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GENERAL REVENUE SHARING AS A SOURCE OF FUNDS IN RURAL COMMUNITIES: SOME PROBLEMS AND SUGGESTIONS

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Six years after a suggestion by Walter Heller, then chairman of the President's Council of Economic Advisors, revenue sharing was introduced in the United States for the second time in the nation's history when the "State and Local Fiscal Assistance Act of 1972" became law in October of that year.[1] This legislation provided $30 billion for state and local governments over a period of five years.

The procedures outlined in the law differed from previous programs of federal aid not only in the latitude allowed in spending the funds but also in that all local governments were entitled to a share. This meant that many small communities were to receive federal money [2] for the first time and raised the question of how such money would affect those towns. In this paper we examine briefly the developing theory, the attitudes of local officials toward the new program and some of the provisions of the Act itself.

The theory has concentrated on the effects of revenue sharing on aggregate local expenditures. Although not without theoretical difficulties, the common assumption is that general revenue sharing stimulates local spending less than do conditional or matching grants. The former involves only an income effect, the latter have a substitution effect as well.[3]

Compared to taxing and spending by the local unit alone, the effect is not so obvious. Since the federal government has a more progressive system of taxation than do local governments, it would appear that wealthier communities would reduce their spending, while poorer communities would increase theirs.[4] Substitution of revenue sharing funds for local taxes is made difficult by the nature of the distribution formula.

The question of whether or not the mix of local government activities will be altered by revenue sharing is also open. While it is still too early to empirically examine these points, the attitudes of local officials and provisions of the Act itself may provide some insights.

A survey taken of all government officials in Cache, Box Elder, and Weber counties in Utah revealed that those in the small communities were generally less enthusiastic about revenue sharing than those in the cities.[5] In communities of under 800 people, only 44 percent of the local officials favored revenue sharing; elsewhere it was closer to 60 percent.

The 1972 Fiscal Assistance Act contained a formula to be used in distributing the funds among the various units of government. For each local community three factors were to be considered: population, relative income position, and tax efforts.[6]

The amount of revenue realized in specific cases could be substantial. For example, 19 communities of Cache County in Utah increased their revenues by about 40 percent a year (table 1).

One major objection to general revenue sharing is that giving funds to every community can mean less money for communities having special needs. Another similar complaint is that the funds are spread so thinly that none of the communities receive enough to do anything worthwhile. The conclusion drawn from these popular arguments is that some of the funds are wasted.

Congress attempted to meet these objections by including the tax effort criterion in the distribution formula of the Act, so that heavily taxed locales would receive more funds, by setting a minimum payment to any community of $200, and by allowing the money to be saved by the accumulated recipient communities for up to two years.[7]

A significant difficulty arises, however, from the tax effort criterion. One of the things revenue sharing funds can be used

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[1] Revenue sharing had been tried briefly before in 1837 when the federal government had a budget surplus for a short period.

[2] In Cache County, Utah, over half the communities had never received a federal grant before.

[3] Local officials did not view general revenue sharing as a substitute for other grants in 1973 but as a new source of funds. Many have since changed their minds. North Logan officials, for example, feel they lost a grant for a sewer system because of the switch. They also had to expand their water system without any matching federal help.

[4] See 5. Poorer communities are in effect subsidized by the rich ones.

[5] See item 2, table 2. The author thanks Gary Cornia who collected and compiled the questionaire data.

[6] Relative income is found by dividing the per capita income of the county by the per capita income of the community. Tax effort is calculated by dividing tax collections (excluding those going for education) by the aggregate income of the community.

[7] Pooling of funds at the county level is also allowed by the Act.

Table 1. Reveune sharing in Cache County, Utah, 1972[1]

Community	Population	Per Capita Income	Adjusted[2] Taxes	Revenue Received: First year	Revenue Received: As percent of adjusted taxes
Amalga	207	2,281[3]	1,979	802	40.5
Clarkston	420	2,281[3]	9,610	4,698	48.9
Cornish	173	2,281[3]	7,975	3,233	40.5
Hyde Park	1,025	2,290	14,027	5,642	40.2
Hyrum	2,340	2,079	47,741	23,300	48.8
Lewiston	1,244	1,363	27,820	18,880	67.9
Logan	22,333	2,398	611,875	224,430	36.7
Mendon	345	2,281[3]	5,641	2,287	40.5
Millville	441	2,281[3]	6,493	2,632	40.5
Newton	444	2,281[3]	7,260	2,944	40.6
Nibley	367	2,281[3]	7,525	3,051	40.5
North Logan	1,405	2,294	27,296	10,942	40.1
Paradise	399	2,281[3]	38,104		39.1
Providence	1,608	2,345	32,624	12,516	38.4
Richmond	1,000	2,089	23,372	11,317	48.4
River Heights	1,008	2,892	25,868	6,525	25.2
Smithfield	3,342	2,020	88,848	45,933	51.7
Trenton	390	2,281[3]	8,493	3,453	40.7
Wellsville	1,267	1,947	27,533	15,322	55.6
Cache County	42,331	2,281	644,858	283,830	44.0

[1]Data comes from the Office of Revenue Sharing, The Department of the Treasury.
[2]Does not include funds collected and used for educational purposes.
[3]All towns with a population under 500 use the county average for per capita income.

for is tax reduction. Use of the option, however, would lead to a reduction of federal funds in the future and the need to reinstate local taxes. Many local officials, especially in the smaller communities felt that the Federal government should simply reduce Federal tax rates and let the local communities decide whether or not to raise theirs in response. In the three Utah counties surveyed, nobody cut taxes as a result of revenue sharing, though some officials said it precluded their having to increase taxes (see items 5 and 6, table 2).

The survey revealed that communities tended to spend the money on one-time capital expenditures. Since it was a new program, uncertainty as to how long it was going to last generated a reluctance to commit the funds for any extended period of time.[8] In Cache County over 75 percent of the money in the first year was budgeted for capital expenditures.[9] Importantly, it is relatively easy to justify capital expenditures to people administering such acts. Revenue sharing funds could be combined with local funds for investment purposes, but if used for current expenditures they had to be kept separated in a special trust fund. The funds cannot simply go into a central pool because of certain restrictions on their use. The funds cannot be used as matching funds for other federal grants, for educational purposes or for general administration.

A frequently mentioned complaint was the paper work required by the federal government. This is particularly burdensome for communities that lack a professional staff. Not withstanding the rhetoric about having few strings attached, the Federal government wants to know in great detail how its money is being spent.

A final problem arises from the lack of data on smaller communities. Towns with populations of 500 or less are plugged into the revenue sharing formula at county averages for income.[10] If the average income of these communities is really below that of the county average, they fail to receive their "fair" share of the monies. Essentially, the income factor is ignored for these communities and tax effort becomes the criterion for judging their worthiness, but even then the tax effort may be divided by an income figure that is inaccurately high. Thus, for every 1 percent that income is overstated for these communities, about 4 percent of possible revenue for that year is lost.

Using Cache County as an example, if Logan and its surrounding suburbs of Providence, River Heights, and North Logan are excluded, the average per capita income of the rest of the county falls from $2281 to $2073, a decline of ten percent. Using this lower figure for these smaller communities would increase their share of funds by about 40

[8]More than half of the government officials surveyed felt uncertain that revenue sharing would be extended beyond 1976 when the present Act expires.

[9]In the smaller (under 800) communities road and water system improvements were the most popular expenditures. At least two new tool sheds were built.

[10]An administrative decision announced by Graham Watt, Director, Office of Revenue Sharing in a letter dated March 6, 1973.

Table 2. Response of local government officials in Cache, Weber, and Box Elder counties

Item	Populations <800		801 to 5000		>5000		Counties	
	Yes	No	Yes	No	Yes	No	Yes	No
1. Were you receiving federal funds prior to revenue sharing?	35.1	64.8	42.5	57.4	73.9	24.1	100	
2. Do you favor the concept of revenue sharing?	44.4	48.1	62.9	33.3	56.5	39.1	66.6	33.3
3. If revenue sharing continues will it become an increasingly important source of funds in your budget?	57.4	31.4	79.6	9.2	73.9	13.0	100	
4. Revenue sharing has given or will give you a chance to provide facilities or services to your constituents you otherwise would not have been able to provide.	66.6	18.5	74	14.8	82.6	13	100	
5. Has revenue sharing made possible any tax reductions for your area?	1.8	98.1	3.7	96.2	13.6	82.6	33.3	66.7
6. Has revenue sharing made it possible to avoid a tax rate increase by your gorernment unit?	42.5	48.1	51.8	44.4	52.1	43.4	66.7	33.3
7. Revenue sharing is most effective when it is used for current expenditures within your annual budget or revenue sharing is most effective when used to finance capital expenditures.	57.3	42.5	27.7	61.1	17.3	69.5	0	100

This survey was taken in the summer of 1973 when revenue sharing was still very new. Questionnaires were sent to all county and local officials in the study area. Out of 232 questionnaires sent out, 134 were returned. The undecided and no response percentages are not presented in this table. The complete results can be found in Gary Cornia, "The Effect of Revenue Sharing on Three Selected Counties in the State of Utah: Box Elder, Cache, and Weber," unpublished Master's Thesis, Utah State University, 1973.

percent a year, while reducing the share going to the larger communities by about 2 percent a year. Fairness recommends such a procedure.

RECOMMENDATIONS AND CONCLUSIONS

The 1972 Act allows states to alter the revenue sharing formula through legislation by attaching weights to the various criteria for distribution. If the tax effort criterion were eliminated by state action, then communities could more readily substitute these federal funds for local ones.

For smaller communities not involved in financing educational facilities or making applications for matching grants, the need to keep a separate trust fund for revenue sharing funds should be dropped. This would allow them to more easily use the funds for current operations and also reduce their paper work. Small communities are much more anxious than large ones to do this.[11]

Alternatively the Act does allow for pooling of resources at the county level. County officials should perhaps actively engage in encouraging beneficial county-wide programs.[12]

Another improvement would be to alter the rule requiring communities with populations of under 500 from being considered as having an income equal to the county average by first eliminating the higher income communities from the averaging process.

Like it or not, revenue sharing is an important new source of funds to local communities for the immediate future. The incorporation of the above suggestions can, in this writer's judgment, help make the program more benificial to the smaller communities and aid in accomplishing the worthwhile objectives intended by Congress.

[11] See item 7, table 2. The amounts these places receive are really too small absolutely to do much capital work.

[12] An example might be a county-wide landfill.

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