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FOR REVENUE SHARING, TIME HAS RUN OUT

INTRODUCTION

The federal government has a huge deficit. The states in the aggregate have a healthy budget surplus. Yet Washington could be sending local governments $4.6 billion this year under a program which, despite the federal deficits, is still named "Revenue Sharing." Declared Ronald Reagan to the nation's governors at their annual Washington meeting last month: "There is simply no justification for the federal government, which is running a deficit, to be borrowing money to be spent by state and local governments." As such, Reagan's proposed FY 1986 budget slashes Revenue Sharing by 80 percent and eventually will eliminate it altogether.

Revenue Sharing gives federal funds to local governments for their unrestricted use. The program was adopted during the Nixon Administration on the rationale that the federal government had preempted the strongest and most effective tax revenue sources, and had a far more secure financial base than state and local governments. Giving local governments unrestricted federal funds, it was argued, would enhance what was viewed as the decreasing power of states and localities relative to Washington.

The original rationale for the program has evaporated completely because of changed financial circumstances. The federal government now faces record deficits, while state and local governments enjoy surpluses--with even brighter prospects for the future. State and local tax structures, moreover, have been reformed to remedy in large measure the perceived inadequacies at the time Revenue Sharing was launched. And concerns over the relative power of state and local governments are today being addressed more effectively through the Reagan Administration's policies to strengthen federalism.

Every local jurisdiction in America receives Revenue Sharing, including the bedroom communities and vacation retreats of the wealthy. The distribution of Revenue Sharing, indeed, is often perverse, with many richer communities receiving more per capita aid than poorer communities. Even without a federal deficit, such poorly targeted subsidies would be unjustifiable.

In FY 1983, Revenue Sharing funds comprised only 1.4 percent of local government revenues; by FY 1986 this share will be smaller. The loss of this relatively tiny contribution to local revenues would be especially easy to absorb now, thanks to the firm financial condition of state and local governments. State governments could aid local communities in the adjustment through their own revenue sharing programs, which already exist in 49 states. Moreover, even after eliminating Revenue Sharing, the federal government would still be funneling $100.7 billion to states and localities, amounting to 10.7 percent of total federal spending.

Revenue Sharing has represented unwise federalism policy from its inception. At last, time has run out for the program, and it should be eliminated.

THE REVENUE SHARING PROGRAM

Revenue Sharing provides federal grants to local governments to be spent without restriction, apart from certain procedural requirements.[1] All U.S. local governments are eligible and virtually all--more than 39,000--receive them. Recipients include counties, cities, towns, townships, villages, and other governmental jurisdictions.[2]

The size of the grant is determined by a statutorily set formula which divides the total Revenue Sharing funds appropriated by Congress among the eligible recipients. Basically, the formula provides funds to recipient governments according to their population. It also awards extra funds if a locality's per capita income is low and if its tax revenues are high relative to local income (a relation known as tax effort).

Revenue Sharing was first adopted in 1972, as part of Richard Nixon's federalism initiative. The grants initially were provided to state governments as well as local governments. It was argued

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1 Discrimination in the use of Revenue Sharing funds is prohibited, public hearings regarding proposed uses of the funds must be held, and recipient governments are subject to audit requirements.

2 "Local government" for the purpose of the Revenue Sharing program is defined as a general-purpose government under the definition prescribed by the Census Bureau, which generally means a government that provides a minimum of three different types of services to its residents.

that the federal government possessed the strongest tax revenue sources and had a far more stable financial base than most state and local governments. Though the federal government was giving substantial funds to state and local governments for specified purposes, Revenue Sharing advocates maintained that this gave Washington too much power over state and local spending priorities. To avoid this, it was urged that the federal government share its surplus revenues without restrictions on how the funds could be spent. This would return some power and flexibility to state and local governments, enabling them to set their own spending priorities. And legislators at lower levels of government, they argued, could best determine what was most needed in their communities.

So far, Revenue Sharing has transferred $78.6 billion to state and local governments.[3] Current law would provide for another $4.6 billion in FY 1986--the level of Revenue Sharing each year since FY 1981.[4] The program's annual funding peaked at $6.9 billion annually in fiscal years 1978 to 1980.[5] Grants to state governments ended in FY 1981, accounting for the drop in spending in that year. Congress took this action because of the improving fiscal conditions of state governments, and because of congressional anger over the call by many states for a Constitutional Convention to pass a federal balanced budget amendment.

The Reagan Administration's FY 1986 budget proposes eliminating Revenue Sharing for local governments as well.

THE LOST RATIONALE

Changing circumstances have nullified the original Revenue Sharing rationale. It is now the federal government which is in deep financial trouble, while state and local governments generally are far more robust. The federal budget deficit for FY 1984 was $185 billion, and the deficit for FY 1985, which ends this September, is currently estimated by the Administration at $222 billion.[6] If no changes are made in current law, the federal deficit will likely remain over $200 billion at least through FY 1990.[7] This compares with federal deficits of less than $10 billion in each year from 1960 to 1970 (except for 1968).[8]

State and local government budgets, by contrast, are generally in surplus and are improving. Many states, including California,

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[3] Office of Revenue Sharing, <u>Eleventh Annual Report</u> (U.S. Treasury Department, June 1984).

[4] <u>Ibid.</u>

[5] <u>Ibid.</u>

[6] Office of Management and Budget, <u>Budget of the United States Government, Fiscal Year 1986</u> (Washington, D.C.: U.S. Government Printing Office, 1985).

[7] <u>Ibid.</u>

[8] <u>Ibid.</u>

are now planning to build up reserves for the future, and several governors, such as Anthony Earl of Wisconsin, are calling for tax cuts. State general fund expenditures increased 8 percent in FY 1984, while general revenues increased 13 percent.[9] State governments ended FY 1984 with an operating surplus (not including pension fund accumulation) of $6.3 billion, plus another $1.0 billion set aside in reserve "rainy day" funds.[10] This total $7.3 billion surplus amounted to 4.4 percent of FY 1984 state expenditures,[11] compared with a FY 1984 federal deficit equal to 21.8 percent of expenditures.[12]

For cities, the latest available data show that in FY 1983 total expenditures increased by 6.5 percent, while total revenues increased by 8.4 percent.[13] Total revenues exceeded total expenditures for cities in FY 1983 by $4.7 billion, equal to 3.9 percent of expenditures.[14] The latest survey of the fiscal conditions of cities by the Joint Economic Committee of Congress estimated that the cities examined would have carry-over contingency funds equal to 7.5 percent of expenditures in FY 1983.[15]

For local governments as a whole, total revenues exceeded total expenditures in FY 1983 by $6.0 billion, equal to 1.8 percent of expenditures.[16] Since 1972, local governments combined have run a modest surplus each year except for the 1975 recession year, while the federal government has incurred increasingly larger deficits.[17] This contrasts sharply with the 1960s, when local governments ran significantly larger deficits each year (relative to their own revenues) than did the federal government.[18]

Preliminary results of a thorough study of state and local government finances by the U.S. Treasury Department indicate that even brighter days are ahead.[19] Using mid-range economic growth

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[9] National Association of State Budget Offices and National Governors Association, Fiscal Survey of the States (February 1985 update).

[10] Ibid.

[11] Ibid.

[12] OMB, Budget of the United States Government, Fiscal Year 1986.

[13] U.S. Bureau of the Census, City Government Finances in 1983-83 (Washington, D.C.: U.S. Government Printing Office, November 1984).

[14] Ibid.

[15] Joint Economic Committee and Municipal Finance Officers Association, Trends in the Fiscal Condition of Cities: 1981-1983 (Washington, D.C.: U.S. Government Printing Office, November 1983).

[16] U.S. Bureau of the Census, Governmental Finances in 1982-83 (Washington, D.C.: U.S. Government Printing Office, October 1984).

[17] Office of Management and Budget, Background on Major Spending Reforms and Reductions in the FY 86 Budget (Washington, D.C.: U.S. Government Printing Office, 1985), p. 72.

[18] Ibid.

[19] Office of State and Local Finance, U.S. Treasury Department, Recent Trends in State-Local Finances and the Long-Term Outlook for the Sector, November 28, 1984.

assumptions, along with current tax and spending policies, the combined annual state and local sector surplus (not counting social insurance funds) would grow to $86.5 billion by 1989, equivalent to 14.1 percent of expenditures in that year. Under high economic growth assumptions, the 1989 surplus reaches $129.8 billion, or 21.2 percent of expenditures. Even under low growth assumptions, the 1989 surplus would still reach $29.9 billion, or 4.5 percent of expenditures. The low growth 1989 surplus would be a record for state and local governments in both absolute and percentage terms.

For the debt-ridden federal government to be "sharing revenue" with states in financial surplus is like bankrupt Argentina providing assistance to oil-rich Saudi Arabia. State and local governments easily could absorb the loss of federal Revenue Sharing grants, since all but Delaware have their own revenue sharing programs for local governments[20] and thus could assist these governments if the loss of federal funds posed a particular problem.

The tax structure of state and local governments also has changed substantially since the early 1970s. Local governments have reduced their reliance on property taxes, drawing an increasing proportion of their revenues from sales taxes, income taxes, and user fees.[21] State governments, too, have shifted toward income taxes and user fees.[22] States, moreover, have granted local governments more authority to tax and develop entirely new revenue sources.[23] And boundaries between local governments, together with service responsibilities distributed among them, have been adjusted to match responsibilities more closely with taxing authority over service beneficiaries.[24] In short, the perceived inadequacies of the state and local tax structure used to justify Revenue Sharing largely have been remedied. The federal government no longer monopolizes the most effective methods of raising revenue.

The Reagan Administration's federalism policies have consolidated many federal categorical grant programs into block grants and eliminated many federal regulations and mandates on state and local authority. This enables state and local governments to exercise more authority and control over priorities than in decades. The Administration's continuing efforts along these lines will further enhance state and local power.

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20 U.S. Department of Housing and Urban Development, The President's National Urban Policy Report 1984 (Washington, D.C.: U.S. Government Printing Office, 1984), p. 18.

21 Advisory Commission on Intergovernmental Relations; OMB, Background on Major Spending Reform and Budget Reductions, p. 72.

22 Ibid.

23 HUD, The President's National Urban Policy Report, pp. 13-21.

24 Ibid.

THE RICH GET RICHER WITH REVENUE SHARING

A particularly troubling aspect of Revenue Sharing is its extremely poor targeting. It is not limited to poor communities. Every local jurisdiction in America receives grants, including posh vacation retreats.

Last fiscal year, for instance, Palm Springs, California, obtained $617,000 in federal Revenue Sharing funds; Greenwich, Connecticut, received $782,000; and Scottsdale, Arizona, $806,000. Together, Palm Beach and West Palm Beach, Florida, received $1.3 million from Washington, while another $4.6 million went to the Palm Beach county government. The various local governments in Palm Beach county received a total of $9.1 million. The local jurisdictions in New York's affluent Westchester County were awarded $12.2 million in Revenue Sharing, and Orange County, California, governments received $28.8 million. Other Revenue Sharing recipients included such well-to-do communities as Vail and Aspen, Colorado, Scarsdale, New York, and Wellesley, Massachusetts.

Booming sunbelt cities do nicely under the program. Phoenix, Arizona, received $10.6 million in FY 1984, with another $7.8 million awarded to its county government. San Diego, California, received $11.3 million, with another $12.4 million to its county. Dallas, Texas, received $14.3 millon, with another $8.0 million for Dallas County. Tampa, Florida, received $5.9 million, with $7.8 million for its county, and Orlando, Florida, received $2.5 million, with another $5.6 million to the county.[25]

These are not isolated cases. They merely indicate how perverse is the formula for distributing Revenue Sharing grants. In FY 1983, for instance, local communities in Alaska, which has the nation's highest per capita income, received per capita Revenue Sharing grants about 4.5 times the national average.[26] Virtually every local government in Alaska received a higher per capita Revenue Sharing grant than local governments in Mississippi, which has the lowest per capita income in the nation.[27]

Local communities in the ten wealthiest states received 25 percent of all Revenue Sharing funds in FY 1983, while communities in the ten poorest states received less than 12 percent.[28] The 3,300 poorest local governments received only 2 percent of Revenue Sharing funds in FY 1984.[29]

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25 All grant totals are from Office of Revenue Sharing, Fifteenth Period Entitlements (U.S. Treasury Department, January 1984).

26 Office of Revenue Sharing, Eleventh Annual Report, Table 2.

27 OMB, Background on Major Spending Reforms and Budget Reductions, p. 73.

28 Ibid.

29 Ibid., p. 74.

Even without record federal deficits, there should not be a federal program allowing the richest states to avoid their responsibilities to assist their own communities by sending the tab to Washington and pushing the federal budget further into the red.

A PAINLESS CUT

Revenue Sharing funds could be eliminated entirely without causing hardship. The program's grants constitute only a tiny portion of total local government revenues and expenditures. FY 1983 Revenue Sharing funds, for instance, amounted to only 1.4 percent of total local government revenues and of total local government expenditures, excluding pension income and expenditures.[30] Because total Revenue Sharing funds have remained frozen since then, they would constitute an even smaller proportion of local government finances in FY 1986.

Since the program's funds must be divided among all local governments in the U.S., moreover, they are spread thinly among individual local jurisdictions and consequently are rarely critical for any particular jurisdiction. Revenue Sharing funds in FY 1983 accounted for more than 5 percent of total expenditures (excluding pensions) in only one city over 300,000 in population, and in only five counties over 500,000 in population, with the highest proportion still just 6.9 percent.[31] Only 4.6 percent of Revenue Sharing funds go to local governments where such funds represent 10 percent or more of local revenues, and only 1.2 percent go to governments where they represent 15 percent or more.[32]

The loss of this relatively small contribution to local revenue would be especially easy to absorb now, given the bright prospects for further improvement in state and local revenue collections. State governments could aid local jurisdictions in the adjustment through their own state revenue sharing programs, particularly in those few minor instances where federal Revenue Sharing funds now constitute a comparatively high proportion of an individual local government's revenues. Federal Revenue Sharing funds under current law would amount to only 8 to 16 percent of the state and local government total combined surplus now projected by the U.S. Treasury for 1986, so the burden would not be great.[33]

In recent weeks, defenders of Revenue Sharing have claimed that specific essential services have been funded by the program. If the program is ended, they claim, these basic services must be

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30 Calculated from U.S. Bureau of the Census, Governmental Finances in 1982-83.

31 Office of Revenue Sharing, Expenditures of General Revenue Sharing Funds, 1982-83, Table 11.

32 Ibid., Table 4.

33 Calculated from Office of State and Local Finance, Recent Trends in State-Local Finances and the Long-Term Outlook for the Sector, Table 8.

drastically cut or even eliminated. But this argument is totally spurious. When local governments claim that the federal assistance is used to fund critical services, such as fire and police departments, they mislead the public. The unrestricted federal money simply goes into the general pot--it is not earmarked for any particular activity. So cancellation of the program means simply that jurisdictions would have to examine their spending priorities, leading to cutbacks in the least important services, not the essential ones.

Even after eliminating Revenue Sharing, the federal government would still be providing an enormous amount of aid to state and local governments. The Administration proposes spending $100.7 billion on aid to state and local governments in the FY 1986 budget.[34] This amounts to 10.3 percent of the entire proposed FY 1986 federal budget, and would account for close to 20 percent of total state and local revenues.[35] The Administration projects this state and local aid growing to $105.4 billion by FY 1990.[36] In no sense, therefore, would the federal government be "abandoning" America's state and local governments by ending Revenue Sharing.

PHONY FEDERALISM

Revenue Sharing has been bad federalism policy from the beginning. State and local government services, such as local roadways and fire protection, should be financed primarily by funds raised at the state and local levels--just as national programs, such as defense, should be financed at the federal level. If the benefits of a particular local service or project are worth the cost, then the local citizens who benefit will be willing to tax themselves to pay for it. If they are not willing to do so, this is strong indication that the costs are not worth the benefits, and the service or project should not be undertaken.

When the federal government offers funds for state and local activities, however, this decision-making process is distorted. Local taxpayers no longer have to pay full costs for their government activities, since part of the funds in effect are provided "free" by the federal government. Consequently, local residents will not take full costs into account, and tend to support services or projects where the costs are not worth the benefits, resulting in substantial waste and inefficiency. Moreover, federal financing for local projects is unfair to federal taxpayers across the

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34 Office of Management and Budget, "Federal Aid to State and Local Governments," Special Analyses of the Budget of the United States Government, Fiscal Year 1986 (Washington, D.C.: U.S. Government Printing Office, February 1985), Table H-7.

35 Ibid.

36 Ibid.

country, who will not benefit from it, but are nevertheless forced to pay for it.

Federal aid to state and local governments may, of course, be justified when a national benefit or priority is involved. For example, the construction of the interstate system, and various waterway projects, helped to secure legitimate security and national development goals. But even in these cases, state and local governments should be given maximum discretion in how to achieve the benefit or priority in the context of local conditions. Revenue Sharing does not serve such a role, precisely because it has no targeted spending restrictions, and does not serve a nationwide need or priority.

Federal Revenue Sharing fails to conform to the principles of federalism. It does not seek to promote a clear national purpose with national funds. The activities supported with federal money are state and local concerns, and so should be funded by those levels of government. Revenue Sharing adopts the rhetoric and facade of federalism without really attempting to accomplish the difficult tasks necessary to restore the historic balance among different levels of government. The program is itself part of the federalism problem.

CONCLUSION

The original rationale for Revenue Sharing is no longer valid. The program, moreover, often perversely grants more to the rich than to the poor. Given present and projected state and local surpluses, the loss of the tiny proportion of local revenues represented by the program could be absorbed especially easily today. The program, meanwhile, is unwise federalism policy. For these reasons alone, Revenue Sharing should be eliminated. Making its elimination urgent is the prospect of record federal deficits well into the future.

The Reagan Administration has proposed eliminating almost 80 percent of Revenue Sharing outlays for FY 1986 and ending the program entirely thereafter. Given the depth of the federal deficit crisis and the ability of state and local governments to absorb the proposed cut, the Administration's proposal makes good sense and is good policy. The time to eliminate Revenue Sharing is now.

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