REVENUE SHARING AND ITS ALTERNATIVES: WHAT FUTURE FOR FISCAL FEDERALISM?

HEARINGS

BEFORE THE

SUBCOMMITTEE ON FISCAL POLICY

OF THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

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REVENUE SHARING AND ITS ALTERNATIVES: WHAT FUTURE FOR FISCAL FEDERALISM?

MONDAY, JULY 31, 1967

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON FISCAL POLICY
OF THE JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The subcommittee met at 10 a.m., pursuant to notice, in room S-407, the Capitol, Hon. Martha W. Griffiths (chairman of the subcommittee) presiding.

Present: Representative Griffiths; and Senators Proxmire and Symington.

Also present: James W. Knowles, director of research; Harley H. Hinrichs and Richard F. Kaufman, economists for the Subcommittee on Fiscal Policy.

Representative GRIFFITHS: This morning the Subcommittee on Fiscal Policy begins hearings on the future of fiscal federalism.

At this point in the record we will place the announcement of the hearings and the schedule of witnesses.

TUESDAY, JULY 25, 1967

CONGRESS OF THE UNITED STATES, JOINT ECONOMIC COMMITTEE, SUBCOMMITTEE ON FISCAL POLICY

REPRESENTATIVE MARTHA W. GRIFFITHS ANNOUNCES HEARINGS ON REVENUE SHARING AND ITS ALTERNATIVES: WHAT FUTURE FOR FISCAL FEDERALISM?

Representative Martha W. Griffiths (D., Mich.), Chairman of the Subcommittee on Fiscal Policy of the Joint Economic Committee, today announced that the subcommittee will hold four days of hearings—July 31, and August 1, 2 and 3—on Revenue Sharing and Its Alternatives: What Future for Fiscal Federalism?

In announcing plans for the hearings, Representative Griffiths said: "Sharing Federal revenues with State and local governments is a vital issue deserving a full study by the Congress. This we intend to give it. The issue is much broader and much more important than simply debating any one revenue sharing plan. Revenue sharing should be seen in the context of being one of many alternative means to deal with a changing array of problems facing the Federal, State, and local governments. Alternative means that have been suggested include revenue sharing, improved or consolidated Federal categorical grants, Federal tax credits against State income taxes, direct Federal grant programs, such as for model cities, and the negative income tax or family allowances. Here in the Joint Economic Committee I feel that we have the opportunity to take a broad and deep view of what policy alternatives there are—and what 'policy mix' may be most effective."

A schedule of the first week's hearings is attached. Dates for further hearings will be announced later.

CONGRESS OF THE UNITED STATES, JOINT ECONOMIC COMMITTEE, SUBCOMMITTEE ON FISCAL POLICY

SCHEDULE OF HEARINGS ON REVENUE SHARING AND ITS ALTERNATIVES: WHAT FUTURE FOR FISCAL FEDERALISM?

(July 31, August 1, 2 and 3)

All sessions to be held in room S-407, The Capitol, at 10:00 a.m.

Monday, July 31.—Lessons of Experience: Federal, State and Local. James A. Maxwell, Professor of Economics, Clark University; Clara Penniman, Professor of Political Science, University of Wisconsin; L. Laszlo Ecker-Racz, Formerly with Advisory Commission on Intergovernmental Relations; Paul Ylvisaker, Commissioner, Department of Community Affairs, State of New Jersey.

Tuesday, August 1.—Fiscal Projections and Their Policy Implications: Fiscal Surpluses: State and Local Needs and Resources. C. Lowell Harriss, Professor of Economics, Columbia University; Lawrence R. Kegan, Director of Special Studies, Committee for Economic Development; Dick Netzer, Professor of Economics, New York University.

Wednesday, August 2.—Future Fiscal Options: Revenue Sharing and/or Tax Credits. Walter W. Heller, Professor of Economics, University of Minnesota; Joseph A. Pechman, Director of Economic Studies, The Brookings Institution; Herbert Stein, Vice President and Chief Economist, Committee for Economic Development; Melville J. Ulmer, Professor of Economics, University of Maryland.

Thursday, August 3.—Future Options: Other Options for Fiscal Federalism. George F. Break, Professor of Economics, University of California, Berkeley; Lyle C. Fitch, Institute of Public Administration, New York, N.Y.; Richard P. Nathan, The Brookings Institution; Harold M. Somers, Professor of Economics, University of California, Los Angeles.

Representative GRIFFITHS. Throughout our history, our government system has been marked by collaboration between the Federal Government and the States and localities. In recent years, there has been increasing discussion and agitation pointed toward altering the form and magnitude of these cooperative arrangements. Some plead for an increase in the traditional categorical grants-in-aid to which conditions are attached. Others ask either for conversion of the conditional grants-in-aid to block grants of unconditional revenue, or for new grants of this character. Some suggest other remedies for what they believe to be the ills of our Federal system on the fiscal front.

What are the facts? Are States and localities really bereft of the fiscal resources to carry out their functions? Is the problem one of lack of resources at the State and local levels, or, is it inefficiency in the use of available resources? Are the categorical, conditional grants made by the Federal Government inadequate in magnitude or are the conditions so onerous as to impede their proper utilization by State and local governments? Would our economy and our State and local governments be healthier if the Federal Government used some of its growing revenue for aid at the State and local level, or would it be more efficient to make tax reductions at the Federal level and to reform the tax structure in such ways as to promote private initiative in solving problems, in the process providing the enlarged tax base to support needed government functions at the State and local levels?

As we begin these hearings, I wish to call attention to the fact that related studies are underway by other subcommittees of the Joint Economic Committee.

The Subcommittee on Economic Progress, under the chairmanship of Representative Wright Patman, has been investigating the needs of States and localities for capital projects over the next decade and the adequacy of financial markets to provide the resources above and beyond those provided from tax revenues.

The new Subcommittee on Urban Affairs, under the chairmanship of Representative Richard Bolling, is beginning a long and detailed study of our urban complexes and their problems. The Joint Economic Committee hopes to derive from these related investigations guidelines to the health of our urban economies.

This week we are hearing from technical experts on various aspects of fiscal federalism. Subsequently, this fall we shall call in policymaking officials from Federal, State, and local governments.

This morning we begin our hearings by hearing from a panel of specialists concerning the lessons to be learned from past experience, both here and abroad, of fiscal programs to assist States and localities with their fiscal problems.

Our panelists include James A. Maxwell, professor of economics at Clark University, Clara Penniman, professor of political science at the University of Wisconsin, L. Laszlo Ecker-Racz, formerly with the Advisory Commission on Intergovernmental Relations, and Paul Ylvisaker, commissioner, Department of Community Affairs of New Jersey. I want to thank all of you for being here this morning, and I do appreciate your attempt to help us eliminate the problems of fiscal affairs of both State, local, and national governments.

I would like to say, too, that whatever you thought before, I would like to bring you a new thought before you begin. I have just come from the sacked and burned city of Detroit. In any sharing of Federal funds, I would assume that there would have to be an unconditional grant, some type of pass-through. I am sure that for the last 10 days it has never occurred to any American that a city or any large geographical area would actually change governments through violence. But I think that everybody has to consider that possibility now, and I therefore think that it makes it a little more essential that you have some type of auditing process, that money just can't be handed out.

At this point we include Senator Javits' statement:

STATEMENT OF SENATOR JACOB K. JAVITS

Tax Sharing and the Crisis in the Cities

Senator Javits. The hearings starting this morning have in the last few days assumed an unexpected sense of urgency. The recent riots in our cities make it imperative that every avenue that may lead to a solution of our urban problems, however remote, be fully explored. For this reason, I urge that this aspect of revenue sharing be fully explored if these hearings are to serve an immediate as well as a long-range purpose.

The questions that we must try to answer are: (1) Is revenue sharing applicable to urban problems, and (2) if so, how the question of State control over funds channeled to the cities via a revenue-sharing scheme can be resolved?

It is true that mayors have been opposed to revenue sharing on the ground that the States would not give them a fair break under such a program. I doubt that this would be the case after the recent tragic events in our cities.

I agree that present revenue-sharing plans would generate sums that are dwarfed by the enormity of our cities' financial needs, but I believe that we should make every attempt to find out whether or not at least part of the answer to our cities' needs can be found within the revenue-sharing concept. I think that this is a valid question to raise inasmuch as years of Federal grants-in-aid programs have failed to make significant inroads into the eradication of slums, the modernization of metropolitan transportation systems, and other urban problems.

While these hearings propose to explore the future of fiscal federalism, I submit that we will also be examining the future of our whole Federal system of government, for we can in no way divorce the vitality of our State and local governments from the fiscal power to carry out their programs and functions.

If the power to tax is the power to destroy, then it can be rightly said that the power to spend is the power to create. It is here that our States and localities have been sadly lacking in recent years. A revenue system that grows slowly, and economic limitations on the amount of debt States and localities can incur, have steadily widened the gap between the level of services they desire and should provide and the level they can afford. The Federal Government has jumped into this breach with its superior revenue gathering powers, mainly the graduated personal income tax. Through categorical grants-in-aid, the Central Government has helped support those service obligations the State and local governments can no longer finance by themselves. However, something has been lost in the process.

With Federal support came Federal control over how the money could be spent. The grant-in-aid system is now a patchwork of matching requirements, allocation provisions, program designations, and various other restrictions. The States and localities have accepted these controls because they need the aid to finance their public services. But the acceptance of the aid and the controls that go with it have reduced the scope of State-local decisionmaking which, in turn, has reduced the demands for vitality and creativity in their affairs.

We have lived with Federal grants-in-aid for many years, adding some here and changing a bit there, without really examining the possible dangers to our Federal system in the meantime. Now as never before, we must closely examine both the benefits and the costs of this system, discover how we can improve it, and what alternatives there are for getting the job done more efficiently and effectively. Innovative and creative ability at our State and local levels of government is one of our greatest resources, and the times certainly call for the use of every means available to solve the country's great social problems.

Since the administration first promoted and then discarded the idea of innovations in the Federal assistance system, Republicans have seized the initiative. I am pleased to be among the first to introduce a detailed plan for comprehensive Federal revenue sharing. In the first 2 months of this Congress alone, over 90 percent of the 100 or so sponsors of bills dealing with sharing Federal revenues have been Republicans. Republicans' faith in the ability and responsiveness of State and local governments to the needs of their people has generated serious study by the Republican coordinating committee of the general area of improving Federal intergovernmental assistance.

However, Republicans cannot claim all the credit. The Chair is to be applauded for initiating these hearings, and I am confident all of us at all levels of Government will greatly benefit from this thorough, comprehensive examination of the future of federalism in America.

(The following material is submitted by Senator Javits:)

[From the Congressional Record, Jan. 18, 1967]

FEDERAL REVENUE SHARING BILL ESSENTIAL FOR FEDERAL-STATE PARTNERSHIP

Mr. JAVITS. Mr. President, I understand that it is agreeable to the leadership to allow a little extra time to Senators at this moment, and I therefore ask unanimous consent that I may proceed for 10 minutes.

The PRESIDING OFFICER. Without objection, it is so ordered.

Mr. JAVITS. Mr. President, I send to the desk for appropriate reference, on behalf of myself, and Senators Baker, Carlson, Cooper, Dominick, Scott, and Young of North Dakota, a Federal revenue-sharing bill, designed to return to the States, and through them to local governments, a portion of Federal tax revenues with a minimum of strings attached.

A companion measure is being introduced in the other body by Representative Reid of New York.

Mr. President, I ask that the bill be printed as part of my remarks, together with specific tables as to the distributions to States and other data which implement the concept of the bill.

The PRESIDING OFFICER. The bill will be received and appropriately referred; and, without objection, the bill and explanatory material will be printed in the Record.

The bill (S. 482) to establish a system for the sharing of certain Federal revenues with the States, introduced by Mr. Javits (for himself and other Senators), was received, read twice by its title, referred to the Committee on Finance and ordered to be printed in the Record, as follows:

"*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled*, That this Act may be cited as the "Federal Revenue-Sharing Act".

"SEC. 2. (a) There is hereby established in the Treasury of the United States a fund to be known as the revenue-sharing fund. The revenue-sharing fund shall consist of such amounts as may be appropriated to such fund as provided in this section.

"(b) (1) There is hereby appropriated to the revenue-sharing fund, out of any money in the Treasury not otherwise appropriated, for the fiscal year beginning July 1, 1968, an amount equal to 1 per centum of the aggregate taxable income reported on individual income tax returns during the preceding calendar year; for the fiscal year beginning July 1, 1969, an amount equal to 1½ per centum of the aggregate taxable income reported on individual income tax returns during the preceding calendar year; and for the fiscal year beginning July 1, 1970, and for each fiscal year thereafter, an amount equal to 2 per centum of the aggregate taxable income reported on individual income tax returns during the preceding calendar year.

"(2) For purposes of this subsection—

"(A) The term 'taxable income' shall have the same meaning as specified in section 63 of the Internal Revenue Code of 1954.

"(B) The term 'individual income tax returns' means returns of the tax on the income of individuals imposed by chapter 1 of the Internal Revenue Code of 1954.

"(c) The Secretary of the Treasury (hereinafter referred to as the 'Secretary') shall, from time to time, but not less often than quarterly, determine the amounts appropriated by subsection (b) and transfer from the general fund of the Treasury to the revenue-sharing fund the amounts so appropriated. Such transfers shall, to the extent necessary, be made on the basis of estimates by the Secretary of the amounts so appropriated by subsection (b). Proper adjustments shall be made in the amounts subsequently transferred to the extent that prior estimates were in excess of or less than the amounts required to be transferred.

"SEC. 3. (a) Subject to the provisions of subsection (d) and sections 4(c) and 5(b), the Secretary shall, during the fiscal year beginning July 1, 1968, and during each fiscal year thereafter, pay to each State, from amounts appropriated to the revenue-sharing fund for the fiscal year in which payments are to be made, a total amount equal to the allotment or allotments of such State in such fiscal year under this section. Such payments shall be made in installments periodically during any fiscal year, but not less often than quarterly.

"(b) From 85 per centum of the amount appropriated to the revenue-sharing fund pursuant to section 2 for any fiscal year, the Secretary shall allot to each

State in such fiscal year and amount (computed by the Secretary) equal to the product resulting from multiplying—

"(1) an amount which bears the same ratio to such 85 per centum of the amount so appropriated as the population of such State bears to the total population of all of the States, by

"(2) a number which is the quotient resulting from dividing the revenue effort ratio of such State for the preceding fiscal year by the average national revenue effort ratio for the preceding fiscal year.

"(c) From 15 per centum of the amount appropriated to the revenue-sharing fund pursuant to section 2 for any fiscal year, the Secretary shall allot, to each State with a per capita annual income of individuals residing in such State which is below the average of all the State per capita annual incomes, an amount (computed by the Secretary) in such fiscal year which bears the same ratio to such 15 per centum of the amount so appropriated as the amount of the difference between the per capita annual income of any such State and the average of all the State per capita annual incomes bears to the total of the amounts of the differences between the per capita annual incomes of all such States and the average of all the State per capita annual income.

"(d) Notwithstanding any other provision of this section, (1) the amount of any State's allotment in any fiscal year under either subsection (b) or (c), (2) the total amount of any State's combined allotments in any fiscal year under subsections (b) and (c), or (3) the total amount resulting from combining any State's allotment or allotments in any fiscal year and any reallotment to such State under this subsection and sections 4(c)and 5(b) shall not exceed 12 percent of the amount appropriated pursuant to section 2 for such fiscal year. In the event of any reduction of a State's allotment or reallotment in any fiscal year under the provisions of the preceding sentence, the Secretary shall reallot and pay, from time to time during such fiscal year, the amount of such reduction to other States in proportion to the original allotment to such States under subsection (b) for such fiscal year.

"(e) For purposes of this section—

"(1) The term 'State' means any of the various States and the District of Columbia.

"(2) The term 'revenue effort ratio', when used in relation to any State for any fiscal year, means a fraction (A) the numerator of which is the total of the revenues derived by such State (including revenues derived by any political subdivision thereof) from its own resources during such fiscal year and (B) the denominator of which is the total income of individuals residing in such State during the calendar year ending within such fiscal year.

"(3) The term 'average national revenue effort ratio' means a fraction (A) the numerator of which is the total resulting from adding together all revenue effort ratios of the States, and (B) the denominator of which is 51.

"(4) The term 'income of individuals', when used in relation to any State, means income subject to the tax imposed by chapter 1 of the Internal Revenue Code of 1954.

"(5) The population of a State and the per capita annual income of individuals residing in a State shall be determined by the Secretary on the basis of the most recent data available from the Department of Commerce; but the same period shall be used in determining the population of all the States and the same period shall be used in determining the average of all the State per capita annual incomes.

"(6) The term 'State per capita annual income,' when used in relation to any State, means the quotient resulting from dividing the total income of all individuals residing in such State by the population of such State.

SEC. 4. (a) Each State may use funds from any allotment or reallotment to it in any fiscal year under this Act for activities, programs, projects, and services (including capital expenditures) in the fields of health, education, and welfare. In addition each State may use a portion of such funds, not to exceed 5 per centum thereof, to provide for planning, research, and development in the fields of modernization of the institutions of State government and the improvement of governmental procedures. Toward these ends, each State may provide for planning, research, and development directed toward the establishment of active, well-staffed State budgetary offices, improved budgetary procedures and expenditure controls, adequate recruiting and retaining of qualified planning personnel, reasonable policy coordination between the various units of government and an appropriate salary schedule for management personnel. None of such funds shall be used for administrative expenses, except that each State may procure the services of special consultants and experts, or organizations thereof, as necessary to carry out the research, planning, and development authorized herein and may establish and operate programs for the training of its employees in order to increase economy and efficiency in the operations of State government and to raise the standards of performance by employees of their official duties to the maximum possible level of proficiency.

"(b) (1) In order to insure that each State shall give maximum consideration to the needs of local governments within such State, the Governor of each State shall, after consultation with officials of such local governments, develop a plan prior to the beginning of each fiscal year, for sharing the anticipated funds which such State will receive under this Act in such fiscal year with its local governments. In determining the anticipated allotments of such funds by such State to its local governments, the Governor shall take into consideration the population and population density of each such local government, the per capita annual income of individuals residing therein, local costs, and other relevant factors.

"(2) On or before such date prior to the beginning of each fiscal year as the Secretary may prescribe, the Governor of each State shall submit to the Secretary a detailed statement showing the intended use of the anticipated funds which such State will receive during such fiscal year, including a report of such State's plan for sharing its funds with its local governments. Any State desiring to amend its reported plan for sharing its anticipated funds with its local governments may do so only after due consultation with officials of such local governments. After such consultation, any State may modify the allocation of its funds for any fiscal year by filing a statement of its amended plan with the Secretary.

"(c) Whenever the Secretary, after giving reasonable notice and opportunity for hearing to a State, finds that such State, or any local government to which such State has apportioned part of any allotment or reallotment—

"(1) has used any amount of such allotment or reallotment for purposes not within the scope of subsection (a),

"(2) has not apportioned any amount of such allotment or reallotment to its local governments in accordance with the provisions of its plan, as filed with the Secretary, for sharing its funds, or

"(3) has not obligated any amount of such allotment or reallotment within five fiscal years immediately following the fiscal year in which such allotment or reallotment was made

the Secretary shall subtract, from any subsequent allotment or reallotment to such State, a total amount equal to the amount referred to in paragraph (1), (2), or (3). In the event of any reduction of a State's allotment or reallotment in any fiscal year under this subsection, the Secretary shall reallot and pay, from time to time during such fiscal year, the amount of such reduction to other States in proportion to the original allotment to such States under subsection (b) of section 3 for such year.

"(d) For purposes of this section—

"(1) The term 'health, education, and welfare' shall be construed in its broadest sense so as to provide the greatest possible coverage of activities, programs, projects, and services related directly or indirectly to the fields of health, education, and welfare; except that such term shall not include any activity, program, project, or service designed to provide—

"(A) administrative expenses for State and local government;

"(B) highway programs;

"(C) State payments in lieu of property taxes;

"(D) debt service; and

"(E) disaster relief.

"(2) The term 'local government' means any city, township, village, school district, municipality, county, parish, or similar territorial subdivision of a State, but shall not include any department, agency, commission, or independent instrumentality of a State.

"SEC. 5. (a) (1) In addition to the requirements of section 4 any State desiring to receive any allotment or reallotment in any fiscal year under this Act shall, on behalf of itself and any local government which may receive any apportionment thereof, certify and provide satisfactory assurance to the Secretary that such State and local government will—

"(A) use such fiscal control and fund accounting procedures as may be necessary to assure proper disbursement of and accounting for any allotment or reallotment paid to such State, and any apportionment made by such State to local governments, under this Act;

"(B) make such reports to the Secretary, the Congress, and the Comptroller General in such form and containing such information as the Secretary may reasonably require to carry out his functions under this Act, including the statement of intent and report of sharing funds required by section 4(b), except that any State may make any such reports on behalf of any local government thereof; and

"(C) adhere to all applicable Federal laws in connection with any activity, program, or service provided solely or in part from such allotment or reallotment.

"(2) For purposes of this subsection, the provisions of title VI of the Civil Rights Act of 1964 shall be deemed to be applicable to any activity, program, or service provided solely or in part from any allotment or reallotment received by a State under this Act.

"(b) Whenever in any fiscal year the Secretary, after giving reasonable notice and opportunity for hearing to a State, finds that the Governor of such State has failed to submit any statement of intent or report required by section 4(b) or that such State or any local government thereof is not in substantial compliance with the purposes of subsection (a), the Secretary immediately shall—

"(1) in the case of the failure of compliance of the Governor of any State or the failure of compliance of any State, cancel any subsequent payments to such State under this Act in such fiscal year and reallot any remainder of such State's allotment or reallotment in such fiscal year to other States in proportion to the original allotments to such States under subsection (b) of section 3 for such fiscal year, or

"(2) in the case of the failure of compliance of any local government of any State require satisfactory assurance that such State will cancel any subsequent payments to such local government under this Act in such fiscal year and reapportion any remainder of or such local government's apportionment to other local governments of such State in proportion to the original apportionments to such local governments under the State plan reported to the Secretary pursuant to section 4(b) for such fiscal year.

"Sec. 6. The Secretary shall report to the Congress not later than the first day of March of each year on the operation of the revenue-sharing fund during the preceding fiscal year and on its expected operation during the current fiscal year. Each such report shall include a statement of the appropriations to, and the disbursements made from the revenue-sharing fund during the preceding fiscal year; an estimate of the expected appropriation to, and disbursements to be made from, the revenue-sharing fund during the current fiscal year; the use by each State of the funds which it received under this Act during the preceding fiscal year and the amounts distributed by each State to its political subdivisions; and any changes recommended by the Secretary concerning the operation of the revenue-sharing fund.

"Sec. 7. The Appropriations Committee and the Finance Committee of the Senate and the Appropriations Committee and the Ways and Means Committee of the House of Representatives, respectively, shall conduct a full and complete study at least once during each Congress with respect to the operation of the revenue-sharing fund, the activities, programs, projects, and services provided by the States from allotments and reallotments received pursuant to this Act, and the manner of the distribution of funds by each State to its local governments, and report its findings upon such study to each House, respectively, together with its recommendations for such legislation as it deems advisable at the earliest practicable date. This section is enacted by the Congress as an exercise of the rulemaking power of the Senate and the House of Representatives, respectively, with full recognition of the constitutional right of either House to change such rules (so far as relating to the procedures in such House) at any time, in the same manner and to the same extent as in the case of any other rule of such House."

The explanatory materials are as follows:

COMPARISON OF PERSONAL INCOME AND TAXABLE INCOME, 1939–64

[Dollar amounts in billions]

Year	Personal income	Taxable income		Year	Personal income	Taxable income		Year	Personal income	Taxable income	
		Amount	Percent of personal income			Amount	Percent of personal income			Amount	Percent of personal income
1939	$72.8	$7.2	9.9	1948	$210.2	$74.7	35.5	1957	$351.1	$149.4	42.6
1940	78.3	10.7	13.7	1949	207.2	71.6	34.6	1958	361.2	149.3	41.3
1941	96.0	22.7	23.6	1950	227.6	84.3	37.0	1959	383.5	166.5	43.4
1942	122.9	36.1	29.4	1951	255.6	99.4	38.9	1960	401.0	171.6	42.8
1943	151.3	50.1	33.1	1952	272.5	107.5	39.4	1961	416.8	181.8	43.6
1944	165.3	55.3	33.5	1953	288.2	115.7	40.1	1962	442.6	195.3	44.1
1945	171.1	57.1	33.4	1954	290.1	115.3	39.7	1963	464.8	209.1	45.0
1946	178.7	65.3	36.5	1955	310.9	128.0	41.2	1964	[1] 495.0	229.9	46.4
1947	191.3	75.4	39.4	1956	333.0	141.5	42.5				

[1] Preliminary.

Sources: Personal income: Survey of Current Business (August 1965). Taxable income, 1939–45: Author's estimates; 1946–63; Table B–4; 1964: Statistics of Income, 1964, Preliminary, Individual Income Tax Returns; Federal Tax Policy, by Joseph D. Pechman.

TABLE C-63.—STATE AND LOCAL GOVERNMENT REVENUES AND EXPENDITURES, SELECTED FISCAL YEARS, 1927-64

[In millions of dollars]

Fiscal year [1]	General revenues by source [2]							General expenditures by function [2]				
	Total	Property taxes	Sales and gross receipts taxes	Individual income taxes	Corporation net income taxes	Revenue from Federal Government	All other revenue [3]	Total	Education	Highways	Public welfare	All other [4]
1927	7,271	4,730	470	70	92	116	1,793	7,210	2,235	1,809	151	3,015
1932	7,267	4,487	752	74	79	232	1,643	7,765	2,311	1,741	444	3,269
1934	7,678	4,076	1,008	80	49	1,016	1,449	7,181	1,831	1,509	889	2,952
1936	8,395	4,093	1,484	153	113	948	1,604	7,644	2,177	1,425	827	3,215
1938	9,228	4,440	1,794	218	165	800	1,811	8,757	2,491	1,650	1,069	3,547
1940	9,609	4,430	1,982	224	156	945	1,872	9,229	2,638	1,573	1,156	3,862
1942	10,418	4,537	2,351	276	272	858	2,123	9,190	2,586	1,490	1,225	3,889
1944	10,908	4,604	2,289	342	451	954	2,269	8,863	2,793	1,200	1,133	3,737
1946	12,356	4,986	2,986	422	447	855	2,661	11,028	3,356	1,672	1,409	4,591
1948	17,250	6,126	4,442	543	592	1,861	3,685	17,684	5,379	3,036	2,099	7,170
1950	20,911	7,349	5,154	788	593	2,486	4,541	22,787	7,177	3,803	2,940	8,867
1952	25,181	8,652	6,357	998	846	2,566	5,763	26,098	8,318	4,650	2,788	10,342
1953	27,307	9,375	6,927	1,065	817	2,870	6,252	27,910	9,390	4,987	2,914	10,619
1954	29,012	9,967	7,276	1,127	778	2,966	6,897	30,701	10,557	5,527	3,060	11,557
1955	31,073	10,735	7,643	1,237	744	3,131	7,584	33,724	11,907	6,452	3,168	12,197
1956	34,667	11,749	8,691	1,538	890	3,335	8,465	36,711	13,220	6,953	3,139	13,399
1957	38,164	12,864	9,467	1,754	984	3,843	9,252	40,375	14,134	7,816	3,485	14,940
1958	41,219	14,047	9,829	1,759	1,018	4,865	9,699	44,851	15,919	8,567	3,818	16,547
1959	45,306	14,983	10,437	1,994	1,001	6,377	10,516	48,887	17,283	9,592	4,136	17,876
1960	50,505	16,405	11,849	2,463	1,180	6,954	11,634	51,876	18,719	9,428	4,404	19,324
1961	54,037	18,002	12,463	2,613	1,266	7,131	12,563	56,201	20,574	9,844	4,720	21,063
1962	58,252	19,054	13,494	3,037	1,308	7,871	13,489	60,206	22,216	10,357	5,084	22,549
1963	62,890	20,089	14,456	3,269	1,505	8,722	14,850	64,816	24,012	11,136	5,481	24,187
1962-63 [5]	62,269	19,833	14,446	3,267	1,505	8,663	14,555	63,977	23,965	11,150	5,420	23,442
1963-64 [5]	68,443	21,241	15,762	3,791	1,695	10,002	15,952	69,302	26,533	11,664	5,766	25,339
1964-65 [5]	74,341	22,918	17,118	4,090	1,929	11,029	17,256	74,954	28,971	12,221	6,315	27,441

[1] Fiscal years not the same for all governments. See footnote 5.

[2] Excludes revenues or expenditures of publicly owned utilities and liquor stores, and of insurance-trust activities. Intergovernmental receipts and payments between State and local governments are also excluded.

[3] Includes licenses and other taxes and charges and miscellaneous revenues.

[4] Includes expenditures for health, hospitals, police, local fire protection, natural resources, sanitation, housing and urban renewal, local parks and recreation, general control, financial administration, interest on general debt, and other unallocable expenditures.

[5] Data for fiscal year ending in the 12-month period through June 30. Data for 1963 and earlier years include local government amounts grouped in terms of fiscal years ended during the particular calendar year.

Note: Data are not available for intervening years. Data for Alaska and Hawaii included beginning 1959 and 1960, respectively. See table C-54 for net debt of State and local governments.

Source: Department of Commerce, Bureau of the Census.

INDEBTEDNESS OF STATE AND LOCAL GOVERNMENTS BY TYPE OF DEBT, 1952-65

[In millions of dollars]

Item	1964-65 [1]	1963-64 [1]	1962	1961	1960	1959	1958	1957	1956	1955	1954	1953	1952
Total	99,512	92,222	80,802	75,023	69,955	64,110	58,187	53,039	48,868	44,267	38,931	33,782	30,100
Long term	94,204	87,527	77,067	71,540	66,801	61,127	55,737	50,845	46,775	42,272	36,898	32,004	28,720
Full faith and credit	56,417	53,266	48,185	44,664	41,650	39,263	35,844	32,577	31,815	29,325	26,992	24,273	22,436
Nonguaranteed	37,786	34,261	28,883	26,878	25,151	21,864	19,893	18,268	14,960	12,947	9,905	7,731	6,284
Short term	5,309	4,695	3,735	3,483	3,154	2,983	2,450	2,195	2,093	1,995	2,033	1,778	1,380
Net long-term debt	85,942	79,950	71,181	65,812	61,596	56,361	51,297	46,678	43,217	38,502	33,182	28,553	25,513

[1] Data for fiscal year ending in the 12-mooth period through June 30. Data for 1963 and earlier years include local government amounts grouped in terms of fiscal years ended during the particular calendar year.

Source: Department of Commerce, Bureau of the Census.

STATE-LOCAL GENERAL REVENUES, PRESENT FEDERAL AID AND ADDITIONAL ALLOTMENTS UNDER FEDERAL-STATE REVENUE SHARING PLAN

State	Total general revenues, 1964–65 (millions)	Revenue from Federal Government, 1964–65		Federal revenue sharing allotment		
		Amount (millions)	As percent of total general revenue	Percent increase over total general revenue	Percent increase over revenue from Federal Government	Per capital allotment
Alabama	$1,014.9	$246.6	24.3	7.3	30.0	$21.14
Alaska	214.6	113.0	52.7	1.7	3.2	13.48
Arizona	667.0	128.2	19.2	4.7	24.4	19.87
Arkansas	527.8	134.5	25.5	10.3	40.5	28.08
California	9,843.5	1,403.8	14.3	2.8	19.6	14.95
Colorado	894.5	165.7	18.5	3.2	17.3	14.67
Connecticut	1,103.3	136.8	12.4	2.7	22.0	10.64
Delaware	232.9	31.5	13.5	2.8	21.0	13.12
Florida	2,033.5	267.5	13.2	4.2	32.1	14.80
Georgia	1,335.8	249.3	18.7	5.6	30.0	17.01
Hawaii	331.6	63.6	19.2	3.0	15.6	13.94
Idaho	274.0	59.5	21.7	8.8	40.3	39.63
Illinois	3,845.8	512.8	13.3	2.9	21.5	10.37
Indiana	1,748.0	193.5	11.1	3.5	31.2	12.34
Iowa	1,073.5	144.4	13.5	3.8	28.1	14.72
Kansas	877.3	127.5	14.5	3.5	23.8	26.39
Kentucky	918.5	212.8	23.2	6.8	29.2	19.60
Louisiana	1,363.1	309.9	22.7	5.7	25.2	21.94
Maine	324.1	53.5	16.5	8.3	50.5	27.38
Maryland	1,268.8	157.1	12.4	3.2	25.7	11.40
Massachusetts	2,122.5	277.5	13.1	3.0	22.9	11.84
Michigan	3,370.3	426.2	12.6	3.2	25.3	12.97
Minnesota	1,553.7	226.9	14.6	3.5	24.1	15.33
Mississippi	656.4	141.7	21.6	11.9	55.0	33.74
Missouri	1,476.9	256.1	17.4	3.4	19.4	11.06
Montana	322.3	84.4	26.2	5.8	22.0	26.46
Nebraska	494.1	75.3	15.2	3.9	25.9	13.37
Nevada	245.0	62.4	25.5	2.4	9.5	13.59
New Hampshire	214.8	33.5	15.6	3.6	23.3	11.59
New Jersey	$2,380.5	$216.9	9.1	3.0	33.1	$10.57
New Mexico	475.9	116.3	24.4	6.9	28.4	32.54
New York	8,700.5	749.1	8.6	2.9	34.2	14.16
North Carolina	1,360.6	214.7	15.8	6.2	39.1	17.02
North Dakota	300.2	57.8	19.3	10.8	56.1	46.69
Ohio	3,306.7	414.6	12.5	3.3	26.6	10.76
Oklahoma	914.0	208.1	22.8	5.2	23.0	19.57
Oregon	875.5	188.8	21.6	3.1	14.3	13.93
Pennsylvania	3,845.7	463.9	12.1	3.4	28.4	11.36
Rhode Island	326.1	62.4	19.1	3.6	15.9	11.11
South Carolina	623.0	104.5	16.8	10.4	61.9	25.37
South Dakota	284.6	70.3	24.7	12.7	51.5	52.77
Tennessee	1,083.8	227.3	21.0	6.6	31.6	18.65
Texas	3,413.0	523.2	15.3	4.2	27.4	13.54
Utah	416.5	109.1	26.2	5.1	19.4	21.33
Vermont	171.0	42.5	24.9	11.6	46.8	49.26
Virginia	1,327.6	268.2	20.2	4.1	20.4	12.40
Washington	1,373.6	220.8	16.1	3.1	19.2	14.23
West Virginia	561.2	133.7	23.8	8.4	35.3	26.01
Wisconsin	1,673.8	163.7	9.8	3.6	36.6	14.47
Wyoming	210.6	79.7	37.8	2.5	6.5	15.76
District of Columbia	368.1	98.1	26.7	2.1	7.8	9.60
All States and District of Columbia						

Source: Department of Commerce, Bureau of the Census.

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FEDERAL-STATE REVENUE SHARING PLAN—STATE ALLOTMENTS

State	Percent of national population (1965 estimate)	Inadjusted primary allotment (col. 1× $2,550,000,000)	General revenue from own sources (1964–65)	Personal income (1964)	Revenue effort ratio (col. 3÷ col. 4)	Relative revenue effort ratio (col. 5÷ 13.2)	Primary allotment (col. 6X col. 2)	Per capita personal income (1964)	Per capita income deficiency ($2,431— col. 8)	Percent share of total deficiencies (col. 9÷ $9,793)	Supplementary allotment (col. 10× $45,000,000)	Total allotment (col. 7+ col. 11)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
		Millions	Millions	Millions			Millions				Millions	Millions
Alabama	1.72	$43.9	$768.3	$6,098	12.6	95.5	$43.6	$1,777	$654	6.68	$30.0	$73.7
Alaska	.14	3.6	101.6	789	12.9	97.7	3.6	3,082	---------	---------	---------	3.6
Arizona	.81	20.7	538.8	3,520	15.3	115.9	24.0	2,272	159	1.62	7.3	31.3
Arkansas	1.00	25.5	393.3	3,374	11.7	88.6	22.7	1,740	691	7.06	31.8	54.5
California	9.50	242.3	8,439.8	56,404	15.0	113.6	275.1	3,133	---------	---------	---------	275.1
Colorado	1.01	25.8	728.8	4,967	14.7	111.4	28.6	2,559	---------	---------	---------	28.6
Connecticut	1.46	37.2	966.5	9,004	10.7	81.1	30.1	3,234	---------	---------	---------	30.1
Delaware	.26	6.6	201.4	1,542	13.1	99.2	6.6	3,121	---------	---------	---------	6.6
Florida	2.99	76.2	1,766.0	12,920	13.7	103.8	79.1	2,285	146	1.49	6.7	85.8
Georgia	2.27	57.9	1,086.5	8,626	12.6	95.5	55.1	2,004	427	4.36	19.6	74.7
Hawaii	.37	9.4	268.0	1,912	14.0	106.1	9.9	2,775	---------	---------	---------	9.9
ǀdaho	.36	9.2	214.5	1,464	14.7	111.4	10.2	2,131	300	3.06	13.8	24.0
llinois	5.49	140.0	3,332.9	32,136	10.4	78.8	110.4	3,050	---------	---------	---------	110.4
Indiana	2.52	64.3	1,554.5	12,556	12.4	93.9	60.4	2,599	---------	---------	---------	60.4
Iowa	1.42	36.2	929.1	6,608	14.1	106.8	38.8	2,392	39	.40	1.8	40.6
Kansas	1.16	29.6	749.8	5,565	13.5	102.3	30.3	2,488	---------	---------	---------	30.3
Kentucky	1.64	41.8	705.7	5,968	11.8	89.4	37.2	1,887	544	5.55	25.0	62.2
Louisiana	1.84	46.9	1,053.2	6,762	15.6	118.2	55.3	1,936	595	5.05	22.8	78.1
Maine	.51	13.0	270.7	2,088	13.0	98.5	12.8	2,122	309	3.16	14.2	27.0
Maryland	1.82	46.9	1,111.7	9,734	11.4	86.4	40.3	2,828	---------	---------	---------	40.3
Massachusetts	2.77	70.6	1,844.9	15,383	12.0	90.1	63.5	2,910	---------	---------	---------	63.5
Michigan	4.29	109.4	2,944.1	22,626	13.0	98.5	107.9	2,772	---------	---------	---------	107.9
Minnesota	1.84	46.9	1,326.9	8,610	15.4	116.7	54.6	2,440	---------	---------	---------	54.6
Mississippi	1.19	30.3	514.6	3,422	15.0	113.6	34.4	1,485	946	9.66	43.5	77.9
Missouri	2.32	59.2	1,220.8	10,988	11.1	84.1	49.7	2,458	---------	---------	---------	47.9
Montana	.36	9.2	238.9	1,585	15.0	113.6	10.5	2,255	176	1.80	8.1	18.6
Nebraska	.75	19.1	418.8	3,500	11.9	90.2	17.3	2,383	48	.49	2.2	19.5
Nevada	.22	5.6	182.6	1,351	13.5	102.3	5.9	3,232	---------	---------	---------	5.9

FEDERAL-STATE REVENUE SHARING PLAN—STATE ALLOTMENTS—Continued

State	Percent of national population (1965 estimate)	Inadjusted primary allotment (col. 1× $2,550,000,000)	General revenue from own sources (1964–65)	Personal income (1964)	Revenue effort ratio (col. 3÷ col. 4)	Relative revenue effort ratio (col. 5÷ 13.2)	Primary allotment (col. 6X col. 2)	Per capita personal income (1964)	Per capita income deficiency ($2,431— col. 8)	Percent share of total deficiencies (col. 9÷ $9,793)	Supplementary allotment (col. 10× $45,000,000)	Total allotment (col. 7+ col. 11)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
		Millions	Millions	Millions			Millions				Millions	Millions
New Hampshire	.35	$8.9	$181.4	$1,600	11.3	85.6	$7.7	$2,428	3	.03	$0.1	$7.8
New Jersey	3.50	89.3	2,163.6	20,501	10.6	80.3	71.7	3,069	---------	---------	---------	71.7
New Mexico	.52	13.3	359.6	2,107	17.1	129.5	17.3	2,090	341	3.48	15.7	33.0
New York	9.34	238.2	7,951.4	55,946	14.2	107.6	256.3	3,127	---------	---------	---------	256.3
North Carolina	2.55	15.0	1,145.9	9,321	12.3	93.2	60.4	1,918	513	5.24	23.6	84.0
North Dakota	.34	8.7	242.4	1,294	18.7	141.7	12.2	1,991	440	4.49	20.2	32.4
Ohio	5.28	134.6	2,892.1	26,736	10.8	81.8	110.2	2,641	---------	---------	---------	110.2
Oklahoma	1.26	32.1	705.9	5,196	13.6	103.0	33.2	2,111	320	3.27	14.7	47.9
Oregon	1.00	25.5	686.7	4,904	14.0	106.1	27.0	2,600	---------	---------	---------	27.0
Pennsylvania	5.98	152.5	3,381.8	29,770	11.4	56.4	131.6	2,588	---------	---------	---------	131.6
Rhode Island	.46	11.7	263.7	2,344	11.3	85.6	9.9	2,652	---------	---------	---------	9.9
South Carolina	1.32	33.7	518.5	4,287	12.1	91.7	30.9	1,696	735	7.51	33.8	64.7
South Dakota	.35	8.9	214.3	1,314	16.3	123.5	11.2	1,877	544	5.55	25.0	36.2
Tennessee	1.99	50.7	856.5	7,130	12.0	90.9	46.2	1,874	507	5.69	25.6	71.8
Texas	5.47	139.5	2,889.8	22,966	12.6	95.5	133.1	2,208	223	2.28	10.3	143.4
Utah	.51	13.0	307.4	2,216	13.9	105.3	13.8	2,268	163	1.66	7.5	21.2
Vermont	.21	5.4	128.5	850	15.1	114.4	6.1	2,130	301	3.07	13.8	19.9
Virginia	2.28	58.1	1,059.4	9,895	10.7	81.1	47.2	2,264	167	1.70	7.7	54.8
Washington	1.53	39.0	1,152.8	8,063	14.3	108.3	42.3	2,714	---------	---------	---------	42.3
West Virginia	.94	24.0	427.5	3,447	12.4	93.9	22.4	1,891	540	5.51	24.8	47.2
Wisconsin	2.14	54.6	1,510.2	10,388	14.5	109.8	59.9	2,534	---------	---------	---------	59.9
Wyoming	.17	4.3	131.0	821	15.6	118.2	5.1	2,429	2	.02	.1	5.2
District of Columbia	.41	10.5	270.0	2,804	9.6	72.7	7.7	3,527	---------	---------	---------	7.7
All States and District of Columbia:												
Total	100.00	2,550.0	---------	---------	---------	---------	2,464.0	---------	9,793	100.00	45.0	2,930.5
Average	---------	---------	---------	---------	13.2	---------	---------	2,431	---------	---------	---------	---------

Source: Department of Commerce, Bureau of the Census.

"MEMORANDUM ON DISTRIBUTION OF THE REVENUE SHARING FUND

"The total amount deposited in the Revenue-sharing trust fund is distributed among the fifty states and the District of Columbia on the basis of state need and state efforts to meet that need. State need for shared Federal revenue is measured in two ways: by population size and per capita personal income. State effort is measured by the ratio of the revenue each state and its localities have raised from their own sources to the personal income of the inhabitants of the state. The revenue is actually distributed in the following manner.

"First, 85 percent of the fund is divided among all the states and the District of Columbia by population share of the national population, the more populous states receiving greater allotments than the less populated. This unadjusted allotment is then adjusted up or down for each state depending on whether the state's revenue effort is above or below the average effort of all states. A state whose revenue effort ratio is 10 percent greater than the average of the states would receive a 10 percent greater allotment than it would be entitled to on the basis of its population size alone. Thus, it is to each state's advantage to increase its revenue from within the state, for a larger revenue effort ratio means a larger share of the Revenue-sharing fund.

"After this primary allotment has been decided for each of the states and the District of Columbia, a supplementary allotment is calculated for the relatively poorer states. This portion, 15 percent of the fund, is distributed among those states with per capita personal incomes below the average for all the states. Each state's allotment is decided by the idea that the lower a state's per capital income, the greater its need and the larger its share of the supplementary allotment.

"To decide the allocation of the supplementary allotment, a per capita income deficiency is calculated for each of the poorer states equal to the difference between the state's per capita income and the per capita income average for all the states. These deficiencies are then added together to obtain the total per capita income deficiency. Each state's share of the supplementary allotment is then calculated from its share of the total income deficiency. For example, if the total per capita income deficiency for all the poorer states equaled $10,000, and an individual state has a deficiency of $1,000, it would receive $1,000/$10,000 or 10 percent of the total supplementary allotment. The total amount received by each of the poorer states is then calculated by adding each state's primary allotment to its supplementary allotment."

Mr. JAVITS. Mr. President, the bill is a modified version of the tax-sharing bill of 1965, which I authored, and would return to the States 1 percent of the annual aggregate income the first year, 1½ percent the second year, and 2 percent thereafter. Using annual taxable income as reported in 1966 income tax returns, about $3 billion would be returned to the States the first year after passage of the measure.

Under the bill, 85 percent of this fund would be distributed to the States on the basis of population. The remaining 15 percent would be distributed among the States with per capita income figures below the average State per capita income—the farther below this norm, the greater the allotment.

I point out that under the bill's formula, for example, New York would receive $256.3 million; Pennsylvania, $131.6 million; Kansas, $30.3 million; Colorado, $28.6 million. Under that portion of the formula used to distribute the additional 15 percent on the basis of per capita income, Kentucky would receive a basic allotment of $37.2 million. Because the per capita income of the State in 1966 was $544 below the average State figure, the State would receive an additional $25 million, for a total of $62.2 million. North Dakota with a per capita income $440 below the norm, would receive an additional $20.2 million for a total of $32.4 million.

Under the plan introduced today, the States would receive the following amounts, based on 1966 figures, during the first year of operation:

[In millions of dollars]

Alabama [1]	73.7	Nebraska [1]	19.5
Alaska	3.6	Nevada	5.9
Arizona [1]	31.3	New Hampshire [1]	7.8
Arkansas [1]	54.5	New Jersey	71.7
California	275.1	New Mexico [1]	33.0
Colorado	28.6	New York	256.3
Connecticut	30.1	North Carolina [1]	84.0
Delaware	6.6	North Dakota [1]	32.4
Florida [1]	85.8	Ohio	110.2
Georgia [1]	74.7	Oklahoma [1]	47.9
Hawaii	9.9	Oregon	27.0
Idaho [1]	24.0	Pennsylvania	131.6
Illinois	110.4	Rhode Island	9.9
Indiana	60.4	South Carolina [1]	64.7
Iowa [1]	40.6	South Dakota [1]	36.2
Kansas	30.3	Tennessee [1]	71.8
Kentucky [1]	62.2	Texas [1]	143.4
Louisiana [1]	78.1	Utah [1]	21.2
Maine [1]	27.0	Vermont [1]	19.9
Maryland	40.3	Virginia [1]	54.8
Massachusetts	63.5	Washington	42.3
Michigan	107.9	West Virginia [1]	47.2
Minnesota	54.6	Wisconsin	59.9
Mississippi [1]	77.9	Wyoming [1]	5.2
Missouri	49.7	District of Columbia	7.7
Montana [1]	18.6		

[1] Funds for States include the supplementary allotment for States with per capita incomes lower than the average of all State per capita income figures.

Mr. President, the aspects of the bills which are the most important, are as follows:

First. A trust fund would be established in the Treasury Department into which an amount equaling 1 percent of the aggregate taxable income reported on individual income tax returns would be appropriated starting July 1, 1968. The fund would increase to 1½ percent of aggregate taxable income starting July 1, 1969, and to 2 percent of taxable income starting July 1, 1970, and thereafter. Using current data this fund would total $3 billion. It would grow as the fund increased and as the tax base expanded.

Second. Payments to the States from the trust fund would be made on the basis of the following formula: 85 percent would be distributed on the basis of population. This amount would be increased or decreased depending on a State's own tax effort relative to that of other States, which would be measured by a "revenue effort ratio" for each State. This is obtained by dividing the total revenue collected by the State and its political subdivisions by the total income of individuals residing in the State. The State's revenue effort ratio is then compared to the average ratio for all States by dividing the State's ratio by the average; 15 percent would be distributed to those States with per capita personal incomes below the average for all the States. The per capita income for each of these States is subtracted from the average of all States. The difference between these figures is then used to compute each State's share of the fund.

Third. No State could receive a total payment for any one fiscal year in excess of 12 percent of the trust fund for that year.

Fourth. A State could use its allotment of funds for programs, projects and services—including capital expenditures—in the general areas of health, education, and welfare. In addition each State may use a portion of its allotment—not exceeding 5 percent—to provide for planning, research and development in the modernization of the institutions of State government and the improvement of governmental procedures.

Fifth. To insure that each State will give local governments a fair share of this fund, the Governor of each State would be required to develop a distribution plan prior to the beginning of each fiscal year and following consultations with local officials. The plan would set forth how the State proposed to share with local governments the funds obtained under the act.

Sixth. Funds could not be used for administrative expenses for State and local governments; highway programs; State payments in lieu of property taxes; debt service, and disaster relief.

Seventh. To benefit from the plan, a State would be required to file reports with the Secretary of the Treasury, the Comptroller General and the appropriate committees of Congress, including a statement of intent as to how and for what purposes it shall spend the money. States would also have to comply with all applicable laws including title VI of the Civil Rights Act of 1964. The Secretary of the Treasury would be required to provide a detailed audit report to the Congress annually on the operation of the trust fund during the preceding fiscal year and on its expected operation during the current fiscal year.

Eighth. Failure to comply with prescribed conditions would require cancellation of future payments and permit reallocation of the remainder of a State's allocation to other States in proportion to the original allotment.

Ninth. Appropriations Committees of both Houses and the Finance Committee of the Senate and Ways and Means Committee of the House, responsible for appropriations and tax legislation, at least once during each Congress, would be required to conduct a complete study of the operation of the trust fund and provide such legislative recommendations as appropriate.

The President missed a great opportunity in his state of the Union message in failing to propose legislation providing for the sharing of Federal revenues with the States. He did, of course, make the declaration:

"* * * Only a total working partnership among Federal, State, and local governments can succeed."

But declarations are not enough. He failed to note that the relationship between Washington and other levels of Government in this country today, in terms of real taxing power, more closely resembles that of a patriarch to poor relatives than a partnership of equals. The interchange of ideas and services so essential to a genuine partnership will not be possible until the States and local governments have the financial resources to innovate, to initiate and to pay for programs designed to meet the individual needs of their people. This cannot be done without money, and many States are already using their taxing powers to the fullest extent possible.

In my judgment there can be no genuine partnership between the Federal and local governments without some well designed program of Federal-State revenue sharing with a minimum of strings attached. The bill being introduced today is designed to accomplish this in the most meaningful and equitable way, so that the poorer States will have an opportunity to improve their services and that the so-called richer States will have the resources necessary to meet the overwhelming problems of their urban complexes.

There has been growing support, both inside and outside of Congress, for legislation to distribute a portion of Federal tax revenues to the States with a minimum of Federal controls since I first introduced a distribution formula based on the Heller-Pechman proposals in 1965. In that year, the Ripon Society, a group of Republican activists at Harvard, and the Republican Governors Association were among the few groups to support such an idea.

But in recent months, Representatives and Senators of both parties have either introduced revenue-sharing legislation or have declared their intention of doing so in the near future. As an example, two of the cosponsors of this measure—Senators Baker and Scott also plan to introduce programs of their own incorporating certain additional innovations. In 1966, both the bipartisan National Governors Conference and the National League of Cities called for the sharing of Federal revenues with States and local governments.

Nevertheless, in view of the administration's failure to act in this field, I am pleased to see the initiative taken by members of my party, including Representatives Goodell and Reid of New York. Republican support for this idea should be based on the record of those State and local governments which can show accomplishment and should be motivated by our desire to enable other levels of government to meet the growing needs of their residents by themselves.

Many Republicans in Congress believe that an effective revenue-sharing program would be a major step in this direction and I hope we can successfully convince the majority and the administration.

The problem facing State and local governments is essentially this: While their expenditures have risen steeply in the postwar period, their present and foreseeable resources are not adequate to meet the expanding demands for greater services, the increased costs of education or the complex problems of development.

Unless legislation is enacted giving States and local governments a share of Federal tax revenues with a minimum of strings and with maximum freedom to spend it as they see fit, the trend will continue inexorably toward more grant-in-aid programs, with increasing Federal intrusion into decisionmaking at the State and local levels.

The strain on State and local government finances is illustrated by the 125 percent increase in total debt outstanding for State and local governments over the past decade while the Federal debt increased by 14 percent. The outlook for the future is not very encouraging either. A study recently published by the Joint Economic Committee estimates State and local government debt, totaling about $100 billion in 1965, will reach $145 billion in 1970 and almost $200 billion in 1975.

The States undoubtedly will increase their sources of revenue from property taxes, sales taxes and individual income taxes. The question is can they increase these taxes without limit? State and local tax revenues increased from $23.5 billion in 1955 to $51.6 billion in 1965.

Interstate competition to attract new industry—and similar competition among localities—will undoubtedly hamper efforts to add to current revenues, particularly in the case of corporate taxes. States and localities generally offer some form of inducement to attract new corporations to their areas, with the long-range objective of creating new job opportunties and increasing the overall tax base. This sort of competition tends to restrain local governments from increasing tax rates.

In the face of heavy demands placed upon State and local governments, the increase in their taxes and borrowing has been insufficient to prevent them from becoming gradually more dependent on financial assistance from the Federal Government. Between 1955 and 1965 Federal aid to the States increased by 252 percent. The bulk of Federal assistance in the form of grants-in-aid has grown from a total of $884 million in 1946 to approximately $11 billion in 1965. In 1964 the Federal expenditure of $9.8 billion represented approximately 16.7 percent of total taxes and other general revenues raised by State and local governments, compared with only 7.3 percent in 1946. Grants to help support public welfare programs and to help build public roads and highways have shown the sharpest increase over the postwar years, and together they totaled some $7.5 billion in 1964.

It may be argued by some that State and local governments will not wisely use Federal funds under a revenue-sharing plan or that they will use them to reduce their own taxes and expenditures for necessary programs. Experience of the past, however, indicates that such fears are groundless. A large proportion of total State and local outlays over the past years have been used for educational, health, and welfare purposes—an indication that local governments are cognizant of the needs of their people in these areas and are attempting to meet them.

Grants made to State and local governments under a plan such as this will enable these bodies to operate more independently. Local officials will be free of Federal domination, and the spread of a growing Federal bureaucracy may be halted. State and local governments will be in a stronger financial position, and a better fiscal balance will be achieved between Federal, State, and local governments.

Now, let me direct one word to those who may feel that the sort of tax-sharing plan I propose would mean further incursion on State prerogatives. Of course, there is always a possibility that this can happen, but the choice we face is not between State dollars and Federal dollars, but between Federal dollars bound by strings and conditions and funds which are relatively unconditional and can help buttress the capability of State and local governments to carry their responsibilities and not to abdicate authority to the Federal Government due to financial inability to discharge it.

For, we have to look to the days and years ahead when the demand for more and better local governmental services will increase.

Critics on the one side of the political spectrum are suspicious of the States and seemingly convinced of Federal infallibility; critics on the other side are suspicious of Washington. But mutual suspicions should not produce a deadlock, for this country cannot be governed well unless government is imaginative and active and responsible and works at all levels in a Federal-State system.

I feel that the proposal embodied in the bill introduced today can help prepare our governmental system to meet needs of the coming decades, and can help us to put cooperative federalism into practice for the benefit of all our people.

The issue of revenue sharing involves a struggle between those who want the Federal Government to earmark everything and those who want to leave something to the States, provided there is something in addition; in other words, the Federal funds provided are added to the States' resources and are spent largely at the discretion of State and local governments on the basis of their priorities.

I am with those who believe that with the safeguards written into this bill—and I am the ranking member of the Committee on Labor and Public Welfare which handles most of these programs—we are better advised to begin the process of some form of Federal revenue sharing with the States and localities, letting them, as they progress in showing their ability to discharge their responsibilities, get a greater and greater share of Federal tax revenues rather than being tied to the grant-in-aid idea which, up to now, has been the best we could do. I do not believe that the grant-in-aid program has given us the optimum efficiency or the optimum return per dollar expended.

Representative GRIFFITHS. Thank you, Mr. Javits.

Mr. Maxwell, you may proceed.

STATEMENT OF JAMES A. MAXWELL, PROFESSOR OF ECONOMICS, CLARK UNIVERSITY

Mr. MAXWELL. Thank you, Madam Chairman. The observations which I make are relevant only when the Federal budget permits Congress to consider a reduction of Federal taxes, which is not this year.

When our federal system was set up nearly 180 years ago, lines were drawn that set limits to the powers of the Federal Government, and reserved certain powers to the States by constitutional provision. The lines were not very clear cut then, and certainly they are quite blurred today. At present no area exists from which Congress and the States are barred by lack of constitutional power.

In short, the intermingling of functions of government has now gone quite far, and the separation which most people in authority once thought to be important no longer exists.

With respect to sources of government revenue, the Constitution made little prescription for separation of Federal-State sources. Yet in fact, separation existed, short of the Civil War, into the 19th century. Federal tax revenues until 1913 came from customs and a few excises. State and local revenues came from a miscellany of levies, none of which was tapped by the Federal Government.

Once again this separation has vanished. Taxes overlap. Ideally and absolutely, the present situation appears unsatisfactory. Overlapping taxes mean, at best, duplication of administrative effort and duplication of compliance effort by taxpayers. Since the best is not achieved, they bring, as additional costs, tax conflict, discrimination, and complexity. Overlapping performance of government functions often leads to friction and fumbling in administration. The difficulties of cooperative performance are great, and unified authority might seem to offer advantages. The principal cause of this intermingling of functions and sources is that the government now does so much. Each level jostles the other levels.

The principal technique by which the separation of sources of revenue and of functions of government has been eroded is the grant-in-aid. By it revenue has been provided by the Federal Government to State and local governments.

When the Congress gives grants it acknowledges that certain State-local expenditures have a higher priority than competing Federal expenditures, and Congress is prepared to tax in order to contribute to their costs. Grants have been of two broad types, the conditional or specific purpose grant—the only kind used in the United States, and the unconditional or general purpose grant—used in such federal nations as Canada and Australia and now under discussion here.

The major philosophical or theoretical criticism brought against grants has been the principle of financial responsibility. The government which makes the spending decision should, it is argued, also make the taxing decision, or as Musgrave puts it, taxes have a "discipline function."

This criticism is blunted with respect to conditional grants by attaching "conditions" which serve to preserve financial responsibility. The Federal Government defines quite precisely the kind of spending which will earn a grant, and it usually requires "matching," that is that some defined share of the spending be provided from State-local revenues. These "strings" can be, and often are, quite extensive. Indeed, by insuring financial responsibility, the Federal Government raises other problems. The conditions imposed uniformly across the Nation may be unsuitable in face of the diversity of State-local program needs. The interest of Members of the Congress in pushing specific programs is supplemented by a similar interest of program specialists in Federal agencies so that conditions are tightened with the passage of time. For example, 20 years ago, critics were saying that the public health grants were too categorical and fragmented—not just academic scribblers, but budget examiners. But program specialists in Washington, with the support of key people in Congress, continued to increase the number of categories; the number of project grants grew as the amount of the grant for general health went down. Only in 1966 was there a move against this trend when a Comprehensive Health Services Act made possible some merging of the health grants.

This "natural" bureaucratic process of strengthening controls has, I believe, impaired the very great value of conditional grants. In the past few years, the proliferation of the Great Society grant programs has aroused the executive branch and the Congress to an awareness of this flaw—witness the convenor order of August 11, 1966; the factfinding surveys of intergovernmental problems by the Bureau of the Budget; the review of the categorical grants of HEW; and the White House memo of November 11, 1966, concerning consultation with State and local officials.

Uniform standards and adequate supervision are difficult or impossible to achieve with respect to many functions. In this respect, the better course of action may be to provide unconditional grants to State and local governments. In this way these governments will be put in a financial position by which they can discharge their responsibilities according to their diverse standards and preferences.

The unconditional grant, provided without strings to be spent according to the decision of the recipient, is vulnerable to the charge of financial irresponsibility. Experience in Canada and Australia does suggest that State—provincial—governments are stimulated by unconditional grants to probe by political pressure for liberalization. What defense can be offered against this charge? One defense is to argue that new grant revenues will be spent as have other recent accretions of revenue, that is, for education, health and hospitals, public welfare, and roads. The same budgetary process by which these needs were appraised would be used to assign revenue from unconditional grants. If the formula is sound by which the annual amount and distribution of an unconditional grant are specified, and if the formula is held firmly, then the State-local budgetary process can be depended on to make reasonable expenditures.

What of the possibility that an unconditional grant would lead some State-local recipients to reduce their own taxes—those judged by the legislatures to be the most onerous, probably sales and/or property taxes. If a cut in taxes is in order, why should the Congress make possible a cut in State-local taxes? Congress could prevent such a step by specifying that the amount of revenue provided from their own sources by State-local governments in a State should be maintained at a level established prior to the grant. On the other hand, Congress might take the view that a modest cut in some State-local taxes would, in terms of equity, be superior to a modest cut in federal taxes.

The arguments which I have advanced do not lead to the conclusion that the principle of financial responsibility is of no consequence; they do suggest that sometimes other principles may override it. The most appropriate setting for the principle of financial responsibility is when State-local governments have, within their reach, reasonable options for raising additional revenues by their own efforts. This was their situation until the 1930's. At present, however, the revenue-raising power of State-local governments, compared with that of the Federal Government, has suffered a grave deterioration. A few State governments and a few local governments do lag behind the others in their tax efforts.

In a nation of 50 States and 19,000 local governments, some unevenness is inevitable and unavoidable. But the dominant fact is, I think, that a greater revenue effort by State-local governments in order to provide additional governmental services which appear to be needed seems a much poorer peacetime option for the Nation than adding modestly to their revenues by larger Federal grants, conditional or unconditional. It is a poorer option than a direct expansion of Federal expenditures in new directions. State-local governments can, in my opinion, handle most civilian functions more efficiently than can the Federal Government. The Federal Government is, however, much more efficient as a collector of revenue. This disparate situation suggests the increased use of grants.

Representative GRIFFITHS. Thank you very much, Mr. Maxwell. Miss Penniman?

STATEMENT OF MISS CLARA PENNIMAN, PROFESSOR OF POLITICAL SCIENCE, UNIVERSITY OF WISCONSIN

Miss PENNIMAN. Madam Chairman, it is a pleasure to have this opportunity to discuss major issues of fiscal federalism in this distinguished company. The Joint Economic Committee of the Congress has held many investigations of great worth and I am proud to participate today—however small my own contribution may be.

Every day this summer we have had headlines that dramatize the difficulties of our metropolitan areas and our States. Individual and public poverty exist in the midst of affluence. Aggregate personal income or aggregate public revenues of potential revenues gloss desparate realities. The Nation has great strengths. It has genuine problems. To stress either tends to minimize the other. The emphasis here on problems is only possible because there is a fiscal potential for some solutions.

In the extended paper I was invited to include in these hearings, I have emphasized that none of the 1970 or 1975 projections encourage me to believe that State and local revenues will be adequate. Citizen's demand is rising faster than the predictable growth in State and local revenues. And the aggregates disguise the more compelling difficulties of some of the States and most of the metropolitan areas.

How can the National Government offer financial assistance and promote local problem solving? Flanders and Swan sing of De Gaulle's "Market recipe" that excludes Britain. My market recipe for national aid is eclectic and excludes few proposals. Shared taxes, grants in aid, the negative income tax all have possible roles. Reduction of the burden of poverty on individuals and on communities may require further national programs, grants in aid, shared taxes and possibly the negative income tax. Presumably Federal programs could expand into every area, in which we see unmet demands rising. National funds and programs will not alone do much to energize the States and the metropolitan areas. To survive as actively contributing partners, the States need to improve their administrative and political structures; and to be able to use whatever existing revenue potential they have without the constant threats of interstate tax competition or political suicide for the Governor. Somehow we need to involve the whole metropolitan area in its own salvation. We need to bring all of the possible civic leadership as well as the revenue potential of the total area to the solution of the general service needs and problems. Both the States and the cities need to attract more able young people to the challenge of careers in their governments.

Remodeled grants in aid can have a role. The early single-minded highway grants and categorical welfare aids brought a revolution to the Nation's highways and its welfare problems a generation ago. The Congress now has appropriated more and more money, extended and extended the number of grants, specificed more and more goals (sometimes contradictory), and involved more and more individuals and agencies at the national, State, and local levels. The confusion of purposes, the multiplicity of voices, and the competition for funds frustrates program administrators, chief executives and legislative bodies alike. Only Congress perhaps can put order into the Federal grants by assignment of all funds to not more than a dozen agencies. If the agencies will assist in clarifying objectives and limiting the administrative points for State-local communication, we might reduce some frustration.

There could be other payoffs. If we actually reduced grants and the number of operating administrators in Washington to something like a dozen, we might in time reduce their counterpart departments in the States to a dozen. This indeed would be reform in many of the sprawling State bureaucracies. There might also be more assurance that the total grants did not affect the States differentially in ways not contemplated in each grant. I pointed out in the paper that despite all the data that would characterize Wisconsin as an average State in personal income, as above average in tax effort, and as above average in government quality, the State ranks next to the bottom in grants in aid received in relation to tax effort.

It may be that 12 grants is too small a number, but it seems to me that if we wanted to have some additional specialized grants for limited periods, it would always be possible to experiment on a 3-year basis and then bring them back into the total of 12 or so.

If Congress not only consolidated present grants into a relatively small number but additionally differentiated among the States on the grounds of past program quality and administrative effectiveness, even greater progress might come. The differentiation among the States would not extend to withholding funds but to rewards in simplifying applications and reports. Broadening grants and rewarding effectiveness would give time and room for creativity in the States most likely to respond.

Shared national tax revenues can assist State governments. Tax sharing offers a flexibility to receiving governments that grants cannot fully do. A number of the American States have supplemented program grants to local governments with shared taxes over a period of five or six decades. The tax sharing has permitted local governments to continue in some programs without detailed State direction. Tax sharing, much more than grants-in-aid, strengthen the elected executive and legislative bodies of the recipient government. Some political power and decisionmaking would shift if shared taxes replaced a similar expansion in grants-in-aid. Governors and legislators would gain opportunities to make greater choices in program priorities. Shared taxes permit greater optimizing of budget decisions. Where the specialized matched grant may distort Government budget decisions merely through the incentive to collect "what belongs to us," the shared tax simply adds to the available revenues for whatever program decisions are made.

Administrators would lose some of their present influence on program emphasis to the chief executive and legislative bodies in their State. They might gain some opportunities for experimentation and innovation that would attract energetic young careerists to the State agency. Manpower problems in State and local governments have worsened, as prospective recruits see most of the exciting and creative administrative decisions being made in Washington.

The experience of shared taxes in the States offer some warnings. Devising a distribution formula is a sensitive political and technical problem. Subsequent change is politically difficult, and the wrong formula may fail to assist as intended or to have unforeseen and unwanted consequences. Where some equalization is intended, returning taxes in great part to the community from which collected will have the opposite effect. Such factors as population or per capita income and tax effort must constitute a major part of any formula that seeks to equalize revenues and needs. In the case of local governments, both State shared taxes and State and Federal grants-in-aids have played unfortunate roles in fragmenting our metropolitan areas into numerous government units.

The metropolitan areas must share in additional Federal revenues to the States. A congressional decision to share taxes with the States will almost necessarily include provision that a portion of these additional revenues go through the State to metropolitan areas. Moreover, the transfer to the metropolitan area will require formulas with many of the same factors as affect the tax sharing with the States. Either a State agency or a metropolitanwide organization will be needed to assure that the core city and suburbs that are hardest pressed by high tax rates and low public services receive the additional funds. No Federal shared taxes should be available to governing units in the metropolitan area whose tax rates are below and whose public services are above the general norm of their neighbors.

Will the States and their metropolitan areas expand programs rather than cut taxes with expanded Federal revenues? The flippant answer is to suggest that Parkinson's law operates: Expenditure demand will rise to claim any unused revenues. The more serious answer comes to the same conclusion. Any sharing of taxes that seriously takes into consideration need or unmet public demands and high tax effort in its distribution to the States and cities is not likely to be used for taxpayer rebates. An earlier analysis of mine found the height of taxes among the States more closely correlated with the individual State's political decisions of past decades than with current economic or political characteristics. Unsegregated Federal funds could assist many of the States in raising the accustomed level of public services and thereby adding weight to future State tax effort.

No decision as to Federal assistance to the States is without its risks. The 50 States vary in their political traditions and their administrative effectiveness. There are potentials for revenues, political leadership, and innovation in the States and metropolitan areas. Congress must help to mark out their work.

(The expanded statement of Miss Penniman follows:)

EXPANDED STATEMENT OF CLARA PENNIMAN

Some Political Implications of Our Federal Fiscal System, 1970?*

I begin with certain assumptions: 1. that a majority of citizens find substantial unmet public needs in the characteristics of their communities and in the available educational, health, and welfare services; 2. that most of us would like to improve the quality of the environment in which we live, work, and play; 3. that many have a concern for those who do not share reasonably in the economic growth of the nation; 4. that in the *aggregate* in the United States today we have sufficient resources to meet most of our public needs and desires without unduly sacrificing private living standards and 5. that the quality of life and the productivity of our economic system in the future rests on decisions that we are now making. Some of the things we want represent public expenditures for consumer items to improve the aesthetics and pleasure of living. Many more of our wishes or demands represent potential investments with prospects of substantial returns far above the tax costs.

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*So much has been written of relevance to this essay that it is impossible to acknowledge all indebtedness and seems pretentious and unnecessary to document most of the statements. Anyone unfamiliar with the field might well begin by reading: Advisory Commission on Intergovernmental Relations, *Metropolitan America: Challenge to Federalism.* A study submitted to the Intergovernmental Relations Subcommittee of the Committee on Government Operations. A Committee Print (Washington: U.S. Government Printing Office. October 1966). I would then recommend Walter W. Heller. *New Dimensions of Political Economy* (Cambridge, Mass.: Harvard University Press, 1966); George F. Break, *Intergovernmental Fiscal Relations in the United States* (Washington, D.C.: The Brookings Institution, 1967); and perhaps Christopher Green and Robert J. Lampman, "Schemes for Transferring Income to the Poor," *Industrial Relations, A Journal of Economy and Society,* Vol. 6, No. 2, February 1967, pp. 121–137; references indicate numerous additional sources.

(1)

For those who would see, the evidence grows of the consequences of our delays in spending. As Harold Groves has graphically put it, "the smell of the city ghettos blows ever stronger in the suburbs" that wealthy citizens have walled in to defend their abdication of responsibility for the problems and costs of urbanization. Wittingly or unwittingly growing numbers of citizens have taken from the city, but have made elaborate defenses against giving. Every metropolitan area in the country suffers from these attempts at insulation and the resultant alienation and burdens of other citizens. There has been a cumulative effect of these actions that has produced a vicious circle of slum growth; poor education where great educational effort is required; and inadequate city services of garbage collection, trash collection, park development, and policing.

Once we prided ourselves on our public education from kindergarten through University. We emphasized that democratic government required it. Today we readily acknowledge the necessity of education for our technological society. Yet we are little by little undermining our public schools. Private schools for children of the economically secure are growing. "We can't take the responsibility for handicapping our children in college preparation," says each parent in turn. What the parents seldom say is that they either have not tried to improve the public schools or have tried and given up. And they do not make the further admission, "Once my child is in a good private school, I do not need to worry about the public schools." The impact of the shift to private schools in fact is even more cumulative. As citizens place their children in private schools, they not only care less about what happens in the public schools but may well resist tax increases that would improve public education. This is on the part of parents who might otherwise be in the forefront of the battle for better local schools. The final irony comes with the request for public moneys for the private schools on the grounds that the superior quality of these schools must be guarded!

This is a plea for the public schools, not an attack on the private ones. We can not afford substantially inferior education for any of our children. In some cases this may mean expanding Headstart programs. It may also mean a higher ratio of teachers to pupils and changes in methods for disadvantaged children. Schools can not carry all the burdens of the society; but without adequate education, many children will never be enticed to develop and use their potential ability.

(2)

The belief that we are not today living as well as we desire or can publicly afford is paired with the assumption that many of the states and major cities, without further aid, cannot do the job demanded. It should be made clear that the several 1970 or 1975 "projections" of state and local government expenses and revenues, whatever *aggregate* balance or imbalance they happen to show, are based on expenditure assumptions of population growth but on few assumptions of significant improvement in the quality of public living. *Aggregate* ability to meet public desires does not give sufficient resources to many states, to many core cities, nor to the Appalachias of the nation. Yet even the states that represent the high part of the economic resource scale in the nation often do not meet their acknowledged responsibilities. The issues of interstate competition, benefit spillover, the presumed limits in the height of particular taxes or their impact on groups that are supposed to be aided all make elected state and local officials politically vulnerable to suggestions for increased taxes.

Our state and local tax systems do not match the service demands made upon them nor the equity standards some of us would wish. We are pushing our state and local taxes in an ever more regressive direction with attendant burdens on those we seek to aid through national, state and local Poverty Programs. Progressive states such as Minnesota and Wisconsin have bowed to the pressures for a sales tax, a less burdensome variety than in many states but nevertheless a sales tax rather than an increase in state income taxes. A one time leader in income taxes, New York has scarred its escutcheon and scuttled the value of its prestige for many earlier supporters first with sales taxes in the City, then a state sales tax, and finally adoption of a lottery system for educational revenues. States, old in the sales tax field, have pushed rates up and coverage out. Pennsylvania and Rhode Island now have general rates of 5%. In many communities Illinois taxpayers will pay a combined sales tax of 5% beginning August 1. California has a state 3% levy and authorizes additional local levies of 1%. Michigan adopted a low rate proportional income tax this year after its sales tax had reached 4%.

Property tax rates, as Harold Groves pointed out in a paper in Volume I prepared for these Hearings, are climbing spectacularly in the country's largest cities even though many of these cities also use income and sales taxes. Where much of the greatest urban poverty exists in each state, there also are the highest urban property tax rates to reduce still further the available income of those in the lowest fifth of the economic scale. Growing state and local borrowing together with rising service demands give no hint that present taxes will be lowered or, what is really more important, that there will be any move away from further deepening the regressivity of the tax systems.

II

Since an important segment of the issues presented here lies at the door of the states and local governments, why bring the problem to this committee and the Congress? National attention is already focused on many of the difficulties. Every city riot and its intertwined roots finds national headlines. Poverty, discrimination and its consequences, educational demands, crime, air and water pollution, and transportation and housing needs may be old. In their modern guises, however, they have national dimensions both in causes and consequences. Individuals and groups who have failed to gain demands at local or state levels have come to Congress for decades for redress. Many of these appeals have been answered through national programs or in grants-in-aid. Other problems develop and further appeals are made. The concern today is with our whole federal structure. How can we make state and local governments work better so that we at least can contain the administrative burden of the National government? Is there no way to justify the states as "laboratories of experimentation" except as a historical statement or a convenient shibboleth? Several sets of problems need disentangling. We can dissect at least part of the intermix of state and city problems though we may need later to put them together again with the national for all round viewing.

(1)

A significant number of the states (perhaps a third to a half) have ample financial resources but for internal or external political reasons have not used the resources at their command to alleviate the ills within their borders. These ills may be imports that they hope to export to others. Or they may never have accepted responsibility and have allowed others to cover for them. Higher education is an example of the latter. A number of states, some rich in revenue potential, failed for years to provide college and university opportunities to many of their young people. Other states received some of these students and gave them an opportunity for education at some cost to the second state's taxpayers. What is the spur for the inactive but well off state?

We don't fully know why some states make more of a tax effort than others. In an increasingly interdependent economy and society, the federal partners in our government enterprise can not make significantly different policy decisions. This point has particular force in the tax realm. There are effective parameters outside of which individual states can neither raise nor lower taxes unless there are "crises" that tend to move all fifty in the same direction.

There is, however, a further characteristic among the states. The interdependence may set upper and lower limits of taxation, but this author's analysis of a couple of years ago found that states showed great persistence in their general rank order.[1]

Using per capita taxation, a rough measure of the quantity of services furnished, California, Massachusetts, Nevada, and New York ranked in the upper quartile decade by decade from 1902 through 1962. Washington ranked there six out of seven times; Colorado, five out of the seven; and Connecticut and Wisconsin, four out of the seven. Consistency is even stronger on the low tax side (low services?). Eleven states (Alabama, Arkansas, Georgia, Kentucky, Mississippi, North Carolina, South Carolina, Tennessee, Texas, Virginia, and West Virginia) were in the lower quartile of twelve states in per capita taxes. Eight of the eleven

[1] See chapter 8, "The Politics of Taxation," by Clara Penniman in *Politics in the American States*, edited by Herbert Jacob and Kenneth N. Vines (Boston: Little, Brown & Company, 1965).

repeated each decade. Tennessee and Texas appeared six times and West Virginia five times. Shifting to *tax burden* and the relation of per capita taxes to per capita personal income, eight states—Colorado, Louisiana, Minnesota, Mississippi, Montana, North Dakota, South Dakota, and Wisconsin—appeared in the upper quartile in at least three of the four decade years it was possible to check from 1932 through 1962. New York was there in two of the four years and not far behind in the other two. Six states—Connecticut, Delaware, Illinois, Maryland, Missouri, and Virginia—repeatedly ranked in the lowest quartile in tax burden at least three out of the four decades reviewed.

Elaborate statistical analysis have been attempted to explain differential tax levels among states and among cities. So far much has seemed to escape the analysts' efforts. To emphasize, as my study did, that there are persisting patterns to tax effort—whether low, high, or moderate—leaves two questions: What started a state in its particular direction? What kind of "crisis" may shift the pattern of acceptable taxes to its citizens?

We do know that the fifty states tend to move up (only occasionally down) together even though there are leaders and laggards. We know that the federal grant-in-aid device has spurred states to act to become eligible for grants. We know that Mississippi apparently provides a low quality of service through its citizens carry a high tax burden. We also know that state experience with shared taxes indicates no long run slackening of local government tax effort when the relative service need is there. The Wisconsin experience (and I believe this is common) offers evidence that shared tax or grant formulas that provide bonuses for less needy governments probably add to the niceties of that community's public service standard as much as in reducing tax effort. (Impressions rather than statistics confirm this evaluation.) Where the good life and low tax rate are a generation or more old, the pattern is built into community expectation and property values.

Some of the central cities as well as states may have unused financial resources, but increasingly the central cities wage an unending battle as the turnover in residents leaves them with more and more problems and fewer and fewer financial and civic leadership resources to call upon. Our cities have borne the full weight of many of our domestic crises with a certain readiness on the part of the state (and at times the national government) to give advice and to "solve" problems by establishing or encouraging competing and/or overlapping jurisdictions in the city's backyard. During the century before the Great Depression many of the cities may have asked for the restrictive treatment they received. The penalties for their past sins have been grave and threaten to engulf much more than the cities. Can we unloose the central cities of our metropolitan areas or must we devise a different governmental structure to more reasonably balance local expenditures and revenues?

The traditional solution would expand the central city's borders to include most of the metropolitan area within its boundaries. City service benefits and their costs would be borne by the whole interacting community. Much can still be said for this approach; and in the smaller, separated metropolitan areas it may be the solution if we can but bring together the political combination to accomplish the reunion and give it direction in infancy. The Nashville-Davidson County organization requires continuing observation for possible lessons. The traditional solution loses force when one thinks of applying it to the New York metropolitan area or the Chicago or the Los Angeles. In the first place it is difficult for anyone including Census to define the physical area with its socially and economically interacting individuals and organizations. Secondly, there is no feasible way to impose such a single structure. Third, for all of the logic of such arrangement, we might well have an amoral and uncontrollable behemoth.

Without much thought we are pushing a third type of government in metropolitan areas, one that has a number of general purpose jurisdictions overlayed in different patterns by functional districts. School districts, water districts, park districts, forest districts, sewage districts, police districts, planning districts (sometimes a contradiction in terms) and a host of others exist in different metropolitan areas. Chicago perhaps is the "model" with 1060 local governments and special districts, but few conscientious citizens in Minneapolis-St. Paul or in any other large metropolitan area would find time to follow the issues and attend the public meetings of all the governments of "their" residence. Who controls the functional districts? Is there any point of evaluating the impact on the system of the separate approaches? Are these problems present under general purpose governments with their functional departments to the same degree or lesser degree? How integrating is a city budget for general purpose governments? Does the quality of the bureaucracy differ depending on the organization?

The most reasonable assumption in 1967 is that the states and the nation will pour more funds into metropolitan areas in recognition of joint responsibility for the conditions. The more uncertain and critical issue is whether the funds will be allocated bit by bit to lessen symptomatic chancres or to assist in restoring local ability to act for the solving of area problems.

The fifty states have great general similarities, but there are important distinctions in political attitudes and assumptions toward government as well as political and administrative practices. The metropolitan areas in each state share, and have contributed to, this political "culture." Can a *national* formula of fund distribution then be written to attain our objectives?

Can we trust the states to use additional federal funds to assist their metropolitan areas in problem-solving? The answer to this as well as the previous question is not absolute. The political power configurations differ among the states, and it seems doubtful that reapportionment with its general shift of power from rural areas to suburbs is likely to generate immediate answers. State reapportionment has come too late for many Cities.

National assistance to the states with some strings to assure metropolitan aid still leaves us with choices without certain knowledge of the consequences of each. Our goal is a metropolitan organization, with possibly differing features among states, that is most likely: (1) to achieve a look at problems on the whole and secure the best match of revenues and expenditures; (2) to provide central and program organizations that will attract young people with verve and energy to work out solutions; and (3) to enlist the active concern of a substantial part of the citizenry.

Where do political parties fit in? Can they knit together the federal system from the City through the state and the nation for program accomplishment? We have never ceased to assume poltical parties at the state and national government levels as the mechanism for compromising diverse interests and accomplishing functional objectives. Locally, political parties in this century have had a less settled role. Many American cities, including some major ones, elect "non-partisan" mayors and councils. We have no large metropolitan governments and thus no experience as to whether the two political parties can organize satisfactorily within such structures. Nor do we know whether as organized contenders they can offer meaningful alternatives to the diverse electorate. Can the political ethnic blending formulas in many of our Cities in the past be a satisfying model to both the party and racial minorities?

If our faith is in political parties to harmonize local interests and give satisfying representation to the diverse groups, then a general purpose government of some type is required. We might, for example, develop a structure that physically covered the metropolitan area, or something less in the very largest metropolises or where the metropolis crossed state lines. To this new government might be given all powers to receive revenue grants from either the state or national government. Present government units could continue and there might be occasion to experiment with neighborhood "governments" within the central city. Over time the local units might transfer some planning and service responsibilities to the new metropolitan-wide government. In any event, the new government would use the metropolis' share of grants and shared taxes to maintain a reasonable service norm and tax burden among all parts of the metropolitan area. The state and national governments would write these specifications into aid formulas. Substantial reduction in present disparities between needs and resources could then be achieved without forcing consolidation of governments. This is a challenge for every political party activist.

III

If the Congress were to accept the desirability of further and different fiscal efforts to assist state and local governments, how might it take action? What are the political, institutional and structural implications?

The United States is not the only nation that has faced this general problem. Where services are decentralized in any fashion, sufficient revenues seldom exist in matched form. The aggregate taxing power that permits an aggregate service need in a nation is a different thing when fragmented. Grants, tax credits, and shared taxes have been developed to assist the operating government level in its revenue needs. Senator Nelson has reviewed some of these arrangements, especially tax sharing, in several of the nations in the British Commonwealth, Germany, Argentina and others. The listing compiled by the Library of Congress appears in the Congressional Record for January 11, 1967, pp. S74–S80. Details of the provisions and characteristics of each nation's experience tend to be a product of the national history and organizational arrangements. Generalizations do not come easily.

Some of the experience of the American states has been reviewed earlier in papers prepared for this Hearing. Past national and state experience in the United States normally is a more reliable guide than the experience of other nations simply because it has been tested in the American political culture and traditions. The states have tried out many variations of present proposals to Congress: reduction of taxes; tax credits; tax deductibility of certain state and local taxes against state income taxes; both narrow and board grants in aid to local governments; and sharing of taxes with local governments. There is no one way to salvation, and there are rough points along the road.

The Wisconsin experience, that has its counterpart in other states, demonstrates that shared tax formulas and grants in aid make it possible for local governments to continue to administer functions that otherwise have been transferred to the state government years ago. The local governments have seldom appeared to waste funds on the grounds "it wasn't their tax money;" but whether it goes for necessities or niceties of public living is a function of whether or not the outside revenues represent a surplus over minimal property tax levies. Education, welfare, and highway functions in Wisconsin local governments would not survive there without the state assistance. Whether all of the highway and welfare functions now at the local level permit the most effective use of resources is debatable. Wisconsin's shared taxes and grants also illustrate that the formulas may contribute to the form of local government. Not all of Wisconsin's local governments would survive without the state funds. The continuance of some obsolete governments and the fragmentation of government in metropolitan areas of the state have roots in half-century old policies that failed to anticipate the economic and social changes.

The shared taxes and grants in their Wisconsin formulations have reduced property taxes, if one could assume local governments would continue all present responsibilities. They have had limited effectiveness in promoting equality of tax burdens. Reports for 1966 indicate that equalized, full value property tax rates, averaged by counties vary from a low of $.01304 to a high of $.02972. Among local governments, the rates in 1965 averaged $.03055 for cities, $.02670 for villages and $.02363 for towns. The range extended from $.00999 to $.04999. Full value tax rates are not perfect measures of tax burden as related to income nor do they differentiate in amount of services bought. Anyone who knows Wisconsin communities, however, would agree that the rates express something of the range of tax burdens and of public services. The failure in achieving greater equalization is not inherent in providing grants or sharing taxes. It *is* a warning to devise formulas with great care. Returning an important share of the income tax on the basis of residence of the taxpayer almost insures that wealthier communities will do even better than they otherwise would and encourages other citizens to incorporate municipalities to claim the advantages. The separate functional grants then operate in part to reinforce the tax advantages, since the specialists tend only to have an eye on their program.

Tax sharing, grants-in-aid, tax credits form part of the tax policy decision-making that are a critical part of the political process. Legislators often debate major tax policies for years before agreement is reached. Many specific details may be a part of the elaborate compromise but occasionally may be accidental without general understanding of their implications. Whether a defined part of the compromise or more casually included, the resulting legislation has something of the permanence of a stone engraving. Changes come slowly. Opponents find it easier to accept than to pursue the debate further. Citizens accommodate themselves and don't want to be disturbed. Such reluctance to change reinforces the critical nature of the original tax policy decision and the need to explore consequences in depth.

National Government Policy Options

The proposals for national assistance to the states today have many supporters. Everyone likes money that fits his own conception of freedom, flexibility, and advantage. The numerous suggestions can be summarized in a few general

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options. Some would reduce federal income taxes as was done in 1964 with the hope that the spur to the economy would increase state tax revenues. This suggestion is not to be overlooked when the economy is lagging, but it does not assist much in equalizing different taxing abilities among the states nor does it necessarily assist citizens with the greatest need. More direct assistance to the states would include (1) continuing and perhaps increasing federal government programs and specific grants in aids to the states; (2) modification of the grants in aid program in the direction of fewer grants of greater size with possibly greater built-in sensitivity to differences among the states; (3) federal income tax credit for state income tax payments; (4) federal income tax credit for all state tax payments or at least sales taxes in addition to income; (5) the negative income tax; (6) block grants; (7) shared tax revenues.

Perhaps none of these proposals is inherently contradictory with any or all of the others. Manifestly the national treasury can not afford them all. One and two could be achieved without necessarily increasing present appropriations. And some action may be due here to reinforce other choices. The income tax credit in this author's judgment comes too late and further tax credits would be extraordinarily blunt instruments for the objectives. A block grant and a shared tax may have technical distinctions, but practically may be merged for consideration of political implications.

1. CONTINUING GRANTS IN AID & FEDERAL PROGRAMS

If Congress takes no new change in direction in its relation with the states and local governments, what can we predict for the next five or ten years?

Historically as unmet demands have piled up at the state and local government levels, Congress has established or broadened programs to be carried out directly by the national agencies or increased grants in aid to state and local governments for specific purposes. There is no reason to eliminate either of these approaches, and both may well need expansion; but there is evidence that the two *together* and *expanded* are incapable of effectively meeting today's needs within the framework of the federal system. To put the full responsibility within the federal agencies would remove many functions from the states and municipalities that historically have been theirs and would place back-breaking demands on the federal administrative structure. One does not have to have an abnormal fear of centralization to believe there are limits to which computers and PPBS can be put to provide desirable control to assure effectiveness and satisfactory responsiveness to local conditions.

Although grants-in-aid programs have done yeoman service *and must continue to do so,* there are difficulties here too. 1. The very number of grants places a burden on the states and localities to understand and to utilize in the most satisfactory fashion. 2. The variety of programs and numerous available outlets make for strictures and limitations at times rather than promoting innovation. 3. All states and localities are treated equally in the sense of the complexity of the application process and most of the strings attached despite differential evidence of past quality performance. 4. The separate formulas at times produce curious seeming inequities when total grants are observed in relation to needs and resources. 5. Inconsistent purposes or at least inconsistent programs are not unknown.

We might restate the problem of grants-in-aid to the states as analogous to the poverty problem. Despite all the specific welfare aid policies (at every level of government and involving huge federal sums), poverty and the grinding effects of poverty still persist. We are now attempting to look at it whole rather than through categories, and our success is likely to be greater. So too, despite increasing national billions (15 billion in 1965) of grants in aid and sustained effort at all levels of government, the states and local governments continue to show strains that reflect continuing budget struggles to match means and ends.

Let me reinforce some of the difficulties cited with the grant-in-aid structure. Wisconsin is an extraordinarily average state among the 50 when many standard characteristics of size, population, income are compared. It repeatedly ranks around the middle as 24th, 25th, 26th. It is a state that I believe most of you know has been relatively free of corruption and graft in this century and at times has been creative and innovative in program. How creative it has been recently might be debated, but that its citizens have been willing to tax themselves heavily for financing welfare, education, and other programs can be substantiated by any reference to per capita taxation records and particularly to per capita taxation in relation to income. Yet these seeming virtues are lost in today's federal grants-in-aid picture. Review of total grants-in-aid whether measured by per capita population, income, or tax effort appears to show that the state receives less than its reasonable share. And there is currently no evidence of a possible shift. At least one 1970 projection shows only New York making a slightly higher effort in the ratio of its own funds to federal grants.[3] Making all the allowances one can think of, I am still driven back to the proposition that Wisconsin taxpayers are the victims of some unanticipated consequences of the total grant-in-aid system that the Congress never intended in writing the grant by grant structure.

Reduction of the number of grants might eliminate some of the unanticipated consequences and ease both federal and state administrative burdens. If all of the present federal grants to the states were consolidated into a dozen or fewer under no greater number of federal administrators, the sources of friction and frustration would be reduced. Governors, legislators, and top administrators might all feel they had better understanding and control of their program responsibilities. By fairly explicitly stating goals or objectives but without tying applications for funds to the general program to each individual goal, Congressmen would have no reason to believe they had lost any of their present control and they might find they were able to gain a better sense of national-state effectiveness in health or welfare or housing or employment or education. Additional goals with additional funds unsegregated could be added from time to time. A dozen applications and subsequent reports from each state could replace numbers now sometimes running into the hundreds with the necessity often of repeating much of the same general data about the state's characteristics. Possibly a dozen or fewer broad grants from the national government would press states with sprawling bureaucracies to pull functions together under fewer and more orderly tents. Local governments too might feel the press for consolidating functions.

Another approach to adding flexibility at the state level would involve recognizing the differential quality of state government and their abilities to carry out programs. Formal equality under the grant procedures may often make for inequality. Why should a state that has not had a major (or even really a minor) corruption scandal this century, that has had an effective merit system for quite literally 99% of its employees, that has shown early leadership and administrative effectiveness in many programs, and that ranks unusually high in its own tax effort have to submit one detailed program application after another. Is it not possible to establish a few objective criteria as to the general quality of individual state governments to permit states highly rated to apply on a simpler basis for large blocks of funds. Thereafter, a few regular reports of uses and accomplishments plus federal post-audit might legitimize further such general grants. No state, under this proposal would be barred from getting its share of grants provided by Congress. This is necessary to meet political realities and to avoid penalizing many of the recipients whom the programs attempt to aid. States below the administrative standard would be subject to closer controls and would have incentives to improve their housekeeping.

What about grants to local governments? Where these exist, the national government seems frequently to be following the path of the states in reinforcing or assisting fragmentation in the metropolitan areas. Should all grants be routed through the state? Should urban grants go only to the central cities with further distribution permitted? Neither of these alternatives is perhaps desirable or politically feasible. Yet today's practice of involving both at the national and local levels individuals and agencies single mindedly pursuing education, or an aspect of health or welfare or housing or airports with little concern for general purpose governments or the central city lays up problems for the future. Some consistent vision of metropolitan government that permits an integrated attack in needs and revenue resources urgently demands the attention of legislative bodies and administrators.

2. TAX CREDIT

In my view the income tax credit proposal can be dismissed in one sentence. It comes too late. If Congress in 1935 or 1940 or perhaps even as late as 1950

[3] Selma J. Mushkin and Gabrielle C. Lupo, "Project '70: Projecting the State-Local Sector," George Washington University State-Local Finances Project (Washington, D.C., March 1966), mimeo.

had authorized taxpayers to credit a portion of their state income taxes against their federal income tax bill, state tax systems today would reflect much less regressivity than they do. They would also be more productive in their responsiveness to economic advances. At an earlier date every state legislature would probably have enacted an income tax, some would have repealed their sales taxes, and it is unlikely that any state without a sales tax would have adopted one. All of the argument in state legislative halls against any state income taxes or increased income taxes on grounds of interstate competition would have evaporated over night. Encouragement to the states to adopt personal income taxes, with all of its merit, was feasible politically only when few states had sales taxes.

The opportunity of the past no longer exists. It is a mirage in my judgment to believe that the Congress would not now be inundated with cries of infringement of state's rights and pressures from taxpayers and states to permit the same credit treatment for state sales taxes and perhaps property taxes. I do not agree with the policy wisdom of the CED minority who argued for equal treatment of all three major taxes, but I believe they are accurate as a practical matter.[3] The present 12 states without an individual income tax and with sales or property taxes or both have the political power, especially when supported by numerous taxpayers in the other states, to prevent enactment of a tax credit proposal for state income taxes alone.

If the price for a state income tax credit today is substantially equal credit for all state taxes, that price is too high. The special argument that the high federal income tax rates usurp the whole income tax field has limited validity. The states have never used fully the potential of the current deductibility feature of the federal income tax that in effect permits very high rates in the higher income tax brackets with most of the cost being borne by the national treasury and not the taxpayer.

No formulas to restrict the tax credit in a manner that would reduce the manifest inequality among taxpayers would have substantial import for improving the equality of resources among the states or enlarging the available tax resources in the states. The subtleties of tax credits have frequently proved too great for the general give and take of political understanding. Interstate tax competition would continue to stalk state capitals, as governors and legislators attempted to recapture the substantial revenue losses to the national treasury. Whatever the amount of recapture, it almost certainly would be in the form of taxes far more regressive than the federal income tax.

3. NEGATIVE INCOME TAX

A few important economic scholars are supporting some form of negative income tax to replace many of our categorical welfare aids—aid to dependent children, old age assistance, aid to the blind, aid to the disabled.[4] Their proposal would also aid individuals and families on no welfare program but with income below the poverty line. (It is estimated this latter group would constitute 75% of the total.) What would such a step accomplish? Its supporters argue: depersonalize support; remove morality issues from poverty; eliminate the possibility of much of the present corruption problem that is argued to arise especially in aid to dependent children (in contrast to social security where such issues appear rare); eliminate the present possibility of needy individuals failing to qualify under any specified program; encourage work by the able rather than penalizing them as is the outcome at times under present programs where money earned reduces assistance in the same amount.

The negative income tax has significant implications for government. It would transfer much of the burden of welfare administration to the Internal Revenue Service. The experience and generally good record of IRS in collecting taxes would be applied to verifying the accuracy of low income reports and paying out funds according to the established schedule. (Do we need to worry about the psychological hazards to tax agents paying out money?) Welfare social

[3] The Intergovernmental Relations Commission and CED have both made such a recommendation. Advisory Commission in Intergovernmental Relations, *Federal-State Coordination of Personal Income Taxes* (Washington. D.C.: Government Printing Office. 1965). A statement by the Research and Policy Committee. Committee for Economic Development, *A Fiscal Program for a Balanced Federalism,* June 1967.

[4] Milton Friedman, University of Chicago economist, would go farther and eliminate most of the insurance plans; unemployment compensation; workmen's compensation; OASDI.

workers would serve exclusively in their trained role of adviser on personal budget and family matters of all kinds. The policing and advising functions would be completely separated.

State legislators would be freed of a major responsibility for setting recipient aid grants to take account of the federal subsidy, other state welfare claims, and in some states local government effort. In state and local budgets that provide bare matching of federal grants in aid for welfare or other functions, there is the probability of a bias in direction merely to collect the grant. Such a bias may be irrational in view of the total demands that the particular state or local budget finds it possible to fulfill. Congressmen would substitute making occasional general policy decisions on the negative income tax to define the poverty line and the tax return rates for their present general policy role, often mixed with varied individual state considerations, on welfare grants. In providing payments to families below the poverty line, neither legislative bodies nor admnistrators would have to distinguish on some "moral" grounds as to why the family had insufficient income.

State governors and administrators no longer would have to work out elaborate interstate, and sometimes intrastate, agreements for handling welfare problems of families judged legal nonresidents of the area in which they are living. A broad negative income tax would turn income verification problems, now in part with Welfare, over to Internal Revenue Service. Neither Welfare Departments or Internal Revenue Service would have to verify family budgets as a condition for payments nor make many of the other determinations now needed to establish recipient eligibility under the laws and administrative rules of local, state, and federal governments. The negative income tax would relieve state and local (particularly core city) budgets of a substantial drain. Present matching aids, though not necessarily all administrative expense in social workers' salaries, etc., would be eliminated.

Of course, the national government could take over much of the financial burden in other ways than by adopting a negative income tax. Parts of welfare, such as general assistance, are not now supported by the national government and recipients in other programs are poorly or reasonably well taken care of depending on the generosity of their state of legal residence. If Congress substantially enlarged federal support and provided greater flexibility to the state and local governments by placing all such funds in a single general welfare grant, certain of the values of the negative income tax would be achieved. Administrative headaches with questions of state residence or differentials in state payments or classification of particular poverty for eligibility for grants might go.

The financial transfer of such a major function to the national government, by whatever means, would permit present state and local budgets to expand in other areas without tax increases. *It is always safer to predict an expenditure rise where no tax increase is required than to predict a rise in taxes at any given level regardless of possible credit offsets to taxes elsewhere.* Parkinson's law operates: Expenditure demands will claim any unused revenues.

Sharing Federal Tax Revenues With the States

Sharing tax revenues permits use of the most effective revenue collecting level of government without automatic assignment of all programs to the same government. One government may have greater tax collecting proficiency than administrative proficiency where the reverse situation holds at another level. There was perhaps an era when fiscal responsibility meant a budget balanced with all revenues raised by the government spending the money, but practice has long since outmoded such a definition. The United States has given grants with many or no strings to state and local governments from the beginning of the nation's existence, but it has not developed a national tax sharing system with its inherently greater freedom to the receiving government. On the other hand Canada has used a shared tax system and some of the American states have had substantial experience with the method.

The idea of tax sharing is not new. The states used it from the beginning in the more arbitrary fashion of a mill rate added to the property taxes local governments collected. Technically such an arrangement is not a shared tax, but it does have the common features of one government collecting taxes for another to spend as it chooses. More sophisticated and freer versions of shared taxes came into the states as state governments developed their own revenue sources and began to share income or sales taxes with local governments as supplements to the overburdened property tax. Massachusetts, Minnesota, New York, and

Wisconsin are among the states with 25 to 50 or more years of experience with sharing taxes.

A shared tax may have absolutely no strings attached, as has been true in Wisconsin or it may be shared for a definite purpose, as in Minnesota where the shared income tax is returned for school purposes. Block grants have most of the characteristics of a shared tax. The block grant ignores the revenue source and usually states a general purpose. The shared tax can assist in improving the tax choice of the receiving government, but leave it totally free or free within some broadly specified limits.

Devising a distribution formula for continuing use over decades is a sensitive political and technical problem. Subsequent change is politically difficult as the experience of every American state will testify. The wrong formula may fail miserably to accomplish the purposes agreed to or may have as many unintended consequences as any series of grant-in-aid programs. If an objective is some equalization among recipients, don't return taxes on the basis of where they were collected. This is a fundamental error in Wisconsin sharing of its income tax, and this 1911 error (though modified two or three times since) has the inevitable result of assisting communities that least need it. Such factors as population or per capita income or per capita income and tax effort give measures that may help in equalizing revenue to meet needs. Other considerations today could include a provision for state transfer of a portion of the shared taxes to its metropolitan areas, again to recognize per capita income and tax effort in the metropolis, or a provision to bar use of the federal shared taxes for selected purposes such as highways where there already is a national trust fund arrangement.

What would the states do with an additional $5 billion or whatever figure might be set aside from the federal income tax and returned to the states each year? Would they expand and improve services or cut taxes? Would they improve their own administrative effectiveness for carrying out programs?

Since we earlier agreed, we can't fully explain why some states are more willing than others to tax themselves for public services, there is no unequivocal answer to whether the states would use all federal shared tax revenues for expansion and maintain their own present tax effort. Unless the shared revenues came in a flood that did not permit gradual absorption each year by rising demands, it would be an easy gamble to bet against tax reduction. The pent-up service demands in the average or less than average income state would almost certainly swallow the new revenues and establish an expanded base for the future. To illustrate: In the spring of 1966, the Wisconsin Tax Department announced that its earlier tax estimates had been too pessimistic. Although presumably an adequate state budget for the biennium had been approved roughly a year earlier, the legislature came back into session and quickly approved increases totalling $21 million for increased aids to local schools (about $14 million); civil service and university faculty salaries (about $4 million); and welfare increases (about $3 million).

States less hard pressed than the average are still, I think, more likely to be lured to spend than to cut. A tax-effort measure in the formula would constitute an incentive to keep taxes moderately high, and no state today has met all of the service demands that most observant critics identify.

Some political power and decision-making would shift if shared taxes replaced a similar expansion in grants in aid. Governors and legislators would gain opportunities to make choices in program priorities. Program administrators would lose some of their present influence—to the extent they have it in policy and administrative negotiation with federal agencies, but would gain some opportunities for experimentation and innovation. A political scientist looking at Illinois budgeting expressed a most pessimistic view of control of federal grants that contributed to the state's seeming lack of purpose and concluded:

"As one official in a heavily subsidized agency put it, 'We can't tell how much we will get from the federal government until the federal allotment comes in. We spend whatever they give us, but it's impossible for us to tell in advance how much it will be.' . . .

"The trappings of Constitutional sovereignty exist, but the expenditure decisions made under this protective umbrella are not the decisions of a sovereign; they are the decisions of an organizational system grown tired with age and enervated by a willingness to let others determine the direction in which the lifeblood of the organization shall flow." [5] This may have been an overdrawn con-

[5] Thomas J. Anton, *The Politics of State Expenditure in Illinois* (Urbana: University of Illinois Press, 1966).

clusion that stemmed from high hopes of the observer and the difficulties of the particular timing in this particular state capital. Shared taxes, nevertheless, could aid to a degree in the sense of choices by the state through additional revenues and greater program flexibility.

What could shared taxes do to improve administrative effectiveness? A resurgence of state creativity with less stringent budgets and increase in flexibility might attract a more competent and imaginative public servant than many of the states have brought in in recent years. In the University, I find repeated evidence that the better student with an interest in a government career will normally look first at international or national programs. There he perceives excitement and service opportunities as well as a long career ladder. State service, and then with only a few states deemed acceptable, often comes third in his choices after a few of the largest cities.

The probability of attracting better entrants to the state service would rise with the greater budget flexibility of shared taxes, rather than further federal grants, combined with changes in the present grant structure. Reduction of grants to a dozen or less that permitted states showing objective evidence of administrative quality (see earlier discussion) to apply and report in broad terms rather than the present minute detail would complement the opportunities under the shared taxes for states to resume their federal partnership more actively. Not all states would accept the challenge immediately, but the leadership of some would add a further pressure to the laggards in our interdependent society.

IV

In summary, I find the evidence persuasive that the states and local governments cannot carry their present share of domestic responsibilities unaided. Many of their problems are national problems. The consequences of action or inaction are national. The inability of the states to act alone either in major program development or with substantial tax increases for fear of economic consequences again places the issues on the doorstep of the national government. It is also the national government that has a revenue raising potential unmatched by the states.

Of the federal policies most often proposed, I doubt the practicality of the income tax credit. At this date it is politically vulnerable to extension beyond state income taxes and would do little or nothing to assist in equalizing revenue potential, lessening the difficulties of interstate tax competition, or generally increasing our revenues. Federal income tax reduction, under the right economic conditions, can raise state and local tax receipts. It will continue to have a place in the nation's economic arsenal. Again, however, it does little for inequalities *among* the states.

Some relief of state and local burden through expanded national programs or grants is likely to continue, but extensive expansion carries costs. There is almost no evidence that federal policies so far have increased the ability of our metropolitan areas to mobilize their own resources to act. Without substantial decrease in the total number of grants and their restrictions, the states will exhibit frustration and their governors and legislators will steadily abdicate broad policy decisions to federal and state administrators. The negative income tax might assist significantly in the general welfare area and in our fight on poverty, problems of great moment to state and local governments. Even if we were actually to eliminate poverty, however, we would still have many other public needs; and the negative income tax is not the solution for these. A carefully devised shared tax formula that would remove some of the present fiscal inequalities and disadvantages among our state governments seems to offer the most hope in any attempt to reinvigorate our faltering states and cities. This does not involve cutting back of national domestic programs. We would continue to have occasion for federal grants that stimulate state or local action in fields more visible nationally. We might even wish to agree to a negative income tax.

Only tax sharing has chances for accurate tuning to give state and local governments modern engines. Any financial assistance requires careful attention to the impact on the organization and prospects for effective, operating governments. Today we find exhibits of inadequate use of potential revenues because of government structure as well as ineffective government organization and operation tied with insufficient revenue sources. Many of our state and local governments require revenues raised with less backbreaking effort than they now have to put forth. There is need for a metropolitan structure that knits a pattern whole for the diverse groupings. If this can not be done by the metropolis, the state may have to use the available revenues (state and federal) to produce some equalizing of services and effort. Both state and local governments require a visible structure that will attract career young people and citizens to accept the challenge of public problem-solving.

No fiscal formula will solve all of the nation's ills or immediately restore state and local governments to the role in the federal system we like to believe they once had. *It is fallacious to assume, however, that fiscal discrepancies between demands and resources in given communities or among the states and the competitive disadvantage of tax leadership or unreasonable tax burdens have nothing to do with the difficulties state and City governments face today.*

Representative GRIFFITHS. Thank you, Miss Penniman. Mr. Ecker-Racz?

Mr. ECKER-RACZ. Thank you, Madam Chairman. My statement is longer than the time allotted, and I will therefore offer it for the record and brief it, if I may.

Representative GRIFFITHS. If there are no objections, it will be printed in full in the record as the other more lengthy statements.

TESTIMONY OF L. LASZLO ECKER-RACZ, FORMERLY WITH ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS

Mr. ECKER-RACZ. Thank you. I too am very pleased to participate in your hearings because the federal system is in difficulty, and for some years has been moving toward a crisis. The reasons, I believe, are self-evident.

On the one hand, we have been making increasing commitments publicly for social and educational expenditures, and we operate under a system in which these commitments impinge upon State-local governments, because these are the governmental entities responsible for social programs under our system.

At the same time, while the expenditure requirements have been rising, the revenue raising capabilities of State-local governments have been progressively circumscribed by such things as interstate competition, interlocal competition for taxpayers, the increasing sophistication of the electorate that is disposed to view with criticism public officials who are associated with tax increases.

Some observers, looking at the American scene, question that there is a problem because they observe expenditures of State-local governments increasing rather dramatically. I submit, Madam Chairman, that while expenditures have indeed been increasing dramatically, State-local governments have been financing this increasing activity in ways that give cause for concern.

A conspicuous development is the increasingly regressive character of State-local tax systems at the same time that the national administration worries about poverty. Despite a record level of taxation, expenditures fall short in many areas of the goals that are critical for the economic-social-foreign policy objectives of National Government.

I conclude that the federal system is in fiscal difficulty because social, economic, and political developments have outraced it and have rendered the original conception of our federal system obsolete.

For example, the assumption that the States and the Federal Government are fiscally cosovereign simply because they are free to use the same tax sources has become invalid because States are not free to do that. Or the assumption that each community has a fundamental right to determine the level of expenditures for social programs is no longer tenable because what happens at local levels is of interest to the National Government because it impinges upon important national policies ranging all the way from economic growth to foreign affairs.

I allege that the imbalance in the system, the relative deficiency in State and local revenues, has become progressively greater over the years despite the fact that intergovernmental activity has greatly accelerated. The other speakers have referred to the substantial increase in grants. I have referred to the substantial increase in State tax levels.

What has been happening is that the revenue-raising capability has been shifting increasingly to the National Government, and the devices we have employed to meet the fiscal problem have not faced up adequately to this basic problem.

Our system of functional grants with matching requirements proceeds on the premise that State and local governments have the resources but need to be induced to use those resources. I submit that the situation requires more. We need to develop methodology for utilizing the superior revenue-raising capability of the National Government for financing services which are now State and local.

Your committee, I observe, will be looking at foreign experience, and I call your attention to the fact that in some of the federal systems, federal systems that are considerably younger than ours, there have been fundamental changes in the basic Federal-State relationships. Both in Canada and in Australia there have been changes in the tax sources that are available to State and local governments. There have been changes in the role of grants. And there have been changes in expenditure responsibilities.

I inquire why our system, which is so much older, has never faced up to the need to change the basic arrangements, but rather has tried to operate within the framework of the original assumptions. And I suggest that the reason is that under our system we view these kinds of problems through the eyes of existing governmental organizations and the people who man those organizations, meaning public officials with an eye on voters. I suggest that this kind of forum is sometimes inhibited in questioning the fundamental assumptions that underlie our federal system.

I point out that in these other countries, the institution of the royal commission, composed of people who can afford to be indifferent to the voters, is freer to question the conventional wisdom about the federal system, and I suggest that this wisdom has to be questioned. We must find a way of either placing Federal resources at the disposal of State and local governments in very much larger amounts than we have talked about, or else must find a way of having the Federal Government assume the responsibility for some of the major functions that we entrust to local governments.

The devices enumerated in your press release, the shared revenue, the unconditional grant, the credit for payment of State and local taxes, are very useful, but I suggest that they do not go far enough. I suggest that what is required is not a matter of a few more billion dollars of Federal grants being made available to the States, but a massive input of nationally raised tax revenues to underpin some of the basic functions, for example, education or welfare or both, which are so critical to our national well-being, but which we persist in viewing as responsibilities of individual communities and States.

I conclude with the observation that in order to face up squarely to this kind of question, we need a forum that has some of the attributes, some of the freedom from political intimidation of commissions used by some of the other federal systems. Thank you.

(The prepared statement of Mr. Ecker-Racz follows:)

PREPARED STATEMENT OF L. L. ECKER-RACZ

THE FISCAL FUTURE OF AMERICAN FEDERALISM

Madam Chairman, my testimony is directed to your interest in the ideas to be gleaned for the revitalization of the fiscal foundations of our federal system from experience here and in other federal systems.

Your concern is timely, if not overdue. This federal system is in difficulty and for some years has been moving toward a crisis.

The concept of public responsibility for the social and economic well-being of the American people has been growing in scope and content at an accelerating pace and has entailed ever larger public expenditure commitments. But this responsibility and response-ability are the true measure of our greatness as a Nation and the rewards of our system. They are the essentials of America's purpose, and happily America has the resources to realize them. An $800 billion economy can well afford the essential governmental needs of 200 million people.

We cling tenaciously to the view that primary responsibility for domestic government services is best lodged close to the people. We believe the basic obligation for fulfilling this public commitment, for financing these activities, should be largely State and local rather than National. This is why in twenty years the public service expenditures of State and local governments increased nearly 500 percent.

Simultaneously, however, the increasing interstate character of private business activity, the accelerating competition for taxpaying industry, and the growing pervasiveness of political aversion to being associated in voters' minds with the sponsorship of tax increases are combining to restrict the freedom of State and local governments to raise revenues. State and local revenue crises are becoming routine. State and local budgets continue to grow, to be sure, but at what price!

The weight of taxation varies widely, light in some places, onerous in more and more; revenue systems grow increasingly more burdensome for low income families while the national government espouses a war on poverty, and the country becomes ever more prosperous; public services critical to the realization of the social, economic, and foreign policy objectives of the Administration are woefully under-financed; and State-local tax and expenditure policies are exerting an unwholesome influence on private enterprise decisions where and how to do business.

The fiscal foundations of the federal system *are* in difficulty because the economic, social, and technological revolution has made them obsolete. The premise that the States are fiscally co-sovereign with the national government and have equal access to tax resources is obsolete. Revenue raising power is increasingly centralized in Washington. The premise that the scope and level of governmental services is the rightful prerogative of individual communities is obsolete. These services, in increasing numbers, have become vital to national policy goals. It follows that the premise that an adequate level of domestic government services can be financed by State and local governments is no longer tenable.

The panel will no doubt concur in this diagnosis, as it would have ten and perhaps even twenty years ago. The remarkably sustained national prosperity has not ameliorated the problem. It may, indeed, have aggravated it by stimulating the public's appetite for governmental services. That the problem should persist is all the more noteworthy for we have come through a period of intensive intergovernmental activity. State financial aid and Federal grant operations have doubled and tripled, and policy cooperation among governments is at an all time peak.

Why, then, is the federal system continuing to drift into progressive imbalance? If, as the evidence seems to indicate, fiscal resources are being concentrated increasingly in the central government, why has America failed to make the necessary compensating readjustments in the other components of fiscal federalism? Why has it failed to develop ways of deploying the fiscal powers of the national government to the financing of State and locally administered services? To re-establish Federal-State fiscal balance, it would be necessary only to shift financial responsibility for one or more of the large revenue consuming functions, i.e., education or welfare, from the local and State to the Federal Treasury, or a corresponding amount of Federal grants would need to be made available for the general government purposes of the States and their subdivisions.

It is thought-provoking to contemplate the degree to which local initiative and local responsibility for all variety of essential functions could be rekindled, even without benefit of additional incentive grants, if the property tax were freed, for example, of the burden of financing education. The Congress could then confidently leave the scores of lesser local functions which now require Federal financial aid to city councils and county boards.

Your prospectus suggests that the Subcommittee will be looking at experience with other federal systems. You will have occasion to observe that some of these with relatively short histories (the Canadian federation is just 100 years old and the Australian only two-thirds that) have already found it necessary more than once to alter drastically their basic federal-state fiscal arrangements: the allocation of functional responsibilities and taxing resources, and the role of financial aids.

You will note that they have tackled the fiscal imbalance created by changed conditions by entrusting the task of reappraisal to prestigeous national commissions; that they have composed these Commissions of distinguished men and women removed from political accountability and responsibility, who therefore are free and willing to re-examine and question even time-honored institutions and political theologies. And therein lies an important difference between our mode of operation and theirs. They have been able to restructure their fiscal federalism to take account of the central government's financial superiority because they created appropriate institutional machinery for handling it.

Although our system has experienced periodic growing pains during most of its nearly two centuries of existence, each has been assuaged with the same old nostrums, within the ongoing governmental apparatus and by those who man it, with all the handicaps that necessarily entails.

Public officials dependent periodically on the good will of their voters simply dare not question the sanctity of long-standing and honored governmental institutions. They dare not question the conventional political wisdom.

Over the years we have cloaked that wisdom, born in response to the 18th Century problems and developed in response to the dialogue of that day, with a sanctity the wise men of the 1780's would be the first to disclaim. A candidate for public office dare no more belittle publicly the need to curb federal power, to maximize local control, or to keep government small than he dare belittle the Constitution itself. The fact that some of the breast beating in behalf of the "American system" is enlisted against and not in behalf of responsive government does not diminish the hold of outworn political cliches over political debate.

I suggest that this circumstance handicaps political officeholders in the objective consideration of needed basic rearrangements in the federal fiscal system. What political candidate feels free, for example, to advocate that multi-State corporations should be placed beyond the reach of State taxes, or that financial responsibility for public education or welfare be shifted to the national level? What suburban officeholder can endorse publicly his community's obligation to make common cause with the central city and share in the cost of its welfare load—a load which it may have helped to create and which, if neglected, threatens the security of persons and property throughout the metropolitan area?

Political leadership is the prisoner of political dogma no longer compatible with responsive and responsible government. Does anyone believe that a Jefferson or Madison, working in 1967, would be willing to entrust the education of America's children and the realization of all of the national policy goals that depend upon good quality education, to the chance distribution of property values among 35,000 political jurisdictions whose tax contribution is invested according to the educational philosophies and political judgments of as many governing boards? Can there be any doubt how the architects of the American system would have dealt with "principles" no longer compatible with the people's needs?

We are handicapped also because the Federal establishment finds it difficult to give adequate attention to the impact of its daily activities on State and local governments. It is functionally organized and oriented, and although the cause of intergovernmental cooperation is accorded an occasional bow on ceremonial days, it is quickly forgotten under the pressure of the departmental mission that takes precedence on the 5th of July and the other 363 days of the year. The President's staff is all too overburdened with policy issues pressed for decision by departmental and agency heads kept under unrelenting pressure by their respective bureaucracies to have time for the problems of the federal system, which are everybody's business but no one's responsibility.

My purpose in contrasting the methods here and abroad for adjusting the federal system to changed circumstances is not to disparage the numerous efforts made here in behalf of improved intergovernmental relations, (efforts in which I personally have had a very small but interesting part). The increased intergovernmental cooperation in program planning, tax administration, expenditure policies, and especially the enlarged flow of Federal funds to State and local governments are noteworthy.

Much *has* been accomplished through the efforts, for example, of the two Subcommittees on Intergovernmental Relations and the Executive Office of the President. There is substantial scope for more of the same in ways spelled out in detail in the far ranging action program of the Advisory Commission on Intergovernmental Relations. These efforts are essential for they keep emerging intergovernmental problems under continuing scrutiny and produce remedies compatible with the political realities.

The accomplishments of the Advisory Commission and the Subcommittees in a very few years leave little doubt that Congress would have been well advised if it had created them much sooner. I would distinguish, however, between the mission of on-going organizations and the need on occasions—perhaps only every 50 or 100 years—to re-examine, if you will, the intergovernmental assumptions of the Constitution itself.

Similarly, the intergovernmental techniques and devices enumerated in your press release—shared revenues, tax credits, grant consolidations, etc.—can all be helpful singly and in combination.

I make bold to suggest, however, that more is required. The degree of fiscal imbalance is far greater than can be set right by adding a few billion dollars to the State side of the scales. In doing so it will be necessary, of course, to come to grips with the issue whether the vaunted efficiency of the central government and the dangers of Federal control it entails are to be feared more or less than the acknowledged inefficiencies of decentralized decision making.

If, as there is some basis of suspecting, the fear of Federal bureaucratic control is partly a reflection of the distaste of one group of bureaucrats for having another group peer over its shoulders in city halls and State capitols, the new computer technology may prove useful. It may not be too optimistic to hold out the prospect that this technology, relatively free of the personal equation, can be employed to satisfy the national government and the Congress, without benefit of many auditors, that State and local governments are deploying Federal revenues effectively and with appropriate regard for prescribed standards. Indeed, the computer may even have the potential of freeing State and local officials of the need to contend with too many visitors from Washington who personify insidious forms of Federal control to the jeopardy of State sovereignity.

I submit, Madam Chairman, that the fiscal imbalance in the federal system is of major proportions and that more is required to set it right than is generally suggested. I futher submit that necessary innovations on this scale will be fairly assessed in terms of long range national goals and their case will be presented persuasively to the public only if entrusted to men and women free of the responsibilities of political office and preoccupation with voter reactions.

Representative GRIFFITHS. Thank you very much, Mr. Ecker-Racz. Mr. Ylvisaker?

TESTIMONY OF PAUL N. YLVISAKER, COMMUNITY AFFAIRS COMMISSIONER, STATE OF NEW JERSEY

Mr. YLVISAKER. Madam Chairman, may I thank you for this opportunity to address your subcommittee. I owe you special apologies for not coming with a prepared statement. I have been on riot duty in New Jersey these last 2 weeks, and the last 3 days having some eye surgery, so it has been rather difficult to get down to writing.

I would ask your leave, if I may, to run a bit over my time, since this will be the only presentation I will be able to make.

Representative GRIFFITHS. You may proceed.

Mr. YLVISAKER. I will be wearing two hats. I came at your invitation as a long-time observer of the American Federal scene, I suppose as a technical expert. But I can't ignore the fact that I also am Commissioner of the Community Affairs Department of the State of New Jersey. What this means I am sure you understand, that as a politican I reserve the right to take exception to conclusions and remarks I might make as a technical observer.

I can start by wearing both hats very easily: Both as observer and commissioner I am generally in favor of a redistribution and redeployment of national tax resources in favor of State and local governments.

As a State commissioner, I am particularly in favor when the money comes to where I am. I am with the States these days. I used to be with the mayors and I suppose in those days you would have found me arguing for very much of a pass-through arrangement, which would avoid the States and get directly to the central cities where I was particularly concerned.

However, I think there are contrary arguments, cases to be made on both sides. Let me start by making the case for decentralization and redeployment.

I think the most persuasive argument in favor of decentralizing our national resources is that the problems in this country have become far too complex, and the national bureaucracies have become far too impotent to get the jobs really done. More and more I think we have to recognize that we have scouts out in front of the National Government in the form of States and in the form of mayors and county people throughout the country, and these scouts need a lot of elbowroom, and a lot of support. We really don't have, as I will argue through this statement, basic solutions to basic problems.

Usually national programs presume clear policies, agreed-upon solutions, and agreed-upon ways of doing things. This is not the case with the major problems we deal with in the United States today. They are extraordinarily diverse, varying from one community to the next as we have seen these last 2 weeks. Therefore, putting some flexible funds, certainly more ample financial elbowroom at the disposal of people where the problems are, will be a generally supportable proposition.

Another compelling argument for a redeployment of national tax resources has been provided by Professor Baumol of Princeton University. He has indicated that as we move toward the service economy away from manufacturing, we get into a situation of escalating costs because labor is the end product of service activity. In manufacturing, one can increase output and reduce the costs by automating out the service element, the labor component. Yet in the field that we are dealing with, in the public sector particularly at State and local levels with the kind of problems we have, services are the end product: fire and police protection, all kinds of security, medical, health, education, welfare, and the rest.

One cannot in the service sector avoid an implicit escalation of costs, and this is what the Government these days is being faced with. Even to keep the quality and levels of services as they are, requires, with an expanding population and rising wages, almost a geometric progression of these costs. Those of us who have to explain increasing budgets to the electorate, as you and we do, have experienced the validity of Baumol's theory.

We in New Jersey have just recently passed a sales tax, and that helped us for only 1 year in abating the escalating revenue curve. We go back immediately to that rising curve after 1 year of this relief, and realize again what Professor Baumol's theory points to. What he is also arguing is that as you move into the service sector, and as one gets into this escalating cost structure, one must tie the tax system very close to the growth of the general economy. This is why I think, at least for a transitional period, that it is important to get general support to State and local governments which face immediately this cost curve, but have not tied their tax structures as the Federal Government has to the rising level of the general economy.

Therefore, at least as an interim device and as leverage, we ought to be redeploying national incomes and resources to State and local communities which are faced with the problem, but without access to that growing tax base.

Still another argument for decentralizing and for moving away from what we now have is the confounding array of present Federal grant programs. I can give you the full horror story of what it is like to deal with 440 separate Federal programs. This is probably the purgatory to which a former foundation official should be assigned.

After 12 years of being on the giving end, I have now been placed on the getting, and I have seen, being responsible in my State for the coordinated manpower program of the State, what it means annually to try to put together scores of grant programs involving different and competing agencies into a workable manpower program for the State.

It is almost impossible. And when one finishes one round of negotiation, the next year one must begin all over again and usually with a lot of resentments that have been built up by his aggressive posture in the last.

I can also argue that this fragmented grant system has never really formulated or expressed its basic policies and purposes. There are three basic purposes for grants and shared revenues:

One is general support to relieve the revenue needs of State and local governments.

Second, equalization so that those States and those communities with more of the problem than others, and less of the resources, get a fair share.

Third, stimulation—grants serve as incentives, prods, gadflies.

Interestingly enough, we have never really segregated these purposes in our grant structure. As one reads through the list of 440 Federal aid programs, one will find a confusion of purpose. And sadly as one looks back over the system and its performance, none of these three purposes has really been fully or very well satisfied.

For example, I am told by those who have studied the matter that there has not been a significant equalization of national resources through the grant mechanisms, though each usually has its own formula for equalization.

Second, it is clear that even the $15 billion of Federal revenue now put out to the States and communities is not a significant relief of the local and State budgets involved. Nor would an extra $5 billion or another $5 billion beyond that be a significant relief of the general State and local tax burden.

Third, as incentives, Federal grants have probably done best. But there is an irony even here. Even when you want to acquire an incentive grant, in most cases flexibility, creativity, invention, independence and evaluation aren't encouraged when you get it.

Over time, congressional oversight plus bureaucratic restraints produce a rigidity that boxes in any creative official at lower levels. Soon he is either ducking, or observing to his own discredit all the regulations and rigidities built into this system. I would like to come back to this point later on.

The final problem with the Federal grant structure that we have noticed this last week or two in New Jersey is that even if one digs through the whole structure and puts together a coherent package, hopefully a coherent package, you do not emerge with something that has much chance of solving the problem. Solutions are not implicit in the grant programs, nor is there the scale required. So that we would return (and no discredit to the Federal officials who must preside over the system and negotiate with us on its incoherent premises) to our problem in New Jersey as you, Madam Chairman, to your problem in Michigan, and find really that the sum total of this massive array of Federal grants does not cut the mustard.

Finally I think another case can be made for decentralizing revenues, and that is on the basis of equalization. This argument is obvious and of long standing.

We now are a nation of highly mobile people, one out of five moving every year; and there is a guarantee to every individual of equal opportunity, no matter where he is born, or where he lives. Yet we find discrepancies from one community to the next, both in the provision of services and the availability of resources needed to provide these services.

So we must equalize. And we also know that is particularly true from the point of view of the central cities with their concentrations of problems and people, with few resources.

Now to my "buts" and these next statements will exhibit the ambivalence of a technician.

I don't think—especially now—that we can examine particular ways and means of changing fiscal federalism without also considering the ends to be served. I don't want to wax emotional, but I have a feeling that spontaneously and almost anarchically throughout the country a constitutional convention is being called. It is being called by angry men of poverty and color, who are wearying of their urban condition.

It is being called by men of reaction who have had enough of social protest. It is being called by central city mayors who are over their heads in poverty and depression; by the mayors of suburbs who are caught in an inflationary cost spiral of increasing services; by Governors who wonder if they should follow the traditional State path of irrelevancy and passivity, or take on jobs which they presently don't have the financial capacity to carry on, and generally by a population, I think, that senses somehow or another that the civilization we have been pushing to the top of the hill, like the Greek hero of old, somehow is gaining such weight that we can't support it, and it is going to roll back and crush us.

There is something going on in our present society of major scale. Professor Ecker-Racz referred to it by saying that the problems we ought to be looking at go very deep indeed. We ought not to stop with a superficial look at a few suggested specifics, but instead I think dig down in ways which I would now suggest:

More important than any distribution formula is the bargaining process that is bound to accompany and govern its use—bargaining as to how much of which resources ought to be owned by whom and be spent on what. As we begin deploying national resources and favoring States and local government, we ought to set the agenda for this national bargaining, and perfect its machinery.

I think that any financial favor to the States and localities should require changes in certain fundamental ways of operation and structure. Clearly, I think the argument would be in favor of moving toward tax systems which rise proportionately with the general economy and national income.

There ought also to be some reallocations of functions. We are now developing national sewage systems, national water systems, national road systems, and national utilities of all kinds through isolated Federal grant programs given to isolated pieces of geography on a first-come, maybe, first-served basis. These grants don't add up to well-planned national systems.

We are a national urban agglomeration. One man's sewage system is another man's front yard. We must be able to develop a national, at least a State, plan for the development of what are national utility systems. I would think that if we are going to favor the States and municipalities with more money, we ought to have a bargaining process which would require annually or every few years, a statement of what the State's plan is for the major use of these funds, and what its strategy might be.

We ought also, I think, to develop continuing mechanisms for the bargaining process. They might, for example, be the Advisory Committee on Intergovernmental Relations, or maybe we ought to set up a different process within Congress and/or the executive. We certainly ought to require of States and municipalities the kind of competence that is reflected in the Council of Economic Advisors, because if we are going to get into national fiscal policy on a three-level basis, there has to be a three-level capacity for sophisticated fiscal analysis and administration.

Another major point: Our perception and handling of the equalization has to be refined. It is true that certain depressed economies in the United States coincide with political boundaries. Appalachia, however, spills over many States, and not all central cities or parts of central cities are equally depressed. What I am saying is that it is not automatically true that if you redeploy your resources in favor of certain political jurisdictions; you will solve the problems that equalization is supposed to solve.

We will have a refine our concepts and zero in on what I would generally call "deficit areas" in the American economy. These can be defined by several criteria which are already available to us through the Bureau of the Census, through economic analysis and through our own viscera.

These "deficit areas" would include Appalachia and the ghetto. Their recovery would require at all levels of government a perfection of the Keynesian analysis that has given us the Council of Economic Advisers, the Full Employment Act, and the sophistication of people like Dr. Ecker-Racz. We must—and soon—develop a subnational economic theory and strategy.

Currently we have stabilized the national economy at high levels of employment, but at less than full local levels of employment and well-being. Therein lies the failure and the missing part of our aggregate strategy for economic stability in the United States. Clearly what we have to do is to make certain that when money goes to the States, and even the central cities, that in fact it reaches and solves the problems of these depressed areas. Further, there is more to the formula for recovery than the mere expansion and redeployment of public outlays.

The Keynesian formulation required policymakers to consider three factors: public outlay, consumer expenditure, and private investment. Until one gets a mix of these three strategies, a Bedford-Stuyvesant will never pull itself up by its bootstraps. Simply adding public outlays to Bedford-Stuyvesant will not solve the economic problems of that area, nor of Newark, or Detroit. We need coherent policy that considers and influences all three kinds of resource flows.

We need at the national level far greater competence in handling subnational economies and deficit areas, in the Council of Economic Advisers, in the Bureau of the Budget, in the Treasury and in the Federal Reserve System. At the State levels we need the same kind of capacities, and similarly at the local levels.

Let me make one other major point. We are now talking about redeploying national resources into the hands of public bodies. I agree this is necessary, but if I had to make a choice (which ought not be made) I would probably vote instead right now for money placed in the hands of the consumer of the ghetto or of Appalachia.

I think what is badly needed (whether through income maintenance programs, liberalized welfare programs or some other novel ideas that have been lately proposed) is to increase effective consumer demand and to get these consumers freely on the open market for housing and their other needs. A dollar spent on, and freely by, a citizen-consumer may well be better than a dollar spent through the mayor or the Governor of a depressed jurisdiction.

Finally: we should be talking more here about ultimate directions in which to move, than about fixed and final solutions. I think that we can begin right where we are now, to move in the direction which I have cited, by making certain immediate reforms, by consolidating present grants, by simplifying present grant structures, by trying to work toward single negotiations so that one community or one State comes to Washington but once a year with a total package of its applications.

We might even take out of the $15 billion presently available for Federal grants a third of that amount and experiment with comprehensive grants—shared revenues of some device—rather than waiting for the post-Vietnam period when our tax capacities may be more liberally available.

We can begin absorbing State and local costs. I would argue along with Dr. Ecker-Racz, that it is important that perhaps we nationalize outright the welfare system and that the Federal Government take entirely the costs of all the welfare categories. One might extend that argument, adding Federal coverage of other personal guarantees and services essential to making meaningful the constitutional rights to equal opportunity and protection of the laws promised to every citizen no matter where he was born or presently resides.

To conclude, Madam Chairman (and I apologize for the length of this statement) I think we can make certain incremental reforms right now, as long as we know the direction in which to move. I have made this longer statement, talked as I have about these substantive problems, because I become nervous when we begin considering ways and means, before making clear our policies, strategies and objectives. Thank you very much.

Representative GRIFFITHS. Thank you very much, Mr. Ylvisaker, and I thank each one of you for your statement. I thought they were very good.

But I would like to point out that merely to suggest that we are going to share income with the States or with local communities is to suggest first that money alone will cure the ills of the States; that the lack of money is their problem. No place can we better prove that that is really not the problem of the State, than in New Jersey. If this suggestion is really true, then why hasn't New Jersey passed an income tax?

Mr. YLVISAKER. I can't speak for the legislature, but I can speak for myself.

Representative GRIFFITHS. All right.

Mr. YLVISAKER. It is hard.

Representative GRIFFITHS. You are right. But the whole problem of all of this and the real reason that you have the grants-in-aid is because of the State legislatures. The State legislatures throughout the whole thing have been the stumbling block. In a new book written recently, Triplett writes, "The States, united they fell," and he points out that the real problem with State legislatures is that their true constituency is not the people, but lobbyists, and it doesn't make any difference what you do. They are still going to react to those lobbyists.

Now I was once a State legislature representative, and while I don't buy the theory completely, I think that this really is one of the problems. It took Michigan three Governors and 15 years to pass an income tax, with all three Governors demanding an income tax, so that I think you have great problems besides money. I think money is not the only problem involved here.

Mr. Maxwell, I believe you began by saying that you would only give the money back in times of affluence. If you only give it then, how many times would we have given money back to the States unencumbered in the last 30 years?

Mr. MAXWELL. I didn't quite say that, Madam Chairman. I said any considerations with respect to increased Federal money going to the States should, in my opinion, wait until we are somewhat out of the mess we are in now, and of course I refer to Vietnam.

Representative GRIFFITHS. I am not going to let you get away with that because I think we will undoubtedly be in another one, so that I think you have to make up your mind that once this begins, then it is going to go through any Vietnam or any world war III or any other thing.

Mr. MAXWELL. After you start it——

Representative GRIFFITHS. So you might as well start today. How much money are you going to be willing to give the States? What would you think would be a possible suggestion to start with?

Mr. MAXWELL. Well, I am going to stick by my position, Madam Chairman, that I wouldn't give any money this year or next year, but sometime in the reasonably near future.

Representative GRIFFITHS. And what would you start with?

Mr. MAXWELL. I would first of all want to consolidate the existing conditional grants, not necessarily increase the amount. Of course many of them increase by a built-in system anyway, and currently they run to $14 billion a year, and in the predictable future, 10 years ahead, with the expansion of the Great Society programs, they are probably going to amount to $40 billion.

Representative GRIFFITHS. Would you take the money that is now being used, for instance, in welfare, and just give each State the amount of money that is now being given and let it spend it as it chooses?

Mr. MAXWELL. No, I wouldn't. I would be very glad, however, to add an unconditional grant, quite separate, without strings attached, so-called Heller-Pechman, and you are going to hear both of these gentlemen later on.

Representative GRIFFITHS. Yes.

Mr. MAXWELL. Personally I favor Heller-Pechman, something like Heller-Pechman, which would mean that I would favor giving let us say $3 or $4 billion fairly soon to the State governments distributed principally on the basis of population, with also an equalization fund of say 10 percent of the kitty going to the poorer States.

Representative GRIFFITHS. Would you say what it should be used for?

Mr. MAXWELL. I wouldn't say anything about what they use it for.

Representative GRIFFITHS. I think that Mr. Ylvisaker and I have a very bad view of today's world and a very personal view. So supposing that you give this money, and in Mississippi they use the money for beautification programs, but in New Jersey, and in Michigan we are compelled to use our money either for riot control or for some type of additional welfare or education. Would you think it was possible that in place of solving the problems you would add to the problems of New Jersey and Michigan and alleviate those of Mississippi?

Mr. MAXWELL. I don't have the fears that apparently you have, Madam Chairman, that State and local governments can't make wise use of additional revenue. It seems to me that in the main in the past I have been pleased with most of their decisions, and I would expect that if they got more money without strings from the Federal Government, they would spend it in very similar directions.

Now I am quite prepared, if the Congress felt it wise to have a post-audit and whatnot, but by and large I think that their needs are so great as compared with their resources that I would trust them to spend a modest increment to their revenue, say $4 billion a year. I don't have the worry that apparently you have.

Representative GRIFFITHS. Mr. Ecker-Racz, may I ask you, do you really feel that an income tax is easier to levy and collect than a property tax?

Mr. ECKER-RACZ. Without question.

Representative GRIFFITHS. Why do you think it is? Property seems to me to be pretty visible, and I really don't feel that income tax is quite that simple. I think there are many people who don't pay income taxes who have the income.

Mr. ECKER-RACZ. This is quite so.

Representative GRIFFITHS. It is not only that they have loopholes, but I think there are many people who are not reporting income and we are just not able to check on them. But the property, you can see it. The real property tax seems to me to be pretty simple to collect.

Mr. ECKER-RACZ. I would respond this way, Madam Chairman. There are problems in the administration of the income tax, but when you consider that nearly 90 percent of our income is wages and salaries, where we don't have the privilege of cheating because our employers see to it that our taxes are withheld, it leaves a relatively small problem area, and over the years as we have deployed more and more of our administrative staff to this problem, we have been solving it too.

We have a property tax system which is administered by about 15,000 administrators, about half elected officials whose qualification for their job is gaged by their popularity on election day, each operating under his own ground rules, some administering taxes just on real estate, but these are relatively few, most have to administer personal property taxes, and quite a few not only business or personal property but taxes on household goods as well. If the property tax can be administered well, this country hasn't discovered how. But it has been improving.

If over the next 25 years we make the progress we made in the last 25 years, it will become a fairly respectable tax. But we have certainly put a tremendous load on it. This is a tax that produced $6 or $7 billion when World War II was over. It is now $25 or $26 billion.

The rates are very much higher, and the higher the tax, the greater the pressure on the administrator, because the greater the rewards for doing favors. I would say without equivocation, therefore, that from the administrative viewpoint the two are not in the same ball park, but we have to have both.

Representative GRIFFITHS. May I ask you what you think would be a fair starting amount to give back to the States, Miss Penniman?

Miss PENNIMAN. I am not prepared to come up with an exact figure. I would make several qualifications or several comments on it, I guess.

In the first place, I think that the recent riots and destruction suggest there are many better ways to use the moneys than what we have done, and that some of these could have been anticipated if the national policy in the past had done more to reward the States with good administration who are making a great tax effort, and who are in other ways leading, and I don't think our grants in aid have ever done this. They have never pushed the States to use the income tax. They haven't pushed the States for quality, and the States that have had quality, that have had income taxes for 60 years, the States that have made tax effort have not been recognized in this process, and I think this might have helped.

I don't say, and I have never said, and I don't think any of us have, that money alone is going to solve our problems. It isn't. There are problems beyond the money, but neither do I think money is inconsequential.

Now I would go on another slightly different point of the same question. It seems to me that any distribution has to be done on some kind of graduated scale, and I don't think that suddenly in this year offering the States $5 billion without any strings would make any sense, because they are not prepared to use it. Neither would any other group be prepared to use it.

Having been involved occasionally in some of Mr. Ylvisaker's funds out of the Ford Foundation, I think that one of the mistakes that the foundation sometimes makes is by giving you $2 million the first year and then scaling it down, and the first year is when you can least use that money, and it seems to me that the same thing applies here with this money.

Representative GRIFFITHS. Well, the Federal Government never makes that mistake. Thank you very much. My time is up.

Senator Proxmire?

Senator PROXMIRE. Thank you, Madam Chairman. I take great pleasure in declaring here that Dr. Penniman is a very, very distinguished scholar and expert from my State, and I have known her for years—since I was in the State legislature, in fact. She has been outstandingly able and competent in this particular field as well as in others; and I think this is the same Paul Ylvisaker who was a classmate of mine at Harvard Graduate School a few years ago.

Mr. YLVISAKER. That is correct.

Senator PROXMIRE. Fifty percent of this panel is very well known to me then, and the others, of course, are also very distinguished.

Now as you know, I am sure you are all sympathetic with our problem. We have been told by Walter Heller, and by other economists, that we are going to have such an enormous surplus we won't know what to do with it. He told us and others told us some years ago, that just because the gross national product is growing, given something like the same tax rates we have had, that we are going to have a problem distributing the excess money we have.

Well, it is just the opposite now. We have a situation where this year we are going to have a deficit of—it has varied in estimates—from $15 billion to $30 billion. It is going to be enormous. And we have some implications as far as inflation and high interest rates and the economy are concerned with respect to that, so that from looking at it from our standpoint, we have that problem.

Then we have the other very basic concern that regardless of all the criticism of this view, I think there is a lot of wisdom to it, that unless you tie the responsibility for raising taxes to those who are going to spend the money, you do lose a certain amount of discipline. Maybe you ought to lose some of it. I am not convinced we should, but we know we do lose it. For this reason I am not yet sold on the notion that Dr. Maxwell gave us, and that the rest of you seem to agree on, that as he put it, there seems a much poorer peacetime option for the Nation in relying on State-local governments to raise taxes.

Isn't there some way that we can open up revenue sources for the States, and then in addition to that, of course we have to provide the equalization function because some of these States and cities are a lot poorer but concentrate on doing a good job in the equalization area, and then try to enable the States themselves to raise the funds that they need? I would like to ask each member of the panel to reply to that.

Mr. MAXWELL. Well, Senator, I don't mean to downgrade the principle of financial responsibility. I believe in it very much. I simply tried to say in my statement that there are circumstances I think we have now which lead you to emphasize other principles, and that perhaps this principle, while never completely out of sight, has to be somewhat overridden.

Now how the States can help themselves I am not sure what you have in mind. The thing that pops into my mind as a possibility is something which has been talked about a good deal, and that is an income tax credit or a tax credit against Federal income tax for State income taxes or maybe for State sales taxes as well.

Senator PROXMIRE. Something like that particularly with regard to the income taxes. I am not sure it is a general consensus, but one or two panel members emphasized the desirability of income-producing tax or an income-based tax, I should say, rather than a property tax or even a sales tax.

Mr. MAXWELL. I am not going to endorse that one. Personally I see no reason in the world why the States shouldn't continue to raise, in the future, most of their money from sales taxes as they do now. I see no objection in the world. If I had my ideal world, I think I would have the income tax wholly a Federal tax, and I would probably have commodity taxes wholly State and local plus property as well.

Senator PROXMIRE. I don't want to get into that argument.

Mr. MAXWELL. No, that is irrelevant.

Senator PROXMIRE. I disagree, yes.

Mr. MAXWELL. With respect to a credit of Federal income tax I confess to be completely unenthusiastic, and I can elaborate on that if you wish. To say it very briefly, in the first place, if it were an income tax credit for State income tax, you would have to get 16 or 17 States which haven't presently got such a tax by Federal legislation to impose a tax in order to get the credit.

Senator PROXMIRE. Let me interrupt, Dr. Maxwell, to say where do we have an oportunity to do this? We did reduce some of our excise taxes. We still have some.

Mr. MAXWELL. Yes.

Senator PROXMIRE. Does that open up an area?

Mr. MAXWELL. Yes, sir, I think a good many of our excises, including the big revenue producers, tobacco and liquor, could in my opinion be well administered by the State governments, and would be a good revenue source.

Now I have one other major objection against the income tax credit. I don't think that the 16 States that haven't an income tax ought to be pushed by Federal legislation in this direction. The other thing is that I have never seen an income tax credit, a credit against Federal income tax yet that did not provide most of the money for the fairly well-to-do States which are therefore less in need.

Senator PROXMIRE. Well, as I say, you would have to supplement this with equalization in my view.

Mr. MAXWELL. Equalization can't be done by the credit, that is what I am saying.

Senator PROXMIRE. I am sure it cannot. I am not saying it will do everything. I am saying that one objective would be that it would provide a greater opportunity for States to raise their own money. The other would be to recognize that, because of the inequality of income and property in the various States, you would also have to have supplemental grants or sharing or something of the kind to provide primarily equalization.

Mr. MAXWELL. Well, that would be a pretty substantial lump of equalization.

Senator PROXMIRE. I understand.

Mr. MAXWELL. It would have a lot of equalization.

Senator PROXMIRE. As Dr. Ylvisaker said, we are not doing anything of these things now. He set up three objectives, an incentive system, an equalization system, and a support system, and he pointed out we are doing none of them.

Mr. MAXWELL. I don't agree with that.

Senator PROXMIRE. It seems to me if we zero in on one it would be better than a poor job on three.

Mr. YLVISAKER. We do a fair amount of equalization. Every grant program doesn't, and the ones that prevent us from doing more equalizing than we do are some of the very old grants that weren't built that way, but we do provide through our grant system a very appreciable amount of equalization.

Senator PROXMIRE. Dr. Penniman?

Miss PENNIMAN. I guess I start out by being very opposed to the tax credit system. I am opposed to it for two reasons. First, I don't think it is possible to restrict it to the income tax politically. If it were, I would have a little bit more enthusiasm for it.

Secondly, I am opposed to it because it really does nothing on this interstate competition problem, and this to me is a basic difficulty in the State tax systems. You cannot have one State attempting to go very far ahead of the others in tax levels without it becoming a major business issue. Wisconsin suffered for years from this, as you know.

Senator PROXMIRE. I recall well.

Miss PENNIMAN. Again and again and again we were pointed out with horror by all our own business people and by business people in Michigan, Illinois, Ohio, Indiana. This was the terrible State with an income tax, and with high taxes. Nobody looked at the quality of our services. They just looked at the tax system. And tax credit doesn't do anything to help this.

Senator PROXMIRE. I am not suggesting necessarily a tax credit. I am just saying some kind of an incentive to persuade States perhaps to use such a device.

Miss PENNIMAN. I am just saying that the tax credit I really don't feel meets this goal. I think the problem within the States is the differential ability to raise taxes and the differential needs within every one of our metropolitan areas.

We have, as I suggested earlier, by our shared taxes and our grants-in-aid both Federal and State have managed to fragment the metropolitan community in a fashion that simply makes the needy area over here and the tax surplus area over here, and until you bring these into some kind of balance, you are not going to be able to raise the kinds of revenue that are needed within the metropolitan area and improve your local ability to raise taxes.

Now this is a very difficult situation, and I am not suggesting there are easy answers. I do think that we managed in Wisconsin at one point to eliminate an enormous number of school districts, and one of the ways we did it, going from something like 5,000 to something like 200 or 300, was by an equalization aid, even as small as it was, that encouraged the nonoperating districts to get out of the business and encouraged other districts to consolidate. I think at the very least our financial fiscal arrangements ought to encourage consolidation.

This is not a total answer. It is not going to do lots of things, but at least it seems to me it is some help. And then I would just like to make one other point, and that is I don't think that the shared tax system in Wisconsin suggests fiscal irresponsibility at the local levels, apart from the fact where your formula gives more funds into the wealthy areas.

Now, obviously you get some problems there. They depend on the State when they don't need to depend on it. But basically throughout the State I don't think our whole 55 or 60 years of experience suggests irresponsibility at the local levels through the shared tax.

Senator PROXMIRE. Thank you.

Dr. Ecker-Racz?

Mr. ECKER-RACZ. Senator, let me begin by saying that I subscribe to that theory that you attribute to Walter Heller, and I am hopeful that our Federal budgetary situation will return to normal and that we will not be embarrassed again by fiscal drag.

Senator PROXMIRE. Normal? It has been a long time since we have had any surplus.

Mr. ECKER-RACZ. Basically I think the theory is sound, but, Madam Chairman, you might want to clear up a point when Dr. Heller is here: I am not sure that the fiscal drag argument is not used by Walter Heller as rationale for something he wants to accomplish anyway.

In other words, I certainly would support a massive input of federally raised funds into State and local services, even if it means higher Federal taxes, because I would rather use the Federal income tax more effectively than more local property and State sales taxes.

All over the country there are problems because the property tax is impinging heavily on low-income people. I spent a couple of days in Huntsville, Ala., not long ago, where I discovered that if you buy a bottle of milk you pay a 6-percent sales tax on it. Now, the Federal tax, in my judgment, can go a great deal higher before it is as evil as a 6-percent tax on a bottle of milk.

You have asked what dimensions we should be thinking of. We should strive for additional Federal financing that would, in effect take off the back of the property tax the cost of public education. We began public education as a local function in the days when it was the prevailing view that if a man cannot take care of his own child's education he doesn't deserve attention. This is no longer true. And I often speculate how many fewer grants we would need to have if the property tax were not consumed by the public school system.

Dr. Ylvisaker mentioned 400-odd grants. Most are chickenfeed grants. We speak of $15 billion a year. If you take out of the $15 billion Federal grant expenditure, the highway program and the public assistance program, you have little left relatively speaking. So let's not overstate what the Federal Government is doing.

Now with respect to equalization, which keeps popping up, one of the problems that concerns me is that when we mention equalization, we immediately have an image of a group of States that are rich and a group of States that are poor, and everybody thinks, for example, of New York as a rich State.

One of the first lessons we have to learn is that average per capita income is not a measure of ability to finance State and local government. New York is a high-income State. Fiscally, in relation to its needs, it is one of the poorest in the country. The Dakotas are low-income States but I would much rather have the fiscal problems of the Dakotas than the fiscal problems of New York, so that the concept of equalization is one that we need to use with sophistication.

Now I think I have responded to most of the questions. What I said can reasonably be interpreted as being in favor of all States using income taxes. Well, let me qualify that. Let me say that if I were free to write on a clean sheet of paper, I would not give the States the right to use the income tax on corporations, for example. It is unfortunate that income taxation enters into business decisions as to location. It would be better if it were only a national tax.

I think we certainly shouldn't use income tax at the local level. We use it at the local level, we use it at the State level because there is need to finance the great responsibility that is put upon those governments.

I submit that when we think it through we will reach the conclusion that increasingly we must put the major cost of education and social programs on the backs of the national taxpayer and not leave the level of these programs to be governed by the distribution of taxable resources among States or cities.

Representative GRIFFITHS. Thank you, Dr. Ylvisaker.

Senator Symington?

Senator SYMINGTON. I would hope the Commissioner would answer, if he may, Madam Chairman, on my time.

Senator PROXMIRE. I appreciate it. Could we have unanimous consent to let Dr. Ylvisaker answer on my time. Senator Symington is very gracious.

Mr. YLVISAKER. Your question, Senator, was quite broad. Let me comment on two parts of it. First was your questioning of Walter Heller's assumption of a present or eventual surplus.

I am inclined to agree both with you and Madam Chairman that there is something like the fiscal counterpart of Parkinson's law referred to earlier. There is never an excess of Federal or any kind of revenue, because it takes only 1 second for others to realize that it might be there and then it is gone.

I happen to think too that the security needs of this country, whether for Vietnam, or for Newark and Detroit, are going to increase. Because if you look at us in historical perspective, we are really a nation of affluence in a world of poverty, and this discrepancy will create continuous tensions at the margin, both from the poor within, and from the poor without. And I think we will exhibit two responses to those internal and external tensions.

One will be the security response, by which we try to defend what we have—our peace and our prosperity—by military or police efforts.

The other response is one which I hope is going to transcend: which is that we try to negotiate, try to find humanitarian solutions to what otherwise could become military problems. But whatever the mix, I can't see in the foreseeable future that security requirements will so vastly diminish as to provide us soon or even later with a financial windfall for domestic purposes. Therefore I think we ought to start where we are.

Representative GRIFFITHS. Right.

Mr. YLVISAKER. And considering now whether it makes sense to go ahead with shared taxes or block grants or whatever within the margin of what we have.

The second reference you began with, Senator, was to a kind of homely truth. As you and I found at graduate school at Harvard, as we plumbed political theories and history, for every truth there is a countertruth. One truth can be granted: that public fiscal responsibility usually is most exercised when officials are immediately responsive to the person from whom they derived their tax moneys.

But there are some countertruths too. I, as I am sure you have, seen the same human qualities at all levels of government. I have seen many cases of officials at the Federal level being much more responsive and responsible financially than people at the local level, even though they might be farther away from the tax source.

Second, it is a good question whose tax money it is we are spending locally and nationally. Even if one draws from the property tax or another kind of local tax, we are now in a national system where flows are almost undistinguishable. The money rolls from one person, and from one sector to the other. And our public problems certainly have the same fluid character about them. What we need now is not to proceed simple mindedly on the old kind of village truths, which gained their validity when problems were local and resources were local. We are now in an economy and in a society where problems are national and resources are national and we are trying to adjust as well as we can with our human qualities as they universally are.

I think far more disciplining than the immediate relationship of the taxpayer to the tax spender, far more disciplining is the problem itself. Are you making a dent on the problem in whose name you justify taking the tax resources?

What I find now is that we don't have many performance requirements. We have a lot of bureaucratic programmatic requirements for a grant system, which admits you to the National Treasury only when you've been spun through a dizzying multitude of doors. Once you have got in and miraculously out, you face congressional oversight directed not at your performance but at your capacity to survive. Seldom are you asked afterwards for what you were rightly expected to accomplish—for example: "All right, we gave you, city X, so many dollars for urban renewal. What is the housing situation now? How many poor still don't have housing? What is the relocation problem after you have dealt with it for 3 or 4 years?"

This oversight expost facto usually asks such questions as who ran away with the money, or what minor administrative requirement did you not observe? As a matter of fact, I have seen much creditable performance done by sleight of hand avoiding administrative requirements, for good purposes; but that question seldom gets asked in a constructive way. And so I think we ought to be moving much more towards performance requirements on stated problems as a disciplining device, and not simply be adhering to the older village truths.

Representative GRIFFITHS. Senator Symington?

Senator SYMINGTON. Dr. Maxwell, I would narrow this discussion from the standpoint of what we could do here. As the chairman has pointed out, we have a problem which involves appropriation of money for an increase in programs.

Many people are apprehensive about increases, the cost of the war, the growing unfavorable balance and so forth. How much money do you think, as a rough estimate, additional money, we should put in the budget this year to create tax sharing with the States?

Mr. MAXWELL. I started my statement, Senator, by saying that I don't think this year you should do anything with respect to tax sharing by the States beyond what is built in already.

Senator SYMINGTON. Then how about next year?

Mr. MAXWELL. Well, I can't time when we are going to get out of the mess, and some of the other members of the panel agree with some of you that maybe are never going to get out of it. I am more optimistic and think that we are.

Senator SYMINGTON. Suppose we never get out of it. Are you still for doing something in the way of revenue sharing?

Mr. MAXWELL. That is too hard a question. I can't answer it.

Senator SYMINGTON. Dr. Penniman, could I ask you how much money you think we should——

Miss PENNIMAN. I ducked it before and I guess I am inclined to duck it now. I fall back in part on the fact that I am not an economist and I think there are some economic problems here. Yet to put some figure, I think we have got to start out, and I too do not believe we can wait.

I think that the suggestion that Walter Heller really is less concerned about fiscal drag than something else, I think perhaps is true, and I would be sympathetic if it is true.

If we are going to try to set a goal, say in 3 years of $5 billion, as the amount of shared tax money, then perhaps this year what we want to do is $1 billion. These are terribly rough figures. And I certainly would not want to be held to them. But it seems to me there is something of this kind of momentum we are talking about.

Senator SYMINGTON. Thank you. How about you, Mr. Ecker-Racz?

Mr. ECKER-RACZ. Your question is how much revenue sharing I would be willing to support this year?

Senator SYMINGTON. How much do you think that the Congress, this committee, for example, should recommend to the Congress be put into the revenue sharing plan this year?

Mr. ECKER-RACZ. Senator, may I reply this way. I think in the present circumstances I would support a revenue sharing plan probably only if it were coupled with some requirement that the States make more effort themselves; for example, through the device of an income tax credit.

If it were in this context, then even this year, I would support enlarging the deficit to begin putting more money into the State-local revenue stream.

It would not disturb me, for example, if the U.S. Congress in effect undid the 1964 tax reduction over the next few years which is now worth about $20 billion in order to make this money available to State and local governments.

Senator SYMINGTON. Then your figure is $20 billion.

Mr. ECKER-RACZ. More toward that over the next few years.

Senator SYMINGTON. What would you do next year, as you move toward it?

Mr. ECKER-RACZ. If you couple it with an income tax credit so there would be an effort test, I would be willing to begin with $3, $4, or $5 billion.

Senator SYMINGTON. We have $1, $3, $4, and $5 billion; one no opinion.

Mr. MAXWELL. One opinion zero, sir, for next year.

Senator SYMINGTON. To my mind zero is still nothing. In other words, a State that did not have an income tax would not participate, is that it?

Mr. ECKER-RACZ. I don't want to tie it down to an income tax. I want to say——

Senator SYMINGTON. You would not want to just hang it——

Mr. ECKER-RACZ. To the income tax alone. It is a tax effort I am really talking about.

Senator SYMINGTON. Would you want to hang it on a special group of States, according to Dr. Heller's idea, that are lowest in income? Would they get a special allowance before you prorate the others, in the tax sharing?

Mr. ECKER-RACZ. I am reluctant—emotionally yes, but I am reluctant to say yes because I think you and I are thinking of different States.

Senator SYMINGTON. You went to Huntsville. I will go to Huntsville with you.

Mr. ECKER-RACZ. No. I view New York, for example, as one of the fiscally critical States because of its cities' enormous needs.

Senator SYMINGTON. So you would rather see New York helped, based on its record, than you would Alabama. Is that correct?

Mr. ECKER-RACZ. I think New York would need it worse than Alabama, yes. We shouldn't mention individual States because we get into trouble.

Senator SYMINGTON. You started the mentioning.

Mr. ECKER-RACZ. Yes, that is true.

Senator SYMINGTON. All in good humor. Mr. Commissioner, how about you? How do you feel about it?

Mr. YLVISAKER. I speak from under two different hats. As commissioner of the State of New Jersey, I could present you with a list of needs which would suggest that you ought to treble the Federal budget and give most of it to us.

Senator SYMINGTON. We are used to that, but talk about the broad picture, if you will.

Mr. YLVISAKER. I will take that hat off and go back to the other. I think it is almost impossible to answer that question without asking some others, as well. For example, you could make unnecessary any kind of return of this kind of money if you would take over the welfare expenditures of my State, which I think might make a certain amount of sense. If you were to also say what is your purpose in returning this money, do you want to try to quell and remove the causes for the civil insurrection that we have seen in the last 2 weeks. If this is the major purpose of the Federal Government right now, then I would suggest specific ways of taking care of the financial costs. But I would not leap now to some form of a general return to all States on some sort of magic formula.

Senator SYMINGTON. What figure do you think the Federal Government should consider at this stage for next year?

Mr. YLVISAKER. Speaking as commissioner, as much as possible.

Senator SYMINGTON. What does that mean?

Mr. YLVISAKER. It means you let us submit the bill.

Senator SYMINGTON. I think you said something in your statement, but unfortunately you did not have a prepared statement, so I have to rely on my memory, that $5 billion was too little and $10 billion was too little, so I was wondering what you thought the figure would be. This is asked sincerely.

Mr. YLVISAKER. Yes, I know.

Senator SYMINGTON. In an effort to be guided by your thinking. I was much impressed with your statement.

Mr. YLVISAKER. Senator, may I back up to it this way. If Congress were to reallocate $5 billion to the States by some general distribution formula, on a straight per capita basis, New Jersey might get how much of that, 3 percent of $5 billion? That amount would probably be absorbed immediately in highway and educational expenditures, without its necessarily making a dent on any of the urban problems to which I have referred.

What I am saying here is that the magnitudes are fantastic, and that if you add $1 billion or $2 billion or $3 billion, it would be like a drop of water dropped on the desert.

Senator SYMINGTON. At least there would appear a clearer reply from the political scientist than there is in the economists. I hope that does not mean political science is a more practical science than the science of economics. If it does, we are up the creek.

I want to ask a question of fact. You said 440 Federal programs in your State, sir?

Mr. YLVISAKER. The Federal Government has now released the most recent compendium of grant and assistance programs. My understanding is they now number 440. I think this has been published by the Government Printing Office and the Office of Economic Opportunity.

Senator SYMINGTON. I am not questioning, just want to understand.

Mr. YLVISAKER. Yes, of course.

Senator SYMINGTON. How many agencies of the Government do you operate with?

Mr. YLVISAKER. Federal agencies?

Senator SYMINGTON. Yes.

Mr. YLVISAKER. There would probably be about two score at the grant-making level; bureaus, divisions, that sort of thing.

Senator SYMINGTON. You think there are about 40?

Mr. YLVISAKER. That's roughly the number we negotiate with.

Senator SYMINGTON. Thank you. I have finished, Madam Chairman.

Representative GRIFFITHS. Thank you.

It is my understanding that the total expenditure this year for all governments—State, local, and Federal—for welfare is $60 billion. Supposing that in place of giving back any money to the States, the Federal Government just took over the total expenditure, because, of the $60 billion, a very large part of it is both State and local, comparatively a much smaller part is Federal.

One of the problems, it seems to me, of the tax return imposed upon the present situation is that New York's fiscal situation will simply become worse, because the human problems will be greater than they would have been, whereas if the Federal Government took over the total expenditure for both welfare and education, you might alleviate some of the human problems. You might keep some of the people in other areas than are going to New York, New Jersey, Detroit, and Chicago.

Would you care to comment?

Mr. YLVISAKER. I certainly would, Madam Chairman.

I think you caught the point that I was driving at. We have to look at this not only from the point of view of governments but from the point of view of the individuals being served. There is a basic constitutional and ideological commitment in the United States that no matter where you are born, no matter where you live you are entitled to equality of opportunity and equal protection of the laws. On that basis it makes a lot of sense for there to be a national system of floors, of minimum guarantees to individuals.

It turns out that if you are born either in Mississippi in poverty or in the ghetto in poverty, you are dealing with political jurisdictions which do not have the resources to provide those basic guarantees. Certainly if you are the mayor of New York City, you must every night pray in frustration when you realize that you are pledged to give to the people of your community these equal guarantees and equal protections. So it makes a lot of sense to provide national floors to individuals.

This also frees them and gives them mobility, so that they are not locked into their place of origin or their place of residence. If you go back to the basic premise on which this economy is based, which is the mobility of labor and capital, this does increase mobility and adds to the growth of the economy and it certainly also makes good political sense.

I recognize that it would be a great leap to move from one status to another, but moving transitionally in the right direction certainly makes sense.

Representative GRIFFITHS. Of course you would immediately hit the political problems of local control of education and the local control of welfare and so on. Let me give you one example.

In one of the statements—Mr. Maxwell's—"State-local governments can in my opinion handle most civilian functions more efficiently than can the Federal Government."

Now surely, if there is anything they can handle it is the police, and yet Mr. Ylvisaker and I can tell you right now that they cannot, and they are not good at it. So there have been three immediate suggestions made. One made by the Congress that we beef up local police forces, the second made by the President that we beef up the National Guard with riot forces. The third has been made by Mr. Cavanagh of Detroit that we have within the Army a Federal riot force.

Now obviously the cheapest way to do it is in the Army, because you could not possibly put enough police into any one city to take care of the problem, and why train 50 National Guards when you might as well just have one group within the Army.

So the problems that are presented are not as simple as they seem on the surface, and the first problem you would have with the last suggestion is that you now have created a Federal police force, and we are not for a Federal police force. You would have then the political problem.

Mr. YLVISAKER. Madam Chairman, may I respond again on this point?

Representative GRIFFITHS. Certainly.

Mr. YLVISAKER. Because I come from the same situation that you do, what we saw in the recent disturbances was the necessity for cooperative federalism. There is probably too much talk about the discrete character and operations of three levels of government. As we have a national economy that is melded, we also have a national policy that should be melded. We found in Newark when that riot broke out, that it is a traumatic experience for the mayor to call in the Governor. It is a traumatic next step for the Governor to call in the President. I think this results from the discrete way in which we have handled our security arrangements.

Certainly what we need are the security forces of all three levels with much greater continuity in escalation than now provided. Let me give you an example.

When we began communicating with the Federal system (through the Attorney General, late one night), we realized that we would in effect, and legally, be admitting our inability to control the situation by calling in the National Guard. (We also could not avail ourselves of emergency Federal relief unless we were formally designated as a disaster area which we would gladly have done if the legislation had provided for such cases.) Yet we badly needed a continuous escalation and later a continuous deescalation of security forces. We did not want to move suddenly and in dramatic steps from one designated condition to another. What we needed then and what we need now is a joint program, a security program of local, State, and Federal troops, so that its decisions and strategies and levels of force become variable by degree. So I would say "No, we do not want a national police force or a national riot force. We want a coalition of forces which would work together, and this can be done."

Representative GRIFFITHS. In the meantime you hear from the people you represent, we who are the good people, who are locked in our houses without a drink while everybody else is out looting the liquor stores.

Mr. ECKER-RACZ. May I add this thought. I would not want the subject to be dropped without observing that the problem of security which you are discussing is a passing problem and that if we had a more responsible and a more responsive governmental structure to the social needs, perhaps we would not need so many police.

Mr. YLVISAKER. If I may add, Madam Chairman, we have recently made some calculations which I think ought to receive some national attention, even if they are saddening figures. At the present rate of growth, to keep the Negro ghetto at its present size, which we think is too big in the cities we have dealt with, roughly a half million Negroes annually must move into what are now white neighborhoods. If this does not happen, the ghetto will increase at present rates so that by 1972 or 1973, five of our major cities will be predominantly Negro, and by 1983, 20 to 25 of our major cities.

This gives you the glacial nature of the problem, and this is why I support you in saying that both internally and externally we are going to have security problems, because as this ghetto grows by that magnitude, the tensions will also grow.

What I am suggesting is more important than just redistributing national resources. It is that we begin formulating national policies over time that are shared in by local, State, and Federal governments and that are potent enough to deal with problems of this magnitude.

Representative GRIFFITHS. If you had your choice, would you support revenue sharing or a negative income tax?

Mr. YLVISAKER. I do not think these ought to be choices, Madam Chairman. I think both may be needed—the reciprocal of increasing consumer demand and also increasing public outlays is very much needed.

Representative GRIFFITHS. Of course unfortunately nobody is going to have a choice, I am afraid, as to which you are going to have, because, as I feel, that probably one of the biggest blocking forces in State governments is the legislature, so I feel that the national congress will look a long time before they will be willing to levy a tax and return it to a State legislature to spend as they see fit.

Mr. YLVISAKER. If I may respond again, on two things. I think that the bargaining power which the Federal Government may exercise through revenue sharing ought to be exploited. I think Dr. Ecker-Racz and others here would agree, from what I hear, that the full and equitable exercise of tax capacities ought to be a requirement for participation by State and local governments in any of these programs.

Second, I want to say in defense of the New Jersey Legislature that they passed all six measures which I proposed to them this last year, and I can only say nice things about them.

Representative GRIFFITHS. May I ask if they were given the right simply to add a tax as a surcharge to the present income tax, and the money be returned to them, would you support that?

Mr. YLVISAKER. I would support it for New Jersey, but I would want to ask some long questions as a professor looking at the entire Federal system.

Representative GRIFFITHS. What would you say, Miss Penniman?

Miss PENNIMAN. I would not, because again this does nothing for interstate tax competition and it seems to me this is much of the problem, that much of these things do not get out. It is part of the reason I would defend the State legislatures. They are working within some broad parameters of the whole taxing system of the 50 States, and even the legislatures which might wish to do it most are restricted. They are constantly badgered with this idea of how this State stands in relation to other States, and anything that does not get at this tax competition issue, and the only way I can see to do it and have freedom or flexibility with it is the shared tax. If you do not get at that, you are not solving their ability to act.

Representative GRIFFITHS. Mr. Maxwell?

Mr. MAXWELL. I would not favor it, Madam Chairman.

Representative GRIFFITHS. Mr. Ecker-Racz?

Mr. ECKER-RACZ. It is not the best way of giving the States access to income tax revenue. As I understand it, this is a percentage of the Federal tax.

Representative GRIFFITHS. Yes.

Mr. ECKER-RACZ. Which means that the State would have no choice as to how it distributes the burden. You have to take the Federal pattern of distribution in a fixed proportion. It is not the best way of doing it. If your purpose in effect is to increase Federal taxation to distribute part of it on the basis of collections, you would accomplish it with a State supplement.

One of its problems is that it works inversely to equalization. You are giving the most to those who have the most.

Representative GRIFFITHS. Senator Symington?

Senator SYMINGTON. Dr. Penniman, in my State we have rural areas, and two large cities, which is comparable to Wisconsin. What is your feeling about the "pass through" to the cities?

Miss PENNIMAN. I would restrict it in the sense that it seems to me you have got to—in other words, I am not just giving this money either to the States or the cities without any controls. I think you have got to—the Federal Government is the only point at which you can do it—you have got to recognize the variations in needs and tax potential and tax effort. I think all of these three items have to be in any consideration here. I would not support shared taxes under any other basis. And I think the formula that you use at the national level has got to be partly transferred to the States and used by the States, required by the Federal Government for it to be used by the States and retransferred.

Senator SYMINGTON. We have a problem in Missouri. Many in the cities feel they are not represented adequately in the State legislature. We have this one-man, one-vote element, a proposed constitutional convention, and so forth. Many would not be satisfied in our State if you allocated a certain amount of Federal money for revenue tax sharing but did not specifically designate part of it to the two large urban and suburban centers.

Miss PENNIMAN. I would designate it and I would designate it in a fashion that required that those urban centers, either by State commission or local coordinating metropolitan area commission, redistributed it on a basis that brought in these same factors.

Senator SYMINGTON. And that the State would have to put a certain percentage of that into the cities.

Miss PENNIMAN. That is right.

Senator SYMINGTON. Based on population maybe?

Miss PENNIMAN. Well, you can get some ideas of need, and tax effort, because the thing that I keep seeing is that the Federal grants go in for specific purposes. The State grants go in for specific purposes. And you do not get an overall view. And just as I argued earlier that the State of Wisconsin seems to be discriminated against in terms of its general grants in aid, so often times the local areas that are most in need do not get the money.

Senator SYMINGTON. Mr. Commissioner, would you comment?

Mr. YLVISAKER. Yes, Senator. I think that a prima facie case for "pass-throughs" to the cities is there. At a certain population level, one moves to double the per capita expenditures required of an urban con-

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centration against a lower concentration of populations. However, I do want to make another point clear. I think that the basic criterion again should be performance and programing. Yes, let us give St. Louis and Newark and Philadelphia, if you want, double their share, but let us ask of them a workable program and some performance reviews.

Now there is also the reciprocal, that the metropolitan area is half the solution of the central cities problem and also half its problem right now, namely the residential restrictions that keep the Negro population in the central city; the fact that the economy is not uniformly tapped or the proceeds uniformly distributed; generally, that economic and social flows are arbitrarily stopped at city lines.

Central city mayors alone, even with good programs, are caught within this governmental trap and cannot accomplish what needs to be done.

One possible but not too popular solution may lie in section 204 of the model cities legislation which calls as of July, for metropolitan reviews of 10 different grant categories. These exclude housing unfortunately. I think some consideration of open housing ought to be in the administrative requirements of regional review under section 204—that is that if you do not want to use the stick of refusing to give funds to those municipalities that exclude, you might use the carrot—offering double the money for sewer and water facilities if a suburb helps with the solution of the central city's problems.

Senator SYMINGTON. Would you comment, Dr. Maxwell?

Mr. MAXWELL. Very briefly, sir. I favor a "pass-through," but I would hate to see Congress attempt to make a prescription uniform for the Nation with respect to pass-through, because the division of responsibilities in States, between the State government and the local government, is extremely different.

Now, as I remember, Senator Javits has a bill which says, in effect, that there shall be a pass-through, but the pass-through shall be sent back to—I am not just sure what place in Washington—but the State government will send back the amount that it proposes to pass through to the local governments, thereby allowing for diversity from State to State, because the situation is diverse from State to State.

Some such approach as that I would favor.

Mr. ECKER-RACZ. Senator, I think I tend to stand with Dr. Ylvisaker. You said pass-through to the cities. If we look at the grave problems, we find them only in some cities. The suburban cities are anything but in trouble fiscally. If in some fashion we could use this money to get more of an areawide acceptance of responsibility for the social problems in the central city, if say revenue-sharing were coupled with income tax effort so that the suburbs would be made to contribute generously to the States' resources—

Senator SYMINGTON. For the premise of the grant, the concept would be the ghettos in the centers of every large city.

Mr. ECKER-RACZ. Yes. I am in sympathy with getting this money directed to where it is needed most. I am in sympathy with the feeling that legislatures, at least as they have behaved in the past, were not very sensitive to the problems of the city, but I am also concerned that some of our poverty problems are rural. I would hope that as legislatures continue the process of becoming more responsive to the needs of the people, there will be less need for nailing down explicitly the ways in which States use Federal money.

Senator SYMINGTON. Thank you.

Thank you, Madam Chairman.

Representatives GRIFFITHS. Thank you.

May I ask you, Professor Maxwell, to comment on the method used in Canada and Australia of giving back block funds?

Mr. MAXWELL. During World War II the Federal Government of Canada obtained complete jurisdiction over income taxation, individual and corporate. Postwar it negotiated "rental" agreements by which percentages of Federal collections in a Province were paid to the provincial governments. In 1962 it shifted to a tax-sharing basis. Provincial governments were to impose their own income taxes. If the base were the same as the Federal base, the Federal Government would collect the provincial tax, free of charge. If, however, a province collected its own income taxes, the Federal Government allowed taxpayers to abate their Federal liabilities by certain standard percentages—in 1964, 24 percent of the individual income tax and 9 percent of the corporation income tax. Only Quebec administered its own individual income tax; Quebec and Ontario administered their corporation income taxes. Three-quarters of Federal estate tax collections are also paid to the Provinces.

Besides these arrangements applicable to all Provinces, the Federal Government makes equalization payments calculated for 1966 as follows: The per capita yield from income taxation at the standard percentages in each Province is subtracted from the average of the two highest Provinces (Ontario and British Columbia). This per capita amount is multiplied by the population of the Province to get its equalization grant. The formula contained an adjustment for natural resources revenue which I shall not describe. Further equalization payments, calculated on a different basis, are made to the four Atlantic Provinces.

In Australia, during World War II, the Commonwealth Government took complete jurisdiction over income taxation and, after the war, it retained this position, despite the objection of the States, through favorable decisions of the High Court. Tax reimbursement grants have been paid to the State governments and, over the years, the basis has moved markedly away from "reimbursement" and toward appreciable equalization. The name was changed in 1957 to financial assistance grants. The explicit basis of the equalization was "adjusted" population; that is, account was taken of sparsity of population. Every 4 or 5 years at a Commonwealth-State Conference the basis for the past term is modified by political bargaining. Pragmatic agreement is reached, but no theoretical basis exists either for the amount or the distribution of the grants.

Since 1933 the Commonwealth Grants Commission has been equalizing grants to three (currently two) poor or "claimant" States. The basis has been a complicated calculation of tax effort and costs of major governmental services of "claimant" compared with nonclaimant State governments.

Representative GRIFFITHS. Has there been any tendency for the local tax sources to decay?

Mr. MAXWELL. The State tax sources are in very bad shape. The local tax source is property tax as in this country, but the State governments have no good source of revenue. They do not even have a gasoline tax in Australia, and so they are in very bad shape.

Representative GRIFFITHS. Thank you very much. I would like particularly to thank each of you. I thought it was very interesting.

Thank you very much for being here.

Tomorrow the committee will meet at 10 o'clock.

(Whereupon, at 12:05 p.m., the committee recessed, to reconvene at 10 a.m., Tuesday, August 1, 1967.)

REVENUE SHARING AND ITS ALTERNATIVES: WHAT FUTURE FOR FISCAL FEDERALISM?

TUESDAY, AUGUST 1, 1967

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON FISCAL POLICY
OF THE JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The subcommittee met at 10 a.m., pursuant to recess, in room S-407, the Capitol, Hon. Martha W. Griffiths (chairman of the subcommittee) presiding.

Present: Representatives Griffiths and Reuss.

Also present: James W. Knowles, director of research; Harley H. Hinrichs and Richard F. Kaufman, economists for the Subcommittee on Fiscal Policy.

Representative GRIFFITHS. The subcommittee will be in order.

I am very happy to welcome each of you gentlemen.

We continue our hearings on fiscal federalism which began yesterday with the review of the reasons which might be drawn from past experience, both here and abroad. This morning we turn to the various projections of expenditures and receipts, Federal, State, and local, and their implications upon policy.

We are grateful to the distinguished experts who are appearing this morning. I regret to announce that one of the participants, Mrs. Selma Mushkin, of George Washington University, is not able to be with us. Our panelists this morning include Prof. C. Lowell Harriss, of the Department of Economics, Columbia University; Lawrence R. Kegan, director of special studies, Committee for Economic Development; and Prof. Dick Netzer, professor of economics, New York University.

Professor Harriss, we will hear you first.

STATEMENT OF C. LOWELL HARRISS, PROFESSOR OF ECONOMICS, COLUMBIA UNIVERSITY

Mr. HARRISS. Thank you very much, Mrs. Griffiths.

I have submitted a corrected copy of my remarks for the record. And at this time I summarize a few of the major points.

The first is that the projections of State-local revenues and expenditures by the Tax Foundation, Inc., for which Dr. Elsie Watters was responsible, show for 1975 a comfortable excess of revenues over expenditures. On the basis of continuation of revenue systems as they exist now, receipts will exceed expenditures as they are provided for, including a very substantial amount of what we call quality and scope improvement. Revenues include present Federal grant programs now on the statute books as nearly as we can project them ahead.

The excess shown under these projections is of the order of magnitude of about $5 billion a year in 1975. That is, continuing the trends as they exist under present law.

This is broken down in detail by the major categories.

The biggest factor accounting for an apparent change in the direction and emphasis of the outlook is the change in population. Both a decline in the rate of increase in population, and a change in the age distribution will mean a small decline in the number of children in the schools. Whereas education requirements have been rising very rapidly for an increasing student body, now the increased funds can go into essentially quality improvement.

The changing age distribution also means that the relative number of people in the over 65 group who will have to claim some aid will be much smaller in the total economy—as it will exist then. Presumably, the number having claims for aid to dependent children, that is, under 18, will be fewer relative to the size of the economy.

Representative GRIFFITHS. Excuse me.

Do you assume that the number is going to go down on aid to dependent children?

Mr. HARRISS. No.

Representative GRIFFITHS. That would be a plateau?

Mr. HARRISS. I would have to check on the actual figures. In relation to the total population it will be much smaller. The expenditures are projected to increase. I am not sure. What I am saying is that it is the smaller part of a much bigger economy. We can have it. It is all in the study.

The totals for education would rise from an average per student in 1965 of about $490 to $852. This is per child in public schools.

So that here is a substantial amount for increase in quality.

In public welfare, the increase will again be fairly substantial. The increase per capita is again shown, a rise of $46. This is per capita and not per recipient. The increase in education per capita is $94 for the whole United States, not per child in school—which was the figure I gave before.

Similarly, table 3 shows the amounts for each of the major categories, in all cases a substantial increase per person. The "other general" includes tax collection, parks and recreation, correction, unemployment insurance administration, general public buildings, general administration, and so forth.

So far as revenue is concerned, the existing revenue systems include a much bigger potential for increase than often recognized. Once again, we must remember that we start from a much bigger base, a much bigger economy, consequently, a given percentage increase involves much larger amounts in absolute terms than in the past decade.

The 1975 projections reveal State and local taxes of $414 per capita. It is almost $2,100 for a family of five.

The breakdown by revenue sources is in the table.

Now, by and large, it seems to me that the assumptions which have been used are on the conservative side, with one exception which I will note in a moment. They have tended to be conservative in projecting increases in expenditure programs, perhaps a little bit on the high side and somewhat conservative on the revenue increases from the existing system. Of course they take no account of the tax increases that have been legislated since this study was made.

So the general effect is one of a fairly comfortable position for State and local governments under systems as they exist now, including an increase in Federal grants from the present level of around $17 billion to about $30 billion by 1975. State and local governments will be able to finance a lot of governmental services without any change either in their own taxing or revenue from the Federal Government.

These estimates assume a rise in total State and local government employment of something over 2 million people, and an average increase in earnings per State-local government employee, an increase of $2,855, as contrasted with $2,000 in the last decade. That is, almost $2,900 increase in average salary in State and local government employees is built into these expenditure projections.

In closing, I have some general points. They are not precisely on the subject of financial projections, about which I was asked to talk. State and local governments will be disposing of a great deal of money by that time on programs many of which will have margins that cannot be very urgent. The programs will be satisfying needs which are not the kind that we can call compelling at all margins, in all respects. Therefore, if there does seem to be pressing desire for some additional activity, or some new urgencies, it is not at all impossible that reduction at some of these other margins is at least a conceivable alternative. Not everything that will be getting this expenditure in 1975 can be of a very high order of importance.

The second point is that as expenditures and revenues rise, the importance of looking for efficiency in State and local government expenditures increases. More money is at stake. And when revenue pressure eases, one of the insistent forces making for economy will be reduced.

The third point, the exception noted earlier on which I have some qualifications, grows out of the apparent increasing effectiveness of some groups of State-local government employees in getting salary increases. We may call it militancy. I hate to use colored terms. But the ability of governmental employees when they are organized to get more and more salary may present a very serious problem for us. State-local governments are not businesses threatened with bankruptcy if productivity does not increase in line with employment. We do not yet have ways of dealing with this problem. And since salaries are the most important cost of government, this is an area that is going to call for a lot of concern.

Frankly, I can imagine cases in which organized groups of employees, seeing good prospects of increased revenue, whether the property tax or Federal grants, attempting to "latch on" to any revenue availability and getting much of it. Such may be desirable. But it is a phenomenon which I think is somewhat different in nature and degree from what we have experienced in the past. For the record, however, let me also state that many of us may be overimpressed by the temporary thing, conditions of the moment—for instance, New York teachers theatening a strike, New York welfare workers striking, and so forth. For me they may be a little too close to home for proper perspective. But I do see a basis for concern.

Another point, the built-in increases assumed in these projections do not necessarily assume that the patterns are most constructive. At least in principle, I have great sympathy for trying to make grant program categories broader—if not completely block form, at least less specificity—within any given total. I do not want to appear to be suggesting that the present detailed grant system is ideal for 1975.

Going on from this, the best area for trying to deal with State-local problems by Federal aid within present and projected magnitudes, seems to me to be welfare. One would expect that with an economy of well over $1 trillion income, the welfare need for 1975 would decline. We do not project that it will. We project bigger outlays. But in trying to deal with the problems of State and local governments, welfare is the chief function which State and local governments "on their own" will be least able to deal with adequately.

Another point I wish to throw out is that it seems to me that a lot can be said for reduction in Federal tax rates as a way of dealing with the problems that we associate with State and local governments. And my candidate is the corporation income tax, assuming that half is shifted to the consumer, the tax bears about as heavily on poor people as does the retail sales tax.

Finally, in making such projections as this I do not want to appear to assume that the alternative of even reduction in State and local tax rates is not better than some of the proposed increase in State and local expenditures. I am not arguing one point or another on this occasion. But one of the advantages, it would seem to me, of rising real income in a rich society is greater personal freedom, greater opportunity of people to make their decisions themselves, and in voluntary groups, rather than through the political process. Of course, politics must be used in some things, but necessity by no means extends to many activities so undertaken.

Therefore in dealing with human problems, which is what we are concerned with, tax reduction and relying upon the marketplace and voluntary associations seems to me in principle to have much greater promise, relative to growth in tax burdens, than may be implied in these projections.

Thank you.

(The prepared statement of Mr. Harriss follows:)

PREPARED STATEMENT OF C. LOWELL HARRISS

FISCAL OUTLOOK FOR STATE AND LOCAL GOVERNMENT TO 1975*

"Surprise" would not adequately describe my initial reaction when Dr. Watters first "pulled together" the many pieces of her Tax Foundation study on state-local finances. The figures for 1975, allowing for considerable quality improvement, showed an almost "comfortable" excess of dollar availability over dollar outlays. In the year or so since most calculations were completed, nothing has seemed to require material change in the overall conclusions.

SUMMARY: OVER-ALL FINANCES

Table 1 summarizes the findings. Tax and other revenue sources now provided by law (including Federal grants) will bring general revenues as shown as

*C. Lowell Harriss, Professor of Economics, Columbia University, and Economic Consultant, Tax Foundation, Inc., prepared for presentation to the Subcommittee on Fiscal Policy, Joint Economic Committee, U.S. Congress, August 1, 1967. For the most part this statement is a digest of Tax Foundation, Inc., *Fiscal Outlook for State and Local Government to 1975*, Government Finance Brief No. 7 (The Tax Foundation, 50 Rockefeller Plaza, New York City, 10020; 1966). The Brief itself is a summary of a study of 128 pages bearing the same title. Dr. Elsie M. Watters, Director of State-Local Research, was primarily responsible. The statement here contains a few of my own value judgments; they are not necessarily those of other members of the Tax Foundation staff nor, of course, of the Foundation.

exceeding general expenditures by about $5 billion in 1975. The spending will be that called for under present law plus quality (and scope) expansion at recent rates. Looking at the still broader financial operations, chiefly extending the scope to include borrowing and debt requirement, we see a slightly larger excess of availability over requirements.

TABLE 1.—SOURCE AND USE OF MAJOR STATE AND LOCAL GOVERNMENT FUNDS,[1] ACTUAL AND PROJECTED FISCAL YEARS 1965 AND 1975

[In billions]

	Actual, 1965	Projected, 1975
Source of funds:		
General revenue	$74.3	$146.9
Profit on liquor stores	.3	.3
New long-term borrowing	11.2	16.1
Other borrowing[2]	1.1	1.0
Total funds available	86.9	164.2
Use of funds:		
General expenditures	75.0	142.0
Long-term debt retiremet	5.0	8.8
Employee retirement systems	1.8	3.0
Deficit on utility operations	1.0	.5
Additions to liquid assets	4.8	3.6
Total funds required	87.5	157.8
Funds available less funds required	−.6	+6.5

[1] Excludes transactions of social insurance systems, chiefly unemployment insurance. Utility and liquor store operations are entered on a net basis.
[2] Net increase in total debt outstanding minus difference between long-term debt issued and retired.

Source: Actual data from U.S. Department of Commerce, Bureau of the Census. Computations and projections by Tax Foundation.

If state-local governments continue to borrow about one-half the amounts they spend for capital investment, as they have in recent years, total debt for all would rise from $100 billion in 1965 to $169 billion by 1975, an average of about $7 billion a year.[1] This change would represent a slackening in the relative growth rate in debt, as well as a decline in the outstanding volume of net long-term debt in relation to revenues from state and local sources.

Under the conditions assumed, without an increase in over-all tax rates, aggregate general revenues will grow somewhat more rapidly than spending.

These findings stand in sharp contrast to widely expressed notions concerning the future of state-local finance. In recent years, it has become almost commonplace to assume that states and localities as a group are in financial straits which will be accentuated, that these governments will become increasingly hard pressed and unable to meet adequately their appropriate responsibilities. Overlooking for the moment the "rubbery" aspect of at least two terms in the last sentence, I hasten to recognize that some jurisdictions (and my close contact with New York City's situation enables me to identify one case) will not be "normal" or average. Yet for most state and local units, the financial outlook is much better than is generally realized.

EXPENDITURES

Expenditures (including quality improvement) are projected to rise from $75 (1965) to $142 (1975) billion. Table 2. This pattern represents continued high growth, but at a relative pace more nearly consistent with that of the first half of the 1960's than with the faster rate recorded in earlier postwar years. For the decade to 1975, the indicated rise is 89 percent—no small amount—in comparison with a 123 percent advance in the decade ending in 1965. (1) Some factors mak-

[1] Long-term debt net after allowing for cash and securities held as debt offsets would grow from $80 to $145 billion. The levels of debt projected here may, however, be overstated. The projected surplus of available funds over those required suggests that, if receipts and outlays on current accounts materialize as indicated, state and local units may not resort to borrowing for capital purposes to the same extent as in recent years. The indicated levels of debt do not appear to exhaust the potential recourse to new debt financing if needed.

ing for expenditure growth are more or less "built in"—population size and age distribution while (2) others represent "policy" decisions—service quality.

Many of the variables influencing the postwar expenditure upsurge will continue to operate with approximately the same force as in the past. Others will tend to accelerate spending. Some, however, will act as decelerators. *A major restraining element is the outlook for population trends*, influenced by the declining birth rate since the late 1950's. This drop, by holding rates of growth in total population below those of the 1950's, will tend to reduce pressures for larger governmental spending. Much more important, however, is the concomitant effect of the resulting population *age distribution* on expenditure levels, notably education and welfare.

TABLE 2.—STATE AND LOCAL GENERAL EXPENDITURES, ACTUAL AND PROJECTED, FISCAL YEARS 1955–75

[Dollar amounts in billions]

Function	Actual amount		Projected, 1975	Increase	Percent change	
	1955	1965			1955–65	1965–75
Total, general expenditures	$33.7	$75.0	$142.0	$67	+123	+89
Education	11.9	29.0	52.9	22	+144	+83
Highways	6.5	12.2	16.6	4	+89	+36
Public Welfare	3.2	6.3	17.1	11	+99	+170
Health and hospitals	2.5	5.4	10.6	5	+112	+97
All other	9.7	22.1	44.8	22	+128	+103

Source: Actual data from U.S. Department of Commerce, Bureau of the Census. Computations and projections by Tax Foundation.

Policy decisions, as distinct from automatic or built-in forces, have the predominant role among factors tending to accelerate spending rates for some functions, notably public welfare.

Some reallocations of funds among the major functions is foretold in the projections. In particular, further growth in local school spending will be tempered by a slackening in enrollments. The two largest functions—education and highways—are expected to grow at an appreciably less rapid pace. (But operating cost the per pupil would go from $490 to $852.) Funds would be "freed up" for larger rates of increase in the remaining functions. The most dynamic growth areas appear to be public welfare, health and hospitals, and a variety of functions grouped under miscellaneous. As before, education will remain the most costly function and will continue to call for the largest dollar increases.

Education

Schools and colleges now enroll more than a quarter of the nation's population. The vast majority—49 million—are in state and local institutions. These institutions made notable achievements in the postwar period, and costs mounted rapidly. A relaxation in enrollment pressures in the next decade is expected to exert a moderating influence on future spending trends. Outlays of $52.9 billion projected for 1975 represent an increase of 83 percent in the next ten years, in comparison with a 144 percent rise during the past decade.

Relatively slow increases in enrollments in local schools are in prospect between 1965 and 1970; thereafter a *decline* of some 1.2 million students is anticipated by 1975. For the decade, enrollment gains will average out at 162 thousand per year, in contrast with the experience of the 1955–1965 period, when additions averaged 1,187 thousand a year. With per-pupil standards rising as in the first half of the 1960's, operating costs per pupil would reach $852 by 1975, about three-quarters higher than in 1965. The operating (non capital) outlay per pupil would *increase* $362 as compared with $216 from 1955 to 1965. *Capital outlays* from 1965–74 would total almost *twice* those from 1955–64 in constant dollars.

Expenditures for institutions of higher education are projected to grow more rapidly than for public schools, but also at rates below those of the past decade. Outlays are projected at $14 billion by 1975, or about 140 percent above 1965. Current expenditures per full-time student are estimated to increase by about three-fifths—from $1,593 in 1965 to $2,558 by 1975.

Public welfare

Public welfare is the third ranking category among state and local government functions, but welfare spending in the postwar period has proceeded at a slower pace than that for other major activities. Most state and local welfare falls under the Federally shared programs. Assistance takes two forms: cash payments to the needy in support of living allowances, and medical payments.

The projections envison a significant increase in the rise of public welfare spending. Total welfare outlays in 1975 are estimated at $17.1 billion, or 170 percent more than in 1965. The previous decade's advance was 99 percent. The higher rates of increase reflect the assumption of widespread response on the part of the states to 1965 Federal legislation on medical care for the "medically indigent." *Emphasis* in the welfare field promises to shift in three ways: (1) from financial aid for living support to payments for medical care; (2) from programs for the elderly to those for younger persons; and (3) from aid to the very poor to assistance to those with somewhat higher living standards. Projections, assuming that all states will implement the new Federal law, indicate that medical costs under public assistance programs will rise by $7.5 billion from 1965 to 1975.

In the other major sector of public welfare—cash living allowances to the needy—only moderate rates of increase are indicated. The slackening in growth reflects expected declines in members of the population under 18 years old, and smaller future increases in the number 65 years old and over. These two groups receive more welfare aids than others, and in the postwar period have tended to increase more rapidly than other age categories. Further downward biases in the outlook for state-local welfare spending are due to the continued increase in the role of social insurance (OASI) programs in the care of elderly persons.

Health and hospitals

State and local governments own and operate 2,041 hospitals and administer a variety of public health programs. They have a predominant role in caring for patients with long-term illnesses, especially mental diseases. The projections for the decade indicate that outlays will rise by 97 percent, to $10.6 billion in 1975. The rate is just slightly below that experienced from 1955 to 1965, but the dollar total will nearly double.

Since 1948, expenditures for state-local health and hospital services have more than quadrupled. The growth in outlays due to quality changes is difficult to separate from that due solely to rising prices. Medical care costs and prices are expected to continue to mount rapidly.

Recent Federal legislation affecting the over-all financing of national health services will have an indirect influence on the state-local health and hospitals sector; in particular, state-local hospitals may become more self-sustaining. These new programs will serve to reduce the role of state and local hospitals in the care of the sick poor; hospitals which serve primarily the poor may become obsolescent in their present form. While the over-all financial responsibility of states and localities for hospital and health services may decline in relation to the nation's total health expenditures, their administrative role in the broader field of health services, which includes medical vendor payments under public welfare, seems likely to expand.

Highways

The management of 3.6 million miles of highways and streets rests largely in the hands of states and localities. This job ranks second to education in financial requirements. Federal highway policy has been a major guiding force in capital spending since 1956. But state and local units have a more extensive responsibility for the 2.8 million miles of city streets and local roads which are outside the Federally aided systems. Land, construction, maintenance, and other highway costs have risen rapidly as a result of both price inflation and the search for improvements in quality. Such increases are estimated to continue at a similar pace throughout the period. The estimates, based as they are on existing law, project that the volume of highway construction will drop somewhat following the completion of the presently designated 41,000-mile Federal-state interstate highway system before 1975. Total highway outlays in 1975 are projected at $16.6 billion, 36 percent above 1965. Future Federal legislation will have an important bearing on actual highway outlays beyond 1972; continuation of Federal financing of 90 and 95 percent of the interstate system or a successor would mean that any new plan approved by Congress would not greatly alter the net state-local financial position projected here.

Other functions

The remaining services provided by the states and localities cover a wide range of activities—parks, recreation, natural resources, correction, unemployment administration, financial administration, general control, public buildings. In total the costs of these heterogeneous services are projected to rise to slightly over twice the 1965 cost, but at a rate somewhat under that experienced in the previous decade.

Per capita trends

Table 3 sketches the indicated future pattern of per capita expenditures for selected functions.

TABLE 3.—PER CAPITA EXPENDITURES FOR SELECTED STATE AND LOCAL FUNCTIONS, ACTUAL AND PROJECTED, FISCAL YEARS 1955–75

Function	Actual amount		Projected, 1975	Increase	Percent change	
	1955	1965			1955–65	1965–75
Total, general expenditures	$205	$387	$655	$268	+89	+69
Education	72	150	244	94	+108	+63
Highways	39	63	76	13	+62	+21
Public welfare	20	33	79	46	+65	+139
Health and hospitals	15	28	49	21	+87	+75
Sanitation and sewerage	7	12	20	8	+71	+67
Police and fire	12	20	33	13	+67	+65
Housing and urban renewal	3	6	12	6	+100	+100
General control	9	14	22	8	+56	+57
Interest on debt	5	13	24	11	+160	+85
Other general	23	48	96	48	+50	+108

Source: Actual data from U.S. Department of Commerce, Bureau of the Census. Computations and projections by Tax Foundation.

Composition of expenditures

Capital outlays for general (excluding utility) functions, $18.6 billion in 1965, are projected to be 43 percent higher in 1975; in the decade to 1965 the rise was 95 percent. The projections envisage some reduction in the rate of growth in state and local government *employment* and payrolls. Under the assumptions, the number of full-time employees would rise from 6.9 to 9.0 million. If average earnings continue to grow as in the first half of the sixties, total payrolls would reach $76 billion by 1975, almost double those of 1965. The rise would compare with 141 percent in the 1955–1965 decade. The *increase* in average annual earnings per employee would be $2,855 compared with $1,993 in the earlier period.

REVENUE

In the postwar period the yields of all major state-local revenue sources have increased substantially, more than matching expenditure growth. Table 4. Addition of new Federal grant-in-aid programs and liberalization of older ones have made the U.S. Treasury the source of largest proportionate increases. State and locally imposed taxes, however, made up the lion's share of the increase.

TABLE 4.—STATE AND LOCAL GENERAL REVENUE, ACTUAL AND PROJECTED, FISCAL YEARS 1955–75

Source	Amount (billions)			Per capita	Percent change	
	Actual		Projected, 1975			
	1955	1965			1955–65	1965–75
Total, general revenue	$31.1	$74.3	$146.9	673	+139	+98
Total from State and local sources	27.9	63.3	116.9	536	+127	+85
Taxes	23.5	51.6	90.2	414	+120	+75
Current charges	3.0	8.4	18.8	87	+183	+124
Miscellaneous	1.5	3.3	7.8	36	+124	+134
From Federal grants	3.1	11.0	30.0	138	+252	+172

Source: Actual data from U.S. Department of Commerce, Bureau of the Census. Computations and projections by tax foundation.

Despite the record of extensive tax-raising measures, the overall state-local tax structure has been quite stable. One notable development was the resurgence of the property tax, in sharp contrast to the decline in its relative role over several years to the end of World War II.

Revenues are projected as rising somewhat more rapidly than general spending. This result would come without any increase in overall effective tax rates, the addition of new taxes, or the broadening of bases of present levies.[2] Conservative estimates of the automatic response of taxes to rising incomes point to a 75 percent rise in yields from existing (1966) taxes in the decade ahead.

Funds from Federal grant-in-aid programs existing in 1966 are estimated to rise (from about $17 billion in 1968) to $30 billion by 1975. The increase is large but at a relatively lower rate than has characterized the past decade. The rates charged to users of specific state and local services are assumed to continue to grow proportionately with expenditures for the associated functions.

State-local taxes per capita would rise by 50 percent to $414, an average of $2070 a year for a family of five.

ASSUMPTIONS AND METHODS

Dr. Watters' complete study spells out the detailed assumption underlying the projections. Although I cannot claim to have reviewed the dozens of decisions she had to make in choosing among reasonably acceptable possible assumptions, I am inclined to agree with her that the composite is conservative, that is, taking care to avoid the overstatement of revenues or the understatement of spending.[3]

The assumptions, in general, envisage rates of economic growth and of general prices similar to the experience of the first half of the 1960's. The projections are consistent with a rise of about 4 percent annually in real gross national product and an annual increase of 1.6 percent in general prices. Under the assumptions, current dollar gross national product would amount to $1.2 trillion by 1975, and per capita personal incomes would rise to $4,240, about one-fifth higher than in 1965.

The population projections assume that the birth rate will continue downward until 1967 and thereafter will gradually rise throughout the projection period. The estimates are based on the revised Series C of the Bureau of the Census. Total population would rise by about 23.7 million, to 218.3 million in 1975.

Expenditures are projected for the several functions by building up estimates of caseloads, unit costs, and prices, under legislative programs already in effect—or in a few instances where it is noted, on anticipatory legislative policy changes. *It is a basic assumption that standards per service unit will advance at the real rate of improvement experienced during the period 1960–1965.* Tax revenues are projected on the basis of the 1966 tax structure; and the increases shown reflect gains accruing solely from expected future economic growth. Nontax revenues and revenues from Federal grants are based on projected expenditure levels for the several functions.

IMPLICATIONS

The projections—as made clear in the study and as Dr. Watters has emphasized in talks before numerous groups—are in no sense predicitions of what will actually happen. They do not claim to deal with future "needs" as defined on the basis of value judgments. Rather, the figures are a statement of the levels of state and local government activity which would prevail in 1970 and 1975 if the assumptions prove accurate. As is the case in any aggregative study involving national totals, the conclusions do not apply with equal validity to all states or to all of the country's more than 80 thousand local taxing and spending jurisdictions.

Existing revenue systems, without tax increases, will be able to finance the expected expenditure growth associated with built-in factors of population, caseloads, and prices, and *in addition provide for improvements in (a) the quality and (b) the scope of services averaging 2 percent per year.* The cumulative improvement ought to be substantial. Yet I hasten to note that dollar outlays do not necessarily measure quality. Results may be either better or not so good as money amounts suggest. Will performance improvement correspond with the increase in average salary of $2,8557? One of the more baffling problems of government finance lies in the measuring output. The potential for bettering the quality of state-local services is substantial—things now being done or new activities.

In closing, and without discussion, I venture a few observations.

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[2] Some such revenue-increasing structural changes have been made during 1967 legislative sessions.

[3] I note one exception below; it may be important.

1. State-local governments will be disposing of sums which are very large indeed. The room for maneuver ought to be greater than we have come to associate with state-local spending. There will then, I suggest, be numerous margins at which urgency, to say the least, will be slight. Would it not seem reasonable, then to expect that emerging needs of high urgency could sometimes be financed by curtailing the growth of existing expenditures? The amounts of some programs will be large enough so that the importance of marginal outlays will presumably be rather slight.

2. The rate of projected rise in revenue might well serve to alert us to the importance of effort for efficiency in state-local spending. Otherwise avoidable waste seems likely to grow. An easing in the net financial position invites relaxation of effort for economy; removal of the power of insistent necessity as a factor for care in state-local spending calls for some counterpart.

3. My third point is the "exception" referred to in the last footnote. A large portion of state-local spending goes for salaries. The power of human desire for more income needs no documentation. The salary projections may understate the rise. One must be cautious lest the immediate and familiar, especially if it is a bit novel, assumes undue weight in assessments for the longer run. Correctives do have a way of appearing, as the change in birth rates reminds us. Yet collective bargaining grows among government employees. Use of the term "militancy" in discussing some groups of public employees may not be sheer hyperbole. It takes little imagination to foresee cities in which more than all available revenue increases are always demanded by employee groups to whose power the public tends to defer.

4. The increase in Federal grants under programs now existing will be substantial. Without this increase, the state-local picture would be rather different. Yet assuming the overall magnitudes projected—and in a sense "planning" on the basis of such an aggregate—one does not preclude change in the form by which the higher total is to be provided. Some move toward broadening grant categories, and even toward block grants, seems to me desirable in principle.

5. The greatest promise of making Federal grant programs more conducive to national well being—whether by rearrangement within the same dollar total or by any increase—would seem to me to lie in enlarging the Federal proportion of the total of the country's pure welfare assistance. (Choice among alternative forms is not my present point.) Perhaps I am too close to the immediate problems of New York City. Increasingly, however, I feel that, per dollar, the best promise of constructive improvement of Federal-state-local financial relations will be found in the broad area of welfare assistance. Perhaps Medicaid will in fact accomplish much indeed along these lines.

6. Reduction in Federal tax rates offers an alternative not to be overlooked. Time has not permitted me to try, as I once planned, to trace out possible effects of reduction in the corporation income tax rate. Getting rid of the top 10 percentage points seems to me to have far greater all-around merit than commonly recognized.[4]

7. The submission of projections such as these involves a subtle risk. The speaker may appear to assume that the growth of state-local spending shown would always, or even generally, be preferable to reduction in tax rates. No such conclusion ought to be read into anything I say. One of the more welcome fruits of rising prosperity could well be greater freedom for the individual and voluntary groups to dispose of more of the increases. Clearly, the political process must be used for some economic decisions. But beyond the essentials lies a considerable area open to choice. The very nature of a society with the total output envisaged for 1975—$1.2 trillion of GNP—would seem to me to be one with relatively greater scope for freedom of choice. At the very least, it would be wrong to imply that no such opportunity will lie before us and our children.

Representative GRIFFITHS. Thank you very much.

Mr. Kegan?

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[4] Much of the discussion of Federal-state-local financial relations now deals, one way or another, with concern for the very low income groups. On the assumption that half of the corporation income tax falls on consumers, the total burden on the "Under $2,000" and "$2,000 to $3,000" income classes is substantially greater than the total of state general sales taxes; even taking account of differences in total revenue yield, the corporation income tax bears heavily on low income groups. (Other considerations add to my reasons for recommending that corporate rate reduction get high priority.) Tax Foundation, *Tax Burdens and Benefits of Government Expenditures by Income Class, 1961 and 1965* (New York: The Foundation, 1967), p. 48.

STATEMENT OF LAWRENCE R. KEGAN, DIRECTOR OF SPECIAL STUDIES, COMMITTEE FOR ECONOMIC DEVELOPMENT

Mr. KEGAN. Madam Chairman, I welcome this opportunity to appear before your Subcommittee on Fiscal Policy to discuss fiscal projections for State and local governments and their policy implications. Doubtless your invitation stems from the publication in June 1967 of a statement on national policy by the Committee for Economic Development on "A Fiscal Program for a Balanced Federalism." Copies have been made available to you. Although my testimony today is based on the staff research which served as a background for this statement, the projections and policy implications summarized here do not necessarily represent the views of other staff members, officers, or trustees of the CED.

Since they are available, and since Mr. Stein will appear before your panel tomorrow to focus on the major policy recommendations concerning the tax credit against the general assistance grants, I thought that it might be helpful for me to focus on the projections which are background for the statement. But since the whole subject is "Revenue Sharing and Its Alternatives, What Future for Fiscal Federalism?" I would like to consider some of the policy implications which will not be covered by Mr. Stein. For that reason, in order to be more responsive to your interests and those of your committee, I have partly changed my statement. And I hope you will permit me to go ahead with it.

First, I should like to deal with the model we have developed for our projections. It is different from, I think, most all other models in trying to highlight separately the changes in the three major factors of State and local expenditures in order to highlight the policy issues that affect each one of them. The three factors are the population-workload, changes in prices, and changes in scope and quality of public services.

Now, by population-workload we mean not simply the changes in the population, but accounting for the changes in the population structure, or the population by age groups. The population will decline, as projected by the Bureau of the Census, from 18 percent in the last decade—and by that I mean 1955–65—to the forward period, 1965–75, to 15 percent. But the growth rates in the age groups requiring the most costly public services are expected to decline considerably.

For example—and this details some of the points that were made by Mr. Harriss—the increase in the age group determining enrollments in the public schools, ages 15 to 17, will fall from 35 percent in 1955–65 to about 7 percent in 1965–75. And this is known now. There is nothing involved here about birth rates in any serious sense for this forward period.

The growth of the college-age group, 18 to 21, the crisis we are now involved in, will also fall from 48 percent in the past decade to about 33 percent in the next decade.

The population growth of older citizens who are heavy beneficiaries of health and welfare services will fall from 25 percent to 17 percent.

The growth in population-workload as a whole—which weights the relative expenditure importance of these groups by the age groups, and the amount in each age group—is expected, therefore, to decline from 27 percent in the past decade to 15 percent in the next decade.

And I think this is significant in that some of the fiscal pressures, some of the greatest fiscal pressures in the past on State and local governments which were due to population-workload will ease in the coming period. And I think the significance there is that we, due to the baby boom in the past period, have experienced the greatest educational crisis and problem. We didn't completely fail in meeting that. Yet the growth in that group will be much less in the forward period, just from the point of view of numbers. This does not take account of the desirable changes in quality and scope.

Now, obviously the projection of price changes is clearly a much more difficult issue. We assume that there is no serious inflation, and that there will be a continuation of the price performance of the past decade.

Now, in the past decade the deflator for prices of goods and services purchased by State and local governments grew 40 percent. This is 15 percent more than the crisis in the economy as a whole. The gross national product deflator for the economy grew 22 percent. We assume this differential will continue for two reasons. First—and this picks up the point that Mr. Ylvisaker made yesterday—there is lesser increase in the productivity within the service-producing sector of the economy than in the goods-producing sector. And of course State and local government expenditures are heavily weighted by services.

And second, there is the previous shortage, and the present militancy, of certain Government employees, particularly public school teachers, with the result that relative salaries have had to be and continue to be raised. And we expect that this will be a real issue. If we want to have improved services in government, obviously we will have to pay them better salaries. If we want to have teachers who can be effective in meeting the problems of the depressed and those in the ghetto areas, they will have to be much better paid and much more competent in order to be attracted to that kind of very difficult job.

So that we have projected, therefore, that the 40-percent increase and the 15-percent differential will continue for State and local government services.

Now, the residual change in public expenditures not due to these two factors, the population-workload change and the price change, we allot to scope and quality changes. And this can easily, therefore, be calculated as a residual change of the multiple of these three changes. In 1965 State and local government expenditures increased 120 percent over 1955. The relative population-workload was estimated, as we saw, to be 127 percent, and the relative price level 140 percent. Thus, for the past period the scope and quality ratio is 124 percent. This suggests that State and local government services in the past decade improved 24 percent during that decade.

Now, unlike changes in either prices of population-workload, and to a lesser extent, prices. the improvement in scope and quality is subject to substantial policy choices. The extent of the expansion in scope and quality of public services depends on the political decisions made by the people acting in their roles as voters and consumers of government services, as well as government officials. Our model, therefore, does not attempt, as the Tax Institute model, to project a single rate of change in scope and quality.

We want to highlight the policy choices. Therefore we indicate the cost of changes in scope and quality of different magnitude. That is, we believe that most students would accept most of the population change figures. Most students might accept the price changes. But even if they didn't, we could always incorporate whatever price assumptions were made, and they won't change the picture very much. The ones where judgments of a personal sort about what social goals are, clearly affect the changes in scope and quality. And if we permit that choice or several choices to be open for inspection so that the policy choices can be made, we then calculate a series of changes, relating them to the changes in the past. And that is what we tried to do.

For example, we estimated that scope and quality increased 24 percent in the past decade. Now, if the voters, through their representatives, choose to continue to improve aggregate scope and quality at this unchanged 24-percent rate, State and local government expenditures in 1975 would be 200 percent of 1965 expenditures. Now, here we are just forecasting or projecting given choices as to scope and quality, the percentage changes, not the dollar changes. We will do that on the revenue side as well as on the expenditure side, so that we can see what the position between them is.

Now, this increase in general expenditures of 100 percent compared with an actual change of 120 percent in the past decade. If future general expenditures were to increase at the past decade rate of 120 percent, the expansion in scope and quality would be 37 percent as compared with the 24 percent of the past decade. We have experimented with other historic changes. And one of them that is most important is that we took each major public service program, elementary education, secondary schools, higher education, health and hospitals, welfare, urban services, and all other activities, and in each case applied price changes that were developed by the OBE and the National Income Division for the purchases of the Government services involved in each program, and we applied the specific population structure, the population groups involved in each of these, and then calculated for each program separately in each 5-year period, 1955–60, 1960–65, the scope and quality changes. And then we took the highest for each program, the highest half. And if we did that, a projection of overall improvement in scope and quality of 34 percent was indicated.

The reason we took that is that this suggests possible plausible changes that might be possible, taking account of the real resources that are available. These are 5 continuous years. They are recent; they indicate what has historically been possible. And therefore we think that these are plausible and not unrealistic measures as to what might be very high projections of scope and quality. We are not saying maximum. But if there were a 34-percent change, that would mean a 114-percent increase in general expenditures.

Now, of course, we complete our expenditure model by adding in the other elements in total finances available to the State and local government—supplementary contributions, other net expenditures, and addition to working-capital funds. And if we did this, compared with the past change of 120 percent in the statement our expenditure projections would grow by 94 percent in 1965–75, if it were at the same rate of growth for scope and quality as in the past decade, and 111 percent if we took the highest 5-year period.

It is important, if I may, to just say again that we have not projected any one level of expenditures. We have laid out the choices that the citizens might make as to what they think should be the scope and quality, whether it is so-called Marshall program for Negroes or rebuilding the cities, or whatever.

We now turn to the CED model for the revenue projections. The existing State and local tax structure will obviously yield increasing revenues in response to economic growth. A number of recent studies under response of various State and local taxes to economic growth—and three of the best studies have been done by people who were on this panel; notably, Selma Mushkin, Dick Netzer, and Elsie Watters of the Tax Foundation—suggests that the existing tax structure of the State and local taxes will yield increases in tax revenues at rates approximately as large as GNP.

Now, reasonable projections concerning the rate of increase in the labor force, productivity in price trend as developed by the staff of the Joint Economic Committee itself, suggest that the national product will rise 80 percent over the 1965–75 decade. Thus, in 1975 State and local revenues are likely to be about 80 percent higher than in 1965, if no changes in the rate of taxes or the coverage of taxes are made over the fiscal 1965 structure.

If we include for this purpose the new sales tax which was legislated in 1965, but not put into effect, we would get an increase of 86 percent, just in the revenues due to growth, but no changes in taxes.

Now, State and local governments also secure funds not only from their own sources in taxes, but from charges, from Federal grants-in-aid, and from increases in debt. We may develop parallel models there, paralleling the assumption that the tax structure is fixed. We assumed a fixed system of charges which takes account of changes in costs and population-workload; the increase in Federal grants-in-aid as applied in existing legislation; and a percentage increase in debt equivalent to that of general revenue from our own sources.

We estimate with price changes that about $31 billion is what is already written into present legislation for the existing grants-in-aid without new programs, and a percentage increase in debt equivalent to that of the general revenue from all sources, which has been a very stable figure. On this basis total State and local receipts, we project, will increase 98 percent over the next decade.

Now, these funds would permit, if no changes were made in taxes, a level of expenditure consistent with an improvement in scope and quality of 23 percent in the next decade, which is clearly comparable with what happened in the last decade, 24 percent, with no changed taxes.

Thus the aggregate rate of improvement in scope and quality achieved in 1955–65, and financed with rapidly rising tax rates and coverage during that period, which was one of the highest periods of growth and action by State and local governments, could be maintained in the forward period even if no further changes were made. But this is not to say that tax increases will not occur. They certainly have. Or that the rate of improvement in Government services need not become more rapid. Neither can we say that individual communities, particularly the cities, or poor States, will not face grave fiscal difficulties. But it is reasonable to conclude that the fiscal resources for substantial improvements in State and local government can be made available only without massive new Federal aid beyond that implicit in the present legislation.

Now, as to the policy implications for the lower levels of government.

Although State and local government can secure the funds necessary to provide substantial increases in scope and quality between 1975, there is no room for complacency with regard to the adequacy of State and local revenue systems. If the public demands faster improvement in scope and quality, the area of policy choice, additional funds will be needed beyond those available from the present tax structure. There are many possibilities for improving and changing the revenue-raising structure of State and local government in a manner which would increase the revenue beyond the amounts available from the fixed structure. If additional funds are needed, State governments can improve the administration of the local property tax, they can increase the relative importance of the State sales taxes and personal income taxes as revenue sources.

Administration of the property tax, which is essentially a local tax, and is the source of 90 percent of local tax revenue, could be improved by the leadership and direction of State governments. And the CED in its policy statement did recommend that correcting inequities in property assessment could make the property tax more productive if the States accept full responsibility for assuring statewide equitable and uniform assessment of real property, if assessment ratios of all classes of real property, including land, were equalized on the basis of market value; if property tax exemptions for special private interest groups such as homesteaders and veterans were abolished; and if States continue to require such subsidies through the property tax exemptions, they should reimburse local government for the revenue losses incurred.

Now, professional property tax assessment with regular periodic reassessment and the abolition of special property tax assessments, we estimate, could result in an increased yield of at least $2 billion in 1975. An action along this line is being taken by many States.

The general retail sales tax is growing in importance. It yields substantial revenues even at low rates, and because it is relatively easy to administer. But the exemption in many States of a wide range of consumer services results in unnecessary taxes. If they need more revenue, State governments could broaden the general retail sales tax to cover consumer services, as other States have, and make much more effective use of such a broad retail sales tax. We have estimated that if all States which have no sales tax, or which have a relatively low rate, or narrow coverage, were simply to adopt the 1965 average rate in coverage, the additional yield would be at least $2 billion in 1975.

Now, as to the personal income tax.

It is the last major source of relatively untapped State and local revenue. Seventeen States had no broad-based sales income taxes in 1965. Two of them have now been added, Michigan and Nebraska. About three-fourths of the States with a personal income tax have effective rates of less than 2 percent of personal income. The possibilities for increases in State personal income tax yields are considerable, because many large industrial States do not use this tax effectively. If all States with no personal income tax—and that includes Illinois, Ohio, Pennsylvania, Connecticut, and some of the most industrial in the country, with the highest income-tax rate—or with relatively low rates or narrow coverage, were to adopt a personal income tax with the 1965 average rate in coverage, the estimated yield would be at least $7 billion in 1975.

Now, the CED also recognizes that revenues from their own sources do not meet the full public service costs of local government, particularly the larger central cities. Supplemental funds are obtained from State grants-in-aid as well as from Federal grants. In 1965, State general expenditures totaled $40 billion. Direct expenditures were $26 billion, and State aid to local government was $14 billion. Twenty-nine percent of the latter went for education, and 17 percent for welfare. A portion of this aid was amassed through the Federal aid to the States.

States do play an important role in the Federal system. In 1965, they raised about a third of total general revenue for civilian domestic public services. Nevertheless, there has been much criticism of State initiative in finding solutions to modern public problems. The States have been attacked for failure to act on urban problems, especially in metropolitan areas, where local government fragmentation severely hampers the attack on social ills and programs designed to aid the poor. Because of the increasing interdependence of local jurisdictions, the role of the States must grow if they are to be strong and effective partners in the Federal system. The States should encourage greater cooperation and coordination among local governments in solving metropolitan problems. In many areas taxpaying ability is greatest in the suburbs, but need greatest in the central cities. The States should do more to equalize resources available to individual local governments to combat social ills. And therefore the CED recommended that States should take greater responsibility for paying for education and welfare, either through direct expenditures or grants-in-aid, to help equalize and improve the financial abilities of local governments to meet their needs in these fields.

Now, the result of all these measures would result in substantial additional tax receipts available to the States of around $12 billion. They are indicative of a tax potential if the people are willing to pay the price for improvements in their public services. There is no presumption that the limits to sales or income taxes have been reached, even in the high-tax States. Consistent with our assumptions of other sources of funds, these measures would permit a substantial increase in total State and local expenditures, and a substantial improvement in the scope and quality of general government services of around 35 percent between 1965 and 1975.

This would be greater than the aggregate improvement corresponding to the highest past improvement if we took each individual program separately and took the highest 5-year period in the past decade.

Now, it is important to be clear about the significance of these calculations. The data outlined here in no manner indicate the rate of improvement of State and local services which may be proper. They are not predictions of things to come, or of revenue requirements necessary to meet future expenditures by State and local governments. They simply establish that the taxing and spending choices of State and local government officials are much wider than is commonly supposed. They suggest that State and local governments can reduce the burden of inequity, and they can achieve a better balance in their tax systems by taking measures which improve their ability to raise revenue from their own sources.

State and local governments can in the aggregate, therefore, speed the rate of improvement in the scope and quality of public services if they are willing to pay the price in higher taxes. But due to population mobility, and to our increasingly interdependent society, the benefits of public services of one State extend into the other States. Thus they serve regional and national interests, not merely their own. The National Government, therefore, has the responsibility for assisting the States to attain a greater physical strength.

I believe that I have taken enough time.

(The prepared statement of Mr. Kegan follows:)

PREPARED STATEMENT OF LAWRENCE R. KEGAN

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The population-workload factor depends upon the age structure as well as the size of population. The growth rate of the total population is expected to decline from 18 percent in the decade 1955–65 to about 15 percent in the decade 1965–75. But the growth rates in the age groups requiring the most costly public services are expected to decline much more. Thus, the increase in the age group determining enrollment in the public schools, that is ages 5–17, will fall from 35 percent in 1955–65 to about 7 percent in 1965–75. The growth of the college age group, 18–21, will fall from 48 percent in the past decade to about 33 percent in the next decade. The population growth of older citizens, who are relatively heavy beneficiaries of health and welfare services, will fall from 25 percent to about 17 percent. The growth in the population-workload as a whole—derived from weighting the relative expenditure importance of these groups—is expected to decline from 27 percent in the decade 1955–65 to 15 percent in the decade 1965–75. Thus, some of the fiscal pressures on state and local governments due to growth in the population-workload may ease in the coming period.

The projection of price changes is an imperfect art at best. We assume that there will be no serious inflation and that there will be a continuation of the price performance of the decade 1955–65 when the prices of goods and services purchased by state and local governments, as measured by the Commerce Department deflator, grew 40 percent. This is 15 percent more than prices in the economy as a whole. We assume that this differential will continue for two reasons. First, there is the lesser increase in productivity within the service producing sector of the economy than in the goods producing sector, and the relatively heavy use of services by state and local governments. Second, there is the previous shortage, and the present militancy of certain government employees, particularly public school teachers, with the result that their relative salaries have had to be, and continue to be, raised.

We assume that the residual change in public expenditures not due to population-workload and price changes is due to the change in the scope and quality of public services. Since the change in expenditures between one period and another is equal to the multiple of the changes in the population-workload, prices, and scope and quality, the residual change in state and local government expenditures may be calculated by dividing out the effects of workload and price from the total change in government outlays. In 1965, the level of state and local government general expenditures was 220 percent of that in 1955. The relative population-workload level was estimated to be 127 percent and the relative price level as 140 percent. Thus, for 1955-65, the scope and quality ratio is 124 percent, suggesting state and local government services improved 24 percent during the decade. The relations are shown in the equation:

$$\begin{array}{ccccccccc} \text{Population-Workload} & \times & \text{Price} & \times & \text{Scope \& Quality} & = & \text{Expenditure} \\ 1.27 & \times & 1.40 & \times & 1.24 & = & 2.20 \end{array}$$

The improvement in scope and quality is subject to policy choices. The extent of the expansion in scope and quality of public services depends on political decisions made by the people acting in their role as voters and government officials. Our model therefore does not attempt to project a single rate of change in scope and quality. Instead, it indicates the cost of changes in scope and quality of different magnitudes, in order to enable us to relate these magnitudes and their costs to the experiences of the past. In doing so, plausible limits to changes in public expenditures and the effects that these changes can have are suggested.

We have estimated that aggregate scope and quality increased by 24 percent in the decade 1955–65. If the voters, through their representatives, choose to continue to improve aggregate scope and quality at an unchanged rate, state and local government general expenditures in 1975 would be 200 percent of 1965 expenditures under our workload and price assumptions. This is shown below:

$$\begin{array}{ccccccc} \text{Population-Workload} & \times & \text{Price} & \times & \text{Scope \& Quality} & = & \text{Expenditure} \\ 1.15 & \times & 1.40 & \times & 1.24 & = & 2.00 \end{array}$$

The increase in general expenditures of 100 percent compares with an actual change of 120 percent in 1955–65. Alternatively, if future general expenditures were to increase at this past rate, the expansion in scope and quality allowed for would be 37 percent compared with the rate of 24 percent in 1955–65. Another alternative is suggested by assuming that the improvement in scope and quality by each major public service program in the future period will proceed at rates equivalent to those experienced in a five-year period, 1955–60 or 1960–65, whichever is higher for each respective program. Using these assumptions, a projection of an overall improvement in scope and quality of 34 percent is indicated.

To complete our expenditure model, we must add supplementary contributions to employee retirement systems, other net expenditures, including profits from liquor stores and deficits in utility operations, and additions to working capital and sinking funds. Compared with an increase in actual total outlays of state and local funds of 124 percent between 1955–65, our projections indicate that the total outlays would grow by 94 percent between 1965–75 if the aggregate improvement of scope and quality estimated for 1955–65 were to continue through 1975; and by 111 percent if rapid but plausible rates of improvement were to take place corresponding to the rate for each program in either the five-year period 1955–60 or 1960–65, depending on which was greater.

We turn now to the CED model for revenue projections. The existing state and local tax structure will yield increasing revenues in response to economic growth. A number of recent studies on the response of various state and local taxes to economic growth (notably by Selma Mushkin, Dick Netzer, and the Tax Foundation) suggest that the existing tax structure of state and local taxes will yield increases in tax revenues at rates approximately as large as the increase in GNP. Reasonable projections concerning the rate of increase in the labor force, productivity and price trends suggest that national product will rise perhaps 80 percent over the 1965–75 decade. Thus, in 1975, state and local tax revenues are likely to be about 80 percent higher than in 1965, even if no change in rates and coverage were to occur. But if we include new sales taxes which were legislated but not yet put into effect by 1965, we project state and local tax revenues, with a fixed tax structure, to increase 86 percent between 1965 and 1975.

State and local governments also secure funds from charges and miscellaneous general revenue, federal grants-in-aid, and increases in debt. Paralleling the assumption that the tax structure is fixed, we assume a fixed system of charges which takes account of changes in costs and population-workload; the increase in federal grants-in-aid as implied in existing legislation; and a percentage increase in debt equivalent to that of general revenue from own sources. On this basis, we project that the total state and local receipts will increase 98 percent over the next decade.

These funds would permit a level of expenditures consistent with an improvement in scope and quality of 23 percent in the next decade, compared with 24 percent in the past. Thus, the aggregate rate of improvement in the scope and quality achieved in 1955–65 and financed with rapidly rising tax rates and coverage, could be maintained in 1965–75, even if no increase in tax rates or coverage were to occur.

This is not to say that tax increases will not occur, nor that the rate of improvement in government services need not become more rapid. Neither can we say that individual communities or states may not face grave fiscal difficulties.

But it is reasonable to conclude that the fiscal resources for substantial improvements in state and local government services will be made available even without massive new federal aid beyond that implicit in present legislation.

Although state and local governments can secure the funds necessary to provide substantial increases in scope and quality of public services between now and 1975, there is no room for complacency with regard to the adequacy of the state and local revenue system. If the public demands faster improvement in scope and quality of services, additional funds will be needed beyond those available from the present tax structure. There are many possibilities for improving and changing the revenue-raising structure of state and local governments in a manner which would increase revenue beyond the amounts available from a fixed structure.

Through time, the ratio of the property tax assessments to the actual market value of taxable property has fallen. It has been estimated that the lag in reassessment between 1956 and 1961 resulted in an increase of assessed valuations which was almost 20 percent below the actual increase in the market value of taxable property. A reassessment lag of this proportion between 1965–75 could cost local governments nearly $4 billion in 1975. Additionally, partial exemption from property taxation for special interest groups, such as veterans and the aged, have been growing. Because of declines in the ratio of assessed value to market value of property, the value of these exemptions may also be growing unintentionally. At the 1956–61 rate of increase, about 5 percent of potential property tax revenues, or about $2.0 billion, would be lost due to partial exemptions in 1975.

In 1965, 37 states had general sales taxes, through which $6.7 billion, equivalent to 1.9 percent of their personal incomes was raised. The range of collections relative to personal income was from 0.8 percent in Wisconsin to 4.3 percent in Hawaii. The broad differences resulted from different coverages as well as in tax rates. We may be able to approximate a level of potential revenue from realistically higher state general sales taxes by estimating the revenue which would be yielded if each state without the tax or with a lower than average general sales tax burden (defined as tax revenue relative to personal income) adopted the tax or raised its rates and coverage to the average of the taxing states. The states with lower than average state general sales tax burdens and those states not having legislated general sales taxes by fiscal year 1965 collected $3.1 billion in general sales tax revenue in 1965, but would have collected $4.4 billion had their sales tax burdens been 1.9 percent. The difference would grow to over $2 billion by 1975.

The possibilities for increases in state personal income tax yields are considerable because 17 states, many of them large industrial states, do not use this tax. These states accounted for 41.7 percent of personal income in 1964, excluding D.C. If the states without personal income taxes or with burdens below the average of 1.3 percent of personal income had taxed at the average level, an additional $3.2 billion would have been collected. In 1975, this would amount to about $7.5 billion.

Representative GRIFFITHS. I am glad to hear that somebody believes that the States aren't really doing all they can to help themselves.

Mr. Netzer?

STATEMENT OF DICK NETZER, PROFESSOR OF ECONOMICS, NEW YORK UNIVERSITY

Mr. NETZER. Thank you, Mrs. Griffiths.

I am somewhat diffident about my role here. I have no specific set of projections to present to you. The projections of the other participants in this program, including Dr. Mushkin's projections, are ones that have involved substantial resources in first-rate research jobs.

As a matter of fact, projections of the future fiscal prospects of State and local governments have proliferated, drastically improved in technique, and have become steadily more optimistic over the last decade since I first began making projections of States and local fiscal outlook. Since the techniques have so improved, it is difficult for me to dispute the optimistic results that others have produced. I really have great respect, as I said, for the jobs they have done. I have a personal note here, though; 10 years ago when I made one of the first projections of this kind, I was roundly denounced by most of my colleagues for being much too optimistic about the prospects for State and local governments. And now I find myself to some extent on the other side of the question.

But I do agree that the existing State and local revenue systems in the aggregate will yield enough revenue even without increases in tax rates or adoption of new taxes to provide appreciable improvement in the scope and quality of public services in the decade or so ahead. This will occur even after taking into account the rise in basic workload—more pupils, college students, et cetera—and the rise in costs, chiefly salaries of public employees, of services of unchanged scope and quality.

Despite this, I think there is general agreement that there is almost sure to be some pressure for tax rate increases in most States and cities. That is, no one really doubts that the desired increase in the scope and quality of State-local public services will lead to expenditures rising more rapidly than the yield of existing State-local revenue systems. This is really a forecast of the political decisions. The likelihood is that there will be, in a generally affluent society, pressure to increase State and local tax rates, and that the increases will occur.

The disagreement that we have is really confined to the issue of just how large this kind of fiscal gap might be, how severe the pressure on State and local tax rates will be. If it is small and widespread, it presents no really serious implication for Federal policy at all, I would say. If it is large and generalized, the implications are quite the opposite. If it is serious in some places but not in others, the implications for Federal policy can be found only in an examination of the specific sources of the fiscal gap in the places in which it is a real problem. I think the latter is the general nature of the situation, that is, it is a very uneven geographic problem.

My own view is that there is an inherent downward bias in fiscal projections of future expenditures where such projections have been made for specific expenditure categories—this does not include the CED model, which is not a projection of expenditures, but rather an appraisal of how much latitude there will be for fiscal choices, as Mr. Kegan has said. This downward bias stems from the inevitable inability of forecasters to prophesy the effect of rapid social changes on the nature of the particular programs which make up the broad-expenditure categories we deal with when we make projections and look at the statistics that are available. I will give you an example of that in a moment.

This bias can be explained away. Our projections would have been right if we excluded one or another "special factor." But these "special factors" taken together are what have produced the continuous State and local tax rate increases that we actually observed. Therefore, I suspect that there will be in this sense a pressure on State and local taxing systems, and that there will be a real fiscal gap, and not a small one either, but the pressure will be highly uneven geographically.

Before taking up this problem of geographic disparities, I would just like to make a brief remark on the other side of the whole issue of fiscal federalism; that is, the fiscal position of the Federal Government. I can't see any way of denying the likelihood of great fiscal ease for the Federal Government assuming that the Vietnam war is ended. There is just nothing that you can see that points in any other direction. And if massive fiscal drag is to be avoided, some combination of reductions in Federal taxes, increases in direct Federal spending or increased Federal financing of State-local services will be necessary. This is the context within which our discussions must take place. If the Federal Government is flush, modest State-local fiscal problems suggest Federal tax cuts, severe State-local problems indicate increased direct or intergovernmental Federal expenditure.

Now, I also think there is really very little argument with the proposition that the really grave fiscal problems, to the extent that there are any at all in the State and local sector, will occur in the more urbanized parts of the country, and within these regions in the large central cities. This is for reasons that are familiar to all of us: the concentrations of the poor and the disadvantaged in large cities, their accumulations of fiscal obsolescence, and their relatively slow rates of growth in income and wealth due to the decentralization of economic activity. Optimistic overall projections of State-local fiscal prospects are based upon the responsiveness of tax systems in a rapidly growing economy. And I think these projections make great sense. But the big central cities show up very poorly in this connection. If their economic or their tax bases are not expanding rapidly, the kind of projections we have been making when we deal in aggregates simply are not relevant to this situation. Meanwhile, central city expenditures are climbing rapidly.

This is not mainly a result of responding to the needed improvements in their physical plant. Consider the largest conceivable increases in expenditure for things like urban renewal, mass transportation, parks and recreation, and so on, that is, to improve the physical plant and public facilities within central cities, increases of several hundred percent over existing levels of spending. These, by themselves, would really present no great problems, because the amounts of money involved really are not large in the aggregate. The real fiscal difficulty in the big central cities arises from rapid increases in expenditures for services relating to race and poverty, notably now what is called compensatory education, health and welfare activities.

In this connection it is important to note that virtually all of those who have projected State and local expenditures, including me, did not really forecast the very large recent rises in the State and local expenditures for resources related to poverty. Dr. Mushkin's projections of public welfare expenditures are really better than most in this regard. But since they are more explicit, they are a good target. She projected a national increase in total public welfare expenditures averaging 6.8 percent a year between 1962 and 1970, and a 4.6 percent annual increase in expenditures less Federal aid, that is, expenditures financed by State and local government.

But between 1962 and 1965, both the total and the portion financed from State-local funds rose by about 8 percent a year, substantially more rapidly than projected. In the 38 largest metropolitan areas, local government expenditures for welfare rose by one-third in this period of less than 3 years.

Now, we don't have any national data beyond the fiscal year 1965 right now. But we do have some scattered data—that is, you can find evidence in the budgets and financial reports of individual and local government. And most of those for the large urban States and large cities suggest much more dramatic increases in expenditures for activities connected with poverty.

I am not talking here about the federally financed war on poverty, but rather about the public assistance programs and other public welfare activities and health services to people of low income, even aside from medicaid. Of course, I have best access to material from New York State. They really present dramatic examples.

Dr. Mushkin's projections for New York State public welfare expenditures for 1975 are for a total of a little over $1 billion, half from Federal aid. The State budget anticipates welfare expenditures in this current fiscal year, that is, the fiscal year ending next March 31, of $1.7 billion, 70 percent above the figures expected two and a half to three years from now. And 40 percent of this will be federally financed. The share of Federal funds in this is smaller than Dr. Mushkin's projections indicate.

State-local funds provided for welfare purposes this year at $1 billion in New York State will be double Dr. Mushkin's projections for State-local funds for welfare for 1970. This, of course, is directly related to the central city problems. For example, New York City expenditures for public assistance alone this year will be nearly 40 percent above the 1970 projections for the whole State.

Again, I don't say this to criticize Dr. Mushkin's projections. I think this is the kind of thing we have traditionally failed to foresee, that something really dramatic has happened here. And I think the dramatic thing that has happened is rather clear. We have always known that there are hundreds of thousands of people eligible for public assistance and other services under the laws of the States in which they reside, who have not been receiving assistance, and have not been receiving the services to which they are legally entitled. Recently, these people have been applying for assistance or other services to which they have always been entitled. And this is dramatically changing expenditures for this purpose.

The fiscal projections, then, raise two central problems. The first is, are we really prepared to contemplate continual State-local tax-rate increases, mainly in connection with large central cities, if the Federal Government is at the same time in a position to massively cut Federal taxes? I would say we should not really contemplate that, for three major reasons:

First, rapid rises in central city tax rates, and in the taxes imposed by the State governments which contain them, will exacerbate their economic difficulties and their social problems as well. And by "rapid rises" here I mean not only the adoption of new taxes, but I mean anything which effectively increases the taxes collected out of the economic base at a given time. I add this footnote at this point because much of the discussion improvement in the administration of the property tax relates directly to central city problems. The property tax in most central cities in the United States—Washington, D.C., happens to be an exception—is very badly administered. The quality of administration is as bad as that in some of the most benighted rural areas.

Representative GRIFFITHS. May I ask you, in view of the fact that I think the property tax in Washington, D.C., is very low, do you suggest that it is better administered because it is low, or do you think it is high?

Mr. NETZER. No, it certainly is low compared to other places.

Representative GRIFFITHS. I don't know why anybody would object to paying a property tax in Washington, D.C.

Mr. NETZER. It is low, but it is well administered in addition. I think that is a separate factor. There are other places where it is low and badly administered, and places where it is high and relatively well administered. The city of Milwaukee, for instance, has really high property taxes, but a pretty good quality of administration.

But the point that I wanted to make clear is that if you say, we will get more revenue out of the property tax by improving its administration, what this means in many large central cities is that you are going to increase the effective rate of property taxation for many property owners, that is, increase the economic burden of the property tax. And I do not see that this is really getting around the difficulty of the central cities. This, it seems to me, as I said, will exacerbate their economic difficulties in many ways.

Now, an indication of what is really happening in property taxes in some of the central cities is something that happened this year in Newark, which happens to have, among good-sized American cities, as high a property tax rate as there is. The city of Newark had this year a 30-percent increase in its property tax rate on top of its previous very high rate. Newark has many low-income Negro homeowners. Certainly this doesn't explain the riot. But it adds to the total degree of privation in the Negro community in the city of Newark.

Now, there is another problem of the property tax. And property tax, after all, is the biggest of the State-local taxes, and it is the one most likely to rise if State-local taxes continue to go up. It is a high fraction of housing costs. And as such, I believe it to be a real deterrent to increases in and improvement of the housing stock in large central cities and among less well-off families for whom the income tax advantages of homeownership mean little or nothing. Again, it is a central city problem, the low income problem.

This question of improving administration of the property tax comes up again here. The city of San Francisco, which, among large American cities probably had the worst property tax administration until recently, is going through a wholesale reassessment which has been forced upon them by the legislature and the State government. If they do nothing but reassess property, if there are no new nonproperty taxes adopted, there will be an average increase of 50 percent in taxes paid by residential property owners. San Francisco happens to be a city which has a large number of moderate-income homeowners owning rather small houses. And looking at the whole series of housing market trends and the statistics in San Francisco, it is a pretty safe prediction to say that the effect of property tax reforms in San Francisco can have a devastating effect on the housing problems of that city.

Now, finally, I think that the final argument for not viewing with equanimity continuing pressure on State and local taxes while the Federal taxes are being cut is that State and local taxes are less satisfactory in almost every important respect—regressivity, effects on location of economic activity, and ease of administration.

All this suggests some form of transfer of fiscal resources from the Federal to the State-local level, or transfer of responsibility for the provision of services from the State-local level to the Federal Government; for example, replacement of public assistance with an all-Federal income maintenance program.

The second central issue concerns the specific role of the Federal Government with respect to the problems of the central cities. My own belief is that the major public services related to poverty, including compensatory education, should be 100 percent federally financed, or directly provided through Federal programs; and that, were this done, there would be no real need for, or national purpose served by, Federal functional grants for other services. The residual fiscal imbalance, assuming this massive fiscal transfer connected with services related to poverty, calls for a transfer of resources, pure and simple—by general grants, not a long list of minor functional grants whose national purpose, other than tax relief at the State-local level, is almost invisible—invisible, that is, if we continue to believe in a Federal system with diversity and with local decisionmaking.

Thank you.

Representative GRIFFITHS. Thank you, Mr. Netzer. I found your remarks very interesting.

And I would like to ask you about your method of applying a political decision.

First, I want to know if your projections assume that the average person is going to leave the labor market at age 65 in the next 10 years? Do you assume that they will leave the labor market at age 65?

Mr. HARRISS. I think so, the general order of magnitude, yes.

Representative GRIFFITHS. Now, I would like you to apply the method—show me how you make a determination of the political decisions in, for instance, the social security bill. I have been struggling with this for 6 months, so I would like to hear what you have to say about it. At the present time the social security bill is going to contain a new provision that the disabled widows can draw social security at 50. Did any projection anticipate this? I mean, really it isn't very much money, it is only $170 million. You can't get down to any such thing as this.

Mr. HARRISS. No.

Representative GRIFFITHS. At the present time widows draw social security at 60—a widow can draw more social security at 62 than her husband could if he quit and retired. That is how sentimental things got in the social security. I want to point out that in my judgment when you reduce the age at which a widow—a disabled widow—can draw social security, you are going to move toward a theory of everybody drawing it at 50. You are already moving toward the theory of everybody drawing at 60. You are pushing toward a new retirement age.

Now, the social security bill also is going to have another provision, that the disabled are going to be taken care of under medicare. Any disabled worker—and all this sounds extremely reasonable—if you are going to take care of people over 65, disabled people over 65, why not any disabled worker? The only problem is that it costs $850 million a year to do that.

Now, the next move is going to be, if you are going to take care of disabled workers, why don't you take care of their families? If you are going to take care of disabled people under medicare, why don't you take care of anybody listed as disabled under medicare?

That triples the cost.

So that in making the political decisions, where obviously you were off on your projections—as pointed out, Miss Mushkin came closest; but nobody anticipated this—what I would like to know is, how do you make the political calculations?

Do you just say what it is going to be?

Mr. KEGAN. In the CED model we explicitly point out that there is a choice—you still can make those decisions. We are saying that scope and quality is open to the political choices. And then we simply indicate for different programs at recent past rates what it has been. It can be much more in the future. So we haven't made any assumption or prediction in our model about what these choices would be. We have deliberately constructed our model so that those choices would be open.

Mr. HARRISS. The Tax Foundation projections are not predictions, but they rest on calculations based on the net financial effects of political decisions.

Of course, the cases you have mentioned have been primarily Federal, rather than State-local finances. The Tax Foundation method assumes that decisions will result in changes at about the same rate as in the past decade.

Incidentally, in answer to your earlier question about the number of aid to dependent children, the projection calls for an increase of almost 2 million people getting aid to dependent children in 1965 to 1975. This is about a 50-percent increase.

Representative GRIFFITHS. The calculations of the Ways and Means Committee are that it will double between 1968 and 1972.

Mr. HARRISS. Is that dollars or number?

Representative GRIFFITHS. Dollars. They are going on the rate of 40,000 adults and 120,000 children a year, I think.

Mr. HARRISS. Yes, that is very close to the dollar figures that come out of these calculations—but for a longer period.

Mr. NETZER. It doubles in 4 years.

Representative GRIFFITHS. In 4 years?

Mr. NETZER. You see, this is what has been happening in the last 3 years.

Representative GRIFFITHS. We are going to come out with $1,500 million just in services, because we are going to try to reach a plateau.

Mr. KEGAN. The thing you suggested, the social security for a widow at 50, and so on, in our system are all changed in the scope and quality of Federal services in this case. And this we say is clearly up to choice. All we have tried to indicate in our model is that the system that currently exists of State and local taxes and their responsiveness provides scope for substantial improvement, but those substantial improvements may not be adequate.

Now, Professor Netzer has indicated that obviously there will be increases in State and local taxes. Of course there will be increases if you want to increase the scope and quality and meet some of these needs of the poor ghetto areas, and so on. We have suggested that those increases be in a direction which would mean that you have more responsive taxes by focusing on the personal income tax in State governments.

And here I would like to make one comment on Mr. Netzer's position. He says that when you compare the Federal system of taxes with the State and local systems, in every aspect the Federal is much superior. Well, this is not true. If one of the issues you are interested in is having a tax that is responsive to changes in growth, and if you assume—which I think all of us do assume—that State and local expenditures will go up faster than gross national product—the pressures there are just tremendous. And then you want to have as elastic a tax instrument as you can have. The most elastic tax instrument that exists in the United States today is the State personal income tax. The Federal personal income tax elasticity, as Professor Goode and Professor Netzer have indicated, is about 1.1 percent. You do get high receipts because of the very high tax rates. But the responsiveness, just taking the existing level of taxes, of State personal income taxes, and their existing rates, is 1 percent or 1.8 percent. That is, for every $10 of gross national product, you get about $17 more of personal income tax revenue on the part of the States. And, therefore, if you are interested in a tax which is responsive, this is the direction you would go.

We also believe that in terms of collection it is about equal to the Federal. There is not a very substantial difference.

But in terms of equity, the potential equity of the State income tax can be great, or much greater than that, according to the position of many people, of the Federal income tax. So that the potential equity involved, the responsiveness, its ease of collection, we think, that if you move in this direction you would be improving the total national tax system. This would also help on the other point you made, to the extent that State and local governments depend more and more on the income tax, the less need there is for pressure on the more regressive taxes; that is, on property taxes and sales taxes. And in addition, you have another advantage. If every State that does have the income tax wanted to decrease the regressivity, they could have a credit, both for the sales tax—as in the case of Indianapolis, where the poor get a credit of $6 per person, and those below the income tax level, over that they get a check, even though they don't file an income tax, which is roughly equivalent to their consumption of food and the sales tax they pay if the sales tax covered food. Similarly, in Wisconsin the poor who own homes get a credit on their income tax. And it seems to me that this could be expanded. So that the regressive qualities of the two taxes, sales tax and property tax, would be limited if you had an effective income tax and then tied these two to the credit.

So that in many ways I think the system would be much more effective, much more equitable, and much more responsive if you had more effective State income taxes throughout the Nation.

Mr. NETZER. I certainly don't want to indicate that I am opposed to income taxation at the State level, or the more effective use of it. Quite the contrary. And I agree quite generally that it would considerably improve State and local tax systems if there were a heavier use of State income taxation. The point is that the income tax remains a relatively minor source of State-local revenue because so many States don't have the tax. And if you were to simply put the choice—which CED does not do—as one between Federal tax cuts and some form of Federal transfer to the States, the first alternative would be a very bad one because State and local taxes taken as a whole are deficient on so many grounds.

Now, the specific point about the elasticity or the responsiveness to economic growth of State income taxes versus the Federal income tax is a consequence of the particular form of income taxation adopted at the State and local level. The 1.8 elasticity figure is very heavily influenced by the experience of the State of New York. Now, I think we have a good income tax in New York State. And in some respects it is superior to the Federal tax. In many respects it is the same. So it has the same disadvantages of the Federal tax, because many of the definitions are the same. It has one silly deduction that the Federal tax does not have. But it has a personal credit which the Federal tax does not have, which improves it. In many ways it is a very good tax, and it is highly responsive to economic growth.

However, there are other State-local income taxes that are much less responsive to economic growth. You can devise a State income tax that just doesn't respond any more than a sales tax. Most local income taxes, for instance, are no more responsive to economic growth than is the sales tax.

Mr. Harriss. May I comment?

Representative Griffiths. Yes, of course.

Mr. Harriss. Professor Netzer and I are more nearly in fundamental agreement than may seem. But there are two points I would like to add. One is, in comparing the Federal tax system with any other, let us look at the margins. What does the last 10 to 20 percentage points of the corporation income tax do in terms of resource allocation, and incentive as well as imposing burden? And here I would contend that it would be very hard to say that this is not a very bad element of the overall national tax system.

The second point is that the property tax consists of two things, a tax on land and a tax on structures. And the economic effects of the two are very substantially different. I am not implying that within the next decade State and local governments are going to make radical modifications. Yet they could shift more of the burden to that part of the tax which is relatively the much better—or less bad—the tax on pure land levels. They could then reduce the portion of the tax on structures.

I would certainly like to see very serious consideration given to this alternative. As Professor Netzer says, the property tax, so far as it applies to structures, is absolutely the wrong thing for central cities. But not so far as it applies to land values. Here is a range of choice open to State and local governments. In looking at constructive alternatives, this shift of emphasis to land values would rank pretty high in what can be done in terms of the desirability of urban renewal, getting rid of the junk in the cities, and in bringing about better things. The property tax is likely to be equivalent to a 30 percent sales tax on pure housing costs. And it is the tax on the structures, not on the land, which is bad.

And finally, to emphasize a point in my paper, the per capita State and local tax as projected by the Tax Foundation for a family of five would be about $2,100 in 1975. And this is indeed a lot of money. Perhaps this is one reason why people may seem to have difficulty in meeting their own needs through the market and privately.

Representative GRIFFITHS. One of the real problems, I think, in this whole question of whether or not you simply send back money from the Federal Government has become the feeling, evidently, or the understanding among the general public that if the money came from Washington, they would get a tax reduction.

Now, there are not going to be any tax reductions no matter which way you do it.

I would like to ask you also, in the matter of care of the central city or, of the cities, you have talked about the city's choice, what about the individual's choice within the city, the fact that the tax base could simply go almost to nothing? I was riding around the city of Detroit on Thursday afternoon with police officers. One of them looked mournfully at the burned-out area and said, "There goes the tax base. I will never draw my pension."

And I got to thinking about it afterward, and I thought to myself, you know, that is really not too farfetched an observation.

The real truth is that the problem of paying these pensions, particularly of police officers, is that they are a very high cost of any city budget. And it is not at all inconceivable that they might welsh on their agreement.

Let me give you a little example:

There is a deputy superintendent of police who retired in the 1930's still living in Detroit. He is in his 90's. The highest salary he ever drew was $3,000. He is now drawing $12,000 in pensions.

Mr. HARRISS. The inherent economic advantages of central cities are very substantial. The tremendous destruction in Europe of one city after another did not lead to the abandonment of the central cities as the place to rebuild. In spite of the rubble, and so forth, the reconstruction took place pretty much in the same locations—testifying among other things, I would think, to the economic viability. The real difference between the central city and other locations is the disadvantaged portion of the population. And Professor Netzer makes a good point about the rate of economic growth of central cities. Here is one reason why I suggested that any change in Federal aid be concentrated on the welfare aspect of the total problem. It is the one that State and local governments are least able to take care of themselves on a satisfactory basis, because of the mobility, interarea competition, et cetera.

Representative GRIFFITHS. Of course, one of the differences, though, between Europe and the United States, it seems to me, is that, first, in the United States there really is quite a lot of land left. And even big factories in the city of Detroit that employ hundreds of thousands of people can move, and they charge it off to the taxpayers anyhow.

Mr. NETZER. Yes. But, Mrs. Griffiths, there is a vast increase in office activity, white-collar activity, which is going on. Much of it is spread around suburban areas. But the increase is so large that it occurs in the central cities even so. What we are seeing in a large number of the bigger cities is a decline in manufacturing employment, or at least stability in manufacturing employment, and an increase in office employment.

This is also something that forecasters didn't really forecast. Around 1950, if one had looked at the economic prospects for central cities, it would be difficult to foresee anything like the office-building boom that is going on in a large number of cities. To be sure, it was going on in New York at that time, but New York was considered a bizzare exception to the general rule.

But now everybody has this kind of boom. And it gives every promise of continuing as far ahead as we can see. This is even taking into account the effects of automation on office activities, which has been a very important factor. But it doesn't seem to reduce the likelihood of very large increases in employment in office activities, in central cities as well as suburbs.

Representative GRIFFITHS. Mr. Reuss, would you like to ask some questions?

Representative REUSS. Thank you, Madam Chairman, for letting me participate in these most interesting hearings.

I would like to ask Mr. Netzer and Mr. Harriss to square off at each other, because there is a sharp difference, I think between you two gentlemen, and what you see as the physical projection for 1975. I leave Mr. Kegan out of it for the moment, because he is, I think, in the middle of this one, as well as physically.

What would you like to say, Mr. Netzer, about the Tax Foundation's fiscal outlook for State and local government to 1975? They in effect say, as Mr. Harriss in effect says, that keeping on as we have been with State and local government revenues and spending will about do the job, and that no great problems are seen for 1975. Your view is different now. To what extent is this value judgment about what the Nation ought to do largely for its cities and largely for poverty, welfare, education, housing, and to what extent is it due to different readings of the economic factors?

Mr. NETZER. I think there is some of that. I think that when one does go through this thing program by program, and you project what expenditures might be, as the Tax Foundation study did, and did it very competently, there is an inherent downward bias. You just don't see the social change occurring. I did it myself in the earlier projections, and understated the rate of increase. I think this is true in the Tax Foundation study, too. One has no basis for projecting a large increase in a particular program.

For example, 10 years ago expenditures by all levels of government on housing and urban renewal had been stable for several years. The Federal Government had net receipts, and the State and local governments were spending about half a billion dollars a year. There was no basis for a forecast that, by 1970, expenditures would be $6 billion a year, as some people did.

So you just don't see it, there is nothing in the historic record which suggests that big increases might occur. And then something happens and it does occur.

I think this is precisely what is happening now with expenditures for public assistance, and similar programs connected with poverty. There has been an explosion that you can't foresee. The chances are that it will happen in other areas as well. Therefore, my reading of the

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economic evidence and our recent history is that the Tax Foundation projections of expenditures are likely to prove to be too low. The problem is not that the State and local governments will be unable to raise the money in some absolute sense. They will be able to raise the money. But they will raise the money by using tax devices, some of which are not bad, such as the State income tax, but in many cases, particularly in the cases of the States with large central cities and the larger central cities themselves, they will have to rely on fairly obnoxious choices. The tax choices open to many of these places are not large. You know, the tax choices open in Michigan and Wisconsin and New York and California are not very large by now.

Representative REUSS. They have more or less graduated income taxes now.

Mr. NETZER. They are adopting a new income tax in Michigan. And they have high property taxes in central cities in Michigan. They have very high property taxes in Milwaukee, and a high income tax in Wisconsin, and a State sales tax. And we have the same thing and more in New York.

The choices are not that wide. To be sure, the choices are still considerable in some of the States. In Connecticut, for example, there is lots of room for maneuver. But the problem is in the places that don't. What are they going to do? I think they will raise the money, but they will do it by using tax instruments which are very decidely harmful, such as increasing the use of property tax on structures.

Representative REUSS. Before Mr. Harriss replies, I would like to suggest that all of you projectors and extrapolators tend, I think, on the expenditure side, to view past expenditure trends as probably projectible in the future. This to me, from the vantage point of the summer of 1967, doesn't seem adequate.

For example, in 1949 we passed the Housing Act, which had the statutory goal of a decent home and a suitable environment for every American. When we passed this bill we had 10 million substandard, crummy slum homes. After almost 20 years we now have 10 million substandard, crummy slum homes. No progress.

Therefore it seems to me that value judgments about what the Nation, Federal, State, county and city are going to do in the next 7 or 8 years are at the heart of any projection. And we first have to find out what the projectors think should happen in 1975.

Isn't there——

Mr. NETZER. There are two distinct elements here. One, from my reading of the evidence, I think the prospects are that expenditures will have a very high rate of increase. And second, it is my own value judgment that it should be a very high rate of increase, because the problems related to race and poverty in the central city, which seems to me to be the critical national problem.

Representative REUSS. Mr. Harriss?

Mr. HARRISS. First, Representative Reuss, we may still have some 10 million junky homes, but we have a vast improvement in the housing stock since 1959.

Representative REUSS. No doubt.

But since the name of the game in the Housing Act of 1949 was to get rid of the crummy homes—and we haven't done it—I don't view our performance in the last 18 years as a glorious success.

Mr. HARRISS. No, neither do I. I do not want to get into discussing housing as such, because, though that presents problems which are directly relevant, they are beyond any reasonable scope within your time here.

First, I cannot emphasize too much that what the Tax Foundation was trying to do was not to say what would be desirable, nor to predict what is going to happen. Rather, the purpose was to try to lay out something about the environment which existing forces would create. You are quite correct, and so is Professor Netzer, that there are elements in past projection experience which cast doubt about the accuracy of assuming a continuation of past trends. Personally, seeing the kinds of pressures that exist in society, I am inclined to agree with you that an increase in governmental sector seems likely to get the support of the general public. But with rising income the need in any real sense to look to growth of the public sector, as contrasted with people acting more freely, such "need" does not exist. I think we have more alternatives in the private sector.

In any case, however, the figures do show that the existing revenue structures will finance a considerable improvement in quality of State and local government functions—maybe not "enough." I do not agree that the last 10 to 20 percentage points of the corporation income tax are not about as bad as any element in the revenue system.

Representative REUSS. I would like to hear—I noticed a paragraph on that in your paper—I would like, if I may, Madam Chairman——

Representative GRIFFITHS. Certainly; go right along.

Representative REUSS. I would like to have you expound on that. I think we have had a complaint and a demurrer on the general issue of projection.

Mr. HARRISS. We are closer in agreement than we are in disagreement.

All taxes are borne by people in one respect or another. A corporation income tax is a tax on people. It is not a tax on some other entity. It is a tax on people as consumers, owners, as employees. It is an extremely high rate by historical standards. The highest rate in the 1930's was only a little over a third of the present 48-percent rate. It is high by international comparison.

Now, assuming that half of it is passed on to the consumer—and this is a difficult assumption—then it takes much more out of the income, of the lowest income group, than do State sales taxes, although this is not true per dollar of revenue.

It may seem to hit General Motors, which has high profits. But it hits the consumers of General Motors' products, which includes about everyone in the country—directly or indirectly—poor people as well as rich people.

The corporation income tax also has allocative effects on the business structure, and on ways of doing business. It seems to me only harmful to the extent that the decisions which businessmen, quite appropriately, take to minimize their taxes, will be second- and third-best decisions. Ten or twenty years from now our economy will be less productive in terms of real output in relation to real input if the 48-percent corporation income tax is continued than if we seek equivalent revenue from other sources, or reduce the growth of governmental expenditures.

Representative REUSS. The Federal corporate income tax now yields nearly $30 billion a year. And you would like to reduce its present take by lowering the bracket by what, $5 billion, $10 billion?

Mr. HARRISS. Let's say 1 percentage point a year of the tax rate for 15 or 20 years.

Representative REUSS. How would you regain that revenue?

Mr. HARRISS. The programed reduction would not start during Vietnam fighting. But as soon as there is any leeway, I would say this is the place to reduce "fiscal drag."

Incidentally, may I also——

Representative REUSS. You would lower corporate taxes and not attempt to regain that revenue for the Federal Government elsewhere?

Mr. HARRISS. As soon as there is any leeway in the budget. As of the moment it is not feasible.

Representative REUSS. Let me put the Keynesian argument to you. As it is now, corporations aren't investing in plant and equipment all the savings the economy is producing. There is an oversaving problem right now. If you diminish the corporate income tax, isn't there going to be simply further oversaving?

Mr. HARRISS. No, I do not think so.

Representative REUSS. And since presumably you are going to cut Government expenditures accordingly, aren't you going to bring on a recession?

Mr. HARRISS. Representative Reuss, this gets into another range of probems. But if I understand you correctly, I do not think so.

Let me take the occasion to mention that we had a big budget surplus in terms of magnitude of the economy in the 1920's without fiscal drag. The Federal Government was a relatively large saver. It retired public debt, and the funds were invested privately.

Representative REUSS. There was a fantastic rate of private capital formation at that time.

Mr. HARRISS. Yes.

Representative REUSS. And there are those who think that in the end it brought on 1929.

Mr. HARRISS. Well, this gets into another set of issues, which are a little beyond us here.

Representative REUSS. But perhaps your colleagues, Mr. Kegan and Mr. Netzer, would care to comment on the specific suggestion that Vietnam apart, the thing to do is to bring about a reduction of the corporate income tax, and not attempt to recoup that revenue elsewhere.

Mr. KEGAN. I don't think it is only the corporation income tax. Even during the Vietnam war I think, given the effects that Professor Harriss notes, as you know the CED has recommended a substitution to the value added tax, and that would help us in our balance-of-payments problems as well, that is, that some of the effects would be dulled. And yet you would still get the revenue; that is, we calculated ways even for increased revenue, instead of increasing the surtax on the corporate tax, moving to the value added. You could, we think, move in that direction.

But Vietnam aside, it seems to me that the way I would like to move more is through the reduction of the personal income tax. But I also see, obviously, given the problems of the cities, and so on, the need for much more Federal expenditures of one sort or another.

The way to deal with the problems of the poor, we believe, is through specific grants, poverty programs that are effective: educational programs, that take account of the children of the poor. And these can be and are much more effective. And this is in the direction, not the general support, but the categorical grants, that we believe the Federal Government should take. So that this would be one way of perhaps even moving by increasing categorical aid beyond what present legislation calls for.

Representative REUSS. Mr. Netzer?

Mr. NETZER. I think most economists in the field of public finance would agree that the corporation income tax is a monstrosity, and it would be better if it had never been invented. No one knows what its incidence is. This is true not only of the corporation income tax, but in general the use of business as an intermediary to collect taxes measured by the volume of business activity, whether profits or gross receipts or what have you. All governments do this because business is a handy tax collector. But in general business taxes are bad ideas, in theory, at any rate—I think you can say that there are a large number of ill effects logically to be expected from business taxation. That is fine, in theory. But we have these taxes now. And here we are with a 48 percent corporate tax rate that only recently was slightly higher than this.

We have been living with the tax for a quite a while. Most of the obnoxious features of the tax already have been worked out. The adjustments have occurred. It seems to me that, in this context, reduction of this tax—or indeed of any other Federal tax, if you have any money to give away after Vietnam, in preference to expanding Federal expenditures, or increasing Federal grants to the States, whether conditional grants or general-purpose grants, is a very bad idea. As I said before, the prospects in that case might be of raising State and local tax rates, and reducing Federal tax rates.

In one case you are reducing rates that have already been adjusted to, however bad the tax is in theory. And in the other case you are increasing the rate of taxes, some of which are pretty bad ones.

Representative GRIFFITHS. May I ask now, if you gave a corporation income tax reduction right now—and after all, there will be a tax bill coming up, and we will use General Motors as an example. General Motors is in the business of negotiating a new labor contract. Would the consumer get the reduction, or would General Motors get the reduction, or would the workers?

Mr. HARRISS. In the present context I think the workers would get probably a very large portion of it.

Representative GRIFFITHS. And don't you think that there has come a moment when you can logically say, does the general population of the United States owe these people that much?

Mr. HARRISS. I certainly agree with the implication of your question. These employees are relatively well paid now.

Representative GRIFFITHS. That here is about $4.58 an hour, I believe; it is $4.38 or $4.58. They are retiring with remarkable pensions, whereas a private professional man has no tax provision to acquire this at all. So that it seems to me that you can logically say, do we really owe this to these people, is their contribution to society of such magnitude that we owe them this?

Maybe it would be better to worry about the teachers in the central city.

Mr. HARRISS. Yes.

Here, however, I think we do better to think, not in terms of what is to be done in August 1967 so much as taking a longer view. But you are quite correct, I think, about the implications of large bargaining power in a few big employers and unions.

But General Motors is only one corporation.

Representative GRIFFITHS. That is right. But at least in this area this could happen.

You will recall when the excise tax went out of the House it went over to the Senate, and the Senate promptly offered them the whole thing back for a few safety devices.

Mr. KEGAN. May I turn to a question that Representative Reuss raised on this problem of projections, and the fact that there were always these unknowns, and probably they were understated?

The deliberate reason that CED took it, it is not simply that it says you should separate the three factors, agree on population, and agree on whatever price changes, and then leave the scope and quality open to various magnitudes of choice. It is relating that difference to the revenue side. It is the percentage changes in both that the CED model tries to take account of, and simply says that without trying to import value judgments initially, but to make it possible for the citizen or the legislator to then introduce whatever value choices—and obviously I have my own value choices here—to say that if you want to have this much scope and quality, then either the present tax system will permit it, or you have to increase it. And then we say, there is room for increasing the State part of it. And in increasing the State part of it, we think that one of the reasons why your statement about the State income taxes not being able to move very much is the very high rates, the almost preemptive rates of the Federal income tax.

So that when we take our position that there may be a time when fiscal drag is something we face, it seems to me that that is a time when the relatively high rate should be reduced in order to permit the State governments to employ this very effective and responsive and potentially equitable tax.

Representative GRIFFITHS. I would like to ask each of you: What was the unemployment rate that you anticipated for 1975?

Mr. HARRISS. These estimates run, as I recall, between 4 and 4½ percent.

Mr. KEGAN. We use the Joint Economic Committee's projection of 4 percent.

Mr. NETZER. I don't speak for any specific set of projections, but in the projections which I have done in the past, it has been on the basis of 4 percent.

Representative GRIFFITHS. I am sorry, I had forgotten that I had these questions.

The number of nonwhite persons who will reach age 18 will increase by 20 percent between 1965 and 1970, and by another 20 percent between 1970 and 1975. The number of white persons who will reach 18 will decline between 1965 and 1970 and increase by only 10 percent between 1970 and 1975.

Now, do the projections take into account future needs and future costs of public services in the light of the expected increase of non-white teenagers, most of whom live in the central city, and other population trends with respect to the central city, and specifically the slums?

Mr. HARRISS. There is no explicit differentiation on the basis of color in any of the Tax Foundation projections; nor really is there a geographical basis. These are national aggregate figures, and they have the many limitations of all estimates of national aggregates.

That was a long question. And I am not sure that I recollect all of it. But my answer is that I think there is no specific allowance for at least many of the major things that you had in mind.

Representative GRIFFITHS. Mr. Kegan?

Mr. KEGAN. In my model we do assume that the problem of the cities and the problem of the poor in the ghettos will create enormous new demands, and that this means increases in scope and quality. We haven't stated how much that will be, but certainly we have said that we would project that there will be increased demand on this kind of account.

What we have said is that, therefore, the States ought to take over more responsibility. And this is one reason we want them to have a strengthened fiscal system with an income tax—to have grants-in-aid or direct expenditures for welfare and education for the cities, for the core cities. And we have also said that the Federal Government has an obligation here, because poverty in education has become much more a national problem, it is no longer purely local or purely State, and therefore that categorical aids are the best way to take account of the specific problems. We have not isolated the amounts of the exact age groups, although we have included it in the general urban poor.

Mr. NETZER. I think your question is a very good one, Mrs. Griffiths, because it illustrates the point that I tried to make about the inherent conservatism that all of us had in making these projections. To my knowledge, nobody has treated this as a factor in what might be called population workload. That is, we have said, "What is the increase in the total number of people under 18, what is the increase in people in the various other age groups?" In the case of Dr. Mushkin's projections for the Council of State Governments, we looked at it by individual States, but not large cities within States. And there certainly has been no race distinction, nor has there been an income distinction. We have generally said, "We know that in this model of the national economy we can expect certain increases in per capita or per household incomes. And this will diminish the poverty problem to some extent."

What we have in effect is that this is not the basic problem to which government is specifically addressing its attention, because it wasn't a few years ago. Now we say, in the summer of 1967, that this is by itself a distinct factor in an appraisal of the problems facing government, that there will be a very large increase in the number of non-white teenagers, and what can we do about it?

Mr. KEGAN. I think in our model we have simply illustrated that the population workload could be much more refined. We did include—

which I didn't state in the presentation, for example—the growth of urban activities. So that we not only have an age structure, but we also have a locational one. It is possible to refine the models so that the color-age structure problem can be included in the population workload if there is related expenditure data rather than as we included in scope and quality.

Mr. NETZER. Yes.

But I think in 1970 somebody might define it as part of workload.

Mr. KEGAN. Yes. But I think that this means total projections. I think both you and Representative Reuss, it seems to me, are hitting at something. The total projections are always going to have this problem of hiding very often the implications of the policy choices. What we have deliberately tried to do by our model is to highlight the policy choices by saying, "Now, once you say population structure is of this sort, the population workload, then you have the scope and quality."

Representative GRIFFITHS. How accurate have your projections been in the past?

Mr. HARRISS. The Tax Foundation has done nothing comparable to this study, at least not in the periods that I have been associated with it. I know of no precedents.

Mr. KEGAN. I would like to make a comment on what Dick Netzer has made a big point of, and that is these past projections as against reality. He did prepare the initial paper for CED, which was very helpful in our whole analysis. And there he did have a specific comparison of past projections, by people like Colm, Mushkin, Otto Eckstein, and actual changes. The specific comparison that you made there involved a comparison, as I think you will remember, of the actual changes which were in current prices against their projection in constant prices.

It is one thing to talk about specific programs, about what you have to do for slum clearance. Once you start saying that you are always going to be wrong. And there are always changes there that take place. But when you take a total which tries to recognize the overall claim on resources, and that there are limits, given productivity, given the labor force to what you can do in the growth of overall income, and what is available, therefore by allocating the resources in an aggregate way, in that sense both Otto Eckstein's and Gerhard Colm's predictions or projections were accurate.

Mr. NETZER. Dr. Mushkin, in addition to Mr. Kegan, claims that my earlier projections were accurate. I don't really believe this to be the case. I think that part of the price level increase here is a relative price level increase. That is, the prices paid by State and local governments, including salaries, have increased more rapidly than other prices. In part, this reflects the expanded scope and quality of State and local activities. To bid away resources from other uses, prices had to increase relative to the price level in general. Now, it is true that the Colm projections turned out to be reasonably accurate in the aggregate. However they included a wholly erroneous set of projections in connection with urban renewal; aside from that, they were conservative too, I think.

Representative GRIFFITHS. I would assume that this would be the year that would be the toughest to have their projections come out with any reasonable accuracy. Because I think that the events of the year are going to press political decisions much more drastically than anything that has ever happened before.

Mr. KEGAN. That is why we suggest changing the technique of making the model. And that is, get agreement on the population, and get agreement on price changes, and then raise the questions of which do involve all the political choices as to scope and quality. This might be the sputnik year, so to speak, just as this had a tremendous effect on education, so the race riots may have a tremendous effect on the whole government fiscal system. But our method deliberately is designed to highlight this issue, and then to permit you to introduce your value choices, where you want to make the argument.

Representative GRIFFITHS. Mr. Harriss?

Mr. HARRISS. You are going to be under tremendous pressure over the next few months, all of you in Congress, and quite rightly so, growing out of the tragic events of the last few days. I would suggest that we try to think most about the elements of strength in the economy. What are they? How can we build on strength? This approach seems better than to focus upon places where there have been deficiencies. For example, there is high unemployment among Negro youth. But most Negro youth of these age groups are employed. Where are they employed? What is the strength there on which we can build?

We have had huge improvement in housing stock. What is there here that we can make work for us? A general tendency to try to do more through government, through the political process seems "normal," especially among those who come to you. Yet government has not, I think, been the source of the greatest accomplishments; that is, all the things of greatest achievement. Naturally, I do not want to overstate the point. Clearly, I fear, we need to spend more on policing. Here is one of the tragic revelations of the last 2 weeks.

But many of the other programs to which attention is being focused need to be examined very carefully in terms of possible alternatives. Let us not be enamored with the dream world of what it would be nice to be able to accomplish by turning something over to government. Have not some of the failures been in government? How can we do better?

Here is the reality: If anything is done, it must be done by people. Some will be working in government; others are going to be working privately, in business and for philanthropic organizations. One limitation of the educational and other processes is the lack of skills in teaching, the various kinds needed. Dollars can help. But dollars are not the only thing.

Representative GRIFFITHS. I personally feel that the welfare system is built largely on a myth. I think that the social security bill will make an attempt to stop that myth. The idea that every woman should remain at home with her children, and so forth and so on, is ridiculous. It never has been done. I don't know why it should be now. I think we will attempt now to end this. But I think, a new generation willing, people are going to be given an educational opportunity. And from then on they are going to be on their own.

Mr. Reuss, would you like to ask some questions? I appreciate your being here.

Representative REUSS. Perhaps one short question of Mr. Kegan on the excellent CED study on this problem, since the first study "Modernizing Local Government" a year ago.

In your June 1967, study of "Fiscal Program for a Balanced Federalism," when you get to the end of your recommendations and look at what the Federal Government can do, you weigh on the one hand Federal income tax credits for local income tax paid, and on the other, Heller plan block grants, and you come out in favor of the former, saying, let's have income tax credits.

Now, the effect of that would be, one, it would constitute a partial reduction in the Federal income tax; and secondly, it would offer excellent encouragement to 17 States which don't have income taxes, and to the others which have less graduated or progressive income taxes to use, to the full this income-tax credit device; and thirdly, and importantly, you would cut down on interstate competition for industry by one State being able to say, look, we don't have any income tax, come build your plant in our area.

My question is this: While I think that a proposal for offering inducements to the States to have income taxes as part of their tax arsenal is an excellent idea, why did you stop there? Why can't you have both inducements to the States to impose income taxes up to the Wisconsin-New York-Alaska level, and some sort of block grant?

Why did you view that as an either-or proposition?

Mr. KEGAN. We did try to state what we thought were some of the advantages, and some of the disadvantages of the block grant system.

First, we said that State governments today, many of them—not all of them—are not very well organized. But one of our problems, as Madam Chairman commented in the beginning, is the fact that there is a gap between what State governments do today and what they should do. We did come out with a new statement on modernizing State governments. We think this is desirable, and we are glad to see one of the sponsors of State legislation move on this kind of effort.

But if general grants today were to go to the States as they currently exist, we feel that a lot of this money would be wasted or dissipated. It would not achieve the objectives. If you believe, as the statement I think partly believes, that there are serious priority problems, like the problem of poverty and the problem of education, associated with urban areas, and so on, it says that that problem you can meet through expanding and making more effective the categorical aid systems rather than general grants.

And second; if you are concerned with improving, in terms of your own priority, certain kinds of national goals, the categorical grants would be the mechanism, rather than general grants.

The third issue is the fact that general grants might have the impact of maybe not reducing the tax load in some areas, although our study that was prepared for us on the poorer States, Mississippi and Georgia, indicated that if there was a general assistance program, it might reduce, literally reduce their taxes, and use the Federal money as a substitute.

But even if that weren't the case in many States, I think over the long term, if you had a general assistance grant, the pressure for increasing taxes to meet State and local responsibilities would certainly not be there, as long as they could count on a trust fund or continued grants from the Federal Government. And we are assuming here, I think at least the panel yesterday and here, that State and local government requirements are constantly increasing at a higher rate than GNP. So that somehow or another we feel that there ought to be more responsibility to meet this kind of thing.

You were right in your first point that this assumed some kind of tax reduction; that is, the receipts available to the Federal Government would be less.

We believe that this is important. A general assistance grant would make the day for a general tax reduction recede far into the future. But part of the opposition here is directly on the issue of the current high Federal tax rates. And since we believe that an income tax is potentially very equitable, very responsive, is something that all States should have; and since we further believe that the high present tax rate in the Federal personal income tax systems is a serious deterrent to many State and local governments, we want to see a reduction in the Federal. Having a general assistance grant makes it less and less likely that you will have a reduction or as much reduction to make this workable.

The last issue, which I think perhaps is the one that is most important, the advantage theoretically of a general assistance grant is that it will increase the equalization among the poorer States as against the rich States.

The position in the paper is that, if you are interested in the poor, it is not areas, it is people, and the poorest—the States that have the most serious problems of the poor happen to be the richest States, in some ways. We have Harlem in New York, Chicago in Illinois, Watts in California, and those are three of the richest States in the country. And Milwaukee in Wisconsin. These States, we feel, that if they had more use of their own income tax base to meet their own problems, together with the categorical aids to meet problems of poverty, they would do a much better job than having their tax money go to other States which theoretically are poor, but in which the money would not be used to meet the problems of the poor.

Representative REUSS. Of course, the CED's income tax credit—and I support it—wouldn't help Wisconsin or some of the other States you mentioned which are already at the top of the State income tax heap. They wouldn't get any more revenue. Their taxpayers would get a Federal tax reduction, which I certainly don't oppose.

Mr. KEGAN. But which would help us; which would help the citizens of Wisconsin—plus one——

Representative REUSS. How?

Mr. KEGAN. There is general poverty——

Representative REUSS. It would make individual taxpayers happy and give them more disposable income.

Mr. KEGAN. Exactly.

And there is a problem here of public versus private, some balance.

Representative REUSS. But this doesn't help on the public problem. It enables them to buy bigger cars, but this doesn't rebuild slums.

Mr. KEGAN. I think, as Professor Harriss was saying that some of these problems, the problems of education in the Job Corps, are effectively being done today by Litton Industries, or by IBM. Perhaps the housing problem, something like a Percy bill or a Kennedy bill, where you enlist the private aid and private support to meet what initially we think of as purely public problems.

So that there isn't this wall between the public and private. To the extent that the private is free to make some of these decisions, it seems to me you might meet some of the problems that the public has to meet simply because the private doesn't have the funds to do so.

There is also indirectly the problem, as you stated, of the tax competition. Wisconsin would not feel as badly as it does today about this issue. And they would be able to attract more industry, or at least the claims that this is a serious deterrent would not be as strong.

Mr. NETZER. I would like to say something about this thing.

Take the specific form of tax credit proposed by the Advisory Committee on Intergovernmental Relations.

Mr. KEGAN. Which is not the CED.

Mr. NETZER. Which is not that; but the CED left more options open.

Mr. KEGAN. But the staff has operated against the Advisory Commission.

Mr. NETZER. Just take this one where you have a 40-percent——

Representative REUSS. Yes, although you can't saddle it on CED.

Mr. KEGAN. Right.

Mr. NETZER. A 40-percent credit as an alternative to present deductibility; that is, the individual taxpayer either can credit 40 percent, or he can use the deduction, which means that if he is in the 40-percent tax bracket or higher, he uses the deduction.

Now, in New York State this would mean that for all practical purposes, until an individual taxpayer has income of pretty close to $10,000, the advantages of the credit would be very small in dollar amount. They would have a credit, but it would be very small. Above incomes of $30,000-odd it would again start to disappear, because of the deductibility feature.

So in effect what we would be saying is that some savings in Federal taxes by taxpayers with family incomes between $10,000 and $40,000, would make for a willingness to increase State taxes. Because those people would have lower Federal tax burdens, you could sell an increase in State taxes within that State. I think this is just the most unlikely kind of political judgment I can imagine.

Representative REUSS. A judgment which I think the staff of CED agrees on.

Mr. KEGAN. Right.

Representative REUSS. Thank you very much, Madam Chairman.

Representative GRIFFITHS. I enjoy having you comment.

All projections assume that Federal aid to States and cities will at least double by 1975.

Should any of this increase be in a different form, now? For instance, family allowance, or negative income tax.

Mr. HARRISS. I indicated a personal preference to see more of the total channeled into welfare as broadly conceived. And may I just comment on a point you just made, the attempt to make the social security structure somewhat more rational, for example, in incentives. I could not agree more that our system of essentially a hundred percent tax on any person on welfare who gets a job is stupid. It is ridiculous. And yet it has gone on year after year after year. "Government" is not all-wise.

One "moral" can be cited: One cannot assume that "the Government" will act as one wants or dreams, when framing laws, and carrying them out. Let us look at the reality, at how governmental programs do actually operate.

Coming back to your basic question, I would say more in welfare. But less in what? To specify invites antagonism from advocates of the health programs or those in education. My qualifications do not permit me to meet each on details. But personally I would concentrate more on welfare, more, that is, of the growing increase.

Representative GRIFFITHS. What would you do, Mr. Kegan? Do you think there should be any changes?

Mr. KEGAN. I think that education is clearly—and the problems of poverty, which raise some problems not governed by present welfare schemes would have very high priority—I am now talking about my own personal schemes, since CED hasn't gone into this yet. CED has under study the negative income tax, an income maintenance plan, and hasn't reached any conclusions there.

But I would suspect that if a case could be made, that this would save a lot of bureaucracy, and give people a much clearer choice about the spending of their incomes. I would personally opt for this as a way of overcoming a lot of the fragmentation and problems associated with the whole system.

But this is a purely personal choice.

Mr. NETZER. I think on this question we are in substantial agreement here. It seems to me that you can demonstrate a truly national interest in programs connected with education, with poverty—including both the traditional welfare programs and the health services of the poor, and so on—since, because of interstate migration, the benefits from such services, spill over the boundaries of any given city or State. And this makes a very strong claim for more Federal financing.

Of course, if you increase the Federal share of a program, to a very high level, it seems to me that you are raising a basic question of whether the Federal Government ought not to be running the program entirely, that there are a lot of administrative disadvantages to a system in which the Federal Government or any level of government is paying the great bulk of the cost and somebody else is carrying it on. I think, for instance, in the employment security program, you can argue that there have been some real adminsitrative disadvantages to the system of 100 percent Federal financing and State operation. But I would say if there is going to be more Federal money in either intergovernmental arrangements, or in direct expenditure, it should be focused on this area, where there is a demonstrated national interest.

Now, less of what? In an environment in which many large cities, the urban States, and some of the poorer States as well, are saddled with the very substantial costs for welfare activities, compensatory education, and so on, such governments are going to try to get every penny they can get from the Federal Government, under any pretext whatsoever. And some of the pretexts, I think, are just plain ridiculous.

For example, this is a small program. But can a self-respecting city government really say that it can't afford to pay the salaries of building inspectors?

This is a trivial expense item for almost any city in the United States. We have a Federal aid program for that. I can't demonstrate any real national interest—and I live in New York City, and I use the transit system all the time—in the Federal program of aid to mass transportation. This is a regional problem. The regions have the wherewithal to do something about it. There is no earthly reason why a taxpayer in Iowa should pay taxes to provide the city of New York with a grant of $27 million to buy new subway cars. There is no spillover of benefits to the whole country. This is a situation in which the benefits are confined in the New York region. I think you can find many programs outside the areas of health, education, and welfare, where the obvious national interest in the program is very, very limited.

But of course, a mayor or a Governor who is faced with a real financial crisis, or financial difficulties all the time, is going to take whatever he can get. And if he can get aid to pay the salaries of building inspectors, he will take that, too.

Representative GRIFFITHS. Two of the Congressmen on the food stamp bill told me—one from Pennsylvania—that they ran a survey in his district in Pennsylvania, and that 44 percent of the people who were getting the food stamps were not entitled to under the rules. And a second one told me that if the States didn't have to pay anything, come election time for the county supervisor, at least a majority would all be getting the food stamps in that area, because it was a very substantial reduction.

So that I would assume that the whole Nation has some interest in poverty. It shows some of the political problems that exist in all these areas.

Mr. NETZER. Of course, it can work the other way too, Mrs. Griffiths.

In connection with medicaid, as you know, medicaid to a considerable extent in New York State is replacing State and local expenditures.

Representative GRIFFITHS. Yes; you have made money on medicaid.

Mr. NETZER. Yes; we have made money on it.

Representative GRIFFITHS. We are going to take part of it away from you.

Mr. NETZER. One of the things that has happened is that the fact that it was covered by a Federal program has permitted tightening of standards of eligibility which existed before. Politically it was impossible to really enforce the standards for municipal hospital services in New York City before this. Now it is not impossible. The answer is, the Federal Government will not put up any money until we do this.

Representative GRIFFITHS. This is a good idea.

We thank all of you. You were very fine. Thank you very much.

And the subcommittee will adjourn until Wednesday, August 2, when we will hear Mr. Heller, Mr. Pechman, Mr. Stein, and Mr. Ulmer.

(Whereupon, at 12:27 p.m., the subcommittee adjourned, to reconvene at 10 a.m., Wednesday, August 2, 1967.)

REVENUE SHARING AND ITS ALTERNATIVES: WHAT FUTURE FOR FISCAL FEDERALISM?

WEDNESDAY, AUGUST 2, 1967

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON FISCAL POLICY
OF THE JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The subcommittee met, at 10:05 a.m., pursuant to recess, in room S-407, the Capitol, Hon. Martha W. Griffiths (chairman of the subcommittee) presiding.

Present: Representatives Griffiths, Rumsfeld, and Reuss; and Senators Proxmire, Javits, and Percy.

Also present: John W. Stark, executive director; James W. Knowles, director of research; Harley H. Hinrichs and Richard F. Kaufman, economists for the Subcommittee on Fiscal Policy.

Representative GRIFFITHS. The meeting of the Fiscal Policy Subcommittee of the Joint Economic Committee will come to order.

We are delighted to continue our hearings on the future for fiscal federalism, turning to the question of the various future fiscal options that are available, devoting our time this morning particularly to revenue sharing and the alternative tax credits. Our panel consists of four very distinguished experts of long experience and training in these matters: Walter Heller of the University of Minnesota, Joseph Pechman, director of economic studies of The Brookings Institution; Herbert Stein, vice president and chief economist, Committee for Economic Development; and Melville Ulmer, professor of economics at the University of Maryland.

We are happy to have you here, and I already have many questions I would like to ask. We will begin with you, Mr. Heller.

STATEMENT OF WALTER W. HELLER, PROFESSOR OF ECONOMICS, UNIVERSITY OF MINNESOTA

Mr. HELLER. Madam Chairman and members of the subcommittee, I am happy to have this opportunity to participate in these important hearings that are centered on some of the widely discussed and widely neglected fiscal problems of our federalism.

Mr. Pechman and I have prepared a joint statement, as you know, and we would like respectfully to request that it be placed in the record.

Representative GRIFFITHS. Without objection it will be done.

Mr. HELLER. Thank you, and we will both make brief oral statements that are based on that prepared statement.

Now, I would like to start with a quick review of the revenue-sharing plan as we conceive it. Since there are now dozens of bills and plans marching under the banner of revenue sharing, many of which can't pass a paternity test and some of which can't even pass a saliva test, it may be worth a few moments of your time to restate the main elements of the plan as we conceive it.

Those elements are, first: That the Federal Government would permanently set aside, and I underscore the word "permanently," up to 2 percentage points of the Federal individual income tax base. In other words, one can think of it as the Internal Revenue Service collecting 12 to 68 percent under the present schedule for the Federal Government, and 2 percent across-the-board for the States and localities, and, by the way, whenever I say States I really mean, hyphenated, State-local government.

This, by the way, would be 10 percent of the revenues of the Federal individual income tax, about $6 billion, 2 percent of an individual income base that is about $300 billion this year.

As I will indicate in a moment, it would grow over the years.

Now, second, this would be channeled into a trust fund for the States, the trust fund emphasizing the fact that it wouldn't be part of the regular yearly appropriation process, so to speak, but that it would belong to the States as a matter of right, something that they could count on year in, year out.

Third, it would periodically be paid out primarily on a per capita basis; that is, on the basis of population. That will have a considerable equalizing effect, but if that were regarded as insufficient equalization, an additional 10 percent could be set aside for distribution to the lowest income States. As I remember our figures, that would raise the allocations to the lowest third of the States by about 50 percent.

Fourth, I have often said that it is essential to the plan to have no strings attached. I will modify that only to the point of saying I mean no hamstrings attached; that is, one would want to have the usual requirements for auditing and applications of the Civil Rights Act and so forth. But as to the object of the expenditure, with the possible exception of ruling out highways which are richly taken care of under the highway program, it would be left to the discretion of the States as to the objects of expenditure.

Next, if it were feared that the States might lower their tax efforts in response to the Federal shares one could put in a tax effort index which would take into account how much they were doing to tax themselves.

And, sixth and finally, Mr. Pechman and I have concluded that there should be a minimum pass-through to the local governments, a floor under that, and he will discuss that.

I want to underscore quickly three points: One, this would go to the States as a matter of right.

Secondly, it would be a supplement to grants-in-aid, not a substitute for grants-in-aid. I visualize that if grants-in-aid grow at the rate they have been growing, we might, by 1972, have something like $25 billion in grants-in-aid. Side by side would be nearly $8½ billion of tax sharing or unconditional grants, if the plan were put in at the 2-percentage-point level.

Third, I want to make very clear that it should not be returned to the point of collection. If it were simply returned to the point of collection it would be a case of "to him who hath shall be given," and it would miss one of the major objectives of the plan.

I think it is worth reviewing for just a moment the criteria or the purposes that ought to be served by this or other plans. The important thing, by the way, is to do something to provide a broad gaged grant, free of onerous strings, to the States. The particular form of it is not the important thing, but the principle is. Whether you call it tax sharing or general assistance or unconditional grants or bloc grants, the main purposes we are trying to serve are six:

One, to build up the vitality, the efficiency, and the fiscal independence of State-local governments.

Second, to relieve immediate pressures on State-local treasuries and even more important, make their revenues somewhat more responsive to economic growth.

Third, to increase the overall progressivity of our Federal-State-local tax systems.

Fourth, to reduce economic inequalities and fiscal disparities among the States.

Fifth, to stimulate or at least not discourage State and local tax efforts.

And sixth, to insure that the plight of local and especially urban governments would be given full weight.

We will be covering in the course of our comments these six criteria.

In a very basic sense, the case for shared taxes really begins with the conviction that strong and financially viable States are essential to a healthy federalism, and more than that, they are essential to optimal performance of public services, Federal, State, and local.

Now, in part, I suppose, this is just a simple expression of the traditional faith in pluralism and decentralization, diversity and innovation and experimentation. For people who lack that faith there can be little attraction in revenue sharing or for that matter in other instruments that rely heavily on local discretion and decision. In other words, if you don't believe in the States there is no point in talking about the things you are talking about in these hearings. I take it that it is an underlying faith in federalism which we use as a point of departure here.

But,.quite apart from the philosophic virtues of federalism, we all have a very direct stake in the financial health of State-local government, for the simple reason that they do perform the bulk of essential civilian services in this country. Partly, they do so as service stations for the Federal Government, and the grant-in-aid programs, it seems to me, typify that.

But what people tend to forget is that there are a great many seemingly prosaic or humdrum services provided by State-local governments on their own account, with little or no Federal help, that form an integral part of the good and great society we seek. Events of the past couple of weeks should remind us that police protection and law enforcement, sanitation, recreation facilities, street maintenance and lighting, things that together with housing and schooling spell the difference between a decent and a squalid environment, between a respectable neighborhood and an explosive ghetto are cases in point. They are handled at the local level, and we neglect these at our peril. This is one of the reasons why plans like revenue sharing and other plans for general support of the State public purse are so terribly important.

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Now, just a few comments on the meaning of a revenue-sharing plan on the revenue side, and its relationship to grants-in-aid, and something on equalization.

I indicated that if 2 percent of the income tax base were set aside this year for the States, the grant would equal $6 billion or roughly $30 per capita. Any State can figure out its annual allocations by multiplying the population of the State by $30, leaving aside for a moment the 10-percent equalization.

Now, over the years it is striking how much the income tax base has grown. It was $65 billion in 1946. It was $210 billion by 1963, and as I indicated it will be about $300 billion this year. The income tax base—that is the base after all exclusions, exemptions, deductions, and evasions—has risen from 31 percent of GNP in 1946 to an estimated 36 percent in 1967. Taking this growth rate, by 1972 our Federal individual income tax base should be $426 billion, and that means that a 2-percent set-aside would grow to $8½ billion for the States by 1972. That underscores the point that a share in the Federal income tax would be a share in U.S. economic growth.

Now, some people are concerned that in recession there might be a very bad setback to the State shares. I would like to note the tax base has declined only twice since the end of World War II—by 4 percent in 1949 and by less than one-tenth of 1 percent in 1958. One could build some safeguards so that even those small declines would not occur.

Another standard that was suggested was that we increase the progressivity of the Federal-State-local tax system. I think putting some of the power of the Federal income tax at the disposal of the State-local government, whether they use it for expanding services, whether they use it in place of increases in regressive State-local property sales and excise taxes or even if they use it for an occasional tax cut, in all of those cases we are still relying more heavily on the Federal income tax and less heavily on the State-local regressive taxes.

And coupled with this is the interstate equalization point. A significant part of the case for the revenue-sharing approach as compared with other approaches now rests on the service that it does in the cause of narrowing the gaps in service levels between wealthier and poorer States. I think we need to remind ourselves how huge those gaps are. In 1964, for example, the total State-local expenditure per capita ranged from $525 on the average in the highest five States to only $252, less than half in the poorest five. For education alone the range was from $197 to $94. For public welfare it was from $52 to $15.

You get much the same story for per capita revenue collections. Yet, the poorest States are making just as great a tax effort in terms of the ratio of tax to income as the richest States. Since they are getting a much poorer diet of government services for their pains, we see here a serious indictment of the workings of our fiscal federalism.

Finally, just a few words on the relationship to grants-in-aid. There is no doubt that grants-in-aid require a substantial amount of internal reform of their own. They are too tightly categorized. They often undercut mayors and Governors in the way in which they are distributed. Yet, they are a fundamental instrument for carrying out functions in which there is a national interest, functions in which we economists say there are large spillover effects, spillover effects that can be recognized only in Federal support. But coupled with that in logic, it seems to me, there has to be a free flow of funds that the States and local governments can use for whatever purposes seem appropriate—that is, for supporting the general structure of State and local government, for strengthening the fabric of State-local government, for strengthening those functions which are not tied into the matching Federal grants.

Very often the matching grant sucks money away from nonsupported functions. Senator Metcalf was telling me last night of a school in Montana, in a federally impacted area, that has a lovely library—a lovely library with no books in it. Why? Because the money that would have gone for books was absorbed into the 50-percent matching requirement for equipment for the physics and chemistry labs. We urgently need some flow of funds that will also help get those books into that library of that school.

This specific example vividly illustrates the general principle of the relationship of a free grant to the tied categorical aids. Thank you.

(Prepared statement of Professors Heller and Pechman follows:)

PREPARED STATEMENT OF WALTER W. HELLER AND JOSEPH A PECHMAN

Questions and Answers on Revenue Sharing

We were very pleased to receive this invitation to present our views on revenue sharing to this committee. First broached in 1964, the idea that the Federal Government should share some of its revenues with State-local government with few strings attached has an unusual degree of support from elected public officials and legislators in both political parties, scholars, businessmen, and other opinion leaders. It also has evoked a great deal of criticism from similar groups. The compendium which this committee has assembled and these hearings will perform an extremely valuable service in identifying the major issues and in evaluating alternative solutions.

Like everything else in politics, there seem to be about as many different versions of the revenue sharing plan as there are supporters. In this statement, we should like to outline in the form of questions and answers the major elements of our plan, to explain its rationale, and to evaluate some of the more important suggestions for modifying it.

Question.—What are the major purposes of revenue sharing?

Answer.—Revenue sharing is intended to allocate to the States and local governments, *on a permanent basis*, a portion of the very productive and highly "growth-elastic" receipts of the Federal Government. The bulk of Federal revenues is derived from income taxes, which rise at a faster rate than income as income grows. By contrast, State-local revenues barely keep pace with income. State-local needs have outstripped the potentialities of their revenue system at constant tax rates, with the result that tax rates have been pushed steadily upward throughout the postwar period and many new taxes have been added. Since State-local taxes are on balance regressive, the higher State-local taxes impose unnecessarily harsh burdens on low-income recipients. In addition, essential public services are not adequately supported in many, if not most, communities because they do not have the means to finance them.

Although there is no room for revenue sharing in the Federal budget this year, it is not too soon to plan for using the Nation's fiscal resources productively once Vietnam relaxes its fiscal grip. In view of their large unmet needs, the States and local governments should receive a generous share of the huge Federal revenue potential in the post-Vietnam economy. Revenue sharing clearly deserves to be considered among the major competing alternatives, certainly before tax reduction is carried too far.

Question.—What are the essential features of the revenue-sharing plan?

Answer.—The core of the revenue-sharing plan is the regular distribution of a specified portion of the Federal individual income tax to the States primarily on the basis of population and with few strings attached. This distribution would be over and above existing and future conditional grants. The essential features of the plan are as follows:

A percentage set-aside.—The Federal Government would each year set aside and distribute to the States an eventual 2 percent of the Federal individual income tax base (the amount reported as net taxable income by all individuals). This would mean that, under the existing rate schedule, the Federal Government would collect 2 percentage points in each bracket for the States and 12 to 68 percentage points for itself.

Use of a trust fund.—The sums collected for the States would be placed in a trust fund from which periodic distributions would be made. The trust fund would be the natural vehicle for handling such earmarked funds, just as it is in the case of payroll taxes for social security purposes and motor vehicle and gasoline taxes for the highway program. It would underscore the fact that the States receive the funds as a matter of right, free from the uncertainties and hazards of the annual appropriation process.

The Federal commitment to share income tax revenues with the States would be a contractual one in the sense of being payable—at whatever percentage Congress provided—through thick and thin, through surplus and deficit in the Federal budget. The plan could hardly have its claimed advantages of stiffening and strengthening State and local governments if they were always fearful that Federal deficits would deprive them of their share of the Federal income tax.

Per capita distribution.—The States would share the income tax proceeds on the basis of population. Per capita sharing would transfer some funds from States with high incomes—and therefore high per capita income tax liabilities—to low-income, low-tax States. If the modest equalization implicit in per capita sharing were deemed too limited, a small portion of the fund could be set aside for supplements to States with low per capita income or with a high incidence of poverty and dependency.

Pass-through.—Whether to leave the fiscal claims of the localities to the mercies of the political process and the institutional realities of each State or to require a pass-through to them is not an easy question. Previously, we have left this question open, but we now conclude that the legitimate—and pressing—claims of local government require explicit recognition in the basic formula of revenue sharing.

Few strings.—Constraints on the use of the funds would be much less detailed than those applying to conditional grants. However, the funds would not be available for highway construction, since there is a special Federal trust fund with its own earmarked revenue sources for this purpose. An audit of the actual use of the funds would be required, as well as certification by the appropriate State and local officials that all applicable Federal laws, such as the Civil Rights Act, have been complied with in the activities financed by the grants.

Revenue impact.—The Federal individual income tax base will reach the $300 billion mark in 1967. Accordingly, each percent of the base would provide the States with $3 billion a year. If 2 percent of the income tax base were being distributed in 1967, the grant would be $6 billion, or roughly $30 per capita. Without taking account of special equalization features, this would mean, for example, grants of about $60 million for Arkansas, $560 million for California, $60 million for Colorado, $320 million for Illinois, $180 million for Massachusetts, $110 million each for Louisiana and Minnesota, $120 million for Missouri, $20 million for Montana, $560 million for New York, $150 million for North Carolina, $360 million for Pennsylvania, $30 million for Utah, $130 million for Virginia, and $120 million for Wisconsin.

The income tax base, to which the allotments are keyed, has grown from $65 billion in 1946 to $128 billion in 1955, $210 billion in 1963, and the estimated $300 billion in 1967—and has risen from 31 percent of GNP in 1946 to an estimated 38 percent in 1967. By 1972, the base should grow to $425 billion (assuming a 6-percent annual growth in money GNP, and the base growing 20 percent faster than GNP). On this base, the 2-percent to be set aside for the states would reach $8.5 billion by 1972. Truly, a share in the Federal income tax would be a share in U.S. economic growth.

The competing claims of Federal tax cuts and expenditure increases would probably require that the plan start modestly (perhaps at one half of 1 percent or 1 percent) and build up gradually to 2 percent over three or four years. This gradual build-up would moderate the impact of the new plan on the Federal budget during the first few years after its adoption and enable the States to program their fiscal affairs more efficiently.

Question.—Why is the per capita method used to distribute funds? Why not return the money where it came from?

Answer.—The per capita method of distributing the grants among the States was chosen because it is the best available index of both fiscal capacity and need. It allocates more money to the relatively populous States; at the same time, it automatically distributes relatively more to a poor State than to a rich State. For example, a $25 per capita distribution would amount to 10 percent of the budget of a State that can afford to spend $250 per capita and only 5 percent of the budget of a State that can afford to spend $500 per capita.

As we have already indicated, more equalization could easily be provided if desired. We favor using a small part of the fund—say, 10 percent—for the poorest third of the States. This additional allotment—though a small part of the aggregate grants—would raise the average per capita grant in the ten poorest States by over 50 percent.

Tax effort might also be given some weight in the formula to give the States an incentive to maintain or increase tax collections out of their own sources. Such a spur could be built in by weighting the per capita grants to each State by the ratio of that State's tax effort to the average tax effort in the country—tax effort being defined as the ratio of State-local revenues to personal income. An interesting and rather mixed set of above- and below-par States emerges by this standard. For example, in 1964:

> Louisiana, New Mexico, and North Dakota would have had effort indexes of 120 or above.
>
> Nine States would have had an index of 85 or less: Connecticut, Delaware, Illinois, Maryland, Missouri, New Jersey, Ohio, Pennsylvania, and Virginia.

On the other hand, it would be totally inappropriate to allocate the funds in proportion to the amounts collected from each State. This would give disproportionately larger shares to the wealthiest States, and would widen rather than narrow differentials in State fiscal capacities.

Question.—What happens during a recession? Aren't you worried that the States and local governments would be in trouble if the revenue sharing funds declined?

Answer.—The tax base has declined only twice since the end of World War II—by 4 percent in 1949 and by less than one-tenth of 1 percent in 1958. These are within the range of fluctuations that State and local governments have become accustomed to in their own tax sources. Nevertheless, in a deep recession, there would be no problem. In such circumstances, the Congress could easily add to the normal amounts going into the revenue sharing reserve fund to prevent financial distress at the State-local level. Few anti-recession measures would be as efficient from both the efficiency and stabilization standpoints.

Question.—The Federal Government already has a well-developed system of categorical grants? Why do we need general-purpose grants?

Answer.—Categorical and general-purpose grants have very different functions and these cannot be satisfied if the Federal system were limited to one or the other.

In distributing future fiscal dividends, the Federal Government can and should give high priority to categorical aid. Their dramatic growth will doubtless continue. They tripled in the 1950's, reaching $7 billion by 1960. They are well on the way to tripling again by 1970, as is reflected in the President's request of $17.5 billion in categorical aids for fiscal 1968.

In appraising the relative role of conditional or unconditional grants, one must be clear on the distinction between the defects or flaws in the administration of the existing grant-in-aid system—those which can presumably be overcome by improvements in it—and those which are intrinsic to the conditional grant-in-aid instrument.

Keen awareness of the limitations in practice was expressed in testimony before the Senate Subcommittee on Intergovernmental Relations last year by the Director of the Bureau of the Budget. He identified the problems as:

> Proliferation of programs to a total of 162 by early-1966, under 399 separate authorizations.
>
> Excessive categorization of grants which, together with direct negotiations between individual bureaus and their counterparts in State-local governments, have led to bypassing of governors and mayors and weakening of their control over their own administrations.

The difficulties in coordination and broad policy planning by Federal, State, and local governments that result from the fragmentation of grants and appropriations.[1]

These problems suggest that there are limits, in terms of efficiency in practical application, to increased reliance on central direction of resources through conditional Federal grants. They obviously call for reforms internal to the grant-in-aid system. To conclude that the categorical grant-in-aid system needs to be scuttled not only goes too far, but misses the point.

Categorical grants are needed because the benefits of many public services "spill over" from the community in which they are performed to other communities. Expenditures for such services would be too low if financed entirely by State-local sources, because each State or community would tend to pay only for the benefits likely to accrue to its own citizens. States have a well-developed system of categorical grants to local governments for this reason. Unless the Federal Government steps in to represent the national interest in the benefits derived from State-local services, the latter will be badly undernourished. So categorical grants-in-aid must continue to be our *major* reliance in transferring Federal funds to the States.

General purpose or block grants are justified on substantially different grounds. In the first place, all States do not have equal capacity to pay for local services. Even though the poorer States make a larger relative revenue effort, they are unable to match the revenue-raising ability of the richest States. Second, Federal use of the best tax sources leaves a substantial gap between State-local need and State-local fiscal capacity. Moreover, no State can push its rates much higher than the rates in neighboring States for fear of placing its citizens and business enterprises at a disadvantage. This justifies some Federal assistance even for purely State-local activities, with the poorer States needing relatively more help because of their low fiscal capacity.

The categorical grant system cannot perform these functions. Though they admirably serve the national purpose, they often put State-local finance at cross-purposes. In drawing on a limited supply of resources to finance and staff particular activities, the matching grant may siphon resources away from nonaided programs. The poorer the State, the greater the tax effort that must be made to achieve any given amount of matching, and hence the less that is left over for purely State-local functions. To some extent, then, the State-local government trades fiscal freedom for fiscal strength.

In contrast, general-purpose grants would combine flexibility with strength. On the one hand, the funds would not be tied to specified national interests, bound by detailed controls, forced into particular channels and subject to annual Federal decisions. On the other, it would not have to be wrung out of a reluctant State-local tax base at great political risk to innovative governors and legislators. In short, revenue sharing would provide a dependable flow of Federal funds in a form that would enlarge, not restrict, the options of the State and local decision-makers.

For these reasons, the general-purpose grants are needed to supplement the categorical grants, but not to replace them. Considering the large unmet needs throughout the country for public programs with large spillover effects, the adoption of revenue sharing should not be the occasion for reducing categorical grants. It is a well-known axiom of logic that two objectives cannot be satisfied by using only one instrument.

Question.—We have been told that the major domestic problem is the plight of our cities. How can you make sure that the cities will get a fair share of the revenue sharing funds?

Answer.—Per capita revenue sharing would miss its mark if it failed to relieve some of the intense fiscal pressures on local, and particularly urban, governments. Indeed, it is in and through the metropolitan area that most of our aspirations for a greater society will be achieved or thwarted. Revenue sharing cannot be expected to break the bottlenecks of tradition and vested interest that stand in our path. But it can be expected to provide some of the financial resources needed for that battle, always bearing in mind that it will be a supplement to Federal programs for model cities, for urban redevelopment, for community action against poverty, and the like.

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[1] Charles L. Schultze, Hearings before the Subcommittee on Intergovernmental Relations of the Committee on Government Operations, U.S. Senate, 89th Cong., 2d sess.; Part I: The Federal Level, pp. 390–391.

The question is not *whether* revenue sharing should put funds at the disposal of local governments, but *how*. Can one count on relief coming automatically from a general grant made to the States, or should a specific part of the State shares be specifically reserved for the local units?

All States give aid to local units and most give significant amounts. As a matter of fact, the State grant-in-aid system for local governments is much more highly developed than the Federal grant system. In the aggregate, transfers from State to local governments account for more than a third of State expenditures and about 30 percent of local general revenues. By contrast, Federal grants amount to only 17 percent of State-local revenues. Thus, even without any specific requirements, we would expect the local governments to receive at least a third of any general funds the States might receive from the Federal Government.

Nevertheless, in the light of urgent local needs and the observed tendency of State capitals to shortchange their major central cities, we have been persuaded that an explicit "pass-through" rule may be desirable to recognize the legitimate claims of local government. This can be done in one of three ways:

1. *State plans.*—The most flexible method of handling the problem is to require the governors to prepare plans for the use of the funds. As guidance for the development of these plans, the Congress might indicate the general areas which it regarded as most urgent, including the need for making funds available to local governments. To be sure that the plan represented a broad spectrum of opinion in the State, the governor might be directed to consult with local officials and representatives of local citizens associations before incorporating the plan in his budget. The development of such plans would provide the occasion for a complete review and possibly a revamping of State-local relations throughout the country.

2. *Minimum pass-through.*—The legislation might provide a minimum percentage pass-through for all States. In view of recent trends, the minimum should be at least 40 percent and might even be as high as 50 percent. This would prevent any State from short-changing its local governments (although it might be difficult to detect offsetting reductions in existing grants if the State legislature was of a mind to do so). The disadvantage of a fixed percentage is that the extent to which the States delegate responsibilities to, and share revenues with, local governments varies greatly. In some States, the appropriate percentage may well exceed the 50 percent mark, and in others it may be below it. The danger is that any minimum percentage is likely to become a maximum, so that stipulating the percentage may do more harm than good in some States.

3. *Minimum pass-through plus guaranteed share for cities.*—Providing a minimum pass-through percentage does not insure a fair allocation to the large central cities, most of which are in dire financial straits and need relatively more help than other communities because of their heavy public welfare loads and disappearing bases as the middle-class continues its exodus to the suburbs. A minimum per capita outlay from the revenue sharing grant to these central cities would solve the problem, but it is virtually impossible to settle on a simple cutoff rule for such cities. For example, if all cities with population above 50,000 were included in this special proviso, no city in Alaska, Idaho, North Dakota, Vermont, or Wyoming would be protected for the minimum. In other States, the counties are major operat onal units and should be eligible for special treatment if this approach is taken. Moreover, the existing distribution of State-local responsibilities for education, health, welfare, and highways differ greatly and it would be impossible, as well as unwise, to set a given figure that would be equitable in all States.

It is, nevertheless, true that the problem should not be insuperable, since there are only 50 States to deal with and our senators and congressmen are very familiar with their State-local patterns and problems. An objective review of these problems on a State-by-State basis by the congressional committees, or the Advisory Commission on Intergovernmental Relations, or an ad hoc commission that might be set up for this explicit purpose should be able to come up with acceptable solutions. Any formula or set of formulas that would be included in any revenue sharing plan could be made subject to periodic review. Furthermore, the legislation could provide escape clauses from the statutory minima in the event that the governor and mayors of the principal local governments make an official request to the trustee of the revenue sharing funds.

These approaches suggest the range of alternatives. Although the problem is complicated by the large number and variety of local government units and the varying State-local relationships throughout the country, it should be possible to arrive at an equitable solution—provided the problem is approached sympathetically and in a constructive attitude by the major decision makers at all levels of government.

Question.—You argue that the States and local governments need financial assistance. Don't most of the current projections show that they will be accumulating large surpluses in the next few years?

Answer.—In spite of dramatic postwar growth in categorical aids as well as State-local tax revenues, there has been no let-up in the intense fiscal pressures on States and localities. Some recent projections seem to suggest that prosperity in State-local finance is just around the corner, that spending pressures will relent while revenues grow. But these projections are vulnerable on two counts:

First, they rely too heavily on projections of demographic factors, which tend to show that the pressure for government services at the State-local level will not build up as fast during the next decade as it did during the last. But these projections not only under-emphasize current deficiencies in State-local services, but tend to underestimate the demand for increased *quality* of these services, which—because of the slow growth in productivity in these sectors—must reflect itself in increased expenditures. Virtually all projections of State-local financial needs have in the past underestimated the great surge in State-local expenditures for this reason.

Second, the projections show relatively small net surpluses on balance for all State and local governments. This aggregation process tends to obscure the sharp pressures for higher expenditures and taxes, because they lump together States where pressures will be heavy with those where pressures will be lighter. In those circumstances where surpluses will be developing, expenditures will tend to rise to eliminate them, since there will be urgent unmet needs in such States. In all the others, it will be necessary to raise taxes to keep going.

Recent and current tax activity among the States testify to the unrelenting pressures for more funds. Between 1959 and 1967, every State but one raised rates or adopted a new major tax; there were 230 rate increases and 19 new tax adoptions in this period. This year, the governors asked their legislatures for $3 billion in additional revenues, and many of these proposed have already been enacted. In the first six months of 1967:

Michigan enacted new personal and corporate income taxes.

Nebraska added new personal and corporate income taxes and a sales tax.

West Virginia adopted a corporate income tax.

Minnesota added a sales tax.

Increases in sales tax rates were enacted in Illinois, Iowa, Nevada, North Dakota, Rhode Island, Washington, Wyoming.

Individual income tax rates were increased in California, Iowa, Maryland, Montana, Vermont.

Corporation income tax rates were raised in California, Iowa, Maryland, Minnesota, Montana, Tennessee.

In addition to these actions already taken, other State legislatures are still considering proposals by their governors. The California revisions, which increased State taxes by more than 20 percent, were approved by the Governor on July 29. Only two States—Kansas and North Carolina—lowered taxes to some extent, and both were cases of tax reductions concentrated at the lower income levels.

All this activity does not warrant the complacent conclusion that State and local governments can meet future needs with their present resources. The projections which were made as recently as last year are already out of date, and will become increasingly so with the passage of time.

Question.—Many people have recommended a Federal income tax credit for State income taxes as a substitute for revenue sharing. Wouldn't the credit do the trick?

Answer.—Federal income tax crediting for State income taxes is an attractive device, particularly if it could be coupled with tax sharing or general assistance. But, if a choice has to be made, the balance of advantages favors the revenue sharing plan:

First, because of its contributions to interstate equalization, which the income tax credit can't possibly duplicate.

Second, because its entire proceeds would flow into State and local treasuries while a good part of the benefits of the tax credit would initially accure directly to the taxpayers rather than to their governments.

Third, because the tax credit would have to overcome the barriers involved in inducing 15 States to adopt a tax they have not chosen to adopt on their own.

Having said this, however, we wish to add that adoption of an income tax credit would be a major advance in Federal-State fiscal relations, a very good second best to the revenue sharing approach.

Question.—Why give any money at all to the State governments. Aren't they obsolete?

Answer.—We believe that the States are an essential feature of our Federal system of government. A local government is an efficient form of government for some things, but not for many others. In taxation, for example, large local differentials in tax rates on income or sales tend to encourage people to move to other communities or to purchase elsewhere to avoid the tax. As for expenditures, only a few very large cities have the financial means to support higher education and even these few are having troubles. As a matter of fact, with the growth of population, the State governments are rapidly becoming metropolitan governments in the true sense of the word. Thus, for reasons of efficiency, the State governments cannot be permitted to wither away.

No doubt, one can find examples to fit almost any charge, but a fair appraisal of the situation is that most States have been doing a good job in recent years. The State governments have actually used most of their scarce resources for urgently needed State and local programs.

Between 1955 and 1965, general expenditures of State governments rose steeply by $23 billion, to around $40 billion. Of this increase, about 60 percent went for education, health, welfare, and housing; more than two thirds of this amount went to education—most of it through grants to local governments. This evidence suggests that, if the States were to receive unencumbered funds from the Federal Government, they would spend them on urgently needed services whether the particular service were stipulated or not. To be specific, if the Federal Government allocated $6 billion for revenue sharing, there is little doubt that about $3 billion of this money would be spent on teachers' salaries, school buildings, and other educational needs.

There is little doubt that the quality of State governments varies widely, but most observers agree that most State governors are competent and dedicated public officials. Many of them have surrounded themselves with excellent staffs, and are shaking up the old State bureaucracies and introducing new programs and policies that are sometimes ahead of thinking in Washington. As the effects of reapportionment are felt, conditions will improve even in those States where many of us have despaired of making progress in improving administration. Furthermore, there is no point in denying urgent fiscal aid to the "good" States merely because there are some "bad" States ("good" and "bad" in their attitude toward public services). As the last election demonstrated, States change complexion rapidly under the impetus of new administrations. It should also be added that the State governments do not have a monopoly on incompetence—some of the Federal agencies administering grants are something less than models of efficiency.

In conclusion, revenue sharing expresses the traditional faith most of us have in pluralism and decentralization, diversity, innovation, and experimentation. For those who lack that faith—for dyed-in-the-wool Hamiltonians and those who want the States to wither away—there can be little attraction in revenue-sharing or other instruments relying heavily on State-local discretion and decision. Yet, apart from the philosophic virtues of federalism, all of us have a direct stake in the financial health of State-local governments for the simple reason that they perform the bulk of essential civilian services in the country. Revenue sharing would help them do their jobs better:

By providing new financial elbow-room, free of fatal political penalties for innovative and expansive-minded State-local officials (i.e., by serving our federalist interest in vitality and independence at the State-local level).

By nourishing the purely local services and building up the staff and structure needed to carry out effectively the national-interest or spill-over type of services financed by categorical aid (i.e., by serving the universal interest in competence and efficiency).

By enabling the economically weaker States to provide the same scope and quality of services as their wealthier brethren without putting crushingly heavier burdens on their citizens (i.e., by serving the national interest in reducing interstate disparities in levels of services associated with any given tax effort).

Representative GRIFFITHS. Thank you, Mr. Heller.

Mr. Pechman, may we hear from you?

STATEMENT OF JOSEPH A. PECHMAN, DIRECTOR OF ECONOMIC STUDIES, THE BROOKINGS INSTITUTION

Mr. PECHMAN. Madam Chairman, I don't know what motivated your seating arrangement, but I ought to call to your attention that this is the first time in my life that I have ever been to the right of Herbert Stein and to the left of Walter Heller at one time. [Laughter.]

I would like to pick up where Professor Heller has left off and discuss in more detail some ideas about the possibility of making sure that the funds allocated to States under the revenue sharing plan do pass through to the local units of government.

In an ideal world, I suppose one would leave it entirely up to the States. My own feeling is that, for the most part, the local governments would get their fair share even without Federal direction.

Nonetheless, there are obvious illustrations throughout the country where the State capitols and the major cities are at odds on particular issues, and there is no reason why the Federal Government should not assure itself that the large cities and other urban communities will get their share.

The trouble is that the term "local government" is an ambiguous term, and covers an awful lot of sins. A general formula could be devised if every State consisted only of county governments and city governments. But, because there are overlapping jurisdictions, one particular formula would do more harm than good.

It seems to me that there are three possibilities to assure ourselves that the money would get to the local governments. Any one of them would be consistent with the kind of plan that Walter Heller and I have suggested.

The first suggestion is borrowed from the education bill. The States might be required to officially draw up plans for the use of the funds in consultation with the heads of local governments and citizen groups. This requirement alone would make them think about how this money should be used for local governmental purposes, and will help see to it that the cities get a fair share.

A second and stricter method would be to require all States to pass through at least *x* percent of the funds they receive through revenue sharing to the local governments. The *x* percent might be, say, 40 or 50 percent. In the last 10 years or so, the States have—through their grants-in-aid—actually passed through about 40 percent of the additional money they have raised to the local governments.

I have no objection to such a minimum pass-through, except that one particular number may become a maximum as well as a minimum. In some States the State-local arrangements are such that you would want much more to go to the local government and in others much less. Writing a particular number into the law, even though it is only a minimum, might do more harm than good.

The third possibility is to write a formula into the bill requiring that cities of certain size should receive a minimum per capita grant revenue-sharing funds. One suggestion I have heard is that all cities with populations above 50,000 should receive this assistance.

The trouble is that no cutoff point would be equitable throughout the country. For example, if you took the 50,000 cutoff point, no city in Alaska, Idaho, North Dakota, Vermont, or Wyoming would be protected by the minimum. In other States, the counties are the major operational units and they should be eligible for treatment if this approach is taken. For example, in the State of Maryland, there is one major city, Baltimore, and the rest of the State is broken up into 23 counties, several of which are very urbanized and ought to receive a specific allotment if you require a pass-through to urban communities.

An alternative plan that I much prefer to the cutoff point is that the legislation might stipulate various formulas for the 50 States. I haven't done it State by State, but—for the few States that I do know—I feel sure the committee that wrote the legislation in consultation with the Governor and the local governmental units could come up with an equitable distribution of the funds as between the urban communities and the State government. I don't think this is too difficult a job for only 50 States and it could be done on a provisional basis to see how it worked. After a few years, the results might be subject to review and revision.

On the whole, while the mayors and people concerned with local government problems have been very worried about this aspect, I think people of good will could get together on this problem—if they were of a mind to do so.

I turn now to the question of whether the States and local governments need financial assistance. You apparently had a session on projections, and perhaps I am out of order, but I do want to call to your attention a few things that the projections I have seen suggest to me.

As you know, past projections of State-local revenues and expenditures have always tended to understate the growth in demand for State-local services. In this particular instance it is hard to pinpoint why these projections will be off, but I feel very strongly that they will be. Moreover, I think I can prove to you that they are already off in important respects.

Before I do so, let me remind you that the projections you have seen are projections for all State-local governments. If the total comes out too close to zero or with a small cash surplus, it means that roughly half the States will have deficits, and the other half will have surpluses.

Now, the States that have had funds available to them have used them for increasing their services, so that the surpluses will be wiped out as the State and local governments build up to the higher revenues. The State and local governments with deficits will raise their taxes. In effect, the projections understate the level of services to the extent that the projected deficits have not been made up by increased receipts from higher tax rates.

The other point that I would like to mention is that the recent activity, at least at the State level, indicates there is just no letup in the tax rate increases.

I have a table, Madam Chairman, which I would like to insert in the record.

Representative GRIFFITHS. Without objection you may do so.

(The table referred to above follows:)

NEW AND INCREASED STATE TAXES IN 1967

NEW TAXES

State	Tax sources					
	Sales	Individual income	Corporation income	Motor fuel	Cigarette	Alcoholic beverages
Michigan		X	X [1]			
Minnesota	X [2]					
Nebraska	X [3]	X [3]	X [4]			
West Virginia			X [5]			

INCREASED TAXES

State	Sales	Individual income	Corporation income	Motor fuel	Cigarette	Alcoholic beverages
California		X [2]	X [2]		X [2]	X [2]
Illinois	X [5]			X [6]	X [6]	
Iowa	X	X	X		X	X
Maryland		X	X			
Minnesota			X	X [5]		
Montana		X [7]	X	X		
Nevada	X [8]					
New Hampshire					X [5]	
New Mexico				X		
North Dakota	X					
Oregon				X [6]		
Rhode Island	X					
Tennessee			X		X	X [9]
Texas	X [10]					
Vermont		X				
Washington	X			X		
Wyoming	X [11]			X	X	

[1] Effective Oct. 1, 1967.
[2] Effective Aug. 1, 1967.
[3] Effective June 1, 1967.
[4] Effective Jan. 1, 1968.
[5] Effective July 1, 1967.
[6] Awaiting approval.
[7] Tax increased in lower and highest brackets, and decreased in some intermediate brackets.
[8] Mandatory county tax imposed, which has been challenged as unconstitutional.
[9] Effective May 26, 1967.
[10] Local sales taxes authorized.
[11] Sales tax increased, but local authority to levy tax was repealed by the same amount, which leaves the effective rate the same in most areas (but increases the use tax).

Source: Commerce Clearing House, State Tax Review, vol. 28, June 13 and July 11, 1967.

Mr. PECHMAN. I have prepared this table on the basis of newspaper reports and reports of the tax services. The Advisory Commission ought to give us a firmer tabulation. But as of today—the last entry made in this table was for California where the action was taken by the Governor on Saturday—as of today, you will note that four out of the 50 State governments have enacted substantial new taxes. Michigan has enacted an individual and a corporation income tax for the first time. Minnesota has enacted a sales tax. Nebraska enacted individual corporate and sales taxes, and West Virginia a corporation tax. And among the other States, 17 have increased their major taxes by substantial amounts.

These are not small adjustments. To my knowledge, none of these tax rate increases and new taxes were incorporated in the projections that have been discussed publicly in the last year or so.

Perhaps Herbert Stein will tell us whether the CED projections which were recently published included some of these. I don't think they included all of them, certainly.

What this means is that the projections that you have seen are already out of date to the extent that these increased taxes have been put into effect, and because of growth they will be even more out of date as time goes by.

The amount of the tax increase, incidentally, is not insignificant.

California, alone, according to the newspapers, increased its taxes by $1 billion—just one State. So this does not suggest to me that there is any letup in the increased pressure for new financial resources at the State level at least. And looking at what has happened in the cities during the last 2 weeks, there is no reason for being sanguine about their financial resources either.

I want to end by repeating one other point that Professor Heller has mentioned. I would like to make it quite clear that, at least for the Heller-Pechman part of the revenue-sharing plan, we do not intend revenue sharing to be a substitute for the categorical grant-in-aid program. These two types of assistance perform different functions in a Federal system. The categorical grants are intended to stimulate activity in areas in which the Federal Government has an interest, for example, education, welfare, and so on. To be sure that these activities are supported adequately, the Federal Government requires that the money be used for specific purposes. The Federal Government has every right and responsibility to provide for minimum standards and to require the expenditure of funds in certain ways. But over and above these particular areas, as we have seen in the past few weeks, there are needs for purely State-local activities that will not be covered by the categorical grant system.

Now, if every State in the Union were affluent, if every State in the Union could afford to provide adequate State-local services, there would be no need for revenue sharing.

But, the fact of the matter is, when you do have 50 States, you do need equalization of fiscal resources. In addition, we have a system in which the Federal Government has made major use of the best tax sources, the income taxes. This means that the State governments can't use these taxes as much as they might want to otherwise, because the rates are already high and also because of the competitive factor. They don't want to get out of line. To use a technical term, State-local taxes are below the "optimum." The Federal Government, therefore, is justified in stepping in and helping even the richer States to some extent.

We do not regard the revenue-sharing part of the Federal grant program, at least for the time being, as being larger than the categorical grant system. It may be that as the system develops the relationship between the two will change.

At the present time, I think it would be well to start with a modest amount like 2 percent of the income tax, which is about $6 billion, and see how it works.

The intemperate reaction to revenue sharing as if it were a substitute for categorical grants is simply misrepresenting the plan. Thank you very much.

Representative GRIFFITHS. Thank you very much, Mr. Pechman. Senator Javits, who is a member of this committee, has to leave and he would like to make a few remarks, and if it is all right with Mr. Rumsfeld we will permit him to do so now.

Representative RUMSFELD. Yes, of course.

Senator JAVITS. Thank you very much, Madam Chairman, I wish to apologize to this distinguished panel. I am the ranking member of the Labor and Public Welfare Committee and we are dealing with a poverty bill. We must mark it up this morning. I am sure you would not want me to omit that duty. But I would like to state, Madam

Chairman, that I believe in this concept of Federal income tax sharing for the States or some other suitable plan of that kind because I am deeply convinced, notwithstanding what some experts may say, that it takes money to avoid riots and violence. I am a member of the Appropriations Committee also, and I was born in the slums and I have been in them very frequently these days, and it does take money and it is just not available on the State and local level alone, although they can do much more than they are doing.

So, Madam Chairman, I would like to congratulate our chairman upon these hearings which I think are tremendously useful to the country, and each of the witnesses, whatever may be their attitude, the attrition will help us to develop what must be done in this field. More money is urgently needed if we are to deal with the slums, and there is no substitute for it. Brains can make it more useful, and a good scheme can make it more equitable, but money is needed, and in large amounts, and on a basis of the military concept that it takes a massing of resources at a given target to score a breakthrough.

Senator JAVITS. Just one other question especially to Messrs. Heller and Pechman to whom I express my great appreciation as I think I have formulated their ideas in the first bill, it was interesting that Professor Heller is a Democrat and I am a Republican, but I think I carried out this idea first, and I am grateful to Professor Pechman who is from the college of my own city, City College. But may I ask you gentlemen to be kind enough to give me a critical analysis of my bill and if you would, as you are the proponents of this thesis, of the other bills which are pending, that is Congressmen Goodell's bill and others so we may have the benefit of your expertise as to what comes closest to the concepts which you have authorized or any suggestions you might have for amendment.

I think my bill comes very close to all your ideas. But certainly I want to present the Congress with an optimum bill and you can be very helpful in doing that and rather than doing it privately, I think it would be much more desirable to do it on the record. Thank you, Madam Chairman.

Representative GRIFFITHS. Thank you, Senator Javits.

Will you proceed, Mr. Stein?

STATEMENT OF HERBERT STEIN, VICE PRESIDENT AND CHIEF ECONOMIST, COMMITTEE FOR ECONOMIC DEVELOPMENT

Mr. STEIN. Madam Chairman, and gentlemen, in June of this year the Research and Policy Committee of the Committee for Economic Development issued a statement recommending that the Federal Government should give a partial credit against the Federal personal income tax for personal income taxes paid to the States. I welcome the opportunity to explain the proposal and to discuss the probable consequences of such a credit. These consequences are difficult to determine in advance. Different people who support the idea of the credit expect or emphasize different consequences. The interpretation of the likely results of the credit which I present here is a personal one, and not an official CED interpretation.

I think what is at issue in the discussion here today is to only a very small degree a question of objectives. I believe that the objectives which the CED had in mind were very similar to those which Messrs.

Heller and Pechman have elaborated. In general, the CED desires to enable and encourage the States and localities to provide more adequately those services which they traditionally and efficiently perform, with as little Federal control as is necessary to assure that result, and with a system of financing which is in general equitable.

I think the point at issue here relates to the effectiveness of the alternative plans in achieving this general objective that we all share.

My main point is that the probable consequences of the tax credit which CED and others have proposed are the opposite of the usual expectations.

I think the credit will result in a larger increase of State and local expenditures, and in more reliance on income taxes than will unconditional grants from the Federal Government to the States.

While I shall in my statement devote some attention to a comparison between the credit plan and the unconditional grant plan, I should say I don't do that as an enemy of the unconditional grant plan which I do regard as one of the four or five best plans now under consideration in this general field. In fact, it has seemed to me that we might take advantage of the opportunity provided by our federal system to experiment with the Heller-Pechman plan west of the Mississippi and the credit plan east of the Mississippi.

There are some reasons that might not be a good scientific test.

Anyway, let me explain the credit plan.

As you know, individuals paying Federal income tax may deduct State income taxes paid, like most other State and local taxes, from their gross income in arriving at the taxable income which determines the amount of Federal income tax they have to pay. The credit proposal would leave this deduction undisturbed. It would give the Federal taxpayer in addition a credit to be subtracted from the Federal tax he would otherwise have to pay; the amount of the credit being based on the amount of his State income tax. This credit might be calculated in any one of several ways. One credit system described in the CED statement would give the taxpayer a credit equal to a flat percentage of the net cost to him of his State income tax after taking account of the value of the deduction. Thus, suppose that the taxpayer is in a 40-percent Federal income tax bracket. The net cost to him of $1,000 of State income tax is only $600, because the $1,000 deduction reduces his Federal tax by $400. The suggested credit would be based on the $600, rather than on the $1,000. CED used an illustrative credit of 25 percent in describing this plan. In this case his credit would be $150, which is 25 percent of $600, and he would deduct the $150 from the Federal tax he owes. Since the net cost of State income taxes, after taking account of deductibility, is about 80 percent of the gross cost, on the average, a 25-percent credit on the net cost would equal 20 percent of gross cost on the average, but it would be a bigger percent of the gross cost for low-bracket taxpayers than for high-bracket taxpayers. The computation of the credit under this plan is illustrated in exhibit A and the effects in different tax brackets are shown in exhibit B.

In my statement the exhibits explain how it works in greater detail, but the details are not of great significance for today's discussion.

This particular plan would give everyone a credit in proportion to what State income taxes actually cost him. Moreover, it would permit the credit to be set at any desired height without running into a situation where some people make money by paying State income taxes. It has the further advantage that States would be able to increase their own revenues by the amount of the credit by a simple across-the-board percentage increase in their own income taxes without leaving any taxpayer better off or worse off than he had been before the credit was instituted. For example, if the credit is 25 percent and every State increases its income tax rates by 33⅓ percent, the increase of State revenue will equal the decrease of Federal revenue, and every income taxpayer will be unaffected.

So much for the mechanics of the system. What about its consequences? Talking about the consequences that I would expect of this plan, I should say that the consequences of all these plans are very difficult to determine with great confidence, but that is really what we must try to do.

In order to illustrate the consequences of the tax credit system I shall compare them with the consequences of an unconditional per capita grant from the Federal Government to the States, which I call a bloc grant. I do not make this comparison as an enemy of bloc grants but simply because the bloc grant idea has received so much attention that it has become the standard by which other proposals must be measured. It is necessary to distinguish between two versions of the bloc grant proposal—one with and one without an effort formula. By an effort formula I mean a provision in which the grant to a State is larger, the larger are its State and local taxes relative to the income of its residents. It has never been quite clear whether the Heller-Pechman plan does or does not incorporate an effort formula. The effort formula has been described by them as something which might be incorporated. Whether they favor its incorporation or not I do not know. Also, I shall be comparing plans with equal costs to the Federal Treasury, either in reduced Federal revenue or in enlarged Federal outlays.

The first thing that should be said in comparing the consequences of these plans is that we must guard against the kind of analysis which says that the bloc grant gives benefits to States in proportion to their population and the credit gives benefits to people in proportion to their State income taxes, so that the bloc grant assists public expenditures in the poor States whereas the credit plan assists the private expenditures of wealthy individuals. This is like saying that if you run water into one end of a bathtub the water will pile up at that end whereas if you run it in at the other end it will pile up there. The situation is actually much more complex, and we cannot be sure of the results, but my opinion is that the probable results are the opposite of the intuitive expectation. What we are really interested in is what happens when all the consequences are worked out.

In a few words, I would expect the following consequences. First, the tax credit plan will result in higher State and local public expenditures than the bloc grant without an effort formula. The relative effects on expenditures of the tax credit and the bloc grant with an effort formula are impossible to judge with the existing information, but probably a reasonable guess is that they would not be very different.

Two, the tax credit plan will result in higher total income taxes—Federal, State, and local combined—and lower sales and property taxes than the bloc grant plans.

Three, the bloc grant plans will provide relatively more assistance to the residents of the poorer States.

Four, the tax credit plan will provide relatively more benefits for poorer people.

The relative effect on expenditures is basic to the whole argument. I believe that the amount State and local governments spend on public services is primarily determined by two things. The first is the amount of resources upon which they can draw, which consists essentially of a pool containing the incomes of their citizens after paying Federal taxes, plus Federal grants. The second determinant is the relative costs and benefits of public and private expenditures, as evaluated by their citizens weighted by their political influence. These costs and benefits are influenced by interstate competition and by the spillover of benefits between States.

For the average State, the three plans would all cause an equal increase in the resources available, whether in the form of a Federal grant or in the form of a reduction in the Federal taxes of its citizens. In recent years, as the available resources of the States have increased, the expenditures of States and localities have increased by about 20 percent of the total increase in resources. I would expect as a first approximation that if a bloc grant, of a tax credit, of, say $5 billion a year were provided, the resulting increase of State and local expenditures would be something like $1 billion. In the case of the bloc grant without an effort formula that first approximation is probably all we get. But with the tax credit, or with the effort formula, there is another force at work, which could be powerful. These plans change the relative costs of public and private expenditures. The credit says to the people of the State that spending another million dollars on public services financed through the income tax will cost them only $800,000, if the credit is 20 percent, ignoring the effects of deductibility. This will make them willing to devote a larger proportion of their resources to public services. We have no doubt that if we gave an income tax credit for expenditures in restaurants there would be more eating out and less eating at home. Similarly, we should have no doubt that if we give a credit for the costs of State expenditures financed in a certain way, those expenditures will increase relative to other expenditures. The effort formula would have a similar effect.

Since this conclusion seems to be the opposite of the intuitive expectation, I would like to illustrate it further. Suppose the Governor of the State is sitting in his office with his budget director, his finance director, and his legislative leaders, drawing up the budget for next year. They have just decided that their urgent expenditure needs are so large that they must ask for $100 million of additional taxes. They have had to cut out of the budget another $10 million of expenditure that they, or the taxpayers, don't think is worth $10 million of the taxpayers' money. Suddenly there is a knock at the door, and a gasping messenger breaks in with the news, "The President has just signed the Heller-Pechman plan and we are going to get $20 million." Perhaps I should say the Javits plan.

Senator JAVITS. I am glad I stayed.

Mr. STEIN. "Great, says the Governor. Now we can spend that extra $10 million."

"Oh, No," says the budget director, who has studied cost-benefit analysis, "if the taxpayers would rather have had $10 million than those projects before, those projects still aren't worth $10 million. We should just raise taxes less and not spend more."

To which everyone reluctantly agrees.

Now we erase that scene and substitute another breathless messenger.

"The President has just signed the tax credit plan," he shouts.

"So what?" replies the Governor. "We're no better off than we were before."

"But wait," says the budget director, "now we can raise $10 million of income taxes and it costs our taxpayers only $8 million. Those projects that weren't worthwhile before are a big bargain now."

To which everyone agrees. This little story illustrates what I consider the main point of a comparison among the plans. The bloc grant without an effort formula would result in less expenditure increase than the tax credit. I shall not go through the story again with a bloc grant with an effort formula, but presumably the intention and effect of the effort formula is to induce States to use more of the grant for increasing expenditures and less for reducing taxes.

Now I should like to comment briefly on the effects of the three plans on the pattern of total taxation—Federal, State, and local. My opinion that the income tax credit will result in more income taxes than the bloc grant plan may seem paradoxical. The income tax credit starts with a reduction of Federal income taxes, simply by virtue of the provision of a new credit. The bloc grant plans, even if, as I expect, they result mainly in a reduction of State and local taxes, would mainly result in reduction of sales and property taxes, since that is what the States and localities have. When I say reduction, of course, I mean reduction relative to the increase that would otherwise probably occur since we are undoubtedly in a trend of rising State and local taxes.

So it would appear obvious that the income tax credit plan would result in more reduction of income taxes and the bloc grant in more reduction of other taxes.

However, things are seldom what they seem. The main point is that the income tax credit creates a strong incentive for the States to impose and raise income taxes, both to finance increased expenditures and as a substitute for other taxes. As we have already noted, the credit reduces the cost of expenditures financed by State income taxes. It also makes the tax burden of a State lower, with a given amount of revenue, the larger the share that is raised from income taxes. If the income tax credit is 20 percent, the people of the State save $2 million for every $10 million shift from other taxes to income taxes. I think these incentives would result in an increase of State income taxes exceeding the reduction of Federal income taxes, or they could be made to do so by proper determination of the rate of credit.

The direction of the effects I would expect, although the amounts are uncertain, can be illustrated as follows. States now raise about $4 billion of income taxes. Suppose that a 20-percent credit would cause a doubling of this, to $8 billion, and that half of the additional State income tax revenue is used for additional expenditure and half is used for reducing other taxes. Then the reduction of Federal income tax revenue would be about $2 billion—which is the 20-percent credit on the $8 billion plus the Federal loss from the deductibility of an additional $2 billion of total State taxes. Then we have a $2 billion decline in Federal income taxes, a $4 billion increase in State income taxes, a $2 billion increase in State expenditures and a $2 billion reduction in States taxes other than income taxes.

By contrast, I would expect a $2 billion bloc grant without an effort formula to result in an increase of State expenditures of about $400 million and a reduction of State taxes, mainly other than income taxes, of about $1,600 million. The effects of the effort formula are more difficult to guess, but it might result in as large an increase of State expenditures as the tax credit plan but would provide no incentive to shift from other taxes to income taxes.

My final conclusion about equalization follows from what I have already said. Poor people have more to gain from an increase of State and local expenditures than from an equal reduction of State and local taxes, because the proportion of the benefits of such expenditures which accrues to poor people is larger than the proportion of the taxes they bear. Poor people also gain from an increase in the proportion of the total revenue that is raised by personal income taxation, because they pay a smaller proportion of the personal income tax. Because I think that the income tax credit will result in more State and local expenditures than the bloc grant without effort formula, and in more use of personal income taxes than either version of the bloc grant, I think that the income tax credit will be more beneficial to poor people.

Economists who talk about these plans give a great deal of attention to the distribution of benefits among richer and poorer States. We are like the man who searched for his lost watch under the lamppost, not because he lost it there but because the light was there. Similarly, we talk about distribution of the benefits by States, not because that is the interesting question but because we have statistics about States. I believe we are interested in poor people, and that the poor people, even of the poor States and certainly of the average and rich States, have more to gain from the income tax credit. I think one thing we have learned in recent years is that the division of the country between poor States and rich States is not very relevant to our problems. The country seems to consist of poor States and rich States with lots of poor people in them.

Essentially, the problem comes down to this: The choice of one or another of these plans will not affect the resources available to the States. The resources available will be determined by the national income and by the total amount of direct Federal expenditure. These plans can do either of two things, or both in some combination. One thing they can do is affect the distribution of those resources among the States. That is what the unconditional bloc grant does. The other thing they can do is influence the terms on which the people of the States make the big general decisions about using their resources, about the division between public and private expenditure and the division among kinds of taxes. That is what the income tax credit plan does. It tilts the scales of decision in favor of more State expenditure and more State income tax.

If you think that the big problem is the unequal distribution of resources among States, the unconditional bloc grant is one way of reducing that problem. It is not the only way, of course. Elimination of the Federal excise tax on cigarettes would have very similar effects, for example. That is, it would increase the resources of the citizens of the various States in proportion to their cigarette consumption, which is probably roughly equal per capita in all States, and thus cause a larger than proportionate increase in the incomes of the poorer States. However, if you think the problem is that States are inhibited from providing the public services they should provide and from relying on income taxes as much as they should, then the income tax credit seems to me a reasonable solution.

(Exhibits supplied with statement of Herbert Stein follow:)

EXHIBIT A.—COMPUTATION OF CREDIT FOR STATE INCOME TAX (MARRIED COUPLE, NO DEPENDENTS)

	Present system	Income tax credit plan
1. Total income	$20,000	$20,000
2. State income tax (assumed to be taxpayer's only deduction)	1,000	1,000
3. Personal exemptions	1,200	1,200
4. Income after deductions and exemptions	17,800	17,800
5. Tax before credit	3,764	3,764
COMPUTATION OF CREDIT		
6. Taxpayer's marginal rate (percent)		28
7. 100 percent minus marginal rate (percent)		72
8. Net State income tax (line 2 times line 7)		720
9. Credit (25 percent of line 8)		180
10. Tax after credit (line 5 minus line 9)		3,584

EXHIBIT B.—COST TO FEDERAL INCOME TAXPAYER OF $1 OF STATE INCOME TAX

Federal marginal tax rate (percent)	State income tax (a)	Value of deduction (b)	Net cost before credit (c)	Proposed credit at 25 percent of (c) (d)	Net cost after proposed credit (e)
14	$1	$0.14	$0.36	$0.215	$0.645
22	1	.22	.78	.195	.585
28	1	.28	.72	.18	.54
32	1	.32	.68	.17	.51
42	1	.42	.58	.145	.435
50	1	.50	.50	.125	.375
60	1	.60	.40	.10	.30
70	1	.70	.30	.075	.225

Representative GRIFFITHS. Thank you very much, Mr. Stein, and now I am going to answer Mr. Pechman's question. The seating arrangement is in order of the palatability of the plans and I have saved the best for the last.

STATEMENT OF MELVILLE J. ULMER, PROFESSOR OF ECONOMICS, UNIVERSITY OF MARYLAND

Mr. ULMER. I wonder, Madam Chairman, if I might depart briefly from my prepared statement to comment on a statement of Messrs. Pechman and Heller, that bears on my own central position and so I would like to say a word, just a word, about it at once.

And that is the statement made and reiterated that tax sharing must be considered as a supplement rather than as a substitute for Federal grants-in-aid or other specific Federal grants made for particular purposes.

This could easily be misleading or certainly easily misunderstood, because we must, I think, recognize the fact that any money we spend, or any purchase we make, is necessarily a substitute for what we otherwise might have done with the money. And tax sharing, hence, must be considered as a substitute for appropriations that otherwise might have expanded for slum clearance, the war on poverty, model cities, or even rat extermination, including these and many of the other bills on which appropriations have recently been actually reduced.

THE EVILS OF TAX SHARING

Well now, there are two points at issue on which I believe tax sharers have recently been required to retreat from the positions formerly held by some of them. For clarity they require mention.

First, it can no longer be contended rationally that the States have exhausted the sources of revenue now available to them, and this includes a large number of the poor States as well as many of the rich ones.

The data presented in my own study of the subject as well as by others make clear beyond a doubt that most of the States have ample latitude at present for expanding their revenue if they need to and to do so. The great majority of the States, even taking into consideration the recent increases cited by Mr. Pechman, make very little use, if any, of the income tax, and a surprising proportion do not even use sales or property taxes effectively. Indeed, there are a few States and localities that, judged by their own advertising, have no taxes at all, claims that sometimes contain only modest exaggerations.

Secondly, it has become much more difficult for tax sharers to contend that the States, in general, face a financial crisis. Studies of the Committee for Economic Development as well as the Tax Foundation show that even at existing tax rates the revenue of State and local governments will increase substantially more in the years ahead than the expenditures required to maintain the present scope and quality of public services. Data released last month by the Census Bureau indicate that this was true in 1966. Thus, even without any increases in existing tax rates it should be possible to expand the range of State and local public services substantially. As I remember the figures from your study, Mr. Stein, it was some 23 percent——

Mr. STEIN. Right.

Mr. ULMER (continuing). Of expansion that was possible, and this is not a modest surplus that I thought had been referred to earlier.

With these facts accepted, the case for tax sharing seems to narrow down to a much more modest, and I think quite indefensible, contention that this is a fair method for raising money at the State and local level, and an efficient method for getting it spent.

Superimposed on the prevailing crazy quilt of State and local taxes, tax sharing is anything but fair. Families in the same income bracket are today taxed very differently around the country. High tax States such as California, New York, and Wisconsin stand in sharp contrast to low tax States such as Missouri, Illinois, Texas, and Kentucky. Now quite perversely, tax sharing would levy its greatest burden, relatively, on taxpayers in the most conscientious States. It would levy its lightest burdens in those States that, compared with others, are today shirking their social obligations. In short, instead of tending toward a greater uniformity of taxes for people in the same income bracket, which would be equitable, tax sharing does the opposite. It would actually increase the disparities which presently exist.

I should like to make clear that I have been referring to disparities in taxes which now exist among States with the same general levels of per capita income—such as between California and New York, on the one hand, and New Jersey and Illinois on the other, or the contrast between such closely positioned States as Wisconsin (a high-tax State) and Indiana (a low-tax State). Such inequities are intensified by tax sharing and are only compounded further when we allow for the disparities in refunds that are called for in some of the tax-sharing plans.

For example, in the Pechman plan, Texas would receive back from the Federal Government $1.40 for every dollar it contributes. But in Texas there are no taxes at all on personal incomes or on corporation incomes. If these refunds can be thought of, for the moment, as negative taxes, their effect is to give bonuses to the taxpayers of Texas and similar States, at the expense, of course, of some of the more responsible States such as Oregon, California, Wisconsin, and New York. There is a strange perversion of justice here, that provides rewards for the sinners and punishment for the good and the upright.

Nor is there anything efficient about the way in which funds are to be spent under tax sharing. Most tax-sharing plans would allocate funds so that more, relative to contributions, would go to the poor States than to the rich ones. The idea seems to be that this scheme would help smooth out the distressing differences in public services observable around the country. And underlying this idea, in turn, is the assumption that these differences in public services stem from differences in financial capability. Analysis of the data shows that this underlying assumption is false.

For example—and this is just an example, and it can be demonstrated, as I have, statistically—Wisconsin is a slightly poorer State than Indiana and a slightly richer one than New Hampshire, but its taxes are materially higher than either one, and in general it spends substantially more, per capita, on public welfare, health and hospitals, parks and recreational areas, and education. Generally speaking, the States differ much more in the degrees of social responsibility that they exhibit than they do in per capita income. Distributing money to them, with no strings attached, would make about as much sense as giving every 10-year-old boy in the United States a left-handed catcher's mitt. It is quite possible to predict that some large proportion of the catcher's mitts, and some large proportion of the tax refunds, will be wasted. The States differ not only in their conscientiousness in meeting social obligations, but in their administrative skills and in their basic needs. And concerning the latter—that is, the needs—average, per capita income is a rather poor indicator. Some of the most explosive problems, as we all know, of poverty reside in the big cities in the richer States.

New Hampshire boasts in its current advertising that it has neither an income nor a sales tax. Will it use its refunds received through tax sharing to strengthen its inadequate public services, or in further efforts to attract the industry that it believes it so sorely requires? There is in fact no way of knowing, or of insuring, how tax refunds will be used. It seems reasonable to suppose, however, that States will run true to form, and that in the more conscientious ones social services will be further improved, while in the least conscientious ones there will be some favor for vested interests, some waste, and quite possibly some tax reductions. In short, it is quite possible that tax sharing will increase rather than reduce the disparities in public services now observable around the country.

In any event, if one objective here is to help the poor, as Mr. Stein has said, I think this can obviously be accomplished more effectively by helping poor people than by helping poor States. And insofar as Federal money is used, this implies Federal programs aimed at specific social targets—a far cry from casting money out upon the waters, no strings attached, but with a hope and a prayer that it will do some good.

Now I realize that the ideal relationship between State and local governments on the one hand, and the Federal Government on the other, requires more study; and I sincerely hope that this committee will sponsor further investigations of this problem. It is no secret, also, that the States are badly in need of administrative reform, for which, incidentally, they need initiative, guidance, and political courage far more than they need additional money. But I do not believe that any service is performed by those who sum this all up in the crude cry of some tax sharers that the States must be strengthened at the expense of the Federal Government. Those in this position, I think, stand in blunt opposition to the progressive and irreversible trend of history. Those services that are purely local, and can best be handled on a State or local basis are, in fact, growing less and less significant in the total picture. Technology and mobility are binding us more and more together as a unified nation. This places a premium, I think, on more intelligent and creative Federal leadership, in mobilizing a massive assault on the numerous important public needs that now go unsatisfied, including a real war on poverty. I should hate to see this assault weakened or offset entirely by a pointless drain of funds from the Federal Government to the States.

Representative GRIFFITHS. Thank you very much, Mr. Ulmer.

May I ask Mr. Heller and Mr. Pechman and Mr. Stein, what is your answer to Mr. Ulmer's argument?

Mr. HELLER. Mrs. Griffiths, let me say, first of all, that Mr. Ulmer's assertion that those who favor tax sharing say the States have exhausted the sources of revenue now available to them is false—he is simply flailing a strawman. I don't think he will find anyone at this table, including Mr. Pechman or myself, who would feel that the States and the localities shouldn't continue to make great efforts to tax themselves. Indeed, a good part of my work in public finance since 1935 has been in this field of trying to determine ways in which the States could more effectively tax themselves. The argument isn't based on that, so let's dismiss that.

Secondly, apropos to the general point that Mr. Ulmer made near the end of his paper about the trend toward centralization, and the fact that the Federal Government has to provide a good part of the leadership, this approach to tax sharing is in no way inconsistent with the proper role of the Federal Government. It simply says that unless States and localities are strong, and stronger than they are today, we are going to weaken the fabric of federalism. We are not going to provide the kind of strength and the kind of equality in the partnership of federalism that is required to give us either optimality in public services or the philosophical advantage of federalism.

Now, third, as to the concern for the poor, let me say first of all that although I disagree with Messrs. Stein and Ulmer on which plan of channeling resources to the States will be more effective in helping the poor, this is not something that can be determined statistically, quantitatively, mathematically. It depends heavily on one's assumptions. For example, Mr. Stein notes that his comparison was based on the assumption that there was no tax effort requirement in the tax-sharing arrangement. If there were, much of his argument falls to the ground.

But even putting that aside, and looking both at the source of the revenue shares (primarily funds that otherwise would have gone into income tax reduction) and the equalizing distribution of those funds (which, unlike tax credits, would channel an extra share of funds into States that have low levels of services but high levels of tax effort on the average), my conclusion is that we would feed more to public services through the tax-sharing plan than the income tax credit plan and hence do more for the lower income groups.

Now, I also want to note I am not going to be driven to the position of opposing tax credits. I think they are a splendid instrument. The ideal system would have both tax sharing and tax credits, and either one would be a major advance over our present position in the Federal-State relationship.

I happen to think that Federal sharing has certain marginal advantages, but either plan, as I say, would meet many of the objectives that we have all, I believe, accepted at this table.

Finally, I don't want to be driven into the position that water doesn't seek its own level. I really believe that water seeks its own level.

Mr. PECHMAN. I would like to make a few comments.

First, I regret that Mr. Ulmer didn't have a chance to revise the third paragraph of his statement in which he quotes the CED and the Tax Foundation. I think I proved rather conclusively that both those projections are already out of date.

Representative GRIFFITHS. They admitted this yesterday.

Mr. PECHMAN. Second, on the question of who gets what under revenue sharing, let me take the example that Mr. Ulmer himself has on page 2 with respect to Texas. He is horrified that Texas would receive back from the Federal Government $1.40 for every $1 it contributes.

Unfortunately, Mr. Ulmer did not mention a few other facts. One is that Texas has a lower per capita income than the average in the country. The U.S. average, according to the Census Bureau for the year 1964–65 was $2,566. The average for Texas was $2,188. Everyone will agree that the Federal grant system intends to redistribute income to the poorer States. For that reason Texas and every State with income below the average, should certainly get relatively more than the richer States. Incidentally, the Federal grants system has not been greatly equalizing; it has become slightly more equalizing in the recent past. There is nothing wrong with Texas getting more than the richer States.

Third, with respect to the point that the poorer States are not making revenue effort, let me take Texas again since that has been raised. I assume that nobody is going to accuse me of being a defender of Texas for personal reasons. Texas, with a per capita income of $2,188, has general revenue per $1,000 of personal income of $150. In other words, its taxes plus grants are 15 percent of its personal income.

Of this, about $23 are Federal grants so that it taxes 13 percent of its income.

Delaware, the highest income State in the Union, $3,460, after you take out Federal grants, taxes itself about 12 percent. In fact, if you take all 10 States with the highest per capita income, they tax themselves about 12 percent of their personal income.

To be sure, there are 50 States and there are a lot of differences, but on the whole, I don't think that one can charge that the poor States are doing badly and the rich States are doing well, and that, therefore, we should not help the poorer States.

I also want to call your attention to the basic assumption underlying Mr. Stein's very cute analysis. The assumption is that the credit will, in fact, result in an increase in State-local government expenditures in the ratio of $5 for every dollar to the credit.

I believe that he left out the last scene in some of his little scenarios. The last scene would be the State and local lobbyists. When the Federal tax credit is enacted, the lobbyist will try to prevent the use of the credit in those States that already have income taxes, to increase tax rates by the amount of the credit. Consequently, you are left with the judgment as to what will happen to the majority of the States that already have income taxes. Will they, in fact, pick up the full credit by increasing tax rates? I doubt it very much.

As Professor Heller said, we are both in favor of a tax credit, but let it be said that, as far as effectiveness of outlays on the part of State-local governments, I believe that in the short or in the long run the increase in expenditures will be larger under the grants.

Mr. Stein also said he is helping poor people and we are helping poor States. Let me give you some figures. Delaware, the richest State has a per capita income of $3,460. Mississippi, the poorest State has a per capita income of $1,438. In other words, Delaware has about 2½ times as much income as Mississippi. A proportional income tax without exemptions or deductions would yield $144 in Mississippi and $346 in Delaware. In addition, you ought to discount that for the fact that you should have exemptions and some deductions for unusual expenses.

My guess is that, with a 10-percent rate and some exemptions, you would wind up per capita, say at about $100 for Mississippi and $400 in Delaware.

In other words, the richer State, because it has a high per capita income, will simply have many, many more resources to take care of its poor. The poorer States will have much fewer resources to take care of its poor; and by definition, they are poorer because they have a larger preponderance of people in the lower income brackets. I cannot understand Mr. Stein's omitting this important point. If these income distributions were the same, then he would be correct. But in fact the reasons why the per capita income differs so much is that there are relatively more poor people in Mississippi; and by making the same per capita grant in all States, we would help relatively more poor people per dollar of grants in Mississippi than in Delaware. Thank you.

Representative GRIFFITHS. Mr. Stein?

Mr. STEIN. Well, with respect to Mr. Ulmer's position, there is part of it with which I agree. I don't myself really think that projecting "needs" really tells us very much about what the problem is ahead.

I don't think that the term "needs" has any definable meaning, and all we are really talking about is whether we think it would be desirable to devote a larger proportion of the national resources to the provisions of public services, especially State and local public services, than we have been doing or we are likely to do without one of these systems. That is, would we like to increase the proportion of the national income which is devoted to these purposes and would we like to take some steps to achieve that? I think this question cannot be answered by projections of past trends. The question is: Are we satisfied with where we are or where we are likely to be going and that is not a statistical question? I think many people who look around the country as it is, are dissatisfied and would like to tilt the scales of decisionmaking in the direction of more provision of public services by the States and localities, which is not quite the same as more provision of public services in total because I think that one thing many people are interested in, and the CED is interested in, is to increase the State and local share in the provision of these services as compared with the Federal share.

But I think the point at which I do agree with Mr. Ulmer's argument is that we are interested in what the States will do with the money and with the behavior of the States and are not satisfied with what we expect will be the behavior if they are simply endowed with certain lumps of money.

Now, I think the discussion that we have just had with Messrs. Heller and Pechman is very relevant to this. I think the main point is finally coming out; that is, what do you expect will be done with this money? It is not a question of to which State will it go but what do we expect will become of it after it goes there.

In what proportions do you think it will be used to increase public services, in what proportion to reduce taxes, and in what proportions which taxes?

Now, we evidently differ about this. I think we could discuss the reasons for our difference.

The point that Mr. Pechman makes about the relative treatment of poorer people and poorer States is more complicated than I follow at the moment, but I would like to explain my simple-minded way of looking at it.

Suppose we take the case of a very poor State like Mississippi and we have two alternative plans, one of which would inject $100 million into the State of Mississippi and the other of which would inject $150 million into the State of Mississippi. The $150 million injected into the State of Mississippi would all be used for reduction of taxes in the State of Mississippi across the board; the $100 million injected into the State of Mississippi would all be used for the provision of Mississippi public services across the board. Which of these two systems would do more for the poor people?

I would think that the system which gave them $100 million, which resulted in $100 million for public services, would do more for the poor people.

We have some evidence, at least for the country as a whole, that poor people—defined as people with incomes under $2,000—get three or four times as large a share of a billion dollars of State and local expenditures as they do of a billion dollars of State and local tax reduction, and it is essentially on the basis of that observation that

I think a system which is tilted in the direction of increasing expenditures does far more for the poor people.

Of course these are quantitative matters. If the bloc grants plan were such as to give Mississippi five times as much as they would get under some other plan it might be better for the poor people of Mississippi.

But I think we are really concerned with making judgments about some quantities, and quantitative effects with respect to expenditures and receipts and revenues, that is, the behavior of the States after these systems are put into effect. I conclude this kind of rambling reply with one remark. I am glad that Walter Heller has joined the rest of us who believe that water seeks its own level.

Mr. STEIN. He does say, or the Heller-Pechman paper says in its analysis of Federal income tax credit one of their objections is that the revenue, under the revenue-sharing plan, its entire proceeds would flow into State and local treasuries while a good part of the benefits of the tax credit would initially accrue directly to the taxpayers rather than to their governments. Well, that is just the kind of analysis I am talking about, an analysis which stops with what happens initially. I think what happens initially is not what we are concerned with. We are concerned with what happens finally.

Representative GRIFFITHS. Thank you.

Mr. Rumsfeld?

Representative RUMSFELD. Gentlemen, I have been very interested in this discussion, and certainly in the presentations.

Although I have a great many questions on the very fine presentations by Dr. Heller, Mr. Pechman, and Mr. Stein, I think it is important to pursue this last presentation, because I had some trouble with it, and it may be because of some underlying assumptions in it, and I would be curious to see if we could not clarify them.

Mr. Ulmer, your statement initially begins with the statement that the States do not face a financial crisis. Is this essentially correct? Didn't you say, for example, even such things as the rat control problem could be handled by the States and the municipalities?

Mr. ULMER. No, I do not think—I certainly did not mean that it could be handled by the State and the local authorities, or necessarily had to on the basis of their own resources. Is that the way you understood me?

Representative RUMSFELD. That was my recollection. You said the States are capable of dealing with these things; you indicated there was not a financial crisis at the State and local level.

Mr. ULMER. I should like to see the Federal Government aid in the extermination of rats, aid in slum clearance, and urban development, and model cities, and so on.

Representative RUMSFELD. I get that later in your statement. But in your opening remarks you say it is very difficult for taxpayers to say that the States face a financial crisis, and you say your own study makes it clear beyond a doubt that most of the States have ample latitude at present for expanding their revenue.

Mr. ULMER. Oh, yes.

Representative RUMSFELD. This is the premise you begin with, is it not?

Mr. ULMER. Well, there are two points on which it seemed to me that the advocates of tax sharing had retreated from positions that they formerly held. Mr. Heller here agreed that most, or many, of these States do have ample latitude for increasing their taxes. As I pointed out, Mr. Pechman's beloved State of Texas, to take one example, has no income tax and has a tax effort that ranks well below the average tax effort, which was my whole point.

And you see in the case of the financial crisis, I here was reiterating, really, a work done by two organizations, one, Mr. Stein's Committee for Economic Development, and the other the Tax Foundation, in which it was shown that revenue on the basis of existing taxes was due to expand over the next 10 years roughly by more, considerably more, than would the required expenditures on the basis of the present scope and quality of public services, the present scope and quality.

Now, just to complete the picture, as I remember it, the CED showed a 23-percent surplus that would be available for improving scope and quality.

Representative RUMSFELD. I appreciate that. But your paper in the first two paragraphs made these statements, and it seems to me that, in my 5 years here in the Congress, I have gathered the impression that a great deal of the pressure, as you suggest, for tax sharing is to relieve a financial crisis, and a great deal of the pressure for Federal programs is a feeling that the States and local governments have not been capable, and if there is a basic difference of opinion here that your paper is premised on, I think it is important to bring it out.

Mr. ULMER. Capability and willingness are two different things.

Representative RUMSFELD. This comes to my second question.

Mr. ULMER. Yes.

Representative RUMSFELD. Let us take your second assumption. I get the impression from page 3 of your paper that—well, let me ask it rather than interpreting it.

Do you feel that the Federal system should be strengthened or are you of the view that really it is a bit of an anachronism, the States and local governments thinking they can do these things?

Mr. ULMER. Well, I am not sure what you mean exactly by these things. But there are certainly things that must be done at the local level, and some things that must be done at the State level. I do not think anyone questions this.

However, I do think that it is a very serious matter——

Representative RUMSFELD. What kind of things should be done at the local level?

Mr. ULMER. Police protection, as one example.

Representative RUMSFELD. Of course, we have a bill up this week in the House to provide Federal funds for policemen.

Mr. ULMER. Yes, I realize that, and I think it is a good bill.

Nonetheless, I think that the general work of police protection is best handled on a local basis; that the cop on the beat does know the thieves in the neighborhood, or the potential ones.

Representative RUMSFELD. Let me back around it, then.

Generally, you feel that the Federal system is working pretty well, and you do not think there is any need to try to strengthen it through this kind of a mechanism?

Mr. ULMER. When you say strengthen the Federal system now, you mean strengthen the States, I believe?

Representative RUMSFELD. State and local government. I am thinking of a whole blend of government levels when we are thinking of the State and local system.

Mr. ULMER. I think we want it strengthened at all levels. I surely would agree with you when you say this is a worthy objective. But I would not want to see this done at the expense of Federal leadership. I think Federal leadership has historically played a key role in strengthening the States.

If we consider Mr. Heller's and Mr. Pechman's statements, they both have different examples of wonderful pioneering work done at the State level, especially by Wisconsin, to some extent by New York and other States.

However, to get this spread around the country, we had to have Federal leadership with the Federal social security law, Federal unemployment insurance, and so on.

Representative RUMSFELD. This is a good point, and it leads to my third assumption which I think is important we clarify. I also get the impression that you have erected something that you are against, and you call it the evils of tax sharing, and what you are against is really not what these other gentlemen have suggested. I was about to open my questioning before your presentation by asking Dr. Heller and Mr. Pechman what is holding all this up. Now I see what is holding it up. And I wonder if it might be useful to explore exactly what it is that is holding it up.

Your paper seems to be to argue against the other papers on the basis that they are to be a total substitute for everything else we are doing.

Now, the third assumption that you led into, and that I would like to state is, I get the feeling that you are convinced that this is to be in lieu of rather than in addition to. If, in fact, I have correctly understood what you really believe, that the Federal Government should provide leadership in certain areas, and I quite agree that it must, to suggest that this would preclude their continued leadership or improved leadership in the coming years seems to me would not be valid, because Dr. Heller said, as I recall, that he feels that both the tax credit proposal and the tax sharing, possibly one or the other or in combination, but either, as an adjunct or in addition to the present approach, where the Federal Government does provide leadership in specific categoric grants to provide incentive and activity at the State and local levels, is what he is talking about.

Now, what you are talking about is not that. It could not be.

Mr. ULMER. Well, as I tried to explain earlier, I believe that any appropriation that we make must be considered in the light of the alternative appropriations that might have been made.

Representative RUMSFELD. So you are for the continued categoric aid by the Federal Government for specific programs, and nothing in these two areas, tax credit or tax sharing, Federal sharing——

Mr. ULMER. I do not recall opposing Mr. Stein's tax credit plan. I did oppose the tax-sharing plan. I think they are rather different things.

Representative RUMSFELD. I correct myself. You are quite right. I do not believe you did either.

Mr. ULMER. And I did not mean to.

Representative RUMSFELD. Yes.

Mr. ULMER. But I do think that it is important to realize that tax sharing is a substitute for something. It is a substitute for the bigger appropriations.

Representative RUMSFELD. For part but not the whole.

Mr. ULMER. Well, whatever it is. We desperately need more money allocated for the war on poverty, for the community development, for all of the other bills that have been before Congress that bear on the rebellion that our country is witnessing now, and these are not the only public services that have been starved, but these are the most dramatic ones.

Representative RUMSFELD. When you say desperately needed, now we are back in this need and the financial crisis in the country.

I agree we need greater expenditures in these areas. This comes back to the second assumption, how can we do some of these things and how can we best strengthen the Federal system, and is not a combination approach a more intelligent one, and you are rejecting that in favor of no blends of these two other proposals.

Mr. ULMER. You see, my basic concern, I think, is the same one that Mr. Stein mentioned earlier here about tax sharing. I think I can say that we are both worried about what would be done with the money. I thought he agreed with me on this, that here we have no assurance what will be done with the money, and one of the aspects of the problem that makes our uncertainty even greater is that money would be turned over to the States for spending by people who did not have the responsibility for raising it.

And, there is even more concern. Experience historically with this kind of plan has shown that it resulted in extravagance rather than wisely allocated expenditures for the most severe and attractive public deeds.

Representative RUMSFELD. I am not going to stand here and defend the efficient administrations of all State governments or all cities. I agree with you that there have been some things that could have been done better.

On the other hand, using this argument you are using, what you are expressing is a reluctance to see State and local governments, because of fear of extravagance, because of fear of no flow through, which is essentially what you say on page 3, you feel that you would be willing to opt for the Federal Government until you see strenghtened administration and efficiency and imagination and a willingness to have flow through at the State and local level; isn't this correct?

Mr. ULMER. Well, I think I have said that I would like to see Federal money, insofar as it is used at the State and local government level, to be allocated for specific purposes. This does not mean that the Federal Government needs to run it. But the Federal Government does need to provide standards for the use of this money, and objectives for the use of the money, and I think in this way the taxpayers and we American people can know what is being done with our resources. The other way, we have no assurance.

Representative RUMSFELD. Thank you, sir.

I think I see what the differences of agreement are here or differences of approach, if you will.

Dr. Heller, what is holding this up? You have been involved in this for a while? What are the—where do you see the roadblocks on this?

Is there any way you can, in a few sentences, bring the real issue point to point?

This is a difficult subject, money and tax sources. It is tough for the people of this country to really get hold of, it is tough for me to really get hold of. At some point in the dialog we are going to have to bring the issues right down point to point, what are we talking about. What are the basic differences of approach that are being contested and that cannot be in stacks and stacks of paper. We are going to have to figure out a way to talk about these things in a meaningful way and a little shorter.

My time is up, but I would be delighted to hear a brief comment on that.

Mr. HELLER. Congressman Rumsfeld, it's hard to be brief on this subject. Let me start out by saying that this is a field in which I have been working, off and on, for more than 30 years. Senator Proxmire, it was 1935 when I made my first study in Wisconsin, comparing Federal and State income tax provisions and returns, and tried to analyze the reasons for the comparative success of the Wisconsin income tax, compared with other State income taxes. Also, I should note that, starting in 1941, I have made a number of alternative proposals for Federal income tax credits for State income taxes paid.

As far as Federal, State, and local fiscal relations are concerned, I sometimes say I have labored not only inside the vineyard, but sometimes inside the grape.

We have had decades of much talk and very little action. In large part, for the past 30 years, the barrier has simply been the lack of Federal resources available to pass on to the State and local governments. We've not had sufficient Federal revenue growth relative to the demands on the public purse to allow us to consider passing out fiscal dividends to the State and local governments beyond the growing volume of grants-in-aid.

Now that situation seemed to be turning in 1964. We were looking forward to the happy day when the automatic revenue growth of now about $8 billion a year in Federal revenues from existing tax rates would have to be distributed; and this understanding seems to have permeated not only the economic community but both political parties. It looked as if we were up against the pleasant choice of distributing this $8 billion a year among tax cuts, Federal expenditure increases and revenue sharing or general revenue support of the social security system, if you want to put that in as an alternative. And then, of course, along came escalation in Vietnam, and postponed all this.

I am not saying, by the way, from a pure revenue point of view we have to wait until the end of Vietnam, because if Vietnam stabilizes, and I am not posing as a military expert, but simply picking one assumption out of thin air, but suppose Vietnam stabilizes at 500,000 men, we could find that this automatic revenue growth and restoration of the full utilization of resources in our country would present us with the fiscal dividend question sooner that we might think.

This may seem quite peculiar to say when we are talking about a $10 billion national income accounts budget deficit, but I do not think that we need to stretch our imaginations too far to see this possibility.

Now, the question is, what is blocking it? Well, momentarily what is blocking it is the war in Vietnam. But you want to go beyond this, I take it, and ask, so to speak, what are the political, what are the philosophical, factors that are blocking something like the income tax or revenue sharing?

That goes to the very heart, first of all, of whether people want to apply more resources to the public sector. These plans, as Mr. Stein has agreed, and as we would urgently stress, will lead to a greater investment of our income in the public sector. That is one, I think, fundamental issue that may be a barrier.

The second one, brought out by Mr. Ulmer's declaration for centralization, is the centralists versus the federalists, if you will. There is a strong contingent in this country that feels that the Federal Government knows best, Daddy knows best, and that the State and local governments cannot be trusted.

Now, I do not think we can wait until we feel that the State and local governments are, shall we say, worthy of these grants, these unrestricted grants. The unrestricted grants are partly the vehicle, the instrument, to make them worthy. It takes some of the pressures off of them. It reduces the penalties on the bold and innovative Governors and local officials, and so forth. It gives them a chance to raise the whole level of performance in the State and local governments, and not just the performance of the federally aided categories of services.

The other side of the centralist argument is not so much that the States can't be trusted, but that revenue sharing or general assistance funds would be drawn away from vital Federal programs, either the directly financed programs or the categorical grants-in-aid. Given the strongly organized groups, both within and without government, who can effectively plead the case for those programs, I doubt that this fear is well founded. But it definitely exists.

Third, there are those that fear revenue sharing or unrestricted grants because they feel it will make the State and local governments more dependent on the Federal Government. This, too, I think is wide of the mark.

Fourth, there are those who strongly prefer Federal income tax cuts to a new distribution of any kind to the States, whether it be in the form of tax shares or tax credits.

Fifth, there are the purely political factors in which some members of Congress may feel they will get more "political mileage" out of tax cuts or direct Federal spending than out of revenue sharing with the States and local governments. And I imagine that members of one party in Congress are not overjoyed to help members of the other party in the State capitols throughout the country. I don't like to think that these considerations would play a major role in such a basic issue in our federalism, but speaking as a political economist, I can't ignore them as a possible barrier in response to your question.

So, these are some of the forces that I see thwarting progress on this front.

Representative RUMSFELD. As I say, my time is up. I appreciate that point, and I think it is useful.

To quote a recently prominent author, I do not think the shortest distance between two points is necessarily through a tunnel; and I hope we can begin to sort a few of these things out like that, and really have a go at them because these are important decisions.

Thank you. I apologize.

Representative GRIFFITHS. I might add, Mr. Rumsfeld, that I think one of the real problems is a real outbreak of puritan ethics.

Those who raise the money are not willing to let somebody else spend it.

Senator Proxmire?

Senator PROXMIRE. Mr. Heller, as I understand it, your proposal and that of Mr. Pechman, is that we go up to 2 percent of the income tax base; is that correct?

Mr. HELLER. Yes.

Senator PROXMIRE. You are not talking about 2 percent of Federal revenues. This is a whale of a lot more. It is 2 percent——

Mr. HELLER. This is equal to 10 percent, Senator, of the income tax revenues, which are about $60 billion.

Senator PROXMIRE. Two percent sounds a little easier for us to contemplate. Two percent would be what, $6 billion, the computation is $300 billion as a base?

Mr. HELLER. That is right.

Senator PROXMIRE. This would mean an additional $6 billion because, as you say, it would not be in lieu of grants-in-aid or any other Federal spending. It would be in addition.

Mr. HELLER. Exactly.

Senator PROXMIRE. And it occurs to me that what is holding this up is not necessarily the Vietnam war, although that is the current problem. What is holding it up, it seems to me, is the fact we have had in the last 30 years deficits virtually every year except in a very few years when we had surpluses which, I think, you would characterize them, and most economists might characterize them, as mistakes. In other words, the surplus resulted—with maybe one or two exceptions, but very few, resulted—in deflating the economy, restraining and retarding growth, so that we should not have had the surpluses in those years.

Now, under the circumstances do you contemplate the future is going to be so different from the past which, it seems to me, to take a pretty wild leap on the basis of the most optimistic kinds of assumptions.

Mr. HELLER. Well, Senator, if you take the national income accounts budget, which is the one that is most meaningful economically, we have been in a surplus position in that a considerable number of times, and a considerable number of right times.

Senator PROXMIRE. What considerable—what years were we in a surplus position with the NIA budget?

Mr. HELLER. If I had the economic indicators——

Senator PROXMIRE. You can do that for the record. Your position is that it has been a considerable number of times, is that correct?

(The following material was subsequently supplied by Mr. Heller:)

Using *Economic Indicators* (July 1967) for calendar years since 1963 and the *Economic Report of the President, January 1967* for earlier years, the results are as follows:

In both 1965 and 1966, there were small surpluses—in both cases, there were sizable surpluses in the first half of the year, not quite offset by deficits in the second half of the year.

There were large surpluses ($9 billion and $6 billion) in 1950 and 1951 during the high pressure of the Korean conflict.

Then again, there were three surpluses (averaging $14 billion a year) in the period of strong economic activity and inflationary pressures of 1955–57.

Going back to the immediate post-war period, there were surpluses totaling just over $25 billion in the inflationary years 1946–48.

All told, then, in the twenty-one years since World War II, there have been twelve surpluses on the National Income Accounts (NIA) basis, the one that best measures the Federal budget's impact on the economy. Most of these surpluses occurred when there was inflationary pressure, so they were welcome weapons in reducing that pressure.

Mr. HELLER. It has been a considerable number of times, and I would say the prospects for the future are better than they were for the past, if we project anything like (*a*) a leveling out of military expenditures, and you may not want to accept this assumption, leveling out or reduction; and (*b*) the average annual increase in civilian expenditures that we have experienced over a fairly long period of time. If you take those two——

Senator PROXMIRE. I disagree on both those points. I think the leveling off of military expenditures is hopeful, and we all hope and pray we can reduce them, everybody in the country does. But on the basis of experience I am doubtful, and we have, I think, a very good and wholesome appreciation by Members of Congress of the immense responsibility we have in the cities especially.

Now, Senator Ribicoff has said this is going to cost us a trillion dollars if we are going to do the job over the next 10 years.

If we are going to spend a trillion dollars, and a lot of these programs are in big cities and in urban areas where it is going to be hard just to have a tax sharing and expect this to end up meeting the problem, I am not convinced that this is the way we are going meet this big and heavy and increasing responsibility.

Mr. HELLER. It is only fair to note that I am entirely in agreement with large Federal programs in the poverty area and in the city area, and so forth. I am sure that is part of the record over the years.

But if you visualize something like $45 billion to $50 billion of additional revenue at the disposal of the Federal Government 5 years from now, simply taking the $8 to $9 billion a year of revenue growth from our existing tax sources, you can deploy a great deal of that for vitally necessary Federal programs, deploy some of it to tax reduction, and still have a margin left over. Eight and a half billion dollars of tax sharing was the figure I was suggesting as of 1972 as part of a blend, as Congressman Rumsfeld mentioned, in the Federal-State-local relationship.

Senator PROXMIRE. Does this really take into account the new realization of what is going to happen to the Great Society program if we are going to meet our responsibilities in education, if we are going to meet the enormous costs of housing, if we are going to do all these other things on the basis of a national program and a national consciousness of the need and the recognition that there is a sharp difference between—there is a sharp difference within the State sometimes as to where the money goes, and very often you and I can cite many instances in which States have not been sympathetic to city problems.

Mr. HELLER. True.

Senator PROXMIRE. Under the circumstances, I just wonder if this is the way to meet what all of us are becoming more and more aware of as the "Big American Problem."

Mr. HELLER. All I can say is that it is part of the picture. If you want to get sounder vessels into which to pour the Federal aids and the Federal programs, if you want to have stronger service stations, so to speak, at the State and local level for the performance of Federal functions, you have to provide more support and strengthening for those State and local instruments through which you want to do your work as a Federal Senator in getting at some of these problems of poverty and urban ghettos.

Senator PROXMIRE. I would have wholeheartedly agreed with you that we need stronger service stations out there. I served in the State legislature, and I know how very vital State operations are. But you said that this should be put out on a per capita basis, possibly, and reluctantly up to 10 percent could be equalization.

Mr. HELLER. No. That is not reluctant.

Senator PROXMIRE. All right. I misunderstood you, then.

I thought you said per capita basis you felt was the way to do it, primarily, and you would go up to 10 percent if the Congress considered that to be wise, and then you said no strings attached other than the civil rights situation, and, perhaps, a provision on highways.

I am just wondering if this, from a practical and realistic standpoint, based on what we have seen from State governments, if this can be the best way that the Federal Government can discharge its responsibility. It is awfully appealing to States. You fellows are mighty popular with the 50 Governors, Democrats and Republicans, because there is nothing rougher than raising the taxes, and nothing more delightful than distributing the money.

Mr. HELLER. One should add, as a matter of conviction, a matter that was left open in the first round of the plan, so to speak, and that is the requirement of a passthrough to local governments.

Senator PROXMIRE. Well, yes.

Mr. HELLER. Because that is an important——

Senator PROXMIRE. Yes; a passthrough.

But, you know, some cities need it and some cities do not. We have in Wisconsin a passthrough that has its advantages and disadvantages.

Milwaukee feels, I think, with some right, that they do not get the amount they need, and it is very hard, it seems to me, to build this in appropriately to a Federal bill.

I think Congressman Reuss, as I understand it, and he is here and can certainly defend himself ably, but, as I understand it, he would have some pretty tight strings.

No. 1, he would require that the States do a job of streamlining and of reforming their operations and of establishing priorities, and so forth, before you would proceed with this distribution. You would have no strings attached or anything of the kind, which, I took it, would be your position.

Mr. HELLER. Well, this would be an enormously appealing thing. But there is one difference that is worth pointing out, namely that the States and localities do need money, and partly they need money to accomplish some of these necessary reforms.

The political penalties for reforms, especially those that require new tax money, are now so considerable that an assist from the Federal Government would facilitate rather than thwart these reforms.

Senator PROXMIRE. Well then, also how about kissing off your fiscal policy flexibility when you make this without—you know, as a permanent right that they have, a trust fund that they are going to get, and no ability to reduce it in the event of inflationary pressures or increased in the event of unemployment or something of that kind?

Mr. HELLER. Well, one reason that we key it to the base rather than to the rate structure, that is, a percentage of revenues, is so that it would not tie the Federal hands in any way in terms of stabilization policy—though, I must admit that making it sound like 2 percent instead of 10 percent is a politically attractive proposition.

Senator PROXMIRE. It is very clever. It certainly is.

Mr. HELLER. That was not our rationale; not that we would not want to take advantage of it.

Senator PROXMIRE. Advantage of it.

Mr. HELLER. But the rationale of it was that by not giving the States a vested interest in a particular set of rates by giving them instead a chunk that is collected for them related to the income tax base, fluctuations in Federal tax rates for stabilization purposes would simply not affect them.

It does mean that the Federal Government at a particular time might have to incur a larger deficit than it otherwise would. But the Federal Government is equipped to do that. It is the stabilization agency. It has the monetary powers and it has the responsibilities under the Employment Act of 1946 to maintain stability.

Senator PROXMIRE. You are following a Friedman-like approach. As far as this is concerned, his notion on monetary policy of having an increase in the money supply at a certain time of the year, you are saying that regardless of whether you had a depression, a recession, inflation, you would feed out a certain amount to the States.

Mr. HELLER. No. It is—heaven forbid.

Senator PROXMIRE. Isn't that what you said?

Mr. HELLER. As far as the States are concerned, this would be, in effect, like saying that under the categorical grants you do not shift the categorical grants down in a recession or up in prosperity. You simply have a stable allocation of a certain percentage of this base. It will change somewhat in relationship to the faster or slower growth of the base, but I do not think that this ties the hands of the Federal Government in its stabilization policy actions at all.

I believe in discretionary changes in the Federal tax rates, and I would not want to pursue a plan that would tie the Federal hands in any way, and I do not believe this does.

Senator PROXMIRE. My time is up, Madam Chairman.

Representative GRIFFITHS. I would like to get on the record some questions that I think have to be answered.

As I have read your plan or your testimony, the way I understand that this would work would be something comparable to social security.

You would set up a trust fund; you would have an automatic feedback.

Now, I want you to explain to me why it does not have some of the other problems of social security.

For instance, Mr. Rumsfeld, I believe, represents the highest level of income in any congressional district in the United States. Every person in his area——

Representative RUMSFELD. I might say I am not representative of that. [Laughter.]

Representative GRIFFITHS. Every person in his area, it is possible, is paying the maximum social security tax.

Now, when we begin to pay back, when you start paying back, you change the whole system, and you have $35 or $44 or something to people who have paid in three quarters on social security, and what you are really doing, you are not helping his district, you are picking up in the rural area people who would otherwise be on welfare.

Now, the thing that I think is the most difficult is that for many of those people in those areas, that $44 could represent the highest money income they have ever had in their lives. They are living in an area where they pay a most modest sum of taxes; they may own their own home; they may be paying, perhaps, $10 a year in property taxes.

But if that money went into my district, which is also paying the top level of social security taxes, they are paying on a four-room home $300 a year in taxes.

The thing that I do not understand about the plan is how are you going to measure the value of the money that goes into a State, what it will do?

For instance, some of you have pointed out something about parks and recreation. In a city you may need parks and recreation, but in Upper Michigan this is a business expense. Tourism is the second biggest industry in Michigan second only to automobiles.

Why should anybody in the rest of the country pay taxes to help set up parks in Michigan unless they are going to pay it with a knowledge in the beginning that they are helping Michigan get business? They may be creating jobs; they may be doing something like that, but this is not that kind of help.

I would like to know also—you have suggested you are going to audit the plan.

How are they going to spend the money? How are you going to audit it? You are going to make a determination on what the money is going to be spent for.

Suppose you decide on education. Are you just going to audit the fact that the city or the State really did spend that Federal money on education? You cannot do that. You are going to have to audit what the State spent, in my judgment, and what the city spent.

You will have to audit the whole thing. And then you will have to look to see what they did with the rest of the tax money, so, in reality, it seems to me, you are going to make the Federal Government a sort of policeman over this whole thing and over all the other expenditures within it.

Mr. Pechman pointed out that people of good will will solve this problem.

Mr. Pechman, that is pie in the sky. People of good will are not going to solve this problem. This bill would have to come before the Ways and Means Committee, in my opinion.

And you might have at least 15 people, who are going to be looking only at the deficit, and 50 Governors are going to be coming in to find out how much money they can get for nothing; how can they solve their problems by getting the money.

You are going to have a greedy group of people seeking the money with every conceivable device to try to get it.

You suggested also that States with deficits would raise their taxes.

Where did you get that idea? Michigan took 18 years to raise taxes. I sat in the legislature when they removed the splints from polio victims that had been on for 2 years because they would not raise the taxes.

These are some of the things that I think you really have to answer. How are you going to get around these problems?

Now, for instance, if you are going to send money into Michigan, the problems are in Detroit. But maybe you could make a real case for some of the suburban areas where they have a tremendous requirement for schools, a tremendous requirement for revenue for roads, a tremendous requirement for other public utilities, but they have a real tax income.

Whatever your theory, if you send it to Owosso, they have more millionaires per thousand of population than any area in America.

How are you going to get around those questions?

Who is going to make this plan, and just remember that people who were struggling for a plan on the social security bill last year, put medicaid into the social security bill, and what did New York do?

Why, they are taking care of people with $6,600 worth of income under medicaid.

How can you solve that?

How can you show up all the weaknesses?

You further suggested that if you began—if you pass out the money on a provisional basis that you could then correct it.

Mr. Pechman, you will never correct it. Once that money goes in there on a provisional basis the only way you will ever correct it is by increasing the amount of money. You will accept those errors and add more money.

I would like to hear your answers.

Mr. HELLER. Mrs. Griffiths—before Mr. Pechman replies—while you were speaking, he leaned over and said, "I am beginning to suspect that Mrs. Griffiths doesn't favor our plan."

With that I am going to defer to him.

Mr. PECHMAN. You took away my punchline.

I do not want to defend Michigan to you, Mrs. Griffiths, but let me point out to you that Michigan, without an income tax, was making the same average effort with the bad taxes that you had before you adopted an income tax, as the average in the United States.

The addition of the income taxes simply improved the effort of Michigan over the average, and I am delighted that you finally did it.

So while I do not want to defend the 18-year delay, you were making an average tax effort.

Also, in the table I submitted, I showed that many other States were making additional efforts. Admittedly, there are differences among the States. But the fact of the matter is that they have raised taxes much more than proportionately to their income and, on the whole, I think they have been doing a good job. There are exceptions, but the exceptions ought not to be regarded as the rule. (See table, p. 120.)

With respect to your auditing point, I think that is really unimportant. I could ask the same question with respect to auditing the present grants. How are the present grants audited? I can ask how these grants can be audited without auditing all the expenditures made by each State.

With respect to the use of the fund, I have here——

Representative GRIFFITHS. Wait a minute. I am not going to let you get away with that.

Mr. PECHMAN. OK.

Representative GRIFFITHS. Of course, you audit. You put it into Arkansas; for every dollar they put on welfare we pay 87 cents of it. There is not any problem with that.

Mr. PECHMAN. All right. But you said——

Representative GRIFFITHS. All right. Now you are going to go into a State and say, "Here is some unattached money, you can spend it on education," and you are going to go in and say, "Right, you spent $120,000 on education."

But you must have in there surely some place that they cannot reduce their own efforts.

Mr. PECHMAN. Oh, no.

Representative GRIFFITHS. You are not going to have that?

Mr. PECHMAN. You do not have that with respect to present grants.

Representative GRIFFITHS. You are going to let them substitute that. Then you are going to let the most important needs be met, the needs where the people themselves may lobby, and you are going to wipe out all other needs. This is the problem of the States now. The only people who are listened to in the State legislature are the lobbyists, in general.

Mr. PECHMAN. That is also an exaggeration.

Representative GRIFFITHS. Not too much; not too much. One of the ways that Michigan put through that tax, I understand, was that the Governor of Michigan asked every lobbyist to lay off, and accordingly, they did.

Mr. PECHMAN. With respect to the other point regarding the use of the fund, let me give you some other data about Michigan. I am sorry to bother you with facts.

Representative GRIFFITHS. I want it, because you have a lot of theories that are not workable. I mean your theory on how people are going to react really does not hold water. Let us hear your facts.

Mr. PECHMAN. The fact is that, of all State-local expenditures in Michigan in 1964–65, 44.6 percent of total expenditures went for education, and for the country as a whole, 38.6 percent of all expenditures went for education.

If you look at the record, you will find that, over the past 10 years, close to half of the additional money that the States, not the local governments, received went into education.

I submit to you that, if you want two and a half billion to three billion dollars to go into vitally needed educational services, give the States $6 billion of unencumbered funds. That is the way to do it.

I am not saying you should scuttle the categorical grant-in-aid programs. They are needed. But if you add resources at the State level, this will float down to the local governments. It has in the past, and I see no reason why one should assume, as you have, that it will not in the future.

With respect to the particular pass-through formula for local units of government, I was surprised to hear Senator Proxmire worrying about the State of Wisconsin.

Well, the fact that one-third of total local expenditures in Wisconsin comes from the State. I have not been in the State except for a visit in over 25 years, but as I recall it, the grant-in-aid system in the State of Wisconsin has been undergoing change over many years.

Senator PROXMIRE. If the Chairman would yield, Wisconsin, I think, has a wonderful system of making sure that the localities do share in the taxes. They get 50 percent of the income tax. They did when I was there.

Mr. PECHMAN. Exactly.

Senator PROXMIRE. But my point was that this goes to the very prosperous cities particularly. In fact, they get the share of the income tax they pay, and cities like Milwaukee that earnestly, desperately need it, do not get it. That is my point.

Mr. PECHMAN. That is the point I was getting to. There are two or three ways you could handle the Milwaukee problem, and I do not agree with Mrs. Griffiths that the Ways and Means Committee does not consist of people of good will.

Representative GRIFFITHS. I think they will be of great, good will. They will be trying to save us from going further into debt, and the Governors will be in with a plan of their own.

Mr. PECHMAN. Well, my point is this: If you gave Wisconsin or any other State $30 per capita with no strings attached at all $15 of that money would filter down to the local government.

If you are not sure of it, you could write into the law the specific amount of money that should go to the local governments. If you wanted Milwaukee to get a certain share, you could also write that into law.

The point is you should not tie your hands with respect to every State by one formula. The goodwill aspect comes in where an effort needs to be made to write a general formula with respect to the pass-through. I think the local governments will receive their fair share if there is a receptive attitude made by those who are involved in the legislation.

Let me give you an illustration of what happened in the State of Maryland without revenue sharing. We just had a substantial tax reform in the State, and a substantial tax increase. We converted a flat income tax to a progressive income tax; at the same time we had a substantial reorganization of the grant-in-aid program which was very, very equalizing in nature. A lot of the new money went to Baltimore and to the rural poor counties. The rich urban counties around Washington were against the plan, as you might well expect.

But the State itself has made Herculean efforts to increase taxes in order to send the money to those parts of the State where it is needed most.

Now, looking over the grant-in-aid formulas throughout the country, whether they are education, health, or other activities, I think the formulas have worked out well. If you want to change them——

Representative GRIFFITHS. Show me how you are going to make the formula fair. That is what I want to know. How can you do it? It is not enough to say that people will finally work out a fair formula. I do not believe that, unless you show me how it is going to be done.

Mr. PECHMAN. I can tell you how this could be done in Maryland.

Suppose you want urbanization to be a factor in your formula. In the State of Maryland there is only one major city; that is Baltimore. The other "cities" are counties.

Now, I do not see that any problem would exist in determining, which of the 23 counties are urban communities. You could identify them in the statute. And you could require x dollars to go to these urban counties as well as to Baltimore City.

You could do the same thing in Wisconsin. You could group States. At the very minimum, you could say x dollars per capita will go to cities, and other urban local governments that have certain identifiable urban characteristics.

I am not being any more definite because there are legitimate differences of opinion as to how much should go to these various communities. I think one of the things we are doing now is trying to decide whether this is a good way of doing it, passing it through the States first. I just do not—I think your——

Representative GRIFFITHS. But you will end up with people voting on it, and the only way you are going to——

Mr. PECHMAN. That is the way you do it in the United States generally.

Representative GRIFFITHS. The only way you can get the majority of those votes is to get them to distribute it on some sort of formula that gives everybody roughly the same.

But the point, Mr. Pechman, is that the need is not the same. How can you get it through here unless you give everybody roughly the same?

Mr. PECHMAN. Let me say that if you gave in Mississippi roughly the same per capita amount as you gave in Delaware, it would be worth three or four times as much for the Mississippi person as it would be for the Delaware person. So, just giving people the same amount of dollars per capita means that you are doing an awful lot for the poor. You are doing precisely what the plan wants, because the same dollar amount per capita is a larger proportion of the income of the poor than it is of the rich.

I do not want to eliminate the contribution of this plan to the States that have higher per capita income because I think they need fiscal resources as well, but I do not think it is true that because we are talking about the same per capita amount, we are not giving the needier relatively larger amounts of assistance.

Representative GRIFFITHS. Thank you.

Mr. Reuss has been kind enough to keep from having his own hearing on this. Mr. Reuss, would you like to ask some questions?

Representative REUSS. Thank you. You are very kind to me, Madam Chairman.

Have all members of the subcommittee, including yourself, had a full opportunity?

Representative GRIFFITHS. Yes; I am sure everybody has many more questions, but we would like you to ask yours.

Representative REUSS. I would like to ask a couple of my friends, Mr. Heller and Mr. Pechman.

I am delighted to see the progress that you are making in your formulation of the Heller-Pechman plan, which is a continuing thing.

For example, in your questions and answers, you have just about adopted the idea of having some tax effort component in your formula, and some pass-through, although you concede its limitations.

I am wondering if a few additional encrustations would not make an excellent plan even better.

In your plan you are basing your revenues on the income tax base. This, and your use of a trust fund, could produce a certain amount of inflexibility.

Let us suppose 3 years from now we are started on some kind of a Heller plan, and we still have the unhappy world situation in which we are now unfortunately engulfed. With the inflexible use of a trust fund, I can see ourselves getting into a position where you two gentlemen, and many of us at this table, would not be able to do what we think needs to be done to rebuild our cities because we have salted away, say, 5 or 6 billion in the Heller plan.

I, therefore, think that you could well stand a bit more flexibility. There is really no magic in the trust fund device. In fact, as fiscal experts, I think you would agree that many times trust funds and tied revenues and expenditures are bad devices.

Then I want to tell you a little secret. I did some surveying of the House Ways and Means Committee some months ago, and I got some inkling of what some prominent members like the chairman of that committee and the chairman of this subcommittee, felt about the Heller plan, and I realized that their love was not absolute, shall I say. [Laughter]

So, by the simple device of getting rid of the trust fund and instead, simply setting up an appropriations system, I got my bill before my committee, the Government Operations Committee.

Now, with all of these factors in your mind, would you reconsider whether the trust fund device or the income tax based device is really essential to your plan, and whether a pretty good refurbishing of your plan could not be found by simply saying we are going to authorize a certain amount of money each year for these Heller plan bloc grants.

Mr. HELLER. Congressman Reuss, I will confess that that gives me some trouble because in order to do the job that I think these funds can and should do for the States and localities they ought to be able to count on them as a matter of year-in and year-out flow into their treasuries. They ought not to be subjected to this kind of uncertainty.

This implies that if we get into a major national emergency, if we get into an inflationary situation, that the Federal Government has to deal with—depending in part on how the States use the proceeds of tax sharing—we may have to increase taxes temporarily more than would otherwise be the case, and it also implies that in a period where you wanted to do expansionary deficit financing that the Federal Government fully has to bear the brunt of the deficit financing operation.

Now, I am not sure that the trust fund per se is necessary. It just struck me as being symbolic of the fact that you were taking out a slice that the State and local governments could count on. Perhaps it should be done some other way.

Representative REUSS. I just postulated a situation we can see 3 years hence where we cannot do everything, and you are saying forget about building the cities, and you disappoint the cities on that, because the money is not there, but you make the Heller-Pechman plan sacrosanct, and I cannot see why it really should be any more sacrosanct than any other good thing.

Mr. HELLER. I am sure Mr. Pechman has something to say on this, too. But my point is, no, I would not sacrifice the cities. I would either temporarily deficit finance, if we had a slow situation, or I would temporarily increase taxes; and furthermore, I would never forget that we had this $8 to $9 billion automatic accrual of Federal revenues year in and year out, and we are not dealing with a situation where we have a static Federal revenue. We have much more rapid growth in Federal revenues from a given base because it is a progressive base, than we have in the State and the local tax situation.

Representative REUSS. Yes. But we said this, or at least I said this 2 or 3 years ago, and here we go with a $25 billion deficit this year.

Mr. PECHMAN. May I just point out a technical matter. The words "Trust fund" have a very technical meaning. You can do precisely what we want to do with the words "revolving fund," and it would be in the budget.

We hit on the trust fund device or the reserve fund device, is that it is a mechanism to insure that the per capita amounts of revenue that go to State and local governments will grow as the economy grows.

Your method requires an appropriation annually. You put a dollar amount into the legislation, and as Mrs. Griffiths points out, you have to legislate every year. That dollar amount may not rise.

If you modified your suggestion and put money into a revolving fund or appropriated money, which starts out at $30 per capita to the States, and grows at 5 percent per year, which is what our formula would do, or a little better, then you are accomplishing precisely what we want.

But the flat appropriation will put a lid on the per capita contribution, and this will decline relatively in proportion to the total, which is what we do not want to have in the future.

Representative REUSS. May I say on that, of course, I envisage the increase in increments maybe over a 2- or 3-year period, so we come out in the same way except I get my bill before the Government Operations Committee rather than the Ways and Means.

Another point. You gentlemen, Mr. Heller and Mr. Pechman, seem to view the Federal income tax credit for State income taxes as probably an alternative to the Heller-Pechman bloc plan.

Actually, isn't it an excellent and important part of it, and wouldn't you gentlemen accept as a very early kind of the tax reduction that we ought to have, the institution of this tax credit?

I think that in Mr. Heller's book he refers to, is it the 20–10–5 formula—you postulate a $35 billion fiscal gap, and then you say spend $20 billion of that on expanded Federal programs, $10 billion in tax reduction, and $5 billion for bloc grants.

Mr. HELLER. That was in the perspective of 1964, and I would say——

Representative REUSS. This is in your excellent book which just came out a few months ago.

Mr. HELLER. But this was postulated as of 1964. All I would say as of 1967 is that the $35 billon in 5 years foreseen at that time would, instead, be something like $45 billion today because the growth of the economy would create that amount. That is all.

Representative REUSS. Whatever it is——

Mr. HELLER. We are better off, in my example.

Representative REUSS. Whatever it is, $10 billion, or more than $10 billion, earmarked for tax reduction, I suggest it should be used as a No. 1 priority for the enactment of some sort of an income tax credit. Would you agree with that?

Mr. HELLER. I would say, first of all, that the ideal flow of revenues from the Federal to the State-local governments would combine these two approaches. In other words, it would have both the income tax credit, with its stimulus to the States to use this fine tax, and the Federal sharing besides. I happen to have a slight preference for the sharing if we had to make a choice. I hope we do not. But there are tremendous disparities in the use of the income tax: only about a third of the States have a real income tax; another third have a medium to mild to almost pusillanimous income tax; and finally another third of the States, well, 15 now, a little less than a third, have no income tax. I agree that a Federal income tax credit that would bring them all into the fold would give a sounder base of State tax effort for revenue-sharing than we have today. Although tax sharing does not actually depend on it, I would certainly like to see the States make this effort, if you will, as a concomitant of getting a share of the Federal income tax.

Representative REUSS. It would also to a large extent, disarm Mr. Ulmer, would it not?

Mr. HELLER. I do not think it will be that easy to disarm Mr. Ulmer.

Representative REUSS. Or at least make it easier for you to lay a glove on him. [Laughter.]

Because this would obviate to a degree, at least, this taxing poor taxpayers in rich States for the benefit of the rich taxpayers in other States.

Mr. HELLER. Right.

Representative REUSS. My third and final question, and I appreciate this opportunity, Madam Chairman, is directed at some more criticism of Heller-Pechman that has come from this bench today; the criticisms boiling down to what good are the States anyhow; how can you be sure they would spend it on good things; how could you be sure they would do the right thing by the localities, et cetera, et cetera.

As you know, in my approach to this, which is before the Government Operations Committee, I have taken a leaf from the Marshall plan of 20 years ago where the United States said to the countries of Europe, "Look, we will help you 20 countries, but only if you will get together first as an act of faith in something like the Committee for Economic Cooperation and Development, and work out plans for the next 3 or 4 years on what you are going to do to restore productivity and get moving. Once you have adopted those plans and they have been subjected to the Socratic dialog of your fellow European countries, we, the United States, by our act of faith, are going to embark upon the Marshall plan, and outside of a few end-use checks, and a little friendly guidance, we are not certainly going to withdraw it because you are not adhering to a particular timetable."

This was done, and I think the consensus of history is that it worked.

Why not do somewhat the same with the Heller-Pechman plan, as amended, and provide that States get it only if they, in conjunction with other States, and maybe working with the Advisory Commission on Intergovernmental Relations, come up with State plans designed to meet not only their own deficiencies but particularly designed to amend State constitutions and laws to let localities do what they need to do to become viable governmental institutions?

Do you have any objection to such an encrustation on the pristine Heller-Pechman proposal?

Mr. PECHMAN. I do not regard it as an encrustation or unnecessary.

My profession is economics, and not political science. You know more about it than I do. I have been told by prominent political scientists that an effective time to get the States and local governments to act is when you introduce new money into the system, that is when they really plan. When they are operating on past resources, as Mrs. Griffiths has pointed out, it is awfully difficult to change.

So there is a lot to be said for Mr. Reuss' approach. When the Federal Government introduces a generous revenue-sharing plan, it might require considerably much more planning on the part of the States and local governments to achieve national objectives than they have done in the past.

While I do not know about the details, I have not looked at those very carefully, I would personally like to see the congressional committees responsible for this area, try to write in some general instructions of this sort regarding planning. But such language should not interfere with the State-local prerogatives in deciding where the funds will go.

Representative REUSS. Thank you very much, Madam Chairman.

Representative GRIFFITHS. Thank you.

My advice would be to accept the Reuss plan right now. But I will give you some additional comfort.

Senator Percy?

Senator PERCY. Madam Chairman, I am very sorry not to have been here to hear the testimony, but we had a Banking and Currency Committee meeting I had to attend.

I must say that I start out with a prejudice. I have been brainwashed by Mr. Pechman over a period of years. We have appeared together on forums, and I took a strong position in favor of the principle of tax sharing some time ago before the American Banker's Association. In addition, I am a proud sponsor of Senator Baker's bill.

As a believer in this principle I have had many groups come to me and argue against it, and it is on their arguments that I now ask for your enlightenment.

For instance, members of organized labor have indicated that this would just enable the State legislature to do even less than they are doing now; that they would not respond to human needs, since they have not been responsive in the past.

How would you expect these States to spend additional funds provided through tax sharing, Mr. Pechman?

Mr. PECHMAN. Well, as we say in our statement, over 60 percent of the funds that State governments now spend annually go for education, health, and welfare in any case.

On the basis of marginal figures, the figures tracing the additional funds they have received in the last 10 years, it is clear they spend their money for the functions we would want them to spend their money on, and this is, incidentally, true of "bad" States as well as "good" States.

The variation in the distribution of State expenditures by type of expenditures is not very great. Education gets a very healthy share of State expenditures throughout the country, with few exceptions.

So, as I said, before you came, I am persuaded that, if we funneled $6 billion of revenue-sharing funds into the State governments, close to half of that would go into education, and I think that is a worthy objective.

Senator PERCY. Dr. Heller, would you want to comment on the same question.?

Mr. HELLER. I am just going to make an ad hominem comment. Given the Minnesota Legislature's action this past year, with its two-thirds conservative majority, of increasing university salaries by 20 percent, the State legislatures cannot be all bad.

And I think that expresses a little bit more than just a point of humor.

Maybe I have been unduly influenced by being exposed to government in Wisconsin and government in Minnesota over the years. But I find it difficult to reconcile some of these charges of irresponsibility, callousness, complete lobbying, with what I have observed.

Oh, sure, lobbies are powerful, but somehow or another we manage to muddle through to the kinds of results that Mr. Pechman has mentioned which, while by no means perfect, by no means as good as they ought to be, I think, are a good deal better than the attackers of this concept of revenue sharing are assuming. And I come back to the central point that revenue sharing itself can be an instrument to help improve the allocation and strengthen the fabric of State and local government.

Senator PERCY. Mr. Stein.?

Mr. STEIN. I would like to comment on the answer given to your question. I think Mr. Pechman has evidence on what proportion of their additional expenditures States devote to education and other purposes. But I think there is a prior question which is what proportion of the grants will be devoted to additional expenditures; that is, you can look at it another way and say if the States have an additional $6 billion, what proportion of it will be spent for State and local functions.

It seems to me the best evidence of this is what happens to the annual addition to the available incomes of the people of the States that accrues every year. Every year the incomes of the people of the States rise by much more than $6 billion. What proportion of that do they devote to State and local services?

Well, it has been running something like 20 percent, and it seems to me a better guess, in answer to your question about what will happen if you put $6 billion into the States, is that they will spend something like 20 percent of that, and of that 20 percent probably, as Mr. Pechman says, 50 percent will go to education. But these figures on the distribution of expenditures do not answer the question of what proportion of the grant would go for additional expenditures, and what proportion will go for less taxes than would otherwise have been raised.

Senator PERCY. Mr. Ulmer.?

Mr. ULMER. I simply wanted to say that if, as Mr. Pechman says, he would hopefully expect that 50 percent of the tax sharing would go to education, and if this is really the objective, why not really strike at that objective? Why not devote $3 billion, which would be half of the $6 billion, to education and make sure this is what the money would be used for?

I know a State in New England now that has neither a sales nor an income tax, which is very anxious to acquire money for building new roads, while at the same time, it's educational system is really in such a shambles that teachers are fleeing to other areas.

Senator PERCY. Isn't this a strong argument for giving States a discretionary power to decide what they need to do? Some States have put a tremendous emphasis on education, others on mental health. Some States may have let their highways deteriorate but to force every State uniformly to spend these additional funds on earmarked items does not take into account the diversity of decision-making that has been taking place all along.

Mr. ULMER. I would not suggest this. I would rather suggest the establishment of some Federal standards relating to the quality of education, and then provide the money required to see that these standards are fulfilled. If States already have them they would not need these funds. If they do not have them they would need them. This I call target financing rather than hopefully, prayerfully distributing money, and expecting that maybe it might go into the right things.

I have in mind a point made by Mrs. Griffiths earlier about the heterogeneity of the States. They have many, many different needs, and many, many different aptitudes and a strict formula of this kind does not do justice to that heterogeneity.

Mr. PECHMAN. May I respond to Mr. Stein's point about the proportion of the money that would go into State-local services? This is really a matter of judgment.

If, in fact, one could notice from the figures a cessation of the growth in the ratio of State-local expenditures to total GNP, then I think he would have a point.

But the fact of the matter is that the ratio has been growing, and we know there are identified unmet needs. I have a great deal of faith that, if the additional fiscal resources were provided, practically all of it would be used for State-local services. This would be one way of achieving a new plateau, a new level, in the ratio of State-local services to GNP.

There is no way to prove this, but I think it is clear that assistance of this sort would be not only welcomed, but used.

The other point is that the Stein point applies to income tax credits as well as to——

Mr. STEIN. Oh, no, because the income tax credit changes the terms of the choice.

What is going on in the States every year is a struggle between the people who want to spend more and the people who want to use more of the additional income earned by the people of the State for their private purposes, and this struggle results in a certain division. That division comes out at the margin, that is with respect to increases in the income of the people of a State, so that they characteristically decide they will devote 20 percent to public and 80 percent to private purposes.

I am saying that this same kind of struggle is going to go on about this additional $6 billion that you put into the States that goes on with respect to the additional income that the people earn.

But the tax credit system changes the terms of that struggle because it says, "Now, if you will collect or pay $10 million more of taxes this is only going to cost you in this State $8 million." That is, it is just like the investment credit which, in a way, reduced the cost of all the private investment by 7 percent.

The credit for State taxes paid reduces the cost of State services financed through the income tax by 20 percent, and it is going to increase the incentive for State expenditures just as the investment tax credit increased the expenditures for private investment, because it operates in the same way.

Senator PERCY. Before I yield to my senior colleague from New York in order for him to put in a commercial for New York, I would like to counter the commercial we have had from Minnesota by just giving you the best judgment I can as to what the Illinois State Legislature will do.

I have been locked in mortal combat with our State legislature for a number of years. I spilled blood with them over FEPC several years ago. We all finally won and got religion. I am still spilling blood on open occupancy legislation. I do not see why they cannot see the light I see in this area, but I think slowly we are going to come around to it.

There is no question in my mind that they know and are cognizant of what must be done in the field of education.

There is no question in my mind that they know well the great progress we must make now in mental health. We are building buildings but we do not have operating funds for those buildings. We have an outpatient service in one of the model program in the country; we are struggling to get the money to operate those facilities.

We would like to move into early education and many, many other areas. I doubt much of this money will go into highways. We earmark gasoline taxes for highways. But we do need to know what goes into public welfare. We have studied it for years and know we must have far more public welfare personnel with fewer caseloads, with more work done for rehabilitation. We know we must find an answer.

I hope we will be ingenious in raising more money on our own, and we must do that, but I really know if the money were made available to Illinois it would go for humanitarian programs that are desperately needed now. Although I have disagreed with them for many years, I think that the Illinois State Legislature would use well any additional money.

Mr. PECHMAN. Senator, it would help revenue sharers if Illinois got an income tax.

Senator PERCY. I will yield to the Senator from New York.

Representative GRIFFITHS. Senator Javits?

Senator JAVITS. Gentlemen, I wonder if you would cooperate with the committee, if you would do something very useful to us, and I suggested this to our distinguished chairman, if we could, at least as academic people, get agreement from you as to what are the advantages and disadvantages of all the plans, and then lay those out across the sheet. We have got your plan, the Federal tax-sharing plan. We have got the income tax credit plan, that is the State income tax credit plan. We have got Professor Ulmer's thesis that it will take care of itself, although I think he will probably argue with me about that, I am going to ask him to argue with me in a minute.

There are other theories. For example, there is a school of thought that says lend the States money or guarantee their own bond issues. But let them assume the responsibility for their own problems for generations to come based upon their own capacity.

There is another school of thought which says that you ought to specially finance those States which are subject to inmigration because they are carrying a national problem.

I have just made a speech on the floor, after various other things, which dealt with the fact that in one decade, from 1950 to 1960, 10 million people, largely Negroes, emigrated from the South into urban centers, and when you look at those figures, you begin to have some concept of the inflammatory material which has piled up in the ghettoes and slums.

I wonder, gentlemen, whether you would be willing, if we could, perhaps get our staff to work with you, because you do represent a mosaic of ideas, to help us so that we might lay before ourselves and the Congress the range of plans and the pros and cons in each.

You would not have to agree with those pros and cons. You would have to, as educators, and that is what you all are, really say these are the pros and cons, and you could each adhere most strongly to your own ideas, but at least we would see in an authoritative way what are the pros and cons.

Would you be willing to do that, Dr. Heller?

Mr. HELLER. Senator Javits, that is a splendid idea. The Advisory Commission on Intergovernmental Relations has a leg up on that problem and they have already some comparative sheets. Perhaps you are thinking of something more extensive.

Senator JAVITS. I am.

Mr. HELLER. I think that would be a very good thing to have come out of these hearings.

Senator JAVITS. These hearings wrap up all the plans, those that you gentlemen have offered, as well—there may be others that have been testified to before us or will.

Mr. HELLER. I assume you are suggesting that the staff will put something before us for correction rather than to ask us to start from scratch.

Senator JAVITS. Exactly right. The staff will really do it so that we could present to Congress, based upon the authoritative review of such distinguished people as yourselves and others who have testified before us, what is the range of choice and what are the pros and cons of each. I see our chairman looking at something.

Representative GRIFFITHS. We already have this. Our staff has done this in volume 1. We will let them explain their methods.

Senator JAVITS. All right.

Could we then, Madam Chairman, submit what the staff has done to these four experts and get the benefit of their expertise, as we may find we ought to do a lot of revising?

Representative GRIFFITHS. Yes, very well.

Senator JAVITS. Now, Professor Ulmer, have a go at it.

Mr. ULMER. Well, Senator, I think you have the impression that I was willing to let things take care of themselves.

Senator JAVITS. Yes.

Mr. ULMER. It is just the opposite with me. I would like to deal with the problems, and I would like not to have the Federal Government avoid the problems that face us today.

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I do not think that money per se is a cure for anything. I think that money properly directed is a cure for.many things and hence, I would like to have the Government face the war on poverty and strengthen it, face the problems of community development or the improvement of American life generally, including education.

But I would like to have the Government do this by aiming at the problems rather than simply distributing money. This is the thing.

Senator JAVITS. Do you believe in the categoric grant idea, as juxtaposed to the general purpose——

Mr. ULMER. I certainly do.

Senator JAVITS. So that you would increase, if we needed to, and we certainly need to, the whole existing Federal concept?

Mr. ULMER. Yes; I think I would. I, however, am deeply conscious of the need for coordination of the many plans that we now have afoot. Many of them are really operating only nominally rather than actually, but I do believe in the principle of categorical grants, yes.

Senator JAVITS. So that when I said that you would leave things as they are, I was substantially correct. You would leave them as they are in the State and the Federal establishments. You might increase the amounts, you might add other programs, but the essential structure by which these activities are supported you would leave intact?

Mr. ULMER. I find myself very reluctant to see myself in the position of leaving things intact, because I would like to see many things changed that are now operating in one way or another.

I would like to see the Federal Government move much more forcefully into the field of education than it has today. I would like to see it move much more forcefully into the area of welfare than it has today, even nationalizing welfare. I do not believe this is leaving things intact.

Senator JAVITS. Well, let us say, aside from emphasis, amount, and general Federal effectiveness, you are leaving the structure as it is, isn't that undeniable?

Mr. ULMER. Well, would you say that nationalizing welfare is leaving the structure as it is?

Senator JAVITS. Nationalizing welfare completely? I think it is just advancing to where we are now pretty much. Most of the programs now have an element of Federal support. I mean it is getting now to where there is practially no welfare program that doesn't have some element of Federal support.

Mr. ULMER. I would say if you want to use those words, I won't object further.

Senator JAVITS. You are not going to quarrel further.

May I ask you this, gentlemen, whoever in the panel wishes to answer, as a fact, is it not true that there is a drive toward the general purpose grants in the Federal Government which will be very harsh on the categoric grant programs unless we give it some opening to the right, as it were, as through the tax-sharing formula, because I wish to call the attention of the panel to the fact that because of such drive in the House of Representatives, we are now faced with a bill on elementary and secondary education which has broad areas of general grant ideas, also that the whole teacher's corps has just been overhauled to eliminate the Federal control and it is now right in the hands of the local people.

What do you say to the fact that one of the reasons for the tax-sharing idea was to afford an opportunity for this kind of general purpose sharing, rather than to bottle all this sentiment up in the other programs and, therefore, to tend to break them down?

Professor Heller, would you like to respond to that?

Mr. HELLER. In part, I think the move to broaden the categories somewhat to cut down the proliferation of separate programs, is a move in the right direction.

What I think you are suggesting in your question is that it can be pushed so far that some of the purposes of the Federal grants-in-aid, some of the zeroing in on specific problems in which there is this direct national interest, these spillover benefits, will be thwarted. The danger exists that the broadening could be carried too far. The general purpose or revenue-sharing or general assistance approach would relieve some of that pressure.

Senator JAVITS. Any other comments on it?

Mr. STEIN. Well, the Committee for Economic Development in its statement indicated its support for continued categorical grants-in-aid to serve a number of important purposes and, particularly for the revision of many of these programs to emphasize their contributions to poor people and to poor jurisdictions, thinking that was one of the basic functions of a grant-in-aid system.

It did believe, however, that it was desirable to provide some further encouragement and incentive and ability for the States to raise unrestricted funds, partly as an alternative to the continued proliferation of categorical grant programs. That is, the committee would not be happy to see all these problems solved by means of the categorical grants, and believes that the pressure for categorical grants would be relieved to the extent that more resources were made generally available at the State level.

Senator JAVITS. It has been said by various witnesses before the committee that the States, gentlemen, having the biggest problems with the poor are at the same time the richest States—that is, on a per capita income basis—in the Union.

These include Michigan, for example, Illinois, Wisconsin; States which have a relatively better position than other States.

If you agree with that proposition how will the various plans which have been suggested across the board here best deal with it? Mr. Stein?

Mr. STEIN. Well, I think with that view of the problem there is a great advantage to the income tax credit because the income tax credit then does precisely what is needed. It greatly increases the ability of the State to tax its own wealthier citizens, makes it easier and cheaper for it to tax its own wealthier citizens; reduces the interstate competition disadvantage of taxing its own wealthier citizens, to provide these resources for the poorer residents of that State, and I think this is a very important aspect of the problem and an important reason for emphasizing this credit.

It recognizes the basic fact that the Federal Government really cannot put money into the States. The only way the Federal Government can put money into the States is by restraining its own expenditures. Everything else is available for the States.

What the Federal Government can do is induce the State to use its resources more fully for the benefit of its poor people, and I think that is what the income tax credit does.

Senator JAVITS. Professor Pechman.?

Mr. PECHMAN. Well, I just want to say that I do not agree with the point made that the greatest problems with the poor are with the wealthy States. I want to repeat that the average per capita income in Mississippi was $1,438 in 1965 as compared to an average in the country of $2,566, and an average in the 10 highest States of $3,125.

Now, it is true that New York and some of the other States in the top 10 have a lot of poor people, but proportionately Mississippi is in much worse shape.

Even if it taxed itself very, very substantially heavier than New York, it simply couldn't provide the welfare and educational services that New York State can provide, and regardless of how you manipulate an income tax credit you cannot do it by way of a tax credit.

The tax credit device is primarily an incentive to adopt a good tax system, which I support, but I do not see how you can argue that the distribution of the tax credit is at all acceptable in the situation we have in this country today.

Mr. HELLER. I want to underscore that point, Senator Javits, that for any given level of services the poorer States have to tax themselves twice as hard as the richer States. That is No. 1.

No. 2, Mr. Stein says that he is anxious to build into the form of Federal assistance to the States a better incentive for them to tax their higher income groups.

At the present time, under the deductibility of the State income taxes from the Federal income tax base, we excuse as much as 70 percent of the State income tax payments to the high income groups. It seems to me that is a strong incentive to state use that already exists in individual income taxation; again, I do not want to speak against the income tax credit per se, but much incentive is already there. The States are using it to some extent but not nearly as much as they might.

So, we both have this same concern for getting more money into the hands of the poor and into the services for the poor. We disagree as to which way is more effective.

Senator JAVITS. Professor Ulmer?

Mr. ULMER. There are two points made in these statements that I would like to comment on. One is the implication that the only thing that is holding back the poorer States is their financial capability. I think you would all agree that this really is not true.

Mr. PECHMAN. I do not agree, let the record show.

Mr. ULMER. Let me say there is, in fact, no correlation between the tax effort that States make and their financial capability.

Mr. PECHMAN. That is also an incorrect statement.

Mr. ULMER. Well, I can prove the contrary, but let me cite the State of Tennessee which has a very low tax effort. It is a poor State, to be sure, but it could be doing very much better than it is doing if it were to adopt the tax levels of New York State.

This is one point on which I wanted to comment.

The other has to do with the poor who are, in fact, with us everywhere, including the rich and the financially important States. We do not have any very sound basis on which to believe that money given to the poor States would necessarily go preponderantly to the poor, and it is true that there are many poor people in the State of New York, in Wisconsin and in our other rich States.

I think it is obvious, and we have said this before, if we really do want to help the poor people, why not do that? Why try to go through the poor States where only some of the poor are anyway?

Mr. PECHMAN. I think the record ought to be corrected. He takes the State of Tennessee which happens to have the lowest—well, Tennessee and North Carolina, of the 10 lowest States, they happen to have the lowest tax efforts. For the bottom 10 States the ratio of tax effort to personal income is higher than it is in the top 10 States, and this is true, whether you take general revenue or any other definition of tax effort.

The fact of the matter is that they have made a solid effort, and have continued to make that effort. There are some exceptions, to be sure. There are exceptions throughout the country, but it is not fair to say that the poorer States do not make an effort.

Mr. ULMER. That is not what I said. I said many of them do not make a reasonable effort, not all of them; and this is true.

Senator JAVITS. Thank you, gentlemen. We have a rollcall.

Representative GRIFFITHS. I would like to point out to you again one of the questions you are not saying anything about, is the fact that $1,400 in Mississippi as compared to $2,500 in Detroit, the $1,400 in Mississippi never has to buy a winter-lined coat, does not have to buy warm clothing, it does not have to heat a house 9 months of the year. It does not have to do many other things as it would in our other colder areas.

Secondly, I think one of the things that you ought to observe is that private business does understand this, so that if you will check carefully in some of these States, you will discover to your amazement that in some of the most rural areas on an item that is absolutely essential they have a very high price in comparison to the price at which you can buy that item in a larger area.

I think that some of these questions have to be answered, too.

I want to thank each of you. I am sure everybody has had a very good time.

(Whereupon, the subcommittee recessed at 1 p.m. to reconvene on Thursday, August 3, 1967 at 10 a.m.)

REVENUE SHARING AND ITS ALTERNATIVES: WHAT FUTURE FOR FISCAL FEDERALISM?

THURSDAY, AUGUST 3, 1967

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON FISCAL POLICY
OF THE JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The subcommittee met, pursuant to recess, at 10 a.m., in room S–407, the Capitol, Hon. Martha W. Griffiths (chairman of the subcommittee) presiding.

Present: Representatives Griffiths, Moorhead, and Reuss.

Also present: James W. Knowles, director of research; Harley H. Hinrichs and Richard F. Kaufman, economists for the Subcommittee on Fiscal Policy.

Representative MOORHEAD (now presiding). It is now 10 o'clock. It is time for the fourth and final hearing of the Subcommittee on Fiscal Policy of the Joint Economic Committee on the subject of revenue sharing and its alternatives.

Today our witnesses are George F. Break, University of California; Lyle C. Fitch, Institute of Public Administration, New York, N.Y.; Richard P. Nathan, The Brookings Institution; and Harold M. Somers, University of California.

STATEMENT OF GEORGE F. BREAK, PROFESSOR OF ECONOMICS, UNIVERSITY OF CALIFORNIA, BERKELEY

Representative MOORHEAD. I think we will take the witnesses in that order. We will call first, then, on Mr. Break.

Mr. BREAK. Thank you very much, Mr. Chairman. I am very pleased to be invited to participate in these hearings. I do not have a prepared statement to read to you, but I would like to make just a few remarks about the alternatives to revenue sharing as I see them.

Before talking about these alternatives, let me indicate the problems which State and local governments face which these alternatives are designed to help them solve.

I think there are two basic ones. One is interstate tax competition whereby even the wealthy States and local governments may be deterred from levying the tax rates that they otherwise would like to have for fear that if their neighbors do not levy as high tax rates, that they will lose resources, business, and residents, to those other jurisdictions; and they are deterred by these fears from levying as high rates as they would like to have.

The second problem is that some, a number of States and many jurisdictions within almost, I think, every State, have income levels that are too low to permit them to afford the kinds of public services that they would like to have or that most people in the country would think that their residents ought to have. So, we have the low-income problem and the interstate tax competition problem.

I leave out of these problems the support to public services of national interest because those I feel, are best solved by means of categorical or functional grants. Where the program is of National, State, and local interest you need a fiscal partnership and your functional grants are well designed to achieve the desired levels of service in these areas, and so I do not regard functional grants as an alternative to revenue sharing. I will not say anything further about it.

Now, there are three ways of dealing with the two problems I have mentioned. Fractional tax credits would be one. Your revenue sharing devices that you have already talked about here would be a second. And, something in the nature of a negative tax would be a third.

Let me just say a few things about each of these.

The *fractional tax credit* approach has the attractive feature of giving aid to the recipient as the recipient helps himself by raising his own tax rates, and so tax effort is rewarded and the fears that the recipients of unconditional grants might not use the funds wisely or might use them to reduce their own tax effort are allayed by this device.

The fractional tax credit approach has two problems, I think, with it. One is that the initial aid is given directly to the taxpayer. The State and local governments can, of course, raise their rates but I am not very sure about how vigorously and how quickly they would react to this situation. The more important difficulty, I think, is that by giving aid to the jurisdiction of source it provides very little help to low-income areas. It would help solve the interstate competition problems because when they levy an additional $1 in taxes, their residents only have to pay, say, 60 cents under a 40-percent-fractional credit, and so it should mitigate that difficulty. But, it does not help the low-income areas.

Revenue sharing can do both. It helps to solve the interstate tax competition problem by giving the State and local governments additional funds which they do not have to worry about what the others are doing to raise them. They are raised nationally. And it helps the low-income areas because all of the plans that I have seen would distribute the funds either on a straight per capital basis which is mildly equalizing, or take part of the funds and distribute them to the lowest third, say, of the States by per capita income.

One of the main worries about revenue sharing of this kind is whether it would be a substitute for local tax effort, and I think you could build into the revenue sharing plan an arrangement that would increase the amount of funds distributed as the effort by the recipient in the tax field increased.

Finally, the *negative income tax*. This would, of course, give its immediate aid to poor families, and I would see it more as a substitute for existing public welfare programs than for revenue sharing, perhaps. But it certainly would assist local governments insofar as it did substitute for our present public assistance and categorical assistance programs. I recently made some calculations for the five counties in the San Francisco-Oakland metropolitan area. The welfare is handled by the county in California, and if you take the amount of money spent by the counties themselves and divide it by the amount of tax revenue which they raise from their own sources, you find that these ratios range from about 30 to 35 percent in recent years, so that a Federal program which did substitute for public assistance, general assistance, and so forth, would release funds in counties in California for alternative uses, and, of course, these tax burdens for welfare at the county level add to the tax burdens at the city level and may deter the expansion of education or other important programs because there is resistance to higher tax rates generally in metropolitan areas.

I think that is all I want to say to begin with, Mr. Chairman. Thank you very much.

Representative MOORHEAD. Thank you very much, Mr. Break. I have some questions I would like to ask you, but I think the hearings will proceed more, produce more if we went through all of the witnesses and then came back. I now call upon Mr. Fitch. If you will present your testimony, please.

STATEMENT OF LYLE C. FITCH, PRESIDENT, INSTITUTE OF PUBLIC ADMINISTRATION, NEW YORK, N.Y.

Mr. FITCH. Thank you, Mr. Chairman. I have a summary statement which summarizes another statement I prepared for inclusion in a compendium on urban affairs which the Subcommittee on Urban Affairs is compiling. The gist of it is that national policy on intergovernmental fiscal relations should be predicated on goals of national domestic development policy. The goals pertaining to urban development and improvement of urban life strike me as being the most important if for no other reason than that 75 percent of the population now lives in urban areas and the proportion is going up.

I think there is a consensus—it is kind of a puzzled consensus and not very well defined yet—that two main goals should command priority now. These goals have both been stated and emphasized. But, I think they have been implemented with somewhat less than full enthusiasm.

The first is the abolition of poverty and the provision of a decent living standard for American families. The abolition of poverty is a somewhat overly simplistic but nevertheless understandable goal.

The second goal is the improvement of the urban environment to make it more efficient, more convenient, more attractive, more livable.

Both of these goals, of course, have many dimensions and require many types of activity. The antipoverty goal implies stepping up the pace of a lot of programs in which we are already engaged. There is a lot we do not know about raising the economic and cultural status of people at the bottom, but we know that jobs, education, training, health, housing are basic and in all of these fields we have lagged badly.

Money is a principal missing ingredient. It is not the only one but it is a principal one. And, if we are really serious about eradicating poverty as a national goal, the Federal Government will have to put up much of the money.

In the city with which I have been associated most, New York, the city government now faces out of its own tax sources a welfare burden of approximately $350 million a year. I would certainly subscribe to Mr. Break's statement that this is the kind of a burden which should not be borne by the local governments.

Then, there are the people outside the labor market, including the aged and the disabled, the lame, the halt, the blind, the children. For these the only help is more adequate public assistance, whether in the form of negative taxes, increased welfare, categorical grants, grants for children, or combinations. I suggest the main source of the transfer funds required is also going to be the Federal Government.

The urban environmental improvement goal covers a lot of things which irritate people nowadays; pollution, congestion, delinquency, dirt and discomfort, and the ugliness of the urbanscape, and the growing difficulty of living comfortably and decently and safely. There has been a notion that urban life steadily improves, what with rising incomes and more gadgetry, but I think there is also growing suspicion that a lot of things may be getting worse.

Here again, we have a lot to learn and here again we are not doing as well as we already know how to do.

Looking ahead at resources which are going to be available, the thing that impresses me more than anything else is that between now and the end of the century, we will have a staggering amount of resources to work with. In the period 1929 to 1966, a 37-year period, the total aggregate GNP was about $15 trillion. We are getting to the point where we have to use the word trillion nowadays. Now, in the period 1967 to 2000, which is a 34-year period, we will have, at a 3-percent growth rate, an aggregate GNP of $42.5 trillion, or nearly three times the amount we have had in the last 37 years. If we can achieve a 4-percent growth rate, which is not out of the ballpark, the total would be $51.5 trillion. The difference between those figures is $9 trillion, and that is equal to about 13 years' GNP at 1966 rates of output. (The figures I am citing are all in 1966 prices.)

A 4-percent growth rate would enable us to double average consumption per household; provide a modern adequate housing stock, replacing three-fourths of the present housing stock and doing other things to upgrade it; greatly improve and expand education, among other things increasing the real expenditure per pupil by 100 percent; treble average expenditure on urban infrastructure, increase the proportion of private business investment in the GNP by 50 percent, which may be necessary to have a high growth rate, and finally, increase Federal nondefense expenditures and State-local government expenditures by 4 percent per year.

All of these things are possible over the next generation or between now and the end of the century with a 4-percent growth rate.

We would have to chop back a bit with a 3-percent growth rate; but any way you look at it, the amount of resources, as I said, is going to be unparalleled.

Given this prospect of abundance, what is going to keep us from achieving national goals? Surely not lack of productive capacity. If we fail to achieve them it will be through lack of imagination and the rigidity of institutions.

On the urban goal front, I am a great believer in the notion that the initiative and incentive and impulse has to come from the urban areas themselves, but what I find as I look at the urban scene, and I have spent a number of years rather high up in the administration of a very large urban government, is that urban governments by and large, and the State governments behind them, are really not equipped to deal with the problem.

The point I am suggesting here has been expressed by two recent publications of the Committee for Economic Development, one called "Modernizing State Government"; the other, "Modernizing Local Government." The Eighth Annual Report of the Advisory Commission on Intergovernmental Relations pretty well sums up both levels in what it has to say about State government: "Only a handful of States has moved to meet the problems of their urban areas and State governments are on the verge of losing control over the mounting problems of central city deterioration and the rapid growth in urban areas."

So, I think we have to modernize governments, we have to adapt ourselves to metropolitan realities. I would suggest that part of the Federal Government's responsibility in all of this is to provide some impulse and incentive and motivation to improve government down at the State and local level.

I have great faith in the enterprise process and the motive power of money, and I would therefore suggest consideration of the possibility of tying the improvement of State and local government standards to Federal grants.

Of course, this has already been done with many of the grants already outstanding, with greater or less success, but if we are going to have a Heller-type bloc grant system, a system of general grants, then I would suggest that it should be tied to improved capacity on the part of the State and local governments to spend such grants wisely. This suggestion raises some difficult administrative problems but I think a good start toward handling them has been set forth in the bill which Congressman Henry Reuss submitted in January of this year, which attempts to accomplish much of the purpose that I have been describing here.

I agree with other critics that the federal grant program has gotten unduly complicated, especially insofar as it relates to urban improvement. The complexity has reached the point where the art of grantsmanship becomes professionalized, with successful grantsmen like Edward Logue and Mitchell Svirdorff gaining national reputations by their ability to manipulate and package grants. I would suggest that we really need to work at clearing out some of the underbrush and getting the system simplified to the point where it will be more accessible to ordinary mortals.

And one last point. So far we have had virtually no experimentation with very large-scale demonstration grants. We have no models of what can be done to build an urban transportation system, an urban health and hospital system, to create a new city, to start a system of regional subcities in a metropolitan area. There are very many things which we need to experiment with and which we cannot experiment with until we have some very large blocks of money to work with. I realize that this is the hardest thing for the Congress to do but, nevertheless, I want to go on record as advocating the idea. Thank you.

Representative Griffiths (now presiding). Thank you very much, and thank you, Mr. Moorhead, for being here.

Mr. Nathan?

STATEMENT OF RICHARD P. NATHAN, THE BROOKINGS INSTITUTION, WASHINGTON, D.C.

Mr. NATHAN. I thank the committee for this opportunity. I have tried to develop my remarks on the subject of this fourth session; namely, a look at the alternatives. In relation to Mr. Fitch's long-range discussion of the staggering resources that will be available in the year 2000, I would say that my comments are on more immediate alternatives and some of the cost figures and administrative and political considerations that are important in this context.

It seems to me that the hiatus in the increase in domestic spending programs because of the war will offer us, hopefully soon, an opportunity for the first time in a long period, perhaps first time ever, to make some fairly broad and hopefully comprehensively planned choices among the number of alternatives, including revenue sharing, which are now being discussed. When the war ends, it will release perhaps as much as $15 billion, maybe $20 billion, in resources now committed for other purposes. This, would be so even assuming continued high level support for defense expenditures and foreign aid in Southeast Asia.

I will say first, that my own view is that revenue sharing should be a major component of the Nation's post-Vietnam fiscal policy mix—both for political reasons as it relates to the structure and future of our federalism and for economic reasons as it relates to needs for improvements in the quality and quantity of the essential public services provided by State and localities. One of the points—and I have been attending the other sessions of these hearings—brought out over and over again is that revenue sharing cannot be considered in a vacuum in developing ideas on the post-Vietnam fiscal policy mix. There are other alternatives. Professor Heller yesterday talked about combining revenue sharing with a tax credit. This approach is embodied in a bill introduced by Representative Laird.

The obvious top priority of many people today is the rehabilitation of deteriorated core cities, which if the ambitious goals of the model city concepts are to be achieved on a nationwide basis will require many times the resources now being devoted to this program. Appropriations for model cities today amount to $400 million. Senator Ribicoff has estimated that we have to spend $10 billion a year for the next 10 years to do the kind of job that needs to be done in our cities, and this really is the goal of the model cities program. Senator Proxmire yesterday referred to that estimate. And there are other estimates.

Another alternative that I would like to talk about has not really been discussed in the hearings, although everyone has mentioned it. That is new efforts, either through a negative income tax or family allowance program, to provide those who live below the poverty line with some appropriate guarantee of a minimal living income on a more efficient, and I would add, a more humane basis than under most existing Federal, State, and local public welfare programs.

There are many options that have been proposed recently in this area. The negative income tax is the most widely discussed. It involves some very substantial and far-reaching political problems of implementation that concern me very much as I look at what would happen with the negative income tax. It would affect every taxpayer, according to Prof. James Tobin's proposal, up to $7,500. That is, if that was the cutoff point, everybody below that would receive a negative income tax and everybody above that would pay positive income taxes. This would involve a complete overhaul of our tax system, which we have now learned to live with, and I suggest that living with a tax system—that is, having one that people are familiar with—is really quite an asset.

Another welfare proposal that has been made and has wide support is a Canadian-model family allowance plan. In addition, the Advisory Council on Public Welfare, Department of HEW, in June of 1966, put out a report which not many people have talked about, which I think is really quite important, entitled: "Having the Power, We Have the Duty." The council proposes that Congress, in effect, nationalize public welfare programs by establishing national standards of eligibility and benefit levels. This proposal comes more into the realm of things that can be done, juxtaposed to the negative income tax, let us say.

A third major option is, of course, tax reduction. With the private sector squeezed by the war, many people feel that when the war is over, tax reduction is going to be needed. Prof. Lowell Harris, who testified at these hearings Tuesday, stressed reducing corporate income taxes. He pointed out that every 1-percent reduction in the current rate would cost a billion dollars. This would stimulate the private sector in his view. Others want other kinds of tax reductions.

These three alternatives by no means exhaust the list. Others are more antipoverty spending, expanded regional economic development programs on the order of the Appalachian program, and increased foreign aid. Another option which, after our commitments have been scaled down in Vietnam, we may want to give major emphasis to is antimissile missiles. Now, that is a very expensive item. It would absorb substantial resources. I think Secretary McNamara estimates something like $8 or $10 billion a year.

Mr. Lawrence Kegan, of the CED, testifying on Tuesday, talked about increasing existing categorical aids, which he said he personally favored. He mentioned education as important, and obviously the Congress could put tremendous resources into schools, judging by the demands of many State education departments and the people I have talked to in the States.

These various alternatives can, of course, be blended and combined in any number of ways and it is ultimately the President and the Congress who will have to deal with these resource allocation issues. The President's 1966 Economic Report set up an interagency planning group to do this. I would suggest that perhaps hearings like this before the Joint Economic Committee are the congressional counterpart of the kind of considerations now going on in the executive branch and in the White House.

My particular bent on this subject is to lay emphasis on not just the economics of these choices but the politics and the administrative considerations, and I would like to stress two points.

First of all, as we look at the post-Vietnam fiscal policy mix questions it is important that we focus on broad and understandable policy goals. Growing out of the New Deal there has been a tendency to fragmentize the Federal-aid system. I quote Budget Director Schultze in the Muskie subcommittee hearings. He referred to the fact that there are now 162 major Federal-aid programs and 399 separate Federal-aid authorizations. Of the total, 91 are formula grants. There are 226 project grants. I agree with Lyle Fitch that the evolution of this system has created problems at the State and local level which revenue sharing, I think, is uniquely designed to deal with by changing the emphasis in the future in the way in which we provide Federal aid to State and local governments.

Budget Director Schultze said that—

> The complexity and fragmentation of Federal grant programs in and of itself creates major problems of administration information flow for both the Federal and local governments and inhibits the development of a unified approach to the solution of community problems.

I think coming from the Budget Director this is important testimony. It seems to me in this context that it is desirable that we move away from this type of aid and focus instead on the development of new and broader Federal-aid instruments.

Revenue sharing and the several major domestic policy alternatives already mentioned fulfill this criteria in terms of being the type of big and clear issues on which people in a free society can make major decisions and really understand what they are doing. The essential point is that revenue sharing, a major core city rehabilitation program, family allowances, all can be levers for reforming our total grant-in-aid system because at the same time that they meet major needs, they also help to simplify and broaden the basis on which the Federal Government provides financial aid to State and local governments.

This is not to say that internal grant-in-aid reforms are not important, but rather that we must go beyond the steps which are being considered now in the administration.

The second point I would stress is that post-Vietnam fiscal policy planning should look at the administrative questions within the various alternatives. Fiscal policy planning must not become the sole province of the economist. The how-to-do-it questions of policy implementation are increasingly becoming as important as the basic questions of what we are going to do.

I want to close with an illustration. It may be that we will ultimately want to consider restructuring the model cities program. It involves certain rigidities, in the way in which planning is required and the fact that the competition is based on planning, and also in the way in which the Federal Government puts up 80 percent of the matching share of Federal-aid programs within the model cities area. There may be wisdom ultimately, and everyone is talking now about the problems of the cities, to looking at core city problems in terms of need, not in terms of good planning, and devising formulas, which now can be done, to recognize factors like deteriorated housing and poverty incidence and high proportions of low-income families in order to provide aid to cities on a broader basis. Perhaps we should also bring the States into this process, where the States are willing to contribute a part of the cost. This is the kind of political factors, as we look at the possibilities and options, that I think would be wise to consider now.

Representative GRIFFITHS. Thank you very much, Mr. Nathan.

Mr. Somers?

STATEMENT OF HAROLD M. SOMERS, PROFESSOR OF ECONOMICS, UNIVERSITY OF CALIFORNIA, LOS ANGELES

Mr. SOMERS. Thank you, Madam Chairman. As the last speaker in 4 day of hearings, it is not very likely that I will be able to say anything that the committee has not heard before. The sensible thing for me to do probably is to tell a joke and then be available for questions on what I have said. But I intend to be sensible and I will avail myself of the kind invitation of the committee to present my own statement of the problem.

INSTANT TAX CREDITS

A thoroughgoing tax credit scheme provides a superior alternative to a revenue-sharing plan. All State and local taxes would be credited against Federal income tax liability up to a certain percentage of State and local taxes—or other limitation. The credit could be given immediately as in the case of unemployment insurance taxes and may be called an instant tax credit. This would avoid liquidity problems for the taxpayer. And there could be inducements to achieve conformity and interstate uniformity in matters of detail. The States would not only spend the money themselves, they would raise it themselves. This puts the tax credit plan doubly on the side of the angels.

Tax credits avoid some of the defects of revenue-sharing plans. Any grants tied to a fixed percentage of the Federal income tax revenues would be procyclical and would get more money to the States in prosperity than in depression. A trust fund or a variable percentage, if used, would introduce the element of discretionary authority and its political and economic complications. At best, revenue sharing makes no contribution to the much-needed improvement of State tax structure and the elimination of multiplicity of tax forms and tax provisions, unless conditions are attached to the revenue-sharing plan in which case we no longer can call the grants "unconditional" grants.

One is reminded of the episode in the musical "Call Me Madam" in which a leading political figure in the mythical Duchy of Lichtenburg refuses to accept a large American loan because it would scuttle the basic economic reforms he had been advocating for years.

In addition to encouraging the reform of State and local tax structures and elimination of the multiplicity of tax forms and tax provisions and the multiple taxation of interstate corporations, a comprehensive tax credit scheme has three important merits:

(1) It gives help to taxpayers in the same income or property classes by the same amount whether they happen to be located in a rich State or a poor State. Under most revenue-sharing plans the poorer States are helped more than the richer States per capita but what benefit accrues to particular taxpayers in those States is unpredictable.

(2) It helps the taxpayers of the core cities directly and does not depend on the generosity of the State or the operation of a pass-through provision of the so-called unconditional revenue-sharing grant. Any help to the taxpayer of the core city strengthens the ability of the core city to raise taxes for its own needs.

(3) It can have built-in countercyclical effect by enabling State and local governments to increase tax rates in depression to maintain public services rather than contributing to and aggravating an economic decline.

Tax credits constitute a form of general purpose, unrestricted assistance to State and local taxpayers which leaves them entirely free to make the decisions on how to use the resources that are thereby made available to them. The State and local taxpayers are allowed to offset part or all of their payments of specified State taxes in computing their Federal income tax liability. This is equivalent to receiving a full rebate from the Federal Government of all or part of the State and local tax paid. When a State or locality imposes or increases its taxes the taxpayer will get part or all of the money back when he makes out his Federal income tax form. The State and locality will still be making the decisions on their own tax system and on the spending of the money; reimbursement is a matter between the taxpayer and the Federal Government.

Tax credits are not new. Proposals to credit some or all State-local taxes have been made by many authors in this country for a period of more than 40 years. No one in his forties of fifties can accept credit for credits unless he was a child genius. The Advisory Commission on Intergovernmental Relations and the Committee for Economic Development recently suggested partial tax credit for State income taxes paid. I believe that it would be preferable to make all State and local taxes and not only income taxes eligible up to a certain percentage or at least to have a "bloc tax credit" consisting of property, sales, and income taxes. This leaves the State and local governments more degrees of freedom in selecting the taxes which they will impose.

Existing examples of State-Federal credits are the Federal estate tax credit and the credits against payroll taxes under the unemployment compensation system. The Federal estate tax credit unfortunately has not actually accomplished uniformity of death taxation and it is an open question how much it has contributed to that end. Certainly death taxes in the various States present a mosaic of types—inheritance or estate of both; exemptions—that is, insurance exemption—and rates. Despite the credit and the resulting costless nature of this portion of the tax to the States, one State (Nevada) levies no death tax at all. Prospective decedents—our gloomy way of referring to all living persons—are undoubtedly grateful for the credit in all the other States.

Tax credits should not be confused with tax deductions. State and local taxes are generally deductible in computing Federal income tax liability. The deductibility feature tends to reduce the burden of State and local taxes to some extent. For instance, if the relevant Federal tax rate is 50 percent, a State tax of $100 costs the taxpayer only $50—in his capacity as a State taxpayer, that is. This looks fine but it has a serious defect. If there is a Federal tax cut, the actual burden of State and local taxes appears to increase. For instance, if the Federal rate is reduced from 50 to 25 percent, a State tax of $100 rises in net burden from $50 to $75. The taxpayer gains in making out his Federal return, on balance, but the burden of State taxation appears heavier on him.

Tax credits do not have this defect. A $10 tax credit is $10 in the taxpayer's pocket even if Federal rates change.

Thank you.

Representative GRIFFITHS. Thank you very much, Mr. Somers. I must say that from the arguments I have heard so far, if we ever have to do this, I am either going to vote for Mr. Reuss or I am going to vote for a tax credit, one or the other. But I would like to compliment those of you whom I have heard. It seems to me that the real problem in all of this is that it is not the economic decision but the political decision that becomes the really difficult decision.

For instance, under the distribution of $2 billion general purpose grants under the formula to recognize need and tax efforts, compared with tax burden by State, this made in 1965, I would have to vote to give Texas back a $1.40 for every dollar while Michigan got back 89 cents for every dollar.

Now, it is possible that in Texas everybody assumes that everybody in Michigan is rich, but let me tell you in Michigan we assume that everybody in Texas owns an oil well on which they are getting a 27½-percent depletion allowance. Furthermore, they were given all that offshore tidal oil, and there are also other factors in it. So that it would be a very difficult decision.

Secondly, I think one of the problems that you have in it is a problem that I watched when I was a member of the Banking and Currency Committee. The thing that I think killed public housing in this country was that it was applied throughout the country and too many people showed up in Congress, the mayors of whose towns were living in public housing. It was a certain vote against public housing.

So that when you begin to apply the thing, the only way you are ever going to be able to apply it is reasonably uniformly at the national level. Then when you move it out into the State level, they, too, are going to try to apply it uniformly or they are not going to be able to pass it in a State legislature.

Now, I would like to point out to you that some 20 years ago I helped on the school board campaign in the city of Detroit. We have no children and I found out to my horror that in the copper country of Michigan, every single necessary thing was supplied to children going to school including books, pencils, and crayons. In addition to that, the State lovingly sent around buses to pick them up to get them there.

But in the city of Detroit, the child paid a public transportation cost and we did not even furnish them toilet paper. The shock—well, I never got over it. I was for running the whole campaign just on that.

But this, I think, is the problem that you have. You are not necessarily going to put this money into the areas that need it. How are you going to get around this? Are you really just going to give back money or are you going to accomplish some national purpose?

I would like to have your comments.

Mr. Somers. Madam Chairman, I think you have put your finger on the problem, that our present difficulties arise from the fact that the poor live all over the country and the riots, and similar problems, are not caused by poor States as such. They are caused, in part at least, by the condition of poor people wherever they live, and many of them as we know, live in some of the richer States. It seems to me undesirable, therefore, merely to allocate unconditional funds according to the statistical richness or poorness of a State rather than according to the individual needs of the persons involved.

Representative Griffiths. I agree.

Mr. Nathan, would you like to comment?

Mr. Nathan. Yes. I just cannot accept this distinction between statistically rich or poor States, and wealth that you can see because you know there are rich people. The fact remains that per capita personal income in Texas is $2,200 and per capita personal income in Michigan is nearly $2,800, which undoubtedly means that more people have low incomes in Texas than in Michigan.

The wealthier States have a broader, more productive, and potentially more productive tax base than do the poorer States by definition.

Now, I would also comment on where revenue sharing fits into this picture by saying that it does not preclude the continuation of existing categorical aids, nor does it preclude the fact that Congress undoubtedly will put resources into model cities or something like model cities or aid to education or family allowances or all the things that are now being talked about. But I do not think that we can count on the real effectiveness of State and local implementation of these programs unless we also look to the need to strengthen and to give meaning and importance to the role of State and local governments.

Over the past three decades, it seems to me that power has flowed with Federal aids to Washington, and one function of the revenue-sharing program, in fact I think the major function of it, is to give emphasis to the importance of State and local government that has the vitality and the ability to do the things that Congress wants done with categorical programs. If the options of Governors and mayors are reduced, and we continue to substantially reduce them by setting up categories and calling for matching funds, we lose a great deal in terms of the participation and the interest of voters in decisionmaking and the overall record of State and local governments. And, I think that revenue sharing belongs in this picture because, as Prof. Walter Heller said yesterday, it looks to the need to have sturdy vessels in which to pour Federal aid to achieve major purposes.

And I would also say that I do not think that Federal categorical aids have necessarily a perfect record. The delivery problems under categorical aids as we know them today are mounting. The Post Office is not the only agency in Washington with delivery problems, and I think that when you balance that out with the need to strengthen State and local governments, it is in this kind of a political context that revenue sharing should be supported as a necessary element of the post-Vietnam fiscal policy mix.

Representative Griffiths. Now, you began and said well, here are the poor States and here are the rich States. Here are people that can be taxed. One of the things that continues to bother me when you tell me how much money each person has in each State is, I think that you should go a little further. I think that you should subtract from the amount of money available to each person in that State the absolute minimum required to live there, because I do not agree with anybody that the cost of living is the same in any of these places.

Secondly, I think you ought to look, then, at the State or the city and you should say, here is the need. In this particular State there is no drastic need. In another, there is a drastic need.

For instance, I think in the burned city of Detroit today, applied to the richness of Michigan, the need is fantastic. And do not tell me that Detroit or Michigan alone can levy the tax that is going to take care of this. If you could assume—well, maybe Hawaii would be a good one to consider, and Alaska—but under any circumstances, if you assume two States, one of them where the cost of living was very low and it was easy to survive, it was new, it had no slums, no problems, and then take an old State where you have difficult winters and there is no lighting in a lot of the houses and you have a high need, then tell me how it is going to work. Maybe everybody in the old State, maybe a large part of them are rich and maybe a large part of them in the new State have a low income, but how are you going to apply this?

Mr. NATHAN. Well, that is just the point. The fact that there is so much diversity of need is an argument for giving State and local governments flexibility to put their resources into what are their primary needs. In some States it is education.

Representative GRIFFITHS. But State governments in my judgment, are not going to do this necessarily. You are going to have a State legislature working and it is going to be looking at the same problem I am looking at between Texas and Michigan. Each one of those State legislators is going to be attempting to take care of his district. We are applying uniformly in Michigan an education formula, but the benefits are not uniform. The need is not uniform, but we are giving them the money uniformly.

Mr. NATHAN. Well, that is——

Representative GRIFFITHS. That is the trouble with the whole thing.

Mr. NATHAN (continuing). A basic judgmental question is what kind of confidence you have in the ability of the State and local governments to make proper choices. I think there is considerable evidence, and the evidence is growing, that State and local governments make what, according to the way Congress sets its priorities, would be considered proper choices.

In the decade just completed, State and local governments devoted, I think, 42 percent of their additional resources to education. Another 20 percent of increased spending in the decade, 1955–65, went to health and welfare. The pressures at the State level are often greatest from the education associations. In the States that I have surveyed, the biggest pressures come from the State university and the education association, to increase minimum foundation State aid to schools and to raise the salaries and improve the facilities of State universities. The marginal dollar spent for education is even larger than this 42-percent figure that I used. And I would say that on your point about the apportionment of the moneys between urban and nonurban school districts, that this, too, is changing because of the reapportionment decisions of the Supreme Court.

I spent some time in Georgia, for example, which underwent a major revision in the way in which it allocates school aid. Formerly the cities, Atlanta and the two counties that Atlanta encompasses, received lower shares than the rest of the State. Now they receive much larger shares.

I think this is happening in many States and a reapportionment really puts us in a position today where revenue sharing is a good deal more palatable than it would have been without it. I would add that we are not just giving the money to the States and putting it on the stump and saying here it is, you take it. There obviously are going to be certain conditions such as Representative Reuss suggests, such as Senator Javits suggests, such as all the other bills that have been put in suggest, for pass-through, for civil rights, for equalization. It is not just unconditional aid that we are talking about, but the adoption of a new and broader instrument designed in part to provide flexibility and give emphasis to the role of State and local governments. I think that my view of it is not inconsistent with the facts as you see them.

Representative GRIFFITHS. Yes, one of the words, one of the other words for a proper judgment is a discriminatory judgment and, of course, this is what you are very apt to get, I must point out; and I would like to say while everybody has told me how great the States are doing on education and the great percentage that they have been spending on education, one of the ways to reduce that percentage is to increase the taxes in those States, increase the amount of money that is available.

Mr. NATHAN. Which they have been doing.

Representative GRIFFITHS. Well, some of them. After 18 or 19 years, Michigan finally fell into line, but they are not doing it that fast.

My time is up. I am sorry. I would like to give time to the rest of you.

Mr. Moorhead?

Mr. MOORHEAD. Thank you, Madam Chairman.

First, I want to say to Mr. Somers as a prospective decedent that I entirely agree with Maurice Chevalier who said that old age is not so bad when you consider the alternative.

Gentlemen, one of the things that is bothering me in this testimony is when we talk about revenue sharing we seem to be very loose about with whom we are sharing. Sometimes we are talking about sharing with local governments, sometimes with State governments, other times with poor people, other times with taxpayers. Now, when we say revenue sharing, with whom do you mean? Mr. Nathan, you seem to be talking mostly about State governments. Is that the way you see it?

Mr. NATHAN. The Heller-Pechman plan would allocate shares to the States and require that 50 percent of that share be passed through by the States to local governments. So, it is State-local revenue sharing. The important element in this is that it is the States under the Heller-Pechman plan, and under most of the plans, that determine what is a local government for purposes of getting this 50 percent that passes through. There are several other proposals that have been made, like the Tydings bill, which would share directly with the cities. This approach has possibilities, but also presents great difficulties of definition. That is what we are talking about.

Representative MOORHEAD. Mr. Fitch, I take it you have a slightly different feeling on this subject, is that correct?

Mr. FITCH. Well, on the definition, Mr. Moorhead, I guess I would understand by revenue sharing any arrangement by which the Federal Government uses Federal tax revenues to make a general bloc grant to States and/or localities.

Representative MOORHEAD. It is that and/or localities thing that bothers me. I would like to get into the record your attention to that.

Mr. FITCH. Well, definitionally, I suppose I cannot get you out of the semantic trap. It seems to me that it is the general grant which distinguishes revenue sharing from categorical grants. When it comes down to techniques, which I guess is probably what is the issue here, techniques of sharing Federal revenues with localities as opposed to the States, we get into all kinds of difficulties. I would agree that the administrative problems of general revenue sharing directly with localities are almost insuperable as things now stand. That is one reason why I go along with the CED when they advocate wholesale consolidation of local governments. In fact, they want to eliminate about four-fifths of existing local governments through consolidation.

If you add a general program of revenue sharing to the present grant system would you not be merely perpetuating the present situation, bucking up an archaic local government system? I am afraid you would.

So Mr. Moorhead, I see great problems in this general revenue sharing with the localities. I see fewer problems of an administrative nature in sharing with the States, but again I would prefer seeing some conditions attached to general grants. I already suggested Mr. Reuss' proposal—which he and I seem to have arrived at independently at about the same time—for attaching some conditions for gradual improvement of the administrative and planning measures of the States and localities.

Well, this may not get at your question. I hope it does.

Representative MOORHEAD. Thank you very much. I know the problem of the localities. We have in my home county, 128 separate municipalities or governments and it is a terrible patchwork.

Mr. FITCH. I might say, however, that it seems to me that the localities would get many of the benefits of direct grants if the Federal Government assumed some of the burdens which local governments now bear, specifically in the welfare and social service field, I go back to New York City. In New York City we have rapidly mounting welfare burdens, they have more than doubled in the last 10 years. The immigration tide continues, and more and more people learn about welfare and come to apply for benefits. Well, no taxpayer is going to move into New York City because it offers such a fine welfare program. In fact, they move the opposite way. And yet, the welfare and social service program is necessary. I would argue that it is necessary to increase it substantially.

At the present time, New York City has one of the most generous welfare plans but it offers nothing for cultural expenditures, nothing for books or newspapers or periodicals. It does not even allow a dime a week for an ice cream cone for the kids. That is how low it is. And people who live on it, I would argue, are living in deprivation and degradation, and I cannot accept continuance of deprivation and degradation as standard. Again, we have a million people living in 40,000 old-law tenements which were outlawed in 1905. That is how far we are behind. And, I do not think the cost of replacing or removal of this kind of situation is the kind of thing you can expect the city government and city revenue machinery to bear, because it only served to chase taxpayers out of town. It is the kind of thing the Federal Government, I would argue, should be taking over. I think it provides a sort of automatic solution to the kind of problems which are troubling Mrs. Griffiths, to get money down to the points where it is needed.

Representative MOORHEAD. My time is running short, I suspect. I would like to get on to this tax credit idea so I can be sure I understand it. As I understand Mr. Somers, he would propose a 100-percent tax credit for all State and local taxes.

Mr. SOMERS. No, sir. All taxes would be eligible but we would not give them a full 100-percent credit. That would cost too much. My point is all taxes should be eligible, not merely income taxes, but the percentage credit would depend on how much you could afford.

Representative MOORHEAD. I see. Then Mr. Break suggested, as I understand it, a fractional tax credit. I am trying to put both of your ideas together.

Mr. BREAK. I think they are the same. I meant that 40 percent of the specified State and local taxes would be creditable against a Federal income tax liability. Forty percent is just a figure I use for illustration purposes and I think that is——

Representative MOORHEAD. Is that the same thing?

Mr. SOMERS. Yes. It would have to be some percentage less than 100 percent because the cost would be just too great. State and local taxes are $45 to $50 billion a year and I do not think that the fiscal dividend is going to be that big in the near future.

Representative MOORHEAD. But the important thing that you are stressing, as I understand it, is that you do not just say, just State taxes or just local taxes or just an income tax, but across the board.

Mr. SOMERS. All State and local taxes, and especially including property taxes, because I believe that is important to help the cities. If I may extend my remarks for a moment, sir, I do not believe reapportionment is going to do the trick because reapportionment, although it has improved the voting strength oi metropolitan areas, has not helped and will not help the core cities, and that is the crucial problem of poverty at the present time. With respect to your question about the definition of "revenue sharing," over the past few years, of course, the term has changed and practically every day we get a new meaning attached to it. Originally, we were to have unconditional grants and then as people raise criticisms, a new gimmick is added to the revenue-sharing proposal and you have a condition attached. And I suspect that if we keep this up for a year or two, we will find that what were originally unconditional grants will have so many conditions attached that they will be more categorical than the categorical grants.

Going back to the question of helping States or helping individuals, I think our current problems are largely a result of the fact that we have not treated individuals as individuals. We have not treated them on the basis of their own problems.

Handing money to a State or even a local government in a lump sum, however much it reflects profound faith in the wisdom of the officials involved to spend the money properly, nevertheless does not give us assurance that the problems that arise because individual members of society have not shared adequately in its benefits will be solved. I think that the revenue-sharing plan would work only if all the poor moved into one State. That might be the only solution.

Representative MOORHEAD. Thank you, Madam Chairman.

Representative GRIFFITHS. Thank you, Mr. Moorhead.

Mr. Reuss?

Representative REUSS. Thank you, Madam Chairman. I welcome your kind remarks, Mr. Fitch, and it is indeed true that you and I were working in our respective spheres and came up with something like the same idea embodied in my bill—in order to become eligible for a bloc grant, a State has to prepare a modern government's program for a 3- to 5-year period which would in general set forth as its goals the kind of reforms suggested by the CED's two studies: "Modernizing Local Government" and "Modernizing State Government," and after these programs had been worked over by regional conferences of Governors and approved by them and worked over and approved by the Advisory Commission on Intergovernmental Relations, the approved States then would be eligible for funding for a 3-year period, without any strings. In other words, if the State reneged on its fine promises, it could get away with it but, of course, this would be taken into account if the program were sought to be r enewed.

In describing my bill, you suggest that it sets forth one technique which, although it might be improved upon, at least indicates that the problem is not insuperable, to quote your language. I would welcome hearing from you any proposals for improving the concept that you may have.

Mr. FITCH. I do not have any specific proposals right now, Mr. Reuss, and indeed the intention of my comments was to suggest that with more people interested in the subject, further discussion might turn up some techniques which would be an improvement. But, I certainly want to congratulate you on having gone as far as you have in working out an administrative technique which is the best thing that has come down the road to date.

Mr. REUSS. I appreciate it.

I would like to ask Mr. Nathan to address himself to the across-the-board tax credit proposal advanced by Mr. Somers and, I gather by Mr. Break, though I did not have the opportunity to hear Mr. Break. My own difficulty with an across-the-board tax credit proposal is that it seems to me to introduce more regressivity into the tax structure. That is, we would be cutting down on the amount of the Federal progressive income tax and probably increasing on the amount of State-local regressive sales and property taxes. It is one thing to adopt for the CED's type of income tax credit which would have the effect of inducing States to adopt an income tax if they do not already have it, but when you apply it across the board, I see this difficulty with regressivity and, heave nknows, if we build more regressivism into our tax structure, we are going to fulfill the gloomy prophecies of all the dismal economic philosophers who have talked about oversaving.

Perhaps you could comment on this, Mr. Nathan, and then Mr. Somers and Mr. Break would care to come back to this.

Mr. NATHAN. I think I would rather leave it to Mr. Somers to say whether he agrees on the point about regressivity. You simply would not be doing what the CED does in pressing the States to adopt State income taxes.

I would make a general comment about Mr. Somers' ideas on the tax credit. One is, I fail to see how it would be possible to provide instant tax credits as he suggests. I would like him to explain that to me. Does that mean that the taxpayer at the beginning of the year would figure out how much he is going to pay in State and local taxes—property, sales, and income—and then file for a payment every month? If it does, I myself would be against it. I have enough trouble filing once a year.

Another point I would make is, I do not think that when you get down to where Mr. Somers is that it makes much difference whether you have tax sharing or a tax credit. Your scheme is simply a scheme for redistributing Federal money to richer States more than poorer States, whereas the per capita revenue sharing plan with equalization would give a little better shake, considerably better, I think, to the lower income States.

So, whereas I like the CED credit less than revenue sharing, I like your credit less than the CED credit for these and other reasons.

Mr. REUSS. All right. Either Mr. Somers or Mr. Break.

Mr. BREAK. Perhaps I should say it was not my intention to support an across-the-board fractional tax credit. My own personal preference, which is based on your question about regressivity, would be to give it for, say, personal income-tax in the State, plus a general sales tax, and the kinds of general sales tax I most like are those now levied in Indiana and Colorado and Hawaii, where they allow a credit for the sales tax burdens to low-income families against the State income tax which converts, I think, the regressive rate structure of the general sales tax into a proportional or even progressive structure over a wide range of family income.

I am not as optimistic as Professor Somers is about a credit for property tax giving aid to people living in the core cities. I wonder how many of those people live in rented houses, in apartments; and where you are giving the credit to the landlords, are the rents really going to go down when you do that? He comes from the city of angels, I know, but I am not so sure there are angels all over the country to the same extent.

So, I did not—I would not support an across-the-board fractional tax credit, but restricted to, say, income and sales taxes.

Representative REUSS. Before I leave you, would you give a tax credit for sales taxes generally or only for those beneficient deductions from the income tax sales taxes as obtain in Hawaii and Indiana?

Mr. BREAK. And Colorado. I would personally, if I were doing it. I think I would try to induce the States to go over to that credit sales tax plan. I like it very much.

Representative REUSS. So, you would not give a general sales tax credit?

Mr. BREAK. Well, I would prefer—my first choice would be to restrict it to the credit sales tax plan. I might compromise on second best if this—well, you would have to consider what kind of support you would get for the proposal.

Representative REUSS. Mr. Somers, would you now address yourself to my groping criticism which is that your proposal would perpetuate the most regressive type of tax, the general property tax, which happens also to be the tax which, falling on the small homeowner to a large extent, makes local progress the most delayed, because the homeowner does not like to be taxed for his neighbor's welfare very much.

Mr. SOMERS. Sir, you mentioned that this plan would perpetuate the property tax with all its defects, but I am not aware of the fact that any of the other proposals would eliminate the property tax. We have to accept the fact that the property tax which raised over $22 billion in 1965 will persist, and we must try to do the best we can with it.

Now, if it is regressive, it is very easy to use the tax credit plan to reduce the regressivity. The tax credit could be set up in such a way that you would give the greatest relative credit to the small taxpayer. What you can do through the tax credit plan is to reverse the regressivity of State-local taxes to the extent that such regressivity exists rather than ignoring it and wishing it away.

I believe that through the tax credit plan we can solve one of the problems that we have not yet been able to solve, the regressivity of certain State-local taxes, whereas by avoiding these taxes in the revenue-sharing scheme, all we are doing is perpetuating the defects of the State-local tax structure.

Regarding the question whether we will help the core cities, I had no intentión of letting the "slumlords" get any benefit. My idea is this: If, through a tax credit, you reduce the burden of property taxation, the core city can fill the gap by raising its taxes sufficiently. Whether we like it or not, the core cities are primarily dependent on property taxes, and if we allow the Federal Government to pick up some of the property tax burden—some of it is now picked up through the deduction process but as I indicated, I think the tax credit plan is a better way of doing it—then the core cities can impose an adequate property tax to take care of their needs; and through the differential tax credit we can avoid or reduce the regressivity of the property tax.

And another thing that can be done is to provide some encouragement to uniformity of taxes. For instance, at the present time we have the very serious problem of multiple taxation of interstate corporations, with which Congress has been very much concerned. One of the problems is, of course, that each State has its own ideas as to what we might regard as a trivial matter, such as the allocation formula, but which in fact has a very serious impact on corporations. Well, it would be possible to make the tax credits conditional on the adherence to certain uniformity provisions. That would be one way in which tax credits could be used to achieve the modernization which is so important a part of your plan.

To say that the tax credit plan relies on the Federal income tax in contrast to the revenue sharing plan is just incomprehensible to me because revenue sharing is based on a certain percentage of the Federal income tax.

The real difference between my proposal and that of the CED is that the CED proposal is consciously attempting to force the remaining States to impose an income tax. My suggestion is that there is no need to impose our views as to the particular type of tax. Some States have decided to rely on other taxes.

So from the point of view of helping particular people in those States, there is no need for us to impose a State income tax. But the reliance on the Federal income tax is the same, because all these plans rely on the Federal income tax, however we may work out the formula.

With respect to instant aspects of the tax credit on the income tax portion, at the present time if you do not have State income tax withholding—or to the extent that your tax liability exceeds the income tax withholding that has been achieved during the year—you pay your State tax on April 15, when you make out your Federal tax, and only a year later do you get credit for or take as a deduction the State income tax paid. This is because when you make out your Federal tax on April 15 you are making it out for the preceding year, but at the same time you are making out a State income tax and you have to pay right away. My idea would be that you could take credit immediately, and in that sense you would get instant credit.

With respect to other taxes, there would be various possibilities. One would be an estimating procedure, which my colleague abhors, but I think he would not abhor it so much if he got some money back. Another would be some provision whereby the taxpayer pays the money to the State or local government and then a credit arrangement is made for the taxpayer to receive a refund if it exceeds the amount that he owes the Federal Government.

Now, with respect to the sales tax, actually what I have in mind is something that is not pertinent to today's discussions to any great extent. I believe that sooner or later, the Federal Government will look with favor on a Federal retail sales tax. My thought there is a blanket Federal retail sales tax which would work something like the unemployment insurance tax whereby nominally it is a Federal tax, but the State imposes most of it and the taxpayer does not have to pay twice. He gets immediate credit for the State portion. That would be one way in which the sales tax could be credited instantly. But in the absence of such a Federal blanket—and I realize that it is not imminent—an estimating procedure would be used.

The main thing is that when people either have rising incomes and therefore pay rising State income taxes, or rising expenditures, they have a liquidity problem. They have to lay out the tax money, so to speak, until they get it back. My thought is that every effort should be made to remove the liquidity problem from the taxpayer and let it rest in the hands of the Federal Government, which has a somewhat better credit standing generally.

Mr. Reuss. Thank you. My time has ended.

Mrs. Griffiths. Thank you very much.

I might say that when the Federal Government actually levies a sales tax, we will call it by a gentler name, excise tax.

I would like to ask you, on the central city part of the problem of aiding State and local governments, is it efficient to pour money into rebuilding central cities, or is it well to recognize that deterioration in the central city is simply a system of forces that render the central city nonviable? Maybe we should rework the system and encourage further decentralization in order to increase efficiency. Are they really worth saving?

Mr. Break. I would say "Yes." I think there is a good deal to be said for letting them save themselves. In this talk of the need for regional government, for instance, in metropolitan areas, I think there is a need for a regional approach to many of the problems of the areas where the solution has to come generally over all of the governments. But I think there is also a lot to be said for letting the cities, the local governments, handle their own affairs in the way they want to, and I think the fear of the Negroes in the core cities that the suburbanites will outvote them if there is a regional government and put in programs for their benefit rather than the Negroes' is very real and pertinent, and something that you need a system of federalism in metropolitan areas to take care of. You may have a regional government, but you also give it limited powers and leave solution to localized problems to the local areas. You may even need to localize more than the core city itself. Maybe some parts of the city should decide how they want their police force to behave and what kind of police force they want, and schools, housing, and so on.

I feel that they are worth saving, and I hope we can do it that way.

Mrs. GRIFFITHS. In the city of Detroit they leveled about 3 square miles, I believe, at one point. They did not sell it and they did not rebuild for 2 or 3 years. As far as I know, every small business around that 3 square miles went broke.

I had a letter from some man in Chicago who pointed out that when it had begun, he had a net worth of $250,000. Five years later he was living on social security. He had nothing, absolutely nothing. So that this, you are further destroying the tax base. You do not just destroy the tax base right there briefly, but you destroy the tax base all around it for a while.

Now, I might say that there is only one good view in the city of Detroit, and that is the river and Windsor. Yet it is very hard to rent high-rise apartments. One beautiful high-rise apartment, long balconies, is not renting at all. They are having a very difficult time renting it because it is too easy for people in Detroit to move out.

So the expressways out of town, and we have lots of them, also increase the problem of modernizing the city, do they not? Maybe you ought to decide on what you are going to do—have expressways or rebuild, or just exactly what are you going to do? Why not just let them go?

Mr. FITCH. May I comment?

First, with respect to the general question: Are the central cities worth saving—I would argue that in large part, this is going to be resolved by the market itself— whether the businessmen and tenants think the central city is worth living in. I think, the other part is the question of what are the alternatives.

Suppose you did not save the central cities? You would have a bunch of urban slag heaps, so to speak, representing the decaying civilization; I do not think this is an acceptable prospect for an increasingly affluent society.

I would argue, too, that the problems you see, Madam Chairman, reflect so far our fumbling approaches to urban renewal. I can think of a lot of high priority things to do in New York City. When I go up into the slum areas and see that the kids have no recreational facilities, I can think that it might be better to build recreation facilities for the people in that part of town, than to build expressways to get people out of town for weekend recreation. When I see the tremendous housing needs, I can think that it would be well to devote a good deal of money to putting up decent housing. I do not think this is impossible. I would suggest that the cost is trivial over the next 30 years compared with the total amount of resources which will be available.

You could have a very high standard of housing for about $2 trillion out of the $50 trillion which we may look forward to having.

So the costs which worry us when you analyze them are costs of urban infrastructure, public facilities, housing. When you look into what it would actually cost with respect to our potential resources, research, turns out to be relatively small. I think if we could work out some kind of program and plans which did not have to be achieved overnight, we could have tremendous improvement.

A lot of people flee to the suburbs because there are no schools in the city to which they want to send their children. But there are other problems. In an inquiry which the Regional Planning Association of New York made of suburbanites in the New York region, they asked the suburbanites what things would keep them from moving into the central city. One of the chief ones, interestingly enough, was sheer dirt, for people in the New York region. Dirt ranked above the problems of schools. Another was physical safety, which also ranked above schools. So perhaps the answer to your question is yes, central cities are worth saving because there are no alternatives. But we have put our money on the wrong horses so far..

Mrs. GRIFFITHS. As a matter of fact, if you are going to put additional parks in cities, additional recreational areas, one of your second big problems is to police them, is it not?

Mr. FITCH. I would say the problem is the whole supporting structure—not only the policeman, but the recreation director and the activities programs and so forth. You cannot turn mobs of kids loose in parks or other recreation facilities with no guidance or organization.

But let me suggest the absence of recreation facilities creates so many of the problems. For example, the youth gangs of New York City fight over their "turf." What does this mean? It means that turf is scarce.

Mrs. GRIFFITHS. Finally, might I say on this problem of dirt, while I agree that the cities are dirty, and surprisingly, right around the Capitol in Washington it is exceedingly dirty, you could dust three times a day and at 6 o'clock it is still dirty. But I would like to say that the way suburbia is being built up, it is going to be dirty, too. The factories are moving with the people.

Mr. FITCH. Well, I would suggest that in part the dirt is an air pollution problem. It certainly is in New York. I think everything we now know about urban environment, both from the amenity and the health point of view, suggests that this is one problem we are going to have to clean up to make the city livable.

Second, I would suggest that a lot of foreign cities, Moscow, for example, where things are as neat as a pin, have solved this problem of dirt in cities. They have shown that it is not actually necessary to be as dirty as we are.

Mrs. GRIFFITHS. Well, would it not be cheaper to move the poor out into smaller communities?

Mr. FITCH. Well, I think as a long-run consideration, yes. I would suggest that both political and social considerations dictate that the poor are going to have to be upgraded to middle-class basis before they will either want to move en masse or they will be acceptable en masse.

Mrs. GRIFFITHS. Would it not be cheaper and more reasonable, anyhow, if the Federal Government just took over the expenditures of educating and the expenses of welfare, rather than to do anything else? Take care of this problem, remove this burden completely?

Mr. FITCH. Well, I would certainly go along with the Federal Government's assuming the cost of welfare and the special costs of education. I would point out one thing that bothers me. It is epitomized by the fact that in New York City we doubled the expenditure per child in the city school system in about 10 years. I do not think anybody would argue that we are really getting a much better product.

It is very easy to pour money in and see it go to the organized professional groups like the teachers, with no increase in output and no improvement in performance standards.

Mrs. GRIFFITHS. Less hours.

Mr. FITCH. Smaller classes, fewer hours, but higher salaries, perhaps. I do not think taking over the financial responsibility is adequate; there must also be incentives for higher standards and better performance.

Also, I think we need to restructure the educational system to enable it better to meet the needs of the changing new clientele. It is almost a cliche now to say, "the educational system was built for a middle-class environment and has never learned to deal with the low-income, low-culture kid." I think this is still true, if I may repeat the cliche.

Mrs. GRIFFITHS. I think one of the problems, and we are going to try to correct it this year in the social security bill, is that the whole thing has been built on a myth. The men who have made the laws have assumed that every child should be taken care of, and that the mother should take care of the child. Now, the fact that the mother is willing to let them starve, too, did not seem to make much difference. We were not going to starve them, but it is all right if she did. So we are going to change that this year. We are going to try to see to it that every mother has a chance to be trained and go to work, which I think would be of some help.

Would the rest of you like to comment on some of these things I have asked Mr. Fitch?

Mr. NATHAN. I would just like to make one comment. As I have sat here these last 3 days listening to the hearings, and as I have listened as we groped to answer your wide-ranging questions, the thing that troubles me is that, with the exception of this kind of hearing, the choice-making machinery that Congress has operates on a committee basis. Each committee knows a lot about the subjects that you are asking questions about. Yet no one committee is in a position, perhaps with the exception of this one, to do what the President is doing now with this interagency, Council of Economic Advisers-led effort to identify and give some priorities to the various options. I felt that this was the right exercise when I saw the way the hearing was set up. But now that we have done it, I have a feeling that we have not really done it. I just leave you with that point that is rather troubling me.

Maybe the answer is to set up something in this committee that looks in the same way with expertise in each of these areas and tries to make some assessment of relative priorities. But until you do that, what worries me is that when the money is available, it is just going to be a big fight over who heads what committee, who is senior, this hopefully rational putting together of priorities and figuring them out is not going to be done. I do not know if we have achieved very much.

I just leave that with you.

Mrs. GRIFFITHS. Thank you.

Mr. SOMERS. Mrs. Griffiths, as I understand your plan for the cities, the central city would no longer be a core, but would be more like the hole in the doughnut. I think that is a good idea if you carried the plan through all the way. The trouble is that it would be a very expensive proposal and would involve a great deal of planning and an almost infinite amount of cooperation on the part not only of officials but also of neighbors.

The probability is that it would not be carried through all the way. Then you would get these areas that are devastated but nothing happens in their place. I think it would be better to have a realistic appraisal of the probabilities of carrying a plan like that through all the way. If the decision should be that the probabilities are very small, I think our only hope is to try to restore the core cities.

Mrs. GRIFFITHS. Thank you.

I would like to ask you also if you would consider as an alternative to using the fiscal dividends as a way of reducing regressive Federal taxes, what about removing the social security tax, using the money to take away the social security tax?

Mr. NATHAN. I think that would be good, to put some general revenue money into the social security system or to try to find some subterfuge for doing that. I would be for that.

Mrs. GRIFFITHS. What would you say?

Mr. FITCH. I recently talked with Marion Folsom, a former Secretary of Health, Education, and Welfare, and a person who was principally concerned with formulating the social security plan back in the 1930's. I can say that in his opinion, at least, it would be a great mistake to take away the idea of social security as an insurance scheme, where people actually contribute in proportion to their earnings.

I respect Mr. Folsom's viewpoint very highly, because after all, he was a principal figure in getting the social security plan in operation in the first place. But I would think one of the biggest and most effective revenue improvements would be to remove the payroll tax, both to improve the incidence of the tax structure and to make it less costly to employ people.

Mrs. GRIFFITHS. Anybody else?

When I become chairman of the committee, I am going to remove it.

Mr. NATHAN. Do not go the whole way.

Mrs. GRIFFITHS. I am also considering removing the whole Internal Revenue Code and applying a small tax to the gross.

Mr. FITCH. On gross income?

Mrs. GRIFFITHS. Yes.

Mr. SOMERS. You will have an entire set of regulations defining gross income.

Mrs. GRIFFITHS. All the loopholes will be plugged.

Did you care to make a comment?

Mr. BREAK. With regard to the social security system, it now tries to accomplish two different purposes, I think. One is to give income assistance to the low-income groups; the other is to induce people to save for retirement and unexpected difficulties when they will need the money and cannot earn it. I have no objection to a contributory system of payments where the second is the goal, inducing people to save more than they would otherwise save for these contingencies.

I do object to a payroll levy as regressive when it is a tax, when you get nothing back for it. If we were to set up something in the future, a good, comprehensive income maintenance program for the low-income groups, I do not think you need that feature in the social security system any more. Then I would say take out that part of the payroll tax. I would like to see the contributory part left, where we say, we think you ought to save more than you otherwise would save for your old age; therefore, you get back something.

Mrs. GRIFFITHS. You are going to get back what you contributed, and it is not going to be weighed against you later. We are going to give women their share, too.

Mr. BREAK. Yes; I think that is desirable.

Mrs. GRIFFITHS. May I ask you, would each of you consider, if you had the right to do it, what type of package would you set up with the growth in income? Would you give tax reductions, would you take over the educational bills, the welfare bills, or just exactly what would you do? What would be the package that you would think best?

Mr. BREAK. I personally would prefer to put more money into welfare and education, health, housing. I think these are national needs now, and I think we need to have them supported by the Federal Government at a much higher level than they are now. I agree with Mr. Fitch that putting more money into them is not a sufficient condition for improving the services.

We have to work very hard, I think, at improving the output and using cost effectiveness analyses and other techniques to make sure that when we put more money in, we get more high-quality services out; that we have clearly specified goals, and we try to achieve them in the best and least costly way. I would try to devote the fiscal dividend to these areas, which I think are critical.

Mr. FITCH. May I support Mr. Break, but add some things which I think are also critical? They are in the general area of improving the urban environment. I would certainly opt at the beginning for much larger, more effective measures on cleaning up the air pollution control problem, the water pollution control problem, improving urban transportation systems, and finally, making better uses of open land in urban areas. I think some of the recent studies on the impact on urban ecology generally of unwise destruction of open land and its impact on the thermal and hydrological controls, as well as the implications for recreation, deserve much more attention than they have gotten to date. So I would list these four things: Air pollution, water pollution, the ecology of open space, and finally transportation, as high priority objectives.

Mr. NATHAN. I take a very different approach from Mr. Fitch. I am for simplicity in the system. I think we would come out at the same place, but do it differently. I would put half of that fiscal dividend into a model cities program that was designed to help all cities across the board, according to need, not just according to their planning competence, and I would give them the flexibility to do what they need to do. Some cities are dirty, some cities are clean; some cities have school problems, some cities have welfare problems. I think we have to set up new instruments in this area. I am not against putting it in the cities, but I just do not want to put it in the way we have in the past. We just have to devise new instruments, encouraging flexibility, and also encouraging private industry to get in and take a part of this action. That is 50 percent.

You have given me a chance to talk about the whole. I would put 25 percent into family allowances. I do not like the negative income tax too much. I think that our welfare system is really a tragedy; that is, that we have let it go as far as it has, particularly AFDC. I think we need a family allowance plan, and I would put 25 percent into that area.

Then I would put the other 25 percent into revenue sharing. I would put it all in the public sector. The reason that I would put 25 percent into revenue sharing is that I think it is essential, too. Unless we build stronger vessels of State government and local government, our goals at home are not going to be achieved. I think the wave of the future is going to be sort of pragmatic decentralism. That is the way we are going to be able really to deal with the problems we are so frustrated about at this table.

Mr. SOMERS. I think that for the foreseeable future, poverty will be a sufficient goal for the use of any fiscal dividend. I think a concentration on that group of problems would be the most desirable, and that, of course, means housing, education in the broader sense, also special training, and jobs. I think that the crucial problems arise in the area of poverty, and a sufficient devotion of the fiscal dividend to that end would be the most useful way of utilizing the extra monep.

Mrs. GRIFFITH. I want to thank all of you.

I would like to point out that this subcommittee is preparing a compendium of the negative income tax and other alternative methods of providing a guaranteed annual income. Later we will have hearings on this problem.

I would like to say in response to your statements that I agree that problems of getting the information around, even within Congress, on what to do about anything is really a tremendous problem. When I first came to this Congress, I sat in on hearings on civil defense that Chet Holifield was running. Every weekend when I went home, I explained to my husband how horrible everything was going to be if we were hit by a bomb. Every time I made a speech I talked about it. Finally, he said to me, "You know, people do not care to hear that. It is all in Dick Tracy, anyhow, so you ought to quit talking about it. Nobody wants to know that they are going to live down in the earth, and other such things."

So, in fact, a good many years afterward someone made a speech one afternoon and Congress was horrified to realize that this is what the bomb would do. Here were Members sitting here who really did not understand what would happen if such an attack took place.

Now, I think this happens, also, on all the rest of it. The Ways and Means Committee has spent many months struggling with the social security bill. It seems out of all proportion until you realize that we are taxing away in this bill, we are taxing away from the American people at an annual rate now of some $24 billion. But in addition to that, we are expending not only that money but another $6 billion on welfare, in one bill. We really have not had time to consider the $79 billion that is being spent on Vietnam. So that it is hard to get information around.

But I think then, when you look at the problems of this revenue sharing and consider the method by which we arrive at political decisions, and then put it back into a State legislature and consider the methods by which they arrive at political decisions, you can conceive better the enormity of the problem.

I sat in the State legislature. One of the things that always entertained me the most was that the bill that received the most consideration in the Legislature of the State of Michigan, the one on which every plant manager, every union leader, the school board members, and so on, were called on to give their opinion, was not the tax bill but annually, everybody was called up on the opening of hunting season—which day did they think hunting season should open and what should be the bag limit.

I always thought it was very funny. Then I discovered that this is one of the real mysteries of State legislatures, their preoccupation with animals.

So I understand that one of the New England State legislatures debated 2 hours on what the bounty should be on wolves and then found out that there were not any wolves in the State.

So I think it is not the economic problem that is a great problem, although I admit it is a very inexact science. But I think the real problem is how to make the political decisions and whether or not you feel that it has helped—I think it has helped—that you have all been kind enough to come here and discuss these matters and to discuss the priorities on the money needs and on the needs that we have in this country. I would like to thank you.

We will include any additional statements received for the record in the appendix to today's hearings.

The hearing is adjourned.

(Thereupon, at 11:50 a.m. the hearing was adjourned.)

82-906 O—67——13

APPENDIX

NATIONAL FEDERATION OF INDEPENDENT BUSINESS,
San Mateo, Calif., August 9, 1967.

Hon. MARTHA GRIFFITHS,
Chairman, Subcommittee on Fiscal Policy, Joint Economic Committee,
New Senate Office Building, Washington, D.C.

DEAR MADAM CHAIRMAN: Enclosed is a statement made in behalf of the more than 237,000 members of the National Federation of Independent Business in connection with your Subcommittee's hearings on Federal Tax Sharing. The statement supports the idea of Federal Tax revenues being shared with the States.

We will greatly appreciate having this statement included in the official report of hearings.

With best wishes,

Sincerely yours,

GEORGE S. BULLEN, *Legislative Director.*

STATEMENT OF GEORGE S. BULLEN, LEGISLATIVE DIRECTOR, NATIONAL FEDERATION OF INDEPENDENT BUSINESS

FEDERAL TAX SHARING

The National Federation of Independent Business appreciates the opportunity to submit this statement in support of Federal revenue sharing.

The National Federation of Independent Business is a nationwide organization composed of more than 237,000 independents in all phases of commercial enterprise and the professions throughout the fifty States.

Our membership is a representative cross section of the nation's entire business community at the retail, wholesale, manufacturing, service and professional occupational levels. Our policies are determined by a direct poll of the members, the majority vote on each issue being the deciding factor. Therefore, this majority position of our large membership distributed through all the States, and very representative by type or trade of all the nation's 4.7 million small businesses, should carry considerable weight inasmuch as it no doubt fairly accurately reflects the opinion of all independents.

While we have not polled our members on all of the bills introduced on this subject, I would like to point out that we did poll our members on S. 482, introduced by Senator Javits. The results of this poll showed that 60% of our members were in favor, 33% were opposed, and 7% expressed no opinion. For your information, we would like to present the poll as it went to our members.

Following are brief arguments "FOR" and "AGAINST" which our members were asked to read before voting:

S. 482. A bill to require that Federal tax revenues be shared with the States. (Sen. Jacob K. Javits, New York.)

[This plan calls for the Federal Government to turn back to the States 1% of total income subject to tax the first year, 1½% the second year, and 2% annually thereafter.]

Argument for S. 482: Proponents of this bill say it would give the states and local governments the means to develop their own programs to cope with today's problems, and at the same time reduce the trend to Washington-controlled programs. The states certainly need this financial assistance without Federal intervention. Between 2 and 3 billion dollars would be available for the states, generally to use as they see fit. The plan calls for 85% of the money to be distributed on the basis of population and the rest on the basis of lower per-capita incomes in certain states.

Argument against S. 482: Opponents of this bill state that the loss of Federal revenue that goes hand in hand with this idea would increase the deficit. Heavy spending for the war and domestic welfare programs must be decreased before any such sharing move can be made. Also many cities are opposed because they are now getting many direct grants from the Federal Government without state intervention or supervision. Others say that poor states shouldn't get more money until they improve their own tax systems, and eliminate overlapping jurisdictions.

Indications are that the nation's small business community is in favor of having the Federal Government return a portion of tax collections to the States. Based on previous votes on this matter, independent business proprietors have voted heavily in favor of rebates of Federal tax collections to State school systems, with no strings attached.

On the basis of four separate nationwide votes conducted by the Federation on the issue of States receiving rebates of Federal tax collections it is obvious that the independent businessmen favor the principle, particularly if the rebates can be left free and clear from excessive controls by the Federal Government.

THE STATE OF WISCONSIN,
EXECUTIVE OFFICE,
Madison, August 1, 1967.

Hon. MARTHA W. GRIFFITHS,
Chairman, Joint Economic Subcommittee on Fiscal Policy,
House Office Building, Washington, D.C.

DEAR CONGRESSWOMAN GRIFFITHS: I have recently learned that your subcommittee is holding hearings on revenue sharing. In February of this year, I expressed my views on revenue sharing in a statement to the Wisconsin Congressional Delegation.

I am enclosing a copy of this statement for the information of your subcommittee. I hope you find it helpful.

Sincerely,

WARREN P. KNOWLES, *Governor.*

AUGUST 22, 1967.

Hon. WARREN P. KNOWLES,
Governor of Wisconsin,
Madison, Wis.

MY DEAR GOVERNOR KNOWLES: I am indeed grateful to you for sending me for use of the Subcommittee on Fiscal Policy a copy of your statement supporting sharing federal revenues to the States as a long-run aim, which you presented before the Wisconsin Congressional Delegation.

We are including your statement in the printed record of our recent hearings on "Revenue Sharing and Its Alternatives." It will be of interest not only to the members of our subcommittee but also to the other members of Congress and the experts concerned with this question.

Sincerely,

MARTHA W. GRIFFITHS,
Chairman, Subcommittee on Fiscal Policy.

THE GOVERNOR'S POLICY STATEMENT ON FEDERAL LEGISLATION—A WISCONSIN POSITION TO THE WISCONSIN CONGRESSIONAL DELEGATION

This, my second formal statement to you on federal legislation, supports sharing federal revenues to the states as a long-run aim. It also supports conversion of some of the present conditional grants-in-aid to bloc grants as another way of obtaining unrestricted funds for state and local use.

My January letter on the disastrous effects in Wisconsin if the projected $25 million cut in highway funds is carried out showed an example of too much direction from Washington. There are other examples, smaller but just as flagrant.

Admittedly, expenses of the war in Viet Nam make it impossible to enact federal revenue sharing to take effect now. But there is no such bar to immediate consolidation of several related grant programs into broader, less rigidly controlled bloc grants. Possible fields to explore include Public Assistance, Water Pollution Control Aids, Education, Housing and Urban Affairs, and many more.

I. FEDERAL REVENUE SHARING

I support the return to states of a portion of federal revenue, unrestricted, to supplement existing grant-in-aid programs.

In normal times federal revenues are expected to increase by about $7 billion a year from growth in the national economy. At the same time, state and local costs of supporting education, welfare, and other vital services increase faster than the revenue available from state and local taxes.

Wisconsin has a distinguished history of creating needed aid programs, unemployment compensation, for example, and of administering them honestly and effectively. We have proven our ability to serve our people with prudence and compassion.

Opposition to federal revenue sharing comes from those who do not believe state governments will use the unrestricted money wisely. We know, on the contrary, that state government can be a dynamic partner in federalism when given a chance.

Support for tax sharing comes from those of us who believe that conditional grants-in-aid are burdened with unnecessarily detailed requirements, that they now overlap with undesirable duplication by both federal and state agencies in program offerings, and that the result is confusion to the public. The National Governor's Conference, meeting last December, supported the principle of tax sharing. Seventy percent of individuals questioned by a recent Gallup poll favor the plan.

Plans for more or less unrestricted revenue sharing are proposed by Professor Walter Heller, Joseph Pechman of the Brookings Institute, Senators Goldwater, Javits and Scott, Representatives Laird, Goodell, Reuss and others. Senator Nelson has suggested a broad-ranging study of the question. While the plans differ in detail, I believe the differences are not substantial. United support is important to get serious consideration of the general idea at this time. Representative Laird and Professor Heller have both minimized their differences and emphasized the need to unite on the principle. However, since there *are* specifics in several of the plans, I want to comment on some of them.

1. *Equalizing.*—We can agree it is in the national interest to provide extra shares to 10 or 12 of the poorest states. But such equalizing aid must go only to states that tax themselves at least at the level of the average state, not to those who make little tax effort.

2. *Tax Effort.*—A reward should be included for states like Wisconsin which are already taxing themselves at an above-average level. Wisconsin would, deservedly, benefit from this provision. In Goodell's plan, Wisconsin would benefit the most of any state.

3. *Share to Localities.*—Wisconsin, which has always shared generously from its own revenue with the localities, needs no Congressional requirement to share. But if a certain percentage of the returned federal revenues are to be earmarked for localities, the distribution and choice of level—town, municipality, county—should be left to the state.

II. WISCONSIN REVENUE SHARING

Federal revenue sharing is consistent with Wisconsin's tradition of unrestricted revenue sharing with its local governments. In the past fiscal year—

> Wisconsin returned $454 million, two-thirds of the total $684 million, of its state collected general tax revenues to local governments to help finance local programs.
>
> Most of the tax revenues returned to localities, $267 million, were unconditionally allocated, to be applied to local government functions in whatever fashion the local jurisdiction determined.
>
> Program aids totalling $187 million were broadly allocated for education, welfare or health purposes, and local jurisdictions were able to determine themselves the thrust of the aided programs.

Wisconsin's fiscal relationship with its local governments contrasts sharply with the federal government relationship with the states. Wisconsin unconditionally shares nearly 40% of its general tax revenues with its local governments—while the federal government shares none of its revenues with the states. Wisconsin's program aids are broadly granted, with great area for local decision-making—while federal aids are often burdened with cumbersome and restrictive requirements.

III. BLOC GRANTS

Besides federal revenue sharing, another way to avoid excessively detailed grants-in-aid while aiding state and local governments is through bloc grants. Bloc grants can be enacted in more fields. A good example is the comprehensive health planning act, (P.L. 89–749) which by 1968 will replace categorical health grants by a lump sum to be spent in health areas determined by the state. Bloc grants enable each state to apply its federal aids to its most compelling problems, which may well differ from those of neighboring states.

IV. ADMINISTRATIVE RESTRICTIONS

Too low standards for building construction, making for short-run economy and long run extravagance:

Delay in federal approval of state and local project applications;

Unnecessarily detailed requirements on grant applications and on financial accounting, taking too much staff time away from program.;

Withdrawal of expected funds, so that planned projects must be scrapped, or redrawn at added expense;

Emphasis on some functions at the expense of others equally needed in an individual state;

Failure to recognize or reward a state's own creative problem-solving devices.

These are some of the problems arising as conditional grants-in-aid multiply. Conversion of groups of specific grants to bloc grants would be a helpful step the 90th Congress could reasonably enact.

V. SUMMARY

Federal revenue sharing is critically needed to ease the crushing financial burdens of state and local services.

Any federal revenue sharing plan should recognize the efforts of each state, such as Wisconsin, which seeks to provide necessary services for its citizens.

Federal revenue sharing would build on the Wisconsin tradition of unconditionally sharing state tax revenues with its local governments.

Bloc federal grants, wiping away excessively detailed grant restrictions, should be enacted whether or not a federal revenue sharing plan is implemented.

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