³ The money received from each of the seven entitlement periods must be used, obligated, or appropriated within 24 months from the end of the entitlement period in which the money was appropriated.⁵⁴ Thus, money received for the first entitlement period must be accounted for by June 30, 1974, for the second entitlement period, by December 31, 1974, for the third entitlement period, by June 30, 1975 and so on for the remaining four periods.

In order to aid in the auditing process each state and local government is asked to use fiscal, accounting and auditing procedures which conform to guidelines published by the Comptroller General of the General Accounting Office (GAO), entitled Standards for Audits of Governmental Organizations, Programs, Activities, and Functions.⁵⁵ The traditional audit does not inform the public or Federal government in the same detail as does the procedure outlined by GAO.

⁵³Ibid., section 123 (a) (5) (A) and (B).

⁵⁴Richard E. Thompson (ed.), "Final Regulations Issued: Summary of Changes", Revenue Sharing Bulletin, April, 1973, p. 3.

⁵⁵U. S., Comptroller General, United States General Accounting Office, Standards for Audit of Governmental Organizations, Programs, Activities and Functions, (Washington: Government Printing Office, 1972, hereinafter cited as Comptroller, Standards).

It is impossible for the Federal government to audit all the recipient governments during the five-year period of life of the program. Therefore, the Treasury Department will conduct random audits annually while relying primarily upon the audits of revenue sharing accounts by state, county, and municipal auditors and examiners, or independent public accountants when conducted consistent with the provisions of the Revenue Sharing Act and its regulations. To be included in the audit procedure is an examination of the statement of assurance (discussed below), maintenance of state effort (discussed below), compliance with reporting requirements and questionnaires of the Treasury Department and Bureau of the Census, and publication and reporting requirements of all information required for public inspection.

The major restriction on revenue sharing funds is that money cannot be used by a state or local unit of government to match directly or indirectly any other Federal grant-in-aid program.⁵⁶ This distinctly means that governmental units may not use their revenue sharing allotment, or any part thereof, as matching shares or to replace other funds on an existing expenditure and thereby free their own money for matching purposes. For a governmental unit to be sure it is not going to violate the Act in regard to the matching restriction a rule of thumb has been developed by the Office of Revenue Sharing in the

⁵⁶p. L. 92-512, section 104 (a).

following question: "But for the receipt of revenue sharing funds, could have you increased the match?"⁵⁷ If the answer is "yes" then there is no violation of Act requirements; if the answer is "no" then the governmental jurisdiction has violated the law.

The direct use of matching is self-explanatory and easily defined for any unit of government. The indirect use of entitlement funds to match Federal funds means to allocate revenue sharing monies to a non-matching expenditure in order to release local monies for the purpose of matching Federal money. The basic test of compliance in the Act suggests that a governmental unit will be in violation of the matching provision if it does not meet a "greater net revenues than base year tests."⁵⁸ This is to say net revenues received by a governmental unit from its own sources during an entitlement period are compared to the net revenue received during a comparable period of time beginning July 1, 1971. The comparison is made in relation to any increase in the governmental units contribution to matching Federal funds during the entitlement period. A violation has occurred if net revenues from the government's own sources does not increase in an amount greater than or equal to the increase in matched dollars for Federal programs.⁵⁹

⁵⁷Interview with E. Francis Bowditch, Interior Deputy Director of the Office of Revenue Sharing, Department of the Treasury, as quoted in "Revenue Sharing Officials Answer Questions on Program," Revenue Sharing Bulletin, Richard E. Thompson (ed.), December, 1972, p. 5.

⁵⁸p. L. 92-512, section 104 (c).

⁵⁹Ibid.

The Office of Revenue Sharing has developed a bench-mark justification which involves the jurisdiction that expends its revenue sharing monies only with non-matched expenditure categories in their budget. Two examples of hypothetical situations are as follows:

Assume, in Government's "A's" budget (see Table 3) that before revenue sharing, it's own revenues totaled \$110,000. Of this amount, \$10,000 was used to match other federal programs, \$100,000 for non-matching expenditures. Then the unit receives a \$30,000 revenue sharing check. Assume that local revenues remain at \$110,000, expenditures for matching stay at \$10,000, but non-match increase to \$130,000. Under these circumstances, the Treasury will assume that all revenue sharing funds have gone into non-match expenditures.⁶⁰

Assume, Government's "B's" budget (see Table 4) is the same as Government "A's" before revenue sharing. If, after the \$30,000 revenue sharing payment, Government B's budget changes so that its own revenues decrease to \$80,000 (such as, it reduces taxation), non-match expenditures remain at \$100,000 and matching expenses stay at \$10,000, then the Treasury will still assume that all revenue sharing receipts have gone towards non-matching expenses.⁶¹

Therefore, as long as the match category is not altered either of the above approaches are legal. If, however, the match category is increased or decreased, then the state or local unit of government must be able to prove the legality of the authorization, specifically that the increases resulted from the recipient governments own revenues. The tests provided by the Act to determine if funds originated from their own revenues are:

⁶⁰Richard E. Thompson (ed.), "Officials Clarify Matching Provisions", Revenue Sharing Bulletin, January, 1973, p. 8.

⁶¹Ibid.

TABLE 3
Government "A" Budget

	Revenues	Non-match Expenditures	Match Expenditures	Total
Before Revenue Sharing	\$110,000	\$100,000	\$10,000	\$110,000
After \$30,000 Revenue Sharing Payment	\$110,000	\$130,000	\$10,000	\$140,000

Source: Richard E. Thompson (ed.) "Officials Clarify Matching Provisions," Revenue Sharing Bulletin, January, 1973, p. 8.

TABLE 4
Government "B" Budget

	Revenues	Non-match Expenditures	Match Expenditures	Total
Before Revenue Sharing	\$110,000	\$100,000	\$10,000	\$110,000
After \$30,000 Revenue Sharing Payment	\$ 80,000	\$100,000	\$10,000	\$110,000

Source: Richard E. Thompson (ed.), "Officials Clarify Matching Provisions," Revenue Sharing Bulletin, January, 1973, p. 9.

- (1) increase in revenues
- (2) cutback in non-match expenditures
- (3) tax surplus from previous years⁶²

If none of the above three or combination of these tests does not occur, then the Office of Revenue Sharing will assume the revenue sharing matching prohibition has been violated.

Revenue sharing monies may be used to supplement Federal grant-in-aid programs as long as the revenue sharing monies are not being used directly or indirectly to match Federal monies. For example, a sewer project to be undertaken by a local unit of government costs \$125,000 and \$100,000 can be financed under a Federal 80-20 percent matching program (i.e., Federal share \$80,000 and \$20,000 local share) then the remaining \$25,000 could be drawn from the revenue sharing allotment to cover the additional costs.

The reporting phase contains another series of regulations required of the recipient governments. There are certain reports to be filed with the Treasury Department and the Bureau of the Census necessary for the administration of the Revenue Sharing program. Each recipient government must provide the Treasury Department and the public it serves both planned use and actual use reports.

The Planned Use Report specifies the amount and purposes for which each recipient government plans to spend, obligate or appropriate

⁶²Ibid., p. 8.

funds.⁶³ The Actual Use Report states the amount and purposes of revenue sharing funds and the interest earned, spent, or otherwise transferred.⁶⁴ Both reports must be published in local newspapers of general circulation and be made accessible for public scrutiny.⁶⁵ Other required reports include reports to the Bureau of the Census necessary to update the data elements used to determine revenue sharing allotments to the state and local governments; reports for review and evaluation periodically requested by the Treasury Department to determine compliance with the regulations and effectiveness of the revenue sharing program; certification that revenue sharing monies are not being used to obtain matching Federal funds and/or that the money has been used only for priority expenditures; and a statement of assurances stating all requirements of the Revenue Sharing Act have been adhered to by the recipient government.⁶⁶

Another requirement of the Act is the maintenance of state aid. This is a requirement to deter states from reducing state aid to local governments. A state government will be penalized if it reduces the average of the aggregate amount it transfers to the local governments within the state. The penalty is a loss of funds equivalent to the amount of aid reduced in distribution to the local governments. If

⁶³P. L. 92-512, section 121 (b).

⁶⁴Ibid., section 121 (a).

⁶⁵Ibid., section 121 (c).

⁶⁶Ibid., section 123 (c).

the present amount of aid is less than the state government provided to any locality for the one year period beginning July 1, 1971 then the penalty is imposed. The penalty amount is not reallocated to other governments, but is retained by the Federal government.⁶⁷ There is a special provision in the Act for adjustments and consideration when a state assumes responsibility for a program formally the full or partial responsibility of a local unit of government or when the state grants a local unit of government a new taxing authority.⁶⁸ The intent of the maintenance of state aid provision in the Act is to encourage states to increase or at least maintain their level of financial help to each local jurisdiction despite the incoming revenue sharing dollars.

In addition to the requirements of the trust fund, auditing procedures, the reporting and publishing of expenditures, the maintenance of state aid and the non-matching provision, there are two laws applying to the use of the revenue sharing monies. The two major exceptions to the Revenue Sharing Act's primary purpose of assuring state and local governments they have wide discretion in the use of funds allocated are the 1964 Civil Rights Act and the Davis-Bacon Act.

The Civil Rights Act is applicable to revenue sharing monies in that funds may not be used in such a way as to exclude people from the benefit of or participation in a program on the basis of race, color,

⁶⁷ Ibid., section 107 (b) (1) (A) and (B).

⁶⁸ Ibid., section 107 (b) (2) (3).

national origin, or sex. This includes any program or activity funded totally or partially with revenue sharing funds.⁶⁹ Although patterned after the Civil Rights Act of 1964, the reference to non-discrimination in the Revenue Sharing Act is more indicative of current national policy. The Revenue Sharing Act specifically prohibits discrimination on the basis of sex and, unlike the Civil Rights Act, it contains no specific exemption of certain employment practices from its coverage. If a local government has discriminated in its spending of the money, it is up to the governor of the state to secure compliance with the act. Failure to comply on a voluntary basis would be cause for termination of a continuation of the allocation to the local jurisdiction for the specific program in which discrimination has occurred.⁷⁰

The Davis-Bacon Act grants the Secretary of Labor the power to determine wage rates for employees on construction sites by area throughout the United States. These determined rates are generally the union scale rates including fringe benefits required to be paid to employees of contractors or sub-contractors on a capital project with 25 percent or more of the total cost paid with revenue sharing money.⁷¹ For a governmental unit to avoid the local union wage rate it would have to use less than 25 percent of the total project cost from its revenue sharing allotment, or if the 25 percent level is exceeded then as much work as possible would have to be performed by employees

⁶⁹Ibid., section 122 (a) and (b) and (c).

⁷⁰Ibid.

⁷¹Ibid., section 123 (a) (6).

directly employed by the local unit of government.

In a similar standard related to revenue sharing monies and wages, state and local government employees whose salaries are paid totally or in part from revenue sharing monies must be paid the prevailing rate of pay for employees in similar jobs in the same unit of government. This is applicable however only if 25 percent or more of the wages of all employees in that category of government are paid from revenue sharing money.⁷²

The Office of Revenue Sharing has been established under the jurisdiction of the Secretary of the Treasury to administer the State and Local Fiscal Assistance Act of 1972. The Office staff is composed primarily of attorneys, economists, accountants, auditors, analysts, administrative specialists, data programmers, and researchers whose responsibilities involve program development, systems and program evaluation, auditing, and the control and verification of the data elements used in determining allotment figures.⁷³ Perhaps the major task confronting the Office is to equitably apply the Revenue Sharing formulas to determine the amount of money due to each state and local governmental unit and to establish policies and guidelines needed to maintain and assure compliance with the Revenue Sharing Act.

As was discussed earlier concerning the provisions of the Revenue Sharing Act, the Secretary of the Treasury is required to audit,

⁷²Ibid., section 123 (a) (7).

⁷³U. S., Office of Revenue Sharing, Department of the Treasury, What General Revenue Sharing Is All About, (Washington: Government Printing Office, 1972), pp. 6-7.

evaluate, and review the revenue sharing program to assure compliance by the recipient government with the rules and regulations of the Act. The Comptroller General is required to review the work done by the Secretary of the Treasury and by the state and local governments for purposes of providing Congress with the information to evaluate the efficiency of the expenditure and to what extent the funds have contributed to the effectiveness of the program in which monies were used.

It will be impossible for the Office of Revenue Sharing to audit and review the revenue sharing expenditures and applicable regulations for the more than 38,000 recipient state and local governments. The Office, with a staff of only 25 accountants, will annually review all specific problems and conduct approximately 300 audits including the 50 states and 50 local units of government receiving the largest individual allocations.⁷⁴

To create a simillance of continuity and operation and to maintain reliability and adequacy, the General Accounting Office published in June 1972 a booklet entitled Standards for Audit of Governmental Organizations, Programs, Activities and Functions, the purpose of which is to upgrade and improve the quality and scope of audits that are conducted by and for federal, state, and local audit organizations.⁷⁵ Because of the non-existence in the Revenue Sharing program of the

⁷⁴Statement by Jeff Schiff, staff manager of the Office of Revenue Sharing, from a question and answer period on Revenue Sharing at the Appalachian Regional Commission's annual Local Development District meeting in Washington, D. C., February 7, 1973.

⁷⁵Comptroller, Standards, pp. 1-2.

many controls formally associated with Federal monies and programs, audit reports must now describe the financial and operational effect of revenue sharing; thus, the close scrutiny and complexity of operation as designed by the GAO. By emphasizing accountability, the GAO auditing process includes the following three elements:

- (1) Financial and compliance - determine (a) whether financial operations are properly conducted, (b) whether the financial reports of an audit entity are presented fairly, and (c) whether the entity has complied with applicable laws and regulations.
- (2) Economy and efficiency - determines whether the entity is managing or utilizing its resources (personnel, property, space, and so forth) in an economical and efficient manner and the causes of any efficiencies or uneconomical practices, including inadequacies in management information systems, administrator procedures, or organizational structure.
- (3) Program results - determines whether the desired results or benefits are being achieved, whether the objectives established by the legislator or other authorizing body are being met, and whether the agency has considered alternatives which might yield desired results at a lower cost.⁷⁶

In any case, when it is determined that a state or local government has failed to comply with the provisions of the Revenue Sharing Act, and proper notice for correction has been given, and a reasonable time for a hearing has been provided, and the governmental unit has still failed to take corrective action within a 60 day period, future payments will be suspended.⁷⁷ In the event a local unit of government

⁷⁶Ibid., p. 2.

⁷⁷P. L. 92-512, section 123 (b).

spends money within a non-priority category, the local government must pay over to the Secretary of the Treasury an amount equal to 110 percent of the amount illegally spent, unless the money spent in violation of the Act is immediately returned to that government's revenue sharing trust fund after notice and opportunity for corrected action has been given.⁷⁸ Should any state or local unit of government receive a notice of reduction in entitlement or a notice of withholding of payments it may file with the United States Court of Appeals a petition for review of the action of the Secretary of the Treasury.⁷⁹

This section of the act has been challenged recently by the city of Chicago. On the basis that a civil rights investigation conducted by the ORS revealed evidence of discrimination within the Chicago Police Department, the federal district court for D. C. in Robinson vs Shultz⁸⁰ has ordered the Secretary of the Treasury to request the Governor of Illinois to secure compliance with the non-discrimination provisions of the revenue sharing law.

The court agreed that the Secretary of the Treasury had the power to defer payment of federal revenue sharing funds pending administrative hearings under Title VI of the Civil Rights Act. However, the court also stated it was premature for the court now to decide whether the

⁷⁸Ibid., section 123 (a) (3).

⁷⁹Ibid.; section 143 (a).

⁸⁰"Chicago May Lose Revenue Sharing Funds for Alleged Discrimination", Urban Affairs Reporter, Volume 3, (Washington: Commerce Clearing House, Inc., 1974), p. 11342.

Secretary should exercise such power in the present case.⁸¹

In addition to the regulations and requirements of the state in the Revenue Sharing Act and an accompanying set of guidelines distributed to state and local officials, there has also been a recent court decision that further clarifies the restrictions imposed upon a local unit of government.

The United States District Court in Atlanta, Georgia held in Mathews vs Massell⁸² that the indirect use of revenue sharing monies was in violation of the revenue sharing regulations.⁸³ On March 15, 1973, the City of Atlanta was enjoined against proceeding with a plan for the use of general revenue sharing funds for tax release. The city council had adopted a resolution to spend revenue sharing monies for firemen salaries (a legal expenditure of revenue sharing monies) and to transfer an equivalent amount from the general fund to the water and sewer fund (an illegal expenditure) in order to reduce taxes. The violation was not in tax relief but in terms of expenditures in an illegal category as defined by the Revenue Sharing Act. Tax relief is legal when the expenditure category is a priority item defined by the Act. The court ruled if a local unit of government determines the final use of revenue sharing funds not to be within a priority expenditure category then the final use is illegal. If, however, the

⁸¹Ibid.

⁸²Mathews vs. Massell, 356 F. Supp. 291 (1973), pp. 291-302.

⁸³Ibid.

final use is in one of the priority categories, this is appropriate regardless of the overall impact of the expenditure upon revenues or other non-priority categories or expenditures.⁸⁴

As demonstrated in this chapter's discussion, revenue sharing is a challenge to state and local officials' ability to comprehend and "find ways of meeting the complicated occasionally contradictory, often ambiguous, sometimes obscure responsibility imposed by the Federal government."⁸⁵ Just how state and local officials have answered this challenge is the subject of Chapter 4.

⁸⁴Ibid.

⁸⁵Laurence Rutter, "The Law on Revenue Sharing: Many Questions, Few Answers," Public Management, LV (January, 1973), p. 11.

CHAPTER 4

GENERAL REVENUE SHARING EVALUATION

The impact of revenue sharing cannot be adequately assessed until a longer span of time has elapsed. The one thing evident now, however, is the complexity of the decision-making process involved in the distribution of revenue sharing funds, a situation heretofore unparalleled in the history of distributing federal funds.

With the Federal government's realization that communities differ greatly in their needs and that the decisions concerning community welfare should be made on the local level, diversity and experimentation is now available to state and local jurisdictions as they can throw off the national molds to more adequately meet the needs and demands of the taxpayer. Potential uses of revenue sharing monies and the monies freed by revenue sharing may be classified under the broad labels of financial strengthening, tax cuts, and expenditures.

Financial strengthening can take the form of supplementing seriously depleted working capital, or retiring short term debts that would otherwise remain outstanding over a long period of time, or establishing revenues for an unforeseen need or known contingency.¹

¹Wayne F. Anderson, "Revenue Sharing--Now It's Up to Us!", Public Management, (hereinafter cited as Anderson, "Revenue Sharing" PM), LV (January, 1973), p. 9.

Tax cuts are sorely needed where the existing tax rate on real estate, tangible personal property, and/or utilities is already burdensome to the individual taxpayer. Of course a tax rate cut would create the need for an unanticipated rapid increase in taxes if the revenue sharing program were to terminate completely in 1976. Furthermore, a decision to implement a tax cut would involve a determination as to the type of cut to be made - general property tax or a senior citizen's tax relief cut for example - realizing that the tax effort factor is a major element in determining the size of the allocation each local government will receive.²

With the implementation of the revenue sharing program, capital expenditures (non-recurring) can now be made where before money was unavailable or the program was one of low priority. In effect, the revenue sharing money reduces the need to borrow. The selection of recurring expenditures requires what numerous authors, consultants, and others have described as a decision-making process involving a consideration of impact, visibility, crisis avoidance, effect on future revenues and expenditures, and innovation.³ For the most part, however, these are the necessary elements and are already a part of a good decision-making process in local government.

Obviously, the more limited the funds the more important the ultimate decision must be "especially if state and local governments

²Ibid., p. 10.

³Ibid.

desire to display their ability to spend these monies effectively on programs that cannot otherwise be adequately financed - a stated intent of the act."⁴ According to one author, when considering alternative uses of funds the local government should consider the distributive effects of revenue sharing expenditures.⁵ For example, under the capital expenditure category money might go to a landfill for solid waste disposal. The benefits derived would be shared by the entire community, and the environment, while as a result several long term jobs would be created. Building a new school as another example would establish several short term jobs, perhaps vocational training to those of low skill levels. A central purchasing office created as a non-capital expenditure (and thus a recurring expenses item) to be staffed by persons supported by revenue sharing monies could improve the efficiency of a community by saving hundreds of tax dollars.⁶ The same money spent on recreation might benefit only a few people in the community. Such a narrow benefit is exemplified by those jurisdictions allocating revenue sharing funds for the construction of a golf course for the affluent. Demonstrating a much higher degree of understanding as to the purpose of revenue sharing, and a recognition of a real need, Chapel Hill, North Carolina invested \$300,000 in a housing

⁴J. Paxton Marshall, "Implementing General Revenue Sharing," (Blacksburg, Virginia: Virginia Polytechnic Institute and State University, March, 1973), p. 17.

⁵Ibid., p. 18.

⁶Ibid.

trust fund. As a result low income families may obtain home loans at only 3 percent interest with the trust fund money paying the lending institution the difference.⁷

Despite the regulations limiting revenue sharing expenditures to capital expenditures in eight priority operating and maintenance categories - public safety, environmental protection, public transportation, health, recreation, libraries, social services for aged and poor, and financial administration - the recipient local government still maintains a great deal of leeway in the decision-making process for determining the final allocation of their revenue sharing allotment.

Two preliminary studies were conducted in early Spring of 1973 to determine exactly how jurisdictions were spending their revenue sharing monies. The first survey was conducted in March by the Advisory Commission on Intergovernmental Relations (ACIR) upon the request of President Nixon. Its purpose was to evaluate the intergovernmental aspects of the operation of revenue sharing. Responding to the questionnaires were budget officers of 43 states, 88 county officials from 30 states, and 59 local governments in Pennsylvania.⁸ The other survey was conducted for the Office of Revenue Sharing (ORS) which sought specifically to determine how those governments receiving revenue sharing monies planned for and spent the initial funds

⁷City of Chapel Hill, Actual Use Report, July, 1973.

⁸U. S., Advisory Commission on Intergovernmental Relations, "Revenue Sharing: View from the Field," Information Bulletin, (March, 1973; hereinafter cited as ACIR, "Revenue Sharing", Bulletin), p. 2.

allotted and, how the jurisdictions felt about the administration of the revenue sharing program. Included in this survey were the 50 state governments, the District of Columbia, 19 Planned Variation Cities, and 715 units of local government.⁹

For purposes of local comparison a survey was conducted in the sixteen governmental jurisdictions in Virginia's Mount Rogers Planning District. Data were collected from six counties, two cities, and eight towns through personal interviews and the planned use reports required by the Office of Revenue Sharing to be published in local newspapers for money allocated for the third entitlement period (January 1, 1973 to June 30, 1973).

Findings derived from the surveys conducted on the national level indicated that recipient governments experienced little difficulty in incorporating the planning, appropriation, and expenditure of the revenue sharing allocation. Those problems that did occur were created by the timing of the revenue sharing allocation as in many cases budget figures for the fiscal year had already been determined.¹⁰

Within the Planning District none of the jurisdictions interviewed expressed any difficulty in incorporating revenue sharing monies into the existing financial operation. For most officials the major

⁹Technology Management Incorporated, Preliminary Survey of General Revenue Sharing Recipient Governments, (June, 1973; hereinafter cited as ORS, Survey), p. 1.

¹⁰ORS, Survey, pp. 4-5 and ACIR, "Revenue Sharing", Bulletin, pp. 2-3.

concern appeared to be how much money was to be put in what bank account or saving certificate to gain the greatest amount of interest. For example, the Town of Marion, Virginia, has yet to expend any of its allocation, having placed a \$162,105 in certificates of deposit. The money has earned interest in the amount of \$5,667, for a total of \$167,772 in revenue sharing monies now available to the Town of Marion.¹¹

The ORS study found 72 percent of all local governments listed capital expenditures as the top priority category for spending.¹² This same conclusion was derived from the ACIR survey as 15 of 31 budget officers, 61 of 75 county officials, and 35 of 51 local officials had allocated revenue sharing monies for non-recurring or capital expenses. State governments also listed capital expenditures 57 percent of the time, while 66 percent listed education as the primary area of expenditure.¹³

In the Mount Rogers Planning District, 16 jurisdictions received a total of \$1,419,348. Of this amount, \$1,129,392 or 98 percent was allocated to capital expenditures. This figure further breaks down to cities expending \$257,363 or 23 percent, the six counties \$579,073 or 51 percent, and eight towns \$292,956 or 26 percent. The greatest area of expenditure within this general category was labeled "other."

¹¹Town of Marion, Virginia, Actual Use Report, (July 17, 1973).

¹²ORS, Survey, p. 7.

¹³ACIR, "Revenue Sharing", Bulletin, p. 2.

Total expended in this category was \$524,766 or 45 percent of the total. This category of expenses included courthouse repairs, purchase of courthouse furniture, water system construction, sewer system construction, street repair and construction, and purchase of general purpose trucks and vans. Other categories of expenditure included environmental conservation, \$299,484 or 28 percent; multi-purpose and general government, \$116,898 or 10 percent; public safety, \$98,000 or 9 percent; transportation, \$73,903 or 7 percent; and recreation, \$16,341 or 1 percent.

The primary cause for this route of expending the revenue sharing monies as determined by both the ORS and ACIR studies is primarily a fear of a cut-off of funds when the revenue sharing program terminates at the end of 1976. Specifically, the ACIR study found 21 budget officers, 56 county officials, and 28 local officials identified the uncertainty factor of the life of the program as the major influence on how the funds were to be spent.¹⁴ If the current five-year program is terminated by Congress, investment in any project requiring recurring expenses would create a tremendous strain on most state and local budgets in 1977. Furthermore, state and local officials would tend to avoid expending the money in those programs which in order to be maintained after the discontinuance of revenue sharing, would require a subsequent reduction in that service or an abrupt increase in taxes. Buildings, roads, sewer lines, and the purchase of new equipment were

¹⁴Ibid., p. 6.

examples of the capital or non-recurring expenditures.

The ORS survey found several additional reasons for the high rates of non-recurring expense spending, other than the major fact of a fear of a cut-off of funds in 1976. One was the past neglect on capital improvement programs and development programs. A reason for this past neglect was the statutory restrictions on the sources and amounts of money available to local governments. Another reason was the lack of success of bond issues for capital outlay in referenda. Many local officials also felt capital expenditures to be the safest route of expenditure to avoid the possible difficulties imposed by the prohibitions and restrictions of the revenue sharing act and to maintain a high degree of visibility to both the public and the accountants required to trace to the final use the revenue sharing monies.¹⁵

While capital expenditures are the primary expenditure for local governments, they are by no means the only category of expenditure. The ORS study found 80 percent of the local units indicating at least one area of spending in the operation and maintenance category. In 57 percent of the cases, the category was that of public safety. The least identified categories were those of library, 6 percent and social services, 8 percent. On the state level, 57 percent of the states indicated capital expenditures as the primary area of expense while 66 percent indicated education as the primary expenditure.¹⁶ The

¹⁵ORS, Survey, pp. 7-8.

¹⁶Ibid.

State of Virginia allocated its entire third entitlement period allocation of \$19,531,480 to education.¹⁷ On the state level the least identified expenditure, according to the ACIR study, was housing and community development, \$0.00.¹⁸

The ACIR study found 32 of 88 county officials intending to use revenue sharing monies for recurring expenses programs (compared to 61 using the money for non-recurring expenses). Of these 32 officials, 25 indicated public safety as one of the specific categories while the least mentioned categories were libraries, mentioned seven times, and financial administration, mentioned by 8 officials.¹⁹

Also 32 of 59 Pennsylvania local government officials intended to use the revenue sharing money for recurring expenses (compared to 35 officials using money for non-recurring expenses). Of this group of 32 officials, 21 indicated public safety as the primary category with social services (2) and public transportation and libraries (3) as the least mentioned categories.²⁰

In another recent study conducted by the General Accounting Office (GAO), the ORS and ACIR studies were supported in the first detailed review of the actual use of revenue sharing monies on the national level. The GAO report to Congress on August 2, 1973 showed

¹⁷State of Virginia, Planned Use Report, (June 20, 1973).

¹⁸ACIR, "Revenue Sharing", Bulletin, p. 3.

¹⁹Ibid., p. 4.

²⁰Ibid.

that of \$957.9 million committed by state government, 58 percent of the money was invested in educational programs. Furthermore, 39 percent of the money was allocated to capital expenditures - primarily construction and land acquisition. Of the money not having been spent, revenue sharing monies had earned a total of approximately \$21 million in interest.²¹

The 16 jurisdictions surveyed in the Mount Rogers Planning District allocated \$289,956 or 2 percent of the total to recurring expense categories. Of this total, the six counties authorized \$284,963 or 98 percent and the eight towns authorized \$4,993 or 2 percent of the total (the two cities in the District allocated their entire third entitlement period funds to non-recurring or capital expenditures). The most frequently identified operating and maintenance categories were environmental protection, \$146,844 or 51 percent and libraries, \$102,005 or 35 percent. Public safety was identified as an expenditure for a total of \$26,700 or 9 percent. The least identified categories were social services for aged and poor (\$0.00 or 0 percent), public transportation (\$1,793 or .61 percent), and financial administration (\$400 or .13 percent).

One interesting use of the funds as determined by the ORS study was the indicated purpose of jointly financed projects with other governments. Although only 21 percent of the respondents indicated such an intention, insofar as intergovernmental cooperation and the

²¹New York Times Service, "Revenue Sharing Uses Listed", Richmond Times-Dispatch, August 7, 1973, A; 15; 4.

concept of regionalism is concerned, the number of jurisdictions indicating such a preference for the usage of their money is significant.²² Perhaps when more local governments become readily aware of the physical, social, and economic planning that can best be achieved through intergovernmental cooperation and that in the end, greater benefits can be derived for less individual money in a cooperative venture, more jointly financed projects will be created.

Within the Mount Rogers Planning District none of the 16 jurisdictions surveyed indicated any intention of allocating their third entitlement period monies to joint cooperative efforts.

The impact of revenue sharing expenditures on tax relief has been varied. Most frequently, the effect of revenue sharing on local finances was the ability of the jurisdiction to avoid or reduce tax increases. The ACIR study found almost 75 percent of the state budget officers expecting revenue sharing monies to provide relief in the area of property taxation. In addition, six budget officers predicted a reduction of state taxes, while nine predicted a local tax reduction. On the local level, 21 county and 23 local officials expected a halt in tax increases. Only seven county and 11 local officials saw an actual tax decrease.²³ The ORS study indicated eight percent of the respondent local governments intending to reduce the property tax because of the inflow of revenue sharing dollars. On the state level,

²²ORS, Survey, p. 8.

²³ACIR, "Revenue Sharing", Bulletin, p. 5.

17 percent indicated a probable decrease in the income tax. Another 17 percent of the local governments indicated an intent to raise taxes, although not at the same rate as anticipated prior to receiving the additional revenue sharing money. The most frequent occurrence was that local governments would not have to raise taxes. This was indicated by 40 percent of all respondent local governments. On the state level, 23 percent of the respondent states indicated a similar intent of being able to avoid a tax rate increase because of revenue sharing.²⁴

Within the Mount Rogers Planning District 50 percent of the surveyed units of government indicated revenue sharing funds would enable the jurisdiction to prevent an increase in the rate of any major tax currently imposed. Thirty-seven percent indicated revenue sharing monies would prevent the need to enact a new major tax. Forty-three percent indicated it was still too soon to predict the effect revenue sharing funds would have on the tax level of their jurisdiction. In terms of how the availability of revenue sharing money would affect the borrowing requirements of the jurisdiction, six percent indicated an avoidance of a debt increase, and 18 percent indicated a lessening of the debt increase, and 18 percent felt revenue sharing funds would have no effect on debt retirement. Another 56 percent felt that it was too soon to predict the effect revenue sharing funds would have on the borrowing requirements of their jurisdiction.

²⁴ORS, Survey, p. 8.

In addition to tax relief and debt retirement as primary targets, the ORS study identifies several additional potential impacts of revenue sharing expenditures. These included:

- a) Accelerated trends toward development of planning/budgeting systems and the use of these systems in the planning process.
- b) Increased understanding of local problems on the part of elected or other officials due to citizen participation in revenue sharing planning.
- c) Improved cooperation between units of governments due to making funds available for joint projects.
- d) Passage of certain forms of expenditure programs for which no local substitute had been available.²⁵

One of the major points stressed by the early supporters of general revenue sharing was that the public and public interest groups would become more fully involved in the decision-making process for the determination of how the revenue sharing allocations would be spent. This element of public scrutiny is evident from the existence of planned use and actual use reports and the requirement they be published in local newspapers. Accordingly, the ORS study found 20 percent of the respondent local governments noting more public participation in the decision-making process since revenue sharing. In addition, 39 percent of the local governments predicted greater citizen participation in the future. Participation increases could be attributed to the uniqueness of the program as well as the national

²⁵Ibid., p. 11.

publicity afforded the revenue sharing program requirements and limitations.²⁶ Within the Mount Rogers Planning District none of the officials interviewed indicated any substantial increase in citizen participation. In fact, four jurisdictions indicated, as in the past, their budget hearings were void of any citizen participation whatsoever.

On the state level, only 9 percent of the state government noted increases in public participation and only 14 percent anticipated an increase in the future. A possible reason for the low level public participation in budgetary processes of State government budgets is that participation in these States' processes is already at a high level and that revenue sharing is too small a percent of the existing budget - in most cases 2 to 3 percent - to warrant significant additional public concern.²⁷

A key element supposedly designed into the revenue sharing legislation was simplicity. The program was set up to operate without the usual external bureaucratic dictation of policy and procedure. However, with the absence of experience and of the proper tools of knowledge for working with revenue sharing, many state and local officials have failed to recognize the true value and potential of revenue sharing. Properly utilized, revenue sharing can make a substantial contribution toward building a stronger delivery system for goods and

²⁶Ibid., pp. 5-6.

²⁷Ibid., p. 6.

services on the state and local level. If those official lacking the proper tools for a practical application of revenue sharing funds would make a genuine effort toward understanding the provisions of the act, revenue sharing would be a tremendous first step toward the redressing of the growing fiscal imbalance currently existing in the intergovernmental system and toward building greater flexibility in the Federal system of financial assistance to state and local governments.

CHAPTER 5
ALTERNATIVES TO GENERAL REVENUE SHARING

Today, increases in expenditures are creating tremendous strains on the financial resources of state and local governments. As these demands for services increase, the state and local governments continuously find their financial resources incapable of bending to meet these needs. Currently state and local governments together combined spend twice as much as the federal government to provide public services to the citizens. Education, roads, welfare, public health, hospitals, police, sanitation are all state and local responsibilities with the cost of providing these services falling primarily upon state and local sources of revenue. Consequently, state and local taxes have been raised almost to the saturation point and the bases of old taxes have had to be enlarged.¹

One of the reasons for this problem has been the lack of coordination in fiscal matters among the Federal, state, and local governments. If the state and local governments are expected to meet the demands for public services there will have to be a coordination

¹James A. Maxwell, Financing State and Local Governments (Washington: The Brookings Institution, 1969; hereinafter cited as Maxwell, Financing), p. 1.

in assistance provided by the Federal government.²

To help alleviate the problem, Federal revenue sharing was implemented in October 1972. However, no Federal program can be construed to be the final answer for the problem of financing state and local governments. To effectively evaluate revenue sharing would be impossible after only two years of existence. However, it is by no means premature to compare general revenue sharing with several major alternatives for providing financial assistance to state and local governments. Each of the following alternative programs - block grants, Federal debt retirement, Federal tax reduction, and Federal tax credits - is designed and presented as an alternative to the Federal government's categorical grant-in-aid program.

Block grants, unlike categorical grants, can be enacted in more fields. Instead of grants for hundreds of different programs and thousands of projects, Congress could authorize grants-in-aid to state and local governments on a block basis, by major functional area. Federal dollars for specific areas such as health, education, or highways would allow the state and local officials the decision-making responsibility as to the exact application of the allocated funds.³ Block grants would also eliminate the excessively detailed grant

²George F. Break, Intergovernmental Fiscal Relations in the United States (Washington: The Brookings Institution, 1967; hereinafter cited as Break, Fiscal Relations), p. vii.

³U. S., Congress, House, Representative Melvin Laird, "Strengthening the Federal System--The Case for Revenue Sharing," Congressional Record, 90th Congress, 1st session, February 15, 1967, Volume 113, Part 3, p. 3456.

restrictions associated with the categorical grants-in-aid. A block grant eliminates the detailed provisions concerning categories and replaces them with broad provisions. They remove the stimulus to spend on specific categories in favor of spending on a group category. Each state could, within limits, supply its own set of priorities. Perhaps the greatest advantage would be the lightening of the financial load borne by some state and local budgets by eliminating the need to expend money on a specific function.⁴

Since the amount of money allocated to each major category would presumably reflect its relative importance from the national point of view and since the use of the money within each category would be left entirely to state and local governments, block grants would represent a combination of attention to national priorities with a high degree of fiscal decentralization.⁵

Ultimately domestic public services could be more satisfactorily provided under the auspices of state and local governments which, unlike the federal government, are capable of devoting all of their time and attention to the familiar wants and needs of their constituents.

Block granting then is similar to the existing revenue sharing program except that revenue sharing represents a permanent allocation of money. A limitation to the block grant program would be the requirement of an annual Congressional review with the purpose of

⁴Maxwell, Financing, p. 68.

⁵Break, Fiscal Relations, p. 157.

receiving an appropriation of money for each block category.⁶ Furthermore, the characteristic red tape, restrictions, and qualifications of Federal grant-in-aid programs could never be entirely removed.

The use of surplus tax revenues to retire part of the public debt is among the several alternatives capable of giving assistance to state and local governments. Skillfully handled, debt retirement requires private and governmental demands for new output great enough to create inflationary pressures, which in turn creates a demand for fiscal and monetary restraint. The latter demand could be met by using surplus tax monies to purchase outstanding federal securities. This would enable state and local governments to borrow on more favorable credit terms, allowing a continuation of capital expenditures at high levels while other types of spending were being curtailed in the interest of price stability. The need to expend primarily in non-recurring categories is due to the uncertainty of the amount of money available and the length of time for which the money will be available for use by state and local governments. Of course, economic conditions do not always permit an accumulation of federal budgetary surpluses for purposes of debt retirement. With private and public demands down and with the existence of expansionary monetary policies, the economy would tend to operate below full capacity level. Consequently, valuable output would be wasted, including valuable state and local

⁶Ibid., p. 163.

services for which funding could not be found.⁷

Another alternative is that of Federal tax reduction. Tax reductions require a reciprocal response by the state and local governments in order to derive a benefit for these jurisdictions. The primary benefit of a tax deduction is the fostering of state and local fiscal independence and responsibility.⁸

Obviously a tax reduction increases the source from which state and local governments may draw their own tax revenues. However, whether the state or local government would increase their own taxing authority is questionable. The response to the reduction may be inconsistent as it depends upon action of many separate executive and legislative bodies. Even if the state and local jurisdictions did decide to broaden the tax base the area of expansion would appear more likely in property and sales taxes rather than with the income tax. Because the Federal reduction would also exclusively apply to the individual and corporate income tax, the aforementioned probable action of the state and local governments would result in a less equitable and highly unstable tax system.⁹

State and local revenues would increase indirectly through the increased national income but would represent only a small percentage of the total amount of Federal dollars released; and then to the extent

⁷Ibid., pp. 150-151.

⁸Ibid., p. 152.

⁹Ibid., p. 151.

state and local government rates are increased the richer localities would derive the greater benefits.¹⁰

A final alternative is the Federal tax credit. Unlike the tax deduction that permits an individual to lower his net income for determining his Federal income tax liability, a tax credit is applied to the total individual tax obligation. In turn, it is treated as a cash payment on the Federal income tax required to be paid by the individual.¹¹

The tax credit allows the taxpayer to credit or offset all or part of an amount paid at a specific state or local tax against the liability owed for Federal taxes. For example, a taxpayer in Virginia with a Federal liability of \$100, who paid the State of Virginia \$10 as a Virginia income tax, could deduct the \$10 amount owed the Federal government, paying only \$90. The total amount of taxes paid would be \$100 rather than \$110. The state would then have the option to pick up the additional tax the taxpayer credited his Federal income tax. If the option is assumed, the final result would have the taxpayer paying out the original \$110 liability but with \$20 going to the state and \$90 to the Federal government. This example employed the state income tax; however, ideally the concept of tax crediting would be

¹⁰Joseph A. Pechman, Federal Tax Policy (Washington: The Brookings Institution, 1966; hereinafter cited as Pechman, Tax Policy), p. 230.

¹¹U. S., Congress, House, Representative Melvin Laird, "Tax Credit Provisions of Laird Revenue Sharing Bill, H.R. 5450", Congressional Record, 90th Congress, 1st session, March 13, 1967, Volume 113, Part 5, p. 6321.

made available for all types of state and local taxes.

The most proper procedure to consider would be that of granting special types of income tax credits for residential property taxes and school property taxes because such are already imposed in every state and in every school district in the country. It would be grossly unfair to grant Federal tax credits only for state income taxes as not all states have such a tax.¹²

Within the field of education the federal income tax credit would be most beneficial. An important share of the educational responsibility is borne by private institutions and their supporters. Granting federal income tax credits for tuition, room and board, and other necessary expenses, and for donations to public and private educational institutions would create financial rewards and provide a greater effective means of enabling the educational institutions to finance themselves.¹³

Tax credits used to strengthen the revenue basis of state and local governments generally contain restrictions used to limit the amount or allowable tax offsetting. Current popular formulas may be classified as follows:

- 1) Proportional tax credit - the tax payer deducts x percent of his state and/or local tax against his federal tax liability.

¹²Ibid., p. 27.

¹³Break, Fiscal Relations, p. 153.

- 2) Graduated tax credit - the taxpayer divides his state and/or local tax liability into brackets and deducts varying proportions of each. For example, x percent of the first \$100, y percent of the second \$100, and z percent of the remainder. Regressive credits ($x > y > z$) include flat sum allowances with a special case while progressive taxes ($x < y < z$) have similar distributional affects as tax deductions.
- 3) Unlimited tax credits subject to a proportional ceiling - the tax payer may deduct all of the state tax but only up to x percent of his total Federal liability.
- 4) Unlimited tax credits subject to a graduated ceiling - the tax payer may deduct his state and/or local taxes from his Federal tax liability limited to, for example x percent of the first \$200 of liability, y percent of the next \$300 liability, and z percent of the remainder.¹⁴

For those states without income taxes, the greatest incentive to adopt them would be the unlimited credits subject to a ceiling. By adopting such a procedure the state would grant a credit up to the ceiling without cost to their own individual taxpayer. Accordingly, those states currently maintaining an income tax greater than the credit ceiling would find their taxpayers enjoying an immediate benefit.¹⁵

Tax credits can bring important financial aid to state and local governments. Supporters find the tax credit an attractive means of inducing states to raise more money by their own tax efforts. To do so, would mean the reliance upon a revenue source that is equitable and highly responsive to economic growth. Furthermore, while reducing

¹⁴Ibid., pp. 42-45.

¹⁵Ibid., p. 44.

the Federal taxation strengths, the tax credit does not diminish the relative importance of the personal income tax in the country's tax structure.¹⁶

Another advantage of the tax credit would be the improvement of tax coordination. For example, eligible state income taxes would be required to be similar in structure to the Federal tax structure, and residents and non-residents, and multi-state corporations would be taxed in uniform ways. As a result, the tax system would be far more progressive.¹⁷

To the opponents of this system the tax credit represents "unjustifiable interferences with state-local fiscal freedoms". Of course, to many people everything the Federal government does interferes with the state and local taxing system. Federal presumption of the tax field limits state freedoms to adopt and/or expand income taxes.¹⁸ Opposition to tax crediting also comes from supporters of higher state-local spending and from the supporters of a stronger Federal revenue maintenance program. The former oppose because the credits would fail to stimulate a much needed additional state and local tax effort. The latter oppose because of the loss of Federal dollars when in their opinion greater Federal monies should be maintained for Federal priorities. The final opposition is that tax

¹⁶Ibid., p. 44.

¹⁷Ibid., p. 230.

¹⁸Ibid., p. 230.

crediting is not capable of reducing existing inequalities in state and local fiscal capacities.¹⁹

General revenue sharing has appeared as "one leg of a three legged stool". The other two legs being continued funding of most categorical grants to meet national priorities created by Congress, and generous funding of four areas of special revenue sharing. There has developed extreme dissatisfaction in many circles of government, primarily among those who supported general revenue sharing, because of President Nixon's budget announcement and ultimate cutbacks in many Federal programs. As a result of these cutbacks the burden has fallen upon the state and local governments to use general revenue sharing monies to pick up these activities themselves. Thus, in many cases, the supposed additional revenue sharing dollars turn out to be nothing more than money to retain programs formerly funded directly by the Federal government.

When general revenue sharing became a reality in October 1972, state and local officials believed there was a clear understanding that general revenue sharing would be concentrated on state and local priorities, with the Federal government continuing to fund national priority programs. Many people believe as a consequence of President Nixon's cutting back in federal programming, that it is evident the administration expected these formerly Federally financed activities to be retained by state and local revenue sharing funds or the programs

¹⁹Ibid., p. 153.

would have to be terminated. Thus, the gaps created by the 1974 budget eliminations or reductions will have to be filled by the already dwindling state and local treasuries that revenue sharing was designed to partially fill.

It is President Nixon's contention, however, that general revenue sharing monies are new monies and to replace programs cut by the Federal government was not a purpose for creating general revenue sharing. To replace these programs special revenue sharing has been designed although not yet implemented.

Designed to provide state and local governments greater flexibility to shape programs to meet specific local needs, special revenue sharing includes four major categories consolidating over 70 federal categorical grant programs. Of the four areas - education, community development, law enforcement, and manpower - all but manpower have been developed into legislation and have been submitted to Congress. Manpower revenue sharing is proposed to be accomplished through administrative reorganization under the current legislation. The use of special revenue sharing is to have money removed from the present categorical grant program, placed in a large catch-all fund, allocated by various formulas based upon specific use and need requirements, distributed to the governors of each state, who in turn allocate the money to the various localities within the state.

Reaction in Congress to special revenue sharing has not been at all favorable. As far as Congress is concerned, the difference between special revenue sharing and categorical grants is primarily

sematics. Special revenue sharing has long been associated with the Republican party whereas the Democrats have long been identified with categorical grants. The likelihood that a Democratic Congress is going to create a Republican administration's revamping of categorical grants within this term of Congress is slim.

Of course much of what happens to general revenue sharing rests with the recipient governments. Congress and the administration created goals to be obtained and purposes to be met by the creation of general revenue sharing funds, including the strengthening of the Federal system and the creation of more responsible state and local governments. The assessment of the program's worth to state and local governments will be a major element in the decision making process to determine if general revenue sharing should be continued beyond 1976. Thus, the primary factor in the revenue sharing program is the financial management and accounting procedures. By providing regulations for revenue sharing funds to be traceable to a level of expenditure which is sufficient to establish that revenue sharing money has not been used in violation of any applicable restriction or prohibition, the Office of Revenue Sharing is capable of evaluating the worth of the program.²⁰

The principal area of evaluation will be the adequacy and accuracy of each recipient government's planned and actual use reports,

²⁰Graham W. Watt, a speech on the future of revenue sharing delivered to the Municipal Finance Officers Association of the United States and Canada, as quoted in Revenue Sharing Bulletin, Richard E. Thompson (ed.), June, 1973, p. 1.

and the adequacy of each government's management of the trust fund accounts with emphasis upon illegal expenditures of the money.

The planned used report is viewed as an extension of the government's approved budget during any entitlement period. Specifically, the Revenue Sharing Act states that revenue sharing allocations are to be dispersed in accordance with the same procedure used for all other revenues. The actual use reports provide the required clear audit trail based upon a comprehensive approved budget. Sufficient evidence of mismanagement and illegal spending by state and local officials will provide the opponents of general revenue sharing ample reason to terminate the program even before the scheduled 1976 end date. A consequence could find the general revenue sharing program develop into yet another categorical grant-in-aid program subject to annual appropriation.

President Richard Nixon has said:

The time has come for a new partnership between the Federal government and the states and localities - a partnership in which we entrust the states and localities with a larger share of the nation's responsibilities, and in which we share our Federal revenues with them so that they can meet those responsibilities²¹

General revenue sharing is a cornerstone of the Nixon administration's philosophy to more actively involve American people in the everyday decision-making which affects their lives. Thus, revenue

²¹U. S., President (Nixon), "The State of the Union", Congressional Record, House, 92nd Congress, 1st session, (January 22, 1971), Volume 117, Part 1, p. 167.

sharing has and will continue to mean a great deal to the entire United States.

For the federal system, revenue sharing provides greater strength by assigning services to the level of government best prepared to perform them.

For the state and local governments, revenue sharing provides relief from fiscal crisis, eliminates the rigidities, and delays of past federal aid, and builds a greater capacity and ability to respond to local needs and demands.

For the individual taxpayer general revenue sharing provides a greater impetus for governmental participation, as his Federal tax dollar is being returned for local use. Thus revenue sharing provides a greater confidence in government as a result of stronger grass roots control, and the hope and belief that rising costs of government can be met in the future without the need for raising taxes.

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THE STATE AND LOCAL FISCAL ASSISTANCE ACT OF 1972

by

Stephen D. Parker

(ABSTRACT)

Revenue sharing was designed as the mainstay in President Richard Nixon's plan to revitalize the American governmental system. When enacted into law in October, 1972 after several years of Congressional struggle for compromising legislation, the revenue sharing program created a new form of federal assistance by authorizing direct payments of approximately \$6 billion each year through 1976 to state and local governments.

Allocations are determined from data collected by the Census Bureau pertaining to state and local populations, income, income taxes, and intergovernmental transfers. This information is utilized in formulas for distribution detailed in the Act.

Since 1972, more than \$12.7 billion in revenues have been returned to over 38,000 state and local governments for "operating and maintenance" expenditures in public safety, environmental safety and protection, public transportation, health, recreation, libraries, social services for the poor and/or aged, and financial administration, and for capital expenditure items. Revenue sharing funds are used in accordance with local needs and priorities and without the restrictions characteristic of the federal categorical grant-in-aid program.

Evaluation of the revenue sharing program to determine how recipient governments have used their allocation and what benefits they have derived is on-going by independent study groups, the Office of Revenue Sharing, and Congress. Alternative forms of fiscal assistance, including the expansion of categorical grants, the development of block grants, a tax rate deduction system, and the issuance of tax credits, are being studied for implementation in the event revenue sharing is not extended beyond December 31, 1976.