The Problem of Redistribution of Federal and State Funds

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During the last 10 years "the crisis" in state and local finance has received an increasing amount of attention. Academic and political authorities point out that the expenditures of state and local governments are rising at an annual average rate of 13 percent while revenues have kept pace only through the widespread adoption of new taxes and higher rates on existing taxes. They also state that the Federal Government is a very efficient tax collector, that the existing federal tax structure has a mildly progressive impact and brings in increasing amounts of revenue each year, while the tax structure at the state and local level is substantially regressive and inelastic.

Most supporters of Federal action favor either block grants to the states and localities or Federal revenue sharing with the states with no strings attached. State governments, in turn, knowing the particular problems of their areas, would use the transferred funds for high priority needs. Advocates of such Federal programs believe they would strengthen the weakened position of state and local governments by providing funds for their most needed expenditures and, at the same time, partially displace regressive taxes.

Although we agree with most of these statements, we believe that the supporters of unconditional grants and/or revenue sharing are much too enthusiastic. We fear that most such programs as presently proposed would not solve the real crisis problems of state and local finance. The logic of our paper is presented in four separate steps.

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1) There is no *aggregate* state and local financial crisis in the United States. A majority of both state and local governments now have the fiscal capacity to meet their financial needs without drastically increasing the real burden of their taxes.

2) A minority of local governments do have serious financial problems. These problems are generally concentrated in central cities and in some low income suburban and rural areas. Moreover, despite large intergovernmental transfer payments, very little is now done by the states or the Federal Government to provide equalizing help for the communities that are under severe financial pressure.

Across the country, the amount of equalizing aid now distributed by states is generally ineffective in accomplishing its goals. In effect, the states do not appear to have the political will to solve the fiscal problems of their most hard-pressed local governments.

3) Thus, if each state were given complete authority to allocate shared Federal monies with its local governments, it is unlikely that state legislatures would transfer the money in a way which would substantially assist the governmental units in financial distress.

It also appears that many technical problems make it difficult for the Federal Government to allocate funds directly to needy units of local government.

As examples of what can happen when the Federal Government attempts to intervene, we find serious weaknesses in the present revenue sharing plans proposed by the Nixon Administration and the Advisory Commission on Intergovernmental Relations.

4) It is easy to be critical of the existing financial system and its many inequitable features. It is much more difficult to suggest workable solutions. We conclude, however, that a short-run solution would be to have the Federal Government provide several billion dollars of additional school aid under a distribution formula that would primarily benefit the schools which serve a low-income population across the country.

No Aggregate State and Local Financial Crisis

We have ample evidence that the financial burdens of most states and local governments have not been and will not become extremely onerous. The state and local tax effort of most of the poorest states in the nation either has increased very little or declined in recent years.

It might be expected, for example, that many of our lowest income states would find it increasingly difficult to raise the level of their government services because of their limited tax resources. However, the level of per capita income in the 13 poorest states in the United States rose by 76 percent between 1956-57 and 1967-68 while it was rising by 63 percent in the 13 wealthiest states.

At the same time these poorest states were able to maintain the relative level of their state-local expenditures even though their level of tax effort – state and local taxes as a percent of personal income – increased by only a median 6 percent as compared to a median 21 percent increase for the wealthiest states.

Thus, the more rapid income growth in the poorer states has permitted a convergence of state-local tax effort among the states. Relative tax effort declined in most of the lowest income states, although there are several notable exceptions, as Table I indicates.

The data for state and local governments in the aggregate also appear reassuring. In 1956-57 state and local government tax collections constituted 8.3 percent of personal income. By 1967-68 the share of state and local taxes had increased to 9.9 percent. This increase can largely be explained by the fact that citizens have supported continual expansion in the scope and quality of state and local government services.

Moreover, there was a 38 percent increase in real per capita income in the United States in this 11-year period. With such a phenomenal rise in real income most taxpayers could easily afford a higher level of government services.

Looking into the future, projections of state and local public finance in the aggregate suggest that the fiscal squeeze will not become significantly more pressing. The Tax Foundation's study of 1966, the Mushkin-Lupo study of 1967, and the CED study of 1968, all suggest that the gap in aggregate state and local financing is not nearly as great as many people have claimed.[1]

The fact is that the majority of local governments in the United States and many state governments as well face no serious financial

[1]Tax Foundation, Inc., *Fiscal Outlook for State and Local Government to 1975,* New York (December 1966), Selma J. Mushkin and Gabrielle C. Lupo, "Project '70: projecting the State-Local Sector," *Review of Economics and Statistics* (May 1967), and Lawrence R. Kegan and George P. Roniger, "The Outlook for State and Local Economic Finance, " *Fiscal Issues in the Future of Federalism,* Committee for Economic Development (May 1968).

obstacles. In fact, it is entirely possible that many affluent suburbs would be hard pressed to spend much more money without wasting resources. We conclude that the real crisis of state and local finance is the financial plight of only a minority of communities in the United States.

Importance of Intrastate Differences in Tax Burdens

Discussions of tax effort or tax burden differences usually involve interstate comparisons for which data are readily available. Less attention has been devoted to the study of variations within states. In the context of our present concern for identifying and channeling assistance to communities suffering the most severe financial strain, this latter question is crucial.

We have clear evidence that intrastate tax burden differentials can be very large, especially in states that rely heavily on local property taxes. An examination of the entire array of local tax rates in such states reveals that *intrastate* variations in total tax burdens – because of differences in the local property tax – may be so large as to overshadow comparisons of *interstate* differences in "average" total state-local tax bills. This result was demonstrated in a recent study by James W. Wightman of industrial tax burdens in the Northeast.[2] The Boston Fed's recent examination of school finance in the New England states[3] shows further evidence of wide intrastate differences in local tax burdens. In Maine, for example, the local school tax rate at the 90th percentile level is almost three times as great as the 10th percentile level of effort (see Table II). Such disparities in school district tax rates are largely the result of even greater differences in equalized valuation per pupil.

Statistical measures of these disparities in school finance are presented in Table II, along with correlation coefficients indicating – for the New England states – the strength of the direct relationship between school tax rates and the size of the local tax base. While school tax rate differentials are quite extreme, intrastate variation in

[2]James W. Wightman, *The Impact of State and Local Fiscal Policies on Redevelopment Areas in the Northeast,* Research Report No. 40, Federal Reserve Bank of Boston, March 1968. Analysis and discussion of the Wightman results appeared in a two-part article, "Tax Structure, Tax Competition, and Tax Burdens on Industry," in the *New England Business Review,* Federal Reserve Bank of Boston, January and February 1968.

[3]Steven J. Weiss, *Exsisting Disparities in School Finance and Proposals for Reform,* Research Report No.46, Federal Reserve Bank of Boston, 1970.

TABLE I

TAX EFFORT PERFORMANCE OF HIGHEST– AND LOWEST-INCOME STATES,* 1956–7 TO 1967–8

13 HIGHEST–INCOME STATES

	% CHANGE IN TAX EFFORT,** 1956–7 TO 1967–8	RANK AMONG THE 50 STATES IN TAX EFFORT** 1956–7	1967–8
Connecticut	17	43.5	44
New York	34	20.5	3
Alaska	204	50	48
Illinois	15	43.5	46
California	32	2	2
Nevada	21	22.5	13
New Jersey	29	47	37
Massachusetts	12	16.5	19.5
Delaware	77	49	30.5
Michigan	20	32.5	22.5
Maryland	32	42	27.5
Washington	18	26.5	19.5
Rhode Island	21	36	29

MEDIAN FOR GROUP: 21
U. S. MEDIAN: 17

13 LOWEST–INCOME STATES

	% CHANGE IN TAX EFFORT,** 1956–7 TO 1967–8	RANK AMONG THE 50 STATES IN TAX EFFORT** 1956–7	1967–8
Georgia	4	29.5	37
North Dakota	-3	1	7.5
Idaho	31	20	5
North Carolina	6	31	33.5
New Mexico	20	24.5	16.5
Kentucky	13	16.5	42
Louisiana	8	6	16.5
Tennessee	6	32.5	37
West Virginia	36	41	21
South Carolina	-2	26.5	43
Alabama	-7	10	37
Arkansas	2	29.5	37
Mississippi	-9	2	25

MEDIAN FOR GROUP 6

*Ranked by 1968 personal income per capita.
**Measured by total state and local taxes in proportion to personal income.

total property tax rates is even greater, as Charts 1 and 2 demonstrate for Massachusetts and New Hampshire.[4] Now the important question is – what types of communities face a financial crisis?

Identifying Key Problem Areas

Obviously the older central cities face severe financial problems. In his study of the ten largest U.S. cities, Feinberg found that assessed valuation in constant dollars actually declined in 7 out of the 10 over the decade 1950-60.[5] Faced with a property tax base that is rather stagnant at best, the typical older core city must nonetheless finance constantly rising levels of public services, including the central city services generally provided without compensation to residents of more affluent communities in the metropolitan ring. The situation in Boston provides a good example: an unusually small area at the heart of a large SMSA, the central city imposes an extremely high property tax rate, straining its tax base to finance a relatively high level of per capita government expenditures. The general picture that emerges from numerous studies of fiscal disparities within metropolitan areas is one of higher tax burdens in the core cities, relative to their suburbs, caused principally by burgeoning non-educational expenditures. A *widening* of central city-suburb differentials has been documented in several excellent case studies,[6] and in its review of data for the 37 largest SMSA's the ACIR concluded that, in the aggregate, metropolitan area fiscal disparities intensified between 1957 and 1965. Generalization is particularly hazardous in this area, but the ACIR extended the gloomy prospect by noting further that "time is definitely working against most central cities with respect to relative tax burdens."[7]

[4] In New England, where local non-property taxes are virtually non-existent, property tax rates are a reasonable index of local fiscal effort. In other states, inter-local comparisons would have to be adjusted for non-property taxes, and possibly charges and fees as well.

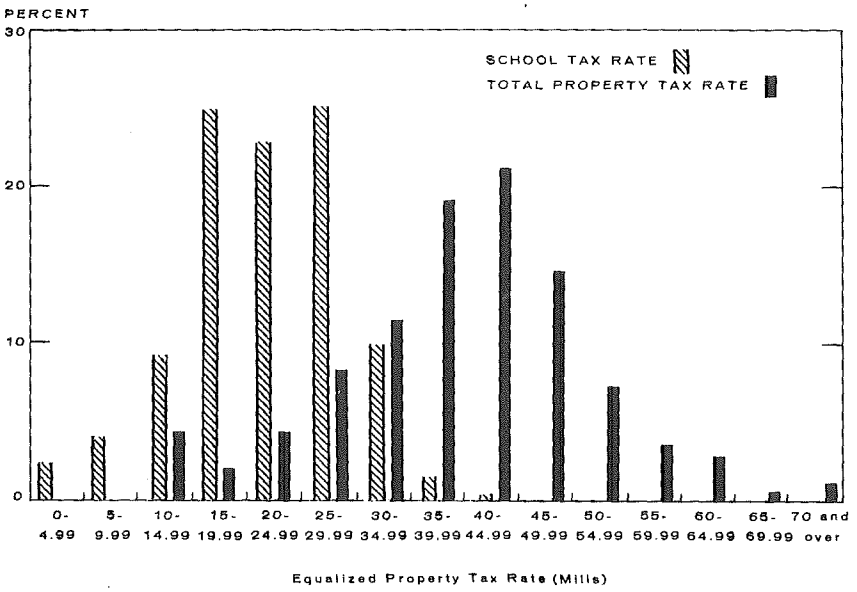
[5] Mordecai S. Feinberg, "The Implications of Core-City Decline for the Fiscal Structure of the Core-City," *National Tax Journal,* Sept. 1964, pp. 213-31.

[6] See, for example, case studies by John Riew and Morris Beck, respectively, of Milwaukee and Northern New Jersey SMSA's, in ACIR, *Fiscal Balance in the American Federal System,* Vol. 2 (Washington 1967).

[7] *Ibid.*, p. 87. Houston, where annexation is facilitated by state law, appears to be a notable exception; see study by Wendell Bedichek in *Ibid.*

Chart 1

PERCENT DISTRIBUTION OF MASSACHUSETTS CITIES AND TOWNS
BY EQUALIZED PROPERTY TAX RATES, 1969

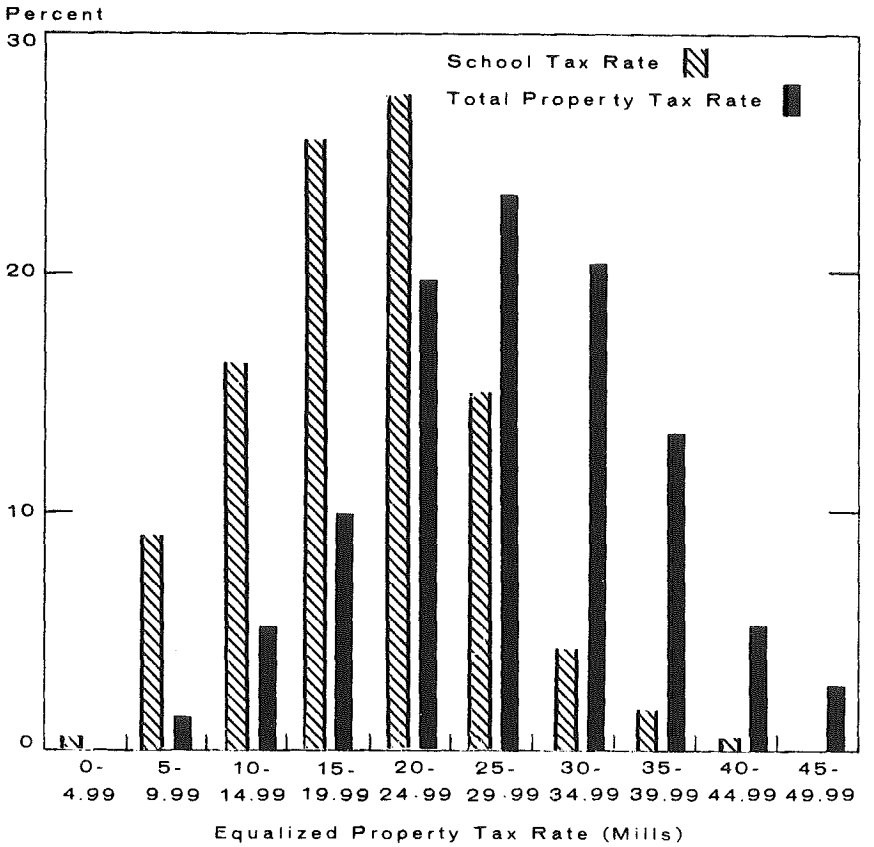


Metropolitan area studies of Buffalo, Chicago, Cleveland and Detroit have highlighted an emerging problem that had been relatively neglected in the earlier emphasis on city-suburb differentials, namely inter-suburban fiscal disparities that either presently or potentially overshadow the general core city-suburb contrasts. In particular, "the older suburban communities are taking on physical, social and economic characteristics similar to the central city's . . . Thus, the suburbs are neither uniformly affluent nor free of fiscal woes. In fact, disparities among suburban jurisdictions may be both greater in magnitude and intensifying as rapidly as the central city-outside central city differences."[8]

[8] *Ibid.*, p. 119. See case studies by Seymour Sacks (Buffalo), James M. Bonovetz, *et al* (Chicago), and Frederick Stocker (Cleveland) in *Ibid.*, and Karl D. Gregory, "Detroit: Crisis in the Central City," in CED, *Fiscal Issues . . .*, p. 39.

Chart 2

PERCENT DISTRIBUTION OF NEW HAMPSHIRE CITIES AND TOWNS BY EQUALIZED PROPERTY TAX RATES, 1967



Apart from the difficulties of some increasingly urbanized older suburbs, quite a different sort of fiscal pressure affects some low-income, rapidly growing suburban communities, where expansion of basic service facilities can cause tax rates to leap sharply to high levels despite concurrent growth in the property tax base. Beyond the metropolitan fringes in areas quite far removed from fiscal problems associated with either urbanization or rapid suburban growth, examples can be found of towns where local tax rates are exceptionally high because — for one reason or another — the tax base has deteriorated.

TABLE II

MEASURES OF EXISTING DISPARITIES IN PUBLIC SCHOOL FINANCE NEW ENGLAND STATES

	MAINE	MASS.	VERMONT	N.H.	R.I.	CONN.
SCHOOL TAX RATE (MILLS)						
10th Percentile Level	16.8	13.2	6.8	10.2	7.3	9.9
Median	28.9	22.4	12.3	18.8	11.8	14.0
90th Percentile Level	47.8	30.6	18.1	25.5	14.2	20.8
Coefficient of Variation	44	31	39	44	28	31
EQUALIZED VALUATION PER PUPIL: ($ THOUS.)						
10th Percentile Level	3.6	15.5	16.0	13.7	23.1	19.3
Median	7.8	22.3	25.9	22.6	28.9	29.5
90th Percentile Level	25.6	45.2	57.4	56.2	42.5	46.8
Coefficient of Variation	107	94	75	69	52	38
SIMPLE CORRELATION OF TAX RATE AND TAX BASE						
[Curvilinear form: (1/r, V/p)] *	.81	.82	.71	.88	.73	.75

Source: Steven J. Weiss, *op. cit.*, pp. 17, 21.

Note: The actual millage rates and valuation per pupil figures are not comparable *across states since valuation practices are not uniform.*

***Simple linear correlations yield coefficients ranging from -.56 (R.I.) to -.69 (N.H.)**

Our basic point is that high local tax burdens can crop up in individual communities under a variety of different economic circumstances. There is much talk of a *general* crisis in state-local finance, supported by figures such as the electorates' record rejection last year of over 56 percent of total school bond issues.[9] However, in the context of rising income levels, real hardship in local tax burdens is certainly less common than such figures might suggest. Many different sorts of reasons can cause local resistance to tax increases. Taxpayers' *un*willingness to pay often reflects political or sociological factors rather than a reaction to actually high economic burdens, as illustrated by the case of Fremont, Ohio, a town where local property taxes are among the lowest in the nation and the

[9]The 56 percent figure is by dollar volume; *Wall Street Journal*, June 3, 1970, p. 1.

schools were closed because voters failed to approve a levy to provide operating funds.[10]

Ineffectiveness of Present State Equalizing Aid

The intrastate disparities documented above persist and individual communities continue under extreme fiscal strain, despite distributions of state aid funds to the localities. Substantial amelioration of the present inequities *could* be achieved if state governments would take greater financial responsibility for expensive programs that are clearly of more than merely local concern (e.g., welfare, education), and generally augment state equalizing aid.

However, the record of state action to relieve fiscal disparities among local governments is a very dismal one. With very few exceptions, states have done very little to equalize tax burdens and public service levels. This is true despite the fact that state aid to local governments has grown substantially in the last two decades and now constitutes, in the aggregate, about one-third of local government general revenues.[11] If state aid money were properly channeled, the volume of funds presently budgeted in most states could go a long way toward relieving the most severe fiscal disparities at the local level. How such relief could be accomplished is no mystery to public finance experts, but help is needed from political scientists, and probably sociologists as well, before general progress can be made. The effectiveness of many a good equalization plan has been seriously weakened or totally destroyed by practical political constraints.

For example, funds are "wasted" (with respect to an equalization objective) when political support for a program requires that *every* jurisdiction – even the richest – gets a piece of the pie; similarly, any proposal that explicitly requires some redistribution of locally raised funds is usually foredoomed in the state legislature.

[10]This case was documented by CBS News; see Transcript, "The Day They Had to Close the Schools," CBS Reports, January 27, 1970.

[11]This includes federal aid channeled through the state capitols to local units; approximately one-fourth of local general revenues came from state aid from states' own sources. Actually, state aid has not increased very much faster than local governments' own revenues in the postwar years, but the absolute increase has been substantial. See ACIR, *State Aid To Local Government,* Washington, April 1969, pp. 3-4.

State School Aid

There is considerable state-to-state variation in the total impact, functional composition, and design of state programs of financial support for local governments. Generally the most important program category, however, is state support of public schools. For the United States as a whole, about 60 percent of all state aid goes to education, although for individual states this proportion varies from 20 percent (Massachusetts) to almost 100 percent (West Virginia and Texas).[12] State school aid merits special attention not only because it constitutes such a large proportion of total state aid, but also because it is widely considered to be a generally admirable example of equalization in practice. In fact, school aid is often the only aid program where the states make even any pretense of attempting to promote intrastate equalization. As the ACIR has noted, equalization programs ". . . are conspicuous by their absence in virtually all other fields in which States extend aid to local governments."[13] We are not very enthusiastic about "equalizing" school aid programs in practice, however.

Increasingly sophisticated methods of allocating school aid funds have been advocated through the years, in keeping with heightened awareness of existing problems and greater attention to equalization as a specific policy objective, but actual practice has seriously lagged behind theoretical advances.[14]

Most state school aid programs, in concept, imply the possibility of *negative* aid, *i.e.*, transfers of local funds *to the state* from at least the wealthiest school districts. Not surprisingly, however, since such explicit redistribution is usually politically unpalatable, programs as implemented are generally designed to eliminate that possibility either by adjusting parameters of the formula or by putting constraints on the outcomes.

Negative payments are actually effected in only one state (Utah),

[12]ACIR, *Fiscal Balance . . .*, Vol. 1, Table A-6, pp. 273-274.

[13]AICR, *State Aid to Local Government*, p. 7.

[14]For a brief discussion of the major types of state school aid programs, see Weiss, *op. cit.*, pp. 29-36; an excellent comprehensive treatment is available in John E. Coons, William H. Clune, III, and Stephen D. Sugarman, *Private Wealth and Public Education* (Cambridge; Harvard University Press, 1970), Chs. 1-5.

and then only to a minor extent.[15] Generally, whenever school aid formula results are constrained by ceilings or guaranteed minimum payments, etc., or when flat grants are included explicitly or implicitly in aid distributions, equalization effects are seriously diluted.

The Massachusetts basic program for support of current school expenditures provides a particularly discouraging example of how a conceptually excellent equalization program can be ruined in practice. The program is a variant of a "percentage equalization" plan, an allocation method enthusiastically recommended as a means of achieving strong equalizing effects while preserving local incentives.

The proponents of the plan demonstrated that, in "pure" form, their program would yield very significant equalizing effects, indicated by a correlation of −.97 between districts' projected aid per pupil and local ability to pay for schools (as measured by equalized valuation per pupil). They conceded that inclusion of several politically necessary constraints would reduce the correlation to −.47.[16] However, before the plan was implemented, additional "modifications" were tacked on, with very damaging results.

Data for 1967 indicate that the overall Massachusetts school aid program actually had a tendency to yield perverse results in practice — a positive relationship (although not a significant one) between local fiscal capacity and state aid per pupil.[17]

Among the New England states, Vermont appears presently to have the "best" school aid program. The state pays 35 percent of the state-local public school budget, and fully 93 percent of its school aid money is channeled through a basic program that is intended to be equalizing. Yet, partly because of under-funding, the actual results are not very impressive — the correlation between aid per pupil and local ability is just −.52 — and current expenditures per pupil range from $471 at the 10th percentile level to $689 at the 90th.[18]

[15]See the discussion in Coons, Clune and Sugarman, *op. cit.*, pp. 87-95 on "Utah: The Foundation Plan at its Inadequate Best."

[16]See Joel S. Weinberg, *State Aid to Education in Massachusetts* (New England School Development Council, 1962), p. 42

[17]For a discussion of the Massachusetts program see Weiss, *op. cit.*, pp. 36-42; also, Andre Daniere, *Cost Benefit Analysis of General Purpose State School-Aid Formulas in Massachusetts* (Massachusetts Advisory Council on Education, 1969).

[18]See Weiss, *op. cit.*, pp. 17, 37-8 and 41-3 for comments about Vermont school aid.

No Significant Equalization

The conclusion that school aid programs are not significantly equalizing is discouraging, especially so since they are widely regarded as paragons of equalizing virtue, at least relative to other state aid programs. Still more discouraging is the conclusion of several metropolitan area studies that state school aid formulas actually have the effect of exacerbating overall city-suburb disparities by supplying, on the average, relatively more assistance to suburban than to city districts.

These results are all the more perverse because educational needs per pupil are *greater* in large city school systems as a result of inner city concentrations of "culturally deprived" children. School aid formulas usually discriminate further against the cities because they neglect entirely or fail to compensate adequately for the cities' differential burdens of non-educational spending.[19] The moral of this rather protracted review of school aid in practice is clear: good intentions are not enough, and an aid program with an "equalization" label does *not* necessarily mean that significantly equalizing results are obtained in practice.

Only very rarely is intrastate equalization even contemplated in state aid allocations for non-school purposes. On the contrary, allocation methods may have perverse results, for example when certain shared taxes are returned according to geographic source of collection, or when aid funds are distributed according to property valuation. To date at least, the overall record of state aid appears to be one of equalization opportunity lost – or not even perceived.

In a study of the Cleveland SMSA, for example, Stocker noted that the three forms of state aid in Ohio "offer a potential vehicle for reducing interlocal disparities in expenditures or taxes. None appears, however, to have operated in such a way as to accomplish any significant equalization within the Cleveland metropolitan area or between the counties of the Cleveland SMSA and the balance of the state."[20]

[19]It should be possible to adjust school aid formulas to account for these factors, but as yet there is no general agreement about how best to do so. It might be asking too much of a mere school aid formula to make these fine adjustments. Compensating state assistance through non-school aid programs would seem to be a more sensible approach, but again the record is not encouraging.

[20]ACIR, *Fiscal Balance . . .*, *Vol. 2, p. 266.*

Similarly, a comprehensive study by Riew of the system of state transfers in Wisconsin concluded "that the state-to-local transfers as a whole greatly aggravate city-suburb disparities as well as overall disparities among suburban municipalities of Milwaukee."[21]

The present picture of state transfers to local governments contains much gloomy evidence of "discrepancies between the states' discretion and local needs."[22] We can only hope that the states will realign their overall aid programs to focus more aid where local needs are greatest. Methods for achieving this goal are available, of course, if states have the will to act.[23]

Unless state governments mend their ways, ". . . there would seem to be little to recommend a program of increased Federal aid distributed through the state government . . . . [U]rban areas . . . may benefit less under a state distribution of Federal money than under a direct Federal-local arrangements."[24]

If the financial problems of some individual units of local government are so serious, and if the states will not provide a substantial amount of equalizing aid, it would seem obvious that some type of Federal action is needed. We agree. We also believe,

[21]John Riew, "Metropolitan Disparities and Fiscal Federalism," in J. Crecine (ed.), *Financing the Metropolis,* Vol. 4., Urban Affairs Annual Reviews, (Beverly Hills, Calif., Sage Publications, Inc., 1970), p. 153, citing his study in *Ibid.* Earlier studies had suggested that Wisconsin's combination system of aid programs and shared taxes struck a "fortuitous balance," with aid programs differentially benefiting suburban areas and the distribution of shared taxes causing a corrective distortion by favoring the cities. See Alan H. Smith, "State Payment to Local Governments in Wisconsin," in Joint Economic Committee, *Revenue Sharing and Its Alternatives,* Vol. I. (Washington, July 1967), pp. 320-30; and Harold M. Groves, "Innovation in Tax Sharing: The Wisconsin Experience," in *Ibid* , pp. 331-39. Groves notes that the combined result yielded a reduction of the range of millage rates within Milwaukee County from 22-39 mills (which would have prevailed in the absence of state transfers) to 20-35 mills. This isn't much of a reduction, but the transfer system was, after all, the product of political compromise (p. 336).

[22]Riew, *op. cit.,* p. 153.

[23]See, for example, ACIR, *State Aid to Local Government,* especially pp. 100-103; and *The States and Urban Problems,* A Staff Study for the Committee on State-Urban Relations of the National Governors' Conference, October 1967, pp. 160-183. An encouraging example of state action is provided by New Jersey, where a general government assistance program was enacted in 1968, specifically designed to emphasize aid to 8 "priority cities" facing extraordinary fiscal problems.

[24]This is the conclusion of Roy W. Bahl in his study of fiscal disparities in the Louisville SMSA, in CED, *Fiscal Issues . . . ,* p. 118.

however, that the typical federal grant-in-aid program and most variations of federal revenue sharing provide poor solutions.

Present Federal Aid Distribution

As is well known, most Federal aid is distributed through conditional grants and is designed to stimulate specific types of expenditure. Only a minority of Federal grant programs do anything to alleviate the financial problems of impoverished units of local government, and even this minimal equalization is more the result of the choice of functions eligible for Federal assistance rather than a deliberate attempt to increase the revenues of financially troubled communities.

Moreover, the typical Federal grant requires matching funds, and, as a result, many of the poorest communities cannot or will not participate. The aggregate statistics for Federal grants-in-aid support these pessimistic conclusions.

Although the pattern of Federal aid distribution across states has become relatively more equalizing over the years, particularly in certain program areas,[25] when Federal aid per capita for 1968 is correlated with personal income per capita, the result is a *positive* correlation of .20. Unfortunately there is little data available regarding the intrastate distribution of Federal funds. We do have one piece of evidence, however, involving the distribution of Federal education aid among school districts in the New England states. The levels of Federal aid per pupil vary widely from state to state, but the figures show even greater variation within states, and, with one minor exception, there is no significant relationship between Federal aid per pupil and school district wealth as measured by equalized valuation per pupil.[26]

We believe that this result is indicative and that it is usually the case that the active, imaginative and wealthy states and communities are successful in capturing the largest shares of most Federal grants.

[25] I. M. Labovitz, "Federal Assistance to State & Local Governments," *Federal-State-Local Fiscal Relationships* (Princeton: Tax Institute of America, 1968), pp. 31-33.

[26] Weiss, *op. cit.*, pp. 66-67. A simple correlation between aid per pupil and valuation per pupil of - .25 for Maine is significant at the 1 percent level; for the other states, correlations range from - .05 to - .12 and are not even nearly significant at the 10 percent level.

Conceivably Congress could attempt to write a bill requiring that states distribute shared Federal revenue or unconditional grants on an equalizing basis directly to local government units. However, a bill with this simple objective would be difficult to draft and even more difficult to administer.

The Administration's Revenue Sharing Plan

What can happen when the Federal Government decides to legislate in this field is illustrated by the attempt of the Nixon Administration to write a Federal revenue sharing bill which specifies how pass-through funds shall be allocated to local government units. The bill is very simple. The proportion of the Federal allocation which must be passed-through to local units is calculated by dividing the combined total general revenues from own sources of general-purpose local governments by the total state and local revenue from own sources. Those states that assign greater financial responsibilities to local governments are required to distribute proportionally more of their Federal allocation to local units.

Thus, Massachusetts would be required to pass through 52 percent of its allocation while Delaware would be required to transfer only 15 percent of its funds. Up to this point, we believe that the proposed arrangement is reasonable and fair.

Next, however, the Administration's proposal requires that each local unit of government receive transferred funds in proportion to its share of total general revenue collections. In other words, locally-shared revenues are to be distributed according to the existing pattern of locally-raised revenues. Although there would clearly be some wastage of funds through very small grants to localities in states where the local pass-through share is small and there are many small local governments, the plan does have the advantage that central cities would receive large allocations.

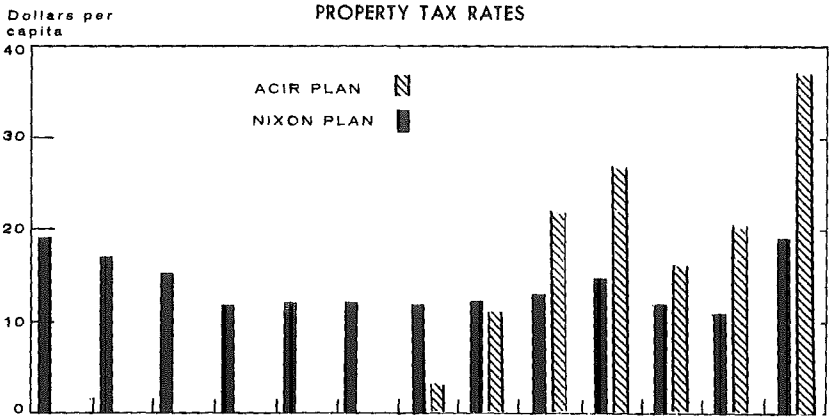
Unfortunately, however, the wealthy suburbs which spend lavishly would receive quite generous grants while the poor suburbs and poor rural towns would receive much less. Most central cities which have special problems would indeed receive above average per capita allocations, but this apparent advantage is more than offset by their much greater needs and higher existing tax rates, and they would receive little or no more aid per capita than many wealthy suburbs. For example, wealthy suburbs of Boston would receive over 50

percent more aid per capita than hard-pressed suburbs or cities where property tax rates are about twice as high.

Charts 3 and 5 clearly demonstrate the perverse distributional effects of this proposed type of revenue sharing in Massachusetts. Some towns with the lowest equalized tax rates would receive substantially more in per capita Federal aid than others with equalized tax rates two or three times as great. These results stem from the fact that the proposed distribution makes no attempt to take present tax effort into account and thereby relieve existing intrastate fiscal disparities.[27]

Chart 3

PER CAPITA GRANTS UNDER FEDERAL REVENUE SHARING PLANS
MASSACHUSETTS CITIES AND TOWNS BY EQUALIZED
PROPERTY TAX RATES



Equalized Property Tax Rate (Mills)	10-14.99	15-19.99	20-24.99	25-29.99	30-34.99	35-39.99	40-44.99	45-49.99	50-54.99	55-59.99	60-64.99	65-69.99	70 and over
Nixon Plan:													
Number of Cities and Towns	15	7	15	29	40	67	74	51	25	12	10	2	4
% of Total State Population	0.3	0.3	1.0	3.7	6.8	11.7	17.9	16.8	8.9	7.8	6.9	2.0	15.7
ACIR Plan:													
Number of Cities							2	4	3	3	4	1	2
% of Total State Population							2.1	5.2	4.7	6.5	5.9	1.8	15.0

Source: Federal Reserve Bank of Boston estimated distribution to Massachusetts cities and towns of a total of $5.1 billion of Federal revenue sharing funds.

Note: Additional data pertaining to this chart appear in Tables 3 and 4.

[27]Data for Massachusetts show a strong correlation of +.74 between local equalized valuation per capita and estimated per capita grants under the proposed pass-through arrangement. Moreover, per capita grants are negatively (but weakly--the coefficient is -.22) related to local tax rates and shows no general tendency to increase with population size.

TABLE III*

PER CAPITA GRANTS UNDER NIXON REVENUE SHARING PLAN, MASSACHUSETTS CITIES AND TOWNS BY EQUALIZED PROPERTY TAX RATES

RANGE OF LOCAL TAX RATES	NO. OF CITIES AND TOWNS RECEIVING AID	% OF STATE POPULATION IN CITIES & TOWNS	GRANTS PER CAPITA: AVERAGE	MINIMUM	MEDIAN	MAXIMUM
10-14.99	15	0.29	18.93	9.49	18.61	49.59
15-19.99	7	0.26	16.89	10.60	13.54	19.96
20-24.99	15	0.97	15.14	8.12	13.94	24.02
25-29.99	29	3.71	11.66	6.35	11.01	19.93
30-34.99	40	6.83	11.93	6.77	10.66	32.52
35-39.99	67	11.71	12.08	1.96	11.57	18.51
40-44.99	74	17.94	11.82	5.14	11.12	18.54
45-49.99	51	16.81	11.92	5.85	11.93	17.18
50-54.99	25	8.91	13.00	7.91	11.18	22.99
55-59.99	12	7.81	14.50	7.01	14.14	21.35
60-64.99	10	6.88	11.65	8.08	11.58	12.33
65-69.99	2	1.98	10.81	10.78	11.06	11.31
Over 70	4	15.72	19.14	14.86	17.09	20.57
	351	100.00				

*Data underlying Chart 3.

TABLE IV*

PER CAPITA GRANTS UNDER ACIR REVENUE SHARING PLAN, MASSACHUSETTS CITIES AND TOWNS BY EQUALIZED PROPERTY TAX RATES

RANGE OF LOCAL TAX RATES	NO. OF CITIES AND TOWNS RECEIVING AID	% OF STATE POPULATION IN CITIES & TOWNS	GRANTS PER CAPITA: AVERAGE	MINIMUM	MEDIAN	MAXIMUM
10-14.99	0	0.0	0.0	0.0	0.0	0.0
15-19.99	0	0.0	0.0	0.0	0.0	0.0
20-24.99	0	0.0	0.0	0.0	0.0	0.0
25-29.99	0	0.0	0.0	0.0	0.0	0.0
30-34.99	0	0.0	0.0	0.0	0.0	0.0
35-39.99	0	0.0	0.0	0.0	0.0	0.0
40-44.99	2	2.1	2.99	1.37	2.92	4.48
45-49.99	4	5.2	11.08	3.25	6.14	22.41
50-54.99	3	4.7	21.28	6.34	20.00	32.92
55-59.99	3	6.5	26.89	22.81	27.97	28.79
60-64.99	4	5.9	16.17	3.53	16.17	19.76
65-69.99	1	1.8	20.38	20.38	20.38	20.38
Over 70	2	15.0	36.88	29.38	34.23	39.08
	19	41.3				

*Data underlying Chart 3.

ACIR's Revenue Sharing Plan

Another type of revenue sharing plan has been proposed by the Advisory Commission on Intergovernmental Relations. The ACIR plan is specifically designed to provide assistance to the hard-pressed central cities and counties and to exclude aid for the typical suburb. Thus, it avoids some of the worst problems of the Administration's plan.

It has its own problems, however. It requires the states to pass through funds only to cities and counties with a population of more than 50,000. Furthermore, it provides a minimal amount of aid to those cities that have only slightly more than 50,000 residents. The ACIR plan specifically excludes townships and rural towns which have more than 50,000 residents but are not incorporated as cities.

The ACIR plan does require that the states also pass through funds to independent school districts. In each state these districts would receive a total allocation in proportion to their share of total state and local educational revenues. In some states, such as Massachusetts, however, there are no independent school districts as defined in the ACIR proposed plan. The regional school districts in Massachusetts are supported from the budget of each member town. Thus, in Massachusetts, the state would not be required to pass through funds to any school system.

The final result of the ACIR distribution for Massachusetts is shown in Charts 3 and 5. As you can see, no aid is provided to communities with very low equalized tax rates. However, the ACIR plan completely ignores the financial plight of many impoverished municipalities which have under 50,000 residents or which happen to be incorporated as towns.

In fact, two-thirds of the communities in the four highest equalized tax rate classes would receive no aid under the ACIR plan. The results are erratic. For example, a wealthy suburb would get about $33 per capita, while no money would go to a depressed municipality adjacent to the core city, where the tax rate is twice as high.

We conclude, therefore, that both the ACIR plan and that of the Administration are severely deficient. If we are to resolve the crisis problems of local finance, allocating Federal revenue in such a casual way is certainly not the answer.

In preparing this paper we had no difficulty in finding serious flaws in every aid formula we examined. In fact, the more we looked at state and Federal formulas the more critical we became. Many units of local government face severe financial problems, and yet very little specific help is forthcoming. As authors, however, we also faced a serious problem. We were unable to propose an entirely defensible plan of our own.

Difficulties of Constructing an Equitable Aid Formula

We knew that no general aid system could be developed at the federal level for all 80,000 units of local government, but we had thought we could devise a good equalizing formula for federal aid to all public school districts. There is considerable logic in concentrating on schools rather than on total local spending. Public school expenditures account for almost one quarter of all state and local spending in the United States.

Moreover, inferior schooling in poor communities obviously has "spill-over" effects throughout the United States. Finally we have the impression that funds allocated to schools are less likely to be squandered and more likely to be used in a professional manner than funds distributed for general municipal purposes.

We found, however, that there simply is no way to measure the relative tax base and tax effort of each and every school district. The differing tax structures within each state and the varying distributions of functional and financial responsibilities of states, counties, townships, and special districts make it impossible to evaluate — across state boundaries — the relative needs of individual districts.

As a result of these complexities, many public finance specialists are recommending Federal block grants for school aid. H. R. 10833 introduced by the National Education Association in the House of Representatives in 1969 is a good example of such a proposal. It would provide a $100 per student grant for all students in public schools. The money would be distributed on a pro rata basis to each state. The states, in turn, would allocate the funds to each of their school districts on an "equitable basis."

This same bill also specifies that for each $100 distributed on a flat grant basis, another $50 should be distributed according to the formula now being used for the Elementary and Secondary Educa-

tion Act of 1965. The NEA proposal has many obvious advantages. One third of the total of $7.8 billion of federal funds would be allocated primarily to low income school districts. Such a large program would partially displace the regressive local property tax with the progressive Federal income tax. The NEA proposal has an important disadvantage, however. It is almost certainly the case that the states would pass through most of their funds on a predominantly flat grant basis. As a result the differential benefit to impoverished districts would be reduced.

An Equalizing Education Block Grant Proposal

As an alternative, we suggest that the Federal Government distribute funds according to the basic eligibility criterion of the Elementary and Secondary Education Act of 1965; namely, in direct proportion to each community's share of the total number of children coming from families earning less than $3000 or from families earning more than $3000 that now receive federal aid for dependent children.

However, we would not follow other allocation provisions of the Act. Specifically we would not cut off Federal funds when they provide more than 50 percent of a school district's support, and we would not provide extra funds per student in states where per student expenditures are above average.

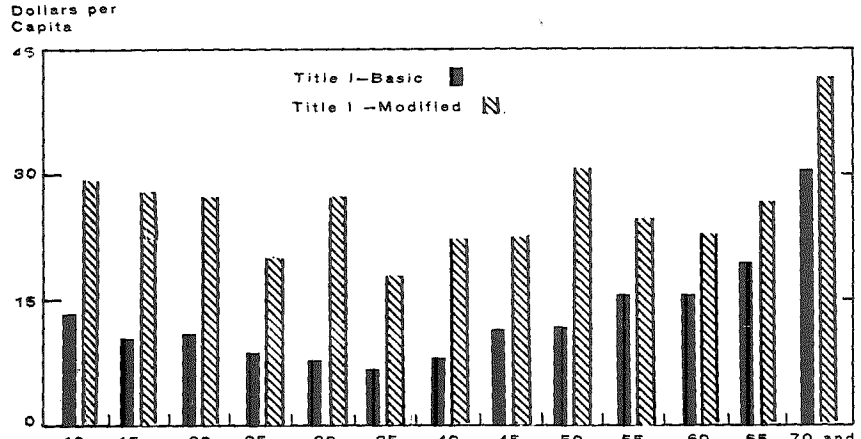
The results, for Massachusetts, as shown in Charts 4 and 5 would be substantially helpful to communities with the highest tax effort. Central cities such as Boston, Worcester, and Springfield, old mill towns such as Fall River, New Bedford, and Lowell, as well as small rural towns with a substantial low income population would all benefit. These types of communities would benefit much less under the Nixon and ACIR plans.

If the Federal Government wished to distribute funds only to financially pressed communities and eliminate many administrative problems as well, it could exclude communities where fewer than 10 percent of the children come from low income families. This modified plan would cut off federal aid to about four-fifths of the school systems in Massachusetts.

As you can see on Charts 4 and 5, this modified plan provides a much larger sum to high tax communities in Massachusetts. Although

Chart 4

PER CAPITA GRANTS UNDER ALLOCATIONS BASED ON TITLE I OF THE ELEMENTARY AND SECONDARY EDUCATION ACT OF 1965 MASSACHUSETTS CITIES AND TOWNS BY EQUALIZED PROPERTY TAX RATES



Equalized Property Tax Rate (Mills)	10-14.99	15-19.99	20-24.99	25-29.99	30-34.99	35-39.99	40-44.99	45-49.99	50-54.99	55-59.99	60-64.99	65-69.99	70 and over
Title I —Basic Plan:													
Number of Cities and Towns	8	7	14	26	40	63	74	50	24	12	9	2	4
% of Total State Population	0.3	0.3	1.0	3.5	6.8	11.6	17.9	16.8	8.9	7.8	6.9	2.0	15.7
Title I—Excluding Cities and Towns with fewer than 10% of resident pupils eligble:													
Number of Cities and Towns	3	2	7	7	8	5	11	9	6	4	4	2	4
% of Total State Population	0.1	0.03	0.1	0.7	0.7	1.0	1.9	7.9	2.8	5.7	5.9	2.0	15.7

Source: Federal Reserve Bank of Boston estimated distribution to Massachusetts cities and towns of an amount equal to the local pass-through under the Nixon Plan of a total of $5.1 billion of Federal revenue sharing funds.

Note: Additional data pertaining to this chart appear in Tables 5 and 6.

TABLE V*

PER CAPITA GRANTS UNDER ALLOCATION BASED ON TITLE I OF ESEA, MASSACHUSETTS CITIES AND TOWNS BY EQUALIZED PROPERTY TAX RATES

RANGE OF LOCAL TAX RATES	NO. OF CITIES AND TOWNS RECEIVING AID	% OF STATE POPULATION IN CITIES & TOWNS	GRANTS PER CAPITA: AVERAGE	MINIMUM	MEDIAN	MAXIMUM
10-14.99	8	0.26	13.38	5.62	9.92	28.85
15-19.99	7	0.26	10.19	3.05	9.88	30.44
20-24.99	14	0.96	10.72	2.52	12.43	120.49
25-29.99	26	3.47	8.65	1.88	10.36	64.70
30-34.99	40	6.83	7.49	1.84	7.20	97.26
35-39.99	63	11.65	6.42	2.13	5.88	25.48
40-44.99	74	17.94	7.78	0.92	7.38	42.63
45-49.99	50	16.81	11.38	2.21	7.90	21.25
50-54.99	24	8.91	11.51	4.26	9.10	26.98
55-59.99	12	7.81	15.45	5.23	13.04	37.37
60-64.99	9	6.86	15.29	5.74	9.87	20.49
65-69.99	2	1.98	19.23	15.08	17.30	19.51
Over 70	4	15.72	30.31	18.72	26.92	33.87
	333	99.46				

*Data underlying Chart 4.

TABLE VI*

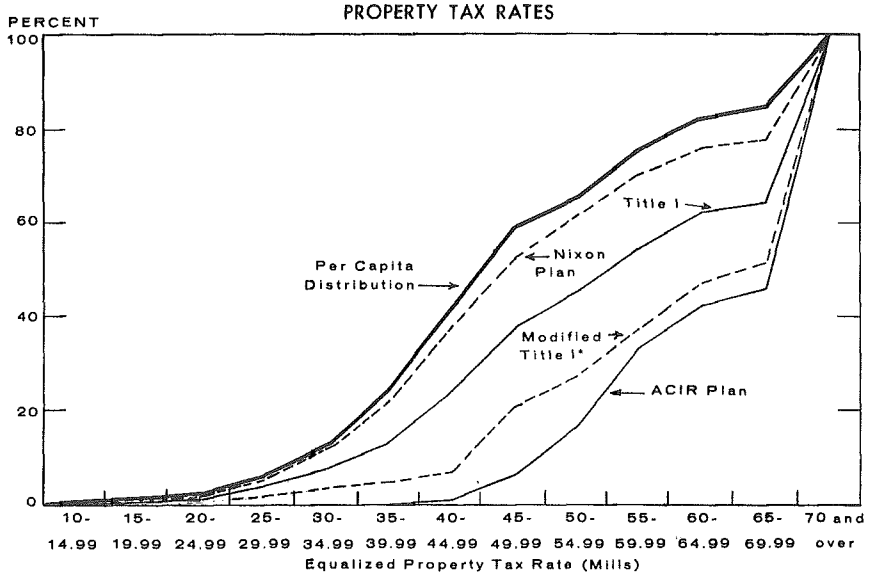
PER CAPITA GRANTS UNDER ALLOCATION BASED ON MODIFIED TITLE I OF ESEA, MASSACHUSETTS CITIES AND TOWNS BY EQUALIZED PROPERTY TAX RATES

RANGE OF LOCAL TAX RATES	NO. OF CITIES AND TOWNS RECEIVING AID	% OF STATE POPULATION IN CITIES & TOWNS	GRANTS PER CAPITA: AVERAGE	MINIMUM	MEDIAN	MAXIMUM
10-14.99	3	0.10	29.16	26.71	36.24	39.75
15-19.99	2	0.03	27.82	24.74	33.25	41.76
20-24.99	7	0.13	27.21	17.47	25.82	165.82
25-29.99	7	0.67	19.92	12.36	26.48	89.06
30-34.99	8	0.73	26.94	18.80	33.39	133.84
35-39.99	5	0.98	17.57	15.35	24.57	34.99
40-44.99	11	1.87	22.17	13.25	22.38	58.64
45-49.99	9	7.93	22.34	15.82	20.47	29.24
50-54.99	6	2.78	30.58	16.47	22.99	37.18
55-59.99	4	5.69	24.68	18.53	24.53	51.42
60-64.99	4	5.90	22.69	15.58	22.22	28.20
65-69.99	2	1.98	26.46	20.76	23.80	26.85
Over 70	4	15.72	41.72	25.76	37.06	46.61
	72	44.51				

*Data underlying Chart 4.

Chart 5

FEDERAL REVENUE SHARING UNDER ALTERNATIVE PLANS
CUMULATIVE PERCENT DISTRIBUTION TO MASSACHUSETTS
CITIES AND TOWNS BY EQUALIZED
PROPERTY TAX RATES



*Towns and cities with fewer than 10 percent of resident pupils eligible for Title I are excluded.

Source: Federal Reserve Bank of Boston estimated distribution to Massachusetts cities and towns: Nixon and ACIR plans, a total of $5.1 billion of Federal revenue sharing funds; all other plans, an amount equal to the local pass-through under the Nixon plan.

Note: Data underlying this chart appear in Table 7.

it does not redistribute proportionately as much to the large cities as does the ACIR plan, it does distribute substantial sums to financially distressed communities which have under 50,000 residents and to communities of over 50,000 which do not happen to be incorporated as cities. These are excluded in the ACIR proposal.

What is surprising is that this education block grant plan benefits low income cities more than the Nixon revenue sharing plan. This is true despite the fact that educational expenditures constitute a much smaller fraction of the total expenditures of large cities and problem cities than is the case of the typical middle or high income suburb.

It is apparent, then, that any formula which distributes funds to units of local government on the basis of their share of low income families is bound to help those communities which have the greatest financial need. The result is encouraging, for it shows that programs for direct Federal aid to local governments can be effectively equalizing and are feasible.

TABLE VII*

PERCENTAGE DISTRIBUTION OF GRANT FUNDS TO MASSACHUSETTS CITIES AND TOWNS, BY LOCAL TAX RATE

RANGE OF LOCAL TAX RATES	POPULATION BASIS**		NIXON PLAN		ACIR PLAN	
	% OF FUNDS	CUMULATIVE %	% OF FUNDS	CUMULATIVE %	% OF FUNDS	CUMULATIVE %
10-14.99	.29	0.29	0.41	0.41	0	0
15-19.99	.26	0.55	0.33	0.74	0	0
20-24.99	.97	1.52	1.09	1.83	0	0
25-29.99	3.70	5.22	3.23	5.06	0	0
30-34.99	6.83	12.05	6.08	11.14	0	0
35-39.99	11.71	23.77	10.57	21.71	0	0
40-44.99	17.94	41.71	15.84	37.55	0.60	0.60
45-49.99	6.81	58.52	15.07	52.62	5.63	6.24
50-54.99	8.91	64.77	8.65	61.27	9.74	15.98
55-59.99	7.98	75.42	8.65	69.92	17.06	33.04
60-64.99	6.88	82.30	5.99	75.91	9.29	42.33
65-69.99	1.98	84.20	1.60	77.51	3.67	46.00
Over 70	15.72	100.00	22.48	99.99	54.00	100.00

*Data underlying Chart 5.

**This distribution represents hypothectical results of a straight per capita distribution of cities and towns.

TABLE VII (cont'd)

PERCENTAGE DISTRIBUTION OF GRANT FUNDS TO MASSACHUSETTS CITIES AND TOWNS, BY LOCAL TAX RATE

RANGE OF LOCAL TAX RATES	ALLOCATION BASED ON TITLE I OF ESEA		ALLOCATION BASED ON MODIFIED TITLE I OF ESEA***	
	% OF FUNDS	CUMULATIVE %	% OF FUNDS	CUMULATIVE %
10-14.99	.26	.26	.23	.23
15-19.99	.29	.55	.19	.91
20-24.99	.76	1.31	.26	.67
25-29.99	2.22	3.53	.99	1.66
30-34.99	3.79	7.32	1.46	3.13
35-39.99	5.54	12.86	1.28	4.41
40-44.99	10.34	23.20	3.08	7.49
45-49.99	14.18	37.38	13.16	20.65
50-54.99	7.59	44.97	6.32	26.97
55-59.99	9.13	54.10	10.44	37.41
60-64.99	7.76	61.86	9.95	47.36
65-69.99	2.82	64.68	3.89	51.25
Over 70	35.30	99.98	48.75	100.00

***Towns and cities with fewer than 10% of resident pupils eligible for Title I grants are excluded.

The Problem of Redistribution of Federal and State Funds

DICK NETZER

The first half of this Conference is devoted to what is surely the most important aspect of the overall problem of financing state and local governments in the 1970's: the restructuring of intergovernmental fiscal relations and responsibilities in our Federal system.

The papers deal with specific policy instruments for accomplishing this restructuring. In reacting to the Weiss-Eisenmenger paper, I found it essential to step back from an appraisal of the policy instruments themselves, to review the appropriate *objectives* of reforms in fiscal federalism, that is, to recall the normative models developed previously by Professors Musgrave and Break and other writers.

This is largely because while I find the Weiss-Eisenmenger arguments unpersuasive, nonetheless I agree with their principal policy conclusion. That is, if a given additional amount of federally raised revenue is to be re-distributed to state and local governments, the highest priority attaches to a greatly expanded system of federal aid to elementary and secondary education, more or less along the lines of the Title I program. Parenthetically, it should be said that my own conclusion rests upon the assumption the Nixon welfare reform will be enacted and that amendments to it within a reasonable span of years will produce effective federalization of the entire income-maintenance system, with only minor and residual state-local fiscal participation.

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The paper before us seems to me unpersuasive for a number of reasons, but the most important traces back to its specification of objective: "channeling assistance to communities suffering the most severe financial strain," defining communities as local political subdivisions. This specification of objective leaves out some important concerns in fiscal federalism and by itself is disturbing, because it seems to equate equalization among political units with equalization among individuals and households.

A large number of American local political jurisdictions are "communities" in one sense only: some element of total local government taxation – the school tax, or the city tax, or the village tax – applies at a nominally uniform rate to all taxable objects or events within the geographic boundaries of the jurisdiction.

Outside New England, even this element of commonalty may be small, since residents of the same school district may be in different municipalities and tax-levying special districts, or *vice versa.* For example, within Westchester County, New York, or Lake County, Illinois, or Orange County, California, there are many hundreds of different total property tax rate combinations. More importantly, each of the political jurisdictions, even within a simple local government structure like that of New England, is an aggregation of heterogenous households. Therefore, it is poor public policy indeed to assume that the political subdivision is a good proxy through which to effect equalization among individuals.

The appropriate objectives, in reform of American fiscal federalism, would seem to be the following:

1. To re-structure fiscal arrangements to assist those *people* suffering the most strain, in terms of the ratios of public services provided and taxes exacted to income.

2. To optimize the output of public services, in quantity and in character, in an environment characterized by heavy geographic spill-overs of benefits and costs.

3. To improve the aggregate tax system so as to minimize the allocational losses produced by any real-world tax structure.

Most of the policy alternatives under discussion in recent years will assist in realizing one or more of these objectives. Some are more efficient than others and some can help with one objective at the expense of worsening things with regard to the other objectives.

The issue, then, is relative effectiveness with regard to a *set* of

objectives, no one of which has anything but an instrumental or even incidental relationship to the current fiscal position of specific political jurisdictions.

To be more concrete, let us turn to two specific sets of problems under present fiscal arrangements: the property tax and the under-supply of public services with large-scale geographic benefit spill-overs. The American property tax is defective on several grounds.

First, it involves substantial interpersonal inequity, both vertical and horizontal (see objective 1, above). Second, the wide variations in effective tax rates within metropolitan areas tend to have inefficient locational consequences (allocational losses – see objective 3, above).

While the empirical evidence regarding actual locational shifts in response to rate differentials is mixed, there is very good evidence that suburban land-use control decisions are heavily influenced by and in turn have effects on rate differentials. Third, the tax, especially in central cities, has adverse housing investment and consumption effects, another form of allocational loss.

Any change in intergovernmental fiscal arrangements that moves away from reliance on locally-levied property tax revenue will tend to improve the situation. This is true of upward shifts in functional responsibilities (e.g., for public assistance) and of increased federal and state aid to local governments, almost regardless of the function aided.

Indeed, the principal political argument for state school aid always has been relief of local property tax burdens. Some lip-service has been paid to equalization, but that has hardly been the goal. (And Weiss and Eisenmenger to the contrary notwithstanding, the literature of public finance does *not* abound with praise of state school aid as "a generally admirable example of equalization in practice.")

In fact, reduced reliance on the local property tax has been the main goal of most state aid and intra-state revenue sharing arrangements. To be sure, the specific policies often have been inefficient ones, in terms of the ultimate objectives I posted above. That is, they have not reduced state-wide interpersonal inequities nearly as much as alternative schemes might have done, nor shrunk inter-local tax rate disparities enough, nor addressed enough aid to central cities where the adverse effects on housing expenditure are most marked.

A large increase in Federal school aid, along the lines of the Title I

formula, would surely be more efficacious than tax credits or any of the revenue-sharing proposals recently advanced, in reducing reliance on the property tax where it hurts the most. The Weiss-Eisenmenger evidence suggests this, albeit indirectly. But revenue sharing is by no means totally ineffective.

In contrast to state aid arrangements, most Federal grant programs are, however inarticulately and imperfectly, concerned with spill-overs. They are designed to elicit more expenditure for specific public services than would be the case if the expenditure were financed entirely from non-federal funds. Quite properly, they have matching requirements, since it is presumed that there are *some* benefits from the expenditure that are internal to the state or local jurisdiction. To be sure, the matching requirements may not be a really good measure of the ratio of internal to external benefits and costs.

In some cases, the matching percentage is far below any rational calculation of internal benefits. Examples are Federal transportation, open space and urban renewal grants, where the benefits external to a state usually range from trivial to non-existent. In other cases, like the public assistance program since 1935, the matching percentage clearly has been far too high.

This is surely true of the Federal role in the financing of elementary and secondary education in general. Interstate mobility of the American population is considerable; large fractions of the post-school years of the children educated in any given school district are spent residing in other districts and other states.

Thus, the public good, or general benefit, aspect of education cannot be internalized within a school district or even a state and rational taxpayer-voters will "buy" less schooling than is optimal from a national viewpoint. Federal school aid equal to 5-10 percent of school costs is far less than is necessary, from this standpoint; 40 percent Federal support, I would guess, is more nearly the appropriate level.

This, of course, far outweighs, in dollar magnitude, all other possible changes in intergovernmental arrangements to deal with externalities. However, one can construct a strong case for more government action at the regional level, to finance and provide services now largely handled by small local governments from locally-raised funds (although sometimes with minor federal aid), in

particular activities connected with transportation, waste management, housing and land use – in short, the physical environment and the public services that affect it.

Various kinds of regional entities have been constructed to deal with these functions over the years, but in recent years, the most effective regional entities have been state governments themselves, in some of the highly urbanized states. But the state governments need large increments of revenue for these purposes, and state government tax systems are by no means ideal on distributive or allocation grounds.

A federal revenue-sharing plan in which a significant amount of money sticks to the state government itself can help finance, from superior taxes, regional functions that state governments might properly take over from local governments and provide at much higher levels of service.

Thus, although I conclude that increased Federal school aid on a Title I basis ranks high as a means of achieving all the objectives set out earlier, I see a place for Federal revenue sharing, as a means of supporting a more active state government role in our federal system. That more active role would have some incidental benefits, in reducing reliance on locally-raised property taxes, but its principal advantage would be in the output of public services with geographic externalities.

In this solution, the pass-through provisions of the Federal revenue sharing scheme do not matter at all, for the concern is not with the fiscal position of local governments but with the country's tax system and output of public services.