Revenue Sharing—New American Revolution or Trojan Horse?

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I. INTRODUCTION

Revenue Sharing1 was signed into law at Independence Hall in Philadelphia on October 20, 1972 with all the oratory and trappings of an historic occasion. President Nixon declared "we return here [Independence Square] to renew the federal system."2 Later he referred to revenue sharing as the basic ingredient in the "new American Revolution to return power to the people and put the individual self back in the idea of self-government."3 State and local officials of both political parties also expressed tremendous support and enthusiasm. New York's Mayor John V. Lindsay called the event "a day of victory for America's states and cities, a major step toward relieving the enormous financial and physical pressures on them."4 However, the release of the President's Budget on January 29, 1973 and the prospect of the impoundment of various programs amounting to more than $8 billion5 aroused cries of "treason.

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1. State and Local Fiscal Assistance Act of 1972, 31 U.S.C.A. § 1221 et seq. (1972) [hereinafter referred to as the Act]. The term "Revenue Sharing" as used throughout the text and the footnotes will refer to the federal assistance program provided by the Act.
and "double cross" from those same officials. Mayor Lindsay dropped his talk of "a day of victory" and instead voiced his criticism that the new federal budget allocations "confirm the worst fears of urban Americans that the Federal government is abdicating its responsibilities to our cities." San Francisco's Mayor Joseph L. Alioto, once a strong proponent of Revenue Sharing, concluded that this program was not "new" money, but merely "substitute" money to replace funds that had previously gone to urban programs in categorical grants. He indicated that San Francisco would lose $40 million as a result of projected federal budgetary cutbacks in exchange for $18 million in Revenue Sharing funds. Wesley C. Uhlman, Mayor of Seattle, referred to Revenue Sharing as a "trojan horse full of impoundments and cutbacks and broken promises."

Although cabinet members placed the burden of many of the budget cuts in the categorical aid programs squarely on the shoulders of Revenue Sharing, President Nixon continued to maintain that Revenue Sharing was "new money" for the states

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6. Henry Maier, Mayor of Milwaukee, was quoted as describing revenue sharing as "a gigantic double cross of the city poor and the rural poor of America," in Christian Science Monitor, Feb. 24, 1973, at 2, col. 1.
7. Adams, supra note 4, at 12, col. 6.
9. Id. It is interesting to inquire as to the congressional intent with respect to Revenue Sharing directly supplanting other federal programs. The report of the Senate Committee suggested that "the broad purpose of this legislation is to fill a gap in the present aid programs by granting State and local governments complete flexibility in the expenditure of the new aid funds so as to supplement the present categorical aid and to secure a more balanced and efficient system of Federal aid." S. REP. No. 1050, 92d Cong., 2d Sess., pt. 1, at 16 (1972) (emphasis added) [hereinafter cited as SENATE REPORT]. However, Governor Milton J. Shapp of Pennsylvania stated that in exchange for about $200 million of Revenue Sharing, the President's budget would cut $365 million from Pennsylvania. Christian Science Monitor, Mar. 9, 1973, at 8, col. 2. For cutbacks in other states, see Wall Street Journal, Feb. 26, 1973, at 1, col. 6. Governor Jimmy Carter of Georgia is quoted: "I think Revenue Sharing is a big hoax and a big mistake," in Governors' Conference, 31 CONG. Q. 353 (1973).
11. See Pierson, Pros & Cons: Do Libraries Need Federal Aid? White House Says No, But Librarians Say They'll Suffer, Wall Street Journal, Feb. 27, 1973, at 42, cols. 1-3. Caspar Weinberger, Secretary of H.E.W., when asked what would happen if Special Revenue Sharing funds were not used in part to finance libraries, indicated that if this response occurred in a significant number of states he "would not hesitate to recommend that we do something about it, and that might take the form of an additional categorical program." Large, Putting Strings on Federal Aid, Wall Street Journal, Feb. 20, 1973, at 20, col. 4.
and localities. As evidenced by his budget message of January 30, 1973, the President appears more dedicated than ever to the concept. In particular, he attached new urgency to Special Revenue Sharing. These four programs of broad purpose grants in the areas of education, law enforcement and criminal justice, manpower training, and urban community development, totaling $6.9 billion, would replace 70 existing categorical grant programs.

Once the euphoria surrounding receipt of the initial Revenue Sharing checks waned, the practical realities of the Revenue Sharing program rapidly surfaced. The tremendous controversy which surrounded the method of allocation was reflected in 3,800 formal objections to the initial allocations, which resulted in massive reallocations. At the political level, many Congressmen began to worry that Revenue Sharing would reduce their ties to special interest groups and could be used to subsidize political rivals. Further, many Congressmen viewed Revenue Sharing—Special and General—as part of the direct assault by the Executive aimed at removing from the Congress its role of establishing national priorities. After a few short months as the hero of a new federal system, Revenue Sharing has now become the villain or at least the scapegoat.

In this light, it is necessary to study the origins of revenue sharing, its history and policy justifications, together with the legislative background, enactment and implementation of the specific program of General Revenue Sharing to ascertain the substance and merits behind the voluminous political rhetoric. In the last analysis, it is hoped that the substance and merits of the program rather than the rhetoric which surrounds it will determine whether Revenue Sharing is the "bright new hope"
the success of which will result in the replacement of most of the categorical grant programs with Special Revenue Sharing or whether the concept is to be discarded on the heap of dismal federal failures.

II. HISTORICAL PERSPECTIVE

The concept of federal revenue sharing is not a new development, either in theory or in practice. A form of revenue sharing was instituted in the United States as early as 1836 but it did not become a serious alternative for financial assistance to state and local governments until the middle of the 1960's. By 1970 every state except Delaware, Montana, Texas and West Virginia distributed some portion of its revenues to localities for general local government support. Within the world community, revenue sharing has been utilized in nearly a dozen countries.

The most ambitious federal revenue sharing plan in the United States was implemented during the Andrew Jackson Administration with the passage of the Surplus Distribution Act of 1836. The sale of large tracts of public land and higher customs revenues due to an increase in foreign trade had caused the accumulation of an embarrassingly large surplus of federal revenues. After the public debt had been eliminated, Congress passed legislation which provided that all funds in the Federal Treasury as of January 1, 1837, with the exception of $5 million, would be distributed to the states in four installments. The distribution to the states was "in proportion to their respective representation in the Senate and House of Representatives of the United States." Although there were no requirements as to how the money was to be spent, the states were placed under a pledge of faith to repay the money whenever it should be re-

17. ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS, STATE-LOCAL FINANCES: SIGNIFICANT FEATURES AND SUGGESTED LEGISLATION 72-112 (1972). The per capita state-aid for general local government support in 1972 ranged from $0.02 in Vermont to $65.21 in Wisconsin. Id. at 72.

18. Countries utilizing revenue sharing include Australia, Sweden, United Kingdom, Malaya, West Germany, Argentina, Brazil, India, Nigeria, Pakistan and Rhodesia. A collection of several articles on the individual experiences of these countries can be found in STAFF OF SUBLCOMM. ON FISCAL POLICY OF THE JOINT ECONOMIC COMMITTEE, 90TH CONG., 1ST SESS., REVENUE SHARING AND ITS ALTERNATIVES: WHAT FUTURE FOR FISCAL FEDERALISM?, pt. 1, 401-643 (Comm. Print 1967) [hereinafter cited as JEC PAPERS].


20. Id. § 18.
quired "for the purpose of defraying any wants of the public treasury." Of the $37 million available, $23 million was distributed in the first three installments during 1837. A financial crisis forestalled the final payment. Although the states could have been required to return the money already distributed to them, it was never requested.

With a hiatus of over one hundred years, the concept of revenue sharing reappeared in several governmental task force reports on federal-state fiscal relations during the forties and fifties but had a less than enthusiastic reception. A Department of the Treasury special committee considered the revenue sharing concept in 1943 but recommended its implementation only with respect to distribution of the revenue derived from the tobacco tax. The first Hoover Commission Task Force Report in 1949 recommended broad grants on a functional basis, yet rejected revenue sharing on general principles of federalism.

[1] It would have the disadvantages of making States more dependent upon the National Government for general revenues and possibly increasing the supervision of the National Government over the States' general governmental functions.

In 1955, the Commission on Intergovernmental Relations, known as the Kestnbaum Commission, recommended a grant-in-aid approach, but again rejected "a comprehensive subsidy program" on the basis that it would deprive the states of fiscal autonomy and financial responsibility.

However, in spite of its inauspicious beginnings, the concept would not die. In 1958 Melvin Laird, then a member of the House of Representatives, submitted a revenue sharing bill in the second session of the 85th Congress. In 1960 economist Walter Heller, based on his experiences as an advisor to the Governor of Minnesota, proposed that revenue be distributed to the

21. Id.
22. A summary can be found in Kaufman, Recommendations of the Advisory Commission on Intergovernmental Relations and Earlier Government Commissions, in JEC Papers, supra note 18, at 195-245.
states with "no strings attached." Although no mention of revenue sharing was made during the 1960 presidential campaign, by 1964 federal financial support to states became a national political issue. President Johnson spoke vaguely of aid "over and above existing aid" and the Republican candidate, Barry Goldwater, proposed that both personal income and federal inheritance taxes be shared with the states.

During this period the primary stimulus for revenue sharing came from the so-called Heller-Pechman plan. In June, 1964, before his retirement as Chairman of the Council of Economic Advisers, Walter Heller had formulated the main outlines of a revenue sharing program. With his interest aroused, President Johnson ordered a task force chaired by Joseph Pechman of the Brookings Institution to refine the Heller plan.

The Heller-Pechman plan suggested revenue sharing as a supplement to existing specific grants-in-aid which it was felt "should remain the basic method of providing assistance . . . ” Rather than premising revenue sharing on political considerations, the plan saw it as a means of eliminating the anticipated "fiscal drag," estimated at $6 billion, which would result from income tax revenues accumulating at a rate faster than the growth in the Gross National Product. The plan called for the regular distribution of a specified portion of the federal personal income tax to the states, with no mandatory pass-through requirements from state to local governments. One percent of the federal income tax base was to be set aside in the first year. Thereafter, the amount set aside was to rise 0.2 percent per year until a 2 percent limit was reached. The revenue was to be automatically distributed to the states without annual appropriations by placing the funds in trust. Use of the money was to be unrestricted except that it could not be used for highway construction and the states would be required to comply with


29. The task force report was never officially made public, but both Heller and Pechman subsequently published papers that described the essential features of their proposal. See W. Heller, supra note 27, at 117-72; Pechman, PROCEEDINGS OF A SYMPOSIUM ON FEDERAL TAXATION, 574 PAMPHLETS 71-95 (1965).

30. Pechman, supra note 29, at 81.

Title VI of the Civil Rights Act of 1964. The distribution formula was based on population, but the plan envisioned two modifications. The per capita amounts were to be multiplied by a tax effort factor to provide an incentive for increased state and local tax efforts, and 10 percent of the funds was to be allocated on a per capita basis to the states which ranked in the lower third of all the states on the basis of per capita income. President Johnson quietly abandoned the proposal in the final days of the 1964 campaign as a result of his irritation over leaks of the proposal to the press and his sensitivity to opponents of the plan, primarily the categorical grant oriented Executive Departments and groups representing labor, education, welfare and health.

When the Vietnam War provided an unfortunate solution to the "fiscal drag" problem and the Johnson Administration emphasized the categorical grants-in-aid as its chosen instrument to implement the "Great Society," the Republican Party adopted the concept of revenue sharing as an alternative to the categorical grant approach. In 1966 the Republican Coordinating Committee submitted its own proposal which rejected categorical grants-in-aid and recommended setting aside an initial 2 percent of both federal personal and corporate income tax collections (as opposed to the Heller-Pechman tax base which was limited to the federal personal income tax), with a gradual increase to 10 percent. One half of each state's share would be computed on the basis of returning income tax collections to the state in which they originated. In order to achieve a measure of equalization, the other half would be based upon population and per capita income. However, "[e]qualization grants [would] only be made available to the States which themselves contribute a fair proportion of their per capita incomes to the cost of their own State and local services" and would be reduced proportionally "if the State and local units [did] not apply an adequate amount of State and local tax revenue [to the cost of their own govern-

32. 42 U.S.C. § 2000(d) (1970) provides:
No person in the United States shall, on the ground of race, color, or national origin, be excluded from participation in, be denied the benefits of, or be subjected to discrimination under any program or activity receiving Federal financial assistance.

33. For a summary of the opposition arguments, see Otten and Seib, No-Strings Aid for the States, 32 The Reporter 33 (Jan. 28, 1965).

34. TASK FORCE ON THE FUNCTIONS OF FEDERAL, STATE AND LOCAL GOVERNMENT, REPUBLICAN COORDINATING COMMITTEE, FINANCING THE FUTURE OF FEDERALISM: THE CASE FOR REVENUE SHARING (1966).

35. Id. at 5.
In addition, the Committee proposed broad functional grants in areas such as mental health.

Beginning in 1965, revenue sharing also became a high priority concern of the Congress as evidenced by the fact that in the 89th Congress 57 bills on revenue sharing were introduced, while 101 were introduced in the 90th Congress. In 1967 the Joint Economic Committee responded to the surge of interest by publishing three volumes of study papers and two volumes of hearings on revenue sharing.

Although revenue sharing had become an increasingly attractive alternative to alleviate the financial crises of state and local governments, it was by no means the only one proposed. A second major alternative was a credit against federal personal income tax for state income taxes paid. However, critics cited several shortcomings of this approach. First, the direct benefits would only accrue to individual taxpayers, rather than to state and local governments. Second, only states with income taxes would benefit. Third, the greatest benefits would flow to the wealthy states under most of the credit proposals. Fourth, since few localities have an income tax, only minimal assistance would be provided at the local level. Nonetheless, tax credits received significant consideration. In 1965, the Advisory Commission on Intergovernmental Relations proposed a tax credit scheme. Two years later, the Committee for Economic Development proposed a 25 percent income tax credit for net payments of state income taxes after deductions had been made. Several of the revenue sharing bills also contained tax credit provisions.

36. Id.
38. JEC PAPERS, supra note 18.
39. For a survey of tax credits, see J. MAXWELL, TAX CREDITS AND INTERGOVERNMENTAL FISCAL RELATIONS (1962). Also under consideration were various proposals to federalize the cost of welfare. See Statement of Richard A. Musgrave, Hearings on the Subject of General Revenue Sharing Before the House Comm. on Ways and Means, 92d Cong., 1st Sess., pts. 1-8, at 348-49 (1971); Statement of John B. Connally, id. at 46-50.
40. ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS, FEDERAL-STATE COORDINATION OF PERSONAL INCOME TAXES (1965).
41. COMMITTEE FOR ECONOMIC DEVELOPMENT, A FISCAL PROGRAM FOR A BALANCED FEDERALISM (1967).
Despite the concentration on categorical grants-in-aid during the Johnson Administration, a movement toward a block grant approach to state and local aid did occur with the creation of the Law Enforcement Assistance Administration (L.E.A.A.) under Title I of the Omnibus Crime Control and Safe Streets Act of 1968. In this Act, Congress recognized that "crime is essentially a local problem that must be dealt with by State and local governments if it is to be controlled effectively." Reflecting congressional doubts over the effectiveness and manageability of large scale federal aid programs administering direct aid to countless local units, the Act placed the states in a central role as the "planner(s), architect(s), and coordinator(s) of the Nation's efforts against crime." Each state was required to establish as an arm of the state executive branch a state planning agency (SPA) which would be "representative of law enforcement agencies of the State and of units of general local governments . . . ." The SPA in turn had the responsibility of establishing priorities and developing comprehensive statewide plans for the improvement of law enforcement. Through the L.E.A.A. the federal government would finance 90 percent of the state planning grants with the stipulation that 40 percent of the federal funds would be passed through to local planning units.

Although the states were given the responsibility for coordinating the program, their control over expenditures was significantly limited by the requirement that a state plan receive prior approval by the L.E.A.A. before funds would be distributed. This was especially important since the program emphasized block action grants. Of all the monies awarded for law

44. Id. § 3701.
47. Id. § 3723(b).
48. Id. § 3724.
49. Id. § 3723(c).
50. In fiscal year 1969, of the $63 million totally allocated to L.E.A.A., $25 million were block grants; in 1971 it had risen to a $529 million total, of which $340 million were block grants; in 1973 the total rose to $850 million of which $536.7 million were block grants. ATTORNEY GENERAL'S FIRST ANNUAL REPORT, FEDERAL LAW ENFORCEMENT AND CRIMINAL JUSTICE ASSISTANCE ACTIVITIES 42 (1972); L.E.A.A. NEWSLETTER, vol. 2, at 1 (Nov. 1972).
enforcement program implementation, called Action Grants, 85 percent were to be “allocated among the states according to their respective populations,” and 15 percent were to be given at the L.E.A.A.’s discretion. To qualify for the block action grant, each SPA had to submit an annual plan for prior L.E.A.A. approval. This forced the SPA’s to work closely with the regional L.E.A.A. representatives in formulating plans acceptable to the federal bureaucracy. In addition, the Act laid down 12 requirements with which each state plan must comply.\textsuperscript{52}

State and local decision making was also materially restrained by the different percentum contributions made by the L.E.A.A. for different types of programs. Since organized crime and civil disorders were priority concerns, the L.E.A.A. was to pay 75 percent of any program in those areas. On the other hand, the L.E.A.A. contribution was limited to 50 percent of the costs for construction of facilities and 60 percent of the costs of other programs such as recruiting and training or public protection.\textsuperscript{53}

Despite these limitations, the Act created state planning agencies to formulate law enforcement programs and to oversee their implementation, thus taking an initial step toward the transfer of responsibility in program planning and implementation from the federal level to state and local governments. However, the growth of a sizable federal bureaucracy to administer the program coupled with the restraints on state and local decision making arguably combined many of the worst elements of both the categorical and the block-grant approaches.\textsuperscript{54}

President Nixon’s plan to convert L.E.A.A. into a special revenue sharing proposal for law enforcement was introduced in the 92nd Congress. See President’s Message of March 2, 1971, 29 Cong. Q. 539 (1971). S. 1087 and H.R. 5408 were subsequently introduced. A revised proposal was introduced in the next Congress. The Bill, introduced by Senator Hruska, included provisions designed to achieve public accountability: (1) The comprehensive plan must be developed “after appropriate hearings and consultation with elected representatives of units of general local government, representatives of law enforcement agencies, and of public agencies maintaining programs to reduce and control crime and delinquency” (§ 203(1)); (2) the state must “adopt measures designed to bring to the attention of the citizens of the state the contents of the comprehensive statewide plan” (§ 203 (4)); (3) the funds must be expended in accordance with the laws and procedures applicable to the recipient’s own revenues (§ 203 (5)).
revenue sharing program for law enforcement was introduced in the 92d Congress, and a revised proposal was introduced in the 93d Congress. Unfortunately, the bill adopted by Congress to extend L.E.A.A. for three years at an aggregate authorization level of $3.2 billion rejected most of the Administration's special revenue sharing proposals and further tightened the requirements for block grants.

III. THE STATE AND LOCAL FISCAL ASSISTANCE ACT OF 1972

In a message to Congress on February 4, 1971, President Nixon presented his Administration's original revenue sharing proposal as "an idea whose time has already come." Bills reflecting the proposals were introduced in the House and Senate and extensive hearings on the subject were held by the House Ways and Means Committee in June, 1971. However, the strongly expressed opposition of Chairman Wilbur Mills resulted in no action being taken at that time.

As a result of tremendous political pressure by state and local officials, and perhaps because of his aspirations for the

60. In a speech before the Oklahoma Legislature on June 4, 1971, Chairman Wilbur Mills made the following statement:
How anyone can suggest general revenue sharing, with a straight face, in full view of Federal deficits of that magnitude and the chronic string of deficits over the past forty years is beyond me.

At the time Secretary of the Treasury John B. Connally completed his testimony on the Administration's proposal the following discussion ensued:
The Chairman (Mr. Mills) . . . I want to congratulate you on making a very fine statement in behalf of a very weak cause.
Secretary Connally, I understand, Mr. Chairman, that it was not your favorite subject.
The Chairman. No sir, it is not.
Hearings, supra note 59, at 51.
Democratic Vice-Presidential nomination, Chairman Mills finally agreed in the latter part of 1971 to introduce and support a revenue sharing bill if it would receive strong support from all the national organizations representing states and localities. The staff of the Joint Committee on Internal Revenue Taxation worked with state and local representatives to draft a bill which Mr. Mills could support as distinguishable from the Nixon Administration's proposal which he had so widely criticized. The result was H.R. 11950, introduced in the House of Representatives on November 30, 1971. This bill provided the basic framework for the congressional deliberations which ultimately led to the enacted legislation.

A. POLICY JUSTIFICATIONS FOR REVENUE SHARING

"Few programs in recent years have been advocated as a remedy for so many diverse and conflicting ills as Revenue Sharing." The justification adopted by the congressional committees and repeatedly espoused during the congressional deliberations was the necessity to relieve the fiscal crisis of state and local governments. In response, the argument was presented

62. Reischauer, Revenue Sharing: Matching the Money and the Needs, Washington Post, May 11, 1972, § A, at 22, col. 3; see Testimony of John B. Connally, Secretary of the Treasury, Hearings, supra note 59, at 38-50; Testimony of Walter W. Heller, id. at 1025-31. In 1968 Walter Heller had stated: Looking beyond current rising Vietnam costs, big deficits, and contingent tax increases, one can visualize an $8 billion annual automatic growth in federal revenues generating new leeway for fiscal dividends—tax cuts, tax sharing, program increases—if Vietnam demands level off. If rising revenues are not to hold the economy back under such circumstances, we need to get our bets down promptly on the competing entrants in the fiscal drag race.

House Report, supra note 60, at 94. However, by 1971, Mr. Heller was justifying Revenue Sharing on the basis of its efficiency and income redistribution effect. See Hearings on S. 1770 and S. 241 Before the Subcomm. on Intergovernmental Relations of the Senate Comm. on Government Operations, 92d Cong., 1st Sess., pt. 1, at 68, 71 (1971).

In considering the financial problems of local governments, your committee came to the conclusion that many localities face most severe financial crises. In part, this stems from the increasing demand for public services resulting from the substantial increase in urbanization occurring in recent
ad nauseam on the floor of the House and Senate that the federal government did not have any revenue to share. That is, given a projected unified budget deficit of $23 billion for fiscal year 1973, the federal government's fiscal crisis was far worse than that of state and local governments. However, this counter-argument failed to recognize that, assuming the federal government would make some expenditures, there would be federal revenue to share. The appropriate question was whether federal aid to states and localities in the form of Revenue Sharing occupied a lower priority than other existing or proposed federal expenditures.

If it did not, the reductions necessary to achieve

years. Closely related to this is the problem arising from the limited jurisdictions of many local governments: they often are called upon to provide many services for persons who do not live in their taxing jurisdictions. At the same time, those within their taxing jurisdictions often are poor and unable to pay for their share of the services demanded. This financial problem for local governments has been significantly worsened by the twin problems of rising costs resulting from inflation and the lower than normal increase in revenues because of the stagnant condition of the economy.

Your committee concluded that States also have financial problems but that their problems are less severe than those of the localities and also of a different nature. Nevertheless the difficulty in obtaining adequate financing, in part because of the nature of their tax structures, has presented the States with problems not only in meeting their own financing needs but also in their increasing role in assisting local governments. Your committee concluded that in the case of States the primary emphasis should be on encouraging them to help themselves—by making more extensive use of their own tax resources.

House Report, supra note 60, at 1-2.

The President's Message to Congress on February 4, 1971 also emphasized the "fiscal crises" of states and localities:

The growing fiscal crisis in our States and communities is the result in large measure of a fiscal mismatch; needs grow fastest at one level while revenues grow fastest at another. This fiscal mismatch is accompanied, in turn, by an "efficiency mismatch:" taxes are collected most efficiently by the highly centralized Federal tax system while public funds are often spent most efficiently when decisions are made by State and local authorities.

President's Message on Revenue Sharing, supra note 57, at 393.

The general explanation for the fiscal crisis is the so-called fiscal mismatch. That is, the federal government has made great use of the highly productive and growth-responsive income tax. At the same time, the pressure on expenditures has been relatively greater at the local level. See, e.g., Statement of John Connally, Secretary of the Treasury, Hearings, supra note 59, at 40-44; Walter W. Heller, supra note 60, at 1026.


65. See 118 Cong. Rec. 9748 (daily ed. Oct. 12, 1972) (remarks of Representative Betts); id. at 9751 (remarks of Representative Mills);
a balanced budget should be made in the areas of lower priority. A more fundamental response to the "fiscal crisis" argument was that the level of aggregate federal aid to states and localities was already adequate, if not excessive, given the significant federal budgetary deficits. In fiscal year 1955 federal aid to state and local governments amounted to $3.1 billion. For fiscal year 1974 it is estimated that this figure will climb to $45.0 billion. The Office of Management and Budget estimates that federal aid programs (including General Revenue Sharing) will finance about 21.3 percent of state and local expenditures in 1974, as compared to 8.0 percent in 1955. However, direct federal grants do not present the entire picture of assistance. Indirect aid to state and local governments through the deductibility of state and local taxes and the exemption of interest on state and local bonds for federal income tax purposes amounted to approximately $11 billion in fiscal year 1972. Therefore, it is not unreasonable to estimate the total direct and indirect aid to state and local governments (including General Revenue Sharing) at $55 billion for fiscal year 1974.

Moreover, if a fiscal crisis existed for state and local governments, it was a short term phenomenon resulting from a simultaneous rapid expansion of services, "catch up" wage inflation in the local public sector and the impact of the economic slow-

SENATE REPORT, supra note 9, at 10 ("The Committee . . . questions whether the presence of large deficits in the Federal budget should in itself preclude Federal aid to State and local governments in view of the vital need for such aid. To do so would imply that State and local fiscal assistance has a lower priority than all other present expenditures, a position the committee does not accept.").

66. See SPECIAL ANALYSES, supra note 3, at 213 ("In some respects, the Federal Government now faces a situation where it is under more fiscal pressure than State and local governments as a whole.").

67. See id. at 211. Also, it is interesting to note the shifts of priorities within the aggregate federal aid to state and local governments:

The functions comprising human resource programs—education and manpower, health and income security—show a rapid growth during the 1960-74 period, rising from 47% of Federal aid in 1960 to an expected 55% in 1974. On the other hand, physical resource programs (mainly in the commerce and transportation function) declined from 52% of the total in 1960 to 28% in 1974, largely because of the dominance of highway grants in the earlier period.

Id. at 212.

68. See id. at 211.

69. See id.; SENATE REPORT, supra note 9, at 10. The Office of Management and Budget has indicated that in 1972 the interest exemption on state and local bonds resulted in reduced interest costs of approximately $2.0 billion and resulted in a revenue loss to the U.S. Treasury of approximately $3.0 billion. SPECIAL ANALYSES, supra note 3, at 211.
down in 1969-1971 on local revenues.\textsuperscript{70} State and local governments appear able to increase revenues from their own sources at approximately the same rate as they increase expenditures. It has been estimated that for the period 1955-1969 state and local expenditures increased approximately 244 percent, while revenues from their own sources (excluding federal grants-in-aid and new debt issued) increased approximately 241 percent.\textsuperscript{71} Furthermore, state and local revenues (excluding federal grants-in-aid) increased from 1946-1970 at an average annual rate of 9.7 percent which is substantially above the increases which occurred in most other major economic areas, including personal income (6.6 percent increase), profits after taxes (4.5 percent increase) and gross private domestic fixed investment (6.5 percent increase).\textsuperscript{72}

Any fiscal crisis that exists for states and localities\textsuperscript{78} appears to be limited to selected entities.\textsuperscript{74} The national income accounts budget showed states and localities with a record $14.8 billion surplus (on an annualized basis) for the second quarter of 1972.\textsuperscript{75} For those cities with a significant "crisis,"\textsuperscript{76} Revenue

\textsuperscript{70} See Reischauer, \textit{supra} note 62; C. Schultz, \textit{Setting National Priorities: The 1972 Budget 136-37} (1971) [hereinafter cited as \textit{National Priorities-1972}] ("The recession has had a double effect. It has slowed the expansion of tax revenues and increased the demand for certain State and local services.").

\textsuperscript{71} See \textit{National Priorities-1972}, \textit{supra} note 70, at 139, 141.

\textsuperscript{72} See \textit{Banfield, supra} note 15.

\textsuperscript{73} See \textit{General Explanation, supra} note 63, at 1.

\textsuperscript{74} See, e.g., \textit{Banfield, supra} note 15.

\textsuperscript{75} See \textit{U.S. Department of Commerce, Survey of Current Business; Special Analyses} at 213 ("In some respects the Federal Government now faces a situation where it is under more fiscal pressure than State and local governments as a whole."). States and localities have experienced a surplus on the national income account basis in 7 out of the last 9 years; only in calendar years 1967 and 1968 did a deficit exist.

The Advisory Commission on Intergovernmental Relations (ACIR) believes that the 2nd quarter 1972 surplus figures are misleading since they include substantial surpluses in the social insurance funds. In addition, the second quarter of 1972 included two major nonrecurring items—a $4.0 billion advance payment of public assistance grants and $0.8 billion of unusually high income tax settlements in Pennsylvania. \textit{Advisory Commission on Intergovernmental Relations, The 1972 State-Local Surplus} (A.C.I.R. Information Interchange Service, No.
Sharing will be such a small percentage of their budgets that relief will be minimal at best. For example, the 1972-1973 budget for New York City is approximately $9.4 billion. The sum of the first two checks to New York City, covering a 12 month period, was $198,108,726. This represented slightly over two percent of a budget which increased from $3.9 billion in fiscal year 1965 (with deficit financing of $256 million) to $9.4 billion in 1973. Thus, Revenue Sharing will not even cover the inflationary cost increases for the city.

In a radio address on March 4, 1973, President Nixon indicated that the "hour of crisis has passed" for the nation's cities and towns. This conclusion concerning the aggregate situa-
tion does not dispute the fact that many individual cities such as Newark, Cleveland and Detroit have continuing problems of major proportions. However, as Wilbur Mills said prior to his very brief conversion to the "faith" of Revenue Sharing:

8 If the purpose of revenue sharing is to meet the needs of our economy today, then revenue sharing is a poor and wasteful means of attaining these ends. Why do I say that it is wasteful? Because under any of the formulas that have been developed so far, substantial funds are given to States and localities where there is little or no need, as well as to those where there is need.

Several studies have reached the conclusion that a limited number of localities certainly have serious fiscal problems which are likely to increase. However, the aggregate picture for all state and local governments is not at present nor in the foreseeable future one of an impending fiscal crisis. Richard A. Musgrave and A. Mitchell Polinsky84 estimated that in 1975 state and local expenditures will exceed receipts, including federal aid and normal borrowings, by $6 billion without Revenue Sharing. They indicated that a 5 percent tax increase would meet this deficiency. Similarly, the Brookings Institution concluded that in 1976 state and local expenditures less revenues will amount to a $9.5 billion deficit or approximately 4 percent of total expenditures of $261 billion.85 This does not amount to a "crisis."

83. Reischauer, supra note 62, quoting, Statement of Congressman Wilbur Mills; see Statement of Richard A. Musgrave, in Hearings, supra note 59, at 347 ("[A] large part of the funds will accrue to jurisdictions which are not in dire need of support, while those which are will not be helped sufficiently.").


This gap [$9.4 billion] is not of huge proportions. It represents less than 4 percent of anticipated state and local expenditures in 1978. The gap could be filled by any one of the following alternatives or by some combination of them:

—An average annual increase of 1.2 percent in state and local tax rates.

—An increase of 21 percent in the size of established federal grants, over and above the level they would reach in 1976 as a result only of price and workload increases. This would imply a considerably smaller rate of growth over this period than in the past five years.

—A general revenue sharing program of $9.4 billion, . . .

—Assumption by the federal government of 40 percent of the current state and local welfare burden, coupled with a federal program that financed all future increases in welfare costs.

Id. at 141-42.
It has been estimated that during the period 1955-1969 price increases were the single most important factor responsible for the 244 percent increase in expenditures, accounting for an estimated 43.8 percent of the total rise in general expenditures of state and local governments.86 The balance was estimated as comprised of a 26.2 percent increase in workload (for example, costs attributable to increases in the number of residents, school-age children and automobiles) and a 30 percent increase attributable to an enlargement in the scope and improvement in the quality of public services.87 The rate of increase in the price index for the goods and services purchased by local governments was twice that of consumer expenditures between 1960 and 1971.88 Thus, for state and local governments, and especially for the large urban cities, inflation was the most important factor in the dramatic increase in expenditures during the past decade.89 It can be argued, therefore, that the most effective form of state and local assistance is for the federal government to curb inflation and simultaneously adopt policies and programs which will significantly improve the scope and quality of local services. In this light, Revenue Sharing must be justified primarily as a method of improving the efficiency of existing federal aid levels in delivering federally financed goods and services at the state and local levels.

A conclusion that Revenue Sharing will result in an increase in relative efficiency must be based, in part, on an examination of the defects in previously existing programs. The categorical aid programs encouraged state and local governments to significantly increase their expenditures in specified program areas which were rigidly and narrowly defined.90 The matching fea-

86. Id. at 139.
87. Id.
88. NATIONAL PRIORITIES—1973, supra note 76, at 296.
89. Id. It has been estimated that since the beginning of 1966, prices paid by state and local governments for goods and services have risen 32 percent, one-third faster than consumer prices. NATIONAL PRIORITIES—1972, supra note 70, at 137.
90. This view is certainly strongly supported in the SENATE REPORT, supra note 9, at 16:
To a considerable extent, the adoption of the revenue-sharing program stems from the need to avoid the problems inherent in many categorical programs which specify how the recipient governmental unit is to spend the funds. Such categorical aid programs may result in forcing the recipient governmental unit to spend the funds for the specified purpose even though the governmental unit may have other more urgent needs to finance.

See, e.g., 118 Cong. Rec. S14184 (daily ed. Sept. 6, 1972) (remarks of
ture of many of these programs, which is frequently $3 of federal assistance for every $1 contributed by the state or local government, caused distortions in expenditure patterns. For example, Mississippi projected an increase in its social services program between fiscal years 1971 and 1973 which would have increased the federal matching share from $1,098 to $463,572, or a 42,118 percent increase in two years. Although the objective of the matching grant programs was to decentralize the federal system, the paperwork and bureaucratic decision making significantly restricted any true exercise of local initiative. In fact, many cities were totally unaware of the aggregate extent to which the matching commitments made by various city agencies were obligating the city to local matching requirements.

In response to the criticism of the categorical grant programs, the Intergovernmental Cooperation Act of 1973, S.834, 93d Cong., 1st Sess. (1973), was introduced by Senator Muskie. The objective of the bill is to counter some of the criticism by improving the management of the programs through the following provisions:

- Permit the President to seek congressional approval to consolidate federal grant-in-aid programs within the same functional areas through a procedure similar to executive reorganization plans;
- Permit states and local governments to submit combined applications for joint projects which require funding from two or more federal programs;
- Permit greater reliance by federal agencies on state and local auditing and accounting systems that meet certain standards;
- Establish a new procedure for congressional oversight of federal grant-in-aid programs through new revenue specialist positions on each standing committee of the House and Senate;
- Insure that state governments obtain full and complete information on the amount and purpose of all federal aid dollars spent in their respective states; and
- Amend the Intergovernmental Personnel Act to permit a new program of federal-state fellows and federal-urban fellows.

91. See Special Analyses, supra note 3, at 217 (“In the last few years, State and local governments have had to allocate about 10% of their own revenue to match Federal grant moneys.”); Hearings on S.1770 and S.241, supra note 62, at 74 (Governor Bartlett: “[T]he categorical grant competes more effectively for local and State moneys than do the priority needs of local and State.”). Walter Heller stated: “The matching requirements have this disadvantage of siphoning funds from other sources and putting pressures that may cause misallocation of the funds.” Id. at 75.

92. Staff data from Senate Finance Committee; see Senate Report, supra note 9, at 65.

93. See Clark, Iglehart & Lilley, New Federalism II: Philosophy, 4 Nat’l J. 1913 (1972). Mayor Norman Mineta of San Jose, California indicated that a $200,000 grant under the Planned Variations Program to review and comment on all federal grants impacting on the city had to be redirected since the city did not know the extent and nature of fed-
The defects in the categorical grant programs were demonstrated by a federal study of the operation of federal grant-in-aid programs in Richmond, Virginia, which reached the following conclusion:

"We had no idea that we were so heavily committed, or in what areas we had agreed to put up matching money. City agencies were applying right and left for money, and the Mayor's office never knew what the extent of the city's matching commitments were. And of course we never had the chance to weigh the individual commitments against any kind of overall needs assessment.

You have to conclude that the city might well have wanted to put its money into other areas."

Id. The Office of Management and Budget in its study of the impact of federal grants-in-aid in Richmond, Virginia concluded that there was no single official or agency in the City of Richmond which had available an accurate figure for the number, amount and matching requirements of federal programs in which they were engaged.

94. Office of Management and Budget, Richmond Study Task Force Report (1971), quoted id. at 1914. The Report reached the following additional detailed conclusions:

—There is ample evidence that federal assistance which has the potential of shoring up existing, financially weak state and local activities and stimulating the development of new approaches has eroded the decision-making capacity of state and local chief executives to coordinate and direct resources to meet emerging problems. Many federal programs have created new and frequently competitive state and local institutions.

—The delivery of federal assistance through functional grant-in-aid channels has resulted in the development of working relationships whereby special purpose functional bureaucracies at all levels of government tightly administer the program for limited purposes. There are few incentives to move beyond the established functional boundaries to develop integrated approaches to common problems. Programs too narrowly conceived deal with pieces of a problem and even then usually with the symptoms and not basic causes.

—The excessive number of categorical grant programs has created a morass of administrative requirements which are inconsistent, excessively complicated, and costly to administer. These requirements have generated significant disillusionment and distaste among recipient state and local officials. Many local governments do not participate in grant programs because they do not know of the programs' availability or they find the red tape too confusing and enervating. State and local officials are faced with so many grant processes they do not have the time or staff to manage them.

—There is no single line of authority with which state and local officials can deal to apply for and receive federal funds. Communities in need of resources cannot turn to a singly accountable federal entity in order to press their demands. Similarly, the federal government is not in a position to resolve competing demands, balancing such demands with resources available.

—Coordination of grant programs among federal agencies as well as with state and local governments is generally very weak. There is no effective point of coordination at the local
We now find, according to most governmental observers, that this haphazard growth of the grant-in-aid system has resulted in resources being delivered in uncoordinated and fragmented fashion through dozens of single-purpose categorical programs. Many of these programs are beyond the direct influence of general-purpose government. The sheer magnitude of the number of programs and the concomitant bureaucratic processes in order to obtain them has inevitably made it clear that the difficulties in managing Federal aid have become immense and in many respects impossible. In fact, the growth of the grant-in-aid system instead of encouraging broad, interrelated, and flexible plans of attack on social and economic problems is designed more to thwart this objective rather than promote it.

The Nixon Administration has highlighted the following problems which accompanied the dramatic increase in federal grant programs during the last two decades:

The major difficulty is that States and localities are not free to spend these funds on their own needs as they see them. The money is spent instead for the things Washington wants and in the way Washington orders. Because the categories for which the money is given are often extremely narrow, it is difficult to adjust spending to local requirements. And because these categories are extremely resistant to change, large sums are often spent on outdated projects. Pressing needs often go unmet, therefore, while countless dollars are wasted on low priority expenditures.

This system of categorical grants has grown up over the years in piecemeal fashion, with little concern for how each new program would fit in with existing old ones. The result has been a great deal of overlap and very little coordination. A dozen or more manpower programs, for example, may exist side by side in the same urban neighborhood—each one separately funded and separately managed.

All of these problems are compounded by the frequent requirement that Federal dollars must be matched by State and local money. This requirement often has a major distorting effect on State and local budgets. It guarantees that many Federal errors will be reproduced at the State and local level. And it leaves hard pressed governments at the lower levels with less money to finance their own priorities.

The administrative burdens associated with Federal grants can also be prohibitive. The application process alone can involve volumes of paperwork and delays of many months. There are so many of these programs that they have to be listed in large catalogs and there are so many catalogs that a special catalog of catalogs had to be published. The guidelines which are attached to these grants are so complicated that the government has had to issue special guidelines on how the guidelines should be interpreted. The result of all this has been described
—Program delays and uncertainty caused by unnecessarily detailed and costly application requirements;
—Unnecessary limitations on the authority and responsibilities of governors, mayors, county executives, and city managers;
—The creation of competitive and duplicative state and local governmental institutions;
—Rigid funding and organizational arrangements which were unable to adjust to changes in priorities over time, such as matching funds requirements.

Finally, the Brookings Institution concluded that an expansion of the existing grant programs would not alleviate the problems of urban core cities:

[M]any of the programs that are intended to assist local governments in providing services are encumbered by stringent regulations that preclude their use for the support of basic services . . . . [I]n many cases, they require that the recipient government match some fraction of the federal contribution. Hence, rather than providing relief from the fiscal burden of running basic city services, they tend to add to that burden . . . .

If these conclusions as to the defects in the existing programs are accurate, Revenue Sharing, both General and Special, should be seen primarily as an alternative delivery vehicle intended to avoid the substantial problems generated by the categorical grant programs. However, it is first necessary to determine whether Revenue Sharing presents potential difficulties of a different sort which may be of a greater magnitude.

The opposition to Revenue Sharing argues that it will not result in an efficient delivery of services because local governments lack the expertise and capability to manage resource allocation and because a higher level of corruption exists at the local level. This view is supported by the widely publicized

by the Advisory Commission on Intergovernmental Relations as “managerial apoplexy” on the State and local level. President’s Message on Revenue Sharing, supra note 57, at 393 (emphasis added).

96. NATIONAL PRIORITIES—1973, supra note 76, at 311.
97. Wilbur Cohen, former Secretary of the Department of Health, Education and Welfare, has been quoted as opining that city governments are “run by political machines which do not allow competent people to be administrators. Instead they are shackled to a lot of political hacks.” Furthermore, he states “the bulk of local government people are not the most competent. They have little or no in-service training, and the good people leave because there is no career service. The only good people at the state and local level are in budget and finance, and not in the substantive programs. That’s one of the biggest weaknesses with the special revenue-sharing proposals; the local competence just is not there to handle them.” Clark, Iglehart & Lilley, New Federalism III: The Opposition, 4 Nat’l J. 1920, 1925 (1972).

Walter Heller has expressed the view that state and local officials must be given an opportunity to restructure their organization and personnel:
report of the investigation by the Government Operations Committee of the House of Representatives, dated May 18, 1972, on operations under the Law Enforcement Assistance Administration. The report stated:

The instances of misuse and misapplication [are a matter of great concern] . . . . Too large a portion of those funds has been wasted on diversion for partisan political purposes, on exorbitant consultants' fees, on equipment and vehicles which are misused or not needed, on excessive payments to equipment suppliers resulting from widespread absence of competitive bidding and unethical relationships between state and local officials and suppliers' representatives.

In response to this criticism, the Nixon Administration has proposed the Responsive Governments Act to develop the necessary planning and management capability at the local level. In the atmosphere created by Watergate, the Ellsberg Affair and the allegations against former Vice President Agnew, arguments based on higher levels of local corruption are not very convincing.

Further, it has been argued that the handicapped, disadvantaged and poor who are now the beneficiaries of many categorical programs will not be able to effectively compete for their share of the Revenue Sharing funds at the local level. In fact, the very purpose of the much maligned extensive regulations and paper work involved in the categorical grants was to en-

[C]ne constantly hears that state and local units are inefficient and wasteful. In effect, what they are told is, shape up and then we will ship out the money. But I say, ship it out to help you shape up. It's a chicken and egg proposition. The argument that somehow or other you have to become a paragon of perfection before the federal government should share its revenues just won't hold water.

Hearings on S. 1770 and S. 241, supra note 62, at 64.


William Safire, former staff assistant to President Nixon, made the following statement in an article on the Watergate scandal comparing federal and local levels of corruption as they relate to Revenue Sharing:

The argument most frequently advanced against the President's New Federalism by liberal critics went this way: "If the power to decide national priorities, presently located in scandal-free Washington, were to be transferred out to states, cities and local communities—then that power would be abused by the well-known venality, greed and irresponsibility of the political hacks who work at the local level."

At some expense to the reputation of several of its officials, the Nixon Administration has finally made the point it had hitherto failed to communicate: No level of government has a monopoly on virtue.


Revenue Sharing

Sure that the grants benefited the designated disadvantaged groups. Former H.E.W. Secretary Wilbur J. Cohen bluntly defended the categorical grants as follows:

"We have to have federal programs with strings attached because it is the only way that the disadvantaged, the poor whites and the poor blacks will get their fair share. If there are not federally regulated programs to disburse money and instead it is handled by local city governments, then they won't get their fair share.

Unlike the federal government, city councils are controlled by the real estate and industrial development interests and they will divert the money to their ends. We have to have federal strings because there is no other political means to reconcile the interests of local real estate people with the broader national interests."

Even strong proponents of Revenue Sharing such as Walter Heller and Joseph Pechman argue that Revenue Sharing cannot be a substitute for categorical grants but rather is a necessary supplement. They suggest that categorical grants are necessary to coerce the state and local governments to act in a manner dictated by the national government and the matching requirements are intended to reflect that portion of the benefits in the program which are local rather than national.

This very negative view of the quality of local decision making and the responsiveness of the local democratic processes will certainly be tested by Revenue Sharing. The ever-increasing political awareness and impact of minority groups at the local level may be accelerated by a program of the dramatic proportions of Revenue Sharing. A recognition of the need to com-

100. Clark, Iglehart & Lilley, supra note 97.
102. Many commentators support an optimistic view of the foreseeable performance of state and local officials under Revenue Sharing. See, e.g., Elazar, Revenue Sharing: Are the States and Localities Responsible?, id. at 322. At a minimum, it can be argued that states and localities should be given an opportunity to demonstrate their ability without the restraints of the categorical programs. See id. at 64, 76, 98.
103. The generally accepted view is that minority and other special interest groups are far more effective influencing Congress than the state and local decision-making apparatus. See, e.g., Banfield, supra note 15 ("From the standpoint of organized interests, dealing with Congress and the Washington bureaucracies . . . is vastly easier and more likely to succeed than dealing with the legislatures and governors of 50 States, not to mention the officials of countless cities, counties, and special districts.").

Vernon E. Jordan, Jr., Executive Director of the National Urban League, has made the following statement:

"The effect of revenue sharing on white people is likely to be harmful; for black people it promises to be devastating."
pete for the funds at the local level may in fact result in a "New American Revolution" in a totally unexpected manner. The same coalition of minority groups which was effective at the national level in influencing congressional decisions may now be forced to concentrate on the local decision making process with far greater impact than generally anticipated.

In conclusion, although potential difficulties certainly exist, it is the thesis of this Article that the major long term contribution of Revenue Sharing must be evaluated in terms of the relative efficiency with which it delivers goods and services at the state and local levels. Initially, the reduction in "red tape" and the elimination of spending constraints, matching requirements and uncertainty in the current grant system should result in some improvement. However, the long term impact of Revenue Sharing must be judged by the ability of local decision making, responsibility and accountability to produce more efficient performance. If the same dollars do not deliver more goods and services to meet the highest priority needs of the recipient governments, Revenue Sharing will have failed the "New Federalism" and presumably will be subject to President Nixon's standard that "Federal programs must meet their objectives and costs must be related to achievements."

It is General Revenue Sharing that must be the driving force to improve the general efficiency of state and local governments in meeting the broad range of priorities they have established. Special Revenue Sharing should follow in broad areas of concentration selected on a national basis, with decisions made at the state and local levels regarding the priorities and particular projects within those selected areas.

B. GENERAL DESCRIPTION OF THE REVENUE SHARING LEGISLATION

An analysis of the State and Local Fiscal Assistance Act

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The federal government has historically been the protector of minority citizens. While it has often been the frailest of reeds, historically it has been more responsive than state or local governments.

Now, just as it has come to be black people's time to benefit from federal actions, it is proposed that the Rule of the game be changed and we rely on some magical mixture of local goodwill along with a heavy dose of individual initiative...

I have little faith in the competence and record of 50 state governments and thousands of local governments to make humane judgements and institute responsible programs.


(Public Law 92-512) requires study of its legislative history in order to interpret and explain the statutory provisions and evaluate the administrative implementation and regulation. Due to the highly political nature of this legislation and the many compromises involved, the legislative history performs a far more substantial role than is generally the situation. The significance of many of the provisions is evident only upon a careful reading of the Committee and Conference Reports and the Congressional debates. Furthermore, the desire of Chairman Wilbur Mills to distinguish his legislative proposals from the Nixon Administration's proposals resulted in provisions which either lacked substance initially or will become without substance as a result of the administrative implementation and regulation.

The Act basically provides for the distribution of $30.2 billion directly to all state governments and to most units of local government pursuant to fixed formulas over a five year period commencing January 1, 1972. The Act was made retroactive to January 1 because many states and localities, especially New York State, had included the grants in their budgets based on commitments from the Nixon Administration and various powerful Congressmen.

The legislation may be analyzed as a framework composed of the following parts:
1. Mechanics of federal authorization and payment;
2. Identification of qualified recipients;
3. Allocation formulas and applicable limitations;


The "priorities" to which local expenditures are limited were not selected after careful analysis of the needs of the 39,000 units of local government involved. The "priorities" were plucked out of thin air for the whole purpose of distinguishing the Committee bill from the Administration's "no strings attached" revenue sharing proposal which had been consistently denounced by some members of the Committee.

Id.

Chairman Wilbur Mills made the following statement:

Finally, I would like to emphasize that . . . there are a series of differences between the fiscal assistance provided by this bill and the revenue-sharing proposal initially presented to us which in my mind are absolutely fundamental.

Third, under the bill, the Federal Government—which is the Government raising the revenues—provides controls on how the local governments will spend the funds distributed to them.


The "General Revenue Sharing Act of 1971" was introduced in the Senate by Senator Baker (S.680) and in the House of Representatives by Congressman Betts (H.R. 4187).
4. Data base for the allocation formulas;
5. Restrictions on expenditures of the funds;
6. Accountability for decision making, including the requirements on procedures, reporting and accounting.

Although the allocation formulas received most of the congressional and public attention for obvious reasons, the success of the program may well be determined by the effectiveness of the provisions in the Act governing expenditure of the funds, administration of the program, and the implementation and regulation thereof. This Article will present a detailed analysis of these provisions in an attempt to explain their purpose and evaluate their impact.

In order to achieve a unified structure of federal assistance to states and localities, the basic framework of the Act should be utilized in the Special Revenue Sharing programs, provided one concludes that the provisions in the Act are adequate for their purpose. A consistent scheme of administration and regulation would facilitate operations at the federal level and certainly would provide a simplified and consistent set of compliance, reporting and performance requirements for recipient governments. In fact, it is possible to envision federal administration of all revenue sharing programs from one centralized office. However, because different congressional committees will consider each of the Special Revenue Sharing proposals, it is unlikely that any consistent framework will result.

1. Identification of Qualified Recipients

a. Identified Recipients

The Act identifies the following categories of entities entitled to receive funds:
1. State governments;
2. Units of local government—defined as the government of a county, municipality, township, or other unit of general

106. In recognition of the unique nature of the legislation, the Act grants broad regulatory authority to the Secretary of the Treasury. The Secretary has established the Office of Revenue Sharing to administer the program and has delegated to the Director of that Office all the Secretary's authority under the Act. 31 C.F.R. §§ 51.0-.75 (1973) [hereinafter cited as Final Regulations]. For the purpose of interpreting the Final Regulations reference will be made to the Proposed Regulations which appeared in the Federal Register, on February 22, 1973, at 4917-28 [hereinafter cited as Proposed Regulations].

Interim regulations applicable to the Entitlement Period January 1 to June 30, 1972 were published in the Federal Register, on October 28, 1972 at 23,100 to 04; and amendments thereto for the Entitlement Period July 1 to December 31, 1972 were published in the Federal Register, on December 27, 1972 at 28507 to 508 [hereinafter cited as Interim Regulations].

107. Townships include equivalent subdivisions of government hav-
government determined on the basis of the same principles as are used by the Bureau of the Census for general statistical purposes.108

3. Indian tribes and Alaskan native villages—defined as the recognized governing body of an Indian tribe or Alaskan native village which performs substantial governmental functions109 and

4. The District of Columbia.110

A major unanticipated problem has arisen from that portion of the definition of units of local government which requires that they be a “unit of general government.” This provision was added because special districts such as school districts, library districts, fire districts and sewage districts were not intended to be recipient entities.111 The provision was also intended to disqualify entities such as election districts, magisterial districts and congressional districts which were not legally empowered to render any services to their citizens but rather were established for administrative, ministerial or political purposes.112

Particularly in connection with townships in the Midwest and counties in Massachusetts,113 there is a question as to the status of entities which satisfy the Census criteria for a unit of local government but perform extremely limited functions. The House Report indicates that the definition of qualified recipients is to include any general government “even though it might not
perform all of the functions that might be regarded as municipal functions or might contract to have some of those functions performed by other entities."\textsuperscript{114} The General Explanation of the Act states that "[a] unit must have a government (i.e., it must exist as an organized entity, have governmental characteristics and have substantial autonomy)—it is not enough that it have a political boundary."\textsuperscript{115} In general, the principles used by the Bureau of the Census for general statistical purposes will be determinative in resolving these questions.\textsuperscript{116}

The Bureau of the Census defines a governmental unit as "an organized entity having governmental attributes and having sufficient discretion in the management of its own affairs to distinguish it as separate from the administrative structure of any other governmental unit."\textsuperscript{117} The Census looks at the following characteristics as evidence of each of the three attributes:\textsuperscript{118}

1. Existence as an organized entity

Some form of organization must exist. In addition, the entity must have some corporate powers such as perpetual succession, the right to sue and be sued, and the right to make contracts, acquire and dispose of property. Merely having the right of existence is not adequate.

Where a former governmental unit has ceased to operate—e.g., receives no revenue, conducts no activities, and has no officers currently—it is not counted as an existing government.\textsuperscript{119}

2. Governmental character

Officers must be popularly elected or appointed by public officials and the entity must be subject to requirements of public accountability such as public reporting or public inspection of records.

Governmental character is attributed to any units having power to levy property taxes, power to issue debt exempt from taxation, or responsibility for performing a recognized governmental function. However, a lack of

With respect to townships in Illinois, the Census states:

Eighty-five of the 102 counties in Illinois have organized township governments . . . . In addition to the assessment of property for taxing purposes, Illinois townships have two main functions—maintenance of local roads and support of indigents. Certain of the township governments also operate libraries, cemeteries, and hospitals.\textsuperscript{116}

\textit{Id.} at 338.

\textsuperscript{114} \textit{House Report, supra} note 60, at 31; see \textit{Senate Report, supra} note 9, at 28.

\textsuperscript{115} \textit{General Explanation, supra} note 63, at 36.

\textsuperscript{116} \textit{See U.S. Bureau of the Census, Classification Manual, Governmental Finances} 6-10 (1971) [hereinafter cited as \textit{Census Classification Manual}].

\textsuperscript{117} \textit{Id.} at 6.

\textsuperscript{118} \textit{Id.} at 7.

\textsuperscript{119} \textit{Id.}
these attributes or of evidence concerning them does not preclude a class of units being recognized as governmental in character, if it meets the indicated requirements as to officers or public accountability.

3. Substantial autonomy

In general, the entity must have the power to raise a substantial portion of its revenue from sources it controls and its officers must be independent of external administrative control in the actual operation of the unit's activities.\textsuperscript{120}

However, the Census definition of unit of government includes independent school districts and special districts,\textsuperscript{121} both of which Congress intended to exclude from the definition of "unit of local government."\textsuperscript{122}

With the exception of Indian tribes and Alaskan native villages,\textsuperscript{123} units of local government are effectively disqualified as recipients for any entitlement period if their allocation would amount to less than $200 for any 12 month period.\textsuperscript{124} The congressional committees considered various population-related minimums\textsuperscript{125} and other revenue qualifications in order to simplify the administrative problems and reduce uneconomical and inefficient fragmentation of political units. Small communities in densely populated areas often provide a minimum amount of general governmental services and rely instead upon county and state governments or contract with other communities for services. However, in a sparsely settled state, a community of 1500 might provide many community services and constitute a significant viable entity. This dilemma made agreement on population minimums or revenue qualifications impossible.

In 1967, a Bureau of the Census report on governmental organizations indicated the following:\textsuperscript{126}

<table>
<thead>
<tr>
<th>Population size group</th>
<th>Municipalities</th>
<th>Township governments</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number</td>
<td>Percent</td>
</tr>
<tr>
<td>Total</td>
<td>18,048</td>
<td>100.0</td>
</tr>
<tr>
<td>Over 5,000</td>
<td>2,964</td>
<td>16.4</td>
</tr>
<tr>
<td>2,500 to 4,999</td>
<td>1,791</td>
<td>9.9</td>
</tr>
<tr>
<td>1,000 to 2,499</td>
<td>3,554</td>
<td>19.7</td>
</tr>
<tr>
<td>Less than 1,000</td>
<td>9,739</td>
<td>54.0</td>
</tr>
</tbody>
</table>

Thus, a minimum population standard of 2500, which was se-

\textsuperscript{120} Id.
\textsuperscript{121} Id. at 10.
\textsuperscript{122} General Explanation, supra note 63, at 36 ("This definition of general government excludes school districts, special utility districts, library districts, . . . ").
\textsuperscript{124} Act § 108(b) (6) (D), 31 U.S.C.A. § 1227(b) (6) (D) (1973).
\textsuperscript{125} The original Mills Bill § 103(e) (9) had a minimum qualification requirement of 2,500 population and $10,000 adjusted revenues. H.R. 11350, 92d Cong., 1st Sess. (1971).
\textsuperscript{126} Governmental Organization, supra note 111, at 2-3.
riously discussed, would have eliminated approximately 74 percent of all municipalities and 84 percent of all townships. This result was unacceptable to many Congressmen, particularly Southern Representatives on the House Ways and Means Committee.

b. Boundary Changes and Governmental Reorganizations

The Act recognizes that structural changes such as annexations, new incorporations, relinquishments of charters and mergers of governmental units occur constantly and often involve significant numbers of people. In general, the Act provides that any boundary change, governmental reorganization, or change in state statutes or constitutions relevant to the computation of the entitlement of a unit of local government will be reflected in the allocation amount for that unit for the next Entitlement Period. However, the Regulations provide certain de minimis rules to reduce the administrative burden.

The most significant problem caused by this provision is the necessity to construct comparable data for the data base period for the comparable units. For example, if Municipality A were incorporated on May 1, 1973, it would be entitled to receive funds for the Entitlement Period commencing July 1, 1973. How-

127. See Letter from Graham W. Watt to General Revenue Sharing Recipients, April 6, 1973 (“the 26,000 places we serve that have fewer than 2,500 people”).


129. Final Regulations, supra note 106, § 51.23(a) (1). The Final Regulations require that the Bureau of the Census be notified of a change within 60 days after the beginning of an Entitlement Period in order to affect the allocation for that period.

We [the Census Bureau] learn about 90 to 95 percent of all geographic changes from our annual Boundary and Annexation Survey. This is a year-end survey in which we send out a list reflecting our latest geographic information to every county government and maps to every municipality of 2500 or more persons. We ask them to post all changes within their jurisdiction on the map and to provide us with a copy of the legal documentation to support those changes. The result of this survey is the notification to Treasury of official and qualifying changes in eligibility status and necessary basic data elements for new units of government.


130. Annexations will not affect the entitlements if the annexing entity had an original population of less than 5,000 on April 1, 1970 or the annexed area had a population of less than 250, or less than 5 percent of the population of the annexing entity. Final Regulations, supra note 106, § 51.23(d). However, the Secretary reserves the right to adjust for an annexation when he “determines that adjustments pursuant to such annexations would be equitable and would not be unnecessarily burdensome, expensive, or otherwise impracticable.” Id.; see House Report, supra note 60, at 32; Senate Report, supra note 9, at 29.
ever, the population and income data in the local allocation formula used for all other municipalities in the county for that Entitlement Period are derived from the 1970 Decennial Census. Therefore, the requirement of using uniform comparable data precludes using 1973 special census data for Municipality A for these data elements. Rather, the Bureau of the Census must reconstruct 1970 data elements on population and income for Municipality A using the 1970 Decennial Census information.\textsuperscript{131} Also, for the Entitlement Period commencing July 1, 1973, the Treasury would normally use the Special Survey of Adjusted Taxes for fiscal year 1973, a period during which Municipality A did not levy any taxes. Therefore, the Bureau of the Census must also construct adjusted tax data for Municipality A if it is to receive any allocation for that Entitlement Period.

2. Allocation Formulas and Applicable Limitations

a. Description of Allocation Formulas

Although most members of the House Ways and Means Committee, the Senate Finance Committee and the Congress as a whole voted on the basis of relative dollar allocations rather than technical formulas, the Act as adopted makes the formulas, subject to specified limitations, the sole and final determiner of the allocations.\textsuperscript{132} In fact, the allocations determined by the Department of the Treasury for distribution vary significantly from the dollar amounts considered by Congress.

The House Ways and Means Committee deliberated in executive session for 35 days using as its reference points the allocation formulas in the original Administration proposal and in the bill introduced by Chairman Mills. Under great political pressure during a period of national political campaigns, Chairman Mills finally agreed to take the bill to the floor in late June, 1972. As a result of its "Closed Rule," the House of Representatives as a body had no alternative to the Ways and Means proposal.\textsuperscript{133} Pressure from an effective coalition of governors, mayors, and county commissioners forced House passage of the bill.

\textsuperscript{131} \textsc{House Report, supra} note 60, at 32; \textsc{Senate Report, supra} note 9, at 29. ("It is understood that reasonable efforts will be made to determine the population and per capita income of new or expanded units using the 1970 census data (rather than conducting a new partial census).")

\textsuperscript{132} See "Limitations on Allocations," § 2(c), p. 45 infra.

\textsuperscript{133} In general, a Closed Rule is a parliamentary determination which prohibits all amendments to the pending proposal. It is interesting to speculate as to whether in the future Chairman Mills will be able to obtain a Closed Rule on other revenue sharing proposals. Chairman Mills has indicated that he would support the request of Charles A.
Thereafter, the Senate Finance Committee, under the leadership of Chairman Russell Long, played a very creative "numbers game." The Committee requested a spread sheet indicating total state allocations according to every available variable and then considered various combinations of these variables in order to achieve the relative dollar allocations desired. Since the Senate Finance Committee was dominated by representatives of the poorer, less urban states of the South and West, the relative shifts from the allocations adopted by the House Ways and Means Committee, dominated by representatives of the wealthier urban states, were readily understandable. Once the broad relative dollar allocations were decided, the Senate Finance Committee refined the formula to achieve the very practical political objective of producing more "winners"—i.e., states receiving more funds under the Finance Committee proposal than under the House bill—than "losers."

The Conference Committee adopted a "best of both worlds" approach, seeking to balance the interests of both urban and rural states. Vanik, D-Ohio, to seek an Open Rule on the bill to extend the interest equalization tax. See Tax Analysts and Advocates, February 12, 1973. The new chairman of the Rules Committee, Ray J. Madden, D-Ind., has been a vocal supporter of Open Rules and voted for an Open Rule on Revenue Sharing. The House Democratic Caucus voted to establish a new mechanism significantly reducing the scope of the Closed Rule. Wall Street Journal, Feb. 22, 1973, at 2, cols. 3-4. An Open Rule would result in a significant number of proposed changes in the allocation formula, which would greatly increase the difficulty of House passage.

The starting point of the analysis was a "spread sheet" showing total and per capita distributions for each state based on the factors of population, urbanized population, relative income, income tax collections and general tax effort.

Senator Russell Long very creatively combined a supplemental $1 billion as a substitute for the Social Services program with the basic $5.3 billion of Revenue Sharing which resulted in allocations where all but four states and the District of Columbia received more funds under the Senate Finance Committee Bill than under the House-
approach. Each state would receive an aggregate allocation on the basis of whichever formula, either House or Senate, resulted in the largest amount for that state. In fact, serious consideration was given to an allocation method which would have taken the average of the House and Senate allocations.

Development of the formulas and calculation of the allocations was complicated by the geographical diversity of the country. For example, in 10 states (Connecticut, Illinois, Indiana, Kansas, Michigan, Missouri, Nebraska, New York, Ohio and Vermont) municipal governments are in townships as well as in counties. This problem of geographically overlapping jurisdictions is highlighted by Cook County, Illinois, which in 1970 had 113 municipalities with populations over 2,500, of which 15 overlapped into another county while 43 were in more than one township within Cook County. Some were in as many as four townships.

In recognition of the problem posed by geographic diversity, the Administration Bill attempted to distribute funds directly among all local governmental units without regard to their geographic locations. In contrast, the allocation formulas in the original Mills Bill and the final Act deal with the problem through the concept of various levels of all-inclusive geographic areas, one within the other. Thus, allocations are made first to state areas, then to county areas, and finally to each local governmental unit (including the county government) within the county area. This method of calculation could cause two identical municipalities on either side of a county line to receive substantially different allocations since allocations are based on a municipality’s characteristics relative to those of the other municipalities in the same county.

If a unit overlaps into another geographic area it is treated separately and receives an allocation from each geographic area. For example, Atlanta, Georgia, is located in DeKalb and Fulton Counties. The part located in DeKalb County is considered a separate city for purposes of sharing in the DeKalb County area allocation, and the part located in Fulton County is considered a separate city for the Fulton County area allocation.

The following formula descriptions indicate the calculations and allocations for State X, which includes County X1, having a Municipality Xa.\footnote{137}{137. These formulas do not indicate the difficulties caused by the presence of townships or Indian tribes. See Act §§ 108(b)(3) and (4), 31 U.S.C.A. §§ 1227(b)(3) and (4) (1973).}
CALCULATION OF AMOUNT TO STATE X AREA

### A. CALCULATION OF AMOUNT OF STATE X AREA UNDER “THREE FACTOR (SENATE) FORMULA”

<table>
<thead>
<tr>
<th>Three Factor Formula Amount to State X Area</th>
<th>$5.3$ billion (x)</th>
<th>Population of State X (x)</th>
<th>General Tax Effort Factor of State X (x)</th>
<th>Relative Income Factor of State X (x)</th>
<th>Sum of Numerators for All States</th>
</tr>
</thead>
</table>

### B. CALCULATION OF AMOUNT TO STATE X AREA UNDER “FIVE FACTOR (HOUSE) FORMULA”

<table>
<thead>
<tr>
<th>Population Amount to State X Area</th>
<th>$\frac{5}{2}$ (x)</th>
<th>$3.5$ billion (x)</th>
<th>Population of State X</th>
<th>Population of State X</th>
</tr>
</thead>
<tbody>
<tr>
<td>Urbanized Population Amount to State X Area</td>
<td>$\frac{5}{2}$ (x)</td>
<td>$3.5$ billion (x)</td>
<td>Urbanized Population of State X</td>
<td>Urbanized Population of State X</td>
</tr>
</tbody>
</table>

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1. The appropriation increases to an annualized rate of $6.65$ billion for the period July 1 to December 31, 1976.

2. The formulas do not reflect the noncontiguous states adjustment provided in Section 106(c). At present, this adjustment applies only to Hawaii and Alaska.

3. General Tax Effort Factor of State X = \[ \frac{\text{Net Amount Collected From All State and Local Taxes}}{\text{Aggregate Personal Income Attributed to State X}} \]

4. Relative Income Factor of State X = \[ \frac{\text{Per Capita Income of U.S.}}{\text{Per Capita Income of State X}} \]
<table>
<thead>
<tr>
<th>Formula</th>
<th>Numerator</th>
<th>Denominator</th>
<th>Result</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inverse Per Capita Income</td>
<td>( \frac{1}{3} \times $3.5\text{ billion} )</td>
<td>Population of State X ( \times )</td>
<td>Per Capita Income of All States</td>
</tr>
<tr>
<td>Amount to State X Area</td>
<td>General Tax Effort of State X((5))</td>
<td>Sum of Numerators for All States</td>
<td></td>
</tr>
<tr>
<td></td>
<td>$0.9\text{ billion}</td>
<td>Sum of General Tax Efforts of All States</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Income Tax Amount to State Area</td>
<td>Adjusted Income Tax Collections of State X</td>
<td></td>
</tr>
<tr>
<td></td>
<td>$0.9\text{ billion}</td>
<td>Adjusted Income Tax Collections of All States</td>
<td></td>
</tr>
<tr>
<td>Five Factor Formula Amount to State X Area</td>
<td>Population Amount to State X ( \times )</td>
<td>Urbanized Population ( \times ) Inverse Per</td>
<td>Income Tax Amount to State X Area ( \times )</td>
</tr>
<tr>
<td></td>
<td>Amount to State X Area</td>
<td>Per Capita Income of State X ( \times )</td>
<td>Area</td>
</tr>
<tr>
<td></td>
<td></td>
<td>General Tax Effort Amount to State X ( \times )</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Income Tax Amount to State X Area ( \times )</td>
<td></td>
</tr>
</tbody>
</table>

C. AMOUNT TO STATE X AREA

Each State Area receives the larger of the "Three Factor Formula Amount" or the "Five Factor Formula Amount." The amount for each State is then proportionally increased or decreased so that the total for All States equals the appropriated amount.

\[(5)\] General Tax Effort = State and Local Taxes \( \times \) State and Local Taxes \( \times \) Aggregate Personal Income
D. ALLOCATION TO LOCAL GOVERNMENTS

1. Calculation of Aggregate Amount to All Units of Local Government in State X Area

\[
\text{Aggregate Amount to All Units of Local Government} = \frac{2}{3} \times \text{Amount to State X Area}
\]

2. Calculation of Amount to County Areas

\[
\text{Amount to County } X_1 \text{ Area} = \frac{\text{Aggregate Amount}}{\text{Population of County } X_1 \text{ Area}} \times \frac{\text{Effective Factor of County } X_1 \text{ Area}}{\text{Sum of Numerators for All County Areas Within State X}}
\]

3. Allocation to County Governments

\[
\text{Allocation to County } X_1 \text{ Government} = \frac{\text{Amount to County } X_1 \text{ Area}}{\text{Adjusted Taxes of County } X_1 \text{ Government and All Units of Local Government in County } X_1 \text{ Area}}
\]

---

(6) General Tax Effort Factor of County \( X_1 \) Area = Adjusted Taxes of County \( X_1 \) Government and All Units of Local Government within County

Aggregate Personal IncomeAttributed to County \( X_1 \) Area

(7) Relative Income Factor of County \( X_1 \) Area = Per Capita Income of State X

Per Capita Income of County \( X_1 \) Area
4. Calculation of Amount to All Municipal Governments within County Area

\[
\text{Amount to All Municipalities within County } X_1 \text{ Area} = \text{Amount to County } X_1 \text{ Area} - \text{Allocation to County } X_1 \text{ Government}
\]

5. Allocation to Municipal Governments

\[
\text{Amount to Municipality } X_a = \text{Amount to All Municipalities within County } X_1 \text{ Area} \times \frac{\text{Population of Municipality } X_a (x)}{\text{Sum of Numerators for All Municipalities within County } X_1 \text{ Area}} \times \text{General Tax Effort Factor of Municipality } X_a^{(8)} (x) \times \text{Relative Income Factor of Municipality } X_a^{(9)}
\]

\[(8) \text{ General Tax Effort Factor of Municipality } X_a = \frac{\text{Adjusted Taxes of Municipality } X_a}{\text{Aggregate Personal Income Attributed to Municipality } X_a}\]

\[(9) \text{ Relative Income Factor of Municipality } X_a = \frac{\text{Per Capita Income of County } X_1 \text{ Area}}{\text{Per Capita Income of Municipality } X_a}\]
The allocation to each state area is on the basis of whichever of two formulas—the "Three Factor Formula" taken from the Senate Bill or the "Five Factor Formula" taken from the House Bill—yields the greater amount for that state area for the particular Entitlement Period. Although the principle was the "best of both worlds," some states, including Colorado, Florida, Indiana, Minnesota, Missouri, Nevada, Pennsylvania, Rhode Island, Texas, Virginia and Wisconsin, received less than under either the House or Senate formulation because the Administration insisted upon limiting the aggregate allocation to $5.3 billion in the first year although the sum of the "best of both worlds" approach was $5.8 billion. The Act provides that each state area's initial allocation would be proportionally reduced to arrive at a total allocation of $5.3 billion.\textsuperscript{138}

The Act's basic local allocation formula for county areas and units of local government other than county governments is presented as Population multiplied by the General Tax Effort Factor multiplied by the Relative Income Factor. However, the formula reduces to Adjusted Taxes divided by the square of Per Capita Income.\textsuperscript{139} Thus, population is not an operative element in the local allocation formula among county areas nor among units of local government other than county governments.\textsuperscript{140} This result was not understood by members of Congress at the time of enactment. Undoubtedly, those who expressed a strong preference for per capita equality at the local level will be troubled by this result.

The selection of the variables used in the final allocation formulas is largely attributable to the fact that data on these vari-

\begin{align*}
\text{Population of Ma} & \times \text{Adjusted Taxes of Ma} \quad \text{Per Capita Income Ca} \\
\text{Population of Ma} & \times \text{Per Capita Income of Ma} \\
\end{align*}

\text{Sum of Numerators for all Municipalities in County}

\text{Ma: Municipality A}

\text{Ca: County X Area}

The formula reduces to:

\[
\frac{\text{Adjusted Taxes of Ma}}{(\text{Per Capita Income of Ma})^2}
\]

\text{Sum of Numerators for all Municipalities in County}

\text{140. However, for those localities at either the 145 percent or 20 percent limitation, population will continue to have a significant impact. See "Limitations on Allocations," § 2(c), p. 45 infra.}
ables are readily available and the fact that their use resulted in a distribution which met the political needs of Congress. There is some question whether the variables have a theoretical justification in addition to these practical considerations that led to their adoption.

Population is a justifiable variable because some portion of every community's financial need is a function of the population of that community. There is also the fundamental notion of nationwide per capita equity which requires that every active community receive some funds under the Act. The use of "urbanized population" is theoretically justifiable because highly urbanized areas have greater needs and higher costs. These areas have much greater concentrations of people with higher levels of need for governmental services, especially services for the poor and aged. Also, the greater population density often results in higher crime rates, dirtier streets and more congested traffic. Services cost more in the major urbanized centers because wage rates are higher and because the higher density makes the delivery of many services more difficult. However, "urbanized population" is defined by the Bureau of the Census as the population of any area consisting of cities with a population of 50,000 or more plus the population of the surrounding closely settled area. The inability of this factor to reflect the increased problems of core cities is indicated by the fact that in 1970 approximately 58 percent of the population of the nation was "urbanized."

Use of inverse per capita income can be justified simply on the basis that areas with relatively poorer people should receive more money. This is true if only because it is more difficult to raise funds for public services in poorer areas.

The state income tax collection variable was intended to be an incentive factor to induce more states to adopt an income tax and to encourage an increase in the rate of existing income taxes. This was based on the belief that the income tax is more responsive to changes in income levels and also is a more progressive tax than the property tax which currently produces approximately 75 percent of all state and local tax revenue.

The general tax effort variable was included so that those entities which were already making the greatest demands on their tax bases would receive more assistance. Use of this variable embodies the simplistic notion that greater assistance

142. See GENERAL EXPLANATION, supra note 63, at 24.
should be given those who "make a greater effort to help themselves." It has been frequently stated that if all states and their localities made the same revenue effort as is made by the average of the 10 states with the highest revenue effort, states and local governments would have raised an additional $21 billion of revenue in 1970. However, the use of a general tax effort factor may be criticized for its failure to distinguish between a highly inefficient government with high taxes and low services and a highly efficient government with relatively lower taxes but a higher level of services.

The use of population, tax effort, and inverse per capita income for the final local distribution was intended "to grant proportionally larger assistance to poorer communities which have relatively small tax bases and high needs." At the same time, the formulas using these variables were designed to grant proportionately larger assistance to governmental units that made relatively greater efforts to help themselves out of their own tax resources.

<table>
<thead>
<tr>
<th>State</th>
<th>Original Totals</th>
<th>Allocated By Treasury</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alabama</td>
<td>90.6</td>
<td>Missouri</td>
</tr>
<tr>
<td>Alaska</td>
<td>6.6</td>
<td>Montana</td>
</tr>
<tr>
<td>Arizona</td>
<td>50.2</td>
<td>Nebraska</td>
</tr>
<tr>
<td>Arkansas</td>
<td>54.5</td>
<td>Nevada</td>
</tr>
<tr>
<td>California</td>
<td>560.3</td>
<td>New Hampshire</td>
</tr>
<tr>
<td>Colorado</td>
<td>54.5</td>
<td>New Jersey</td>
</tr>
<tr>
<td>Connecticut</td>
<td>67.2</td>
<td>New Mexico</td>
</tr>
<tr>
<td>Delaware</td>
<td>16.1</td>
<td>New York</td>
</tr>
<tr>
<td>District of Columbia</td>
<td>23.9</td>
<td>North Carolina</td>
</tr>
<tr>
<td>Florida</td>
<td>146.7</td>
<td>North Dakota</td>
</tr>
<tr>
<td>Georgia</td>
<td>109.6</td>
<td>Ohio</td>
</tr>
<tr>
<td>Hawaii</td>
<td>23.7</td>
<td>Oklahoma</td>
</tr>
<tr>
<td>Idaho</td>
<td>21.3</td>
<td>Oregon</td>
</tr>
<tr>
<td>Illinois</td>
<td>274.0</td>
<td>Pennsylvania</td>
</tr>
<tr>
<td>Indiana</td>
<td>113.8</td>
<td>Rhode Island</td>
</tr>
<tr>
<td>Iowa</td>
<td>75.5</td>
<td>South Carolina</td>
</tr>
<tr>
<td>Kansas</td>
<td>52.4</td>
<td>South Dakota</td>
</tr>
<tr>
<td>Kentucky</td>
<td>87.0</td>
<td>Tennessee</td>
</tr>
<tr>
<td>Louisiana</td>
<td>122.5</td>
<td>Texas</td>
</tr>
<tr>
<td>Maine</td>
<td>31.0</td>
<td>Utah</td>
</tr>
<tr>
<td>Maine</td>
<td>31.0</td>
<td>Vermont</td>
</tr>
<tr>
<td>Massachusetts</td>
<td>165.1</td>
<td>Virginia</td>
</tr>
<tr>
<td>Michigan</td>
<td>224.4</td>
<td>Washington</td>
</tr>
<tr>
<td>Minnesota</td>
<td>108.4</td>
<td>West Virginia</td>
</tr>
<tr>
<td>Mississippi</td>
<td>88.4</td>
<td>Wisconsin</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Wyoming</td>
</tr>
</tbody>
</table>

b. Optional Local Formula

The Act provides that once during the five year life of the program, beginning with the January-June 1973 Entitlement Period, a state legislature may alter the allocation formula within the state, subject to certain constraints, by enacting a law of general application within the state. The primary justification for this provision is "to permit State governments to employ their more intimate knowledge of the needs and requirements of the State for efficient and equitable allocation of funds." In addition, this provision allowed many Congressmen to support the bill and yet criticize the allocation to particular areas within their districts. If the citizens of a locality complained that their allocation was too small, particularly when compared with that of a neighboring locality, the Congressman could express his sympathy with their position and explain the difficulty in arriving at a formula of nationwide application. He could then state that, notwithstanding the obvious injustice to the complaining locality, he supported the legislation because the state legislature could rectify the situation. In essence, this provision attempts to shift some of the political burden of the allocation formulas to the state legislatures. Based on the tremendous difficulty Congress experienced in arriving at a formula, it will be interesting to see how the state legislatures fare in their attempts to alter the existing formulas.

Actually, the flexibility that the Act gives the state legislatures is severely limited. There was some sentiment for giving the state legislatures the absolute right to change the formula in any manner which they determined best reflected local needs and conditions. In the end, however, Congress was not willing to delegate that much power to the state legislatures. Also, Congress could not permit the states complete freedom in choosing variables because the data collection and computer programming problems would have become unmanageable. Therefore, the option found in Section 108(c) provides that the state legislature may only affect the allocation among county areas or among localities within county areas. No change may be made in the one-third—two-thirds split between the state and local governments or in the method of allocation between the county

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On July 19, 1973, the Department of the Treasury announced massive reallocations attributable to the initial four Entitlement Periods. See Washington Post, July 20, 1973, at 1, cols. 1-3. Adjusted figures for the first Entitlement Period have not yet been released.

147. GENERAL EXPLANATION, supra note 63, at 35.
government and other units of local government within a county area. Furthermore, no alteration is permitted which changes the limitations on allocations.\textsuperscript{148} Only the basic intrastate allocation formula, Population times the General Tax Effort Factor times the Relative Income Factor, may be altered. For the purpose of allocating among county areas, or among units of local government (other than county governments), the basic formula can be changed to:

\[ K_1 \text{ times Population times General Tax Effort Factor plus } K_2 \text{ times Population times Relative Income Factor.} \]

The constants in the optional formulas may be any numbers which make the formulas produce the total amount of money to be distributed at the affected level.\textsuperscript{149} For example, each of the following is an acceptable alternative to the allocation method provided by Section 108 (a) and (b) (2) and (3):

Allocation to county areas = $100,000.
Allocation to units of local government = $500,000

1) Among county areas: Population x General Tax Effort Factor x $100,000.
Among units of local government (other than county governments): Population x Relative Income Factor x $500,000.

2) Among county areas: [Population x General Tax Effort Factor x $40,000] + [Population x Relative Income Factor x $60,000].
Among units of local government (other than county governments): Population x General Tax Effort Factor x $500,000.

3) Among county areas: [Population x Relative Income Factor x $30,000] + [Population x General Tax Effort Factor x $70,000].
Among units of local government (other than county governments): [Population x Relative Income Factor x $200,000] + [Population x General Tax Effort Factor x $300,000].

In addition to the foregoing limitations, any legislative action to adopt an alternative formula is subject to the restriction that it must\textsuperscript{150} (1) provide for allocation of 100 percent of the

\textsuperscript{148} See "Limitations on Allocations," § 2(c), p. 45 infra.
\textsuperscript{149} GENERAL EXPLANATION, supra note 63, at 35-36.

In adopting its formula, the State may weigh these two factors equally or it may vary the weights for each of these factors between zero and 100 percent. Where both factors are employed in the optional formula, they will be used additively and each will affect a different sum of money; that is, if the two factors are weighted equally, one-half of the amount available for allocation will be distributed on the basis of population multiplied by the general tax effort factor and the other half will be allocated on the basis of population multiplied by the relative per capita income factor.

\textsuperscript{150} ACT § 108(c) (1), 31 U.S.C.A. § 1227(c) (1) (1973); Final Regulations, supra note 106, § 51.27(a) and (b).
amount to be allocated under the altered formula, (2) apply uniformly throughout the state and (3) apply from the first day of an Entitlement Period through December 31, 1976. The first restriction prohibits any alteration in the formulas other than the two alternatives previously discussed. Although the factors may be weighted so as to dramatically affect certain areas within the state which possess certain characteristics, the second restriction provides that the discrimination may not be more specific. For example, provision for a zero weight to the General Tax Effort Factor and full weight to the Relative Income Factor would generally result in a dramatic shift of funds from large commercial cities to rural areas. However, it would not be permissible to make this discrimination more specific by providing that for cities with more than 200,000 population the allocation will be based on the Inverse Income Factor and for all other localities it will be on a different basis. The last restriction provides that only one change is allowed during the five year life of the program.

c. Limitations on Allocations

In recognition of the fact that the great diversity of local governments prevents any single formula from providing universal equity, the Act provides the following limitations which will adjust local allocations so as to avoid some possible gross inequities and anomalies:

1. The per capita amount allocated to any county area or any unit of local government (other than a county government) shall not be less than 20 percent, nor more than 145 percent, of the aggregate state-wide per capita local grants;\textsuperscript{151}

2. The amount allocated to any unit of local government shall not exceed 50 percent of such government's adjusted taxes plus the intergovernmental transfers of revenue to such government (other than transfers of Revenue Sharing funds);\textsuperscript{152} and

3. Any entitlement of a unit of local government below the level of the county government of less than $200 for a 12 month entitlement period is added to the entitlement of the county government of the county area in which such unit is located.\textsuperscript{153}

In many areas of the country the foregoing limitations, rather than the allocation formulas, determine the amount which will be allocated. For example, in West Virginia 45 of the 55

\textsuperscript{151}. Act § 108(b) (6) (B), 31 U.S.C.A. § 1227(b) (6) (B) (1973).

\textsuperscript{152}. Id. at (C).

\textsuperscript{153}. Id. at (D).
county governments are at the 50 percent limitation and many major cities, including Boston, Cincinnati, Cleveland, Philadelphia and Pittsburgh, are at the 145 percent limitation.

An example of the distortions which the limitations are designed to prevent is presented by municipalities which are "industrial enclaves," such as City of Commerce, California and River Rouge, Michigan. City of Commerce has a population of 10,536 and per capita income of $2,565, which is very low when compared to a countywide per capita income of $3,864. However, the adjusted taxes for City of Commerce equalled $5,429,293 which is significantly higher than many other cities in Los Angeles County having populations as much as eight times as great.154 Absent the 145 percent limitation the extremely high tax effort resulting from the high concentration of industry in a locality with predominantly low income residents, would cause City of Commerce to receive a per capita allocation of several hundred dollars. Absent the 50 percent limitation, municipalities in many of the Southern states with relatively large populations and low income levels, particularly in South Carolina and West Virginia, would receive an allocation equal to between 100 and 150 percent of their own revenues (local taxes plus transfers). This would result from their low tax rate due to a low level of services or reliance on the county government for the services.

The major issue surrounding the limitations was the manner and sequence of their application. For example, if the $200 limitation was applied before the 20 percent limitation, many small rural units which do not receive more than $200 under the formulas because of a very low tax effort would nevertheless receive sizable grants on the basis of the later application of the 20 percent limitation. The Act provides the following order for applying the limitations:155 20 and 145 percent limitations to county areas,156 20 and 145 percent limitations to units of local government (excluding county governments), 50 percent limitation to units of local government (including county governments) and $200 limitation to units of local government (excluding county governments). While the Act did not indicate the internal order of the 20 and 145 percent limitations with respect to each other,157 the Final Regulations specify that at

154. See Department of the Treasury, Data Elements—Entitlement Period I (1972).
156. Id. at (B).
least for county areas, the 145 percent limitation is to be applied prior to the 20 percent limitation.158 This is the only sequence determination to be made pursuant to the Treasury regulations.159

Although not expressly provided in the Act, the legislative history160 indicates that the amount of any reduction in the allocation to a county area or to a unit of local government caused by the 145 percent limitation is to be proportionally allocated among the other county areas within the state or among the other units of local government within the same county, respectively. Likewise, if the 20 percent limitation requires an increase in an allocation, the amount of that increase is to be derived proportionally from the other units at the same level. In the event the allocation to a unit of local government or to a county government is reduced because of the operation of the 50 percent limitation, the amount of the reduction will be allocated to the next higher level of government.161 This determination reflects the fact that the next higher level of government generally bears the costs of furnishing services to the residents of the government incurring the limitation.

The methodology employed by the Treasury in applying these crucial limitations is not clearly presented in the Final Regulations. It has been suggested that the Treasury's sequence of applying the adjustments is different from that provided in the Act.162 The issues are subtly raised by Section 51.29(b) (3)163

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158. Final Regulations, supra note 106, § 51.29(a) (1)-(3).
159. See General Explanation, supra note 63, at 34; Senate Report, supra note 9, at 26.
160. See General Explanation, supra note 63, at 34; Senate Report, supra note 9, at 26:
   In the event that the allocation to a county area or to a unit of local government is reduced because it exceeds the 145 percent maximum limitation, the amount of the reduction may be allocated among the other county areas within the State or among the other units of local government within the same county, respectively, as the government which had its allocation reduced.
161. Act § 108(b) (7) (C), 31 U.S.C.A. § 1227(b) (7) (C) (1973). In the case where the limitation is applied to a municipal or township government, the excess goes to the county government. Application of the limitation to a county government results in the excess being redistributed to the state government.
162. Letter from James E. Smith, Deputy Under Secretary of the Treasury, to all members of Congress, Dec. 7, 1972:
   In computing this [sic] entitlement payments we have utilized a computational sequence which is somewhat different than was used in the print-outs prepared during the period of legislative consideration. This revised computational sequence is designed to assure the full effect is given to the “20% floor” requirement contained in the statute.
and (4) of the Final Regulations. The Treasury Department's present methodology simultaneously applies the 20 and 50 percent limitations to units of local government with the objective that "allocations to places below the 20 percent minimum will not be made in those cases where the additional allocation could not be retained by the local governments because its allocation is in excess of the 50 percent limitation." According to the Joint Committee on Internal Revenue Taxation, this produces some results which were not "originally intended." An example illustrates the divergent results:

**Municipality A in County X**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Statewide local per capita grant</td>
<td>$15</td>
</tr>
<tr>
<td>Adjusted taxes plus intergovernmental transfers</td>
<td>$14,000</td>
</tr>
<tr>
<td>Initial allocation prior to imposition of limitations</td>
<td>$10,000</td>
</tr>
<tr>
<td>Population of Municipality A</td>
<td>5,000</td>
</tr>
</tbody>
</table>

**Sequence set forth in § 108(b)(7)(A) of the Act**

1. \((20\% \times \text{Statewide local per capita grant} \times \text{Population of Municipality A})\) results in an increase in the Initial Allocation to $15,000.
2. \((50\% \times \text{Adjusted taxes plus intergovernmental transfers})\) results in a reduction in the adjusted allocation from $15,000 to $7,000.
3. Thus, the allocation to Municipality A subject to limitations is $7,000.
4. Allocations to all other municipalities in County X are reduced by the amount of $5,000 which was necessary to bring the Initial Allocation to the 20% minimum ($15,000) in Step 1.
5. The allocation to the county government would be increased by the amount of $8,000 which was the

163. Final Regulations, supra note 106, § 51.29(b)(3) specifies: "If a unit of local government is allocated an amount less than the 20-percent limit, its allocation shall be increased to the lower of the 20-percent limit or 50 percent of the sum of that unit's adjusted taxes and transfers."

164. If the amounts allocated to recipient governments of a State do not total 100 percent of the amount allocated to that State, the amount to be allocated to county areas shall be adjusted appropriately, and the allocation process shall be repeated until the amounts allocated to recipient governments of a State total 100 percent of the amount allocated to that State. Id. § 51.29(c).

165. General Explanation, supra note 63, at 34 n.10; see Letter from James E. Smith, supra note 162.

166. General Explanation, supra note 63, at 34 n.10 ("Since allocations in excess of the 50-percent limit go to the next higher level of government, not making the preliminary 50-percent test would result in reducing the allocation to some local governments and passing some of the funds from the reduction up to the next level of government rather than retaining them at the level of government for which they were originally intended.").
amount of reduction resulting from imposition of the 50% limitation ($15,000-$7,000).

**Sequence set forth in Proposed Regulations § 51.29(b)(3)**

1. Calculate the 20% limitation: 20% x Statewide local per capita grant x Population of Municipality A ($15,000).

2. Since Initial Allocation ($10,000) is less than the 20% limit ($15,000), adjust Initial Allocation to the lower of the 20% limitation or 50% limitation.
   - (A) 50% x Adjusted taxes plus intergovernmental transfers ($7,000).
   - (B) Adjust the allocation to the lower of 1 or 2(A): Initial Allocation is adjusted to — $ 7,000

3. Since the lower figure was derived from the application of the 50% limitation, the excess of Initial Allocation less adjusted allocation ($3,000) will increase the county government allocation.

The difference between the two methods in this example is that the county government receives $5,000 less and the aggregate of municipalities in County X (other than Municipality A) receives $5,000 more under the Treasury Regulation than under the Act. Thus, the result of the Treasury Regulations will be an increase in the allocations to some municipalities. Since the next higher level of government would otherwise be entitled to the excess, the allocations to some county governments will be correspondingly reduced.167

Unfortunately, the method of applying the 145 percent limitation results in additional uncertainties.168 The General Explanation of the Act described the methodology utilized by the Department of the Treasury as follows:169

1. The 145 percent limitation is applied to county area with amount of any reduction "set aside.”

2. The amount so “set aside” is then used to proportionally increase the allocations to all county areas which were not at the 145 percent limitation.

3. All county areas are brought to the 20 percent limitation through a proportionate reduction in the allocation to all county areas which are neither at the 20 nor 145 percent limitations.

4. The allocation is divided between the county government and local governments.

5. The 20 and 50 percent limitations are applied to all units of local government (other than county governments) as described above. The total amount necessary to bring all

167. *See id.*
168. *See General Explanation, supra note 63, at 34 n.11.
169. *Id.* It is understood that the Department of the Treasury approved the description provided in the General Explanation prior to publication.
localities to the lower of the 20 or 50 percent limitation is recorded.

6. The 145 percent limitation is applied to all units of local government (other than county governments). The total amount of the reduction is recorded.

7. The 50 percent limitation is applied to all units of local government (including the county governments), other than those whose initial allocation was below the 20 percent limitation.

8. The sum of the amounts recorded in steps 5 and 6 (which may be either positive or negative) is then used to proportionally adjust the amounts to all county areas.

9. Steps 1–8 are repeated until the recorded amounts balance.\textsuperscript{170}

The effect of these procedures is to materially reduce the amount of funds which go to the state governments. Lesser amounts will be transmitted from the local governments to the county governments as a result of the combination of the 20 and 50 percent limitations as applied to local governments. The Treasury then applies the 50 percent limitation to the county governments in the same manner, resulting in correspondingly lower amounts being transferred from the county governments to the state government, which is the next higher level of government. Thus, the 20-50 percent limitation methodology used in the Treasury Regulations indirectly acts to reduce the amounts which should be transmitted to the state governments. Furthermore, it appears possible that part of any reduction resulting from the application of the 145 percent limitation to localities is indirectly distributed on a proportional basis among the county areas rather than among the localities within the same county as the reduced locality.\textsuperscript{171}

Although it is difficult to draw precise conclusions from the allocation amounts published by the Joint Committee on Internal Revenue Taxation as a Supplemental Report to the Conference Report,\textsuperscript{172} the report provides some information as to the

\textsuperscript{170} See Final Regulations, supra note 106, § 51.29(c).

\textsuperscript{171} See note 160 supra and accompanying text.

\textsuperscript{172} Deputy Under Secretary of the Treasury James E. Smith made the following comments on the Treasury's initial allocations:

In the main, I stress that, in the main these changes have occurred because of the updating of the revenue data elements in the program, using Fiscal Year 1971 revenue data versus the Fiscal Year 1966 revenue data that was used for the purposes of our Congressional computations. This five year updating has resulted in many changes, and, indeed, in marked changes in certain allocations.

I think it is important, though, that . . . there are five states and those are Alabama, Nebraska, Oregon, South Carolina, and the State of Washington [where] . . . the downward adjustments occurred primarily because of the correction of a
impact of the limitations. Under the published figures, the following amounts would have been returned to the indicated states (among others):

<table>
<thead>
<tr>
<th>State</th>
<th>Conference Report</th>
<th>Treasury's Initial Allocations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alabama</td>
<td>$2,112,154</td>
<td>$ 27,250</td>
</tr>
<tr>
<td>Arkansas</td>
<td>4,655,035</td>
<td>1,452,160</td>
</tr>
<tr>
<td>Delaware</td>
<td>1,370,739</td>
<td>1,001,962</td>
</tr>
<tr>
<td>Florida</td>
<td>437,083</td>
<td>11,678</td>
</tr>
<tr>
<td>Georgia</td>
<td>330,475</td>
<td>29,544</td>
</tr>
<tr>
<td>Illinois</td>
<td>187,510</td>
<td>301,340</td>
</tr>
<tr>
<td>Kentucky</td>
<td>9,214,908</td>
<td>5,703,828</td>
</tr>
<tr>
<td>Louisiana</td>
<td>3,330,094</td>
<td>304,834</td>
</tr>
<tr>
<td>Maine</td>
<td>1,209,014</td>
<td>53,742</td>
</tr>
<tr>
<td>Massachusetts</td>
<td>275,326</td>
<td>8,776</td>
</tr>
<tr>
<td>Mississippi</td>
<td>4,194,492</td>
<td>320,418</td>
</tr>
<tr>
<td>Missouri</td>
<td>385,248</td>
<td>137,758</td>
</tr>
<tr>
<td>New Hampshire</td>
<td>127,579</td>
<td>29,577</td>
</tr>
<tr>
<td>New Mexico</td>
<td>2,018,572</td>
<td>1,015,876</td>
</tr>
<tr>
<td>North Dakota</td>
<td>24,302</td>
<td>181,002</td>
</tr>
<tr>
<td>Pennsylvania</td>
<td>606,927</td>
<td>243,620</td>
</tr>
<tr>
<td>South Carolina</td>
<td>11,245,740</td>
<td>551,092</td>
</tr>
<tr>
<td>South Dakota</td>
<td>13,428</td>
<td>198,196</td>
</tr>
<tr>
<td>Texas</td>
<td>2,555,141</td>
<td>129,302</td>
</tr>
<tr>
<td>West Virginia</td>
<td>8,914,183</td>
<td>5,880,744</td>
</tr>
</tbody>
</table>

Even adjusting for the aggregate reduction in state entitlements between the Conference Report and Treasury's initial allocations, it is interesting to note that while substantially smaller amounts were returned to some states under the Treasury allocations, other states actually received more—e.g., Illinois, North Dakota and South Dakota. This is due to the fact that the Conference Report figures do not reflect application of the 50 percent limitation to units below 2500 population, many of which are subject to the limitation. Application of the 50 percent limitation to these small units results in significant aggregate amounts being transmitted to county governments, and thus indirectly to state governments. The Department of the Treasury has indicated that it will release the allocation computer program in the near future. At such time, the logic of that program must be carefully examined to determine the extent of compliance with the provisions of the Act.

d. Data Base for the Allocation Formulas

The data to be used in the allocations and their sources are as follows:173

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173. See GENERAL EXPLANATION, supra note 63, at 40; SENATE REPORT, supra note 9, at 31.
In general, the Act provides that population, urbanized population, per capita income, intergovernmental transfers, and state and local taxes shall be determined on the same basis as these items are determined by the Bureau of the Census for general statistical purposes. However, in recognition of the fact that census statistics were traditionally not accumulated pursuant to procedures which reflect the rigorous demands of an allocation program involving many billions of dollars, the Secretary of the Treasury is given the authority by Section 109 (a) (7) (B) to use such additional data (including data based on estimates) as he determines is necessary when the census data are not sufficiently current or comprehensive. Also, Section 142 of the Act provides that the Secretary of the Treasury shall prescribe such regulations as may be necessary or appropriate to carry out the Act. The Senate Finance Committee Report indicated that this provision "would permit classifications or definitions somewhat different from those which the Census Bureau has formulated pri-


This is a new dimension for the Bureau in government statistics. Small volumes within a large universe which heretofore have had very little effect statistically on the summary results now must be developed with pinpoint accuracy.

Rubin, supra note 129.
marily for other purposes when a modification would more nearly meet the objectives of the bill. 175

Administrative or judicial challenges to the data used in computing the allocations are severely circumscribed. The Regulations provide a "grace period" during which the Secretary will adjust data and allocations if it is established to his satisfaction by factual evidence and documentation that the data used in the computations were erroneous. 176 A recipient could argue that the data are inaccurate since they were not derived in accordance with the procedure and definitions of the Bureau of the Census for determining data for general statistical purposes. However, this will be a very difficult argument to support when the recipient has the burden of proof since it is unlikely that the particular method of derivation will be ascertainable. A recipient could also argue that the Secretary of the Treasury should exercise his authority pursuant to Section 109(a) (7) (B) or 142(a) to use additional or different data. However, it would be necessary to show that the classifications, definitions or methodology established by the Bureau of the Census either were so unreasonable on their face or resulted in such material variations from the actual data that the Secretary had acted in an arbitrary and capricious manner in refusing to use alternative data. This would be difficult to prove because there is a strong presumption favoring the Census determinations. In connection with the population count of minorities, however, the census figures have properly been questioned. 177 The U.S. Civil Rights Commission has recommended that the Treasury ascertain what steps have been taken by the Bureau of the Census to validate counts of minorities and to provide corrected figures where necessary. Several of the national civil rights organizations have indicated an intention to litigate the issue if it is not satisfactorily resolved through administrative action. 178

175. Senate Report, supra note 9, at 29.
176. Final Regulations, supra note 106, § 51.22(b).
178. See Letter from Stephen Horn, Vice Chairman of the United States Commission on Civil Rights, to George P. Shultz, Secretary of the Treasury, Jan. 5, 1973. In response to demands to adjust the undercount of minorities, the Department of the Treasury asserts that the
The Secretary of the Treasury has reserved one percent of the initial entitlement funds and five percent of the subsequent payments in order to make adjustments for data errors. Thirty-eight hundred objections to the data were filed prior to the February 12 deadline for the initial Entitlement Period. This resulted in massive reallocations.

Perhaps the area of greatest potential concern under the five-year program is the continued validity of allocation formulas which utilize substantial amounts of data which reflect fixed relationships existing as of a significantly earlier date. The seriousness of this problem varies with the different data elements. The most severe problem exists with regard to data derived from the 1970 Decennial Census—i.e., Population, Per Capita Income and Urbanized Population. Current data will be available on Adjusted Taxes and Intergovernmental Transfers as a result of the annual Special Survey by the Census. Information on state and local taxes, by state, will generally be available in September of each year for the prior fiscal year. Likewise, data on personal income, by state, will generally be available in October of each year for the prior fiscal year. State individual income tax collections and the federal individual income tax liability attributed to a state will also be available annually.

The very significant problem of out-dated data was recognized at the earliest stages of the legislative deliberations. As a result two legislative provisions which would facilitate updates on the decennial census data were considered crucial to the program. First, the Internal Revenue Code was amended by adding a new section requiring individuals to provide information as to

Bureau of the Census has not established the extent of the undercount for each locality. Since population does not affect the local allocation, no appropriate adjustment would be possible. It can be argued that since the Bureau of the Census concedes an undercount of blacks in the aggregate amount of 7.7%, the Department of the Treasury and the Bureau of the Census should have the burden of establishing the undercount by locality. Furthermore, although population does not figure in the basic local allocation formula, many of the most affected localities are at the 145 percent limitation and thus receive an allocation which is a direct function of their population. See Washington Post, July 24, 1973, § A, at 3, cols. 1-3.


On July 23 the Office of Revenue Sharing announced that it had completed its review of data, calculated adjustments to past payments based on new data and closed the books on the first 18 months of the Revenue Sharing program. See Press Release, Dept. of Treasury, July 23, 1973 at 1.
their state, county, township and municipality of residence. Second, a provision was proposed which would have required the Secretary of Health, Education and Welfare (H.E.W.) to collect income statistics on welfare recipients and members of their families by place of residence. During the final days of deliberation by the House Ways and Means Committee on the draft bill, John Veneman, Under Secretary of H.E.W., appeared before the Committee to testify that H.E.W. opposed the latter provision because the cost of data collection would be as much as $500 million per year. As a result, this provision was dropped. However, the House Ways and Means Committee Report and the Senate Finance Committee Report indicate that H.E.W. should provide this data in the future if welfare reform or other legislative or administrative change allows the collection of this data at a reasonable cost.

The basic objective of the amendment to the Internal Revenue Code was to obtain information from income tax returns which, when combined with information obtained from other sources, would make it possible for the Bureau of the Census to derive workable estimates of population and per capita income levels for local governments at regular intervals between the decennial censuses. The income figures used by the Bureau of the Census reflect total money income. Although the adjusted gross income figure on the Form 1040 does not include many items of income such as interest on tax-exempt bonds, social security benefits, railroad retirement benefits and veterans administration payments, reasonably accurate estimates should be possible through the use of various statistical techniques. Since heads of households representing approximately 90 percent of the population file income tax returns, the Bureau of the Census, using additional sources of information, should be able to arrive at a set of workable updates for the population and per capita income data at least every two years. The H.E.W. information on welfare recipients would have achieved nearly a 100 percent sample since it would have provided information

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181. Testimony presented by Dr. George H. Brown, Director, Bureau of the Census, Department of Commerce, Executive Hearings on H.R. 14370 Before the House Comm. on Ways and Means, 92d Cong., 2d Sess. at 5 (1972) [hereinafter cited as Brown Testimony].
182. Id.
183. House Report, supra note 60, at 30; Senate Report, supra note 9, at 31.
on individuals whose income levels place them below the minimum Internal Revenue Service filing requirements.

During the final days of committee deliberations on the draft bill, Chairman Mills requested that Dr. George H. Brown, Director of the Bureau of the Census, appear before the Ways and Means Committee to answer the following question: "Just how well can you perform here in helping us to keep updated on these various factors that go into our formula for distribution of money?" Dr. Brown was very careful and conservative in his testimony. He indicated that even without income tax form change "it was reasonable to talk of workable numbers for population estimates for counties to be done on an annual basis," based on a "considerable amount of experience estimating population each year in the periods between the once-every-10-year complete count." In fact, the third Entitlement Period payments (January-June 1973) were based on 1972 estimates of population for state areas compiled by the Bureau of the Census rather than the decennial census data.

On the issue of population estimates for cities, Brown was noncommittal. In his view, "more work is needed in methods development to get this kind of information [cities' population] every year, but it will be only for larger cities [units of 50,000 or more], not for all cities." After indicating that the margin of error on the 1960 Decennial Census population count averaged approximately 3 percent (with Mississippi having approximately a 6 percent margin of error), he stated that population figures for cities over 50,000 would be considered workable if they involved an average error of 5 to 6 percent, but recognized that in some cases the error might be as high as 10 percent. An inquiry as to the impact of the additional Form 1040 information and H.E.W. information on welfare recipients elicited the following response:

Now we have said on several occasions that the availability of this kind of information would help us. We cannot tell you

186. Id.
187. Id.
188. Id. at 4. The Bureau of the Census has announced that the 1970 population census missed approximately 5.3 million persons, approximately 2.5% of the total population. New techniques permitted the Bureau to reduce the percentage error from approximately 2.7% in the 1960 Census. However, since there is no estimate of the 1970 error for individual states, counties or cities, no changes would be made in the data for purposes of Revenue Sharing. Wall Street Journal, April 26, 1973, at 3, col. 1; N.Y. Times, April 29, 1973, § 4, at 3, col. 1.
how much it will help until we have the information and work with it. But it will certainly enable us to move down in the size of the political unit for which we can make reports with reasonable margin of error on the average and hopefully with not more than just a handful of very loose ends, say, beyond 10 percent.¹⁸⁹

The testimony on income figures raised serious doubts not only on the potential for annual estimates but also on the decennial figures. Dr. Brown indicated that the decennial census includes a 20 percent sample on household money income. Although he did not know the margin of error on the decennial income statistics, he indicated that the statistics were "workable" and that his staff believed the error to be much less than 10 percent in the aggregate.¹⁹⁰ Dr. Brown conceded that during the inter-censal period "we do not have a regular procedure for making estimates of income for counties at the Bureau of the Census."¹⁹¹ He also did not think that the Bureau of the Census had the capability to develop small area estimates for income. In response to these problems, the 1973 budget proposed a Census Bureau survey of one million households to be conducted in 1975 which would produce population estimates and characteristics for states, counties and cities with population in excess of 50,000.¹⁹² It is indicated that "[d]ata derived through this process will . . . be one of the main ingredients in the allocation of funds under revenue sharing programs."¹⁹³

Major problems are posed by the use of selective updates of the data. At the local level obvious inequities result if the Treasury uses updated data for a particular municipality and not for all other municipalities in the same county. The House Ways and Means Committee reported that:

It is important to note that the data for any unit of local government used with regard to any allocations must be com-

¹⁸⁹. Brown Testimony, supra note 181, at 5.
¹⁹⁰. Id. at 8; see Rubin, supra note 129, at 9.
¹⁹². SPECIAL ANALYSES, supra note 3, at 91 ("The program envisions a limited size sample survey, approximately 1.5% of the population.").
¹⁹³. Id. See N.Y. Times, June 27, 1973, at 24, col. 2, indicating that the House Appropriations Comm. rejected the budgetary request.
parable to the data used for the other units of local government sharing in that allocation. For example, a special census of population for a municipality may not be used in allocating funds among municipalities within a county area unless there are corresponding updated population data for all the other municipalities located in that county area.\textsuperscript{104} Therefore, local special surveys and selected data updates for recipient governments at the same allocation level generally should not be utilized.

Although approximately 75 percent of the 1972 tax returns contain answers to the Revenue Sharing residence questions, it appears likely that a high percentage of those returns contain incorrect or incomplete answers.\textsuperscript{105} If this trend continues, this potential source of information will not contribute materially to the Census Bureau's ability to arrive at estimates.\textsuperscript{106} If the in-

\begin{itemize}
  \item \textsuperscript{194} House Report, \textit{supra} note 60, at 29; Senate Report, \textit{supra} note 9, at 30.
  \item \textsuperscript{195} See Wall Street Journal, Mar. 21, 1973, at 1, col. 5, which states that the early returns indicated that approximately 93 percent of the 1972 returns contained incorrect or incomplete answers. The Department of the Treasury has made a proposal for simplification of the Form 1040 tax return. See Statement of George P. Shultz, Secretary of the Treasury, before the House Committee on Ways and Means on April 30, 1973.
  \item \textsuperscript{196} A Bureau of Census official has made the following statements on updating the data:
    \begin{itemize}
      \item We have been discussing with Treasury techniques for updating the population and the per capita income estimates. The Bureau produces annually updated State population estimates as part of its regular program. The latest available are provisional July 1, 1972 estimates, and these were given to Treasury. They could be used in calculating the State allocations for the third entitlement period (January-June 1973).
      \item In terms of population and per capita income updates for the substate level, we are perfecting techniques for assembling information from administrative records; those available from a variety of federal agencies. The Internal Revenue Service is collecting and coding the place of residence reported by taxpayers on the tax forms 1040 and 1040a. Those residences reported on the 1040 are being coded in IRS based on a coding directory which we provided. That file will provide us with a data base.
      \item In addition to IRS data, we will also be using reported vital statistics (birth and death) to measure the natural increase component of population change since the last census.
    \end{itemize}
  \item Right now IRS data are only one of the elements that go into the formula. Summary geographic data from Social Security benefit records, Veterans' benefits records and others will help in estimating other types of money income. The result of the process which meshes into information fed to us from the Bureau of Economic Analysis, will be reliable State and county population and per capita income estimates for mid 1973. These estimates are expected to be available in June of 1974.
\end{itemize}

Rubin, \textit{supra} note 129, at 9-10.
come tax forms cannot be used to update the income data base for local allocations, only the data on adjusted taxes could be updated (as a result of the annual Special Survey). If the recent historical pattern of demographic change involving the exodus of the wealthy to the suburbs and the influx of the poor to the central cities continues, the adjusted taxes of the suburbs will continue to increase relatively faster than those of the core cities. However, the benefit to be derived from the lower income levels in the core cities will only be reflected at the time of the decennial census, while the suburbs will benefit from their increasing tax effort on a current basis. If the Treasury decides to update only the data for adjusted taxes, the result would be an artificial benefit of sizable proportions for the suburbs as compared to the central cities.

3. Restrictions and Limitations on Expenditure of Funds

a. Categorical Restrictions on Local Expenditures

Section 103(a) of the Act contains pro forma restrictive categories for local expenditures. There are no restrictive categories for state expenditures.

197. The issue must be raised as to whether certain other Federal statutory restrictions on the use of Federal funds will be applied to Revenue Sharing funds, e.g.,

2. Hatch Act which limits the political activities of public employees paid with Federal funds.
3. Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970 dealing with persons displaced as a result of Federally-assisted programs.

The argument that Revenue Sharing funds are not subject to these additional restrictions is twofold:

1. The Act expressly provides for all other Federal statutory restrictions applicable to Revenue Sharing funds—Davis-Bacon Act and the 1964 Civil Rights Act.
2. The Act does not provide Federal funds for specific programs or projects. Rather it provides general fiscal assistance to recipient governments.

The contrary position must basically argue that Revenue Sharing funds are indistinguishable from other Federal funds, and in the last analysis the policy objectives reflected in these Federal statutes are equally applicable to Revenue Sharing funds.

The Office of Revenue Sharing has taken the position that none of the aforementioned Federal statutory restrictions apply to Revenue Sharing funds:

"Generally speaking, we take the position that only those federal laws specifically referenced in the State and Local Fiscal Assistance Act of 1972 apply to the use of revenue sharing funds." Speech by
Funds received by units of local government under the Act may be used only for—

(1) ordinary and necessary maintenance and operating expenses for—

(A) public safety (including law enforcement, fire protection, and building code enforcement),
(B) environmental protection (including sewage disposal, sanitation, and pollution abatement),
(C) public transportation (including transit systems and streets and roads),
(D) health,
(E) recreation,
(F) libraries,
(G) social services for the poor or aged, and
(H) financial administration; and

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

The phrase "ordinary and necessary" was added as a qualification in the Conference Committee in order to provide a basis for possible future regulatory or administrative action against purely frivolous expenditures or expenditures which are


The Guidelines of Council on Environmental Quality provide the following exclusion from the types of actions covered by the National Environmental Policy Act:

"Actions" include but are not limited to:

Projects and continuing activities: directly undertaken by Federal agencies; supported in whole or in part through Federal contracts, grants, subsidies, loans, or other forms of funding assistance (except where such assistance is solely in the form of general revenue sharing funds, distributed under the State and Local Fiscal Assistance Act of 1972, 31 U.S.C. § 1221 et seq. with no federal agency control over the subsequent use of such funds); involving a Federal lease, permit, license, certificate or other entitlement for use. . . .


198. See INT. REV. CODE of 1954 § 162(a) which allows a taxpayer to deduct all the "ordinary and necessary" expenses of carrying on a trade or business.

The requirement that expenses be "ordinary and necessary" is interpreted quite broadly. Thus an expense need not be essential in order to be considered necessary. All that is required is that the expense be "appropriate and helpful" to the business. Similarly, an expense can be "ordinary" although it is not frequently incurred in the taxpayer's business. The expense is considered ordinary if others in the taxpayer's situation would ordinarily incur the same expense.

primarily for the personal benefit of a local official. The con-
ferees could not agree on specific examples of frivolous expendi-
ture which would not be ordinary and necessary, but carpeting
for the police chief's office was discussed at length.

The original Administration proposal and the version passed
by the Senate did not contain categorical restrictions on the use
of the funds since such restrictions were generally considered
inconsistent with the philosophy of returning decision making
to the local level so as to avoid the inefficient and artificial
allocation of resources which exists in the categorical grant pro-
gram. Given President Nixon's commitment to a "no strings"
program, it is safe to conclude that the categories will be ad-
ministered very liberally.

The categories were originally introduced in H.R. 11950 (the
original Mills Bill). According to Representative Byrnes, then

199. The Senate bill omitted any limitation on expenditures to high
priority items as "inconsistent with the broad objectives of general
revenue sharing."

To a considerable extent, the adoption of the revenue shar-
ing program stems from the need to avoid the problems inher-
ent in many categorical programs which specify how the recipi-
ent governmental unit is to spend the funds. Such categorical
aid programs may result in forcing the recipient governmental
unit to spend the funds for the specified purpose even though
the governmental unit may have other more urgent needs to
finance. . . . In the opinion of the committee, forcing local
governments to spend their aid funds for these listed items
would inevitably prevent them from achieving the optimum
expenditure pattern from the standpoint of their needs.

Senate Report, supra note 9, at 16; see 118 Cong. Rec. § 14001 to 02

200. See note 204 infra.

201. Section 102 of H.R. 11950, 92d Cong., 1st Sess. (1971), pro-
vided for the following "high-priority expenditures"—

(1) maintenance and operating expenses for—
   (A) public safety (including law enforcement, fire protec-
tion, and building code enforcement),
   (B) environmental protection (including sewage disposal,
sanitation, and pollution abatement),
   (C) public transportation (including transit systems and
streets),
   (D) youth recreation programs,
   (E) health,
   (F) financial administration, and

(2) capital expenditures for—
   (A) sewage collection and treatment,
   (B) refuse disposal systems,
   (C) public transportation (including transit systems and
street construction),
   (D) the acquisition of open space for parks and public facil-
ities, and
   (E) urban renewal programs.
ranking Republican member of the House Ways and Means Committee, they constituted one of the major pro forma bases upon which Mr. Mills reversed his position on the concept of Revenue Sharing which he had previously opposed.\textsuperscript{202} The philosophical justification for the categories was that the federal government had a duty to see that, at a minimum, the funds were spent for purposes which were recognized by the national government as high priority purposes since it had raised the revenues involved.\textsuperscript{203}

Although neither the Act nor the regulations contain any more definitive standards for the various categories, the House Committee Report provides some additional interpretation for several of the categories:\textsuperscript{204}

\textsuperscript{202} See \textit{House Report}, supra note 60, at 88 ("The 'priorities' were plucked out of thin air for the sole purpose of distinguishing the Committee bill from the Administration's 'no strings attached' revenue sharing proposal which had been consistently denounced by some members of the Committee.").

\textsuperscript{203} See Id. at 11-12. The extensive nature of the list makes the ostensible rationale appear to be merely rhetoric—

In framing the list of priority items for which local governments will be permitted to spend the assistance funds, the Congress was guided by the consideration of items which are clearly priority items in terms of national objectives. Although the total assistance provided under this bill is substantial, the fact that it must be distributed to a large number of local governments led the Congress to the conclusion that the assistance given to local governments must be concentrated on priority expenditure items if the Act is to have an appreciable impact. For this reason, the list of priority items excludes expenditure categories which generally are considered worthwhile but which, nonetheless, have a lower order of national priority than the included items.


\textsuperscript{204} \textit{General Explanation}, supra note 63, at 20 (emphasis added).

The Senate floor debates indicate that "law enforcement" is to have the same definition as in the Omnibus Crime Control and Safe Streets Act, including police, courts and corrections. \textit{See} 118 CONG. REC. \textsection 18021 (daily ed. Oct. 13, 1972) (remarks of Senators Fannin and Long). Furthermore, Senator Long stated:

In providing that revenue sharing money could be used to provide social services to the poor and for health, it was intended that the communities should be permitted to do just about anything they wanted to provide in the way of a health service or any other kind of service to the poor. Within any sort of rule of reason, it is intended that the communities can define 'the poor' or 'health' for this purpose quite broadly and that this would clearly cover community programs for the mentally ill. \textit{Id.} at \textsection 18024. Senator Long also indicated that under "health" the funds could be used in programs for the developmentally disabled. \textit{Id.}

The Office of Revenue Sharing has released a detailed statement providing guidance on social services for the poor and aged:

Administrative expenses incurred in the operation of programs for the poor and aged have been allowed as ordinary and
Public safety is intended to include law enforcement, police, courts, corrections, and crime prevention; fire protection, civil defense, and inspection of buildings, plumbing, electrical facilities, gas pipelines and equipment, boilers, and elevators, as generally categorized by the Bureau of the Census in its report of governmental finances. Environmental protection similarly is intended to include certain environmental health activities [The environmental health activities to be included are smoke regulation, inspection of water supply, sanitary engineering, water pollution control, and other similar activities for eliminating or abating health hazards . . .] and sewerage, street cleaning, and waste collection, disposal and recycling activities. Current expenditures for flood control, depending upon the specific nature of those expenditures, might properly be characterized under public safety or environmental protection. Public transportation similarly is intended to include expenditures for highways, transit systems, streets, grade crossings, and the parking, servicing, and storage facilities related to public transportation. Expenditures related to snow and ice

necessary operating expenses. For example, the cost of administering a Food Stamp Program is considered an ordinary and necessary expense of providing social services to the poor. The cost of operating a Community Action Program providing services for the poor and aged has been held to be a valid expenditure of revenue sharing funds . . .

Salaries of social workers, case workers, and others working in programs with the poor or aged may be paid from revenue sharing funds.

The operating expenses of neighborhood social centers and other neighborhood facilities which are of benefit to the poor and aged may be partially funded with revenue sharing funds to the extent that such funding reflects the use made of those facilities for the benefit of the poor and aged. A reasonable allocation of funds is required.

Direct welfare payments to the poor and aged are not permitted by the Act, but the payment of a portion of a poor tenant’s rent is a permissible expenditure if the money goes to the landlord and not to the tenant. Revenue sharing funds may also be used to operate and maintain public housing. A day care center and day care services may be funded through revenue sharing. The local unit of government must determine eligibility for the use of a day care center, as families with working mothers may well exceed the Bureau of Census definition of low income family. Nursing homes and old-age homes for the poor or aged may be funded with revenue sharing funds.

Other examples of social service uses on which revenue sharing funds may be expended include:

- Interest free loans to aid welfare recipients in securing jobs.
- Adult education programs which benefit the poor and aged.
- Youth development programs which aid the poor or disadvantaged youth.
- Youth employment programs which either directly hire poor or disadvantaged youths or assist them to secure jobs in the private sector.

As can be seen from these examples, any activity which can reasonably be called a social service for the poor and aged may be funded through revenue sharing. As with all revenue sharing priorities, the final decision as to the use of funds within priority expenditure categories is exercised by the local unit of government, and a reasonable determination by the local officials will not be questioned by the Office of Revenue Sharing.

removal from highways would appropriately also fall within the above categories.

In general, the legislative history also indicates that the permitted operating categories are not to be extended to indirectly involve education and welfare. In particular, "public transportation expenditures . . . are not intended to include expenditures directly related to school busing. . . ." Although education and welfare are glaring omissions from the list of permitted categories for maintenance and operating expenses, it must be emphasized that capital expenditures for education and welfare are permitted. The omissions are questionable given that the ostensible justification for the categories was "that the Federal Government ought not make payments under the bill unless these payments are for the purpose of encouraging or implementing. . . . purposes determined by the Federal Government to be matters of high priority to the national government."

The omissions were generally explained as matters which should be handled by separate legislation. This is a rather weak argument since extensive legislation already exists in several of the other categories such as environmental protection and public transportation. Rather, the omissions may have been intended to provide state and local officials with a basis for refusing the demands of organized teacher and welfare groups for increased benefits.

Great confusion has been caused by the possibility of using Revenue Sharing funds for payment of principal and interest on debt which was incurred for purposes within the permitted categories. Initially the Department of the Treasury took the position that repayment of principal and interest on all such debt, whenever incurred, was a permitted expenditure. The Treasury reversed this position primarily due to congressional staff pressure based on the following language in the House Com-

205. See General Explanation, supra note 63, at 20; House Report, supra note 60, at 19.


207. House Report, supra note 60, at 17.

208. See General Explanation, supra note 63, at 15; House Report, supra note 60, at 12.

209. Pontiac, Michigan planned to use $1.9 million of Revenue Sharing funds to pay the first two years' interest on a $25 million pro sports complex. See Wall Street Journal, Dec. 11, 1972, at 13, col. 4.

210. See, e.g., Speech by Charles E. Walker, Deputy Secretary of the Treasury, to the Regional Council Conference, in Atlanta, Georgia, Nov. 27, 1972.
mittee Report: 211

... an expenditure of funds from borrowing (such as the proceeds of a municipal bond issue) is generally regarded by the Bureau of the Census as a currently made expenditure, while repayment of the debt is not so regarded. However, the repayment of a debt (but not including interest on the debt) is to be considered a currently made expenditure for purposes of this bill if: (1) the debt originally was incurred for a high-priority category purpose (for example, a bond issue earmarked for construction of special sewage treatment facilities), (2) the actual expenditure (i.e., for materials, contractors, etc.) was made on or after January 1, 1972 (the start of the first entitlement period), and (3) the actual expenditure was not treated as a currently made expenditure under the bill (this avoids double counting of amounts regarded as expenditures for high-priority purposes).

The elimination of the requirement in Section 105(a)(3) of H.R. 14370, as initially passed by the House of Representatives, that funds be used only for capital items that are additional and not of a character for which the local government regularly makes expenditures on a recurring basis would seem to substantially weaken the argument for imposing limitations on debt repayment. Furthermore, the substantial expansion of the categories in the Conference Bill, together with the omission of any reference to a debt repayment limitation in the Conference Report, would seem to provide an adequate basis for not imposing any limitations in the regulations. The limitations were defended by the general proposition that Revenue Sharing should result in new programs and capital expenditures. 212 However, it is difficult to justify such limitations on local decision making since most localities will in fact be in a position to use the displacement approach and effectively use Revenue Sharing funds to retire existing debt. Also, for many localities, improvement of their credit rating and reduction of their interest payment burden may constitute the highest local priorities.

Nevertheless, the Treasury Department issued Administrative Ruling No. 1 which reversed their earlier position effective February 15, 1973. 213 After that date, repayment of debt qualifies as a proper expenditure of Revenue Sharing funds only if:

1. Revenue Sharing funds are not used to pay any interest incurred because of the debt,

211. House Report, supra note 60, at 18 (emphasis added); see General Explanation, supra note 63, at 21.

212. See House Report, supra note 60, at 11-12. Also, one might argue that due to the highly contingent nature of the amount of the payments it is highly unlikely that such funds would constitute, by themselves, adequate security for future debt issues.

2. The debt was originally incurred for a purpose within one of the permitted categories,
3. The actual expenditure from the proceeds of the indebtedness was made on or after January 1, 1972,
4. The actual expenditures from proceeds of the indebtedness were not expended in violation of any other restrictions in the Act.

This position was incorporated in the Final Regulations.\(^{214}\)

One of the most controversial subjects is the use of Revenue Sharing funds to reduce taxes.\(^{215}\) Although tax reductions are clearly not within the permitted categories, it was contemplated that the displacement procedure could be used to achieve a tax reduction in an amount equal to all or part of the Revenue Sharing funds.\(^{216}\) A reading of the legislative history leaves no doubt that such use of the funds is entirely consistent with the purposes of the Act.\(^{217}\) Congressman Mills stated:

> The money can be used to reduce the local taxes of a locality, and I think that would be a good thing. I would like to see it all used for that purpose, frankly, because the cities primarily raise their money through property taxes, which I consider to be a very onerous type of tax.\(^{218}\)

The initial survey of Revenue Sharing recipients by the Department of the Treasury indicated that 63 percent of the respondents intended to use Revenue Sharing funds to reduce taxes, avoid an increase in taxes, or reduce the amount of a required increase in taxes.\(^{219}\)

\(^{214}\) See Final Regulations, supra note 106, § 51.31(b).

\(^{215}\) See, e.g., Anderson, Revenue Sharing—Now It's Up to Us!, 55 Public Management 8, 10 (1973).

\(^{216}\) See Department of the Treasury, What General Revenue Sharing Is All About 13 (1972).

QUESTION: May Revenue Sharing funds be used to reduce taxes?

ANSWER: Yes. Whether local governments use the funds for this purpose is a judgment which each government must make, based on its evaluation of local needs.

Id.

\(^{217}\) Senator Humphrey offered an amendment in the Senate which would have required localities to maintain their tax effort. The amendment was tabled. See 118 Cong. Rec. § 14319 (daily ed. Sept. 7, 1972). Senator Long indicated that Revenue Sharing may, and in some instances should, be used for tax reductions. See id. at § 14321. However, he indicated that excessive use of the funds for tax reductions would result in future limitations. Id.


\(^{219}\) Address by Graham W. Watt, Director of the Office of Revenue Sharing, in San Francisco, California, June 19, 1973:

Eight percent of the respondents intended to use revenue sharing funds to reduce taxes; 40% said that revenue sharing would allow them to avoid an increase in taxes. Seventeen percent of the respondents said that while property taxes were
The maintenance of effort provision contained in the original Mills Bill was omitted in order to make the categories meaningful exercises in cosmetics. The fungibility of money and the facility with which funds could be displaced at the state and local level was intended to effectively render the categories without substantive impact. However, it was recognized that for a limited number of localities with a high percentage of dedicated revenue sources and a financial structure such that Revenue Sharing funds constituted a significant portion of total revenues, displacement would be significantly restricted.

The displacement process, which was generally recognized and approved by the Congress, has been severely limited by the decision of Judge Freeman of the Federal District Court, Northern District of Georgia, in Mathews v. Massell. The City of going up, the amount of the increase would be less because of revenue sharing.

220. Section 105(a)(3) of H.R. 11950, 92d Cong., 1st Sess. (1971), provided for a local maintenance of effort through a requirement that localities spend at least as much for the specified categories as they did out of their own sources (on the average) in the five preceding years. This provision was eliminated in the Ways and Means Committee in substantial measure due to concern that localities experiencing a current operating deficit would thereby be forced to continue this deficit; also the limitation this provision placed on the ability of localities to alter spending patterns to reflect changing priorities. For example, the City of Rochester projected an $8 million deficit for the fiscal year ending June 30, 1972, which amounted to over 10% of the entire 1971-72 budget. See Letter from Stephen May, Mayor of City of Rochester, to Barber J. Conable, Jr., April 6, 1972. Also, the Committee did not wish to deny the municipalities the option of reducing taxes instead of increasing their expenditure level.

221. The Senate Finance Committee Report expressly supports this conclusion:

Moreover, the adoption of the high priority items in the House bill merely results in substantially complicating the mechanics of the aid program without any real substantive effect on spending by the local governments. A complicated and elaborate procedure would be required to determine that local governments spend the aid funds only on the high priority items. However, since the local governments are not required to maintain the level of their own prior expenditures on the high priority items (i.e., expenditures financed out of their own revenue sources), as a practical matter, they could arrange to use the aid funds to increase their spending for other than high priority items. As a result, provision for the high-priority categories, at best, is illusory.

SENATE REPORT, supra note 9, at 16.

Congressman Broyhill, a member of the Ways and Means Committee and one of the House Conferees, stated: "... these are artificial restrictions. By shifting funds and programs, local governments should be able to circumvent these barriers with relative ease." 118 Cong. Rec. H 9757 (daily ed. Oct. 12, 1972); see id. at H 9752 (remarks of Congressman Johnson).

lanta had anticipated receiving Revenue Sharing funds for 1972 and the first three quarters of 1973 in the approximate amount of $10,500,000. Its Board of Aldermen passed several ordinances committing the Revenue Sharing funds to a Trust and Agency account and appropriated the funds for the payment of firemen's salaries. The city's brief indicated that:

[T]he receipt of $10,500,000.00 of revenue sharing funds for the years 1972 and 1973 freed for other purposes $10,500,000.00 of revenues of the City of Atlanta which otherwise would have gone for the payment of Firemen's salaries . . . . [I]t was determined that only $6,000,000.00 of these . . . freed . . . up dollars were necessary for use in the continuing on-going operation of the City government . . . . There were, therefore, $4,500,000.00 in revenues which had previously been earmarked for payment of Firemen's salaries free to be used by the City as it saw fit. That the Mayor and Board of Aldermen decided to use this $4,500,000.00 for some form of financial relief to the residents and citizens of the City of Atlanta was in keeping with one of the main purposes of the Revenue Sharing Act. 223

The city admitted that the $4,500,000 of "freed-up" funds was used to reduce the water/sewer rates. 224 The suit, brought by 19 individual plaintiffs on behalf of all Atlanta residents, alleged that this use of the Revenue Sharing funds was improper under the Act and also violated the equal protection clause of the fourteenth amendment. Judge Freeman issued a permanent injunction against the indirect use of Atlanta's Revenue Sharing funds for rebates on water/sewer bills, holding such use was not within the permitted categories set forth in Section 103(a). 225

224. Brief for Defendants at 4-5. The Board of Alderman of the City of Atlanta adopted the following resolution:

Now, therefore, be it resolved by the Mayor and Board of Alderman of the City of Atlanta, Georgia, that it is the intention of the Mayor and Board of Alderman to utilize approximately $4,500,000 of these funds made available by the application of Federal Revenue Sharing funds to the City's fiscal requirements, to provide some form of meaningful tax relief for the citizens of the City of Atlanta.

356 F. Supp. at 293. Further, Mayor Massell in his State of the City Annual Message, delivered on Tuesday, January 2, 1973, stated that he intended to return directly to the citizenry of Atlanta a portion of the Revenue Sharing funds in the amount of $4.5 million. On February 12, 1973, in a news release, defendant Massell announced that he was going to use the Revenue Sharing funds at least in part to "create some relief for the monthly budget of the average Atlanta household . . . a total benefit to the public of $4.5 million." Id. at 294.

225. On the matter of jurisdiction over the action, the court held:

As a result of § 123(a)(3) of the Revenue Sharing Act which imposes a penalty for violation of § 103(a) of the Act by a local government, the court holds that a taxpayers' complaint which alleges that a local government has spent Revenue
The court's basic error which ultimately resulted in its reaching the wrong conclusion was its determination that "it was the intent of Congress that local governments be permitted to expend Revenue Sharing funds only on priority expenditures as defined in Section 103(a)" and that Congress intended this restriction to be "effective." Thus, the court would find a violation of Section 103(a) whenever the substance of "defendants' proposed plan would entail the expenditure of federal Revenue Sharing funds for other than one of the priority expenditures." However, the statements of Wilbur Mills, who was the motivating force behind the initiation and maintenance of the restrictions, indicate that unrestricted use of the displaced funds was to be permitted. Also, statements by other conferees such as Congressman Joel Broyhill and Senator Russell Long are to the same effect.

The court's decision is quite ambiguous as to whether all displaced funds are subject to all of the restrictions in the Act or whether it is only blatant artificial use of the displacement process resulting in a "sham transaction" that is prohibited. Judge Freeman stated:

It is true that the Revenue Sharing Act does not specifically impose any restrictions upon the use of legitimately freed-up funds. Thus the Act seems clearly to have contemplated that the infusion of Revenue Sharing funds into state and local governments would permit future tax relief. . . . Further, there is no requirement that a local government maintain at pre-Revenue Sharing levels its spending on priority expenditures. There is a clear difference, however, between funds which are legitimately freed up by the designation of federal Revenue Sharing funds to provide municipal services which otherwise would have to have been paid for out of general city funds, and funds which are transferred from one account to another simply to avoid the restrictions imposed by § 103(a) of the Act.

Sharing funds in violation of the priority use requirements of § 103(a) constitutes a case or controversy within the meaning of Article III.


226. The court considers the inclusion of the categories in the final legislation, after removal in the Senate, determinative of the congressional intent. "The fact that the language of § 103(a) is identical to the language of the original house version of the bill, except for a broader list of priority expenditures, clearly demonstrates that the restriction of the funds to priority expenditures was to be taken seriously." Mathews v. Massell, 356 F. Supp. at 300. It may be argued to the contrary that since the Senate conferees recognized that the "provision for the high-priority categories, at best, is illusory," Senate Report, supra note 9, at 16, the inclusion in the conference bill was considered a harmless exercise.

227. See text accompanying note 218 supra.

228. See notes 217, 220 supra.
[A]n attempt to avoid the clear restrictions of a federal statute cannot be accepted. . . . [The] courts have long made it clear that Congressional intent cannot be overridden by sham transactions. . . . Thus the court must recognize that the defendants have merely transferred funds from one account to another in an effort to disguise the fact that they plan to distribute $4.5 million of Revenue Sharing funds to the holders of water/sewer accounts.229

This statement suggests a narrow construction of the decision, limited to funds displaced by the application of Revenue Sharing funds directly and expressly to purposes for which a formal or informal prior commitment existed. Even recognizing that the use of Revenue Sharing for any purpose always reduces the theoretical burden on other potential revenue sources, this construction would not extend the Act's restrictions to all displaced funds. The court's reference to "funds which are legitimately freed-up" may imply a maintenance of effort standard in the sense that absent use of the funds to satisfy a formal or informal prior commitment or an existing level of expenditure for the category of use, there will be no inquiry as to the use of the displaced funds. However, the significant number of more sweeping conclusions in the opinion provide an adequate basis to cite it for a strict application of the Act's restrictions to all displaced funds.

The court's opinion indicates in dicta that its reasoning applies not only to the Section 103(a) categories, but also to all the other restrictions in the Act, including Davis-Bacon, prevailing wage and nondiscrimination provisions.230 Extensive litigation throughout the nation on the use of displaced funds can be safely predicted since the displacement process has been widely and expressly utilized.231

229. 356 F. Supp. at 299-300 (emphasis added).
230. The court states:
If defendants were to prevail on their arguments, other statutory restrictions placed on the use of Revenue Sharing funds would likewise become meaningless. This court cannot conclude that Congress intended for its prohibition against the use of funds in a manner that discriminates on the basis of race, color, national origin or sex (§ 122) to be so easily read out of the Act. Similarly, the restrictions set forth in § 123(a)(6) and § 123(a)(7), establishing standards for wages paid with Revenue Sharing funds, and § 123(a)(8), requiring that funds received by certain local governments be expended for the benefit of certain Indian tribes, would be nugatory according to defendants' analysis of the Act.

Id. at 301.
231. An interesting postscript to the Mathews v. Massell suit is the decision by the Atlanta Board of Aldermen to use $750,000 of Revenue Sharing funds for Economic Opportunity Atlanta, Inc., the local "war on poverty agency," and additional amounts for a new public-safety build-
On June 19, 1973, in a speech to the Conference of Mayors, Graham W. Watt, Director of The Office of Revenue Sharing stated:

The Office of Revenue Sharing will continue to administer the general revenue sharing program without modifying our original view that funds freed-up in accordance with the laws and procedures applicable to a government's own revenues may be used without restriction to priority categories for operating and maintenance purposes.²³²

One of the most disturbing aspects of the categories is that they induce the use of the displacement approach thereby providing an opportunity for nondisclosure of the "real use" of the funds to the public. The categories provide a convenient justification by which local officials can choose a non-controversial item as the ostensible use of the Revenue Sharing funds on the basis that this minimizes exposure to penalty for failure to comply with the provisions of the Act, while they actually spend the funds for another purpose which is highly controversial. The disclosure and reporting provisions of the Act and the regulations do not require or promote reporting on the "real use" of the money in an aggregate sense.²³³ The inducement to place the funds in a cosmetic category, coupled with the absence of any requirement or inducement toward "real use" reporting, could undermine one of the philosophical premises of the Act, namely that accountability to the federal bureaucracy should be replaced with accountability to the local citizenry through complete and accurate disclosure. The absence of rigorous public disclosure requirements lends support to the judicially imposed restrictions on fund usage found in a broad interpretation of the Mathews v. Massell decision.

b. Prohibition on Use to Match Federal Funds

The House Bill²³⁴ provided that Revenue Sharing funds

²³⁴ H.R. 14370 (§ 101), 92d Cong., 2d Sess. (1972). The Administration Bill placed no restrictions on using funds for matching. The original Mills Bill provided that "subject to the conditions and limitations provided in this title, such government [localities] may use such funds for the purpose of matching Federal funds if such payments and funds are used for high-priority expenditures and if the amount of such Federal funds are limited by law." H.R. 11950 (§ 101), 92d Cong., 1st Sess. (1971).
were not to be used by local governments to match federal funds for other programs where matching non-federal funds were required by federal law. The Senate Finance Committee extended this provision to apply to cases where the matching formula provided by federal law allows matching from either non-federal or federal funds. It also extended the prohibition to use of Revenue Sharing funds by state governments. However, the most significant Senate modification was a prohibition of indirect as well as direct use of Revenue Sharing funds to obtain federal matching grants. This modification was added in direct response to an indication that the prohibition in the House Bill was essentially meaningless because it did not prevent displacement of other local funds to be used for matching purposes.

The use of Revenue Sharing funds to supplement other federal grant funds is not prohibited. For example, if a project costs more than the amount available from non-federal matching funds plus the federal matched funds, the local government could use Revenue Sharing funds to defray the excess cost, if (1) the Revenue Sharing funds were not being used to match other federal funds, and (2) the program qualifies under one or more of the priority expenditure categories.

The legislative history of the Act also evinces an intent to prohibit indirect matching by multiple transfers or transfers through independent or quasi-independent agencies. The General Explanation of the Act stated that:

[w]hile funds received by a local government from a State government generally can be used for matching Federal grants, it must be clear that the funds derived from the State are not in themselves funds provided by the Act. If a local government is receiving funds from the State and is matching Federal funds, the Secretary of the Treasury may require the local government to show that the funds it received from the State had not been originally received by the State as funds under the Act.

235. Final Regulations, supra note 106, § 51.30(a) provides "[t]his prohibition on use of entitlement funds as matching funds applies to Federal programs where Federal funds are required to be matched by non-Federal funds and to Federal programs which allow matching from either Federal or non-Federal funds."

236. On the floor of the Senate, Senator Long unequivocally indicated his view that the provision on indirect matching was intended to prohibit use of the displacement process to circumvent the prohibition. 118 Cong. Rec. § 14392 (daily ed. Sept. 8, 1972).

237. See Final Regulations, supra note 106, § 51.30(g).

238. Id.

239. General Explanation, supra note 63, at 22; see Senate Report, supra note 9, at 36.
The Final Regulations expressly apply the matching prohibition to a recipient government's funds which are transferred to another governmental unit or private organization.\textsuperscript{240}

Due to the fact that governmental funds are fungible, the prohibition on indirect matching is potentially a source of major difficulty in regulating compliance under the Act. Strict enforcement would require major reporting requirements on all aspects of the recipient's budget, and rigid maintenance of effort provisions. The potential impact of this prohibition on local accounting practices and expenditures was increased by the Senate Finance Committee Report which indicated that the burden of proof of compliance with this prohibition was on the recipient governments. The Report stated that:

[i]n determining whether the governmental unit has indirectly used revenue sharing funds to match Federal funds, it is expected that the Treasury will generally hold that revenue sharing funds are used for matching purposes unless it can be shown that the matching funds came from other sources.\textsuperscript{241}

The extent of the burden posed by the matching prohibition was further reinforced by the discussion of the reporting requirements in the Senate Report:

[T]hese reports will set forth the amounts and sources of non-revenue-sharing funds used for matching Federal grants and the amounts of Federal grants thus obtained. . . . The committee is also concerned that the funds not be used directly or indirectly as State or local matching funds for Federal matching programs. The reports are also intended to serve as a way of being sure that the revenue sharing funds are not used for this purpose.\textsuperscript{242}

The Administration's representatives expressed great concern over the burden that such reporting requirements would have placed both on the Department of the Treasury and on state and local governments. Compliance with the requirements would have required a dramatic change in accounting practices, since in general, state and local governments do not have federal funds accounting. In fact, many major cities appear not to have the information on either total federal matching grants received or the local matching obligation to obtain those grants.\textsuperscript{243}

\begin{footnotesize}
\begin{enumerate}
\item Final Regulations, supra note 106, § 51.30(b). A violation of the matching prohibition by a secondary recipient constitutes a violation by the recipient government and the penalty provided by the Act shall be imposed on the recipient government. \textit{Id.}
\item Senate Report, supra note 9, at 36.
\item Senate Report, supra note 9, at 34; \textit{see General Explanations}, supra note 63, at 44.
\item See Clark, Iglehart & Lilley, \textit{New Federalism II: Philosophy},
\end{enumerate}
\end{footnotesize}
emphasized these problems to the Conference Committee and proposed the language which is now found in Section 104(e) of the Act. This language was intended to provide that filing the certification would constitute prima facie satisfaction of the burden of proof of compliance with the prohibition on direct and indirect matching unless other facts came to the attention of the Secretary of the Treasury which would indicate that a particular certification is unreliable. Thus, the conferees overrode the earlier indications with respect to reporting on the matching prohibition. However, a state or local official continues to bear the burden of ascertaining whether there has been indirect matching before he executes the certification provided for in Section 104(e).

Section 104(c) of the Act provides a "safe harbor" in the sense that fulfillment of the conditions set forth in that subsection results in a conclusive presumption of compliance with the prohibition on matching. However, failure to fulfill those conditions does not result in a determination or presumption of non-compliance with the basic prohibition. An increase in net revenues from a recipient government's own sources for any entitlement period over the net revenues from its own sources for the base period commencing July 1, 1971, will be presumed to have been used for matching purposes, and to that extent, there would be a presumption of compliance with the matching prohibition. For example, if net revenues from the recipient government's own sources for the 12 month period commencing July 1, 1971 were $100,000 and for the corresponding period commencing July 1, 1973 were $150,000, while the local contributions to federal matching programs were $25,000 in 1971 and $110,000 in 1973,
$50,000 of the increase in local matching contributions would be deemed to be attributable to the increase in net revenues from its own sources. Therefore, $35,000 ($110,000, less $25,000, less $50,000) of local matching contributions in 1973 would remain unaccounted for and could potentially have come from the Revenue Sharing funds. If the Revenue Sharing funds to this particular recipient government amounted to $95,000 for the 12 month period commencing July 1, 1973, the recipient government must prove that at least $35,000 of that amount was not used directly or indirectly for matching purposes. It would be consistent with the philosophy of this "safe harbor" to also conclude that the remaining $10,000 ($95,000, less $50,000, less $35,000) was not used for matching purposes. However, the Department of the Treasury has not publicly indicated its position on this matter.

This statutory "safe harbor" caused the Treasury and the Office of Management and Budget great concern about possible discouragement of tax reductions at a time when the President was publicly expressing his hope that Revenue Sharing would reduce or prevent further increases in property taxes. However, this concern seems misplaced since, as previously indicated, failure to come within the Section 104(c) "safe harbor" does not constitute a violation of the matching prohibition, nor a presumption of such a violation. A reduction in net revenues as compared to the base period or earlier entitlement periods does not result in a conclusion that there has been a violation of the matching prohibition because the difference in net revenues must be considered in relationship to increases in matching fund contributions and the amount of the Revenue Sharing grant.

The Senate Finance Committee Report245 suggests several other potential "safe harbors":

1. Proceeds from one or more bond issues that exceeded bond issue proceeds in fiscal year 1972; and
2. Discontinuance of a fiscal year 1972 expenditure program, but only if the recipient government's Revenue Sharing funds are not being used for an essentially similar program in order to avoid the intent of the anti-matching rule.

Furthermore, the Final Regulations246 provide that when the fol-

245. Senate Report, supra note 9, at 36; see General Explanation, supra note 63, at 21-22.
246. Final Regulations, supra note 106, § 51.30(e). The language in the Regulations is in the form of an indirect double negative—"No recipient government shall be determined to have used entitlement funds in violation of the indirect prohibition of paragraph (a) of this subsection to the extent that. . . ."
lowing situations occur there will be no presumptions of "non-compliance":

1. The expenditure of Revenue Sharing funds was accompanied by an aggregate increase in non-matching expenditures.

2. The receipt of Revenue Sharing funds permits that government to reduce taxes, provided revenue from sources other than Revenue Sharing is sufficient to cover all matching funds contributions;\(^{247}\) and

3. The matching funds contribution in question is accounted for by an in-kind contribution which was not financed directly or indirectly with Revenue Sharing funds.

The "non-presumption" which results from an increase in non-matching funds expenditures seems inconsistent with the general framework of the statutory scheme which generally considers only the revenue side of a particular transaction. The very significant problem raised by this approach is exemplified by a recipient whose aggregate increase in non-matching funds expenditures resulted from an overall budgetary deficit in an amount in excess of the amount of Revenue Sharing funds received, rather than an increase in non-matching funds revenues. In general, it simply is not valid to assume that an increase in aggregate non-matching funds expenditures supports a conclusion that non-Revenue Sharing sources of revenues were used for the purposes of contributions to matching programs. Furthermore, it is unclear whether a causal connection will be required under category (2) between the tax reduction and the receipt of Revenue Sharing funds. For example, a municipality may reduce taxes as a result of increased transfer payments from the state, a reduction in the number of employees or reduction in the level of services.

It therefore appears that the concern about discouraging tax reductions is misplaced insofar as it relates to the statutory "safe harbors" and the matching prohibition, and that the objective of providing additional "safe harbors" could better be served by alternative means. It should be possible to formulate

\(^{247}\) It is interesting to compare the language in the Final Regulations to the same provision in the Proposed Regulations:

The receipt of entitlement funds permitted that government to decrease its other revenues without a commensurate reduction in its nonmatching expenditures: Provided, Nonentitlement revenue is not less than the local matching funds contribution.

Proposed Regulations, supra note 106, § 51.30 (d) (2). Obviously, the Department of the Treasury decided to deal with the political issue of tax reductions directly. However, the result appears to significantly weaken the matching prohibition.
a regulation whereby a presumption of compliance would exist so long as aggregate expenditures in the broad categories of usage for Revenue Sharing funds were increased by at least the amount of the particular expenditures of the Revenue Sharing funds. For example, if a recipient government indicated that its Revenue Sharing funds were used for the purchase of a fire engine, and the aggregate expenditure for the category “fire protection” increased by at least the amount of the Revenue Sharing funds so used, one would presume that in fact the funds were used as specified, rather than indirectly for matching purposes. The weakness of this approach is that it implies a crude aggregate maintenance of effort concept and does not deal with the argument that the increase in the aggregate categorical expenditures may be for another purpose or that the displacement was otherwise planned. Nevertheless, it is far more defensible than an aggregate expenditure test.

It is unlikely that such a stringent prohibition on use of the Revenue Sharing funds for matching purposes would have been included were it not for the “tale of horrors” under consideration simultaneously by the Senate Finance Committee with respect to the Social Services provisions under the Social Security Act. The great danger in this prohibition is that Revenue Sharing will be used to “police” the matching programs and their administration. If all the matching programs had limitations on aggregate and specific expenditure amounts, the prohibition on the use of Revenue Sharing funds for matching purposes could be omitted from the Revenue Sharing program as an undue limitation on local decision making.

For example, the highest priority local need in many localities is a new sewage-disposal system. However, the prohibition on matching will effectively preclude use of Revenue Sharing funds for this purpose by many localities since the prohibition would be violated if they seek additional federal assistance for this purpose on a matching basis.

James E. Smith, Deputy Under Secretary of the Treasury, has indicated that although the Administration did not seek the matching prohibition, it is a prohibition fully in keeping with the

248. See, e.g., text accompanying note 92 supra.
249. It is interesting to compare the anti-matching provision in the Revenue Sharing Bill originally introduced by Wilbur Mills:

Subject to the conditions and limitations provided in this title, such government (localities) may use such funds for the purpose of matching Federal funds if such payments and funds are used for high priority expenditures and if the amount of such Federal funds are limited by law.
philosophy of the program since one of the objectives of the program is to give states and localities a chance to exercise their own creativeness and ingenuity. He hoped "that their creativity could take a somewhat higher form than merely using the funds to obtain other Federal funds." This, of course, implies an extremely negative evaluation of the desirability of the goals and objectives reflected in the existing federal matching programs. Since the matching programs reflect a value judgment of the Congress as to the highest priority needs of the nation, it is difficult to conclude that local officials should be penalized for concurring in that conclusion and using their Revenue Sharing funds for those purposes.

c. State Maintenance of Effort

In order for a state to receive its full entitlements under the Act it must maintain the level of its aid to units of local government (excluding limited purpose governments and special taxing districts) within that state since Revenue Sharing is intended to provide assistance to localities in meeting their needs, to provide additional services and to relieve local financial pressures.

The Act provides for the comparison of a two-year average of aggregate state transfers of revenue from its own sources to localities in order to eliminate the effects of temporary reductions arising from the financing needs of the state. The base period for the purposes of this comparison is the one-year period beginning July 1, 1971. Obviously the state may reduce the amount it potentially would have spent so long as it does not fall below the base period level and reallocate its local transfer payments among localities to redistribute the impact of the Revenue Sharing funds. Therefore, although the state may change the within-state formula only once within the five year life of the program within the limits set forth in the Act, the state legislature may reallocate state assistance to localities in a way which will indirectly affect the impact of Revenue Sharing. For example, if the state determines that the allocations under the Act unduly favor a given locality, the state could appropriately reallocate its assistance funds so as to readjust the situation so

252. Id. at (1)(A). The average is for the Entitlement Period in question plus the preceding Entitlement Period.
253. Id. at (1)(B).
long as the aggregate funds transferred to all localities within the state exceed the base year level.

Section 107(b) (1) of the Act requires maintenance of revenue transfers from the states' own sources, thus requiring "each state government to continue to use its own funds to assist all units of local government . . . within the State to the same extent that had been done previously." The Final Regulations define "own sources" as meaning "all sources of State revenue (including debt proceeds and the State's revenue sharing entitlement funds) but excluding intergovernmental revenues received from the Federal Government." The inclusion of the Revenue Sharing funds in the state's own source revenues appears to extend the statutory language and congressional intent. The Final Regulations further provide the following formula to apply in those situations where the state's accounting system cannot ascertain the source of transfers to units of local government (e.g., transfers from a commingled fund with no identification as to specific revenue sources):

\[
\text{State's transfers to localities from its own sources} = \frac{\text{State's total transfers to all localities}}{\text{State's own source revenues}} \times \frac{\text{State's total revenues}}{\text{State's own source revenues}}
\]

The underlying assumption of the formula is that the ratio of a State's own source intergovernmental transfers to units of local government to that State's total intergovernmental transfers to units of local government is equal to the ratio of that State's own source revenues to its total revenues.

The validity of this assumption is subject to serious question where a state has restricted revenue sources which cannot be used for intergovernmental transfers. At a minimum, all revenues from such sources should be removed from the denominator of the formula.

The Act recognizes two instances in which a state may justifiably reduce its assistance to its localities for reasons extrinsic to Revenue Sharing: (1) the state's assumption of responsibility for a category of expenditures previously assumed by localities, and (2) the state's conferring a new source of tax reve-

254. Senate Report, supra note 9, at 22.
255. Final Regulations, supra note 106, § 51.26(a) (emphasis added).
256. Id. at (b).
257. Id. at (b) (1).
258. The Regulations provide that the Secretary of the Treasury may use any other formula, procedure or method deemed equitable if the prescribed approach provides an inaccurate or unfair measure of transfer effort. Id. at (c).
nues on the localities in lieu of transfer payments. The permitted reduction in state transfers based on state assumption of responsibility for a category of expenditures applies only to those categories which were previously the responsibility of localities. For example, a state could not lower its level of local assistance by assuming responsibility for enforcing federal environmental control standards if the localities would not thereby be relieved of any responsibilities.

Neither the Act nor the regulations define “categories of expenditures.” A broad definition of “categories” would restrict the state’s ability to adjust its level of local support. For example, if the categories set forth in Section 103(a) of the Act define the term, a state which assumed responsibility for law enforcement, where that function had previously been the responsibility of localities, could not correspondingly reduce its assistance to the localities because the category of public safety is far broader than the category of law enforcement. It is incumbent upon the Treasury to provide some guidance in this area.

A dramatic application of this provision allowing reduced assistance to localities where the state assumed a category of expenditures would have occurred if the Rodriguez case had been upheld by the Supreme Court. Many states would have been forced to assume all or part of the responsibility for financing education within the state. However, state court decisions similar to Robinson v. Cahill which are based on state constitutional grounds may have the same practical effect. This raises interesting questions under Section 107(b). First, would the state be considered to have assumed responsibility for a category of expenditures if it merely provided a standard grant to each student within the state, leaving a local option to supplement

259. Act § 107(b)(2) and (3), 31 U.S.C.A. § 1226(b)(2) and (3) (1973).
260. Rodriguez v. San Antonio Independent School District, 93 S. Ct. 1278 (1973). The Supreme Court held that the use of local property tax revenues to finance public education did not violate the equal protection clause of the fourteenth amendment even though the result was per-pupil expenditure disparities among school districts.
261. 62 N.J. 473, 303 A.2d 273 (1973). The New Jersey Supreme Court held that the use of the property tax to finance public education which results in per-pupil disparities among school districts violates the following provision in the state constitution:

The legislature shall provide for the maintenance and support of a thorough and efficient system of free public schools for the instruction of all of the children in this state between the ages of five and eighteen years.

N.J. Const. art. 8, § 4, ¶ 1.
this amount out of the localities' own revenue sources? Second, what level of reduction in state assistance would be justified by a given assumption of responsibility? Section 107(b)(2) indicates that the allowable reduction in assistance is measured by the increased state government spending from its own sources rather than the prior level of expenditures by the localities for that category of expenditures. For example, if the localities expend an aggregate of $10 million for education prior to assumption by the state, but thereafter the state government only expends an additional $8 million because of greater efficiencies or a reduction in the level of services, the state would be justified in reducing transfer payments only in the amount of $8 million. Correspondingly, if the state expends an additional $12 million, the permitted reduction would be in that amount. However, if the source of $3 million of the expenditures was federal grants to the state, such expenditures are not from the state's own sources of revenues and to that extent, a reduction in transfer payments would not be justified.

The second instance in which a state may justifiably reduce its transfer payments is when the state has conferred the authority to levy a new kind of tax upon a locality lacking such prior authority. Thus, by conferring new sources of taxation on City A, transfer payments to City B can be reduced, since conferring new taxing authority upon one or more units of local government justifies an aggregate reduction in transfer payments. Section 107(b)(3) expressly states that an increase in the authorized rate of an existing local tax does not generally justify transfer payment reduction. For example, authorizing an increase in the local sales tax rate from 3 to 4 percent will not justify a reduction in transfer payments. However, an increase in the rate of an existing local tax will justify a reduction in state transfer payments if it results in a decrease in a "related state tax." There is some question as to the extent of the requisite relationship between the state and local tax. If the state allows local governments to levy a personal income tax, is a corresponding reduction in state corporate income tax a decrease in a "related state tax"? It is also not clear whether the reduction in the related state tax must correspond in amount to the increase in the local tax. If the state confers the right to increase the local sales tax from 1 to 4 percent resulting in collections of $2 million, does a reduction from 5 to 4½ percent in the state

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263. Id.
sales tax rate, with a reduction in state collections of $500,000, justify a state reduction in local transfer payments?

Regarding the extent of any permissible reduction, the Act indicates that the state may reduce its local transfer payments to the extent of the larger of

1. an amount equal to the amount of the taxes collected by local governments by reason of the exercise of such new taxing authority, or
2. an amount equal to the loss of revenue to the State by reason of such new taxing authority being conferred on such local governments.264

Therefore, it would appear that a reduction of $2 million would be justified, notwithstanding the fact that the state itself only lost revenues of $500,000. Furthermore, the last clause of Section 107(b)(3) does not require a proportionate or substantially equal reduction in the related state tax to justify reductions in the local transfer payments if there has been an increase in the authorized rate of an existing local tax.

If a state fails to maintain its effort as the Act requires, the amount that otherwise would be distributed to the state is to be reduced in an amount equal to the unwarranted reduction in transfers to its localities after the state has had reasonable notice and opportunity for a hearing.265 Any reduction in a state entitlement is transferred to the general fund of the Treasury; it does not increase the entitlements of other states or the localities in the offending state.266 The remedy thus fails to improve the position of the injured locality.

d. Davis-Bacon Act and Prevailing Wage

Section 123(a)(6) of the Act requires payment of the prevailing wage rates as determined by the Secretary of Labor in accordance with the amended Davis-Bacon Act267 to all laborers and mechanics who are employed by contractors or subcontractors on any construction project which derives 25 percent or more of its funds from the recipient state or local government's Revenue Sharing trust fund.268 By providing that the wage re-

264. Id. at (3)(A) and (B).
265. Id. at (6).
266. Id. at (7).
267. 40 U.S.C. § 276a et seq. (1970). Basically, the Davis-Bacon Act empowers the Secretary of Labor to determine wage rates for employees of contractors or subcontractors engaged in any construction activities supported by federal funds.
268. Neither the Act nor the Regulations contain a definition of the term "construction project." Obviously the scope of this definition will determine the impact of the 25 percent limitation.
striction applies only when "25 percent or more of the costs of the project are paid out of its trust fund" (emphasis added), Section 123(a) (6) contrasts with other sections of the Act. For example, Section 104(a) provides that "[n]o State government or unit of local government may use, directly or indirectly, any part of the funds it receives under . . . [the Act] as a contribution" to obtain federal matching funds (emphasis added), and Section 122(a) provides that "[n]o person in the United States shall on the ground of race, color, national origin, or sex be excluded from participation in, be denied the benefits of, or be subjected to discrimination under any program or activity funded in whole or in part with funds made available under" the Act (emphasis added).

The House-passed version of Section 123(a) (6) would have required payment of all laborers and mechanics employed by contractors or subcontractors of construction financed in whole or in part out of government trust funds at rates not less than those prevailing on similar construction in the locality as determined under the Davis-Bacon Act.269 However, the Senate Finance Committee omitted this provision because it seemed inconsistent with the general "no strings" approach to Revenue Sharing.270 Also, the Davis-Bacon provisions were considered to result in increased costs for governmental services and facilities which were inconsistent with the intended relief from the fiscal crisis.271 When the provision was reintroduced on the floor, Senator Humphrey, a traditional ally of labor, proposed the limitation that the Davis-Bacon Act would apply when 25 percent of the total costs of the project were derived from the recipient government's trust fund.272 This provision deals with the fungibility-displacement problem in the matching area by circumscribing the inquiry to the prima facie use of the funds as demonstrated by the transfer from the trust fund. If the direct transfer from the trust fund is for purposes other than construction, the inquiry as to Davis-Bacon should end. Thus, this provision may be circumvented by displacing other expen-

270. SENATE REPORT, supra note 9, at 17, 38.
271. See 118 Cong. Rec. § 14189 (daily ed. Sept. 6, 1972) (remarks of Senator Fanin); id. at § 14192, § 14196, § 14200 (remarks of Senator Long); id. at § 14197 (remarks of Senator Tower).
272. Senator Humphrey's original proposal would have limited the application to those projects where 50% or more of the costs of the project are paid out of the recipient's trust fund. 118 Cong. Rec. §§ 14194-95 (daily ed. Sept. 6, 1972). Senators Long and Hartke compromised on the 25% limitation. Id. at § 14202.
ditures with Revenue Sharing funds. For example, a municipality with a police budget of $100,000 could write a check from its trust fund to the police fund for $100,000 representing all or substantially all its annual Revenue Sharing funds, while the displaced funds from the police department are used for the construction by contractors of a new town hall.

The provision applies only to construction projects financed with Revenue Sharing funds and imposes no limitation whatever on acquisitions or purchases. The House Report stated that

[T]his provision is to apply only to work on construction financed under this provision and is not to apply to an item merely because it has been purchased by the local government. As a result, it would apply to a building or to a sewage treatment plant constructed by or to the order of the local government. However, it would not apply to a sewage treatment plant already in existence which is purchased by the local government.

The provision does not apply to employment by the local government directly, but only to employment by contractors and subcontractors.

Section 123(a)(7) requires state governments and units of local government to pay to its employees whose wages are paid in whole or in part out of the recipient government's trust fund wages which are not lower than the prevailing rates of pay for its similarly occupied employees. This requirement must be met only if 25 percent or more of the wages of all employees of the recipient government in the same category of employment are paid from its Revenue Sharing trust fund.

Since a violation requires a finding of a direct expenditure out of the trust fund for the payment of 25 percent of the aggregate employee wage payments, few violations should occur unless the Treasury gives "category of employment" an extremely narrow definition. But even if the restriction is applicable, it merely requires payment of the prevailing rate of pay for persons employed in similar public occupations by the same employer. It is not the prevailing wage in the community generally, nor is it the federal minimum wage applicable to the employee under the Fair Labor Standards Act, nor the state or local government minimum wage for the most nearly comparable covered employment. Thus, only a complete absence of planning could result in a violation of this restriction.

273. House Report, supra note 60, at 34; General Explanation, supra note 63, at 47.
274. House Report, supra note 60, at 34; General Explanation, supra note 63, at 47.
275. All of these requirements were strongly urged by the AFL-
Circumvention of Davis-Bacon and prevailing wage requirements could result from the transfer of Revenue Sharing funds through independent or quasi-independent entities as intermediaries. For example, a unit of local government might transfer its funds to an entity such as an independent or quasi-independent sewage district for the purpose of constructing a new facility. Although the restrictions of Section 123(a)(6) should apply to the construction by the sewage district, if the transfer is for the purpose of employing additional personnel, the restriction of Section 123(a)(7) requiring a recipient government to pay its prevailing wage will only apply if such employees are considered employees of the transferor unit of local government. If the transferee is a completely independent entity whose employees are not considered employees of the transferor for other purposes, Subsection (7) should not require the transferee to pay either the transferor's or its own prevailing wage to those additional employees.\footnote{276}

e. Non-Discrimination

Section 122(a) of the Act provides that no person shall on the basis of race, color, national origin, or sex be excluded from participation in, be denied the benefits of, or be subjected to discrimination under any program or activity funded in whole or in part with Revenue Sharing funds.\footnote{277} The Final Regula-

\footnote{276} If the Department of the Treasury intends that the Subsection (7) restriction on wage rates follows the funds, it should specify whether the transferor's or transferee's prevailing wage rate applies.

To ensure the Labor Department's legal position to sue on behalf of affected workers if the Davis-Bacon wage rates and standards are not met, the Final Regulations, \textit{supra} note 106, \S\ 51.33(b), impose the following requirements on recipient governments in situations where the Davis-Bacon standards are applicable. The recipient must (1) file with the regional office of the Department of Labor a request for a wage determination for each intended project at least 30 days before the invitation for bids; (2) ascertain that the issued wage determination and required contract clauses are incorporated in the contract specifications (See 29 \textit{C.F.R.} \S\S 5.5 and 5a.3); and (3) satisfy itself that the contractor is made aware of his labor standards responsibilities under the Davis-Bacon Act. \textit{See General Explanation, supra} note 61, at 47.

\footnote{277} Section 122 of the Act is patterned after Title VI of the Civil Rights Act of 1964 (42 \textit{U.S.C.} \S\ 2000d \textit{et seq.}). However, there are two major extensions in Section 122: (1) prohibition on sex discrimination and (2) no specific exemption of certain employment practices.
tions define "program or activity" as "any function conducted by an identifiable administrative unit of the recipient government, or by any unit of government or private contractor receiving entitlement funds from the recipient government." The italicized disjunctive clauses were not present in the Proposed Regulations. Their addition suggests that shifting the noncomplying function to other units of the recipient government or to a private contractor will not limit the scope of a Title VI order. However, in many cases it will be difficult or impossible to trace Revenue Sharing funds to a particular "function." For example, if the Planned and Actual Use Reports refer to a transfer to the Transportation Department for public transportation purposes, it will be difficult to ascertain whether any of the funds were in fact used to finance a particular "function" conducted by the Transportation Department. The flexibility with which the Treasury Department interprets "function" will determine the scope of this problem.

The phrase "funded in whole or in part with Revenue Sharing funds" is defined in the Final Regulations as a transfer of the Revenue Sharing funds "in any amount from the recipient government's trust fund to an identifiable administrative unit and disbursed in a program or activity." Since no change was made in this definition to parallel the amendment to the Proposed Regulations' definition of "program or activity," a transfer from the recipient government's trust fund to the general fund and ultimately to a program or activity, or a transfer to an independent or quasi-independent unit, seems to insulate future expenditures from the anti-discrimination provision.

Similarly, the definition of "funded in whole or in part with Revenue Sharing funds" gives broad latitude to the use of the displacement approach, i.e., the use of Revenue Sharing funds for noncontroversial purposes and expenditure of the displaced funds for activities which might have a discriminatory impact.

278. Final Regulations, supra note 106, § 51.32(a) (emphasis added).
279. Proposed Regulations, supra note 106, § 51.32 defined "program or activity" as "any function conducted by an identifiable administrative unit of the recipient government."
280. Final Regulations, supra note 106, § 51.32(a) (emphasis added).
281. See Letter from Stephen Horn, supra note 178:
State and local governments are granted wide discretion in how they will use revenue sharing funds, allowing them to choose those programs or activities to be funded with assistance provided through revenue sharing and those to be funded by other sources. The use of revenue sharing funds for a particular expenditure can free State and local funds for other uses. This type of allocation enables a State or local government to
The federal district court's opinion in *Mathews v. Massell* refuses to allow this approach:

If defendants were to prevail on their arguments [that displaced funds are not subject to the restrictions in Section 103(a)], other statutory restrictions placed on the use of Revenue Sharing funds would likewise become meaningless. This Court cannot conclude that Congress intended for its prohibition against the use of the funds in a manner that discriminates on the basis of race, color, national origin or sex (§ 122) be so easily read out of the Act.\(^{282}\)

If this opinion prevails, the definition of "funded in whole or in part with Revenue Sharing funds" in the Final Regulations is invalid.

However, given the historical development of the Regulations, the Treasury apparently concluded that use of the displacement approach and insulation of the general fund must be preserved as basic to the "no strings" philosophy. The Commission on Civil Rights concedes that "the Revenue Sharing Act does not provide any mechanism to expand the coverage of its civil rights provisions to programs or activities made possible by Revenue Sharing entitlements but not directly financed with those funds."\(^{283}\) But the Lawyers' Committee For Civil Rights Under Law disagrees:

The range of programs and services eligible for revenue sharing makes it possible for state and local governments to use revenue sharing funds to displace local funds from one program to another. This will mean that any government, which believes or is informed that one or more of its programs and services might be susceptible to a charge of discrimination, can simply apply its revenue sharing funds directly to other programs, and displace local funds from those programs to the program it feels might be subject to attack. There can be no question that, where revenue sharing funds are so used, the suspect program is being funded in whole or in part by Revenue Sharing funds within the meaning of Section 122 of the Act.\(^{284}\)

Nondiscrimination restrictions are enforceable by the Treasury. If the Secretary has conducted a compliance review based upon an investigation which leads to a determination of non-compliance, he can request the governor to secure compliance of the state or local government. If within a reasonable period

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\(^{282}\) Id.

\(^{283}\) Letter from Stephen Horn, *supra* note 178.

\(^{284}\) Letter from Lawyers' Committee for Civil Rights Under Law (signed by Stuart E. Benson) to Samuel R. Pierce, General Counsel of Department of the Treasury, Dec. 21, 1972.
of time the governor fails or refuses to secure compliance, the Secretary is authorized to (1) refer the matter to the Attorney General with a recommendation to institute civil action, (2) exercise the powers and functions provided by Title VI of the Civil Rights Act of 1964, or (3) take such other action as may be authorized by law.

The Final Regulations provide that an order under Title VI of the Civil Rights Act of 1964 shall become effective only after (1) the Secretary of the Treasury has advised the recipient government of its failure to comply and has determined that compliance cannot be secured by voluntary means, (2) there has been a hearing and an express finding on the record of noncompliance, (3) action has been approved by the Secretary of the Treasury, and (4) 30 days have elapsed after the Secretary of the Treasury has filed with the House Ways and Means Committee and the Senate Committee on Finance a full written report of the circumstances and grounds for the action. With respect to the payment of Revenue Sharing funds, the order may provide for termination, refusal to grant, refusal to continue, demand of forfeiture, demand of repayment or withholding.

While an order demanding forfeiture or repayment of Revenue Sharing funds must be limited to the particular program or activity in which noncompliance has been found, a withholding order applies to all Revenue Sharing funds of the noncomplying government until the Secretary of the Treasury is satisfied that there will be compliance. Thus, the Final Reg-

286. See Final Regulations, supra note 106, § 51.32(f)(3).
287. Final Regulations, supra note 106, § 51.32(f)(3)(v); see § 602 of Civil Rights Act of 1964. The U.S. Commission on Civil Rights had the following recommendation on this matter:

The regulations should prohibit the reallocation of revenue sharing funds once prima facie evidence of discrimination has been given, including receipt of a nonfrivolous complaint. The regulations should also require that in the event that sanctions are imposed upon a State or locality for discrimination in a particular program, the revenue sharing entitlement will be reduced by the amount previously allocated to that program until correction of the violation, again permitting no reallocation of funds.

Letter from Stephen Horn, supra note 178.

288. In response to the Proposed Regulations, which did not provide for the withholding of all entitlement funds, the office of Civil Rights of the Department of Health, Education and Welfare recommended that “the regulation should provide the Secretary with the authority to withhold an entire entitlement to a recipient government on the basis of a Title VI finding of discrimination.” Letter from Patricia A. King, Acting Director, Office of Civil Rights, Dept. of Health, Education
ulations forbid avoidance of the penalties by shifting the funds to other functions which have not been found to be in non-compliance. Similarly, the provision\(^{289}\) governing noncompliance with other restrictions in the Act\(^{290}\) provides that after notice, an opportunity for hearing and 60 days for corrective action, the Treasury will withhold all future payments until such time as it is satisfied that appropriate corrective action has been taken and that there will no longer be any failure to comply.\(^{291}\) The Lawyers' Committee for Civil Rights Under Law would extend the Regulations "to withhold all Revenue Sharing funds to a jurisdiction when discrimination is found in any program eligible for revenue sharing funds,"\(^{292}\) but such an extension of the withholding penalty would exceed the Treasury's general regulatory authority.

Many civil rights groups\(^{293}\) have expressed strong concern about the adequacy of the nondiscrimination provisions in the Act and the Regulations thereunder. They particularly believe that since state and local governments have widely engaged in discriminatory practices in the areas designated as high priority under the Act, the recipient governments should be required to file affirmative action plans setting goals and timetables to correct deficiencies in their employment of women and minorities before funds are distributed.\(^{294}\) Reporting requirements which follow the guidelines in Bulletin 73-3 of the Office of Management and Budget have also been suggested. Such reports would provide data by race and ethnicity on the beneficiaries of the program and reveal the nature of any adverse effects of the program on the minority population.\(^{295}\)

\(^{289}\) Final Regulations, supra note 106, § 51.3.


\(^{291}\) See letter from Stephen Horn, supra note 178.

\(^{292}\) Letter from Lawyers' Committee for Civil Rights Under Law, supra note 284 (emphasis added).


\(^{294}\) See Letter from Stephen Horn, supra note 178. This recommendation would require compliance with standards similar to those set forth in 41 C.F.R. § 60.2 (1972) ("Revised Order Number 4" issued by the Office of Federal Contract Compliance of the Department of Labor).

\(^{295}\) See Letter from Leadership Conference on Civil Rights, supra note 293; Letter from Stephen Horn, supra note 178; Letter from Patricia A. King, supra note 288 ("Recipient governments should be re-
The U.S. Commission on Civil Rights also expressed concern "that the remedies for non-compliance with the civil rights requirements of the Act are weaker than those for non-compliance with the other sections." For example, the specific regulatory provision applicable to nondiscrimination in the Final Regulations seems contrary to the general provision that the violation of any prohibition or restriction (including nondiscrimination) on the use of funds by a secondary recipient shall constitute a violation by the recipient government. The inconsistency arguably is avoided by the Act's exclusion of discrimination as a potential violation for a recipient government since the definition of a violation of the nondiscrimination provision excludes those situations where there has not been a transfer "from the recipient government's trust fund to an identifiable administrative unit." But unfortunately the conclusion is inescapable that Congress meant the distinctions to exist. The Treasury Regulations are not the proper vehicle to alter this legislative determination. By stating "the Act should be amended to make the penalties for discrimination as strong as all other violations," the Commission seems to recognize this conclusion.

Although the Final Regulations set forth the type of actions that will be considered discriminatory, including the discriminatory effect which results from the site location of facilities, there is no requirement of affirmative action to overcome the consequences of past discrimination. Rather, there is a provision which states:

required to provide data as to the race, national origin, and sex of the beneficiaries and of the employees of particular programs and projects funded" and "the extent to which the needs of the minority community are to be met under planned expenditures").

296. Letter from Stephen Horn, supra note 178.
297. See text accompanying notes 275-76 supra.
299. Letter from Stephen Horn, supra note 178.
300. Final Regulations, supra note 106, § 51.32(b).
301. See the revised Title VI Regulations of the Department of Transportation:

The Lawyers' Committee for Civil Rights Under Law recommends

49 C.F.R. § 21.5(b) (7) (1972).
A recipient government shall not be prohibited by this section from taking any action to ameliorate an imbalance in services or facilities provided to any geographic area or specific group of persons within its jurisdiction, where the purpose of such action is to overcome prior discriminatory practice or usage.\textsuperscript{302}

Broad remedies are available for alleged racial discrimination on a variety of constitutional and statutory grounds,\textsuperscript{303} and Section 122 of the Act provides additional administrative remedies which may be desirable for “political” reasons or as a less expensive method of obtaining relief.\textsuperscript{304} It is likely that a substantial number of complaints will be filed based on discriminatory practices regarding municipal services and facilities financed in whole or in part with Revenue Sharing funds. Various civil rights groups have suggested that the small staff of the General Counsel’s office of the Treasury will not be able to conduct the compliance investigations and reviews required by the Final Regulations.\textsuperscript{305} It is expected that a major portion of

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\textsuperscript{302} Final Regulations, supra note 106, § 51.32(b)(4).

\textsuperscript{303} The existing remedies for discriminatory provision of municipal services are illustrated by the Fifth Circuit decision in Hawkins v. Town of Shaw, 437 F.2d 1286 (5th Cir. 1971), which found a violation of the equal protection clause of the fourteenth amendment based on statistical evidence showing a substantial qualitative and quantitative inequity in the level and nature of services accorded “white” and “black” neighborhoods. The evidence indicated that 98 percent of all homes fronting on unpaved streets were occupied by blacks and 97 percent of homes not served by sanitary sewers were in black neighborhoods. The court stated that “[i]mprovements to existing facilities provided in a discriminatory manner may also constitute a violation of equal protection.” Id. at 1290 (emphasis in original). Furthermore, the court went on to say that the fact that extensions of the sanitary sewers were currently being made to new areas in a nondiscriminatory manner was not sufficient when the effect of such a policy is to “freeze in” the results of past discrimination. The court required the town of Shaw to submit a plan for the court’s approval detailing a proposed program of improvements that would, within a reasonable time, remove the existing disparities. For other examples of discrimination in municipal goods and services see Hadnott v. City of Prattville, 309 F. Supp. 967 (M.D. Ala. 1970) (municipal parks); Gautreaux v. Chicago Housing Authority, 304 F. Supp. 736 (N.D. Ill. 1969) (public housing).

\textsuperscript{304} After exhausting their administrative remedies, complainants alleging an improper abuse of discretion by the Secretary of the Treasury for failure to invoke the termination or withholding provisions under a Title VI order may seek appropriate judicial relief to obtain such a result.

\textsuperscript{305} Final Regulations, supra note 106, § 51.32(d) and (e).
the responsibility for compliance investigation and review will be delegated to other federal agencies, with overall coordination and supervision in the Treasury Department. 306

4. Accountability for Decision-Making—Budgetary Procedures

a. Reporting and Accounting

The underlying objective of Revenue Sharing is to achieve the most efficient use of the federal money for the highest priority needs of the individual recipient entities. In order to reach this objective, decision making should be returned to the local level, where the decision makers are closer to the local problems and more informed about local options and priorities. 307 However, opinions diverge regarding the mechanics of assuring the proper degree of accountability and responsibility in connection with the local decision making. At one extreme is the position that the Revenue Sharing funds should be identical to other sources of local revenue. Therefore, the federal government should merely distribute checks in the appropriate amount with no further requirements or restrictions on the recipient governments since state and local laws, practices and procedures are adequate to insure the appropriate expenditure of the money. At the other extreme are advocates of rigorous accounting guidelines, reporting requirements and evaluation procedures. While the decisions on specific items of expenditures should be made by state and local officials rather than through the application-review process within the federal bureaucracy, the federal government arguably must insure adequate review, evaluation and compliance through the imposition of stringent controls over the expenditure process. The Act attempts to steer a middle course between these extremes through a scheme which seeks to insure

306. There is a provision permitting delegation of the responsibilities to officials of other departments or agencies of the federal government. Final Regulations, supra note 106, § 51.32(g).

307. Senator Russell Long unequivocally stated the philosophy of Revenue Sharing:

The accountability, in the last analysis, should be to the people in those communities rather than to the Treasury Department, or a committee of Congress . . . . The main thing we wanted was that the people should know what their money went for, because the people of each community will be far better policemen on the expenditure of their money than any committee of Congress would be . . . . [W]e are delegating accountability to local people.

accountability and responsibility to the local citizens rather than to the federal bureaucracy. It uses reporting requirements calculated to fully inform citizens concerning the decision making process so that they are in a position to exercise their formal and informal remedies under the local system of democracy. This view reflects the realization that effective federal review of the expenditures of 39,000 governmental units, having a wide diversity of characteristics and procedures, would be extremely inefficient and expensive.

The traditional approach of federal grants is represented by the categorical grant process of extensive detailed applications, substantial federal auditing staffs and regional offices to monitor performance and compliance. Regarding an informed public as crucial not only to the quality of the decision making but also to insure compliance with the statutory restrictions is a revolutionary concept in the area of federal grants. However, reliance on local accountability and responsibility is basic to the long-term success of Revenue Sharing, whether General or Special. Although state and local officials have argued that local decision making is always responsive to local needs and accountable to the people, requiring no additional federal rules, regulations or guidelines, Congress has required certain minimum standards of disclosure and procedural safeguards with respect to Revenue Sharing funds in order to insure a high quality of decision making. The requirements are a response to a frequently voiced concern that the taxing function should not be separated from the spending function since it is the public reaction to the former which acts as a constraint on the latter. Revenue Sharing requires informing the public that it is an effective participant in the decision making and compliance process, since with respect to these federally collected funds neither the Congress nor the federal bureaucracy exercises any substantial review or restraint.

308. See id.
309. See id. (remarks of Senator Bennett) ("[W]e have built into this bill an effective, if unusual method of controlling the actual expenditure of these funds at the local level.").
310. See General Explanation, supra note 63, at 16 ("This requirement was provided in large measure because the Congress believes that full disclosure to the local citizenry in advance as to how it is proposed to spend the funds as well as how the funds are actually spent will help to ensure that the funds are spent wisely.").

One of the few precedents in this area is the Economic Opportunity Act which reflected an emphasis on community action and maximum feasible participation as a method for ending poverty. The impact of this approach has been summarized as follows:
The basic framework provided in the Act to achieve the desired local accountability and responsibility is as follows:

1. **Budgetary Procedures**: Funds must be expended only in accordance with the state or local laws and procedures applicable to the expenditure of the recipient government's own revenues.\(^1\)

2. **Reporting**: Reports on planned and actual use of the funds must be filed with the Department of Treasury and published in a newspaper of general circulation within the geographic area of the recipient government.\(^2\) Such annual and interim reports as are reasonably required must be filed with the Treasury.\(^3\)

While the planners of the Act might have supposed originally that organized pressure by the poor could be accommodated by the system—as the system had accommodated so many interest groups—and conversely, that the organized poor would for this purpose abide by the rules of the game, the reality from the point of view of community organization was quite different. Community action based upon maximum participation was more than a tactful concept. It was the release of a potentially great force, namely, territorially organized citizen power. No other interest group has that “sovereign” base. Thus, organizations based on this principle were quite extraordinary compared to the normal varieties of interest groups which pressure the government. It soon appeared to the government not that the poor would willfully break the rules of pressure politics, but that the government had endorsed a principle of organization that itself transcended the character of interest group politics.

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312. Act § 121, 31 U.S.C.A. § 1241 (1973). Many of the civil rights groups were concerned that the requirement in § 121 (c) of the Act for publication in a newspaper which has “general circulation within the geographic area of that government” will not adequately inform minority groups. See, e.g., Letter from Stephen Horn, supra note 178:

Because minorities have traditionally failed to receive Federal assistance in the same quality and quantity as non-minorities and because the brunt of negative effects of Federal projects has frequently been disproportionately borne by minority citizens, it is essential that they receive full information about activities funded by Revenue Sharing.

Federal agencies are beginning to recognize that too often a newspaper with wide circulation will not adequately reach minorities . . .

H.U.D., in its affirmative marketing regulations, strongly suggests that builders and developers publicize the availability of housing opportunities “through the type of media customarily utilized by the applicant, including minority publications. . .

The Revenue Sharing Act’s implementing regulations should therefore define “general circulation” to include both minority and majority groups and indicate that publication in the minority press is an essential means of meeting the goal of general circulation.

As a result, Final Regulations, supra note 106, provide that in addition to advising the general news media, recipient governments must advise minority and bilingual media.

3. Audits: Audits, evaluations and reviews will be conducted by the Secretary of the Treasury and Comptroller General to evaluate compliance and operations.314

b. Budgetary Procedures

The requirement that the Revenue Sharing funds be expended in accordance with state and local laws and procedures applicable to expenditure of the recipient government’s own revenues should not be an onerous provision. The provision was added in the Senate Finance Committee to assure the Senators from certain southern states that the sizable Revenue Sharing grants would not become a “slush fund” for the governor to use at his discretion for “special” projects.316 While state law probably would have been an adequate safeguard, the Senate report indicated that the provision was “intended to assure that the expenditures of the Revenue Sharing funds are provided for not only by the executive but also by the legislative branch of the governmental unit as well.”316

The question raised by this provision is whether funds may be added to the general fund of the state or locality and processed through the legislative process as merely a line item in the budget, or whether the Revenue Sharing funds must be treated as a separate and distinct budgetary item and acted upon as a unique matter. It is probably in keeping with the overall philosophy of this requirement that the Revenue Sharing funds be the subject of a separate budgetary determination.317

314. Act § 123(c), 31 U.S.C.A. § 1243(c) (1973). The General Accounting Office is conducting an initial survey of the 50 state governments, with the objective of presenting a report to Congress in July, 1973. The survey will include an investigation of the extent to which the various restrictions in the Act influenced the states’ decisions on the use of the Revenue Sharing funds, with particular emphasis on the prohibition on the use for matching purposes. Further, inquiries will be made as to the equity of the distribution formulas and any adjustments in existing fiscal relationships between state and local governments.


316. Senate Report, supra note 9, at 37.

317. An interesting aspect of this provision is highlighted by a proposal in New York State to ostensibly use the funds for every item in the budget on a percentage basis—i.e., Revenue Sharing will be used for 3 percent of every item in the budget. This seems to be a rather ill-advised determination by state officials since it subjects every item and activity in the budget to the additional restrictions, limitations and requirements of the Act and the regulations thereunder.
c. Reporting

1) Legislative Provisions

The reporting requirements in the Act provide for information flow to the federal government and to the local public. The following “reports” are required to provide information to the Treasury: (1) Assurances of Future Action (§ 123(a)), (2) Planned Use Reports (§ 121(b)), (3) Actual Use Reports (§ 121(a)), (4) Other Required Annual and Interim Reports (§ 123(a)(5)(3)), and (5) Compliance Evaluations and Reviews (§ 123(c)(1)). To insure adequate information at the local level, expenditure of funds must be in accordance with the laws and procedures applicable to the expenditure of the recipient's own revenues (§ 123(a)(4)). Additional requirements are Publication and Publicity of Planned Use Reports (§ 121(b) and (3)), Publication and Publicity of Actual Use Reports (§ 121(a) and (3)), and Other Required Annual and Interim Reports (§ 123(a)(5)(c)). The nature and specific requirements of these reports will be determined by the Treasury.

2) Objectives

The information system should be structured to achieve several broad categories of objectives. It should encourage local public participation and local accountability and responsibility, while deterring questionable practices and fraud through disclosure. The number of federal audits should be kept at a minimum by providing a factual basis for the Treasury to determine prima facie compliance. Performance and compliance under the program should be documented to Congress and the national media. The information system can provide a technical data base for in-depth performance evaluation by administrative agencies and independent research entities. However, the overriding administrative restraint on the reporting system is the President's statements that:

318. Congress has clearly indicated that as the planned use of the funds is changed, supplements or amendments to the planned use report must be filed and published. Senate Report, supra note 9, at 37; General Explanation, supra note 63, at 46.

319. General Explanation, supra note 63, at 45 (“This provision is included in order to facilitate the public scrutiny—by the citizenry as well as by the Congress and the Treasury Department—of the uses to which funds provided by the Act, are to be put and the extent to which the planned uses are carried out.”) (emphasis added).

320. 4 Nat'L J. 1911 (1972). However, John D. Ehrlichman, formerly Assistant to the President, has been quoted as stating “[w]ithout
[He is] determined to keep red tape out of this program. States and cities will not have to worry about filing complicated plans, filling out endless forms, meeting lots of administrative regulations or submitting to all sorts of bureaucratic controls. When we say no strings we mean no strings.

3) Some Observations on the Information Requirements

Although the transmission of information to the federal government is less important than transmission to the local level, every recipient government should provide the federal government some information as to the use of the funds to form a basis, however slight, for a presumption of compliance. The legislative history indicates that these reports should at least "provide both information on dollar expenditures by purpose and information on the additional employees and capital equipment that the funds were used for." Section 123(a) requires "assurances" documentation solely to provide a basis for administrative action against noncompliance with the requirements of the Act. Such requirements include the spending restriction on all but the high priority categories, the prohibition against matching, and the requirement of paying Davis-Bacon wage rates. Section 123(a) does not require a state government or unit of local government to assure the Secretary of the Treasury that it will comply with the prohibition on discrimination in Section 122(a). However, the Secretary of the Treasury has required such an assurance pursuant to his broad regulatory power under Section 142(a), providing that the "Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the provisions of this title."

The Planned Use Report generally must be filed prior to the beginning of an Entitlement Period. The level of planning as strict program evaluation and audit, general revenue sharing could find itself in real trouble very early in the history of the program." J. Haber, Revenue-Sharing Report/Ehrlichman promises audits, strict evaluation of local program, 5 Nat'l J. 234 (1973).

321. General Explanation, supra note 63, at 44 ("In part the purpose of these reports is to indicate to Congress whether the discretion left with the States and localities as to the purpose for which the Act's funds are to be spent has led to misuse of the funds."); see Senate Report, supra note 9, at 34.

322. General Explanation, supra note 63, at 16; see Senate Report, supra note 9, at 34.

323. See Final Regulations, supra note 106, § 51.32(c).

of the Report's filing date should be accepted. Thus, executive proposals (by governors, mayors or chairmen) may be accepted if the legislative body (state legislature, town council or county supervisors) has not acted as of the filing date.\textsuperscript{325} The Report\textsuperscript{326} requires information on the amount of planned expenditures for operating and maintenance expenses in each of the priority categories set forth in Section 103 (a) of the Act with a percentage breakdown in each category between maintenance of existing services and new or expanded services. Further requirements include disclosure by category of planned capital expenditures, with a percentage determination for equipment purchases, land acquisition, construction and debt retirement. The report form presents a series of questions in order to determine whether the Revenue Sharing funds are expected to have an effect on tax levels in the form of a rate reduction of a major tax, the avoidance of enactment of a new major tax or of a rate increase in a major tax, or the reduction in the rate increase of a major tax.

Whether amendments or supplements to the plans should be required as the decision making process proceeds is an important issue. The legislative history indicates that Congress expected recipients to periodically update the information submitted on the Planned Use Report, thereby facilitating public, congressional and Treasury Department comparisons with the Actual Use Reports to determine the extent to which the planned uses are carried out.\textsuperscript{327} However, the Treasury Department has indicated that no amendments to the Planned Use Reports will be required.\textsuperscript{328}

\textsuperscript{325} Instruction A to the Planned Use Report provides:

\texttt{This report may be based on:}
\begin{itemize}
\item Budgetary action on the part of your government; or
\item Executive proposals made as the basis for future legislative or budgetary action.
\end{itemize}
(\textit{This option is intended for use by those governments which, due to the timing of their normal fiscal planning procedures, will not have considered the use of Revenue Sharing funds until after the due date of this report. . . .}).

\textsuperscript{326} The Planned Use Report forms for the entitlement period January-June 1973 must be returned to the Department of the Treasury by June 20, 1973.

\textsuperscript{327} \textit{Senate Report}, supra note 9, at 37; \textit{General Explanation}, supra note 63, at 46 ("It is expected that those regulations [Treasury regulations] will require the State or local government to periodically update the information it submits as to its intended uses for the funds.").

\textsuperscript{328} \textit{Treas. Press Release, Planned-Use Reports Mailed Out}, April 18, 1973 ("'The Treasury Department will continue to stress the importance of this local process and will not ask for updates to these reports when local plans are changed,' Watt said.'").
Except for the initial report, there appears to be no policy justification for requiring the filing of the Planned Use Report with the Treasury. The submission of a Planned Use Report to the federal bureaucracy is uncomfortably close to the categorical grant scheme of application and review of grants. However, the provision as enacted was the only acceptable alternative to a proposal strongly advocated in the Senate Finance Committee that the plan for use of the funds be made subject to a popular referendum at both the state and local levels. Although the Nixon Administration strongly supported the concept of public disclosure of the planned use of the funds in order to encourage effective public participation in the decision making process, it strenuously opposed this filing requirement. Dr. Charls Walker, Deputy Secretary of the Treasury, advised the Senate Finance Committee that the Treasury was opposed to the requirement and intended to file the Planned Use Reports in the Treasury basement without substantive review. During the initial period, however, these Planned Use Reports may have some purely informational value to the Treasury as an indicator of the initial response to a significant infusion of money.

The Actual Use Report is in a different category from the Planned Use Report since the Treasury has a strong interest in utilizing this Report as an information gathering device to perform its functions under the Act, including its obligation to report to the Congress. The Report requires the same general type of information as the Planned Use Report on the actual use of the funds. It also requires information on the amount of any surplus or deficit for the fiscal year. The Interim Regulations provided that the report on actual use of the Revenue Sharing funds received for the Entitlement Periods January 1 to June 30, 1972 and July 1 to December 31, 1972 need not be filed, nor presumably published locally, until March 1, 1974. Thus, there would be no required disclosure of fund usage until nearly 15 months after the first check was received. The Final Regulations which apply to Entitlement Periods commencing on or after January 1, 1973 provide that the Actual Use Report must be filed annually on or before September 1 and must provide a “status of fund” report as of June 30 of each year. The “status of fund” report discloses the amounts and purposes for

329. See Act §§ 105(a) (2) and 123(c) (1), 31 U.S.C. §§ 1224(a) (2) and 1243(c) (1).
330. Interim Regulations, supra note 106, § 51.10 (b).
331. Final Regulations, supra note 106, § 51.11 (b).
which funds have been spent or otherwise transferred from the trust fund during the reporting period. As a result of the "status of fund" format utilized by the Actual Use Report, it will be impossible to associate particular expenditures with funds received for a particular Entitlement Period. Accordingly, it will be impossible in most circumstances for the Treasury or local citizens to ascertain whether funds have in fact been spent in accordance with the published Planned Use Report. This is contrary to the expressed desires of the Senators on the Senate Finance Committee who insisted on the Planned Use Report, and it significantly weakens the public participation role of the Planned Use Report.

The extensive practical problems in the area of effective information disclosure at the local level are best illustrated by the difficulties of "real use" reporting. The existing public accounting systems are understandably not structured to link a particular use of funds with the source of those funds. For example, a municipality receiving Revenue Sharing funds may ostensibly use those funds to purchase a fire truck, while the funds previously intended for the truck were in fact used to increase the budget for teachers' salaries. Displacement of funds could effectively reduce or eliminate public disclosure of the "real" use of the funds. The purchase of a fire truck may be noncontroversial, but utilization of the funds for increased teachers' salaries may be of significant interest to various public interest groups. Therefore, if it is impractical to impose accounting guidelines to insure disclosure of "real use," the underlying philosophy of reliance on an informed public as a substantive participant in Revenue Sharing must be questioned.

The "trend analysis" argument recognizes that local citizens should not be concerned with the specific application of funds from any specific source. The argument postulates that local citizens should rather inquire as to the contribution of Revenue Sharing funds to shifts in emphasis and quality of services over a period of time. The local reporting requirements should be structured to disclose the data necessary for such a trend analysis. It is not sufficient merely to provide the detailed budgets for a number of years. Rather, the figures must be presented in a manner which is readily comprehensible and facilitates this type of analysis by the layman. Obviously, this implies reporting by category of expenditures on a comparable basis from one period to the next. For example, a comparison of the percentage of total expenditures for categories of operating functions such as police protec-
tion, fire protection, education, health, or social services, with subcategories for personal compensation and administrative costs would provide a possible basis for analyzing the shifts of priorities in the delivery of services. Some difficult technical questions are involved concerning the definitions for categories of functions, but this problem is susceptible to solution.

The critical objection to this approach is that it may impose significant additional accounting requirements for areas of the budget which are not involved in Revenue Sharing. However, the Treasury is mandated to "provide for such accounting and auditing procedures, evaluations and reviews as may be necessary to insure that the expenditures of funds . . . comply fully with the requirements of this chapter." Arguably, the only method by which the Treasury could insure full compliance is to require identifiable source and application of funds accounting and reporting. Therefore, given the fundamental nature of the need for local information on the actual use of the funds, it is not feasible to accept the existing local accounting procedures if they do not provide the necessary information.

If the Mathews v. Massell decision is followed in other jurisdictions and strictly interpreted to subject all displaced funds to the restrictions and limitations of the Act, recipient governments would be forced to adopt some form of source and application of funds accounting and reporting. It would seem advisable for recipient governments to urge the Treasury to adopt effective reporting requirements to deal with the displacement problem in order to strengthen their position in future litigation.

The basic problem in designing reporting forms is achieving the many intended objectives. Since the information requirements of the Treasury are significantly less exacting than those


One final argument by defendants is that § 103(a) has no effect because it is so difficult to enforce. They draw support for this argument from the Senate report on the Senate version of the bill, in which the committee justified the Senate's deletion of the restrictions on a local government's use of the funds by the argument that enforcement of the restrictions would be impossible and that therefore any restrictions would be illusory. And facially this argument is persuasive, but, as noted above, it was in effect overruled by the action of the House-Senate conference and by the passage of the Act in its present form by both houses of Congress. Moreover, the Act itself provides an enforcement mechanism by requiring the Secretary of the Treasury to establish accounting and auditing procedures (§ 123(c)) and also by providing for imposition of a penalty if funds are spent in violation of § 103(a).

Id. at 301-02 (emphasis added).
of the local public and press, a separate federal reporting form should be designed to meet the minimum information needs of the Treasury, the Congress and the national press. But some additional vehicle should be utilized to facilitate information flow at the local level, insuring adequate information for local monitoring of the decision making and compliance review process. The design of such an additional vehicle for information flow at the local level requires a preliminary consideration of the auditing and accounting requirements of the Act and its Regulations.

d. Auditing and Accounting

The basic mandate of the Act is that “the Secretary shall provide for such accounting and auditing procedures, evaluations, and reviews as may be necessary to insure that the expenditures of funds . . . comply fully with the requirements of [the Act].”334 A program which utilizes the surveillance of an informed local electorate and press to initially establish compliance, combined with effective local disclosure requirements is considered the most responsible performance under the Act. Accordingly, the Treasury should not attempt to initiate its own compliance audits of any significant number of recipients. This approach would initially rely on local publicity and remedies to compel compliance. If this initial level of compliance effort is not effective, complaints to the Treasury could then be used as the basis for further enforcement activity, including audits.

There simply is no efficient method by which the Treasury can audit approximately 39,000 recipient units. The Treasury’s much publicized statement that its proposed staff of 25 auditors could perform 300 audits a year, including each of the 50 states and 50 largest cities, representing two-thirds of the aggregate funds, was simply wishful thinking.335 It is doubtful that a

335. See Department of Treasury, What General Revenue Sharing Is All About 14-15 (1972). In an address to the National Association of Minority Certified Public Accounting Firms in Washington, D.C., on May 4, 1973, Graham W. Watt, Director of the Office of Revenue Sharing, stated that compliance reviews were planned of the 100 recipients of the largest amounts of Revenue Sharing funds (which receive more than 50% of the funds). The audit teams will be composed of one Office of Revenue Sharing staff member and one auditor borrowed from another federal department. According to Mr. Watt, the compliance review by this two-member team will include review of compliance with the non-discrimination provision in Section 122 of the Act. See Treas. Press Release, Compliance Check on Revenue Sharing Funds to Begin May 9, May 4, 1973.
staff of 25 federal auditors could properly perform an in-depth audit of more than California, New York State and New York City in any one year.

The Treasury intends to rely as much as possible on state-conducted audits or independent certified public accountants' audits of the localities, but to effectively implement such a system would require detailed accounting guidelines in order to form the basis for a certification by the auditing entity. The Regulations provide that audits must be performed in accordance with generally accepted auditing standards and encourage the use of the Standards for Audit of Governmental Organizations, Programs, Activities and Functions issued by the Comptroller General in June, 1972. For many localities in this country which are not now subject to a regular state or C.P.A. audit, the expense of obtaining such an audit could be substantial in relation to the amount of Revenue Sharing funds received. The scope of audit contemplated by the encouraged Standards far exceeds the usual governmental financial reporting:

The Audit standards [of the Comptroller General] are a set of criteria that call for an audit of a much broader scope than

336. Final Regulations, supra note 106, § 51.41(c); see Senate Report, supra note 9, at 38-39 ("The Treasury Department has indicated to the committee an intention to rely on State audits to a significant extent. The committee intends to encourage such reliance upon the actions of State officials, to the extent consistent with the purposes of this bill. However, if the Treasury Department wishes, it may also make use of private audits.").

337. See Staats, Auditing the Federal Funds, 55 Public Management 5, 6 (1973).

The Department of the Treasury has indicated that to a great extent it plans to rely on the staffs of state, county and municipal audit organizations and independent public accountants to audit the revenue sharing funds that are received by the state and local governments. Before accepting the work of these auditors, the Secretary of the Treasury must determine that the audit and the audit procedures are sufficiently reliable to fulfill the Secretary's own audit responsibilities under the act. We will be interested especially in the guidance that the Secretary of the Treasury gives to other organizations that audit expenditures made with revenue sharing funds and the manner in which Treasury satisfies itself that these audits are adequately and competently conducted.

Id.

338. Final Regulations, supra note 106, § 51.41 (c) (1).

339. Elmer B. Staats, Comptroller General of the United States, has expressed serious reservations about the Treasury's reliance on state and C.P.A. audits because of insufficient audit resources, the inexperience of auditors in assessing management, administration and results of a program or activity, and the generally inadequate records at the local level. Staats, supra note 337, at 7.
the traditional, financially-oriented, governmental audit. In addition to requiring a review of compliance with applicable laws and regulations, the standards specify that the audit should include reviews of efficiency and economy in the use of resources and of the effectiveness of the results of the program or activity under review. The standards also are quite demanding as to staff competence, independence, and the requirement for professional proficiency.\textsuperscript{340}

In general, C.P.A. firms do not perform effectiveness and efficiency audits.\textsuperscript{341} Therefore, state conducted audits and C.P.A. audits will not provide an effective basis for nationwide satisfaction of the audit requirements under the Act.

The Conference Report clearly indicates that Revenue Sharing was not intended as the vehicle to impose major uniform accounting changes on states and localities.\textsuperscript{342} In general, recipient governments were to use the same fiscal, accounting and internal reporting procedures relative to Revenue Sharing funds as they used with respect to expenditures from revenues derived from their own sources.\textsuperscript{343} However, it was recognized that the existing accounting systems would not always be sufficient to meet the disclosure objectives of the Act.

The accounting burdens posed by the restrictions on categories of expenditures and the prohibition on matching were recognized during the legislative process. The Conference Report indicates that Sections 104(e) and 103(b) of the Act were added to authorize the Treasury to accept a certificate of compli-

\textsuperscript{340} Staats, \textit{supra} note 337, at 6.

\textsuperscript{341} See Letter from Ernst & Ernst to Graham Watt, Mar. 19, 1973 ("The American Institute of Certified Public Accountants has suggested that certified public accountants should not perform these types of audits [GAO effectiveness and efficiency audits] until useful quantitative units of measure are agreed upon in advance or are inherent in the subject matter under examination.").


\textsuperscript{343} This is based on the following language in the Conference Report added at the Treasury's insistence:

\textit{The committee of conference expects that, insofar as possible, guidelines established by the Secretary of the Treasury with respect to fiscal, accounting, and audit procedures . . . will permit State and local governments to use the fiscal, accounting, and audit procedures used by them with respect to expenditures made from revenues derived from their own sources.} \textit{Id.}

The Final Regulations have altered this concept by providing,

\textit{"The accounting for entitlement funds shall at a minimum employ the same fiscal accounting and internal audit procedures as are used with respect to expenditures from revenues derived from the recipient government's own sources."} \textit{Final Regulations, supra note 106, § 51.40(d) (emphasis added).}
REVENUE SHARING

ance as fulfillment of the audit and compliance requirement with respect to these restrictions, unless the Treasury has reason to believe that a particular certificate is not sufficiently reliable to enable the Treasury to carry out its duties under the Act.\textsuperscript{344} These sections were added in direct response to a request of Dr. Charls Walker, Deputy Secretary of the Treasury, based on his explanation of the major accounting problems posed by the prohibition on indirect matching. Thus, despite earlier indications in the House Report and Senate Report concerning reporting requirements with respect to matching, Congress clearly intended to avoid the imposition of any additional accounting burdens, relying on the certification as prima facie evidence of compliance.

Under the Final Regulations recipients must maintain separate fiscal accounts in such a manner as to (1) permit the reports required by the Treasury to be prepared therefrom, (2) permit the tracing of Revenue Sharing funds to a level of expenditure adequate to establish that such funds have not been used in violation of the restrictions and prohibitions of the Act, and (3) document compliance with the matching funds certification.\textsuperscript{345} The Regulations in this regard are consistent with the Act and the legislative history. The Treasury has effectively notified the recipient governments that although the certification would be accepted as evidence of prima facie compliance, the burden is on the recipient governments to document compliance if there is reason to believe that the certification is not accurate. Category (2) above may prove to be a major latent problem for recipient governments since maintenance of fiscal accounts to support a presumption of compliance with the nondiscrimination, prevailing wage and Davis-Bacon Act provisions will require a high degree of detail and specificity. For example, it might not suffice to indicate expenditures for "street repairs" or "street lights" without detailing their location, since a limitation to white neighborhoods may be discriminatory. Similarly, expenditures for hiring new employees would require documentation identifying employees hired and the conditions of their employment to support compliance with both the nondiscrimination and prevailing wage requirements. Surveillance by local organized labor and minority groups could render this requirement a major burden.

\textsuperscript{344} Conference Report, supra note 342.
\textsuperscript{345} Final Regulations, supra note 106, § 51.40(d).
e. A Recommendation

Recipient governments ultimately must either disclose more information at the local level or increase their reporting to the federal government and cope with a significant federal audit effort. The only solution to the need for local information which avoids burdensome reporting to the federal bureaucracy and preserves a presumption of local compliance so as to avoid unnecessary federal auditing is a local disclosure booklet consisting of a detailed standardized questionnaire and data sheet designed to provide adequate information on the decision making process, highlighting instances of noncompliance.34 The information should be maintained at the state and local level for public inspection and review, maximizing the information flow to the local citizens while minimizing the flow to the federal government. State and local officials oppose additional disclosure requirements, contending that their existing laws and procedures provide adequate public access to all local records and documents. However, the information must be readily available and comprehensible to the ordinary citizen, lending itself to an analysis of the performance and compliance criteria established by Congress and the Treasury. Access to massive records and documents, without assistance and guidance for interpretation, does not meaningfully encourage general public participation in the decision making and compliance review process.

The disclosure booklet should set forth the planned and actual use of funds in a specific and detailed manner. In addition to the broad categories of use established in the Planned and Actual Use Report, e.g., Public Safety, the specific use must be

346. The Final Regulations provide the following limited requirements with respect to public inspection:

Each recipient government shall make available for public inspection a copy of each of the reports required under § 51.11(a) and (b) [the Planned and Actual Use Reports] and information as necessary to support the information and data submitted on each of those reports.

Final Regulations, supra note 106, § 51.13(c) (emphasis added). Due to the limited information required on the Planned and Actual Use Report, this provision does not adequately provide for support documentation on compliance with the provision of Davis-Bacon, prevailing wage and non-discrimination; nor does it require detailed information as to the specific use of the funds within the categories set forth in Section 103.

347. See 118 Cong. Rec. § 14392 (daily ed. Sept. 8, 1972) (remarks of Senator Long) ("We require that they put it on a standard form so it would be intelligible. . . .").
disclosed, e.g., two police cars. Other items of information which should be available regarding Revenue Sharing funds include (1) the number of additional employees and wage rates of such employees, (2) the specified recipients of any salary increases and the magnitude of those increases, (3) copies of all executive, administrative and legislative actions dealing with the planned or actual expenditure of Revenue Sharing funds, (4) the amount of any tax reduction directly or indirectly attributable to Revenue Sharing funds, (5) comparative expenditure patterns for major functions over the past three years, with a trend analysis presentation indicating the extent to which variations are attributed to the Revenue Sharing funds by local officials, (6) data revealing compliance with the matching restriction, together with the aggregate amount of all transfer payments received during the period,348 (7) opinions of municipal counsel indicating that the Revenue Sharing expenditures complied with the requirements of the Act, and (8) additional detailed information to indicate compliance with the nondiscrimination, Davis-Bacon wage rate and prevailing wage provisions.

IV. POLICY ISSUES FOR FUTURE STUDY

The following discussion is not intended to be an exhaustive treatment of the many complex policy issues presented by Revenue Sharing. Rather, it has the limited purpose of suggesting areas for further investigation.

A. REDISTRIBUTION OF REVENUE

Revenue Sharing has been criticized because it fails to redistribute revenue sources349—"the rich get richer and the poor get poorer." Documentation for this criticism has been found in the following table which indicates relatively lower per capita grants to many of the states with lower per capita incomes. The counter-arguments are several. First, redistribution of revenue sources was not one of the justifications for and objectives of Revenue Sharing as it was advocated by the Nixon Advi...
ministration, Chairman Wilbur Mills or Chairman Russell Long. Second, a comparison based on relative per capita incomes is inadequate in its failure to adjust for significant cost differentials in many of the states. Third, the redistribution analysis should be considered in terms of the respective costs and benefits when viewed in terms of financing the program through the federal individual income tax.

<table>
<thead>
<tr>
<th>State</th>
<th>Per Capita Income Rank&lt;sup&gt;1&lt;/sup&gt;</th>
<th>Percentage of Initial Revenue Sharing Payments&lt;sup&gt;2&lt;/sup&gt;</th>
<th>Percentage of Federal Individual Income Taxes Paid by Residents&lt;sup&gt;3&lt;/sup&gt;</th>
<th>Per Capita Initial Revenue Sharing Payments Annualized&lt;sup&gt;4&lt;/sup&gt;</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alabama</td>
<td>3</td>
<td>1.71</td>
<td>1.04</td>
<td>26.86</td>
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<tr>
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<td>1</td>
<td>.11</td>
<td>.17</td>
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<td>Arizona</td>
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<td>.72</td>
<td>28.65</td>
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<td>.92</td>
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<td>California</td>
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<td>10.83</td>
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</tr>
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<td>Colorado</td>
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<td>1.03</td>
<td>.96</td>
<td>25.02</td>
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<tr>
<td>Connecticut</td>
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<td>2.38</td>
<td>22.49</td>
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<tr>
<td>Delaware</td>
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<td>.30</td>
<td>.34</td>
<td>26.65</td>
</tr>
<tr>
<td>District of Columbia</td>
<td>1</td>
<td>.45</td>
<td>.44</td>
<td>32.04</td>
</tr>
<tr>
<td>Florida</td>
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<td>2.77</td>
<td>3.05</td>
<td>21.90</td>
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<td>Georgia</td>
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<td>2.07</td>
<td>1.78</td>
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<td>Hawaii</td>
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<td>.45</td>
<td>.40</td>
<td>31.64</td>
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<tr>
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<td>.40</td>
<td>.22</td>
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<tr>
<td>Illinois</td>
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<td>5.16</td>
<td>7.08</td>
<td>24.96</td>
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<tr>
<td>Indiana</td>
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<td>2.15</td>
<td>2.51</td>
<td>22.13</td>
</tr>
<tr>
<td>Iowa</td>
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<td>1.43</td>
<td>1.14</td>
<td>27.06</td>
</tr>
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<td>.92</td>
<td>23.58</td>
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<td>1.64</td>
<td>1.08</td>
<td>27.52</td>
</tr>
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<td>2.32</td>
<td>1.21</td>
<td>34.37</td>
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<td>.36</td>
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<td>2.02</td>
<td>2.36</td>
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<td>1.67</td>
<td>.47</td>
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<td>1.85</td>
<td>2.13</td>
<td>21.18</td>
</tr>
<tr>
<td>Montana</td>
<td>3</td>
<td>.38</td>
<td>.26</td>
<td>30.06</td>
</tr>
<tr>
<td>Nebraska</td>
<td>2</td>
<td>.73</td>
<td>.61</td>
<td>26.50</td>
</tr>
<tr>
<td>Nevada</td>
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<td>.22</td>
<td>.35</td>
<td>23.86</td>
</tr>
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<td>New Hampshire</td>
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<td>.31</td>
<td>.33</td>
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</tr>
<tr>
<td>New Jersey</td>
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<td>3.15</td>
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</tr>
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<td>New Mexico</td>
<td>3</td>
<td>.59</td>
<td>.32</td>
<td>33.07</td>
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<td>11.34</td>
<td>32.76</td>
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<tr>
<td>North Carolina</td>
<td>3</td>
<td>2.57</td>
<td>1.73</td>
<td>27.41</td>
</tr>
</tbody>
</table>

350. In the opinion of Messrs. Heller and Pechman redistribution of income was the major philosophical justification for Revenue Sharing. *Hearings on S.1770 and S.241 Before the Subcomm. on Intergovernmental Relations of the Senate Comm. on Government Operations, 92d Cong. 1st Sess. 91* (1971); Statement of Joseph A. Pechman, id. at 91: "The basic purpose of revenue sharing is to provide supplementary financial assistance to states and local governments with fiscal capacity impaired by low incomes."
The Table indicates that every state ranking in the lower one-third by per capita income receives a higher percentage of the initial Revenue Sharing payments than the percentage of federal individual income taxes paid by its residents. The significance of the redistribution can be observed by comparing Mississippi and Louisiana with Connecticut and Illinois. With the exception of Colorado and Hawaii, every state in the top one-third of per capita income receives a lower percentage of the initial Revenue Sharing payments than the percentage of federal individual income taxes paid by its residents.

However, a complete consideration of redistribution requires an analysis of the broad range of alternative costs and foregone opportunities associated with Revenue Sharing. Analyzing benefit distribution alone or compared only to the cost distribution of the federal individual income tax neglects alternative possibilities for financing Revenue Sharing such as a personal income tax surcharge or a categorical grant substitution.\(^\text{351}\) For ex-

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\(^\text{351}\) See **National Priorities—1972**, supra note 70, at 135-36:
Revenue sharing is but one of several possible ways of strengthening the fiscal position of State and local governments. One alternative would be to increase federal funding for existing categorical aid programs; another would be for the federal government to assume one or more major functions now

<table>
<thead>
<tr>
<th>State</th>
<th>Rank</th>
<th>Initial Grant</th>
<th>Federal Individual Income Tax</th>
<th>Revenue Sharing Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>North Dakota</td>
<td>3</td>
<td>.41</td>
<td>.18</td>
<td>36.33</td>
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<tr>
<td>Ohio</td>
<td>1</td>
<td>4.04</td>
<td>5.75</td>
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<tr>
<td>Oklahoma</td>
<td>3</td>
<td>1.11</td>
<td>.93</td>
<td>23.58</td>
</tr>
<tr>
<td>Oregon</td>
<td>2</td>
<td>1.00</td>
<td>.95</td>
<td>25.78</td>
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<td>Pennsylvania</td>
<td>1</td>
<td>5.24</td>
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<td>23.82</td>
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<td>Rhode Island</td>
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<td>South Carolina</td>
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<td>.76</td>
<td>28.58</td>
</tr>
<tr>
<td>South Dakota</td>
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<tr>
<td>Tennessee</td>
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<td>4.79</td>
<td>22.56</td>
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<tr>
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</tr>
<tr>
<td>Vermont</td>
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<td>.37</td>
<td>.17</td>
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<td>Virginia</td>
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<td>2.01</td>
<td>2.08</td>
<td>23.40</td>
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<td>Washington</td>
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<td>1.47</td>
<td>1.78</td>
<td>23.26</td>
</tr>
<tr>
<td>West Virginia</td>
<td>3</td>
<td>.98</td>
<td>.61</td>
<td>30.55</td>
</tr>
<tr>
<td>Wisconsin</td>
<td>2</td>
<td>2.51</td>
<td>1.97</td>
<td>30.52</td>
</tr>
<tr>
<td>Wyoming</td>
<td>2</td>
<td>.19</td>
<td>.14</td>
<td>30.40</td>
</tr>
</tbody>
</table>
ample, although Walter Heller initially believed Revenue Sharing more desirable than a reduction in federal income taxes, President Nixon's recent budget message suggests that Revenue Sharing is partially financed by reductions and foregone increases in categorical grant programs. A meaningful analysis thus requires comparing the geographic distributions\(^353\) of these alternative costs with the distribution of Revenue Sharing benefits.\(^353\)

Effective discussion of redistribution requires an analysis of cost and benefit distribution not only geographically but by income class. Determining the income levels of the ultimate individual beneficiaries would require a detailed study of the Revenue Sharing expenditure decisions by states and localities. For example, in a poor rural state the budgetary decision making process at the local level may result in using significant amounts of the funds to benefit a few wealthy individuals, while the states with higher average aggregate income levels may in fact siphon the funds into benefits for the urban poor.

352. See Special Analysis, supra note 3, at 218.

Within these totals [of federal aid to regions], however, an important qualitative shift is taking place—the increasing emphasis on urban areas. The American population is becoming increasingly urban; today, about 70% of the population lives in the 269 standard metropolitan statistical areas (SMSA's). SMSA's include the bulk of that urban population which places heavy pressure on public service requirements—are where population growth and population density are highest. $31.4 billion or 70% of Federal grants will be either spent in or directly affect these SMSA's in 1974. This is an increase of $25.8 billion, or nearly 460% more than the level provided to these urban areas in 1964.

353. See Dresch, An "Alternative" View of the Nixon Revenue Sharing Program, 24 Nat'L Tax J. 131 (1971). An analysis of the original Administration proposal led to the following major conclusions:

1. revenue sharing as financed through a personal income tax surcharge redistributes income from urban to rural states and from high income to low income states; (2) the overall redistribution effected by special purpose or categorical grants is even more discriminatory against urban states and is to some degree beneficial to high income states at the expense of low income states; and (3) in consequence, a revenue sharing-categorical grant substitution redistributes income from rural to urban states and from high income to low income states.

Id. at 131.
B. Central Cities-Suburbs Bias

In recent years increasing attention has focused on the plight of the nation's core cities. Many of the problems have been attributed directly or indirectly to the growth of the suburbs:

The cities' fiscal crisis stems from the interaction of two developments. First, the levels of per capita local expenditures are higher and are generally growing faster than those of the surrounding suburbs. While some of the reasons for this lie in deliberate choices made by central city governments, others spring from demographic, economic and social developments that are outside their control. Second, although the revenue base in most central cities is still somewhat higher than in surrounding suburbs, this advantage is steadily eroding. Retail sales, personal incomes, and property values, which form the basis for taxation, have been growing more slowly in the central cities than in the suburbs.

The interaction of these two developments intensifies the fiscal squeeze on central cities. Public services appear to be deteriorating while tax rates climb. Compared with the suburbs, the central city is becoming a less desirable place to live, to shop, and even to work, especially for middle- and upper-income groups. The resulting change in the cities' economic and demographic structure increases its need for public expenditures—for welfare, crime control, and social programs—while reducing its ability to pay for them.354

Since any relative shift in revenue sources from the urban core cities to the suburbs arguably will contribute to the rate of decline of the core cities, it is important to determine whether the allocation formulas under the Act distribute the funds in a manner which is relatively more beneficial to the suburbs than the urban core cities. The Brookings Institution has criticized Revenue Sharing as an inefficient method of dealing with the problems of the urban core cities because significant amounts of the money will be distributed to suburban governments which are not facing critical fiscal problems. The criticism was subject to the political reality that "such a general distribution may be the price necessary to persuade a nation of suburbs to support increased aid for its cities."355

The following table compares the per capita entitlement payments for the initial Entitlement Period and the per capita incomes of New York City, Los Angeles, Chicago and Detroit, with the data for their respective suburbs.

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355. Id. at 314.
### Per Capita Income

<table>
<thead>
<tr>
<th>County</th>
<th>Actual First Entitlement Period</th>
<th>Per Capita Payment First Entitlement Period</th>
<th>Per Capita Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>New York City</td>
<td>$100,847,538</td>
<td>$12.77</td>
<td>$3,698</td>
</tr>
<tr>
<td>Nassau County</td>
<td>6,547,860</td>
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<td>4,644</td>
</tr>
<tr>
<td>Cedarhurst</td>
<td>14,790</td>
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<td>5,320</td>
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<tr>
<td>Brookville</td>
<td>6,844</td>
<td>2.13</td>
<td>5,882</td>
</tr>
<tr>
<td>Old Westbury</td>
<td>5,683</td>
<td>2.13</td>
<td>10,287</td>
</tr>
<tr>
<td>Oyster Bay</td>
<td>2,813</td>
<td>2.13</td>
<td>9,811</td>
</tr>
<tr>
<td>Massapequa Park</td>
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<td>3,747</td>
</tr>
<tr>
<td>Hempstead</td>
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<tr>
<td>Rye</td>
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<td>Huntington Bay</td>
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<td>Los Angeles City</td>
<td>15,781,264</td>
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<td>Beverly Hills</td>
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<td>Palos Verdes Estates</td>
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<td>South Gate</td>
<td>167,327</td>
<td>2.94</td>
<td>3,642</td>
</tr>
<tr>
<td>Baldwin Park</td>
<td>129,900</td>
<td>2.75</td>
<td>2,601</td>
</tr>
<tr>
<td>South El Monte</td>
<td>84,256</td>
<td>6.27</td>
<td>2,413</td>
</tr>
<tr>
<td>Chicago</td>
<td>31,185,549</td>
<td>9.26</td>
<td>3,402</td>
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<tr>
<td>Cook County</td>
<td>7,273,303</td>
<td>1.32</td>
<td>3,771</td>
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<tr>
<td>Evanston</td>
<td>234,861</td>
<td>2.93</td>
<td>5,139</td>
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<td>Wilmette</td>
<td>52,294</td>
<td>1.63</td>
<td>7,010</td>
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<tr>
<td>Flossmoor</td>
<td>12,769</td>
<td>1.63</td>
<td>7,573</td>
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<tr>
<td>Barrington</td>
<td>23,138</td>
<td>2.67</td>
<td>5,081</td>
</tr>
<tr>
<td>Winnetka</td>
<td>22,780</td>
<td>1.63</td>
<td>9,904</td>
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<tr>
<td>Markham City</td>
<td>71,680</td>
<td>4.48</td>
<td>2,793</td>
</tr>
<tr>
<td>Lake County</td>
<td>510,303</td>
<td>1.33</td>
<td>4,179</td>
</tr>
<tr>
<td>Highland Park</td>
<td>54,838</td>
<td>1.70</td>
<td>7,432</td>
</tr>
<tr>
<td>Lake Forest</td>
<td>35,650</td>
<td>2.28</td>
<td>7,190</td>
</tr>
<tr>
<td>Detroit</td>
<td>18,302,265</td>
<td>12.09</td>
<td>3,200</td>
</tr>
</tbody>
</table>

Source: *Initial Payment—Entitlement Period 1, Department of Treasury, (1972) Data Elements—Entitlement Period 1, Department of Treasury, (1972)*

The initial allocations did provide substantially greater assistance to the urban core cities than to their surrounding suburbs. The Joint Committee on Internal Revenue Taxation stated that:
[T]he combination of tax effort and relative income [under the Act] tends to provide larger allocations per capita to central cities than to suburbs (the central cities having both greater tax effort and lower relative income than the surrounding suburbs) and generally allocates relatively larger per capita amounts to rural areas (which tend to have lower tax bases and lower levels of public services) than to suburban areas.\textsuperscript{356}

However, some of the poorer municipalities in the suburbs (particularly those outside Los Angeles) received significantly lower per capita grants than did the urban core cities. The result of this infusion of funds into the urban core cities which, although large in absolute terms, represents only a small percentage of the total budget, awaits study. Although the per capita amounts to the core cities may be substantially larger than to the suburbs, the additional assistance to the suburbs may provide the critical increment necessary to accelerate their advancement relative to the core cities.

C. FRAGMENTATION

Most students of the local problems, both rural and urban, argue strongly for the consolidation of units of local government in order to maximize the efficient delivery of goods and services:

[Although cities may not be able to do much by themselves, most metropolitan areas as a whole do have the capability for dealing with the growing imbalance between the resources and needs of their core cities. One way is to expand the city's resource base by annexing surrounding areas or consolidating the central city with a larger unit of government, such as the county. In effect, this would allow the city to share in the growth occurring in the suburbs and would shift its demographic makeup toward families that are less in need of local government services.\textsuperscript{357}

Urbanologists generally conclude that “[t]he bewildering multiplicity of small, piecemeal, duplicative, overlapping local jurisdictions cannot cope with the staggering difficulties encountered in managing modern urban affairs.”\textsuperscript{358} Many rural areas are also desperately inadequate in providing needed services.

Revenue Sharing will apparently discourage consolidation of inefficient units since the new influx of revenue, constituting 50 percent of the existing revenues in many areas, will provide the resources to continue their independent operations. This may be particularly true of the many townships in the Midwest.

\textsuperscript{356} General Explanation, supra note 63, at 31.
which were slowly "dying on the vine" from declining revenues. If Revenue Sharing encourages fragmentation or decelerates the consolidation trend, the legislation should be amended to increase substantially the level of activity necessary to qualify as a recipient. For example, a minimum population and revenue test might be required together with some additional indication of the level of services provided. Although such minimums were politically unacceptable to the rural representatives on the powerful Ways and Means Committee, strong evidence of fragmentation may reverse the original determination. It may also be necessary to modify the limitation on allocations to a lower percentage (e.g., 35 percent rather than 50 percent) of adjusted taxes and intergovernment transfers, and a lower percentage (e.g., 10 percent rather than 20 percent) of the state-wide per capita amounts.

V. CONCLUSION

As compared to the categorical grant programs, particularly those with a matching element, Revenue Sharing appears to offer a more efficient method of providing governmental services. Experience must determine whether the improvement is merely marginal or truly significant. When President Nixon signed the Act he asked the Advisory Commission on Intergovernmental Relations to "monitor and evaluate" the program. Furthermore, program performance will be evaluated in a nationwide study by the Brookings Institution.

The Senate Subcommittee on Intergovernmental Relations conducted an initial survey of 750 municipal officials which indicated a general tendency to commit Revenue Sharing funds to capital improvements, officials' salaries, public safety and tax relief. However, a study by the General Accounting Office indicates that 58 percent of the expenditures by state governments were being directed toward education. The initial limited survey by the Advisory Commission on Intergovernmental Rela-

<table>
<thead>
<tr>
<th>Function</th>
<th>Percentage of Total Authorized and Planned Expenditures</th>
</tr>
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<tbody>
<tr>
<td>Education</td>
<td>57.5%</td>
</tr>
<tr>
<td>Hospitals</td>
<td>5.1</td>
</tr>
<tr>
<td>Highways</td>
<td>3.8</td>
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tions also showed that “a large proportion of both State and local officials indicated they would use revenue sharing funds for non-recurring expenses.” All such surveys are of limited

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<tbody>
<tr>
<td>Public Safety</td>
<td></td>
</tr>
<tr>
<td>Public welfare and social services</td>
<td>1.9</td>
</tr>
<tr>
<td>Corrections</td>
<td>3.2</td>
</tr>
<tr>
<td>Recreation and natural resources</td>
<td>10.1</td>
</tr>
<tr>
<td>General control</td>
<td>.8</td>
</tr>
<tr>
<td>Financial administration</td>
<td>1.3</td>
</tr>
<tr>
<td>General public buildings</td>
<td>2.2</td>
</tr>
<tr>
<td>Salary increases and employee retirement</td>
<td>6.0</td>
</tr>
<tr>
<td>Debt retirement and interest</td>
<td>1.7</td>
</tr>
<tr>
<td>Insurance benefits and repayments</td>
<td>2.5</td>
</tr>
<tr>
<td>Assistance and subsidies</td>
<td>1.8</td>
</tr>
<tr>
<td>Other</td>
<td>.6</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100 %</strong></td>
</tr>
</tbody>
</table>

Furthermore, 39% of the total authorized and planned expenditures were designated for capital expenditures—mainly construction and land acquisition.

However, recognizing the widespread use of the displacement approach, the report cautions:

The actual impact of revenue sharing on a state may be quite different from and more elusive than the apparent impact indicated by the use a state makes of its funds. When a state uses the funds to wholly or partially finance an activity which the state's own revenues previously financed, it becomes difficult to objectively identify the actual impact.

Id. at 2.

State officials responded as follows to inquiries concerning their subjective assessment of the broad fiscal impact that revenue sharing funds would have on their states:

- 18 said the funds would help to permit some form of tax relief.
- 16 anticipated that the funds would postpone future tax increases.
- 14 expected the funds to increase, at least temporarily, the year-end balance available for appropriation in the succeeding year.

Id. at 3.

361. A preliminary survey dated March 7, 1973 by the Advisory Commission on Intergovernmental Relations yielded the following results:

1. Survey of state budget officials from 43 states:
   A. How the state planned to use its Revenue Sharing funds:
      - 12 No decision yet
      - 15 For non-recurring expenses
      - 24 For recurring expenses
   B. 21 budget officers indicated that uncertainty about the future had an important bearing on the utilization determination. Twelve of those budget officers indicated that the uncertainty led to use for non-recurring expenses.

2. Survey of officials in 88 counties in 30 states:
   A. How the county planned to use the Revenue Sharing funds?
      - 13 No decision yet
      - 61 For non-recurring expenses
      - 32 For recurring expenses

utility in evaluating the impact of the program due to widespread operation of the displacement process. Fairly extensive use of the initial funds at the local level for capital improvements has been recommended by national organizations such as the National League of Cities and Conference of Mayors since visible nonrecurring expenditures were considered desirable to support continuation of the program, minimize opportunities to violate restrictions in the Act and avoid the necessity of cutbacks if the program is terminated by Congress.362

The relative importance of any increased efficiency resulting from Revenue Sharing has already been questioned by those who believe that General Revenue Sharing was used as the justification for terminating many social welfare programs for the poor and disadvantaged.363 A general skepticism has been expressed concerning the ability of the poor and disadvantaged to compete locally for their share of the Revenue Sharing dollars.364

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362. See Large, infra note 364. Wayne Anderson, City Manager of Alexandria, Virginia, indicated that it is a widely accepted principle of public management that one-time revenues should to the extent possible be devoted to non-recurring purposes, and the first two Revenue Sharing checks for December, 1972 and January, 1973 were generally viewed as non-recurring fiscal windfalls. Anderson, Revenue Sharing—Now It's Up to Us, 55 PUBLIC MANAGEMENT 8, 9 (1973).


364. Richard Lugar, Mayor of Indianapolis, provides an interesting response to the view that priorities are better served by categorical grants, with detailed regulations aimed at aiding those specific groups, than by revenue sharing. He stated:

But what happens in actuality is that if the political sentiment of the local community is just hell bent not to help those people, then they will not be helped. The guidelines will be bent, or the money will simply be misspent.

Any really tough-minded congressional examination of just what happened to a well-meant categorical-grant program will show that. Look at the Title One grant program for educating poverty-stricken children. Lots of educationally viable things were done with the money, but the categorical purpose of the program was subverted and localities found all kinds of ways to spread the money around.


See Senator Muskie's statement that the President's budget and reorganization proposals "bestow added blessings on the affluent and added cares on the weak." Washington Post, Feb. 3, 1973, § A, at 2. He opined that the Revenue Sharing money "will go to the most powerful—and that means, by and large, the most privileged—elements in every local power structure." Id.; see Large, Putting Strings on Federal Aid, Wall Street Journal, Feb. 20, 1973, at 20, col. 4.

On the basis of a survey by the Christian Science Monitor of the use of Revenue Sharing funds, it was concluded that:

Cities and towns across the United States are saying "yes" to paying for police stations, fire trucks, tax rebates, and new
The success of the program will depend upon its ability to implement the national commitment to solve social problems of the poor, handicapped and disadvantaged by delivering a broad range of services, including health care and social services.\textsuperscript{365} If experience indicates that a broad range of goods and services which satisfy the highest priority needs of the recipient government are efficiently delivered through Revenue Sharing, but that a particular segment of the population is not able to compete effectively for the funds, a separate effort must be made to help that minority, including an improved system of categorical grants.

The single most important aspect in determining the program's future will be the participation of local citizens in the decision making process, actively reviewing performance and compliance by the local decision makers to achieve the local responsibility and accountability basic to Revenue Sharing. A "New American Revolution" of democratic participation in the local decision making process will be required. In this instance the political rhetoric and labels do reflect substantive needs. Past experiences provide little basis for expecting a reversal of the existing indifference and apathy at the local level. However, the Nixon Administration's commitment to the "New Federalism" or the "New American Revolution" will be tested by the extent to which it adopts policies to induce and encourage the necessary local participation. The initial survey of the Treasury Department found that only 20 percent of the respondents noted an increase in public participation in their planning and budgeting process as a result of Revenue Sharing.\textsuperscript{366} A require-

\textsuperscript{365} Senator Humphrey argued strongly that the funds should be used for services rather than capital expenditures. 118 Cong. Rec. § 14310 (daily ed. Sept. 7, 1972).

\textsuperscript{366} Address by Graham W. Watt, supra note 219. The Summary of the Report concludes:

Given that the normal budgeting process was used and that the statutory requirement for publicizing planned and actual use reports had not been implemented at the time of the survey, the increase in public participation, though modest, should be encouraging to those who felt that this was an important objective of the program. There are indications that the recipients who experienced increased participation were those who encouraged it; e.g., by holding public hearings . . . [T]he Office of Revenue Sharing should . . . urge recipient governments to encourage public participation in the local planning and budgeting process.

ment of information disclosure and participation at the local level is not inconsistent with the "no-strings" rhetoric. Rather, it is the only justifiable basis for that approach.

The allocation formulas and the supporting data elements will continue to draw increasing criticism. The pragmatic answer to the criticism of the formulas is that any method of allocation evolving out of the political process must of necessity be a compromise between many competing interests. Nevertheless, the formulas do distribute significant amounts of money to the large urban core cities and the poor rural areas. Furthermore, there is a redistribution of the federal personal income tax revenues to the poorer states. The availability of the optional formulas should limit the intensity of the criticism.

The problem of the substantial variations between the census data determinations and the actual or imagined figures claimed by local officials will continue. It is clear that the overall quality of the individual data determinations must be improved. This will require dramatic efforts by the Bureau of the Census which traditionally operates on the basis of nationwide or statewide aggregates. However, unless a concentrated effort is made to utilize the information from the federal income tax forms to update income statistics with some reasonable frequency, the program will be jeopardized. In 1976 it will be impossible to justify allocations based on 1970 indications of relative "need" for the funds.

The controversy concerning the use of the displacement process to circumvent the restrictions in the Act will become more serious as labor and civil rights groups observe the ease with which the protective provisions in the Act are avoided. Although the decision in Mathews v. Massell is erroneous in its reasoning, it illustrates the difficulty of achieving the congressional objective of local accountability under circumstances where the displacement process operates freely. Therefore, a great danger exists that either the restrictions in the Act and the concept of local accountability become "dead letters" or substantial accounting and reporting burdens will be placed on the

367. It appears that the Department of the Treasury may have abandoned its efforts to use the federal income tax form as a source to update the income data. The preliminary indications are that the tax form for taxable year 1973 will not include a question as to the municipality of residence notwithstanding the fact that this is expressly required by Section 6017A of the Internal Revenue Code of 1954. See Washington Post, Sept. 1, 1973, § A, at 6, col. 3.
Hopefully, the concerned parties will realize the danger of judicial and congressional reaction to circumvention of the letter and intent of the Act and accept reasonable regulations to achieve the objective of local accountability. If effective local accountability exists, adequate compliance with the restrictions should result.

Although the various levels of government—state, county, local—effectively combined to advocate passage of Revenue Sharing, a substantial probability exists that fierce competition will develop between officials at the various levels for the power which was previously wielded by the federal government. Unless the balance of power at the various levels stabilizes, increased efficiency in the provision of service may never be realized.

The inevitable local scandals concerning the use of Revenue Sharing funds will result in great pressure to restrict or terminate the program. Although it is difficult to predict congressional reaction, it is probable that additional restrictions will be imposed on the program, including some form of maintenance of effort requirement. It is likely that Congress will have approved an extension prior to expiration of the program on December 31, 1976, since 1976 is again a national election year. However, the absence of a Closed Rule in the House of Representatives, and the increased awareness of the political reality that Revenue Sharing represents a diminution in congressional power and influence, will materially increase the task of state and local governments in obtaining favorable congressional action.

While General Revenue Sharing resulted in large measure from massive lobbying efforts of state and local governments based on the assumption that the funds would be in addition to the existing federal programs, Special Revenue Sharing merely replaces existing programs with the same amount of funds. Furthermore, while categorical grant programs have a greater prospect for future increases in funding since there is a constant demonstration of need in the backlog of approved but unfunded

368. See 118 Cong. Rec. § 14391 (daily ed. Sept. 8, 1972) (remarks of Senator Buckley). Senator Buckley proposed an amendment to eliminate all restrictions in the Bill which was defeated.

369. See Clark, Iglehart & Lilley, supra note 364, at 1910, 1912.
applications, no such mechanism to demonstrate the need for additional funding exists in the Special Revenue Sharing proposals. It is thus unlikely that the same coalition of support will exert pressure on behalf of Special Revenue Sharing. At a minimum, no support will be forthcoming from those states and cities which have developed the expertise to derive more than their proportionate share from the categorical grant programs.

In the last analysis, General Revenue Sharing must be judged by its efficiency in delivering the widest range of goods and services to the general population which satisfies the highest priority needs of each of the recipient governments.

The most ignored aspect of Public Law 92-512 is Title II which provides for the federal collection of state individual income taxes. If a significant number of states elect to have the federal government collect the state income taxes, the concept of Revenue Sharing could be dramatically altered. Instead of the federal government transferring $5 billion per year to the states and localities in the form of a transfer payment, a transfer of a portion of the federal income tax base directly to the states and localities could be used to achieve the same result. Thus, pure revenue sharing may result from this dormant provision in the legislation. Although congressional approval of this shift in the tax base will be difficult to obtain because it represents a further diminution in the power of Congress, the long term interests of the federal system will be best served by sharing this efficient, progressive and responsive tax source with state and local governments.

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370. The Nixon Administration has decided not to pursue congressional action on The Better Schools Act in 1973. Also, the Congress has passed a three year, $3.25 billion extension of the law enforcement assistance program which does not include the major elements of the Special Revenue Sharing proposal. See Washington Post, Aug. 13, 1973, § A, at 22, col. 1.

371. Walter Heller has made the following statement on efficiency in state and local governments:

[E]conomic efficiency is not just a matter of administrative effectiveness, but of channeling any given amount of money to the highest priority uses. Dollars spent "efficiently" for low-priority uses may yield considerably less benefits than dollars spent "inefficiently" for high priority purposes. So let's be careful to distinguish between efficiency in the sense of an ideal administrative set-up that can carry out a function at least cost with efficiency in the sense of using dollars for the purposes where they are needed most.

Hearings, supra note 59, at 65.