Cabinet

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A Time for Sharing

. . . The case for new initiatives to strengthen the fiscal base for American federalism has recently become more convincing.

Youth: Jobs and Wages

. . . Minimum-wage legislation has been hailed as a weapon for fighting poverty—and denounced as a bar to teenage employment.

Editor: William Burke

A Time for Sharing

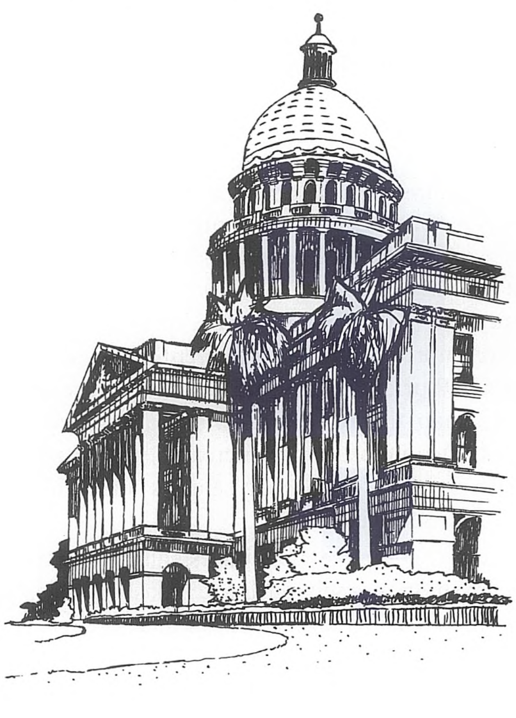
President Nixon sent Congress a message in August asking for legislation to permanently enlarge the proportion of Federal tax revenues channeled to state and local governments. This message added Executive support to an emerging consensus that the division of total tax revenues among the Federal, state and local governments is becoming increasingly incompatible with the responsibilities the nation vests in each of these levels of government.

This proposal is the culmination of work begun by the Task Force on Intergovernmental Fiscal Cooperation set up by President Johnson in 1964. In the intervening years, the case for new initiatives to strengthen the fiscal base for American federalism has grown more urgent and convincing. Although the ultimate direction these initiatives should take is still being debated, two Councils of Economic Advisors, the Subcommittee on Fiscal Policy of the Joint Economic Committee of Congress, and the Advisory Commission on Intergovernmental Relations (ACIR) have all endorsed an expansion of Federal support for the states and municipalities. Agreement on a specific program has been difficult to achieve because of conflicting concerns over the degree of central control required to ensure efficient allocation of federal funds at the local level, and the degree of control which can be accepted without seriously compromising the sovereign status of the states and their dependent local governments. However, the strength of the bipartisan support for some form of expanded federal assistance suggests that a decision may be forthcoming soon.

The case for greater Federal assistance to states and localities is based on the lack of a *quid pro quo* balance between revenue-raising capabilities and expenditure requirements at different levels of government. With the current budget structure, economic expansion produces increments in Federal revenues faster than it spawns additional requirements for Federal civilian expenditures, while at the state and local levels, the situation is just the reverse: growth-generated responsibilities tend to outrun growth-related increases in revenues. In recent years this "fiscal mismatch" has left state and local governments in a more or less continual state of budgetary crisis, and, the Federal government with potential budgetary surpluses.

Trend of expenditures

Understanding the causes of intergovernmental fiscal imbalance requires an appreciation of the types of things which Americans do through different levels of government and the manner in which they finance these services. State and local expenditures are mainly for "people-related" activities which respond promptly and directly to increases in population, changes in the composition of



the population, and rising per capita income. These governments have responsibilities for education, the maintenance of law and order, health and sanitation, water supply and sewage disposal, parks and recreation, streets and highways, and other functions which affect the quality of our lives in a direct and personal way. A larger population requires more public facilities of this type and more personnel to staff them; and a more affluent society demands quality improvements in public services commensurate with higher standards of living.

Sharp increases in state and local government expenditures during the last decade evidence the acute sensitivity of the demand for governmental services to demographic and economic change. According to census data, state and local expenditures for general government increased 132 percent between 1957 and 1967, compared to a 16-percent growth in population and a 79-percent rise in gross national product. Two of the leading items in the budget expansion, education and public welfare, responded dramatically to a disproportionately large increase in the dependent population — persons under 18 and over 65 years of age — and to the realignment of population and economic activity resulting from urbanization and suburbanization.

Price trends also exerted strong upward pressure on these governments' budgets. The price index for state and local government purchases of goods and services rose 38 percent over the 1957-67 decade, or about two-thirds more than the 23-percent increase in the GNP price deflator and about 40 percent more than the rise in the Federal expenditures price index. Price increases were especially notable for teacher salaries and other personal services.

Real Federal expenditures also experienced sharp growth during the last decade, but unlike state and local outlays, Federal outlays remained a fairly constant percentage of GNP over this period. (They actually declined in relative magnitude, if we exclude the extraordinary financial burden of the Vietnam War.) The Federal expenditure pattern reflects the fact that major budget items—national defense, international relations, interest on the Federal debt, and space research and technology—are not directly linked to changes in the size and composition of the population, or to the level of per capita income. Federal outlays for health, education, and welfare—outlays which do have a direct relation to income and population growth—are typically handled through intergovernmental transactions or through trust funds which have their own sources of revenue. Thus, Federal direct-expenditure commitments were not subject to the degree of automatic upward pressure which economic growth brought to bear on state and local budgets.

Trend of revenues

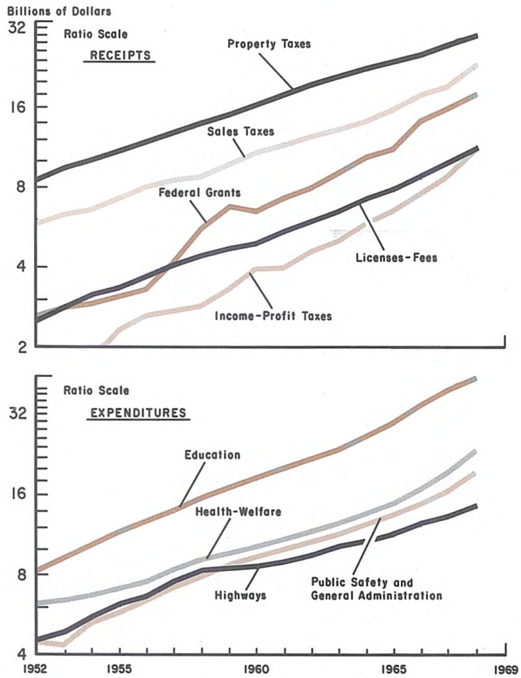
The expenditure situation during the past decade was the reverse of the revenue situation. The Federal revenue system is designed to be highly growth-responsive, and yields from the income taxes which provide about three-fourths of total Federal receipts (excluding trust funds) grow proportionately faster than GNP. Progressive marginal tax rates automatically increase the percentage of personal income collected by the Federal government in periods of economic expansion, and conversely reduce the percentage take to provide built-in stability for the economy when the rate of economic growth declines. Long periods of uninterrupted expansion, such as the U.S. economy has experienced in the 1960's, underscore the enormous productivity of the income tax; Federal revenues have risen 63 percent since 1961, in spite of a $14-billion tax cut (at 1965 income levels) in the middle of the decade.

In contrast to the resilient Federal income tax, the revenue measures which finance other governments respond somewhat sluggishly to economic growth. These governments derive roughly half of their receipts from the property tax (27 percent) and taxes on consumer expenditures (23 percent), which (at constant rates) add increments to revenue at roughly the rate of growth in GNP. Since state and local expenditure commitments grow considerably faster than the rest of the economy, these taxes do not generate revenues commensurate with expenditure requirements. Thus, tax rates must be continually increased in an effort to extract more income from these reluctant tax sources. That state and local governments have managed a 115-percent increase in the combined yield of the property tax and consumer expenditure levies during the last decade, is a tribute to their ingenuity and political courage, since about half of this increase is directly attributable to new and increased taxes, and less than half is traceable to the response of existing revenue measures to economic growth.

Another distinguishing feature of the state and local revenue system is its "regressivity." Almost without exception, the *combination* of state and local taxes takes a larger percentage of personal income from families at the lower end of the income scale. This, of course, accounts for low growth response; as per capita income rises, a smaller, rather than larger proportion of the total is captured by the tax collector.

Unrelenting pressure on state and local budgets in recent years has exacerbated the problem of regressivity of the revenue systems, because higher expenditure commitments generally have been met with new or higher regressive taxes. While regressivity has always been a feature of these tax systems, the equity problem it poses has become much more serious as state and local budgets have grown relative to the more progressive

Federal grants pay for rising share of sharply rising state-local spending

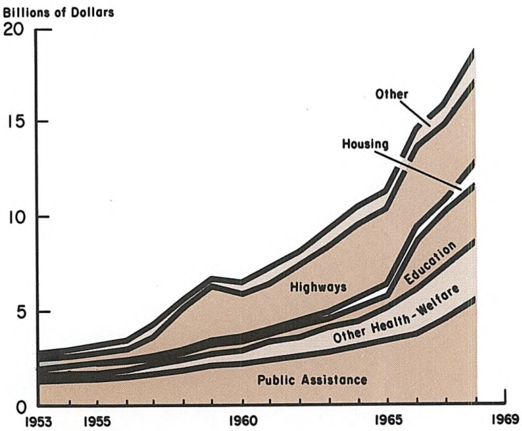


Federal revenue system. Hence, part of the rationale for proposals to expand Federal assistance is to relieve the pressure which steers the nation's total tax structure in a more regressive direction.

Self help

The states in particular have been criticized for failure to modernize their tax systems—to make them less regressive and consequently more responsive to economic growth. Progress toward this goal is slow for a variety of reasons, but mainly because meaningful tax reform generally requires diminished reliance on traditional sources of revenue like sales and property taxes, greater use of the income tax, and some administrative linkage between the income tax and other revenue measures to relieve the regressivity of the latter. State efforts to reform their tax systems in this manner frequently are stymied by state constitutional restric-

Federal grants allocated increasingly to non-highway purposes



provide general support to relieve chronic shortages of revenue, and the program as a whole eventually began to perform that function without any specific Congressional declaration of intent.

The categorical-grants program basically was designed to "interfere" in the state-and-local budget process; to affect the order of parochial priorities; and to bring about expenditures for specific activities, at certain levels, within a definite time frame. Categorical grants are an efficient and flexible way to pursue these objectives, because they permit the Federal government to focus its aid on specific projects and programs and to stimulate appropriate policies at the other levels of government.

As this article indicated at the outset, a case is now being made for Federal "general support" to embrace broader policy objectives. Yet if general support is to be a permanent objective of policy—as may well be, given the present dependence of certain governments on grant funds—then a new approach to assistance which provides more latitude for state and local options in spending Federal funds may be desirable.

Literally hundreds of bills proposing new approaches in this field have been submitted during recent sessions of Congress, but these proposals generally fall into one of three basic plans: (1) Block Grants, (2) Tax Credits, or (3) Revenue Sharing. Each of these plans and their various permutations have their own fiscal and political merits and defects. All three plans, however, share the twin objectives of raising the level of Federal assistance and increasing the flexibility of recipient governments in deploying Federal assistance according to their own priorities.

Block grants

Block grants were originally proposed as a way to consolidate the medley of existing categorical-grant authorizations into a smaller and more manageable number of program areas, each having a central point of coordination and control. The primary objective was to facilitate a "systems approach" and to simplify the tasks of obtaining and monitoring Federal grant funds. However, with the expansion of the general-support role of Federal grant assistance, the objectives of block-grant proposals have also grown. Current proposals generally focus on the problem of overall fiscal disparity, and on the means of providing flexible general support which is responsive to total state and local fiscal needs and efforts.

Because the block-grant approach shares some of the objectives of both categorical assistance and general support, it may be viewed as two separate programs linked through common administration. One portion of the block-grants system would be "program" oriented: grant packages would be tailored to the dimensions and character of the particular problem being addressed by the participating state or local government. The other portion of the system would be concerned with general support; funds would be allocated among the individual states on the basis of some formula, such as population weighted by the ratio of total tax burden to total personal income.

Congress could fix the division of grant funds between the program and general-support sectors of the block-grant system, according to the degree of control over ultimate areas of expenditure it wished to exercise. It could likewise vary the strength of conditions for participation in the program and general-support funds.

The block-grants scheme outlined above is a compromise between the present restrictive system of categorical grants and the "unconditional" assistance envisaged by tax-credit and revenue-sharing proposals. Still, it is not exclusive of such arrangements; block-grants (especially program grants) conceivably could be combined with either tax credits or revenue sharing to accomplish objectives similar to those of a system composed of program and general-support grants.

Block-grants provide a compromise solution to the overall assistance problem, and thus have certain pragmatic virtues, as is noted by the Advisory Commission on Intergovernmental Relations: "It is highly unlikely that Congress would permit 'no strings' money to drive out categorical aid money. As long as Congress holds the purse strings, it will be under unremitting pressure to attach conditions to its grants in order to make sure that national expenditure policy objectives are realized with tax dollars collected from a national revenue system. This pressure will serve as a powerful countervailing force to the demands of state-and-local officials for ever larger shares of unconditional aid." (ACIR Report, *Fiscal Balance in the American System.*)

In short, politics and politicians being what they are, fiscal federalists may have to accept block-grant arrangements, or continue to live with the more restrictive present system of categorical grants-in-aid. At the very least, block-grants would unravel some of the administrative knots which bind the present system, and if properly constituted, they could represent a useful long-run solution to the problem of general support.

Tax Credits

The Federal tax-credits scheme would allow Federal income taxpayers to deduct part of their state and local tax payments from their Federal income-tax liability. This approach to Federal assistance is analogous to present tax arrangements which permit the Federal taxpayer to deduct certain state and local tax payments from his "taxable income" in computing his Federal tax liability.

There are, however, important differences between tax credits and tax deductions. Credits reduce the taxpayer's Federal income-tax *liability,* instead of reducing the *base* from which his liability is computed. Moreover, tax credits potentially could benefit all Federal income taxpayers, whereas the benefits from present tax-deduction arrangements are restricted to upper-income groups who itemize their deductions rather than claim a standard deduction.

Tax credits, like tax deductions, provide direct assistance to the taxpayer, rather than to his state of residence. States and local governments, in turn, can benefit from the scheme by pre-empting Federal credits through higher state and local taxes—which, if the federal credits covered all of the state and local tax increment, could be levied without increasing the taxpayer's total Federal-state-local liability.

The Advisory Commission on Intergovernmental Relations endorsed a specific tax-credit plan in 1965. (ACIR Report, *Federal-State Coordination of Personal Income Taxes.*) Under this plan, the Federal taxpayer would be given the choice between exercising the present deductibility option or crediting 40 percent of his state income-tax payments against his Federal income-tax liability. This proposal was designed to assist the states in raising large amounts of revenue free from Federal controls, and to encourage greater state reliance on the growth-responsive individual income tax.

The ACIR plan singled out state income taxes for special treatment on grounds that intensive use of the income base by the Federal Government may have deterred its exploitation by the states. Hence, the Commission regarded its plan more as a means of neutralizing the deterrent effect of the Federal income tax, than as a way of favoring a particular source of revenue.

The number of potential tax-credit proposals is at least as great as the variety of state and local taxes, and the provisions selected for any one plan automatically imply a certain mix of objectives for that plan to accomplish. In devising a specific credit plan, the important choices to be made concern (1) the taxes which will be eligible for use as credits, and (2) the maximum value of credits which the individual taxpayer can claim.

The ACIR plan would restrict credit-eligible taxes to the state income tax, while other plans would admit a wider range of state and local revenue measures as credits. Restricting the plan to the income tax has a certain logic, since the extension of Federal credits automatically frees an additional piece of the personal-income base for use by the states. On the other hand, a case can be made for crediting property taxes and consumer expenditure taxes, if the main objective is to lessen the regressivity of the total revenue system, rather than to shift the direction of its future development.

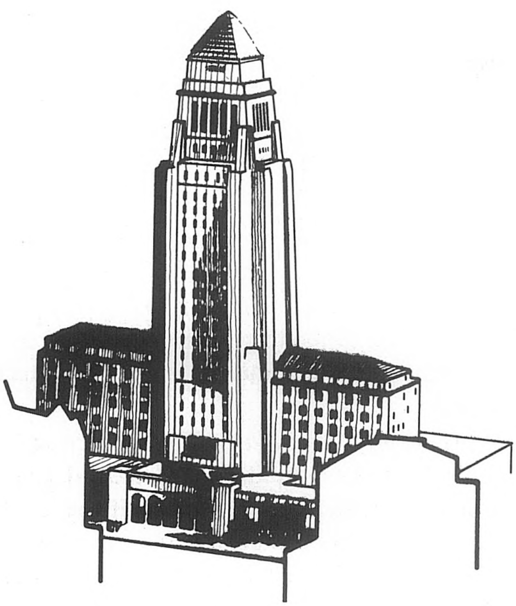
The method for determining the maximum-credit limitation is also subject to dispute. Frequently mentioned approaches include setting credits equal to (1) a fixed dollar amount, (2) a fixed percentage of the taxpayer's total Federal income-tax liability, (3) a fixed percentage of the taxpayer's total liability for selected state or local taxes, or (4) the balance of the taxpayer's total state-local liability above a fixed percentage of his net taxable income.

Setting the credit limitation at a *fixed dollar amount* would increase the progressivity of the present tax system, since a one-dollar credit represents a larger percentage of the income, and tax liability, of lower income groups than it does for higher-income groups. This operates just the reverse of a tax deduction, which increases in "value" with each marginal tax bracket above the cut-off point for the standard deduction. On the other hand, setting the credit limitation at a *fixed percentage* of the taxpayer's Federal income-tax liability would reduce the progressivity of the Federal tax structure, since one percent of the tax liability of the high-income taxpayer represents a larger proportion of his total income than one percent of the tax liability of a low-income taxpayer (because the Federal income tax is progressive).

Assigning credits at a constant percentage of the taxpayer's total liability for selected state and local taxes would probably increase the progressivity of the nation's overall tax system. In view of the regressivity involved, one percent of the state-and-local tax liability represents a larger percentage of total income for a low-income taxpayer than for a high-income taxpayer. The extent of the change in total progressivity would depend upon the particular type of taxes allowed as credits. Restricting the program to state income taxes would increase progressivity less than would including the more regressive taxes, such as those on property and consumer expenditures. However, restricting tax credits to state income taxes might persuade the states to place greater reliance on this source of revenue, and might thereby bring about greater overall progressivity in the long-run. Finally, accepting all state and local tax payments above a fixed percentage of the taxpayer's net taxable income as credits would probably increase progressivity again because of the regressivity of the average state and local tax system.

The tax-credits plan is widely favored because it restricts Federal influence on state and local fiscal decisions to the revenue side of the budget. With eligible credits confined to specific revenue measures, such as the individual income tax, the states are provided both the opportunity and a powerful incentive to exploit those sources of revenue. Meanwhile, the states can spend their revenues as they see fit, free from Federal interference.

Still, the states would have to pay a price for having a free hand in allocating the funds made available by Federal tax credits, since the plan provides no mechanism for redressing interstate fiscal disparities. Because of this "defect," some previous advocates of tax credits—notably Walter Heller, member of the Kennedy and Johnson Councils of Economic Advisors and long-time advocate of expanded federal assistance—have eventually shifted their support from a tax-credit plan to a revenue-sharing plan.



Revenue sharing

Any form of Federal assistance to state and local governments could be called Federal "revenue sharing." However, the plan which goes by the specific name of "revenue sharing," is distinguished from other assistance programs in that the Federal government would collect revenues from a national tax source on behalf of the states and/or localities and would deposit those revenues in a trust fund in their name. These funds would be outside of the regular Congressional appropriation process and would belong to the states and localities from the moment of collection.

The most well-known scheme of this type is the Heller-Pechman plan (Walter Heller and Joseph Pechman). This plan would allocate up to two percent of the Federal individual income-tax *base* — equivalent to ten percent of tax revenues — to a shared-revenue trust fund which would be distributed "unconditionally" to the states on the basis of population. Variants on the Heller-Pechman plan would temper the unconditional nature of state participation in one way or another by applying the provisions of the Civil Rights Act, by ruling out highway claims on shared revenues (because highways already have an adequate source of Federal funds), and by imposing a minimum "pass through" requirement for channeling Federal funds to the states' political subdivisions.

The Heller-Pechman plan is designed to accomplish a certain set of specific objectives. These objectives are to (1) relieve the immediate pressure on state and local treasuries and make their revenues more responsive to economic growth, (2) increase the overall progressivity of the Federal-state-local tax system, (3) reduce fiscal disparities among the states, and (4) foster creativity and vitality in state and local governments by strengthening their fiscal independence.

Under a plan like this, the critical decisions center around the amount of revenue to be shared and the basis for allocating revenues among states and localities. The former sets the level of assistance, and the latter spells out conditions for state-and-local participation.

In setting the level of assistance, the Heller-Pechman scheme would allocate a fixed percentage of the Federal income-tax *base* to states and localities. This approach can be recommended for generating stable revenues and for responding quickly to economic growth. A second possibility is to set aside a fixed percentage of Federal income-tax *revenues;* this would be slightly less stable than the first alternative, because periodic changes in the Internal Revenue Code, unrelated to the objective of aiding state and local governments, could alter the size and growth of the shared-revenue trust fund. A third possibility is to designate a fixed sum of Federal revenue which would increase at a predetermined rate each year. This third approach sacrifices some of the "natural dynamics" of the first two methods, but it provides individual states with more exact information about the annual amounts to be made available.

Determining the allocation of trust-fund revenues among the states and municipalities is a more difficult matter. The funds could be returned to the states from which they were collected, or they could be distributed on a per capita basis (Heller-Pechman plan), or they could be distributed on the basis of state-and-local fiscal effort — that is, each state's share could vary directly with the ratio of its per capita state-and-local taxes to its per capita personal income.

The first option, returning funds to the point of collection, would take advantage of the Internal Revenue Service's efficiency in administering state and local income taxes, but it does not embrace the goal of interstate equalization. The second approach, the Heller-Pechman plan, would take advantage of IRS efficiencies, and also provides for a measure of interstate equalization through per capita distribution of funds. The third approach, which bases the distribution on local fiscal effort, can accommodate equalization objectives but can also provide fiscal incentives to states and localities to exploit their own revenue sources more fully.

Fortunately, it is not necessary to choose any one specific plan, since a formula can be devised which incorporates some of the best features of each. Indeed, one of the virtues of the shared-revenue approach to Federal assistance is its flexibility. There are, however, limits to the range of innovation: If conditions are imposed which in effect disqualify a state from shared-revenue participation, or which seriously impair its claim to the funds supposedly collected on its behalf, then the program ceases to be "shared revenue" and becomes a system of conditional grants-in-aid.

The Nixon proposal

The draft legislation which the President recently sent to Congress is closely related to the Heller-Pechman revenue-sharing plan.

Revenue shared: "The size of the total fund to be shared will be a stated percentage of personal taxable income."

Trust fund: "A permanent appropriation will be authorized and established for the Treasury Department, from which an amount corresponding to the stipulated percentage will be automatically disbursed each year."

Allocation formula: "The allocation of the total annual fund among the 50 states and the District of Columbia will be made on the basis of each state's share of national population, adjusted for the state's revenue effort."

Pass through: "The allocation of a state's share among its general units of local government will be by prescribed formula . . . based on the individual unit of local government's share of total local government revenue raised in the state."

Conditions: "Administrative requirements are kept at a minimum. Each state will meet simple reporting and accounting requirements."

Mr. Nixon has asked Congress to approve a revenue-sharing trust fund which, in fiscal 1971, would receive one-third of one percent of personal taxable income, or about $500 million. The base for this fund would be augmented annually until it reached one percent of personal taxable income, or about $5 billion, in fiscal 1976. After that year, trust-fund growth presumably would be determined by automatic growth in the taxable-income base.

To put these figures in perspective, $5 billion in shared revenues would be enough to cover a little over three percent of total state-local expenditures for general government in 1975. Alternatively, $5 billion in revenues in 1975 (according to ACIR projections) could finance almost one-tenth of projected expenditures for education, or almost one-third of the outlays for either highways or public welfare, or just under half of projected expenditures for health and hospitals.

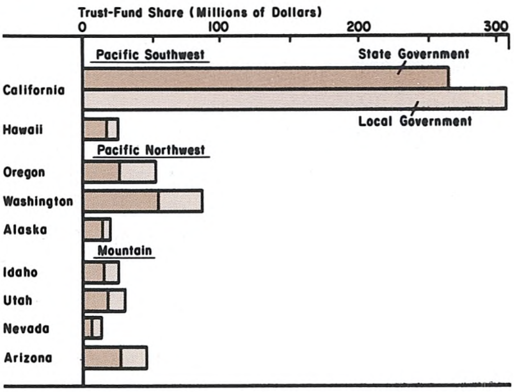
It is difficult to project trust-fund shares with any great accuracy, since both the distribution of population and the relative degree of fiscal effort among individual states

FACTORS AFFECTING TRUST-FUND SHARES

	Percent of U.S. Population	Index of Fiscal Effort	State Share (Millions of Dollars)		
			Total	State Govt.	Local Govt.
United States	100.0	100.0	5,000	2,565	2,435
Alabama	1.8	97.6	88	60	28
Alaska	0.1	123.6	19	13	6
Arizona	0.8	114.6	46	26	20
Arkansas	1.0	89.4	45	29	16
California	9.6	119.5	574	266	308
Colorado	1.0	110.6	55	27	28
Connecticut	1.5	80.5	60	29	31
Delaware	0.3	103.3	16	11	5
District of Columbia	0.4	79.7	16	0	16
Florida	3.1	97.6	151	70	81
Georgia	2.3	97.6	112	62	50
Hawaii	0.4	120.3	24	17	7
Idaho	0.4	122.0	24	14	10
Illinois	5.5	79.7	219	99	120
Indiana	2.5	91.9	115	61	54
Iowa	1.4	110.6	78	38	40
Kansas	1.1	100.0	55	26	29
Kentucky	1.6	93.5	75	47	28
Louisiana	1.9	117.9	112	78	34
Maine	0.5	94.3	24	14	10
Maryland	1.9	95.1	90	48	42
Massachusetts	2.7	95.9	130	62	68
Michigan	4.3	101.6	218	120	98
Minnesota	1.8	121.1	109	59	50
Mississippi	1.2	106.5	64	39	25
Missouri	2.3	83.7	96	47	49
Montana	0.3	120.3	18	8	10
Nebraska	0.7	104.1	37	15	22
Nevada	0.2	117.9	12	6	61
New Hampshire	0.4	62.9	17	7	10
New Jersey	3.5	85.4	150	60	90
New Mexico	0.5	129.3	32	23	9
New York	9.1	117.9	536	254	282
North Carolina	2.6	91.9	120	82	38
North Dakota	0.3	143.9	22	13	9
Ohio	5.3	82.1	218	97	121
Oklahoma	1.3	104.9	68	42	26
Oregon	1.0	104.9	53	27	26
Pennsylvania	5.9	85.4	252	135	117
Rhode Island	0.5	88.6	22	13	9
South Carolina	1.3	91.1	59	41	18
South Dakota	0.3	118.7	18	8	10
Tennessee	2.0	91.1	91	52	39
Texas	5.5	86.2	237	120	117
Utah	0.5	115.4	29	17	12
Vermont	0.2	110.6	11	7	4
Virginia	2.3	88.6	102	59	43
Washington	1.6	108.9	87	55	32
West Virginia	0.9	104.1	47	31	16
Wisconsin	2.1	113.0	119	70	49
Wyoming	0.2	142.3	14	8	6

Sources: U.S. Department of Commerce (Census Bureau; Office of Business Economics) and Federal Reserve Bank of San Francisco. Items do not sum to totals due to rounding.

Population, "fiscal effort" determine hypothetical trust-fund payout



change over time, as does the division of revenues among states and municipalities. However, by making assumptions about the future course of these variables, it is possible to construct a hypothetical distribution of funds which gives a fair notion of relative shares. The table shows hypothetical distribution of the $5-billion allocation for 1975, assuming the continuation of (1) the 1968 ratios of state-and-local general revenue to state personal income, (2) the 1955-65 rates of interstate migration, and (3) the 1968 distribution of state-and-local revenue.

Population is the dominant variable in the allocation formula, since the ten largest states in terms of population are also the ten largest in terms of trust-fund shares, even though five of them (Texas, Illinois, New Jersey, Pennsylvania and Ohio) are among the ten lowest states in terms of fiscal effort. This is because there are much larger differences among the states with respect to population than with respect to fiscal effort. California and New York *each* have almost 10 percent of the nation's population, whereas the ten least populous states *together* have less than 2.5 percent; on the other hand, there is less than a 2-to-1 ratio between the states with the highest and lowest fiscal efforts, as measured by the ratio of general revenue to personal income.

Notwithstanding greater population differences, one should not underrate the importance of the fiscal-effort index in the allocation formula. Given the above assumptions, California and New York, which together contain about 19 percent of the nation's population, would receive about 22 percent ($1.1 billion) of the total trust fund in 1975, because each of these states has a relatively high index of fiscal effort. But Illinois, Ohio, New Jersey, Pennsylvania and Texas, which together have about 24 percent of the nation's population, would also receive about 22 percent (but no more) of the trust fund, because each of these states has a low index of fiscal effort. The effect is more dramatic in the case of some of the smaller states; North Dakota and Wyoming, which together account for less than one-half of one percent of the U.S. population but which boast the nation's highest indices of fiscal effort, would be awarded 50 percent more revenue from the trust fund than their small populations would suggest.

Mr. Nixon's proposal has at least a "fair" chance of Congressional acceptance sometime during the 1970 session. The Heller-Pechman plan, the precursor of the Administration plan, enjoys considerable bipartisan support and can appeal to a wide variety of Congressional interests. The channeling of shared revenues through state governments will appeal to the guardians of the states' position in the federal system, yet the inclusion of a definite "pass through" formula should help to satisfy advocates of more local control. Countering this support will be the continuing economic exigencies imposed by the war in Vietnam and resistance from those who see revenue sharing as a threat to the detailed objectives of the existing categorical grants system in which they have an interest. Mr. Nixon's task will be to persuade the Congress that the solution to state and local government fiscal problems is urgent enough to command a place in an already tight federal budget, and that we can not afford to risk delay by tying the solution to these fiscal problems to the amelioration of all of the nation's other ills.

The federal system

The duration of the present prosperity, and the real prospect that it can be perpetuated more or less indefinitely, has opened up a new range of fiscal opportunities and problems for the public sector of the economy. Among the more significant problems is a growing disparity between the responsibilities traditionally vested in state and local governments and their capacity to bear the consequent financial burdens. Happily, continued prosperity has strengthened the Federal government's ability to relieve fiscal distress at lower levels in the federal system.

As was outlined above, three basic plans have been proposed for expanding Federal government assistance to the state and local partners in the federal system. *Block grants* represent a reformation and expansion of the present categorical-grants program; *tax credits* could help state-and-local governments to solve their fiscal problems within their own tax systems by extending tax relief to Federal income taxpayers; and *shared revenues* would permanently assign a portion of the yield from the enormously productive Federal income tax to states and their political subdivisions.

Each of these proposals has unique advantages. Block grants can focus expenditures on specific problem areas; tax credits can help move the national tax system in the desired policy direction; and shared revenues can provide a quick method for relieving overall revenue shortages at state and local levels and for equalizing interstate fiscal disparities. This range of possibilities ought to permit us to adopt a mix of assistance measures which reflects the detailed nature of the problems confronting us, rather than the theoretical niceties of any single approach.

The fundamental objective of intergovernmental fiscal cooperation is not to preserve the federal system "at all costs," but rather to promote efficiency while permitting maximum diversity and creativity in devising solutions to human problems. The nation as a whole is extremely wealthy by world standards, but its wealth is not uniformly distributed among the states and their political subdivisions; nor does the distribution of wealth always coincide with concentrations of population and people-related problems of government.

Federal assistance is a means of partially correcting the balance and of freeing state and local governments to seek the "best" solutions to public problems—to permit those responsible for hammering out specific solutions to worry at least as much about "what the world is coming to" as about "where the next dollar is coming from." That kind of flexibility does not generally exist in America today, and that is why new initiatives in fiscal federalism are high on the list of national priorities.

Kent Sims

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Youth: Jobs and Wages

During the Great Depression, Congress passed such legislation as the Fair Labor Standards Act (1938) in an attempt to alleviate certain inequities and improve the functioning of the labor market. That Act, among other things, provided for a minimum hourly wage for millions of industrial workers. The \$.25 minimum of 1938 originally covered 12½ million employees of industries producing goods for interstate commerce; the \$1.60 minimum today covers 41½ million employees, or 82 percent of all nonsupervisory industrial employees. Then as now, the minimum generally has been about one-half or less of the average wage in manufacturing.

The minimum-wage legislation has been hailed by many as a great aid in fighting poverty, but it has been denounced by others as a barrier to increased employment. This criticism, especially insofar as it applies to younger workers, is particularly relevant at a time like today when masses of young untrained workers are entering the labor market. It may thus be worthwhile to survey the recent fortunes of this particular age group—the youngest bracket in the labor force and also the one with the highest unemployment rate—in the light of the controversy surrounding the minimum wage, and in the perspective of the four increases in this wage floor that have taken place over the past decade.

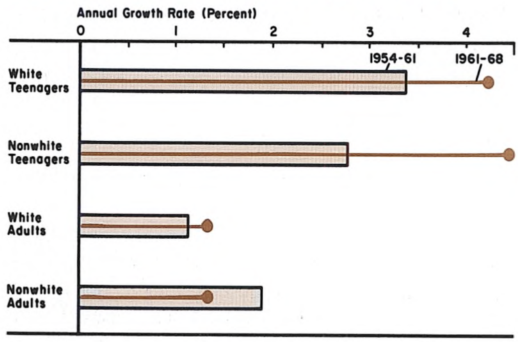
Minimum-wage coverage is still not universal. Roughly six million private-industry employees are not covered today—all domestic workers, most farm workers, and most employees of small retail and service firms. Most workers in manufacturing, mining, construction, and utilities, nearly one-half of all retail workers, two-thirds of all service workers, and smaller numbers of farm workers and government employees are now covered by the mandatory wage requirements.

More jobs, more jobless

The teenage labor force, according to Labor Department data, has grown sharply during the 1960's. The number of 16-19-year old jobseekers increased 3 percent annually during the 1954-61 period, but the number rose almost 4½ percent annually during the 1961-68 period—several times the average annual increase for adult workers. Teenage workers accounted for about 6½ percent of the civilian labor force in the 1950's, but they make up about 8½ percent of the labor force today.

Moreover, these young workers are concentrated in occupational categories which have not been covered, at least until quite recently, by minimum-wage legislation. The 16-19-year old group accounts for less than

Teenage labor force increases much faster than adult labor force



6 percent of total employment, but it accounts for 8 percent of service-industry workers, 9 percent of clerical and sales workers, and 15 percent of unskilled laborers.

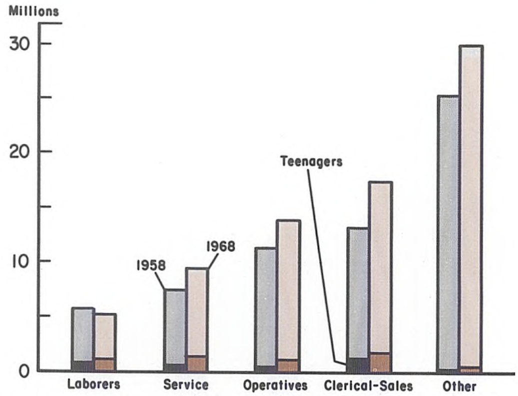
With the sharp expansion in the number of young job seekers, their *relative* unemployment rate has risen throughout this decade. (This is the ratio of a specific group's unemployment rate to the average jobless rate for all workers.) From 1948 to 1961, the ratio for teenage workers moved in phase with the business cycle, rising during expansions as adults were more quickly absorbed into jobs, but dipping during contractions as older workers were more rapidly laid off. But during the expansion of the present decade, this ratio has risen, from 2.34 to 2.81, for young white workers, and it has jumped, from 4.00 to 6.14, for young nonwhite workers. In the meantime, the adult-worker ratio has declined sharply, for adult workers, from .76 to .56 for whites and from 1.75 to 1.08 for nonwhites.

Thus, in contrast to the comparatively trendless period of the 1950's, the relative jobless rate for teenage workers has risen sharply since 1961. Perhaps coincidentally, Congress increased the minimum wage only twice before 1961 — in 1950 and 1955 — while it increased it four times during the present decade—in 1961, 1963, 1967, and again in 1968. Some labor analysts see no coincidence, and claim that the rising trend in the teenage unemployment ratio can be related to the rising cost of hiring teenagers, notably the cost involved in the upward ratcheting minimum wage. Others contend, however, that this development is more closely related to the sharp rise in the number of young workers.

Secular deterioration

Whatever the basic reason, the labor market has witnessed a sharp secular increase in the problem of teenage unemployment. This can be seen by comparing the fortunes of this group during two separate periods — Korea and Vietnam — when the overall unemployment rate dropped to 3 percent. In mid-1952, the 16-19-year old group accounted for 6½ percent of the civilian labor force but for 18½ percent of total unemployment; in early 1969, this group accounted for 8½ percent of the civilian labor force but for 31 percent of total unemployment. Moreover, its relative unemployment rate jumped from 2.7 to 3.7 between these two points of time.

Young workers concentrated in low-wage occupational categories



Most teenage jobseekers have been successful in finding jobs during the past decade. Over the 1961-68 period, teenage employment has increased about 41 percent, as against a 14-percent increase for adult workers. This expansion has helped to reduce the unemployment rate for teenagers, from 17 percent in 1961 to 13 percent in 1968, but it has failed to make sufficient inroads into the pool of unemployed workers. In a period when the number of jobless adults has been cut in half, the number of unemployed teenagers has risen 1 percent, and the number of unemployed *nonwhite* teenagers has risen 22 percent.

Underlying the rapid business expansion of the 1960's, in other words, is a fairly constant reservoir of jobless teenagers — about 800,000 in all. The faces of the individuals

Western Digest

Bank Credit Expands

Large District banks increased bank credit by $72 million during November, reflecting mixed trends in both loans and investments. . . . Banks increased their business loans by $104 million over the month. (This was almost half of the entire business-loan gain nationwide.) At the same time, they suffered declines in all other categories except consumer loans. . . . District banks, like their counterparts elsewhere, increased their holdings of Treasury bills and notes in November, with much of the rise in intermediate-term issues coming from a drop in long-term issues. They reduced slightly their holdings of municipals, but meanwhile added to their holdings of Federal agency issues.

Time-Deposit Decline Continues

During November, District banks recorded a $584-million gain in demand deposits adjusted, but they also posted a $394-million decline in total time deposits. The District accounted for considerably more than half of the time-deposit reduction nationwide. . . . The largest part of this drop came from the seasonal pay-out of Christmas Club accounts. But all other categories also showed declines, ranging from small depositors' savings accounts to large corporate depositors' negotiable certificates of $100,000 and over.

Aerospace Employment Declines

Employment in the District's aerospace industry continued to decline in November. The 8,000 drop in November brought employment down to 668,000 — off about 12 percent from the late '67 peak. . . . Washington, which is heavily dependent on the aerospace industry, continued to weaken. As a consequence, total unemployment in the Seattle area has, within a year, jumped from 2.8 to 4.5 percent of the labor force. . . . Federal budget cutbacks meanwhile spelled a 0.2-percent decline in Federal employment in Pacific Coast states during November. (These states account for over 15 percent of all such jobs in the entire nation.) Recent cutbacks have mostly affected California, which now has fewer Federal employees than at any other time of the past two years.

Power Industry Plans Big

The Administration in October approved a long-range plan for coordinated power development in the Pacific Northwest. The plan involves a $1.4-billion private investment in thermal plants — coal-fired or nuclear — over the next ten years, and rules out future Federal construction of thermal plants in this area. Since thermal plants now provide only 5 percent of Columbia River Basin power, as against 95 percent for hydro-electric plants, the thermal-power share will rise substantially over the next decade. . . . By 1980, about 15 million KW will be added to the area's present 18-million KW of total generating power. In the thermal sector, 7 new coal-fired or nuclear plants will add about 7 million KW of generating capacity; in the hydro sector, expansion of current facilities by the Bonneville Power Administration and by private utilities will add about 8 million KW.