Federalism, 1971

SLUMBERING in the shadows of powerful central government is a diminishing generation of states' rights devotees and resisters of paternalism whose voices are stilled. As their past fades into the oncoming future the word is "federalism," The weekly lecture series at HGS headquarters closed on this theme.

John Shannon represented the Advisory Commission on Intergovernmental Relations in Washington, D.C. and spoke of Major Issues of Fiscal Federalism, on December 1st. He said the tension at various government levels is not the product of mistrust or will to power, but the result of differing views at each level of the system. Federal policy-makers see the shared power as an inverted pyramid. They possess the big picture and view the state and local jurisdictions as narrow in perspective. Since the federal government collects about 90 percent of all personal income tax and has virtually cornered the revenue producer most sensitive to economic growth, it is viewed by the state and local governments as having all the money and consequently all the power.

Because progressive loss of freedom is the price that must be paid by all state and local jurisdictions, the Advisory Commission has set up what it considers a balanced federal support which includes the closely linked revenue sharing plan and a system of federal tax policies resting in part on tax credits. These would raise revenue capabilities of state and local governments by partially shielding them from the impact of intergovernmental tax competition. If we start sharing revenue in large amounts with the states we will make them more dependent on federal, not less. "The long range prognosis for our system of decentralized government is bleak," the speaker said, "unless we can establish the principle that state and local governments have a right to share in the nation's number-one revenue and power source, the personal income tax."

High income tax states such as New York need immediate financial aid that revenue sharing can provide and the long range assistance that tax credits can furnish. The tax credits would tend to prompt New York's non-income tax neighbors (Connecticut, Pennsylvania and New Jersey) into utilization of this revenue source, and the resultant reduction in New York State's vulnerability to interstate tax competition would then permit the state to make greater use of the personal income tax.

A second major imbalance described by Dr. Shannon is created by public welfare. In 1970 this expenditure probably reached $17 billion, with the national government paying about $9 billion. No amount of federal revenue sharing promises to eliminate the inequities in the public welfare system. Although federal takeover of welfare financing and federal revenue sharing would reduce state and local tensions, they cannot be viewed as alternatives or substitutes for one another. Federal revenue sharing is needed to strengthen the financial foundation of the system of decentralized government while the "nationalization" of public welfare financing is necessary to secure a just method for assisting the poor and a fair procedure for spreading welfare costs. To put the welfare burden on the government would be like taking the brake out of the car and throwing it away. If the U.S. paid the bill there wouldn't be any pressure to hold down the people on welfare. States are being stripped of their power to discriminate regarding the residence requirement, so the brakes are off anyhow.

A table showing the percentage of personal income paid out of state funds from 1966 to 1969 showed New York and California far in the lead. For instance, New York's percentage paid for public assistance was 1.86 as against the lowest, .19 in Arizona and Florida. California pays a percentage of 1.50—Massachusettes, with 1.30, and Rhode Island with 1.06, are the other high paying states.

If the national government adopted revenue sharing and assumed full financial responsibility for welfare the states would be in a position to correct the third imbalance, which favors education to the detriment of general city and county functions. The speaker explained that the property tax is incapable of supporting the growing claims of both school districts and local general governments, therefore instead of education being the senior claimant on the property tax it ought at best to be a very junior claimant. By "kicking the educational burden upstairs to the state" and lifting off the local property tax base as he proposes, the state would undercut much of the fiscal logic that now supports exclusionary zoning practices in many suburban jurisdictions. It could also take into account the equalization of educational opportunity.

The Minnesota state legislature was cited as one that is giving serious consideration to a way of keeping interlocal fiscal disparities within tolerable limits in a splintered metropolitan area. Under a "share the tax growth" plan approximately half of all the property tax revenue attributable to new industrial and commercial construction would be divided among all of the local governments within the seven-county Minneapolis-St. Paul metropolitan area.

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In the closing lecture, William G. Collman, former director of the Advisory Commission on Intergovernmental Relations, reviewed the federal structure and enlarged upon urban expectations. He said seven basic issues all rooted in the concept of federalism or the failure of federalism, confront urban localities. These are: political and fiscal fragmentation of the local government tax base, disorderly and destructive patterns of urban growth permitted and encouraged by federal and state policies, a seriously unbalanced intergovernmental revenue system, uncontrolled growth of functional federalism spawned primarily by the federal categorical aid system, shocking decline in productivity and equity in the delivery of municipal services, growing alienation and disaffection of low income minorities, and breakdown in the state-local system for law enforcement and administration of justice.

An arsenal of weapons should be provided to local governments to permit them to cope with the spread of population beyond jurisdictional boundaries, he said, and states should take direct action to control and modernize local government by reducing the number of special districts and regulating new incorporations. Formulation of a national urbanization policy vested in the executive office of the President to assure that federal programs would not operate converse to national goals was suggested to cover such things as financial incentives for industrial locations in large city poverty areas and rural growth centers, as well as migration allowances to facilitate population movement from labor surplus to labor shortage areas, and preference in the award of federal contracts to areas where it is desirable to attract population.

A massive rearrangement in the scale of fiscal resources available to the three levels of government is absolutely essential if the federal system is to remain viable. Otherwise each functional category with its hordes of professionals at all government levels becomes, in effect, a government unto itself—a vertical autocracy. Like the previous speaker he suggested sharing a percentage of the federal personal income tax base with states and major localities, and would encourage more intensive use of the income tax by state governments. He favors assumption by the federal government of all costs of public welfare and medicaid, and would have state governments assume substantially all local costs of elementary and secondary education.

It was emphasized that a high quality state-local tax system depends on a fairly heavy yielding state personal income tax, a moderate and tightly administered state sales tax, and a moderate and equitably administered local property tax. State personal income tax exemptions should be as generous as those under the federal income tax. A sales and use tax should cover personal services as well as tangible sales items, to ensure productivity. Income tax credits and cash refunds would make the tax less regressive for low income taxpayers.

Reciprocity arrangements could be made with other states with authorization for local governments to piggyback a sales tax onto the state sales tax. At present about fifteen states permit local piggy-backing, and several employ various means to protect the low income taxpayers. Five states are missing something—Oregon, Alaska, New Hampshire, Delaware and Montana do not yet have a sales tax!

In a plea for property tax reform he would establish the state in the driver's seat with respect to all major aspects of assessment and administration. The National Commission on Urban Problems summarized property tax reform as follows in 1968: limit legal coverage to forms of wealth that can be effectively reached and valued through such taxation, minimize exemptions and tailor with great care any property tax relief provisions, provide appropriate machinery for assessment work with responsibility assigned to well-staffed and professionally directed jurisdictions large enough to employ modern equipment, and move as rapidly as possible toward full-value assessment of taxable property. States should revise their laws and constitutional provisions relating to the property tax so as to limit its coverage, at most, to real estate, tangible personal property used for income producing purposes, and motor vehicles. States should avoid the enactment of partial exemptions for particular types of private property owners and should use means other than preferential assessment to limit onerous residential property taxes for low income families.

Assessment directly under a state agency or with state technical supervision and cost-sharing is proposed by major county and multicounty jurisdictions with a population of at least several hundred thousand persons. Popular election is not favored as a basis for selecting assessors. Appropriate standards of education and technical experience for assessment personnel are recommended. States should reaffirm the principle of "full value assessment" and move toward substantial compliance with official valuations for property taxation. Assessments should be as uniform as possible in relation to market value.

The states should review their existing machinery and carry out scientific studies of the relationship of assessed valuations to market value of taxable property and should publish detailed findings in the form of averages and measures of dispersion for various assessing jurisdictions.

Aside from the adoption of revenue sharing, a positive way to restore balance between functional government and general government is to aim toward reform and revitalization of the latter at state and local levels. Increased investment in the Model Cities program is suggested in order for states to develop their own course of action on urban problems. To restore equity and competition to municipal services, state urban agencies need to sit down with city and county administrators to examine the relative quality of the services and facilities they provide.

It was considered necessary and urgent to take immediate steps to reverse the disastrous rise in alienation between big city government and its disadvantaged citizens. We must revitalize the neighborhood, contributing to the citizen a sense of self respect and self reliance. The neighborhood government concept is one possible approach to communication between the poor and the city hall and county building. Neighborhood sub-units could have an elected council with such powers and functions as levying a small head tax on residents, undertaking rehabilitation, beautification and other self help projects and holding hearings on neighborhood actions (but without veto).

Finally a strong administrative system for modernized and humanized law enforcement by the state police was proposed with a unified state supreme court system and district judges appointed under a merit plan to serve full time. The state would be expected to assume all or most of the court costs while placing increased emphasis on rehabilitation.

Dr. Coleman, in closing the fifteen-week series, said, "we must make federalism work in the city streets, in the corridors of the county building and the legislature, and in the halls of Congress. As 1976 approaches we must again rededicate ourselves to the ideals of Washington, Jefferson and Madison. Our individual and collective response to this challenge will—in the long run—determine whether our constitutional heritage of ordered liberty, balanced government, and division of powers can endure."