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ACIR MEETING
Thursday, March 11, 1976
Room 4200 DSOB
Room 2212 Rayburn HOB
All day

~~[illegible]~~ IGR

1) President's commitment

Ford
Nixon
John
[illegible]
IRF.

new coalition
story of the states

2) Quality of staff -

3) ~~[illegible]~~ Objectives / goals of IGR office.

with ✓ $ app

~~[illegible]~~

① 3 3/4 cut to 3 3/4

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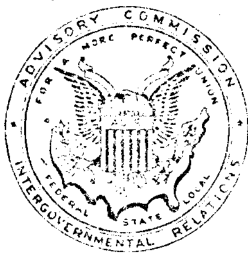
② urban needed
to help homeless



ADVISORY
COMMISSION ON INTERGOVERNMENTAL RELATIONS
WASHINGTON, D.C. 20575

March 10, 1976

MEMORANDUM

TO: Members of the Commission

FROM: Wayne F. Anderson, Executive Director

SUBJ: Updating of City Financial Emergencies Report

At its November 1975 meeting in Chicago, the Commission adopted a motion to update ACIR's 1973 report, City Financial Emergencies: The Intergovernmental Dimension.

John Shannon and I have since undertaken to determine which subject areas should be updated and where the report should be extended to deal with new questions and needs highlighted or caused by the New York and Massachusetts emergencies. We have conferred on this subject with Philip Dearborn, the principal author of the 1973 report.

Following is a list of ways in which we believe it would be fruitful to update or extend the report:

1. Whereas the 1973 report dealt with only cities, the new report should encompass the whole interdependent state and local government orbit, meaning the state itself, state agencies, cities, counties, school districts, special districts, and other local governments.

2. Accordingly, the descriptions of past financial emergencies would analyze the emergencies in New York State, the State of Massachusetts, these states' housing and other agencies, New York City, Yonkers, and Long Beach, or at least a selected group of these experiences.

3. The analysis of what States should do to prevent financial emergencies should be expanded to describe in more detail what the States with the strongest programs are doing now to supervise and regulate local financial administration, short-term borrowing, etc.;

and to lay out more fully the elements of a model system.

4. The discussion of remedies should further evaluate the extent to which States are capable of dealing with local government financial emergencies, and the conditions and criteria under which Federal assistance should be made available. The appropriate form of Federal assistance would also be explored.

5. Whether there should be Federal assistance to States under any circumstances and, if so, the conditions, criteria, and form of assistance should also be examined.

6. The treatment of Federal bankruptcy laws would be updated to reflect the recent experience and legislative history of the amendments now awaiting the President's signature. Consideration should also be given to whether a workable process for reorganizing a State's finances should be enacted.

7. Inasmuch as the recent financial emergencies (as well as some earlier ones) have been precipitated by the closing down of money markets these governments have relied upon for short-term operating cash, there is a need to evaluate whether there are means by which access to the market can be assured and whether some type of backstop arrangement for providing short-term credit is necessary.

We should also identify areas where updating does not seem necessary. Except for a little sharpening, updating, and changes in emphasis here and there, it appears that the 1973 report's definition of a financial emergency, the warning signs, and the anatomies of pre-1973 financial emergencies would not be changed materially. Because of the new sensitivity of municipal credit markets and, more importantly, because our purposes do not require it, we would not contemplate examining the current financial condition of any cities or other governments as we did in the earlier report. We, furthermore, believe that we cannot expand the report to include certain tangential material if we are to keep the project manageable and within our likely resources. I refer to the taxable bond option and other proposals to strengthen the bond market, the full disclosure issue, and State and local pension systems.

While the project design inevitably will change as it is further considered by the Commission, staff, and a "thinkers' session", we now estimate that the research and report preparation phase would require a staff of two professionals for about 12 months meaning that the total cost would be in the range of $100,000 to $125,000.

The project furthermore, requires at least one staff member with a background in financial administration, which ACIR does not have on its permanent staff, so this virtually necessitates securing a grant from which to engage qualified personnel for this project.

The Commission, of course, has approved the updating, but we now request your review of the project content as outlined herein, as well as reactions to other parts of this report.

ADVISORY
COMMISSION ON INTERGOVERNMENTAL RELATIONS
WASHINGTON, D.C. 20575

March 9, 1976

MEMORANDUM

TO: Members of the Advisory Commission on Intergovernmental Relations

FROM: Wayne F. Anderson, Executive Director WFA

SUBJECT: UNITED NATIONS CONFERENCE ON HUMAN SETTLEMENTS

This year from May 30th through June 11th, the United Nations will hold a worldwide conference on human settlements in Vancouver, British Columbia, Canada. One of our staff members has been helping in the preparation of positions to be taken by the U.S. delegation to that conference. It is important that the roles of State and local government, as well as the national, be given a prominent place in the policies adopted at Vancouver. While those policies, of course, will not be binding on the various nations, it is hoped that they will strongly affirm the need for what ACIR refers to as national growth policy planning processes that rely upon State, regional, and local planning efforts below the national level. This would be consistent with positions enumicated in various ACIR reports including Urban and Rural America (1968), Substate Regionalism and the Federal System (1973-1974), and Toward More Balanced Transportation (1974).

Secretary Hills of HUD has been invited to chair the official U.S. delegation to this conference and is expected to accept. Assistant Secretary David Meeker (former Deputy Mayor of Indianapolis under Mayor Lugar) has taken the lead in many of the substantive preparations for the conference and will undoubtedly also be a member of the U.S. delegation. The rest of the delegation is unknown at the present time, but there have been discussions to the effect that State and local officials should compose part of the 25 member group. While no State or local officials have been approached about this as yet, it is nearing the time when they probably will be.

ACIR has the opportunity, through either Secretary Hills or through Stanley Schiff who is the State Department's coordinator for this conference, to support the concept of State and local members in the delegation, and to suggest those officials who might be tapped. A small number of nongovernmental people may also be placed on the delegation.

Perhaps as important as the policies adopted in Vancouver will be the opportunity to share experiences in urban development programs with people throughout the United States and Canada as well as some 120 other nations. A substantial commitment of time would be needed by anyone serving on the official delegation, but others may wish to attend some of the unofficial activities for a shorter period of time.

The staff requests expression of any interest the Commission may have concerning the make-up of the official U.S. delegation or attendance by one or more Commission members in the unofficial activities of the conference.

RECENT CHANGES IN DOMESTIC
COUNCIL ORGANIZATION AND STAFFING

In the few weeks since Chapter IV, "Executive Branch Organization for Assistance Policy and Management," was prepared, a number of changes have taken place which have an effect upon the activities of the Domestic Council in intergovernmental relations and domestic policy generally. These include:

-- Staffing increase. A supplemental appropriation for $300,000 (and $75,000 for the transition period) has been provided to the Domestic Council, representing a staff increase of ten positions. This brings the current staff total to forty. The Council had sought twenty-nine additional positions.

-- Upgrading of IGR liaison. On January 28, President Ford announced the appointment of Stephen G. McConahey as Special Assistant to the President for Intergovernmental Affairs. McConahey assumes the responsibilities which had been performed by James H. Falk, a former Associate Director of the Domestic Council. Professional staff assigned to this area have been increased from two to five. While McConahey is not technically a member of the Domestic Council staff, he works closely with it and Director Cannon. The provisions of EO 11690, which assigned the responsibilities of the Office of Intergovernmental Relations to the Domestic Council, have not been altered by the new appointment.

There have been a number of other recent appointments:

-- Arthur F. Quern has been named Deputy Director of Policy and Planning for the Domestic Council. This position, which was held previously by Richard L. Dunham, is concerned with the "longer-range" policy issues. The appointment recreates the two-sided Council staff structure which existed previously.

-- James H. Cavanaugh, the second Council Deputy Director, has been named Deputy Assistant to the President for Domestic Affairs.

-- Arthur A. Fletcher has been appointed as Deputy Assistant to the President for Urban Affairs.

-- Rogers C. B. Morton has been named Counselor to the President, with domestic, economic, and political liaison duties. The former Secretary of Commerce, Secretary Morton retains his membership on the Domestic Council, Energy Resources Council, and Economic Policy Board.

Finally, a recent article in the National Journal (2/14/76, p. 209) indicates that Vice President Rockefeller is no longer supervising the activities of the Domestic Council on behalf of President Ford.

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THE WHITE HOUSE

WASHINGTON

March 10, 1976

Dear Bob:

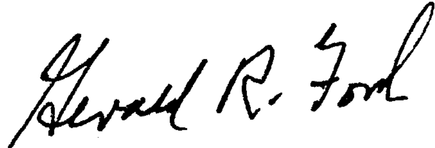
Knowing that the Advisory Commission on Intergovernmental Relations is meeting in Washington this week, I take this occasion to express my appreciation for the contribution which the Commission continues to make as we seek to improve the workings of our federal system. As was reflected in my recent State of the Union Message, I place a very high priority on dealing with the problems of intergovernmental relations. Efficient accountable government at any level depends on the effective relations among all levels. We need to simplify and clarify the federal aid system. We need to deal with the growth in the public sector and the resultant dollar and regulatory burden of government on the American people.

ACIR's current work in each of these crucial areas will surely contribute to the efforts to understand and overcome these problems. I look forward to the publication of your findings and recommendations on how to improve the federal delivery system and on how to strengthen the block grant mechanism. Similarly, your analysis of the factors affecting the growth in the public sector and the impact of that growth is most timely and much needed.

Finally, I want to acknowledge the value of ACIR's report and recommendations urging reenactment of general revenue sharing, which, as you know, I have made a priority objective.

As this Administration and the Congress wrestle with these and other complex intergovernmental issues--issues which are at the heart of all government--I will welcome and look forward to ACIR's continuing service. I thank you and the other members of ACIR for your devoted service.

Sincerely,



Mr. Robert E. Merriam
Chairman
Advisory Commission on
Intergovernmental Relations
726 Jackson Place, N.W.
Washington, D. C. 20575

THE WHITE HOUSE

WASHINGTON

March 5, 1976

MEMORANDUM FOR: JIM CANNON

FROM: RAY HANZLIK

SUBJECT: ACIR Meeting on March 11, 12

The ACIR meeting next week will concentrate on two policy discussion areas:

- Health Delivery Systems and Block Grants
- Organizing the Intergovernmental Grant System

The Commission will take up several additional agenda items, all of which are staff reports or informational matters. You should devote your preparations to these two policy issues.

Health Delivery Systems and Block Grants

The first agenda item -- scheduled for 1 to 1 1/2 hours -- is entitled "Partnership in Health." This is a continuation of the Commission's discussions of block grants and focuses here on health delivery systems.

The Commission staff has presented a series of options that cover the entire range of possible policy alternatives in the public health assistance area -- alternatives that range from the total recategorization of health services to a complete block grant approach. Several in-between options are proposed that attempt to retain the advantages of both the block and categorical grants.

You may wish to refer to pp. 181-194 in the Docket book under TAB B for descriptions of these options. Charts comparing the options to the Administration's health proposal can be found just following the TAB B introduction.

Spencer Johnson and Sarah Massengale are presently reviewing the materials under TAB B and will prepare for you substantive comments, if warranted.

Organizing the Intergovernmental Grant System

Following the Health discussion the Commission will address the major agenda item: organization reform of the Federal grant system. This should occupy the Commission for the remainder of the day.

ACIR is completing a major study on the Federal Grant System, several chapters having been discussed at previous Commission meetings. Chapter VI of this study is the focus of the March 11 meeting. Primary attention will be directed at the Commission's recommendations for correcting the organizational and procedural defects in the Federal grant system.

Your participation in this portion of the meeting is important because some of the proposed recommendations focus on the intergovernmental organization within the Executive Branch, and, most importantly, the past and present role of the Domestic Council.

The Domestic Council comes under strong criticism in the draft report, as seen in the following excerpt:

> "Since 1972, the Domestic Council has served as the primary liaison between the President and policy-level officials of State and local government. Hampered by a small staff, the Council has devoted little attention to intergovernmental relations and has not provided sufficient representation of State and local concerns. Similar responsibilities had been assigned previously to the Office of Intergovernmental Relations, the Vice President, and the Office of Emergency Planning. While results were mixed, these arrangements were somewhat more effective, with a key variable seeming to be the degree of personal commitment on the part of the President and the official assigned responsibility for the liaison activity, as well as the ability of staff."

At this meeting the Commission will consider a series of recommendations on Federal Executive Branch organization (see pp. 34-54 under TAB C of the Docket book). These recommendations range from a cabinet-level "Office of State and Local Governmental Affairs" to a strengthening of the present "pluralistic" arrangement of authority, primarily between OMB and the Domestic Council.

As preparation for the meeting, I suggest you review under TAB C of the Docket book the following pages:

Pages 1-10 (Introduction & background)

Pages 16-28 (Issues)

Pages 29-54 (Recommendations)

You will find additional recommendations and discussion issues beyond these topics, but these involve management tools, the OMB circulars, the Federal Regional Councils, and inter-agency grant management. I would not recommend your sitting through these discussions, unless you can afford the time. You should be present, if possible, for the Commissions discussion on the issues outlined above, however.

You may also wish to familiarize yourself with the contents of Steve's proposed Executive Order establishing an Office of Intergovernmental Relations, for you will be able to point out to the Commission the activity and thinking in this area since the first of the year. (Wayne Anderson, the Executive Director of ACIR, has expressed to us his private delight in some of the efforts Steve is considering).

ADVISORY

COMMISSION ON INTERGOVERNMENTAL RELATIONS

WASHINGTON, D.C. 20575

March 4, 1976

MEMORANDUM

TO: Members of the Advisory Commission on Intergovernmental Relations

FROM: Wayne F. Anderson, Executive Director WFA

SUBJECT: Change in Meeting Place

The Commission meeting on March 11 will be held in Room 4200 of the Dirksen (New) Senate Office Building. We had earlier designated a room in the Russell (Old) Senate Office Building.

A corrected agenda, for insertion in your docket book, reflects this change.

AGENDA
FIFTY-SIXTH MEETING
of the
ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS
March 11 - 12, 1976

1. Remarks by the Chairman

2. Minutes of the Fifty-Fifth Meeting — TAB A

3. Further consideration of reports on Block Grants

   Partnership in Health — TAB B

4. Report on Federal Grant System: Middle-Range Reform Efforts

   Chapter VI Issues and Recommendations — TAB C

   The following chapters are a part of TAB C but were transmitted earlier under separate cover:

Chapter I	Managing the Assistance System: Categorical Aids and Strategies for Reform
Chapter III	Federal Efforts to Standardize and Simplify Assistance Administration
Chapter IV	Executive Branch Organization for Assistant Policy and Management
Chapter V	Federal Procedures for Strengthening State and Local Coordination and Discretion

5. Staff progress report and Commission discussion on Public Sector Growth Study chapter titled "Inflation and the Income Tax" — TAB D

6. Information memorandum on "The Government Economy and Spending Reform Act of 1976" — TAB E

7. Staff progress report and Commission discussion on Study of National Forest Shared Revenue Program — TAB F

8. Oral report on Implementation Activities

9. Executive Director's reports on:

   "Understanding the State and Local Bond Market" information report — TAB G

   Updating City Financial Emergencies report (A-42)

   NACO request for updating Labor-Management Policies report (A-35)

Thursday, March 11, 1976 — 9:00 a.m.
Room 4200, Dirksen (New)
Senate Office Bldg.

Friday, March 12, 1976 — 9:30 a.m.
Room 5104, New Executive
Office Bldg.

ADVISORY
COMMISSION ON INTERGOVERNMENTAL RELATIONS
WASHINGTON, D.C. 20575

March 4, 1976

MEMORANDUM

TO: Members of the Advisory Commission on Intergovernmental Relations

FROM: Wayne F. Anderson, Executive Director

WFA

SUBJECT: ACIR's Evening with the Comptroller General

Arrangements for the Commission's evening with Comptroller General Elmer B. Staats and other officials from the General Accounting Office are now complete, as follows:

PLACE: Room 7112, GAO, 441 G Street, N.W. Enter through Room 7000, the Comptroller General's Suite

PROGRAM:	6:00 p.m.	Reception
	6:45 p.m.	Buffet
	7:30 - 8:30 p.m.	GAO-ACIR discussion

GAO OFFICALS PLANNING TO ATTEND:

Elmer B. Staats, Comptroller General of the United States
Paul G. Dembling, General Counsel
Phillip S. Hughes, Assistant Comptroller General, Special Programs
Ellsworth H. Morse, Jr., Assistant Comptroller General, Policy and Program Planning
Gregory J. Ahart, Director, Manpower and Welfare Division
Henry Eschwege, Director, Resources and Economic Development Division
Albert M. Hair, Deputy Director, General Government Division

Harry S. Havens, Director, Office of
Program and Budget Analysis
Victor L. Lowe, Director, General
Government Division
Donald L. Scantlebury, Director, Financial
and General Management Studies Division
William Thurman, General Government Division

We hope you will all be able to attend. Further information on transportation, parking, and other details will be transmitted at our March 11 meeting.

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ADVISORY
COMMISSION ON INTERGOVERNMENTAL RELATIONS
WASHINGTON, D.C. 20575

FIFTY-FIFTH MEETING
OF THE
ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS

PALMER HOUSE
CHICAGO, ILLINOIS
NOVEMBER 17-18, 1975

Members Present

Honorable Robert E. Merriam

Honorable John H. Altorfer

Honorable John H. Brewer

Honorable John H. Briscoe

Honorable Clarence J. Brown, Jr.

Honorable William E. Dunn

Honorable Daniel J. Evans

Honorable Conrad M. Fowler

Honorable Harry E. Kinney

Honorable Richard F. Kneip

Honorable Robert P. Knowles

Honorable Charles F. Kurfess

Honorable Richard G. Lugar

Honorable Jack D. Maltester

Honorable Philip W. Noel

Honorable John H. Poelker

Observers

Mark W. Alger, LEAA-EMSI

Duane Baltz, NACo

Len Carlman, I.C. Industries

William Cassella, National Municipal League

Tom Graves, U.S. Railway Assn.

Doug Guerdat, HEW/ASPE

Don Haider, Northwestern U.

Jerry Sohns, National Conference of State Legislatures

Glenn Kumekawa, Governor's Staff, Rhode Island

Helen Kurfess

John Lagomacino, National Governors' Conference

James Martin, National Governors' Conference

Roy Owsley, Louisville, Kentucky

Frank C. Paul, Representative of Mayor Lugar

John Pickett, LEAA

Andy Plattner, Army Times

Jane Roberts, National Conference of State Criminal Justice Planning Administration

Ophelia Gonzales Ross, League of Women Voters, Chair "Voz Latina"

Daniel G. Smith, State of Wisconsin

Richard Sullivan, U.S. Railway Assn.

George H. Watson, Friends World College

Stanley Wolfson, ICMA

Florence Zeller, NACo

Chairman Merriam called the 55th meeting of the Advisory Commission on Intergovernmental Relations to order on November 17, 1975 at 9:50 A.M. at the Palmer House Hotel, Chicago, Illinois. The Chairman welcomed the members to Chicago and noted that this would be an innovative joint meeting held in conjunction with the National Municipal League's Conference on Government. He welcomed Mayor Kinney of Albuquerque, New Mexico as a new member of the Commission and noted Mr. Kurfess' reappointment. The appointment of Carla Hills, Secretary of HUD, also was announced.

Wayne Anderson, Executive Director, was recognized to make some announcements concerning the logistics of the afternoon open session, and he noted that Gov. Noel and Gov. Evans would be the main speakers at the National Municipal League's luncheons on Monday and Tuesday, respectively.

The minutes of the 54th meeting were read. Mayor Poelker corrected them to show that he had been in attendance. Mayor Maltester moved that the minutes be approved as corrected; Senator Knowles seconded. The minutes were approved as corrected.

Mr. Anderson announced that the Commission would first take up city financial emergencies, then the Safe Streets Act, and finally the Partnership in Health program.

City Financial Emergencies

Chairman Merriam commenced by observing that if the Commission failed to discuss the New York City fiscal crisis--the main intergovernmental problem of the moment--it would suggest that ACIR is not doing its job. He recommended that the Commission should consider its past recommendations in City Financial

Emergencies and look forward to see whether additional lessons can be learned. He asked whether the Commission should direct the staff to do some more probing of the Federal assistance issue, Federal bankruptcy procedures, the question of regulation of the municipal securities market, pension reform, and State supervision. He pointed out that these issues are clearly highlighted by the present New York City situation.

Mayor Poelker pointed out that the public does not appreciate the difference between short-term financing to overcome temporary cash flow problems which most cities must do, and capital outlay financing via long term general obligation bonds. He said that short-term borrowing in most cities is analogous to private firms selling their accounts receivable in order to cover immediate cash needs. He felt a paper should be issued on this.

Congressman Brown questioned whether the staff should be asked to study topics that relate to New York or to local fiscal matters generally. He noted the complexity of the New York situation with something new on it every time you pick up a newspaper. He indicated that he thought the staff does not have the wherewithal to get a handle on the whole New York crisis and that a more general study should be done. The Chairman agreed and suggested that ACIR's main contribution could well be to spur States to implement the Commission's earlier recommendations. Mayor Maltester urged an up-dating of the 1972 report.

Mr. Anderson indicated that the Commission would have the opportunity to explore the subject further during the first phase of the afternoon session.

Block Grant Study

The members were briefed on the Safe Streets program and its place in the overall study of The Intergovernmental Grants System: Policies, Processes and Alternatives.

Mr. Walker explained that the overall study will probably last until the fall of next year and that there probably will be a total of 19 chapters. LEAA and Partnership in Health, which are the chapters currently before the Commission, represent only two of four block grants to be explored.

Mr. Walker highlighted four basic features of a block grant:

1. The program terrain that is covered is fairly broad;
2. A statutorily dictated formula is always present;
3. General governments almost always are favored in the eligibility provisions; and
4. The degree to which the grantor intrudes on recipient government is supposed to be minimal, consistent with achieving certain broad national objectives while maximizing the discretion of State and local governments.

Mr. Walker summarized the positive findings on the Safe Streets program noting: (1) a greater awareness of the complexity of crime problems and of the needs of the criminal justice system had been generated by the program; (2) a process for recognizing the linkages between and among the functional components of this system has been launched; (3) Safe Streets funds have been used for many law enforcement and criminal justice efforts that recipients otherwise would not have undertaken, and, moreover, a substantial number of these efforts have been continued after their LEAA funding was terminated; and (4) ACIR surveys indicate that, despite the Act's ambitious goals and comparatively meager funding, most elected officials feel the program has helped to reduce crime.

Mr. Stenberg continued the staff presentation and cited seven negative findings: (1) Safe Streets has had only a limited effect on developing

strong ties between criminal justice components; (2) the block grant approach has not succeeded in keeping all functional and jurisdictional actors satisfied and some have sought remedial action in the Congress; (3) this approach, in effect, is a hybrid, thanks to statutory and administrative actions and the project grant relationship that operates between most States and their localities; (4) only a few State Criminal Justice Planning Agencies (SPAs) have developed strong ties with their governors and legislatures; (5) most SPAs concentrate on funding actions and coping with LEAA's procedural requirements; (6) meaningful performance standards have not been developed by LEAA; and (7) SPAs, as well as LEAA, have suffered from heavy personnel turnover at the top management level.

Mr. Walker identified the percentage of LEAA funds going to various recipients as follows:

STATES		37 percent
LOCALITIES		59 percent
CITIES	30%	
COUNTIES	29%	
PRIVATE		4 percent

Mr. Walker proceeded to outline the four policy recommendation alternatives for the members. Commission members began the general discussion with expressions of concern about the lack of mutual trust implied in administrative requirements associated with Federal and State aid programs. They also expressed concern that administrative costs of aid programs were too large a percentage of their overall cost. Judge Fowler noted the apparent lack of local discretion with regard to using Safe Streets funds.

Mr. Walker described the difficulty of separating administrative costs of this program from costs of other criminal justice activities. He spoke of the wide diversity among the 50 States regarding local discretion, and how it depends in many cases on the extent to which States have decentralized criminal justice operations. He reminded the Commission that only the States can change the pattern of the State and local components of the criminal justice system.

Mr. Anderson then summarized the four policy recommendation alternatives: (1) a purified (decategorized) block grant; (2) a modified block grant with some more categories added to it (e.g., earmarking for courts and major cities and urban counties); (3) a project grant approach; and (4) a special revenue sharing approach with substate distribution formulas. Alternatives 1 and 2 would continue the Act; alternatives 3 and 4 would replace it with different forms of aid.

Governor Kneip noted that the consolidation of categorical aids into block grants tends to reduce the amount of Federal funds directed to the consolidation program area. Mr. Walker concurred and observed that one explanation might be that States and localities have difficulty assembling facts and demonstrating impacts of the program to the satisfaction of Congress. Mr. Altorfer suggested that this aspect of block grants may be best from the taxpayer's viewpoint--fewer dollars but more State and local discretion about spending.

The morning session ended to allow members time to attend the NML luncheon featuring Gov. Noel as speaker.

Chairman Merriam reconvened the Commission meeting at 2:30 P.M. as part of the National Conference on Government of the National Municipal League. The Chairman explained the Commission's procedures to National Municipal League members in the audience and introduced ACIR members. He announced that three topics would come before the Commission during the afternoon session: City Financial Emergencies; the Safe Streets block grant; and State and local tax status of military pay.

City Financial Emergencies

Mr. Anderson spoke on the New York City situation and its consequences. He explained that the purpose of his presentation was to look beyond current events. He capsuled the Commission's earlier report, City Financial Emergencies, and referred to the six warning signals and five recommendations developed in this study. Additional information describing the New York City situation was cited. He then identified for Commission discussion five subjects on which some type of action is needed in the future: (1) criteria for Federal assistance; (2) Federal bankruptcy legislation for States and State instrumentalities; (3) registration and regulation of municipal bonds; (4) State and local pension systems; and (5) the adequacy of the municipal bond market.

Mayor Poelker began the general discussion by moving that the staff prepare a primer on borrowing by municipal governments. Judge Fowler seconded the motion. Congressman Brown felt that the staff study would be too late for any Congressional action and indicated that Congress is likely to act soon in accordance with the Administration proposals on this issue. Mayor Lugar urged that ACIR widely distribute its report. He felt that it would be too late to assist in the New York City crisis, but if others noted the warning signals, the report would be of service to them.

Gov. Noel asked that the Commission take a stand now on Federal fiscal assistance to New York City in its time of need. He felt the Federal government had a responsibility to work in tandem with States to help cities out of their fiscal dilemma. Commission members spoke to the pros and cons of Governor Noel's request. Mayor Maltester admonished those who opposed Federal assistance to New York to avoid leaving the impression that States and cities don't want Federal aid. Mayor Poelker urged a vote on the motion to update the report. The Chairman called for the vote and the motion passed.

Gov. Evans noted five separate and sequential levels of responsibility for dealing with New York City's crisis: (1) the citizens of New York City; (2) the municipal employees; (3) the city government itself; (4) the State; and (5) the Federal government. Gov. Evans suggested that any ACIR statement spell out these responsibilities and make clear that Federal assistance to New York should be forthcoming only after the other levels of responsibility had taken action. He also added that Federal assistance should be so structured as not to set a precedent and avoid creating windfall profits to certain investors. Gov. Noel and Mayor Maltester urged the Commission to avoid such specificity and Congressman Brown agreed.

Mayor Maltester then moved that the Commission adopt the statement: "It is the view of ACIR that the Federal government has a role to play in helping New York City." Gov. Noel seconded the motion. Gov. Evans wanted the role defined--when and how does the Federal government come into the picture? Congressman Brown suggested adding, "to the extent that it is necessary to ameliorate the impact on the finances of State and local governments generally stemming from New York's fiscal crisis." Commission members had a wide ranging discussion of the pros and cons of both simple and complex policy statements. Mayor Lugar suggested that the Commission leave the situation to work itself out. Mayor Poelker offered a substitute motion which failed for lack of a second. Representative Kurfess offered a substitute motion which was accepted by Mayor Maltester and Gov. Noel. After additional discussion, a vote on the motion resulted in its passage, with Mayor Lugar registering a dissent. The motion reads as follows:

> "The Commission recognizes that the officials, employees, and citizens of New York City and New York State have the initial responsibility for alleviating the fiscal crisis of New York City. The Commission also recognizes, however, that the Federal government, as required, should act in support of New York State and City efforts in order to

assure that New York City's fiscal crisis does not have a nationwide effect on the economy and on the borrowing activities of other State and local governments."

Safe Streets Block Grant

Chairman Merriam directed the members' attention to Tab C in the docket book. Mr. Walker set the scene for the Commission action by describing the three basic assistance methods--general revenue sharing, block grants, categorical grants--and explaining the Safe Streets block grant. Mr. Stenberg then highlighted the study's findings and the alternative policy recommendations.

Mayor Poelker commenced the discussion by urging that units over 100,000 should receive mini-block grants from SPAs to be distributed according to their own priorities. Gov. Noel suggested that Alternative 1, the broad block grant option, be used as a framework for the Commission's deliberations. Mayor Lugar urged consideration of Alternative 4, noting that the staff analysis provided a basis for adopting a special revenue sharing approach. Gov. Noel felt this would destroy the planning effort built up by the Safe Streets program.

Commissioner Dunn, with a second from Judge Fowler, moved that Congress amend the Safe Streets Act to establish a program of block grant assistance involving additional funding to be channeled by LEAA through the SPAs to urban counties and cities, or combinations thereof. The motion received only four affirmative votes and therefore failed.

Congressman Brown, seconded by Mayor Maltester, then moved that Alternative 1 serve as the framework of the Commission's deliberations and the motion carried. Mayor Maltester, with a second from Mayor Poelker, moved adoption of the first two subsections of Alternative 1 relating to decategorization of the existing program and opposing future earmarking for particular program areas, but adding a new provision calling for Congressional authorization for major cities and urban

counties, or combinations thereof, to submit annual plans to their SPAs which, when approved, would serve as the basis of a "mini-block" award to such jurisdictions. The motion was approved unanimously.

Gov. Noel moved adoption of subsection 3 A relating to removal of the statutory ceiling on grants for personnel compensation. Gov. Evans seconded the motion and it passed.

Mayor Maltester then moved adoption of item 4 A relating to LEAA "standards and operational criteria." Mayor Kinney seconded the motion and it passed with the word "performance" substituted for "operational" in the text. Gov. Noel urged that subsection 4 B also be considered and moved adoption of a modified version: "In lieu of an annual comprehensive plan, SPAs be required to prepare five year comprehensive plans and submit annual statements relating to the implementation thereof to LEAA for review and approval." Mayor Poelker seconded the motion and it carried unanimously.

On subsection 5, relating to gubernatorial efforts to strengthen SPAs, Gov. Evans moved its adoption without the brackets surrounding the phrase "except for courts." Gov. Noel seconded and the subcomponent was adopted. On proposed State legislative efforts to strengthen SPAs, Representative Kurfess moved adoption of subcomponent 6 with a second from Gov. Noel. Gov. Evans urged substitution of the word "establishment" for "composition" in the text and with this modification, the proposal was adopted.

On the special problems of the judiciary, Judge Fowler moved adoption of the three part proposal for the courts, subsection 7, and Commissioner Brewer seconded the motion. It carried unanimously. With reference to generalist participation in the program, subsection 8, Judge Fowler moved its adoption with the understanding that staff would develop an appropriate definition of "local elected officials." Mayor Maltester seconded the motion and it passed without

opposition. At this point, Gov. Noel moved adoption of the entire recommendation as amended, with a second from Mayor Maltester. It was unanimously agreed to. The text of the full recommendation reads as follows.

The Commission finds that crime reduction and the administration of justice have been and continue to be mainly State and local responsibilities. Yet, it is appropriate for the Federal government to provide financial assistance to initiate innovative approaches to strengthening and improving State and local law enforcement and criminal justice capabilities and disseminate the results of these efforts; to help support the crime reduction operations of State and local agencies; and to facilitate coordination and cooperation between the police, prosecutorial, courts, and correctional components of the criminal justice system. The Commission concludes that the block grant approach contained in Title I of the Omnibus Crime Control and Safe Streets Act of 1968, as amended, generally has been effective in assuring that the national interest in crime prevention and control is being met while maximizing State and local flexibility in addressing their crime problems. However, achievement of these objectives has been hindered by statutory and administrative categorization and by Federal and State implementation constraints.

THEREFORE, THE COMMISSION RECOMMENDS THAT:

Functional and Jurisdictional Categorization

(1) Congress refrain from establishing additional categories of planning and action grant assistance to particular functional components of the criminal justice system, repeal the Juvenile Justice and Delinquency Prevention Act of 1974 and subsume its activities and appropriations within the Safe Streets Act, and amend the Safe Streets Act to remove the Part E correctional institutions and facilities authorization and allocate appropriations thereunder to Part C action block grants.

(2) Congress refrain from amending the Safe Streets Act to establish a separate program of block grant assistance to major cities and urban counties for planning and action purposes.

(3) Congress amend the Safe Streets Act to authorize major cities and urban counties, or combinations thereof, as defined by the State Planning Agency for criminal justice (SPA), to submit to the SPA a plan for utilizing Safe Streets funds during the next fiscal year. Upon approval of such plan, a "mini block grant" award would be made to the jurisdiction, or combination of jurisdictions, with no further action on specific project applications required at the State level.

Personnel Compensation Limits

(4) Congress amend the Safe Streets Act to remove the statutory ceiling on grants for personnel compensation.

LEAA Oversight

(5) LEAA develop meaningful standards and performance criteria against which to determine the extent of comprehensiveness of State criminal justice planning and funding, and more effectively monitor and evaluate State performance against these standards and criteria.

State Planning

(6) In lieu of an annual comprehensive plan, SPAs be required to prepare 5 year comprehensive plans and submit annual statements relating to the implementation thereof to LEAA for review and approval.

The Governor's Role

(7) Governors and, where necessary, State legislatures, authorize the SPA to (a) collect data from other State agencies related to its responsibilities; (b) engage in system-wide comprehensive criminal justice planning and evaluation; and (c) review and comment on the annual appropriations requests of State criminal justice agencies.

The Legislature's Role

(8) Where lacking, State legislatures (a) give statutory recognition to the SPA, including designation of its location in the executive branch and the establishment of a supervisory board; (b) review and approve the State agency portion of the States' comprehensive criminal justice plan; (c) include Safe Streets supported programs in the annual appropriations requests considered by legislative fiscal committees; and (d) encourage the public safety or other appropriate legislative committees to conduct periodic oversight hearings with respect to SPA activities.

The Courts

(9) SPAs give greater attention to the needs of the courts, while recognizing their unique constitutional position, by (a) providing for greater participation by representatives of the judiciary on the supervisory boards; (b) increasing the proportion of action grants awarded for the judiciary and for court-related purposes; and (c) establishing, where feasible, a planning group representing the courts to prepare plans for and make recommendations on funding to the SPA.

Generalist Participation

(10) Congress amend the Safe Streets Act to (a) define "local elected officials" as elected chief executive and legislative officials of general units of local government, for purposes of meeting the majority representation requirements on regional planning unit supervisory boards, and (b) encourage SPAs which choose to establish regional planning units to make use of the umbrella multijurisdictional organization within each substate district.

Military Pay and Federal State Tax Information Exchange

Chairman Merriam recognized Daniel G. Smith of the Wisconsin Department of Revenue for the purpose of bringing the Commission up to date on the status of the Federal military pay information program. Mr. Smith expressed indignation on behalf of State tax administrators at the abrupt rescission of the OMB Circular A-38 without prior consultation with State tax officials. He called attention to a random survey of military personnel at three installations in Maryland which revealed that better than three out of four persons interviewed wanted withholding of State income tax. The survey results were reported in the Army Times, Navy Times, and Air Force Times. Mr. Smith concluded that withholding at the source was the best way to satisfy the concern of State tax officials about the lack of compliance on the part of the military and the concern of military people that they not be confronted with multi-year tax obligations upon their release from military service.

Mr. Smith relayed to the Commission the concern of State tax administrators that an interpretation of the Privacy Act provisions with respect to the use of social security numbers for identifying individuals could lead to serious curtailment in the Federal-State tax information exchange program. Mr. Smith also spoke of the State tax administrators concerns with a host of bills before Congress that would limit disclosure of Federal tax return information and restrict State authority to inspect returns. He noted that in the 40-year history of the Federal-State Exchange Program, there has been only one instance in which a State employee was apprehended using Federal tax return information for other than authorized purposes, and that the employee was tried and convicted.

He supplied the Commission with proposed amendments to Federal laws to provide State withholding from military pay, guarantee continued use of social security and employer identification number for State tax purposes, and continue the Federal-State exchange of tax information.

Chairman Merriam recessed the meeting until the following morning, November 18, 1975.

* * * *

The Chairman reconvened the 55th Meeting of ACIR at 9:15 A.M., November 18, 1975. He called on Mr. Shannon for the presentation of the docket book material on the State tax status of military pay.

State Tax Withholding on Military Pay

Mr. Shannon reported that the Office of Management and Budget (OMB) had rescinded its Circular A-38 on September 25, 1975, and that the Department of Defense (DOD) announced on November 10, 1975 that it had sufficient legal authority to continue the military pay information reporting program. He further reported that the General Accounting Office had issued a report recommending State tax withholding which the OMB also favors. He noted that DOD still resists the withholding idea largely on grounds of its additional cost.

Senator Knowles moved the adoption of the recommendation requiring withholding of State and local income taxes from military pay. Mayor Poelker seconded the motion. Subsequent discussion concerned whether withholding should be on the basis of domicile or physical presence. The Commission had previously recommended the States be given authority to tax military pay of those physically present in the State, the same rule that applies to State jurisdiction to tax non-military persons. The Commission retained that position. Chairman Merriam asked if there was an estimate of the additional revenue States might be expected to gain. Mr. Shannon explained that withholding had usually resulted in an increase in State revenue from better compliance. He noted, however, that the range of State income tax rates and the lack of any information that could be used to estimate a marginal tax rate that might apply to military pay, precludes an estimate of State revenue gain. The Chairman called for the vote and the recommendation passed. It reads as follows:

> The Commission concludes that the revival of the A-38 type information program should be viewed as an inadequate response to the income tax requirements of both miliary personnel and State and local tax administrators. The Commission therefore recommends that Congress amend P.L. 82-587 (governing State income taxes), the District of Columbia Revenue Act of 1956 (governing the D.C. income tax), and P.L. 93-340 (governing local income taxes) to require withholding of State and local income taxes from military pay. In this latter instance, military and Federal civilian employees should be considered jointly in determining whether the threshold of 500 Federal employees that triggers local income tax withholding has been reached.

Mayor Maltester moved the adoption of the recommendation calling for garnishment of military and civilian pay for delinquent State and local income taxes. Mr. Kurfess seconded the motion. The lack of means to enforce State and local tax delinquency against Federal employees was noted in the discussion. The motion passed and reads as follows:

<u>The Commission recommends that the Congress adopt legislation waiving Federal immunity from State court actions to the extent necessary to make feasible wage garnishments of military pay and Federal civilian pay for delinquent State or local income taxes. Such legislation should explicitly instruct the Federal agencies to accept and act upon court orders in such cases.</u>

Senator Knowles, with a second by Mr. Altorfer, moved the adoption of the recommendation calling for a certification of domicile by DOD. The motion passed and reads as follows:

<u>The Commission recommends that the Defense Department require a separate form specifically designed to obtain from the military personnel a declaration of legal residence for tax purposes and also require that records of legal residence be kept current through annual up-dating.</u>

Mayor Maltester moved that the report in its entirety be approved for publication. Judge Fowler seconded the motion. The motion was approved.

<u>Threat to Federal-State Exchange of Tax Information</u>

Chairman Merriam called on Mr. Shannon for discussion of the memorandum then before the Commission on Federal-State cooperation in tax administration. Mr. Shannon described ACIR's long standing interest and recommendations on Federal-State cooperation in tax enforcement. He noted that the target of bills to prohibit disclosure of tax return information was the abuse associated with actions by parts of the Federal executive branch but that the cures for such abuses now being proposed in Congress adversely affect State tax administration. Mr. Shannon suggested that a recommendation that the Federal-State tax information program be continued might strengthen the hand of IRS and State tax administrators in negotiating legislation that would preserve one of the more beneficial aspects of Federal-State cooperation.

Senator Knowles moved the adoption of a policy statement calling for continuation of the program. Governor Kneip seconded the motion. The Chairman noted that if the States can't be trusted to use tax information for tax enforcement purposes, then our federal system is in trouble. Senator Knowles said that he understood that IRS benefited as much or more from information they gain from the Wisconsin Tax Department as the Department gains from information obtained from IRS. The Commission approved the motion which reads as follows:

> The Commission views the Federal-State tax exchange program as one of the most important elements of Federal-State intergovernmental cooperation. The Commission is convinced that the cessation of the Federal-State information exchange program could seriously undermine the effective enforcement of many State personal income tax laws. Therefore, the Commission urges Federal and State policy-makers to continue this program under effective safeguard conditions that will assure that the information exchanged is used solely for tax compliance and enforcement activities.

Partnership in Health Act

The Chairman called on Mr. Walker to lay the background for Commission consideration of recommendations related to the Partnership in Health block grant. Mr. Walker described the history and background of the Partnership in Health Act (sec. 314(d) of the Public Health Services Act). The Act created the oldest of the existing five Federal block grants. Experience to date demonstrates what can happen to a block grant if care is not taken to see that the unique features of such a grant are protected. This grant, established in 1966, now can be characterized as a "good can of putty" which is useful for filling small cracks in public health services at the State and county levels. The effectiveness of the grant has been limited mainly because its funds have been stabilized at a very low level.

The 314(d) and 314(e) block grant was the product of merging nine formula and seven project grants and earmarking one portion of the total for mental health service. The original authorization was established at a level just a little bigger than the total of the individual merged categorical grants. The purpose of the block grant was to support the establishment and maintenance of public health services provided by State and local governments. It was based upon the assumption of a mutual compatibility in State and Federal public health goals. In fact, the history of the Act suggests that there has been a significant incompatibility in these goals.

In addition to the original earmarking of mental health funds, subsequent Congressional action directed emphasis toward other specific goals, such as rat control and the encouragement of HMOs in 1970. Also in that year, Congress enacted legislation authorizing three new separate categorical health grants. Since 1970, the funding level has been kept stationary at about $90 million per year. The relatively low level of funding raises the question of how much discretion is really given to grant recipients when the amount of funding is small. The 314(d) grant in 1974 constituted 3.2 percent of total State and local public health outlays and 16 percent of total Federal health grant funds.

Apart from the constraint of relatively small funding, the Partnership in Health legislation gives significant discretion to the States in expenditures for the public health services. A large part of the staff's research on the operation of grants centered on a questionnaire survey of State health departments. All 50 States responded to the questionnaire. The results indicated a high degree of satisfaction with the 314(d) program among State health officials.

There has been very little Federal intrusiveness in the program, particularly in recent years. The principal Federal report required now is the submission of an annual preprinted form covering the coming year's planned expenditures. Another index of the modest scale of Federal involvement is that PHS assigns just one person part-time in Washington to administer the program, and there are on the average about one and one-half persons assigned to the program in each regional office.

A number of key issues arose in analysis of the experience with the 314(d) program.

First, has the program been more responsive to Federal policy, to State policy, or both? In practice, responsiveness to State government has been greater. As indicated, this has resulted in fiscal restraints being placed on the scope of the program.

A second issue has to do with the appropriate Federal role in the administration of this block grant. At the outset, the Federal role was rather significant, reflecting an inclination by Federal administrators to continue the type of surveillance that they had followed with the predecessor categorical programs. In recent years, however, the Federal administrative role has tended to be minimal. To a large extent this is due to the fact that the 314(d) monies are merged with other State and local public health monies and, being relatively smaller, are difficult to trace.

The third issue is the flexibility that is sought as one of the goals of the block grant. Experience indicates that the $90 million in the case of the 314(d) grant tended to become the ploy of the various interests that had been established around the original categories prior to merger. The relatively low funding also tended to make it difficult to initiate any innovative measures in the public health field.

Congress acted in 1975 to extend the 314(d) program for another two years. This legislation eliminated the matching requirement and abolished certain categorical emphases. However, Congress continued to regard the program as a small one from the standpoint of funding.

Mr. Walker outlined the five alternative recommendations:

(1) abolition of the existing block grant and recategorization of the funds;

(2) abolition of the block grant and authorization for transfer of up to 15 or 25 percent of the funds from any one categorical health grant to any other categorical grant--this would be similar to a Commission recommendation of 1961 and a provision of the proposed Allied Services Act;

(3) retention of the existing block grant program, with greater emphasis on auditing, reporting, and evaluation;

(4) endorsement, in effect, of an approach recommended by the Association of State and Territorial Health Officials (ASTHO), calling for Federal sharing of costs of a package of specified health services in each State, up to a ceiling related to population and State and local health expenditures in each State; and

(5) a broadened block grant approach.

Judge Fowler asked how alternative #2 would make any difference, since 314(d) money goes to the State with little possibility of identifying its specific use. Mayor Poelker noted that alternative #2, providing for transferability of 15 to 25 percent of the funds from one category to another, would not allow such transfer of money to be used for non-specified categories. After further

discussion of alternative #2, Mr. Anderson asked whether it would be feasible to combine the recommendation for continuation of the block grant with the recommendation of the transferability of 15 to 25 percent? Mr. Walker said he thought it would be possible.

Gov. Noel said he was not surprised that there is greater interest in using the categorical approach to health needs as compared, for example, with law enforcement needs. He said the specific nature of various health conditions invites a targeting on particular categories of needs. Mr. Brewer said that block grants are better for moving money around among different needs. Judge Fowler said that one of the problems with block grants is that Congress tends to lose interest in funding them because the purposes are much more diffuse than under categorical grants. Mayor Poelker observed that block grants tend to transfer pressure from Congress down to the city hall and courthouse level.

Gov. Kneip moved for the adoption of alternative #5, calling for a broader block grant similar to special revenue sharing for public health services. Mayor Maltester seconded the motion.

Judge Fowler asked Mr. Walker if he knew what the position of HEW Secretary Matthews is regarding option #4 (the ASTHO option). Mr. Walker said that he had learned that the Administration's present position was for the abolition of the 314(d) block grant, based on fiscal reasons.

Judge Fowler said that he supports the option of ASTHO. He said that county health officials, who are at the cutting edge at the local level in the delivery of service, support that option. This alternative, providing funds on the basis of total State and local health expenditures, gives the States and localities the incentive for greater efforts. It would produce

an upgrading of health services. The provision for HEW to negotiate the package of services in each State gives HEW the leverage to encourage higher priorities areas. In addition, if the cost sharing system is successful, the existing categorical health grants could be folded into the block grant in time.

Mr. Kurfess asked whether option #4 did not tend to over-emphasize certain health areas, since all Federal expenditures would be tied to specified health needs.

Judge Fowler moved to substitute option #4 for Gov. Kneip's motion, with an amendment to provide that the categorical health programs would be folded into the block grant in time, and that the bracketed language calling for abolition of 314(d) programs would be deleted. Mr. Brewer seconded the substitute motion.

Gov. Kneip said that the distribution formula should specify distribution on the basis of need in order not to penalize the small States. Judge Fowler said that he was agreeable to adding a needs factor to the text of the recommendation language.

Mr. Kurfess said that he thought the substitute recommendation was too broad and he favored combining options #2 and #3.

Mayor Poelker said he detected some feeling that the whole issue of the continuing of block grants in any form might be somewhat moot. He raised the question of whether it might not be a good idea to include in the report, along with the recommendation, a description of the other alternatives that the ACIR had considered but did not really resolve. The question was raised as to whether it would not be better to delete all reference to 314(d) in the recommendation for the ASTHO proposal. Judge Fowler said he thought it would

be well to be sure that Congress continues 314(d) if it does not buy alternative #4, and, therefore, he did not want 314(d) repealed until there was assurance that alternative #4 was adopted. He suggested that the language of the recommendation be changed by providing for repeal of 314(d) at the end of the recommendation rather than at the beginning.

Mayor Maltester asked why 314(d) should be repealed if it works and why should we not just ask for the addition of more money.

Mr. Kurfess said that he was concerned that option #4 represented what the health professionals support, whereas the role of the Commission is to reflect the point of view of general purpose governments.

After further discussion, Chairman Merriam asked whether the 314(d) report should be put off until Commission members had further opportunity to consider the various options. Mayor Maltester moved that action on the report be deferred until the next meeting. Hearing no objection, Chairman Merriam ruled that the report would be deferred until the next meeting.

Other Business

Chairman Merriam asked that the members authorize the Chairman to set the date for the next meeting. Commissioner Dunn made the motion and it was seconded by Mr. Altorfer. The motion passed.

Mayor Maltester, seconded by Mayor Poelker, moved that the Chairman be authorized to draft an appropriate expression of remembrance to be sent to the family of former ACIR member and Mayor of Honolulu, Neal Blaisdell. The motion passed.

Chairman Merriam called on Richard Sullivan, vice president of the U.S. Railway Association. Mr. Sullivan updated the Commission on the progress of the Northeast and Midwest regional railroad reorganizations. Gov. Noel indicated

his disagreement with the plans and his preference for Federal government ownership of the roadbed as more analogous to Federal involvement in the competing modes of transportation. Commissioner Brewer agreed with Gov. Noel and suggested that roadbed rebuilding could help deal with the unemployment problem. Chairman Merriam thanked Mr. Sullivan for his appearance.

Judge Fowler relayed a request from the National Association of Counties that the Commission review and update its report on labor-management relations in the public sector. Mr. Anderson said the staff would report at the next meeting on the scope and feasibility of responding to the NACo request.

Chairman Merriam asked that the members turn to Tab D of the Docket Book which contained a proposal by the National Academy of Public Administration to establish a Bicentennial Commission to undertake a major study of American Government. The Chairman reported that the idea had support in the Senate, met with mixed reaction in the House, and encountered soul-searching in the Administration.

Commission members agreed that a reexamination of the roles, functions, and relationships of the three levels of government was an appropriate start for the nation's third century. Mayor Maltester, with a second by Gov. Noel, moved that the Commission support the National Academy of Public Administration's proposal for a Bicentennial Commission. The motion passed.

ACIR Implementation Activities

Chairman Merriam called on Mr. Anderson and Mr. Gilson for a progress report on the implementation of ACIR recommendations. Mr. Gilson reported significant staff involvement with State and local government officials in 36 States during 1975. Mr. Anderson reported a higher level of implementation

activity in the Congress as evidenced by appearances at hearings on general revenue sharing, technology transfer, growth policy, and LEAA renewal legislation and by the development by the staff of a Congressional implementation work plan.

Mr. Anderson reported that the contract with the U.S.D.A. Forest Service calling for an ACIR study of the forest receipts sharing program had been signed.

Mr. Gilson distributed the first edition of a quarterly ACIR publication, Intergovernmental Perspective. The Quarterly is designed to highlight recent Commission reports and recommendations as well as other current thinking on intergovernmental issues for a wide audience. It contains a series of regular features such as a report on developments in Washington. It provides a vehicle for publishing current ACIR staff work on a variety of intergovernmental topics. Mr. Shannon distributed a preliminary edition of ACIR's Significant Features publication which contains most of the tables of comparative State tax rates. This preliminary edition was produced for the use of State legislatures during their 1976 sessions.

Mayor Maltester moved that the 55th ACIR meeting be adjourned. Judge Fowler seconded the motion and the meeting was adjourned.

B

ADVISORY
COMMISSION ON INTERGOVERNMENTAL RELATIONS
WASHINGTON, D.C. 20575

MEMORANDUM

TO: Members of the Advisory Commission on Intergovernmental Relations

FROM: Wayne F. Anderson, Executive Director

SUBJECT: The Partnership in Health Block Grant

The purposes of this memorandum are three-fold:

(1) to briefly summarize the Commission's deliberations on the Partnership in Health Act at the November 18 Chicago meeting; (2) to describe follow-up staff efforts; and (3) to provide a basis for comparison between and among the President's proposed Financial Assistance Health Care program and alternatives 4 and 5 under this Tab.

The Chicago Meeting. At the November 18 Commission meeting in Chicago, members were apprised of the history and background of the Partnership in Health program, the lessons regarding block grants that are to be learned from this case study, and the rationale behind the five alternative recommendations set forth in the docket book (see pp. 16-19 in the minutes for this meeting). The ensuing discussion focused on alternative 2 (the 15-25 percent fund transfer provision), alternative 5 (the broader block grant option), and more heavily on alternative 4 (the Federal cost-sharing approach), as well as the relationship between and among them (see minutes for the Chicago meeting, pp. 19-22). Factors relating to the long-term

desirability of certain of these alternatives as against the more immediate practical appeal of others prompted a postponement of a final decision.

Staff Follow-up. Following the November meeting, staff completed revisions on the background chapters and convened another critics' session on the draft recommendations with DHEW, ASTHO, National Governors' Conference, NACO and other representatives attending. This group agreed that the five options covered the range of possible and feasible policy alternatives in the public health assistance area. Hence, the five, with some minor adaptations, are re-presented herein for Commission consideration.

The President's Proposal and the Commission's Options. Finally, with the President's State of the Union Message and the follow-up draft bill on Financial Assistance for Health Care, the Commission's PHA study and proposed recommendations took on an added element of relevance. Attachment A, which immediately follows, identifies the program and fiscal differences between the President's proposal and alternative recommendations 4 and 5. In brief, alternatives 4 and 5 cover 21 public health service programs which amount to over one billion dollars (FY '76), while the Administration measure merges 22 various health care programs accounting for $9.2 billion (with $8.3 billion of this relating wholly to Medicaid).

Attachment B explains some of these differences in greater detail and highlights the proposed changes in the Medicaid program. This Attachment concludes with a reiteration of the Commission's three earlier recommendations relating to Medicaid. These recommendations, along with the research done on the Partnership in Health program, prompted staff in drafting alternative recomendations to continue to work within the functional terrain covered by the 21 existing programs for public health services.

Attachment C is the DHEW fact sheet, dated January 20, 1976, on the Administration's proposal while Attachment D identifies in spread-sheet fashion the major points of contrast between and among alternative recommendation 4, alternative recommendation 5, and the President's proposed Financial Assistance for Health Care Act.

Attachment A

Programs Proposed for Merger under (1) ACIR Draft Report (Recommendations 4 and 5) and (2) Administration's Financial Assistance for Health Care Act

Existing Program Title	Revised FY 76 budget (millions)	ACIR Report Recs 4 & 5	Administration Proposal
314(d)	$ 68	X	X
Alcohol Formula Grants		X	X
Special Alcoholism Projects		X	X
Alcohol Community Service Programs	80	X	X
Alcohol Demonstration Programs		X	X
Drug Abuse Prevention Formula Grants	35	X	--
Drug Abuse Community Service Programs	138	X	--
Drug Abuse Demonstration Programs		X	--
Crippled Children's Services		X	X
Maternal and Child Health Services	223	X	X
Sudden Infant Death Syndrome		X	X
Community Mental Health Centers	160	X	X
Mental Health-Children's Services		X	X
Migrant Health	19	X	X
Disease Control-Project Grants	25	X	X
Lead-Based Paint Poison Control	4	X	X
Urban Rat Control	5	X	X
Family Health Centers		X	X
Community Health Centers	155	X	X
Emergency Medical Services	25	X	X
Family Planning	79	X	X

Attachment A (page two)

Existing Program		ACIR Report Recs 4 & 5	Administration Proposal
Title	Revised FY 76 budget (millions)		
Medicaid	$8,262	--	X
Health Planning	66	--	X
Construction	--	--	X
Developmental Disabilities	54	--	X

Revised FY 76 budget total for merged programs

	ACIR Report Recs 4 & 5	Administration Proposal
Medicaid	$ --	$8,262
All other	1,016	963
Total	$1,016	$9,225

Attachment B

A Further Note on Administration's Proposal for Financial Assistance for Health Care Act

The Administration proposal merges most of the health programs embraced in alternative recommendations 4 and 5 in the ACIR draft report. However, it also merges four that are not included in the ACIR packages: Medicaid, Health Planning, Construction, and Developmental Disabilities. Medicaid is the program of medical assistance for the poor under Title XIX of the Social Security Act; Health Planning and Construction are the programs incorporated in the National Health Planning and Resources Development Act of 1974, successor to the Comprehensive Health Planning Act and the Hill-Burton health facilities construction program; and Developmental Disabilities is a program offering a wide variety of services, including health care, for the mentally retarded, cerebral palsied, and epileptic. These four are essentially different from the traditional public health service programs that have been included in the ACIR packages. The ACIR approach has interpreted those traditional services to include the services under the 314(d) block grant and those closely allied which are within the scope of responsibilities commonly assigned to State and local public health agencies.

While the opening sentence of the HEW Fact Sheet suggests that the 16 programs (22 by our count) proposed for merger are linked by their common objective of providing delivery of health services to the poor, later explanation in the paper indicates that low-income groups are not the only target population of the merged programs. Thus, covered services

are broken down into "personal health care services" (including Medicaid), "community and environmental health activities," and "other health activities." The services "under community and environmental health activities" (community health protection, mental health, and disabilities) may be offered to all persons regardless of income. "Other health activities," such as planning and rate regulation, will benefit the whole population. Even "personal health care services" may be provided to other than low-income persons; States must assure that the basic health services are provided to low income persons, but beyond that they are given broad discretion in defining the eligible population.

The administration proposal would make major changes in the Medicaid program. Principal differences are as follows (more details on the Administration program are found in Attachment C--the HEW Fact Sheet):

	Existing Medicaid Program	Administration Proposal
Federal funding commitment	Federal govt. matches State expenditures without limit ("open-end" appropriation--$8.3 b in FY 76.	"Closed-end" appropriation ($10 b FY 77 for Medicaid and 15 other health programs).
Federal matching	50 - 83 percent, varying inversely with State's per capita income.	100 percent Federal funds. But States are "expected" to maintain present level of expenditures ($16 b in 1975).
Distribution formula	A State's claim on Federal funds depends generally on matching rate and on policies set by State on such matters as eligibility and payment standards for public assistance, inclusion or exclusion of medically indigent from eligibility, optional services offered, and reimbursement rates.	After initial period of transition, funds to be distributed according to formula giving primary weight to a State's low-income population, but also reflecting relative "tax effort" and per capita income. Phase-in of distribution formula will avoid any reductions in FY 77 below amounts States estimated to receive in FY 76 (see Fact Sheet, p. 2, for details).

	Existing Medicaid Program	Administration Proposal
Federal regulation	Federal statutes and regulations define minimum standards of eligible population, covered services, provider standards, reimbursement methods and rates, provisions for fair hearings for applicants, quality assurance system, and utilization review.	States given broad discretion, but on most of these matters required to explain changes from previous Medicaid provisions.
State planning, evaluation, and reporting.	Few requirements beyond financial reporting.	States describe planning, evaluation, and reporting activities.
Planning provisions	State plan is approved as a condition for getting funds. It is basically a commitment to follow Federal requirements; no public participation required in plan development.	State Health Care Plan must be developed annually to qualify for Federal funds. Must be published and made available for public review and comment.
Federal enforcement, compliance, penalties.	HEW monitors, may initiate compliance actions to withhold funds. Periodic Federal audits.	HEW tracks conformity to State plan and Federal requirements. Annual Federal financial audit. HEW may initiate compliance actions, withhold funds or reduce Federal payments up to 3 percent for each non-complying requirement. State must have mechanism for citizens to file complaints, receive hearing. Citizens may bring civil suits.

Commission Recommendations on Medicaid

In its September 1968 report, Intergovernmental Problems in Medicaid (A-33), the Commission made several recommendations under the heading, "Allocation of Responsibility Between Federal and State Governments." These included:

Recommendation 4. Continuation of an "Open-End" Appropriation for Medicaid

The Commission recommends that the present provisions of Title 19 of the Social Security Act be retained whereby Congress appropriates for Medicaid on an "open-end" basis, that is, without limits on the amount of money that may go to any single State.*

* Chairman Bryant, Governor Daniel, Congressman Fountain, and Congressman Ullman dissented from this recommendation.

Recommendation 6. A Study of Allocation of Fiscal Responsibility Among the Levels of Government

Recognizing the fiscal problems which arise out of the Federal mandating of additional State and local responsibilities through Title 19 of the Social Security Act, the Commission recommends that Congress and the Administration study the present allocation of fiscal responsibility among the levels of government with special reference to the more circumscribed revenue capability of the States and their localities.

Then, in its April 1969 report, State Aid to Local Government (A-34), the Commission adopted the following recommendation:

Recommendation 2. National Government Assumption of Full Financial Responsibility for Public Assistance (Including General Assistance and Medicaid)

The Commission concludes that maintaining a properly functioning and responsive public assistance program, as presently operating, is wholly beyond the severely strained financial capacity of State and local government to support. The Commission therefore recommends that the Federal Government assume full financial responsibility for the provision of public assistance. The Commission further recommends that the States and local governments continue to administer public assistance programs.

The Commission wishes it understood that these recommendations are designed to relieve inequities of resource capacity among the levels of

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government and apply until such time as Congress and others shall determine a more efficient and appropriate method of welfare administration applicable to the complex social problems of our time.*

* Congressmen Fountain and Ullman, Senator Knowles and Commissioner McDonald dissented. Senator Mundt, Secretary Finch, Secretary Romney and Budget Director Mayo abstained.

Attachment C

HEW FACT SHEET

U.S. Department of Health, Education, and Welfare January 20, 1976

FINANCIAL ASSISTANCE FOR HEALTH CARE ACT

The President's FY 1977 budget proposes to improve delivery of health services to the poor by consolidating 16 Federal health programs, including Medicaid, into one $10 billion block grant to States. The proposal, called the "Financial Assistance for Health Care Act," is designed to:

* Improve access to quality health care at reasonable cost
* Increase State and local control over health spending
* Control Federal spending, restrain growth of the Federal bureaucracy, and reduce Federal red tape
* Achieve a more fair and equitable distribution of Federal health dollars among States.

The proposal includes a requirement for the development by States of a State Health Care Plan. Public participation in the development of the plan is required to insure that increased State responsibility is coupled with expanded public accounting of State health policies.

Main features of the proposal are listed below. The Administration regards these concepts as the basis for working with Congress, the Governors, and other interested groups with respect to enacting legislation.

I. Programs Included

The sixteen programs shown in Attachment A will be included, effective October 1, 1976. They fall into four major categories: (1) Medicaid; (2) Public Health Service (PHS) preventive and community health programs; (3) health planning, construction, and resources development programs previously subsumed under the National Health Planning and Resources Development Act of 1974; and (4) the developmental disabilities program.

II. Funding Request

The FY 1977 Budget requests $10 billion for the State block grant with $500 million annual increments in Federal funds in future years. An additional $1.5 million in budget authority is requested for program administration costs for an estimated 100 positions.

III. Distribution Formula

After an initial period of transition, funds will be distributed according to a formula giving primary weight to a State's low-income population. The formula gives weight also to the relative "tax effort" made by a State and to a State's per capita income. Under the present system of matching grants and the categorical eligibility structure, some of the States with highest per capita income receive more than four times as much Federal money per poor person as do States with low per capita income. Under this proposal, the poorer States will realize the greatest increases in the share of total Federal assistance.

IV. Phase-in of Formula

A phase-in of the distribution formula will avoid any reductions in FY 1977 below the amounts States are estimated to receive in FY 1976.* A gradual phase-in will allow States to make the necessary program adjustments. The formula will be applied beginning October 1, 1976, with the proviso that the maximum increase for any State not exceed 10 percent the first year, and that the remainder of the total be distributed so that all States not receiving the full 10 percent realize an equal percentage increase over FY 1976. This will be about 8 percent (8.1 percent). In subsequent years States will move toward the amount allocated by the formula; increases in any year are limited to a maximum of 20 percent over the prior year, and decreases are limited to a maximum of 5 percent. Attachment B shows the distributions of block grant funds in FY 1977 and 1978.

V. Protection for Direct Federal Grantees

To avoid distruptions in health services delivery and insure an orderly, gradual transition to the block grant program, direct Federal grantees (e.g., community mental health centers, neighborhood health centers, and alcoholism programs) will be protected from large budgetary reductions during the first three years of the program. Grantees will be guaranteed at least 80 percent of their FY 1976 grant level in the first year, 50 percent in the second year, and 25 percent in the third year.

VI. State Financial Participation

No State match is required under the block grant program. States and localities spent $16 billion of their own funds for health purposes in 1975 and at least this level of spending is expected to continue.

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* Assumes enactment of the President's FY 1976 Budget.

VII. Reimbursement and Cost-Sharing

States will have broad latitude on reimbursement levels and methodologies, except that payment amounts should be sufficient to assure access to services by the target population. States may impose any level of premiums or cost-sharing they deem appropriate on services.

VIII. Covered Services

1. Personal Health Care (minimum 90 percent). At least 90 percent of Federal funds must be spent on personal health care services. These include a broad range of activities including all services now covered by Medicaid and other grants being consolidated, as well as other health services deemed appropriate by States (e.g., living arrangements that potentially substitute for institutional care).

2. Community and Environmental Health Activities (minimum 5 percent). At least 5 percent of Federal funds must be spent for (1) community health protection (e.g., disease control, environmental health, health education); (2) community-based mental health services, including alcoholism and drug abuse treatment, and (3) developmental disabilities programs.

3. Other Health Activities (maximum 5 percent). The remaining 5 percent may be spent on other State-selected health activities including State and sub-State planning, rate regulation, data acquisition and analysis, and resources development. They may also be spent for services in categories 1 and 2 described above.

IX. Target Population and Eligibility

States will have broad discretion in setting income and other standards for defining the eligible population, except that funds must be used to assure that the State's basic health services are provided to low income persons. States are not required to use Federal categorical restrictions in determining eligibility (e.g., childless couples, single persons between ages 21 and 65, and intact families may qualify for assistance), and may deduct out-of-pocket medical expenses in counting income.

States may not impose duration of residence requirements as a condition of participation, or illegally discriminate against service applicants or recipients. Changes in eligibility from existing State standards must be presented for public review and comment as part of the State Plan.

Services financed with the 5 percent community health protection, mental health, and disabilities monies may be offered to all individuals without regard to income.

X. State Plan Requirements

1. A State Health Care Plan must be developed annually as a condition of receiving Federal funds. It will have two major components: Part A will cover the entire State population, both publicly and privately financed health services. Part B will concentrate on the population and services covered by the Financial Assistance for Health Care Act.

   The State Health Care Plan should be directed at a minimum, toward achieving the following goals:

   - Assuring all citizens of the State, and particularly populations covered under the Financial Assistance for Health Care Act access to needed health services of acceptable quality.

   - Development and utilization of preventive health services.

   - Prevention of reduction of inappropriate institutional care.

   - Encouraging the use of ambulatory care in lieu of in-patient services.

   - Provision of primary care services especially for those located in rural or medically underserved areas.

   - Assurance of the most appropriate, effective, and efficient utilization of existing health care facilities and services.

   - Promotion of community health.

2. Part A Requirements

This portion of the State Health Care Plan must include, at a minimum, the following information:

- evaluation of the supply and distribution of State health care facilities and services (e.g., inpatient, ambulatory, long-term care);
- assessment of the supply of health manpower and manpower training programs;
- analysis of the sources of health financing available to State residents (e.g., private insurance, public subsidies);
- evaluation of the health needs of the population, especially those in medically underserved areas (e.g., rural areas).

3. Part B Requirements

This portion of the State Health Care Plan must, at a minimum, include the following:

- Definition of the eligible population, including the numbers and categories of individuals to be served (e.g., aged, children). States must provide a rationale for differences in coverage from the plan of the previous year or, from current eligibility standards.
- Definition of covered services--including amount, duration and scope--and a rationale for any change from current State programs.
- An assessment of the health care needs of the target population, and a description of the needs assessment process.
- Estimates of individuals to be served and of the expenditures for each service to be provided and each category of individuals to whom services are provided.

- Identification of categories of service providers and their distribution by geographic area.

- Specification of the standards for each group of providers, explanation of the process for enforcing these standards, and identification of the State agency (agencies) responsible for enforcement.

- Description of the methods used to reimburse each category of providers and the levels of reimbursement proposed to be offered.

- Assessment of the impact of the services program on particular populations, including, but not limited to, children, the elderly, migrants, the mentally ill, the developmentally disabled, the handicapped, alcoholics and drug abusers.

- Explanation of the mechanisms for program coordination between the State's personal health services program and other human service programs (e.g., Medicaid, SSI, Title XX) and the overall State Health Planning activity.

- Description of a system under which service applicants and recipients may file complaints and receive a fair hearing.

- Provisions regarding the safeguarding of information on applicants and beneficiaries.

- Definition of the organizational structure responsible for administration of funds provided under the Financial Assistance for Health Care Act.

- Description of quality assurance system(s) to be used for each type of provider. A rationale must be presented for any differences from the norms, criteria and standards used for Medicare patients.

- Description of the State planning, evaluation, and reporting activities for implementing the Financial Assistance for Health Care Act.

4. Planning Process

An open and public planning process is required in which broad input from health planning organizations representing health interests (e.g., providers, consumers,

insurers) at State and sub-State levels is assured. Both Parts A and B of the State Health Care Plan must be published and made available for public review and comment. State Plan publication, review, and amendment procedures will be monitored by HEW.

IX. Certificate-of-Need

To assure efficient development and distribution of costly institutional health services, States must administer a certificate-of-need program that includes a review and approval or disapproval of new institutional health care services proposed to be offered in the State.

XII. Quality Assurance and Utilization Review

States must have quality of care systems, including peer review of services provided based on objective norms, criteria and standards.

XIII. Reports and Maintenance of Records

States must submit a report to HEW at the end of each program year which accounts for the expenditure of funds in accordance with the State Plan and explains major variances. States must also maintain records necessary for the proper and efficient operation of the program including records regarding applications, determinations of eligibility, the provision of services, and program expenditures.

XIV. Enforcement, Compliance, Penalities

States must have a mechanism for citizens to file complaints and receive a hearing. In addition, aggrieved citizens may bring civil suit. HEW will track conformity by States to State Plan and Federal requirements and complete an annual financial audit of State records. HEW may hold compliance hearings and terminate all Federal funds when there is both a finding of noncompliance and State refusal to come into compliance or alternatively, reduce Federal payments by up to three (3) percent for each requirement for which a State is not in compliance.

XV. Federal Health Planning Activities

1. National Council for Health Planning and Policy

A National Health Planning and Policy Council will continue to serve as a forum for addressing issues of nationwide concern affecting health care in the U.S. The Council will be composed of representatives of major health interests, including consumers, State and local government providers, insurers, and educational institutions. The Council will address such concerns as (1) health costs; (2) manpower; (3) resources allocation/ planning and regulation by States; and (4) the impact of new medical technology on the costs and quality of health care.

2. Federal Technical Assistance and Research for Health Planning

The Department will continue to develop technical assistance materials, including data, analyses, comparative studies, and guidelines to assist States in their health planning and regulatory activities. The Department will also continue to conduct research on the impact of health planning and regulatory decisions. Finally, HEW will continue its efforts to develop national guidelines describing a more desired distribution of health resources.

Attachment D

Comparison of Basic Features of Block Grants under Recommendations 4 and 5 of ACIR Draft Report and Administration's Proposed Financial Assistance for Health Care Act

Feature	Recommendation #4 (ASTHO proposal modified)	Recommendation #5	Proposed Financial Assistance for Health Care Act
1. Level of Federal funding commitment	May vary year by year depending on each State's pattern of expenditures for health services for which cost-sharing may be claimed. Ceiling is based on population. ASTHO proposes a ceiling of $4 per capita, equalling about $900 million nationwide.	First year, $367 m; ultimately, by folding in grants covered by footnote 2 of the recommendation, $939 m	Beginning in FY 77: Medicaid $ 9,292 m Other 876 m $10,168 m
2. Distribution formula	Population	Population and financial need	After initial period of transition, distribution by formula giving primary weight to a State's low-income population but also reflecting relative "tax effort" and per capita income.
3. Federal matching	75 percent of expenditures above base year to maximum of $4 per capita (ASTHO proposal), except that Congress might specify higher rates for specific services reflecting different national priorities.	Variable matching based on population and financial need	100 percent, but States are expected to continue their present level of contributions to these programs, which amounted to $16 billion in 1975.

Comparison of Basic Features of Block Grants under Recommendations 4 and 5 of
ACIR Draft Report and Administration's Proposed Financial Assistance for Health Care Act

Feature	Recommendation #4	Recommendation #5	Proposed Financial Assistance for Health Care Act
4. Method of merging categoricals	ALTERNATIVE A: Immediate merger of 5 existing formula and 6 existing project grants directed primarily to State and local govts.; and gradual merger of 9 existing project grants directed primarily to public and private nonprofit agencies. ALTERNATIVE B: Gradual merger of all grants specified in Alternative A.	Immediate merger of 5 existing formula grants directed primarily to State and local govts. Automatic merger of 15 existing project grants, and formula grants enacted in the future, as Congress reviews each program 3 years after enactment, unless Congress specifically excludes such grants from merger upon review.	Immediate merger of all 16 grants, by Act of Congress.
5. Programs to be merged	See Attachment A	See Attachment A	See Attachment A
6. Planning and review process	Annual comprehensive plan developed by State and local health and elected officials to be published and available for citizen review and comment before submission to HEW.	Each State to give due recognition to roles of local, regional, and private sector service providers.	Annual State health care plan. An open and public planning process is required assuring input from health planning organizations at State and substate levels. Plan must be made available for public review and comment.

Comparison of Basic Features of Block Grants under Recommendations 4 and 5 of ACIR Draft Report and Administration's Proposed Financial Assistance for Health Care Act

Feature	Recommendation #4	Recommendation #5	Proposed Financial Assistance for Health Care Act
7. State and local role	State determines health service priorities in annual comprehensive plan, subject to Federal approval, and administers plan with local govts. as appropriate. State includes localities in planning where appropriate.	State determines and administers plan covering merged services. In allocating funds, State gives due recognition to public health servicing and expenditure role of local, regional, and private sector agencies.	State health care plan defines organizational structure responsible for administering Federal funds; describes various aspects of operations, most of which relate to Medicaid and other personal health care programs.
8. Federal role	HEW approves State plan in accordance with statutorily-established goals and priorities, monitors development and implementation of plans; periodically evaluates effectiveness.	HEW reviews and approves plan, monitors implementation and reporting, evaluates results.	HEW tracks State's conformity to State Plan and Federal requirements and completes an annual financial audit of State records.

Chapter V

Major Findings and Issues

The preceding sections of this Chapter have traced the origin and evolution of the 314(d) block grant component of the Partnership for Health Act, and have examined the way this block grant is administered by Federal and State officials. In the course of this examination, conclusions have been reached in such areas as: the impetus for the initial consolidation; the themes present in subsequent modifications of the block grant's legislative base; the objectives of the consolidation; changing styles of Federal administration of the block grant; patterns of State block grant administration; the roles of local government and the private sector in the program; the reality of State flexibility under the block grant; an overview of block grant expenditures; and the attitudes of State public health officials toward this program. Specific findings in each of these areas are briefly summarized below.

Impetus for the Initial Consolidation. Permanent Federal grant support for health services began in 1935 with a general health formula grant program. Over the next 30 years, this broad grant--actually a small block grant--was joined by many specialized programs directed at particular client groups or diseases. By 1966, this had produced a Federal health grant structure dominated by categorical programs.

As early as the late 1940s, however, this categorical structure came under criticism for inhibiting the development of balanced and flexible State and local health programs, and for imposing an excessive administrative burden on grant recipients. The first Hoover Commission, the Kestnbaum Commission, the House Intergovernmental Relations Subcommittee, the Joint Federal-State Action Committee, and a 1961 ACIR report on Federal health

services grants all expressed concern with these negative aspects of categorical grants. Each acknowledged that categoricals often had been effective in promoting new health programs, stimulating increased State and local expenditures for public health services, and enlisting political support for such programs. At the same time, they generally concluded that the predominantly categorical health grant structure had inhibited the development of a desirable system of Federal-State-local responsibilities in this functional area. The major recommendation of the five studies was a call for greater recipient flexibility in the administration and expenditure of Federal grants, although the specific means to this end varied from modification of the categorical system to its replacement by a block grant for public health services.

These systemic criticisms of categorical grants was not sufficient to produce revision of the Federal health grant structure, as long as it appeared that the programmatic purposes of categorical grants were being achieved. It was only after these concerns were joined by mounting dissatisfaction with the quality of health care that legislative action occurred. In the early and mid 1960s, four major study commissions profoundly influenced official assessments of categorical health grants. Beginning with the National Commission on Community Health Services and continuing with the 1965 White House Conference on Health, the National Conference on Medical Costs, and the National Advisory Commission on Health Manpower, the nation's fragmented and excessively specialized health care system was scored, and categorical grants were cited as contributing to this condition. As a step toward achieving comprehensiveness in health care, a much stronger role for the block grant, within the Federal health grant system, was advocated.

These two streams of thought converged in the mid 1960s resulting in the Comprehensive Health Planning and Public Health Services Amendments of 1966. This Act, commonly known at the Partnership for Health Act, accomplished a fundamental revision of the Federal health grant system. All nine categorical health service formula grants were consolidated into one block grant;[1] a similar merger converted seven project grant programs into one; and grant support for State and areawide comprehensive health planning was authorized. These components were intended to constitute an integrated approach, involving all levels of government and the private sector, to the planning, financing and delivery of public health services.

The block grant, created by Section 314(d) of the Act, was adopted with little controversy in 1966, although previous consolidation attempts had generated intense opposition from specialized health interests. Potentially the strongest opposition, that of the mental health constituencies, was avoided by retaining a minimum 15 percent earmark for mental health services within the block grant. Other key features of the original 314(d) block grant are noted below.

- Grants were to be awarded to States on a formula basis, contingent on HEW approval of a State Plan for comprehensive public health services submitted by each State's health and mental health agency.
- The initial (FY 1968) authorization, $62.5 million, was only a slight increase from the combined levels of the consolidated categorical grants, but it was clearly intended that the block grant would grow rapidly to a level four to five times that size.

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[1] Several health programs not then administered by the U.S. Public Health Service were excluded from this merger.

- The requirements for State-local matching were variable, ranging between one-third and two-thirds of a State's total expenditures under its 314(d) allotment, depending on its per capita income level.
- The basic purpose of the block grant was simply to assist the States in "establishing and maintaining adequate public health services." Despite this broad statement of goals, the record clearly shows that the basic block grant dilemma--striking an appropriate balance between providing relatively unrestricted financial support for State and local health programs, and promoting national health care priorities--was not resolved.
- The link between the block grant and State and local comprehensive health planning (CHP) was left somewhat vague, the only stipulation being that block grant services must be "in accord with" any State CHP plans. No connection with local CHP activities was specified.
- Lastly, P.L. 89-749 required that block grant funds be "made available," by the State agencies to other public and private non-profit organizations, to secure their "maximum participation" in the provision of block grant services. Here, too, the manner in which funds were to be made available, and any measures or targets for maximum participation of other agencies, were left unspecified.

Themes Underlying Subsequent Amendments. The modifications of the block grant authority since 1966 evidence two main themes, both of which are manifestations of the basic tension in the block grant between furthering national priorities and supporting virtually any State and local health programs. The stronger theme has been the tendency of Congress to recategorize the health grant system by mandating attention within the block grant to particular health problems, and by creating numerous new categorical programs outside the block grant. With the exception of the vetoed 1974 amendments, which would have created a 22 percent earmark for hypertension control, these actions stopped short of setting aside a minimum portion of block grant funds for specific categories. Instead, State health agencies were required by the 1970 amendments to address alchohol and drug abuse in the preparation of 314(d) State Plans, and to provide such services pursuant to the Plan commensurate with their importance in each State. In 1972, these provisions were strengthened by requiring 314(d) State Plans to provide for licensing of drug treatment facilities, and for expansion of programs in the field of drug abuse. The Special Health Revenue Sharing Act of 1975, however, reversed this trend by eliminating special encouragement of these categories, and by omitting the 1974 bill's inclusion of an earmark for hypertension. It remains to be seen whether Congress henceforth will be able to resist the temptation to reinstate categories within the block grant. Beyond partial categorization of the block grant, Congressional preference for this approach is demonstrated by absence of major funding increases for the block grant and by the creation of many new categorical programs since 1966 which could logically have been made a part of the block grant. The 1975 legislation indicated no change in this pattern.

The second theme has been the search for an appropriate link between the block grant and the comprehensive health planning (CHP) called for by the Partnership for Health Act. In 1970, this linkage was addressed by requiring 314(d) State Plans to contain assurances of their compatibility with the total health program of the State. This was carried further in the 1974 bill, which would have mandated approval of 314(d) plans by the State CHP agency. The 1975 legislation modified this language to account for the Health Planning and Resources Development Act of 1974, stipulating that services supported by the block grant must be in accord with either the CHP State Plan or the State Plan prepared under the new health planning act.

These developments illustrate the Congressional desire to tie the block grant to broader State decision-making and priority-setting processes, and simultaneously to impose national priorities on the program. Both tendencies highlight the need for accountability of the block grant to someone, but represent attempts to fix the locus of this accountability at different levels.

Objectives of the Consolidation. Six different, and in some cases conflicting, elements of legislative intent have been highlighted in this Chapter. These are crucial to any assessment of the block grant's record:

- One objective was simple and quite clear, though not of overriding importance. Consolidation of separate grants was viewed as a way to lessen the administrative burden--in terms of time and cost--which (it was felt) categoricals imposed on recipients.

- Perhaps the most important goal was providing State health agencies with greater flexibility in the use of Federal assistance, which then would be spent in accord with the peculiar health needs and priorities of each State. This flexibility also was sought because it was believed that the States would be better able, with this greater discretion to provide services directed at the total health needs of their populations, rather than services directed at particular disease categories.
- In potential conflict with this emphasis on flexibility was another purpose, not present in 1966, but which emerged in 1970 and increased in intensity in succeeding years. This was that block grant funds were to be expended to further national health services priorities. This objective generated the trend toward partial recategorization of the block grant discussed earlier and the refusal to fold into the grant new categoricals that were functionally related to it.
- A fourth objective was assuring the complementarity of the block grant and comprehensive health planning activities, as discussed above.
- Congress also clearly intended that block grant funds would be used primarily to provide services, instead of covering administrative costs. To ensure this, the legislation stipulated that at least 70 percent of the 314(d) grant must be used to support "services in communities," thereby limiting expenditures for administrative purposes.

- Lastly, broad participation of other public and private non-profit agencies was clearly desired in the State health agencies' provision of comprehensive public health services. This was essential to achieving the intergovernmental and inter-sector "partnership" envisioned in the original Act.

Changing Styles of Federal Block Grant Administration. Administration of the 314(d) block grant by HEW falls into two, more or less, distinct periods. The first, dating from the program's inception to approximately 1970, was a period of adjustment to the new administrative problems posed by a block grant. During this period, program administrators in the HEW Regional Offices, accustomed to managing categorical grants and lacking a model of block grant administration, made sporadic attempts to exercise a degree of control over the content of 314(d) funded programs. These efforts received no support from the HEW central office, and gradually became less frequent.

The implementation of a 1970 decision not to require submission of detailed State Plans for 314(d), and to replace these plans with pre-printed assurances that a plan exists which satisfies all applicable Federal requirments, marked the beginning of the second period. The style of administration which has characterized this period, up to the present, is one of very little attention to the block grant, and a corresponding lack of interest in it. This pattern, of course, is the opposite of that sought by Congress, which has exhibited a growing tendency to increase controls over the block grant.

In general, the current picture is one of less Federal involvement in all aspects of administration under the block grant that was the case in the categorical grants consolidated into 314(d). To a great extent, the pattern reflects the strong emphasis placed by HEW on the objectives of administrative simplification and recipient flexibility, relative to the other four objectives mentioned above. Central office policy basically was to treat this program as money to which the States were "entitled" regardless of the use to which it was put.[1] The following specific findings concerning different aspects of Federal administration of the 314(d) program underscore this generalization.

- Manpower allocated to this program is minimal. In the central office, one person is assigned to this program on a part-time basis. Recent guidance on regional office staffing recommended that only a one-half man-year per region be assigned to 314(d), and even this level would result in an increase in many regions. Several, in fact, have experienced a period of years in which no one was assigned programmatic responsibility for the 314(d) grant.
- Central office policy has followed the legislative intent where that was clear, but generally has not clarified legislative ambiquities in the areas of local and private sector involvement, the importance of innovation and reform under the block grant, and the relationship of comprehensive health planning to the block grant. Above all, little has been done administratively to help resolve the conflict between supporting State programs and furthering national priorities, where these differ.

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[1] To a certain, but lesser, extent this view applied to the previous health formula grants as well.

- Evaluation by Federal officials has been less extensive under the block grant than the prior categorical grants. Only one Federally supported study was conducted in the first seven years of program operation, and this was of limited scope. A second study was undertaken in 1975, when controversy over the program was at its peak. The State health agencies concur in this assessment, since in our 50 State survey, 32 reported a decline in Federal evaluation activites under the block grant, while 16 observed no change and no State indicated an increased Federal role.[1]
- Auditing also is regarded by both Federal and many State officials as less extensive now. Very few States have been audited in recent years; only two States suggested an increased Federal role in auditing, while 20 indicated less activity now, and 26 observed no change.
- Federal involvement in both the preparation and review of State Plans appears to have declined since 1966. With respect to plan preparation, 35 States reported a diminished Federal role, and only six suggested the reverse; in plan review, 26 States cited a decrease and six, an increase. This changes, it should be noted, occurred largely during the second phase of HEW's administrative evolution.
- Technical assistance, monitoring, and enforcement of reporting requirements also are regarded by Federal officials as having declined under the block grant, and the States overwhelmingly confirm this view.

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[1] Two States were unable to compare previous and current Federal evaluation practices.

- Disputes between State and Federal officials, concerning the 314(d) program, have been very rare since 1970. Only seven States report ever having had such a dispute, and in all but one of these cases, the outcome was deemed satisfactory by the State involved.

Thus, while some observers suggest that certain functions, especially evaluation and auditing, ought to receive greater Federal attention under a block grant, this has not happened under this program. Instead, the Federal role appears to have decreased in all functions since the consolidation.

Basic Patterns of State Block Grant Administration. Perhaps the most important finding here is that, once the block grant reaches the States, it ceases to be an identifiable program in the normal usage of the word and becomes instead simply another source of funds. These funds are merged with other revenues in support of numerous State or local health programs, with the 314(d) funds sometimes, but not always, traceable in State accounting systems to particular activities. It is not suprising, therefore, that the States report "314(d) staffs" as either nonexistent or very small--usually financial management staff who allocate 314(d) funds to State program accounts. The broad scope of the 314(d) grant and its administrative convenience are major factors in decisions regarding the way States administer these funds. Still, block grant funds are viewed by most States as having a separate role in their total health programs from that of categorical grants.

Decisions regarding allocation of 314(d) funds are made with limited involvement of persons outside the State health agencies. While most States report that the block grant goes through the regular State budget process, their responses regarding the practical importance of major budget actors (Governor, central budget office, and appropriations committees) in 314(d) allocation decisions call into question the impact of this review in some States. Other interests, including comprehensive health planning agencies, are seldom important participants in block grant allocation decisions.

The following specific findings elaborate on these general conclusions:

- Only two States report that the 314(d) funds are administered as a discrete State program. In contrast, 35 States indicate that block grant funds are merged with other revenues but can be traced to particular State health programs, while 11 States report that these funds are merged with other revenues and are not identifiable within particular activities.[1]
- The reasons given for the manner of administration varied considerably. The broad scope of the block grant was cited as a factor by 35 States; maintenance of an audit trail and ease of meeting Federal planning and reporting requirements were each noted by 26 States; and ease of financial management, the number and restrictiveness of other Federal grants, and the size of the block grant were mentioned by 24, 21, and 12 States, respectively. The suggestions of Federal officials were a factor for only three States.

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[1] Numbers may not always total 50, due to non-responses to some items.

- Thirty-seven States indicated that the block grant plays a unique role in their total health programs, while 12 stated that these funds have the same function as categorical grants. The essence of this unique role is the block grant's availability for expenditure based on State and local priorities, and for support of broad, cross-categorical servicing efforts. In 43 States, the block grant reportedly is covered in the regular State budget process, while six States indicated a different treatment and one did not respond to this question. This is somewhat different from the response on categorical health grants, which 39 States indicated are covered by the State budget process.
- The major participants in 314(d) allocation decisions, cited by the States, include the central budget office, appropriations committees in the State legislature, local general purpose governments and the Governor, listed by 14, 13, 12, and 11 States respectively. In 11, the Governor, the central budget office and the appropriations committees--are all reported as having no important role in 314(d) allocation decisions; this finding suggests that the budget review applied to the block grant is largely perfunctory in some States.
- Comprehensive health planning agencies are generally not major participants in 314(d) expenditure decisions. State CHP agencies were listed as major actors by only six States, as minor participants by 23, and as unimportant by 18. Areawide CHP agencies were even less involved and were cited as major participants in only five States.

- Federal officials, the private sector and citizens' groups, along with A-95 clearinghouses, are generally viewed as unimportant in this block grant's allocation decisions.

Local Government and Private Sector Involvement in State Block Grant Administration. Despite the relatively minor role of these interests in State expenditure decisions, most States involve local or regional agencies in the operation of the 314(d) program by making sub-allocations of block grant funds to these units. The devices employed for these sub-allocations include formula based awards, project grants, and combinations of both approaches, and the States vary in the degree to which they impose restrictions on recipients' use or administration of these funds. Due to this wide variation, from the perspective of a local governmental or private agency, the block grant will have very different implications for local level involvement and flexibility in different States.

Private health care providers and private non-profit health related organizations generally are not involved in these programs. For the most part, consolidation apparently caused little change on this score. But, those States that discerned an impact of the block grant mechanism on private sector roles, more often than not, saw it as decreasing private sector involvement. An expanded partnership between the public and private sectors clearly did not occur under the block grant.

Over all, most State health officials perceive little impact on State-local relations in the public health sphere attributable to the switch to block grant funding, but those who do, overwhelmingly view it as a positive one. The following facts elaborate on these conclusions.

- Ten States make no block grant sub-allocations to local or regional agencies, while 37 allocate part of their 314(d) award to such agencies, and three report the entire award is sub-allocated. Of the 40 States which made sub-allocations, 18 reported that they do so on a project basis, 12 by a formula, and nine by a mixture of both methods. Ten States indicated that no restrictions are placed on recipient use or administration of these funds, while 29 employed such restrictions. Those States relying on the project grant for sub-allocations most often impose restrictions (80%), followed by those using formula allocations (50%), and those utilizing both methods (33%).
- Priorities for expenditure of block grant funds are set by the State most frequently (28 States), by local recipients in two States, and by joint State-local actions in 13 States. In seven States, priorities are not set at one level, but it is not clear from the responses whether they are set at the other level.
- Private health care providers are described as having a major role in the 314(d) program in only two States, minor participation in 11, and none in 36 States. Private non-profit health related organizations are assigned a major place in the program in two States, a minor role in 18, and no part in 30 States. In comparison with the position of these organizations under the prior categorical programs, 29 States report no change under the block grant, six claim an increased role, and ten cite a diminished status for these bodies.
- Over all, 29 States report no impact on State-local relations due to the block grant, while 17 States cite a beneficial impact, and only two States indicate a negative effect.

<u>Reality of State Flexibility Under the Block Grant.</u> The issue of flexibility is at the heart of the block grant rationale, and is one area in which the legislative intent clearly has been realized. The States overwhelmingly report that the block grant affords them greater discretion than did the categorical grant programs, although many note that this discretion has been severely limited by the absence of significant funding increases for the block grant. Further, most States indicate that this increased flexibility has been used, as reflected in new activities or changes in the levels of support for existing activities. With respect to the few restrictions in the 314(d) block grant, nearly half of the States assert that none of these provisions actually constrains, nor could restrain, their public health activities. The restrictions most often cited as limiting State discretion include the mental health earmark, the 70 percent minimum for services in communities, and local merit system requirements. Yet, none of these was cited by more than one-third of the States. Apparently, the difficulty of enforcing these restrictions does not relate only to the small size of this program, or the potential for fungibility presented by other Federal health grants, since few States indicated the impact of these restrictions would change if the 314(d) grant were larger or represented a larger percentage of Federal health grant funds. These difficulties, then, may arise from problems inherent in the nature of these restrictions, or from the opportunities for fungibility presented by large non-Federal health expenditures. These contentions are based on the findings outlined below.

- State discretion under the block grant, relative to that under the old categorical grants, is viewed as greater by 44 States, and not greater by three, with three States unable to make this

comparison. Of these 44 States, 30 report that they have used this increased flexibility in such areas as supporting local health departments, funding of cross-categorical health services, and basic supportive services such as central State laboratories. Twelve States indicate they have not used the increased flexibility, presumably because in the absence of significant funding increases for the block grant, new activities would have been undertaken at the expense of existing programs.

- Twenty-three States maintain that none of the six major restrictions in the 314(d) program limits their discretion under the block grant, while 25 cited one or more of these provisions as an actual constraint. Most frequently mentioned were the mental health earmark (16 States), the 70 percent rule (14 States), and local merit system requirements (10 States), followed by the maintenance of effort and State matching requirements (six States each). Five States cited the local matching requirement. Only seven States responded that the impact of these restrictions would change if the 314(d) program were larger--generally in the direction of greater contraint, and only six States anticipated a different impact if the block grant represented a larger percentage of all Federal health grant funds.

Overview of State Block Grant Expenditures. The lack of adequate data on expenditure of 314(d) funds has been a perennial weakness in the block grant. While progress is being made in this regard by the Association of State and Territorial Health Officials' Health Program Reporting System, the necessary data do not exist for confidently comparing block grant expenditure patterns with those of the prior categorical grants. For a variety of reasons, especially the unverified nature of the data and the inconsistent and incomplete reporting of local expenditures, the accuracy of the available figures is questionable. In addition, it is not clear what meaning should be attached to even "accurate" expenditure data for this (or any other single) program, due to the problem of fungibility of revenue sources.

With these caveats in mind, several tentative conclusions can be offered. The first is that, while the 314(d) grant is small on a national basis in comparison with total State health department expenditures, its importance varies considerably among the States. Moreover, its role in the support of certain health activities is disproportionately large, particularly in radiation control, chronic disease, and communicable disease control programs. Perhaps of greatest interest in the picture of general stability across categories over time which the available data suggest. Only two of the prior categories, heart disease control and home health services, appear to have fared poorly since the consolidation, while the general health category, alone, significantly increased its share of block grant funds. No other major shifts are evident, however. The following data illustrates these points in greater detail:

- As reported by the ASTHO reporting system, the block grant comprises only about 3.2 percent of State health department expenditures nationwide (FY 1974), but individual State figures range from 0.8 percent in Hawaii to 15.2 percent in Iowa, with 12 States in which the share of expenditures derived from 314(d) is 10 percent or more. Similarly, the block grant represents nearly 16 percent of total Federal grant funds received by the State health departments, while individual State figures range from 7.3 percent in Kentucky to 38.5 percent in Missouri.
- While the 314(d) block grant accounts for only 3.2 percent of total State health department activities, it is not evenly distributed among particular health activities. The block grant represents a disproportionate share of reported State health department expenditures in general health (8.8%); communicable disease (12.4%); chronic disease (14.5%); general environmental health (10.6%); general consumer protection (7.9%); radiation control (22.8%); general sanitation (5.1%); and laboratory services (5.1%). In some other areas, it represents a very small part of total expenditures.
- Block grant funds have been allocated mainly to the following areas: general health (30.0%); communicable disease (15.1%); chronic disease (7.3%); funds to local agencies not identified by categories (9.6%); and "other programs and administration" (13.5%). Of the prior legislative categories, the dental health share of 314(d) funds is now down to 0.9 percent, compared to a pre-consolidation figure of 1.7 percent; general health's 30.0 percent compares with 17.4 percent in 1966; and the 15.1 percent share for chronic disease contrasts with 21.4 percent in 1966.

<u>State Public Health Officials' Attitudes Toward the Block Grant.</u> Probably the most clear cut and least surprising finding is that State public health officials like the block grant. By an overwhelming margin, they report general satisfaction with the operation of the 314(d) program. They consider its chief advantage to be its flexibility across program categories, regarding types of activities, in light of local conditions, and over time. A distant second among the advantages cited was simplified or less costly administration. The main disadvantage of the block grant, relative to categorical grants, is perceived to be the lower political support--and, therefore, funding levels--it obtains. Despite this drawback, on balance, nearly all State public health officials declared a preference for expansion of the block grant rather than categorical grants. Most held to this preference even if it were to be achieved by consolidating categorical grants within 314(d), and a majority would like to see all existing categorical grants folded into the block grant. This strong support for the block grant is reflected in the following specific findings.

- The block grant is viewed as generally satisfactory by fully 46 States, with only four States responding in the negative. Its chief attraction is flexbility, cited by 48 States, while administrative simplification was mentioned by nine States. The major disadvantage associated with the block grant is low or uncertain funding levels, cited by 30 States, while 16 States deny that any disadvantages exist in comparison with categorical grants.

- In keeping with the above, 46 States prefer expansion of the block grant to that of categorical grants; three States indicate no preference between the two; and one State declared a preference for categorical expansion. Of these 46, all but ten of the 45 States responding would continue to favor expansion of the block grant, even if achieved by melding existing categoricals into the 314(d) grant. Lastly, of these 35 States, 28 are determined block grant advocates, favoring consolidation of all existing categorical grants within the block grant, while five States suggest exceptions which should be retained as categorical programs, and two States did not respond to this item.

Intergovernmental Issues and Recommendations

The history of the 314(d) block grant raises many issues which may be salient to broader consideration of the role of block grants in the intergovernmental aid system in this country. This determination, of course, must be made by comparing the results of this case study with those of other block grants. Whether these issues prove to be generally applicable to block grants or not, they must be addressed in considering the future course of the 314(d) program.

To sharpen possible generic block grant questions and to highlight certain continuing dilemmas specific to the 314(d) grant, four basic questions should be addressed.

- First, is the basic purpose of the Federal block grant essentially the furtherance of State and local health services priorities, or rapidly changing national program priorities, or both?
- Second, can an appropriate Federal administrative role be defined for a block grant?
- Third, is recipient flexibility necessarily achieved under a block grant; if not, under what conditions is this flexibility achieved?
- Fourth, what are the political effects of a block grant; who fares well and who fares poorly under this form of Federal aid?

These broad issues, of course, are highly interrelated. But, to clarify the analysis they are discussed separately insofar as is possible, and in the context of the 314(d) block grant.

To What Extent Should the Block Grant Be Responsive to State, Rather Than Federal, Priorities? It has been observed repeatedly in this Chapter that the fundamental dilemma of the 314(d) block grant is the ambiguity surrounding its basic purpose--whether the block grant is intended chiefly to support practically any State and local health activities the recipient prefers, or to further particular national priorities in public health. Stated in terms of fiscal accountability, are block grant funds meant to be responsive to State and local, or to national priorities? Neither Congress nor HEW came to grips with this question during the measure's legislative development. Instead, HEW asserted that national and State interests were complementary; hence the question was academic. While the committees expressed some skepticism that this would always be the case, they did not provide unambiguous guidance about how any disagreements between Federal officials and the States should be resolved.

This assumption of congruence of State and Federal interests is not supported by the history of the 314(d) program. The early years of the program were marked by a number of disputes over State program content. In the absence of prior resolution of this issue, these disputes caused great administrative confusion. The States involved maintained that they were entitled to the funds, regardless of how they intended to use them, while HEW's regional offices argued that Federal accountability for the program could not be preserved without authority on their part to exercise a degree of control over State programs. These conflicts were resolved by acceding to the States' viewpoint, but at a cost of a very considerable decline in HEW's interest and Congressional confidence in this program. With Congress, the lack of congruence between State and Federal interests under the block grant led to repeated moves to partially recategorize the block grant, by requiring that the States address certain problems of national concern with these funds.

This evidence that State and Federal priorities in public health do not coincide perfectly means that it is necessary to face the issue of the extent to which the block grant should be responsive to State, rather than Federal, interest. A corollary issue is the question of whether a State-dominated block grant can develop sufficient policitical support at the national level to survive the severe competition with categorical grants for limited resources.[1] The failure of the 314(d) block grant to achieve the higher funding levels envisioned at its inception, and the recategorization of the Federal health services grant structure since 1966, suggest what the answer to this question may be if insufficient recognition is given to the need for national level accountability under the block grant. It is in the first instance, easier to mobilize political support around assaults on particular health problems than for general or comprehensive health services. Furthermore, if the block grant is not responsive to the need of Congress and HEW to demonstrate action on well-publicized health problems, or does not document what has been achieved by the States with block grant funds, it will be at a considerable disadvantage in the Federal budget process. This holds true regardless of the merit of the activities supported with block grant funds. In fact, this has been the experience of the 314(d) grant. Based on this record, it may be surmised that, despite this year's reaffirmation of Congressional support of the program, the continued survival of this block grant in its present form is problematic, unless a better accommodation is reached between responsiveness to Federal, and to State or local, priorities. At the same time, moving too far in the direction of

[1] See Robins, 1974, pp. 156-161.

responsiveness to Federal influence would undermine the recipient flexibility and administrative simplification which distinguish block from categorical grants, and which were such crucial factors in the creation of the block grant in the first place.

How Should The Federal Administrative Role Be Defined In A Block Grant? Intertwined with the previous issue is that of defining a Federal administrative role appropriate for the block grant. The awkward period of adjustment by Federal program officials to this new funding mechanism, after the 1966 consolidation, was no doubt due in part, as some observers have argued, to the lack of a normative model of block grant administration. Without such a model, HEW administrators turned initially to the style of operation they were accustomed to under categoricals, and later adopted a management style for the block grant bordering on abdication. Neither of these extremes seems satisfactory, for reasons discussed above. Yet, no appropriate middle ground has been articulated.

In searching for this superior middle ground, three major aspects of Federal block grant administration must be considered. The first involves the Federal administrative functions treated earlier in this Chapter: provision of technical assistance; review and approval of State Plans; program evaluation; monitoring of State programs; auditing; and resolving disputes which arise over program implementation. All of these activities, of course, could apply to either a block or a categorical grant. The issue is deciding which of these functions should be emphasized, and which deemphasized, in block grant administration. Some observers have suggested that the administrative style best suited to this block grant is one which focuses on the evaluation and audit functions, whereas, in fact, these functions

appear to have received the least attention by 314(d) officials. Other commentators have stressed different functions, particularly monitoring, and still others argued that technical assistance should take on increased importance under a block grant, both as a natural complement to a change in the locus of decision making for grant funds, and as an avenue for encouraging response to problems of national prominence. Selecting from, and achieving a balance among, these functions is the essence of block grant administration. Neither task can be safely avoided, since they both have substantial implications for the survival of a block grant. After all, the ability of Federal officials to devise an administrative role in which they feel comfortable is an important determinant of their attitudes toward a program, which in turn strongly affects the treatment afforded the program in the budget process.

A second key aspect of Federal block grant administration is selecting an appropriate focus for these functions, especially monitoring and reporting requirements, evaluation, auditing and technical assistance. Should Federal attention be directed to the block grant funds only, to all Federal funds, or to State and local public health expenditures in their entirety? Traditionally, Federal officials have concentrated exclusively on the block grant (or particular categorical program) funds, but some observers maintain that this focus is too narrow to obtain a meaningful picture of what the block grant is accomplishing. Instead, they suggest the entire State and local public health program as the proper subject of these administrative functions. Underlying this argument are the problems of fungibility of revenue sources, and the apparent tendency of many State health agencies arbitrarily to allocate block grant funds to program accounts in such a way as to minimize accounting complexity. On the

other hand, expanding the focus in this manner would subject all State and local health activities to Federal review, even those financed entirely by State and local revenues. Such a course might, particularly in the case of reporting requirements, substantially increase the cost and burden of State and local grant administration, not to mention the likelihood of political and legal resistance--results which would weaken one of the major arguments advanced in favor of the block grant.

The last aspect of Federal block grant administration considered here is whether the particular program requirements are enforceable. This issue arises, of course, from the problem of fungibility. Nearly half of the State health agencies report that not a single one of the restrictions embodied in the 314(d) statute have any impact on their total health program, while most of the remaining cite only one or two of these requirements as having such an impact. This situation appears to result from the existence of plentiful opportunities for rebudgeting revenue sources in particular program areas, so as to counterbalance the effects of Federal program requirements. In short, the presence of categoricals and of major recipient outlays from own sources must be considered when constraints are contemplated. The imposition of restrictions which cannot be enforced can have few beneficial effects on the integrity of Federal and State grant administration. At best these requirements serve to communicate Federal policy preferences, while at worst they force Federal and State officials to engage in a meaningless and debilitating form of intergovernmental grant administration. Moreover, they may unconsciously establish a dual standard of recipient administration which is more restrictive for less sophisticated or more circumspect States.

For these reasons, definition of an appropriate mode of Federal block grant administration must consider the enforceability of current or proposed program requirements. While the preceding statement also applies to the administration of some categorical grants, the broader scope of block grants may render them somewhat more susceptible to this problem.

To What Extent is Recipient Flexibility Actually Realized Under a Block Grant? Probably the most important objective of the 314(d) consolidation was to provide recipients with the flexibility to expend grant funds on the basis of their own health service priorities. This examination of the 314(d) block grant suggests that several factors (in addition to program restrictions, discussed above) may jointly determine the extent to which recipient flexibility is actually realized under a block grant, and the manner in which it is exercised. One such factor is the size of the block grant. Even though it removes all categorical restrictions on expenditures (with the exception of the 15 percent mental health earmark), the magnitude of the 314(d) block grant clearly places limits on the flexibility it provides. This program, after all, operates in an area dominated by categoricals and it is small in relation to total State and local health expenditures. Hence, its discretion may be less fully utilized than that of an identical block grant which comprises a greater share of its program area.

Another potentially significant factor is the origin of the block grant. Those block grants, such as 314(d) which are formed by consolidating existing grants may have very different implications for recipient flexibility than block grants in largely new program areas (such as the LEAA program). The former will have inherited established programs and their vested constituencies, while the latter have no corresponding claimants for continuing support. The political difficulty of eliminating established programs may be a strong

counterforce to a State block grant administrator's desire to initiate new programs or to alter the funding levels of existing programs. Similarly, the presence of "new money"--increases in real funding levels--in the initial year of consolidation, and in later years of both consolidated and "new" block grants, may be a prerequisite to large scale exercise of a block grant's flexibility. In both types of block grants, the dynamics of program support tend to lock administrators into continuation of the previous year's activities, and "new money" often provides the real margin for flexible resource allocation.

Finally, as was noted in the body of this Chapter, even where State level flexibility is achieved under a Federal block grant, there is no guarantee that local level flexibility will be similarly enhanced. Widely varying patterns of State aid systems interact with the 314(d) block grant to produce widely varying effects on local recipient flexibility. It is possible to specifically prohibit States from recategorizing or otherwise restricting the portions of the 314(d) grant they sub-allocate to local agencies, but doing so would diminish State administrative flexibility. Thus, in a block grant which is awarded directly only to State level recipients, State and local flexibility may constitute conflicting program objectives. Alternatively, Federal block grant awards could be made directly to both State and local recipients, although such a practice would considerably increase the complexity of the 314(d) block grant and, in many cases, tend to ignore the States' prime role in this functional area.

What Are The Political Consequences of Block Grant Funding? In the view of many observers, the most critical block grant question is who fares well and who fares poorly under a block grant. That is, in comparison with categorical funding, which programmatic areas, types of activities, population subgroups and geographic areas tend to benefit and which tend to suffer, under the block grant mechanism? This question is even more pressing in the case of block grants formed through consolidation, such as the 314(d) program, where established programs are no longer protected by legislative categories and are compelled to compete at the State and local levels for continued funding. Despite the overriding importance of this issue, the paucity of detailed expenditure data for the 314(d) block grant precludes authoritatively answering this fundamental question. The available evidence suggests that large scale redistribution of resources has not occurred under the 314(d) grant, although heart disease control and home health programs have lost ground to general health activities (the probable reasons for this general stability were discussed in the earlier section on recipient flexibility). Yet, this issue is of considerable interest to Congress and the special health constituencies, and is the primary concern of block grant opponents. Clearly, if block grant allocation decisions appear to have been made on capricious or purely political bases, or seem systematically detrimental to certain groups or activities in favor at the national level, the future role of the block grant will be problematic.

Alternative Approaches To Resolving Outstanding 314(d) Block Grant Issues

The preceding section outlines four unresolved issues associated with the 314(d) block grant. A number of different approaches to resolving these issues have been suggested over the years, ranging widely in scope and probable political feasibility. Five alternative approaches, representative of the major reform proposals, are presented here. None of these appears capable of resolving all the outstanding issues. But, each has distinct advantages, and the task is to select the approach with the most compelling cluster of assets. Since these proposals are competitive--that is, the arguments in favor of one constitute implied criticisms of the others--only the proponents' position on each is described.

Alternative 1: Recategorization.

The Commission finds that the block grant approach in the health services area is inherently unworkable. Hence, the Commission recommends that Congress phase out Section 314(d) of The Public Health Service Act, as amended [and gradually reallocate those funds that would have been authorized and appropriated for this program to existing and new categorical health services programs of high national priority.]

This proposal eventually would entail abandoning the block grant approach as essentially infeasible in the health area [and channeling the 314(d) funds into existing or new categorical health services programs.] Proponents would argue its adoption from two very different vantage points. One group maintains that Federal funds properly should be expended only in pursuit of Federal priorities. Hence, State flexibility in the administration and discretion and use

of Federal funds is either unimportant or actually undesirable. Another group recognizes the value of flexibility for grant recipients but would favor this proposal on grounds that substantial flexibility is always present, in practice if not in theory, in categorical grants as well as in block grants. If categorical and block grants are seen as equivalent on this score, they contend, then the superiority of the former in cultivating political support must become the controlling consideration.

Both groups emphasize the need for a national level focus of accountability for Federal grants and stress the proven appeal of categorical grants to Congress, special interests, and Federal administrators. They also place great value in the protection categorical grants offered to worthwhile, but politically vulnerable, activities. Lastly, some point out that this approach obviates the need to struggle with the difficult administrative issues intrinsic to the block grant.

In short, proponents find the categorical approach to be a sensible, simple, and sensitive-to-national-priorities method for the Federal government to involve itself in public health servicing activities, and that any administrative or other problems it creates for recipient jurisdictions are either illusory or relatively unimportant.

Alternative 2: Recategorization With A Fund Transfer Provision.

The Commission finds that the block grant approach in health services is inherently unworkable, but still believes that recipient funding and administration flexibility are vital goals that cannot be

ignored. Hence, <u>the Commission recommends that Congress repeal Section 314(d) of the Public Health Service Act, as amended, and insert in lieu thereof a new provision authorizing recipient jurisdictions to transfer up to [15%][30%] of the funds from any one Federally supported categorical health program to another.</u>

This approach to reform would eliminate the 314(d) block grant and reallocate its appropriations to categorical grant programs. In addition, however, it would explicitly recognize the need for recipient flexibility by permitting the transfer of a specified percentage of the funds from one Federal health grant to another. In this way, its advocates hope that the primary advantages of the block grant would be retained, while its main drawbacks would be avoided. The transfer device, they point out, is embodied in HEW's proposed Allied Services Act, which would permit the transfer of up to 30% of the funds from a given HEW program (with a few programs excepted) to any other such program, for services directed at substantially the same population or for use in common administrative support services. Advocates also stress that this Commission endorsed such an approach (at the 15% level) in its 1961 report on <u>Modification of Federal Grants-in-Aid for Public Health Services (A-2)</u>, largely on grounds that the block grant approach was simply an "unrealistic" means of achieving greater recipient flexibility at that time.

This proposal represents a compromise between block and categorical grants. It retains the basic Federal accountability structure of the categorical grant, while at the same time providing for considerable

recipient flexibility in the use of Federal grant funds. In effect, this approach would resolve a basic block grant dilemma by placing well-defined limits on the extent to which all Federal health grants are to be responsive to State and local, rather than national, priorities. Its supporters maintain that this alternative takes advantage of the categorical grant's ability to generate political support, and, therefore, increased funding levels. While admitting that the operational details of this approach might be complex, they emphasize it would not require sorting out the even more difficult administrative issues inherent in the block grant. Lastly, unlike some other options, they point out that this one would address local, as well as State level, flexibility.

Alternative 3: Retention of the Current 314(d) Program.

The Commission finds that the existing 314(d) block grant program is a vital component of the Federal government's overall health services assistance package. Hence, the Commission recommends that Congress and the Administration retain the program essentially in its present form, but that the latter should upgrade its monitoring and evaluation of the program.

Proponents of this essentially status quo recommendation argue that it is the most politically feasible, since it reflects the current situation as reflected in the 1975 amendments to the legislation. Moreover, they contend that a balanced approach to Federal public health services assistance is required, one that considers both services having high national priority and the different and on-going program needs of the States. The latter goal, they stress, necessitates a program having flexible administrative, program and funding features; in short, a block grant. But, the former

goal is best achieved by categorical grants. This mixture of transfer devices in the overall health services area, they claim, permits the basic goals of each mechanism to be achieved without the many complications that arise when a block grant is expected simultaneously to achieve stimulative, support, and systemic goals. These advocates, however, usually seek stronger evaluation and monitoring of the block grant component, noting the Congressional resentment that past failures in these areas has produced. In stressing these administrative reforms, they intend no major diminution of recipient discretion, but simply to fortify the block grant program as it encounters perennial efforts to curb, recategorize, and/or castigate it.

Alternative 4: Federal Cost Sharing

The Commission finds that the existing public health services block grant has failed to live up to the commendable flexible servicing, expanded funding, and broad systemic goals of its framers, essentially because of the subsequent failure of Congress and the Administration to achieve an effective balancing within the program of national priorities and State program discretion. Hence, the Commission recommends that Congress enact legislation authorizing Federal cost sharing for

(a) [a range of statutorily specified public health services]

(b) [services related to statutorily specified public health goals]

up to a per capita ceiling within each State, with the added provision that any changes in national health protection priorities, as determined by Congress, would be reflected in a temporary variation in cost sharing for the service(s) in question.

The Commission also recommends that with enactment of this cost sharing program Congress repeal Section 314(d) of the Public Health Services Act

[ALTERNATIVE A]

[and other public health programs which primarily involve State and local governments,[1] and, over a reasonable period of time, fold into this program other public health programs which primarily involve public and private nonprofit agencies.[2]]

[ALTERNATIVE B]

[and, over a reasonable period of time, fold into this program other public health programs.[3]]

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[1] These, at a minimum, could include the following formula-based programs: Drug Abuse Prevention Formula Grants (Drug Abuse Office and Treatment Act of 1972, Title IV, Section 409), Alcohol Formula Grants (42 U.S.C. 2688), Special Alcoholism Projects to Implement the Uniform Act (Section 304, Comprehensive Alcohol Abuse and Alcoholism Prevention, Treatment, and Rehabilitation Act Amendments of 1974), Crippled Children's Services (42 U.S.C. 704), and Maternal and Child Health Services (42 U.S.C. 703). They could also include the following project grant programs: Community Mental Health Centers (42 U.S.C. 2681-2688), Migrant Health Grants (42 U.S.C. 242h), Disease Control-Project Grants (42 U.S.C. 300d-1 - 300d-3), Family Health Centers (42 U.S.C. 246), Childhood Lead-Based Paint Poisoning Control (42 U.S.C. 480), and Urban Rat Control (Public Health Act, Title III, Section 314(e)). They would not include Medicaid (Title XIX of the Social Security Act.)

[2] These, at a minimum, could include Family Planning Projects (42 U.S.C. 300), Drug Abuse Community Service Programs (Community Mental Health Centers Act, Part D, Sections 251 and 256; Drug Abuse Office and Treatment Act of 1972, Title IV, Section 410), Alcohol Community Service Programs (Community Mental Health Centers Act, Part C, Section 242), Alcohol Demonstration Programs (Community Mental Health Act, Part C, Section 247), Sudden Infant Death Syndrome Information and Counseling Program (42 U.S.C. 300c-11), Community Health Centers (42 U.S.C. 254c), Drug Abuse Demonstration Program (Drug Abuse Office and Treatment Act of 1972, Title IV, Section 410), and Mental Health - Children's Services (42 U.S.C. 2681).

[3] These, at a minimum, could include all the programs included in footnotes 1 and 2 above.

The Commission further recommends that Congress include in this cost sharing legislation provisions requiring:

-- each participating State and--where appropriate--in conjunction with the units of local government involved to develop a comprehensive annual plan applicable to its (their) program and priorities for rendering public health services;

-- such plans be published and generally made available to the public for review and comment, before submission;

-- the appropriate unit in the Department of Health, Education and Welfare to give substantive review in light of statutorily determined public health program goals and priorities, to approve such plans, to monitor the process by which they were developed as well as their implementation, and periodically to evaluate the effectiveness of this cost-sharing arrangement.

This reform proposal parallels that of the Assocation of State and Territorial Health Officials and the National Association of County Health Officers. Under it, the block grant would be replaced with a Federal reimbursement of fixed percentage of State and local expenditures for a defined set of health services.[1] Moreover, the numerous related categorical grants directed as preventative health care either would be simultaneously repealed with the enactment of the new program or gradually folded into it. The key issue involved in these alternative strategies, of course, is political feasibility v. program and administrative simplification.

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[1] For more details on this proposal, see Association of State and Territorial Health Officials, "A National System for Health Protection" (Washington, D.C.: A.S.T.H.O., September, 1975) Mimeographed.

The cluster of services covered by this arrangement could vary from State to State and would be reflected in a comprehensive plan that would be developed by State and local health and elected officials with citizen inputs. The parameters of each package, however, would be set by the program and priority goals set forth in the legislation and, under one version, include the range of other separate health service grants. Limits would be placed on the Federal share for each approved servicing package based on each State's population and need, or by a per capita ceiling for each State. A pass through of Federal funds to local governmental units would occur in those program areas where such units are the basic providers. A non-supplanting provision would bar States and localities from substituting Federal cost-sharing funds for their own outlays in the affected program areas. In addition, this proposal grapples with the Congressional concern for special service categories of high priority by providing for specific legislative identification of such categories, a higher initial Federal sharing percentage for these programs, and a subsequent reduction to the basic Federal percentage for the foundation cluster of services.

To help clarify the potentially controversial role of HEW in this program, the proposed legislation would provide statutory guidelines for the Department's role in plan review, approval, monitoring of plan development and implementation efforts, and program evaluation. As with regular block grants, these efforts are vital to the success of a program of this sort. Moreover, if a delicate balance is not struck here between effective substantive involvement, on the one hand, and non-intrusiveness, on the other, the merits of this approach are lost.

Advocates maintain that this approach, in effect, would resolve the basic block grant dilemma by defining the Federal purpose simply as sharing in the cost of State and local public health services, although changing national priorities could be addressed through the provision permitting temporary variations in Federal matching rates for particular services. The problem of funding uncertainty, they point out, would be reduced considerably by the nature of the matching. They note that it would provide for local government flexibility and direct participation as well as provide a major incentive to increased funding of health services by recipient governments. Proponents of this approach also stress that its consolidation features as well as the expanded funding over time would make recipient program flexibility more of a reality than it is today. Finally, its advocates maintain that under such a cost sharing arrangement there would be a return to State and local governments of authority and responsibility for setting their area's health service priorities to meet their special needs and for determining the total level of their public health program outlays; but there also would be an appropriate method for recognizing and supporting service areas of high national priority.

Alternative 5: A Broader Block Grant

The Commission finds that the existing 314(d) program is but a pale replica of the program envisioned by its founders in 1966, due to meager funding, recategorization, and the enactment of a cluster of new categorical health service programs. Hence, the Commission recommends that Congress repeal the mental health earmark within Section 314(d) and fold into

Section 314(d) other categorical formula grant programs providing public health services.[1]

The Commission also recommends that the Public Health Service Act be amended to require, by the end of each succeeding three-year period following enactment, the automatic consolidation into the 314(d) block grant of all health service project grant programs,[2] and health service formula grants enacted in the future, which Congress does not reassess and specifically exclude from such mergers.

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[1] These primarily include Alcohol Formula Grants (42 U.S.C. 2688), Special Alcoholism Projects to Implement the Uniform Act (Section 304, Comprehensive Alcohol Abuse and Alcoholism Prevention, Treatment, and Rehabilitation Act Amendments of 1974), Drug Abuse Prevention Formula Grants (Drug Abuse Office and Treatment Act of 1972, Title IV, Section 409), Crippled Children's Services (42 U.S.C. 704), and Maternal and Child Health Services (42 U.S.C. 703). They would not include Medicaid (Title XIX of the Social Security Act).

[2] These could include Community Mental Health Centers (42 U.S.C. 2681-2688), Migrant Health Grants (42 U.S.C. 242h), Disease Control-Project Grants (42 U.S.C. 347b), Emergency Medical Services (42 U.S.C. 300d-1 - 300d-3), Family Health Centers (42 U.S.C. 246), Childhood Lead-Based Paint Poisoning Control (42 U.S.C. 480), Urban Rat Control (Public Health Service Act, Title III, Section 314(e)), Family Planning Projects (42 U.S.C. 300), Drug Abuse Community Service Programs (Community Mental Health Centers Act, Park D, Section 251 and 256; Drug Abuse Office and Treatment Act of 1972, Title IV, Section 410), Alcohol Community Service Programs (Community Mental Health Centers Act, Part C, Section 242), Alcohol Demonstration Programs (Community Mental Health Centers Act, Part C, Section 247), Sudden Infant Death Syndrome Information and Counseling Program (42 U.S.C. 300c-11), Community Health Centers (42 U.S.C. 254c), Drug Abuse Demonstration Program (Drug Abuse Office and Treatment Act of 1972, Title IV, Section 410), and Mental Health - Children's Services (42 U.S.C. 2681).

The Commission further recommends that Congress amend the Public Health Service Act to (a) authorize a funding level for this expanded 314(d) block grant that is at least equal to the aggregate funding for the merged programs; (b) specify allocation and varying matching formulas for this grant, based on population and financial need; and (c) require each participating State in its allocation of 314(d) funds to give due recognition to the public health servicing and expenditure roles of local, regional, and private sector agencies.

Finally, the Commission recommends that immediate steps be taken to strengthen the reporting, evaluation, and auditing of this program.

Advocates of this full fledged block grant approach maintain there was nothing wrong with the vision of Section 314(d)'s framers. What has been missing, they claim, is the ingenuity, the persistent interest, and the spirit of intergovernmental comity necessary to make the device work and to reconcile national and State-local health service goals. While conceding that the block grant is a difficult transfer device to administer, they point out that the present hodgepodge of categoricals, earmarkings, and a blunted block grant is no answer to the dilemma confronting the nation and the States in the public health service area. Real State flexibility in the use and administration of Federal public health assistance is still a vital goal, they contend, pointing out the heavy State commitment of its own resources to this program area.

The four components of this reform proposal, its advocates emplorize, are all vital to achieving this broad block grant. In focusing initially on existing formula-based categoricals, they contend, programs that already

are largely the responsibility of State public and mental health agencies are singled out for early consolidation. This strategy is more realistic than the one calling for a wholesale merger of all formula and categorical service programs and it avoids potential major State-local conflict at the outset. The proponents concede that the mental health-public health merger will not be easy but argue that it should be faced and overcome before the complex question of the numerous project categoricals is confronted.

Regarding the latter, these block grant advocates advance a phasing-in strategy that would require all such existing grants to be folded into the 314(d) program at the end of every third year following enactment of this proposed reform measure. The only exceptions would be those health service project grants that had been reassessed during each third year by the pertinent standing committees of Congress and statutorily exempted from this merger provision. Formula based public health service programs enacted subsequent to the passage of this omnibus 314(d) measure also would be subject to the same procedure and provision. In defending this feature of their strategy for reform, the proponents point out that most such grants now contain termination dates that rarely exceed three years and the specific exemption requirement is a necessary device to engender a thorough set of oversight hearings as well as to raise the basic question in Congress as to whether the program in question merits continued high priority. In short, these advocates claim, this procedure strikes a healthy and realistic balance between strengthening the block grant and recipient program discretion that goes with it, on the one hand, and recognizing Congress' legitimate concern for giving certain health services preferred attention.

The fiscal component of this broad block grant proposal recognizes the need for Federal 314(d) authorizations and appropriations to grow commeasurately as the mergers mount. Consolidations, the proponents point out, all too frequently resemble Federal efforts to retrench, not to reform. In calling for the reinstitution of the variable match, these reformers note that with an expanding program such a step is necessary--fiscally, politically, and programatically. Many of the larger grants slated for merger have matching requirements, they point out, and the current fiscal sensitivity of Congress suggests the wisdom of including this fiscal provision. The requirement that States consider the fiscal and servicing roles of city, county, regional, and private sector health service providers in their allocation decisions and health planning constitutes a clear recognition that a truly broad public health service block grant inevitably involves these providers and that many of the project grants that might be merged with the 314(d) program deal largely with these agencies and units. Moreover, it complements the purposes of the recently enacted health planning legislation. This approach avoids the arbitrary and administratively complicated statutorily required pass-through. Instead, it borrows partially from the experience of the Safe Streets program where State planning agencies in 1970 were urged by Congress to give greater attention to the needs of urban high crime areas in their substate allocation decisions and where the subsequent record indicated that this admonition was heeded.

FInally, most of these proponents acknowledge that Congress and HEW have legitimate need for more substantive plan review, better monitoring, improved evaluation efforts and more systematic and reliable reporting

under an all-encompassing block grant. Let the conflicts, when and if they arise, be worked out within the framework of these efforts and this kind of program, they contend, rather than through sporadic battles within the numerous health programs and in counter-productive clashes between the political branches of the national government. In the long run, the goals of a more integrated, collaborative, and better administered public health service system are more likely to be achieved with this kind of block grant than under any other transfer device, they maintain.

C

ADVISORY
COMMISSION ON INTERGOVERNMENTAL RELATIONS
WASHINGTON, D.C. 20575

MEMORANDUM

TO: Members of the Advisory Commission on Intergovernmental Relations

FROM: Wayne F. Anderson, Executive Director WFA

RE: Chapter VI -- Findings, Issues and Recommendations Chapter of The Federal Grant System: Middle Range Reform Efforts volume

The chapter that follows is the final one in the third volume of the Commission's overall study of the Intergovernmental Grant System: Policies, Processes and Alternatives (The Safe Streets Act: Another Look at the First Major Block Grant Experiment and Partnership for Health Act: Lessons From a Pioneering Block Grant being the first two). The research schedule on the remaining portions of this major undertaking suggests (1) completion of the block grant component with Commission consideration of the Community Development and CETA programs at the spring meeting; (2) completion of the State role in the intergovernmental grants' system, the fourth basic part of the study, by spring; and (3) completion of the categorical component in time for the fall meeting.

The chief focus of the chapter presented here (and the four backgrounders sent out under separate cover) is on Federal organizational, procedural, and certain program efforts to upgrade grants management within the executive branch and, to a lesser degree, at the recipient governmental levels. The probe of organizational responses then does not cover Congress or State and local governments. The procedural assessment deals wholly with circulars and other mechanisms relating to improved grants management or improved intergovernmental communications, not with those involved with environmental, civil rights, or other policy objectives. Moreover, the procedures for grant management, not the technical assistance and special grant programs relating thereto, are the concern here. Some of these excluded topics, it should be noted, will be covered in remaining portions of this study.

This particular volume then deals with the range of organizational and procedural efforts mounted at the Federal level, chiefly during the past ten years, to help correct some of the operational defects in the grant system: They began as a move to streamline the administration of the categoricals. They now cover both categorical and block grants. We have described them as "middle-range reform" efforts, since they (1) go well beyond the modest undertakings of the fifties and early sixties, (2) stop short of the strategy that would convert the Federal aid system into one composed wholly of general revenue sharing and block grants; and (3) are rooted in the assumption that categoricals will not disappear, that more block grants may be enacted, and that both forms of transfer raise various questions of a coordinative management nature.

The summary findings and analysis of the basic issues raised by these efforts are presented in the first two parts of Chapter VI. They help provide a framework for consideration of the 13 draft recommendations that round out this chapter. The recommendations, in turn, are divided into three parts:

> The first (Recommendation 1) provides the Commission with an opportunity to enunciate a general policy position on the contemporary role of management at all levels.
>
> Part II contains a pair of recommendations (2 and 3) dealing with the fundamental Federal executive branch organizational question (with five basic alternatives) and the Federal Regional Councils (with three alternative strategies, in effect). For some, the propriety of an intergovernmental body considering such matters is questionable. Yet, the ACIR, from its earliest reports to its most recent, has never refrained from urging structural and procedural reforms in State and local governments. Moreover, in its Fiscal Balance and Urban and Rural America reports the Commission already has gone on record for certain organizational and process-related changes within the Federal executive branch. The paramount issue here is whether the Federal government's role in contemporary intergovernmental relations is affected by all, some, or none of the structural and procedural features of the Federal executive branch. The alternatives presented in Recommendation 2 address this central issue, one way or another.
>
> Part III presents ten draft recommendations covering a range of possible procedural reforms. In general, they are less controversial than the two previous ones. At the same time, they cannot be wholly divorced from the earlier organizational options.

CHAPTER VI. FINDINGS, ISSUES AND RECOMMENDATIONS

INTRODUCTION

This phase of the Commission's study of The Intergovernmental Grant System: Policies, Processes, and Alternatives has focused chiefly on organizational and procedural efforts undertaken at the Federal level to remedy some of the operational defects in its grant system. We have termed these "middle-range reform" efforts because they work within and accept the likely continuance of the categoricals. Moreover, they stop short of a transformation of Federal aid into a general revenue-sharing and block grant-oriented system. Hence, they seek to improve the management of Federal grants, which at this point includes a still growing number of categoricals as well as block grants.

Some have viewed these measures as a necessary prelude to far more reaching block grant and revenue sharing approaches. Others view these efforts as mere palliatives and see in block grants and general revenue sharing the only real cure to the problems of categoricals. Still others, on the other hand, interpret them as a necessary component of a Federal assistance undertaking that includes all three of these intergovernmental fiscal transfer devices. This group notes that with the advent of block grants, the difficulties of coordinative management among them as well as between them and categoricals only underscores the need to pursue further these undertakings.

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Chapter I in this volume provided a historical and analytical introduction to these "middle range reforms." Chapter II, considered at the Commission's September, 1975 meeting, assessed the role of three "target grants" in seeking new approaches to better grant coordination and management. Chapter III probed Federal efforts to standardize and simplify grant procedures and to strengthen interlevel communications. The following chapter considered the Federal organizational response within the executive branch to the challenges of achieving better grants management and improved intergovernmental relations. Finally, Chapter V examined various Federal procedures geared to bolstering recipient State and local coordination and discretion, both in administrative and substantive program areas.

This portion of the Commission's study, then, is restricted to Federal organizational, procedural, and certain program efforts geared toward upgrading grants management either at the Federal and/or recipient levels. The organizational focus is chiefly on the Federal executive branch, not on Congress or State and local governments. The procedures cover governmental circulars and the mechanisms relating to improved grants administration, not those that seek to implement environmental, civil rights, or other policy objectives. Moreover, those procedures that deal with recipient coordination and discretion concerns are simply that--procedures, not programs of technical or program assistance like the 701 planning effort or the Intergovernmental Personnel Act. So much for what is covered and not covered in this phase of the Commission's study.

BACKGROUND AND SUMMARY FINDINGS

The following provides a brief background and summary of the findings regarding these "middle-range" procedural and executive branch organizational responses at the Federal level.

Organizational Responses

Background: An initial set of changes in the organization of the Federal executive for intergovernmental relations was made during the Johnson administration. This period saw the development of three "target grants," all of which were intended (among other objectives) to redirect the flow of Federal assistance to especially needy areas and to promote better coordination among various Federal programs. Among the organization developments associated with these programs were the creation of the Office of Economic Opportunity within the Executive Office of the President and its interdepartmental Economic Opportunity Council, which President Johnson hoped would become the domestic equivalent of the National Security Council. The Appalachian Regional Commission was established on a Federal-multistate partnership basis, while at the local level community action agencies, city demonstration agencies, and local development districts were formed. During this period, the Bureau of the Budget also became increasingly concerned with achieving more effective coordination among Federal agencies and with its own internal organization and processes. The first pilot Federal Regional Councils were created, and the President designated the Vice President and Office of Emergency Planning as his liaisons with mayors and governors, respectively.

Reorganization Plan #2 of 1970, proposed by President Nixon, was the genesis of the current organization framework for Federal assistance policy and management and, indeed, for all domestic activity. The plan created a new cabinet-level Domestic Council which was to be concerned with "what" the government was to do, while the Bureau of the Budget was redesignated the Office of Management and Budget and assigned responsibility for "how" these activities were to be carried out and "how well" they were performed.

Other important actions were the establishment of the Office of Intergovernmental Relations and the ten Federal Regional Councils in 1969. The Office, which operated under the direction of the Vice President, provided another element of the new machinery--a center for liaison between the President and State and local governmental officials. The FRCs provided mechanisms for program coordination, information, and liaison in the field. A process of decentralizing grant administration to the regional offices and the standardization of regional boundaries and office locations also was begun.

By a series of separate actions, significant changes in the roles of many of these organizations were made in late 1972 and early 1973. The Office of Intergovernmental Relations was disbanded, with its activities transferred to the Domestic Council. The Domestic Council itself also was altered by the development of the system of Presidential "counselors" as a new coordinating element and the reduction of the Council staff by about fifty percent. At about the same time, several grants management procedures were transferred from the Office of Management and Budget to the General Services Administration and another to the Department of Treasury. These changes were justified by the necessity of reducing the size of the

the Executive Office of the President by placing certain "line" functions in other agencies. In late 1975, the GSA's activities in intergovernmental management were returned by action of the Congress (and over OMB's opposition) to the Office of Management and Budget.

Organizational Findings:

The activities and performance of these organizations reviewed in Chapters II and IV, suggest the following general conclusions:

--Considerable attention has been devoted to the better "coordination" of assistance programs throughout the past decade. A wide variety of administrative reforms have been executed, and still others proposed, in the service of this objective. However, none of these have had more than limited success in eliminating conflicts or differences of policy and procedure among Federal agencies and their grant programs. To date, it has proven impossible to make more than marginal improvements by means of organizational and procedural change in the operation of a system of Federal assistance programs largely characterized by fragmentation, inconsistency, complexity, and duplication.

--Traditional administrative theory suggests that organizational coordination can best be obtained through a hierarchical organization under the direction of the chief executive. Hence, many analysts have recommended the creation of a "focal point" unit for intergovernmental relations located close to the President. An alternative theory suggests that sufficient coordination often can be attained without recourse to hierarchical organization or centralized management. These conflicting theories make the selection of an optimal coordination system difficult. Moreover, the past record of efforts based on both theories in the intergovernmental area show few positive results.

--The attempts to improve coordination among programs have demonstrated that Federal agencies have few incentives to standardize, simplify, or "target" their activities. Their primary concern (shared by the Congressional committees which oversee them, as well as most interest groups) is to be able to account for and make effective use of each specific grant program they administer. This naturally leads to differences in requirements and procedures.

--One of the most important constraints on coordinative activities and Federal coordinating agencies has been the limited interest and attention of the President and his top-level staff. While many observers believe that steady Presidential involvement in domestic program management is essential, the record offers little reason to suppose that priorities will change.

--A multiplicity of coordinating agencies sometimes has led to conflict among them and made it difficult to identify specific areas of authority and responsibility. Coordinating systems frequently have been altered or discarded and replaced after short periods of use.

--Since 1970, the Domestic Council has been formally responsible for developing basic domestic policy, while the Office of Management and Budget is charged with budget development and management oversight. In practice, this division of functions between the two has not been sharply defined, and neither has monopolized the activities assigned to it. Some management activities were transferred to other Federal agencies, while the OMB, special White House working groups, Presidential counselors and assistants, other Cabinet-level organizations, and sometimes departments have played significant roles in policy formulation.

--The Bureau of the Budget, later the Office of Management and Budget, initiated (sometimes in response to Congressional enactments) many of the procedures to coordinate and simplify the operation of the categorical grant system. However, despite several reorganizations, the Office has not become the significant force for management improvement which had been anticipated; most of its attention and resources continue to be concentrated on its budgetary activities and these, in turn, rarely have been geared to management purposes.

--Since late 1972, the Domestic Council has served as the primary liaison between the President and policy-level officials of State and local ogvernment. Hampered by a small staff, the Council has devoted little attention to intergovernmental relations and has not provided sufficient representation of State and local concerns. Similar responsibilities had been assigned previously to the Office of Intergovernmental Relations, the Vice President, and the Office of Emergency Planning. While results were mixed, these arrangements were somewhat more effective, with a key variable seeming to be the degree of personal commitment on the part of the President and the official assigned responsibility for the liaison activity, as well as the ability of staff.

--The Federal Regional Councils have engaged in a variety of useful special projects and provided important communications links. But they as yet have made only minor contributions to the coordination of Federal program operations and the strengthening of relations among the levels of government. The most significant constraint upon their activities is the continuing centralization of decision-making for many assistance programs and the lack of full administrative authority among the regional officials who make up the Council membership.

Procedural Reforms:

Three of the major procedural thrusts of the recent movement for "middle range" reform of categorical grants have been the standardization and simplification of grant administration procedures through management circulars, the improvement of intergovernmental information and communication, and development of Federal procedures for strengthening State and local coordination and discretion.

The Management Circulars: Description and Findings: The reform of grant procedures has been approached mainly through three key management circulars administered by OMB, then GSA, and finally (in January 1976) again OMB:

* GSA Circular FMC 74-7 (formerly OMB Circular A-102) -- Uniform administrative requirements for grants-in-aid to State and local governments.

* FMC 74-4 (formerly A-87) -- Cost principles applicable to grants and contracts with State and local governments.

* FMC 73-2 (formerly A-74) -- Audit of Federal operations and programs by Executive Branch agencies.

FMC 74-7 was a landmark circular. It standardized and simplified 15 areas of grant administrative requirements, and placed restraints on Federal grantor agencies' imposition of "excessive" requirements. Its major objectives were to ease the burden of time-consuming grantee requirements, emphasize performance rather than procedures, require only essential information in reports and applications, and decentralize managerial responsibility while still enabling effective Federal managerial oversight.

FMC 74-4 established the principles for determining allowable costs of programs administered by States and localities under Federal grants and contracts. Besides standardizing direct cost definitions, it provided a standard method for State and local recipients to recover indirect costs associated with administrative support services in Federal grant programs.

FMC 73-2 was the Federal audit circular. In conjunction with the promulgation of audit standards by the Comptroller General and the initiation of the Intergovernmental Audit Forum, it was designed to improve the efficiency and effectiveness of Federal program auditing. Equally important, it was designed to promote the acceptance of non-Federal audits and encouraged greater consistency and quality of audit work.

What general conclusions may be reached concerning this trio of circulars?

-- Responses to ACIR questionnaire surveys of State budget officials and Federal grant program administrators, comments by Federal agency grants coordinators, the general reactions of the public interest groups, and the reports of the General Accounting Office and others, indicate that the three management circulars as a group have achieved improvement in the administration of the categorical grants. Congressional consideration of the possibility of action to force abandonment of the circulars in late 1975 provoked strong support for continuation of the circulars from State and local public interest groups and others.

-- A review of the experience under the circulars also suggests that they have not been complete successes and that they need different kinds and degrees of improvements to attain their potential. While they have shortcomings in the substance of their provisions, their major deficiencies are in the manner and degree of their interpretation and implementation.

-- On substance, for example, some Federal administrators feel that the procurement provisions of FMC 74-7 place too much trust in the adequacy of State and local procedures and safeguards. Others feel that this circular imposes too much standardization on Federal programs, with too little regard for the differences that are vital to the achievement of individual program objectives. On the cost circular, staff members of the GAO, who are in the midst of an appraisal of the circular's effectiveness, have voiced concern over the clarity of the concepts incorporated in the circular and some States charge that the audit standards in FMC 73-2 are not as standardized as claimed.

-- Regarding implementation, public interest groups are concerned that GSA and OMB have not held Federal agencies' feet to the fire sufficiently, and have relied too much on complaints as the chief, if not sole, means of monitoring compliance. Federal grant administrators have complained that GSA interpreted the circulars too rigidly and without regard to the realities of day-to-day operation. Moreover, some observers feel that GSA and OMB do not put enough weight behind circular provisions which merely encourage rather than require certain practices. An example is the encouragement of non-Federal audits use under the audit circular.

-- These criticisms of the circulars and their administration highlight a paramount point that must be understood when judging experience under the circulars: parties representing different interests in the grants process have different kinds of complaints. The public interest groups stress enforcement failures, whereas Federal grantor agencies chafe at efforts to standardize or complain about "unrealistic" interpretations of circular provisions. This suggests that in the development of improvements in grants management, the nature of the grantor-grantee relationship is such that it will never be possible to completely satisfy both ends of the grant process.

Intergovernmental Communications and Consultation: Background and Findings: In the field of intergovernmental communications and consultation, the new measures initiated over the past decade also have worked to ease some of the strains in the categorical grants system. Yet, the record is more spotty than that of the management circulars, perhaps reflecting the plowing of newer ground than in the areas covered by the management circulars.

--The Regional Management Information System (RMIS) was an effort to equip the Federal regional councils with new tools for their task of interagency and intergovernmental coordination in the field. Only one of its three components, the Program Budget Information Subsystem (BIS), survived the period of experimentation, and there was some question about how useful it continued to be.

--Another component, the Grant Tracking Information Subsystem (REGIS), focusing on regional offices, helped underscore the need for a better system of tracking grant applications. This contributed to the development of a new system for tying together grant award information and information on grants subjected to the A-95 review and comment process.

--T.C. 1082, the Treasury Circular requiring Federal grantor agencies to inform States of grant awards made within their jurisdictions, has not attained its potential. But again, the new system for reporting on grant awards holds forth hope for better compliance by affected Federal grants agencies.

--The Catalog of Federal Domestic Assistance has become well-established as an indispensable source of information, despite continuing complaints about inadequacies and imperfections. Year-by-year refinements were making it more useful and enhancing its value as the basic reference for information on all Federal assistance programs. A recurrent complaint, however, was and is the inadequacy of fiscal data: current information on how much money is available under specific programs.

--Information on past expenditures began to be reported by location of the expenditure through the Federal Outlays report initiated in 1967. While it also has limitations, it is accepted by many as better than anything else available.

--Not the least of the efforts to improve communications and involve State and local officials more as partners in the grant process was the A-85 procedure for consultation with chief executives of State and local general purpose governments in advance of the issuance of new regulations. Initiated in 1967 in response to longstanding pleas from public interest groups for an opportunity to be heard before regulations were frozen in concrete, the process was and is falling short of original expectations. Some have questioned whether the procedure is worth the effort being expended on it, but the public interest groups at least are unwilling to give up on it.

Federal Procedures for Strengthening State and Local Coordination and Discretion: Exploration and Conclusions: The six measures examined in Chapter V are OMB Circular A-95, HUD's Annual Arrangements, and Chief Executive Review and Comment (CERC), Integrated Grant Administration (IGA), the Joint Funding Simplification Act, and the proposed Allied Services Act.

OMB Circular A-95 implements Title IV of the Intergovernmental Cooperation Act of 1968 and has four Parts:

* Part I establishes the Project Notification and Review System (PNRS). This is a process by which State, regional and local governments are given the opportunity to review and comment on proposed applications for Federal grants that affect physical development and human resources. The objective is to strengthen their respective planning and decision-making processes and offer them a chance to influence Federal program decisions affecting their jurisdictions.
* Part II establishes the framework for a similar review and comment system applicable to direct Federal development projects.

* Part III give Governors the opportunity to review and comment on State plans required under Federal programs with respect to their consistency with State plans and policies.

* Part IV provides for the coordination of Federal planning and development districts with substate districts to help bring some order to the tangled undergrowth of federally spawned districts.

What effect have the four Parts of A-95 had on State and local processes for controlling and coordinating the impact of physical development and human resources grants?

--Probably the most effective is Part I through the support it has provided for areawide planning and coordination performed by regional councils. Serious doubts exist about the degree to which Part II has helped States and their political subdivisions.

--Similar doubts are raised regarding the extent to which Governors have availed themselves of the opportunities offered by Part III to coordinate Federal program plans with State comprehensive plans. Unofficial figures, indicate some strides in bringing order out of the multiplicity of substate districts stimulated by Federal grants, but it is unclear how much this can be credited to Part IV of the circular.

--A clue as to A-95's effectiveness is the degree to which State, regional, and local jurisdictions take advantage of the opportunities presented by the circular: the initiatives asserted by Governors and their generalist budget and planning staffs, by regional councils, and by mayors, county executives, and city managers. Indications are that not only have Governors fallen short in this regard, but also local chief executives.

--The possibility of taking advantage of the opportunities offered by A-95, however, depends critically upon the apparatus established by OMB, Federal agencies, the States, and perhaps to a somewhat lesser extent regional bodies and local governments for channeling information and making decisions. It also depends on the resources and zeal which each dedicates to making the several processes function.

--Criticisms have been leveled at these aspects of A-95, particularly under Part 1, and with justification in many instances. There has been notable progress in responding to these criticisms, insofar as it is reflected in improving the provisions of the circular and the efforts of the limited OMB staff managing it. Yet, there is serious question whether the procedure can work effectively without additional OMB central staff and as long as primary responsibility for compliance is left with the Federal agencies.

Annual Arrangements and CERC were demonstration programs initiated by HUD to help prepare local officials for broadened discretionary powers expected under the community development block grant. An Annual Arrangement culminated in an annual negotiated agreement between the local chief executive and HUD whereby HUD agreed to approve specific grant programs in exchange for the city's meeting certain project selection criteria and taking certain prescribed steps. Limited to HUD programs, it expired with the advent of the block grant.

Like the project notification system under A-95, CERC aimed to strengthen the chief executive's influence over Federal grants coming into the city and to support the city's planning and decision-making process. It embraced more Federal programs than A-95 but also was terminated with the coming of the community development block grant.

What does the brief record of these two procedural innovations suggest?

--Evaluations of Annual Arrangements were mixed. Some indicated substantial progress in preparation of city wide development strategies, creation of coordinating mechanisms, and enhancement of the chief executive's leadership role. Others indicated tepid city responses for various reasons, including suspicion of the Federal government's motives and a basic indifference to federally-initiated programs.

--CERC seemed successful in many of the few cities where it was tried, in helping strengthen chief executives' influences over Federal programs affecting their communities. Yet, some felt that a chief executive's profiting from CERC depended on the authority that he already wielded in his community.

--As Annual Arrangements and CERC cities accumulate experience under the block grant, there should be a better opportunity to judge how useful the two demonstrations were.

IGA was an experimental, then demonstration, program of the Administration geared to simplifying the job of recipients in obtaining Federal funds and to enhancing their capacity to integrate Federal and other programs, including their funds, directed at common objectives. The program was intended to test the feasibility of a Joint Funding Simplification Act, and expired when that legislation was enacted in 1974.

--Many of IGA's weaknesses were inherent in the experimental nature of the program, such as the vagueness and apparent inconsistency of policies and procedures.

--The program scored enough successes, however, and showed enough potential for improvement to help persuade Congress to authorize a five-year trial through the Joint Funding Simplification Act.

--Implementing regulations for the new Act respond to most of the suggestions that were made for improving the IGA process.

A proposed Allied Services Act was first introduced in Congress in 1972; the current version, like its preaccessors, is endorsed by the Administration. It seeks to demonstrate how State and local governments can improve delivery of human services programs by integrating presently separate programs through State and local "allied services plans." It would enhance the processes of planning human services at both the State and local levels and promote the simplification and effective delivery of related services. Its slow legislative progress is ascribed to the opposition of interest groups supporting programs they fear would be folded into an integrated program and the sharing of legislative jurisdiction by four House committees.

ISSUES

The record of these various organizational and procedural efforts at the Federal level to strengthen grants management in Washington, the field, and among recipient jurisdictions inevitably raises certain basic questions. The following analysis of some of these, along with the previous catalogue of summary conclusions, provides a foundation for considering the range of recommendations that completes this chapter.

Basic Organizational Questions: Three fundamental issues emerge from the efforts to mount an effective organizational response in the Federal executive branch to the challenges of better grants management and of improved intergovernmental communications and relations:

(1) Can and should a degree of centralized, hierarchic organizational control be exerted over the performance of Federal activities having an impact on intergovernmental relations?

(2) Related to the above, but couched in more specific organizational terms, can and should there be a centralization of all Federal central management and policy development activities that impact on intergovernmental relations? and

(3) What do such activities actually include at the present time? Existing assistance and assistance-related efforts? Existing and planned assistance and assistance-related undertakings? Or all these, as well as various direct Federal activities and national economic matters (in short, the bulk of the Federal domestic sector)?

The first question is raised in several different contexts: at the national headquarters level, at the regional level, and within the various departments. Moreover, it has generated at least two contending schools of thought. On the one hand, those with a traditional approach to public administration believe that coordinated action is most readily obtained by a properly-structured organization headed by a "strong" chief executive, whose oversight capacity is strengthened by the assistance of his staff agencies. On the other hand, a second group offers a variety of criticisms to the traditional approach, which they find has little relevance to many contemporary problems of policy and administration, especially in the intergovernmental area. The practical and political limits on the ability of a chief executive to impose coordinated action also are stressed. Large-scale, centralized organizations, these critics argue, are often inefficient, unresponsive, and unreliable. Moreover, they contend that an adequate degree of coordination can often be attained without organizational centralization, and that some positive advantages flow from a certain amount of "overlap and duplication"--"competition," in their view--among administrative agencies.

To complicate matters, the issue is confronted in a variety of guises. At the national level, it is raised in connection with the appropriate role of the Office of Management and Budget, as the management arm of the President. Many regard the OMB as the "proper" location of central management activities, and believe that it should exert considerable leverage upon the departments in attaining conformance to its circulars and other management initiatives. The opposing view holds that program management is at the core of Federal domestic administration and that it must be viewed primarily as a departmental and agency, rather than a Presidential responsibility. Where the

first concept places the President at the top of an administrative pyramid, the second places him in a secondary role, emphasizing instead the links between the Secretaries or bureau chiefs, on the one hand, and the Congressional committees which have authorized and oversee their programs as well as OMB's budget examining staff on the other.

Few now hold to this second conception of administrative roles in its most extreme form. In between, however, there is an entire spectrum of intermediate positions, with some tending more one way, some the other. Moreover, and in the wake of Watergate, some of the anti-heirachic proponents have developed new arguments. Those in this group stress that the President, while the chief executive, is also a political leader concerned with his own re-election and that of members of his party or other supporters. The danger, they warn, is that he will seek to use the central administrative apparatus for his personal, political objectives. For this reason, some would place more restraints upon him, limiting his administrative authority. The opposing group, however, believe that an energetic executive is a key to the effective operation of the American national government and argue that such measures may cause more harm than they are worth. An alert press, a probing Congress, and effectively functioning public interest groups, they claim, provide adequate checks at this point. Here again, there is a wide range of opinions between these extremes.

This same general issue arises when considering the Federal Regional Councils. As currently conceived, the Councils are chiefly meeting-places for discussion and action by co-equal agencies. This is symbolized most clearly by the status of the chairman who, though appointed to the office

by the President, serves on a part-time basis for a brief period, after which the job is rotated to one of his colleagues. The underlying theory is that adequate coordination can be achieved without administrative force, simply through consultation and cooperation. But the critics argue for placing the Councils in a stronger line of hierarchical authority. Frequently advanced reforms include linking them directly with the Office of Management and Budget; a permanent, full-time FRC chairman; and an independent FRC staff. Some of these critics even argue that the FRCs should become (or should be replaced by) "little OMB's" which can serve as representatives of the President in the field. This is, of course, what the BOB had sought initially: the recreation of its field offices and the addition of a field staff. But Congress, at least through its Appropriations Committees, has generally opposed such moves, which leaves the impression that this body adheres tacitly to an anti-hierarchic viewpoint regarding Federal field mechanisms.

Interagency agreements are a third area in which this issue presents itself. These, in the traditional administrative view, are weak and generally inappropriate coordinative management instruments, to be used in only those cases in which they are absolutely essential. Such agreements, the traditionalists argue, evidence poor organizational design. Moreover, they contend such agreements are often ineffective, since they often rely simply on the desire of two individuals in different agencies to work together. Their basis then is fragile, and a change in personnel or circumstance may void the agreement. For this reason, some have proposed that such agreements be given firmer official standing, and be "policed" and enforced by a central management agency.

The proponents, on the other hand, find that the ad hoc, semi-voluntary, and fairly informal character of these agreements are what make them so useful. After all, the most effective interagency cooperation, they claim, is that which emerges out of shared needs, not higher level coercion. Moreover, they dispute the charge that such agreements are a sign of poor organizational design, arguing that no structural rearrangement(s) could possibly take into account the wide variety of interprogram contacts and conflicts that present-day Federal activities can generate.

This question of organizational centralization also is raised in connection with the various departments. Many of these, like the executive branch generally, have little internal cohesion, but follow widely varying policies, practices, and procedures--dictated by their internal functional divisions. Some argue that the responsibility for grants management and other IGR activities should be centralized with (or at least centrally monitored by) a unit located close to the office of the Secretary. The rationale here is that there is likely to be a better balance between specific program concerns and those of coordinative management at this level. Yet, this position, in turn, raises serious questions for those seeking more of a government-wide effort from the OMB.

The second question raised by the organizational record deals with the functional breadth of the central administrative and policy units. The chief problem here is to determine the best organizational placement of the several activities having intergovernmental impacts which may be distinguished: budget preparation, policy development, State-local liaison, evaluation, government-wide management procedures, and legislative reference.

One common view suggests that these functions are essentially only two, those relating to policy (some would say "politics") and those relating to administration or management. The first involve the setting of basic goals and program strategies and is held to be a function of the highest levels: the President, the Congress, and to some degree the Cabinet. The second or administrative function is that of executing or implementing these pre-determined activities. This is a departmental reponsibility, though one which a central management agency is supposed to oversee. This split-level theory is, of course, that which underlies the division of responsibility between the Domestic Council and the Office of Management and Budget as set forth in Reorganization Plan #2 or 1970.

Another approach to this organization locational issue proposes the unification of many of these activities. A single central unit, it is argued, should assist the President in conceiving, developing, and then executing a coherent strategy. "Policy," some of its proponents argue, is partly the sum of an array of budgeting and central management actions as well as day-to-day administrative and program decisions. Those who oversee and those who operate programs are in a very real sense involved in this policy process, these analysts claim. Moreover, decisions regarding the development of policy must take into account the practical administrative problems which determine the capability of central management and line departments to implement policy and programs. For these and other reasons, these activities are seen as essentially interrelated and that all, but those pertaining to the Departments and agencies, are susceptible to unification under a single central unit.

Still others see many of these activities as discrete and necessarily separable. While there is a need for a certain amount of communication and "coordination," actual performance may be dispersed. Indeed, in the view of some, there are benefits to separation. "Monopolies" over an activity or service are thought to be as detrimental in the public as in the private sphere. A number of centers with closely-related or even overlapping functions, they contend, offer greater assurance that all important issues will be raised and all crucial tasks performed. A certain "separation of powers" permits each unit to act as a watchdog upon the others.

Some would argue that this is preeminently the case with the Federal executive branch's role in contemporary intergovernmental relations. Here, they point out, there is a range of fairly discrete activities that all fall under the coordinative management heading but would be difficult, if not impossible, to subsume under a single central unit. Communications regarding existing intergovernmental programs and procedures as well as emerging problems and proposals; liaison on specific difficulties with specific jurisdictions as against liaison on more general questions affecting several governmental units; policy development for intergovernmental programs as against that for management; and management of programs versus management of the program managers, they stress, are all intergovernmentally related activities, but they inevitably involve a range of executive branch actors.

These pluralists usually concede the need for a better monitoring and coordination of these various efforts, but they reject the idea that any single unit within the Executive Office of the President should or could assume a direct role in and responsibility for all of them.

Looking at the recent record more directly, the Bureau of the Budget, until the mid-sixties, was the primary center for budget preparation, legislative review and policy analysis, management improvement and "coordination," and was also a key contact with generalist officials of State and local governments--especially their own budget staff. Thus, many activities were unified, although the BOB's control over the departments was by no means absolute and some questioned its effectiveness in some of its directly assigned activities.

In the period since, these activities have been divided in a wide variety of ways. Key staff units have included the Office of Economic Opportunity, the Council for Urban Affairs (and another for Rural Affairs), the Domestic Council, a network of Presidential counselors, an Office of Intergovernmental Relations, the General Services Administration's Office of Federal Management Policy, and a variety of special-purpose boards and Presidential assistants. Yet, this pattern, too, has produced its critics. Hence, the organizational location question explored here is still very much an open one.

A third issue pertains to the very definition of "intergovernmental relations." To some, the concept is very broad, essentially identical with domestic affairs. There are few domestic activities, these commentators argue, which do not involve all levels of government. The Federal government, they point out, offers some support for nearly every type of State and local service--or, to put the matter the opposite way--State and local governments are a primary instrument of the Federal government's efforts to meet its own national objectives. Moreover, direct Federal initiatives in the national economic, fiscal, income maintenance, and health areas--to cite only the more obvious--can critically condition State and local operations.

Clearly, the levels are more interdependent than ever before, so this argument runs. Hence, a strong case can be made for joint action and considerable State-local participation in the development of domestic policy proposals as well as in the executive budget process.

Others argue that intergovernmental relations is a much narrower field, properly embracing only the range of assistance issues and those few Federal actions that impact directly on State or local governments. State and local governments have no special role, according to this view, in setting the Federal government's own basic national objectives. Instead, they are seen as one interest group among many, acting as special pleaders and claimants upon the Federal treasury.

Though this debate appears to hinge sinply on contrasting definitions, the outcome can condition one's position on the earlier organizational location issue. And depending on the outcome, it could even buttress arguments that the internal organizational pattern of the executive branch of the Federal government, especially the components of the Executive Office of the President, is or is not a proper topic of analysis and criticism by State and local governments or by a Commission whose chief concerns are intergovernmental relationships.

Procedural Issues: There seem to be two general procedural issues with regard to these "middle range" reform measures: (1) Are they worth the effort, even assuming they achieved reasonably good standards of performance? (2) If they are worth the effort, what are the ingredients needed to make them more effective?

Are these reform efforts worthwhile? The answer to the first question seems obvious, in light of the fact that the management circulars, improved communication efforts, and Federal procedures for strengthening State and local coordination capabilities are rational responses to the problems they were designed to deal with; are managed and, in some cases, were initiated by such top-management bodies as OMB, GSA, and the FAR group; have been pursued over the past decade with considerable (though some would say inadequate) amounts of time, money, and talent drawn from many parts of the Federal government; and have the encouragement and support of interested parties, particularly the public interest groups.

Yet, there are those who hold that the answer is not so obvious, particularly in relation to FMC 74-7, OMB Circulars A-85 and A-95, and the Joint Funding Simplification Act. In relation to FMC 74-7, the circular requiring standardization and simplification of grant requirements, these skeptics contend that the full range of project, formula-based categorical and block grants are inherently difficult to manage in a uniform and simplified way because of their sheer number and variety. Their different forms and requirements, these observers note, reflect the fact that they are aimed at discrete and different kinds of problems; hence, it is impossible to standardize and simplify them without interfering with their capacities to deal with individual problems. The truth of this analysis, they claim, is demonstrated by the difficulties of obtaining compliance with FMC 74-7, the requests for exceptions, and the complaints by some grant administrators that the circular is a blunderbuss approach to a problem that requires the targeting precision of a rifle.

With regard to OMB Circular A-85, they point to the frequent failure of Federal agencies to channel proposed regulations through the consultation process and the apathetic response of the public interest groups in many instances. On OMB Circular A-95, they contrast the volume of paper flow generated with the lack of feedback from Federal program administrators on comments submitted by clearinghouses and State and local agencies. A papermill procedure is their summary judgment here. The Joint Funding Simplification Act, they contend, while directed at helping overcome the burdens of grant applicants, defeats its purpose by over-burdening Federal grant administrators, making them hesitant to commit serious support to the joint funding idea. The Act, some feel, is totally ignorant of the realities of interdepartmental and interprogram competition.

These critics are very skeptical of making much improvement in the present system without interfering with the achievement of individual program goals. Some would prefer to see more effort put into grant consolidation and the development of support for block grants. This, they feel, would really give more discretion to grant recipients in the administration of Federal funds and thereby dispense more and more with the need for the kinds of detailed and different requirements that created, in the first place, the need for standardization and simplification, better interlevel information exchange, and strengthened State and local coordinative capability. Others see some merit in standardization and unification effort, but urge their application on a departmental (broadly functional) or on an intergovernmental transfer mechanism (project, formula-based categorical, and block grant) basis. Either of these approaches, these middling critics claim, would help eliminate two of the most stubborn obstructions to effective government-wide undertakings in this area.

Defenders of the government-wide approach, while usually conceding the advantage of consolidation of narrow categoricals and promotion of more block grants, believe that there will always be a large number of categorical grants, given Congress's desire, indeed the national obligation, to direct funds to specific high priority needs and the inexhaustibility of new needs. That being the case, they are convinced that for the foreseeable future there will be the necessity on an across-the-board basis to ease the task of the grantor and particularly of the potential recipient. In addition, they acknowledge the great diversity in the problems that categoricals and block grants address and in the conditions under which grant funds need to be spent. They, therefore, would accept the need to look more carefully at the differences among programs and review FMC 74-7 and other circulars to ascertain whether such differences should be reflected in less standardization, or a greater willingness to allow exceptions, at least on a temporary basis. But they insist that all this can and should be done within the context of a government-wide undertaking. They would acknowledge the existing shortcomings of A-85, A-95, and Joint Funding Simplification, but point to the progress that has been made in improving each since their inception and the basic support they elicit from the groups representing State and local grant recipients.

These supporters of continuing efforts to improve grant management also point out that even under block grants, it is necessary to guard against the danger of too many and too diverse requirements, to strive constantly to improve interlevel consultation, and to upgrade coordinative capacities at the State and local levels. As noted in Chapter III, there are some indications that in soome statutes authorizing block grants there

is a tendency to establish more detailed requirements than now are permissible under FMC 74-7. Interprogram coordinating capacity, if anything, becomes a greater problem under block grants than under the categoricals.

A final point made by those who support these procedural kinds of middle-range reform efforts is that government, like any enterprise, must always strive to improve its operations.

On balance, while fully supporting the enactment of additional block grants and the effective administration of existing ones, the Commission concludes that categoricals will continue to be an integral component of the Federal assistance system. Hence, the Commission believes that efforts must be continued to improve grant[1/] administration through such means as management circulars, measures to improve intergovernmental information and consultation, as well as procedures for strengthening State and local coordination and discretion.

Accordingly, at this point, we proceed to the second general question: What are the ingredients needed to make the management circulars, the various communication/consultation measures, and the procedures for enhancing State and local coordination more effective? Varying responses to this question are considered in the context of the arguments relating to Recommendations 5-13 that follow.

1/ This includes block grants as well as categoricals.

RECOMMENDATIONS

The foregoing section probed four major questions raised by the recent Federal efforts to mount effective executive branch and procedural responses to the challenges of better grants management and improved intergovernmental relationships. This analysis and the summary findings set the scene for considering the following thirteen draft recommendations.

PART I - GENERAL POLICY STATEMENT

The Commission concludes that legislators, chief executives, and the central management agencies[1] at all levels generally have failed to come to grips with the crucial impact of intergovernmental fiscal transfers and programs on contemporary governmental operations. The Commission concludes further that the political branches at all levels have the prime responsibility for strengthening the central management agencies within their respective administrative systems. The Commission recognizes that short-term and specific program concerns along with usual executive-legislative tensions tend to undercut the development of this management capacity. At the same time, the Commission is convinced that both the special program and institutional goals of political executives and legislators will not be achieved until the broader questions of interprogram and interlevel conflict and of better bureaucratic accountability are addressed. The Commission believes that these systemic challenges cannot be overcome without this management capacity.

RECOMMENDATION 1: BASIC POLICY POSITION.

1 Hence, the Commission recommends that the political branches of the
2 Federal, State, and general units of local government assme their historic
3 responsibility for jointly establishing and sustaining the necessary
4 central management mechanisms to achieve improved operations of govern-
5 mental programs and to render the civil service more fully accountable.

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[1] Meaning those units responsible for policy management and administrative support (budgeting, financial management, procurement and supply, and personnel administration) efforts.

<u>The Commission further urges that the intergovernmental dimensions (fiscal, programmatic, and policy) of public management be made an integral component of all such administrative systems.</u>

Any analysis of recent Federal efforts to establish and maintain an executive branch structure and the procedures needed to manage better the executive Federal grant system leads one to the general conclusion that the role of central maangement is less recognized today than a decade ago when most of these efforts first got underway. Moreover, the prime place that intergovernmental relations must occupy within the range of central administrative activities is only slightly more apparent to top executive branch decision-makers than it was to their predecessors in the mid-sixties. Commission survey and other findings suggest that nearly identical problems exist in a majority of State and local governments.

From its beginnings until now, this Commission has adopted a series of policy recommendations that underscore its support for certain prime contemporary governmental principles:

-- a strong executive branch is needed at nearly all levels and among most jurisdictions; this, in turn, should be matched by a strong, unshackled, and professionally staffed legislative body;

--strength in the executive branch is partially a product of effective staff functions in the budgeting, planning, and personnel areas; and

-- intergovernmental fiscal and program relationships impact heavily on these functions, hence key decision-makers should adapt these functions to give proper recognition to these fundamental features of an increasingly interdependent age.

These principles now appear to be ignored or rejected by many. Yet, the Commission is convinced that they are as valid today as they ever were. Perhaps more so! The current rampant skepticism about political leaders, public programs, and civil servants should strengthen--not weaken--the drive for a more effective management of the public's business in both the legislative and executive branches. And a vital component of this effort is the effective establishment (in some jurisdictions, the reestablishment), full utilization, and adequate support of the range of central policy and administrative support activities without which a political executive is armless and the legislature is ill-informed. In light of these current conditions, the Commission believes it appropriate to restate, perhaps in stronger terms, its traditional position on the basic role and general significance of properly charged central management.

Hence, the Commission urges the executive and legislative branches of the Federal, State, and appropriate general units of local government to assume their basic responsibility for effectively establishing and sustaining the central management units and mechanisms necessary to help achieve a more efficient and effective operation of their governmental functions. The Commission believes this is vital to achieving a more responsible public service and to enabling political executives to be more responsive to their electorates. The Commission also stresses the undeniable need to incorporate within the activities of these central management units the procedures and mechanisms necessary for giving full weight to the intergovernmental fiscal, program, and operational

impacts that condition so heavily the administrative systems at all levels. Finally, the Commission is convinced that the traditional concept of legislative oversight must be broadened to include periodic reassessments of these jurisdiction-wide management activites.

PART II

FEDERAL EXECUTIVE BRANCH ORGANIZATION

In this part, three draft organization recommendations are presented relating to the central management mechanism, Federal Regional Councils, and the Departments.

RECOMMENDATION 2: THE CENTRAL MANAGEMENT MECHANISM.

Five basic alternative approaches to the central management question are presented herein. These alternatives are:

A. OMB as the focal point;

B. An Office of Domestic Policy and Management;

C. An Office of State and Local Governmental Affairs;

D. A separated management/policy strategy; and

E. A strengthened pluralistic pattern.

Within the fifth alternative (E), a variety of specific organizational possibilities are set forth, each of which is intended to strengthen the performance of a particular activity.

These five alternatives may be viewed as different organizational "packages" of a number of vital domestic and intergovernmental-related activities. The most important of these activities include intergovernmental liaison, government-wide grants management, domestic policy development, budget preparation, and legislative reference. These activities could be distributed among existing or newly-created executive branch agencies in a variety of ways, with each distributional pattern reflecting a different set of political, organizational, and management values. The five advanced here reflect only the more obvious prototypes.

	OMB	DC	OSLGA	OTHER
CURRENT RESPONSI-BILITIES	budget legislative reference grant coordination other management improvements assistance catalog	intergovernmental liaison domestic policy national growth report		TC 1082 (Treasury) A-85 (ACIR)
ALTERNATIVE A: OMB AS THE FOCAL POINT	budget domestic policy legislative reference national growth report grant coordination other management improvement assistance catalog TC 1082, A-85 intergovernmental liaison			
ALTERNATIVE B: OFFICE OF DOMESTIC POLICY AND MANAGEMENT	budget	domestic policy legislative reference national growth report grant coordination other management improvement intergovernmental liaison TC 1082, A-85 assistance catalog		
ALTERNATIVE C: OFFICE OF STATE AND LOCAL GOVERN-MENTAL AFFAIRS	budget other management improvement legislative reference	domestic policy national growth report	grant coordination intergovernmental liaison assistance catalog (TC 1082, A-85) certain operating programs	
ALTERNATIVE D: SEPARATED MANAGEMENT/ POLICY	budget grant coordination other management improvement TC 1082, A-85 assistance catalog	domestic policy legislative reference national growth report intergovernmental liaison		

ALTERNATIVE E: A STRENGTHENED PLURALISTIC PATTERN (Includes a Presidential Counselor)

Intergovernmental liaison:	Domestic Council or Office of Intergovernmental Relations
Grant coordination and assistance catalog:	Office of Management and Budget or Office of Executive Management
Domestic Policy, national growth report, and legislative reference:	Domestic Council

When considering these alternatives, certain caveats should be kept in mind. First, it is by no means certain that the fundamental coordinative dilemma is wholly organizational or structural in nature. Some believe it is primarily political in that political decision-makers have assigned effective coordinative management a very low priority. Existing units, they claim, could do an adequate job with more leadership and better top-level support.

Second, public administration theorists are by no means in agreement on many of the fundamental issues subsumed in these five alternatives. Several of the traditional canons of organization theory are under attack, and many of these canons never really dealt with the intricacies of Federal-State-local administrative, program, and fiscal relationships. At the same time, the divisions among the theorists are reflected in the fact that five options are presented here.

Finally, many of the management activities and organizational questions covered in some of these alternatives (especially 1 and 2) go well beyond what some would deem to be properly intergovernmental. Those adhering to a wholly grants and grants-related definition of the Federal government's intergovernmental management role could argue that proposing changes in the overall domestic central management and policy area is an improper action on the part of State and local governments and on the part of this Commission. Yet, not to be overlooked is the fact that the ACIR has had no hesitancy in recommending reforms in the executive and legislative structures of State and local governments. And in its 1967 Fiscal Balance and 1968 Urban and Rural America reports, it dealt with Federal executive branch organization and procedures, though chiefly from the grant management and growth policy vantage points.

ALTERNATIVE A: OMB AS THE FOCAL POINT:

The Commission recommends that the Office of Management and Budget be designated as the primary Presidential staff agency for the development of domestic policy, the coordinated management on an interagency basis of Federal domestic assistance programs and other activities, and communications between the President and policy-level officials of State and local governments. To this end, those functions delegated by the President to the Domestic Council should be transferred to the Office of Management and Budget. Further, the Congress should amend Title VII of the Housing and Urban Development Act of 1970 to require that the report on national growth be prepared by the Office of Management and Budget. The Commission also recommends that the activities relating to intergovernmental relations and grants management delegated by executive order to the Domestic Council (liaison with State and local officials) and the Department of the Treasury (TC 1082) and by Circular A-85 to the Advisory Commission on Intergovernmental Relations be vested in the Office of Management and Budget.

The Commission further recommends that the internal organization of the Office of Management and Budget be reviewed and altered as required for the effective performance of these additional responsibilities. Specific provision should be made for regular consultation between the Office of Management and Budget and officials and representatives of State and local governments on long- and short-range budgetary and fiscal issues. Additionally, the Commission urges the President and Congress to enlarge the OMB staff as appropriate to discharge its current and expanded management duties.

ALTERNATIVE B: AN OFFICE OF DOMESTIC POLICY AND MANAGEMENT:

1 The Commission recommends that there be created an Office of Domestic
2 Policy and Management in the Executive Office of the President, with the
3 Executive Director of the Domestic Council serving as the Director of this
4 Office. The Office should provide staff support to the Domestic Council
5 and its Executive Director in the performance of duties in domestic policy
6 development and analysis and intergovernmental relations, as previously
7 prescribed by executive order. In addition, the Commission recommends
8 that all non-budgetary duties delegated to the Office of Management and
9 Budget by executive order be reassigned to the Office of Domestic Policy
10 and Management. Activities relating to intergovernmental relations and
11 grants management delegated by executive order to the Department of the
12 Treasury (TC 1082) and by Circular A-85 to the Advisory Commission on
13 Intergovernmental Relations should also be vested in the Office of Domestic
14 Policy and Management. Further, the Commission recommends that Reorganization
15 Plan #2 of 1970 be amended to re-designate the Office of Management and
16 Budget as the Office of the Budget.

17 The Commission further recommends that the performance of the Domestic
18 Council in the identification of domestic problems requiring national attention
19 and in the development of general domestic objectives and policies through
20 the report on national growth and other activities be improved. Meetings
21 of the full membership of the Council for the consideration of domestic
22 policy problems and issues should be held on a regular basis. Other domestic
23 policy-related councils and boards with membership which largely duplicates
24 that (in full or part) of the Domestic Council should be consolidated with
25 the Domestic Council and the avoidance of the creation of similar bodies
26 in the future should be avoided.

ALTERNATIVE C: AN OFFICE OF STATE AND LOCAL GOVERNMENTAL AFFAIRS:

The Commission recommends that the President and the Congress create an Office of State and Local Governmental Affairs within the Executive Office of the President, whose functions would include: the administration of the program of general revenue sharing; the administration of existing and any new grant programs intended to improve the policy, administrative, and general planning capabilities of State and local governments; the administration and further development of management procedures intended to simplify and coordinate Federal grant programs; the provision of information to State and local governments concerning Federal assistance programs; general liaison between the Federal executive branch and officials of State and local government on problems and issues which require action by more than one Federal department or agency; close collaboration with the Advisory Commission on Intergovernmental Relations; the representation of State and local problems and viewpoints within the Domestic Council and other Cabinet level policy units of the Executive Office of the President; the provision of technical planning and management assistance to State and local governments; and oversight of the multi-state Federal regional development commissions.

The Commission further recommends that the Office be headed by a Director who simultaneously serves as the Counselor to the President for Intergovernmental Relations and is armed with convener authority vis-a-vis other Federal departments and agencies on issues relating to intergovernmental relations. As required for the achievement of these purposes, those functions and activities directly related to the above responsibility currently performed by the Office of Management and Budget, Domestic Council, Civil Service Commission, Department of the Treasury, Department of Housing and Urban Development, Appalachian Regional Commission, Department of Commerce, Department of Agriculture, and other Departments and agencies, should be transferred to the Office of State and Local Governmental Affairs

ALTERNATIVE D: A SEPARATED MANAGEMENT/POLICY STRATEGY:

The Commission concludes that the distinction between and separation of the longer-range policy and "political" duties of the Domestic Council and the budgetary and managerial responsibilities of the Office of Management and Budget as initially expressed in Reorganization Plan #2 of 1970 and related executive orders are essentially sound, and provide a basic framework in which each may be performed effectively. Yet, the Commission finds that, consistent with the orginal conception in the reorganization plan, steps must be taken to clarify and broaden the authority of and improve the operations of both agencies.

Hence, the Commission recommends that the organization, staffing, and internal operating procedures of the Office of Management and Budget be thoroughly reviewed and evaluated by the President, the Director, and the appropriate committees of the Congress with a view toward making the OMB the primary focal point with adequate staff for management improvement on an interdepartmental, inter-program, and intergovernmental basis. Specific provision should be made for regular consultation between the Office of Management and Budget and officials and representatives of State and local governments on long- and short-range budgetary and fiscal issues. Activities relating to intergovernmental relations and grants management delegated by executive order to the Department of the Treasury (TC 1082) and by Circular A-85 to the Advisory Commission on Intergovernmental Relations should be vested in the Office of Management and Budget.

The Commission further recommends that the performance of the Domestic Council in the identification of domestic problems requiring national attention and in the development of general domestic objectives and policies through the report on national growth and other activities be improved. Meetings of the

full membership of the Council for the consideration of domestic policy problems and issues should be held on a regular basis. Other domestic policy related councils and boards with membership which largely duplicates that (in full or part) of the Domestic Council should be consolidated with the Domestic Council. The creation of similar bodies in the future should be avoided. The Commission also recommends that the President transfer the legislative reference function from the Office of Management and Budget to the Domestic Council. The Commission further recommends that the President reaffirm the importance of the intergovernmental liaison function assigned to the Executive Director of the Domestic Council, and that Congress provide a larger staff to assist in the performance of this function.

Finally, the Commission recommends that OMB and the Domestic Council continue to collaborate, but more effectively, in "the determination of national domestic priorities for the allocation of available resources" and in assuring "a continuing review of ongoing programs from the standpoint of their relative contribution to national goals as compared with the use of available resources," as was called for in Executive Order 11541.

ALTERNATIVE E: A STRENGTHENED PLURALISTIC PATTERN:

The Commission concludes that there are several distinct kinds of activities which must be performed at the Federal level in order to secure the harmonious, effective, and efficient operation of the intergovernmental system. At a minimum, those within the central management sector include: (a) the development and oversight of management procedures intended to coordinate and simplify the administration of Federal assistance programs; (b) the development, analysis, and evaluation of basic domestic policies and major programs; and (c) communications

and liaison between the Federal government and State and local governments. Even these may be subdivided further: for example, the liaison activity embraces communications regarding specific problems experienced by a particular jurisdiction in regard to a specific program as well as communications on more general problems of an essentially "policy" nature which affect an entire class of jurisdictions. Because of this diversity, the Commission concludes that the consolidation of these various responsibilities in one or two central staff agencies would not be the most effective or feasible
1 organizational strategy. Instead, the Commission recommends adoption of a
2 general administrative policy that is designed to strengthen the performance
3 of these vital intergovernmental activities and to improve the coordination
4 among them.

5 More specifically, the Commission recommends that the President appoint a
6 Counselor for State and Local Governmental Affairs. This Counselor, with a
7 small professional staff, should monitor and evaluate for the President the
8 various intergovernmental relations activities performed on a government-wide
9 basis with a view toward identifying and overcoming their conflicts and
10 weaknesses..

AN IGR PRESIDENTIAL COUNSELOR

11 The Commission further recommends that the peformance of intergovern-
12 mental liaison activities be improved by:

IMPROVED LIAISON

13 Alternative (1): re-creation of an Office of Intergovernmental Relations
14 within the Executive Office of the President, which would serve as the
15 principal point of contact and liaison between the President and policy-
16 level State and local government officials and would assume those activities
17 relating to intergovernmental relations which the President has delegated
18 by executive order to the Domestic Council. The Office should be directed

1 by (a Presidential appointee having status equivalent to that of a member
2 of the Cabinet) (the Vice President) and be provided with a small, but
3 adequate professional staff.

4 Alternative (2): a Presidential directive strengthening the Domestic Council's
5 role in achieving effective, clear, and continuing communications with
6 policy-level officials of State and local government on matters of joint
7 concern. The Commission further recommends that the President seek, and
8 the Congress provide, such additional staff as may be required for the
9 effective performance of these Council liaison activities.

IMPROVED INTER-PROGRAM MANAGEMENT

10 The Commission also recommends that the performance of government-wide
11 grants management activities be improved by:

12 Alternative (1): Congressional establishment of an "Office of Executive
13 Management" within the Executive Office of the President. The Office should
14 be a primary source of information concerning Federal assistance programs,
15 and be responsible for the development and oversight of procedures and
16 government-wide circulars intended to improve, simplify, coordinate, evaluate,
17 and decentralize the operation of Federal assistance programs, and such other
18 domestic management activities as the President may determine and assign.
19 Reorganization Plan #2 of 1970 should be amended to re-designate the Office of
20 Management and Budget as the Office of the Budget and Legislative Review.

21 Alternative (2): A fundamental strengthening of the Office of Management and
22 Budget, especially its management components. The organization, staffing, and
23 internal operating procedures of the Office of Management and Budget should be
24 thoroughly reviewed and evaluated by the President, the Director, and the
25 appropriate committees of the Congress, and the necessary additional management
26 staff provided.

IM-PROVED POLICY DEVELOPMENT

1 Finally, the Commission recommends that the performance of the
2 domestic policy development and analysis activities within the Executive
3 Office of the President be improved by an upgrading of the Domestic
4 Council through (a) the holding of regular meetings of the full membership
5 to consider basic domestic and intergovernmental policy problems and
6 issues; (b) the merger with the Council of other domestic policy-related
7 councils and boards whose membership in whole or in part duplicates that
8 of the Council and avoidance of creating similar bodies in the future;
9 (c) the expansion of its professional staff, as appropriate, to help
10 discharge these expanded responsibilities and to enhance its general
11 capacity to identify domestic problems requiring national attention and
12 to develop domestic policies and objectives through its report on national
13 growth; (d) providing for the Council to receive State and local policy
14 proposals that arise as a consequence of the liaison activity; and (e)
15 reassigning OMB's legislative reference function to the Council with a view
16 toward strengthening and unifying the process by which the President's
17 domestic program is developed.

The first alternative approach would build upon the Office of Management and Budget, converting it into the focal point for intergovernmental relations and domestic policy and management more generally at the national level. The Domestic Council would be terminated and its responsibilities (which now include domestic policy analysis and intergovernmental liaison) transferred to the OMB. Other measures proposed here would secure the Office's control over those grants management procedures now entrusted to other agencies and would provide for full intergovernmental consultation in the development of the President's budget recommendations. All this, of course, would necessitate a reorganization of OMB's internal structure, if such new activities are to be performed effectively, and additional staff would almost certainly be required.

On the basis of present practice and past experience, there are a number of arguments for assigning all these responsibilities to the Office of Management and Budget. First, the OMB (previously, the BOB) traditionally has been the most important institutional source of professional policy and budgetary analysis and management expertise available to the President. This role has won fairly widespread acceptance; hence, many believe that the OMB "ought" again to be the center of such activities. The assignment, then, of the functions of domestic policy development, intergovernmental liaison, and general management improvement to the Office of Management and Budget would be a return to an historical model. The BOB was, in fact, involved in all of these activities until new mechanisms were developed under Presidents Johnson and, especially, Nixon.

A second argument focuses on the fact that the BOB was the first executive branch agency to become greatly concerned about the overall administration of intergovernmental programs and their combined impact on State and local governments. Members of its staff in the past have been among the leaders and real innovators in this field. An equally significant argument in support of an OMB-centered management process stresses that the agency currently is the center of the largest number of activities which have an impact on intergovernmental relations. The budgetary process (which is the Office's primary function) is one which greatly affects subnational units. Moreover, the OMB initially administered all of the major grants management circulars and other procedures. Some of these, of course, for a period were overseen by the General Services Administration, but now these have been returned to the OMB, thus re-establishing its role in this area. The Office also sponsored and works closely with the Federal Regional Councils, and through this and its other capacities has some continuing contact with State

and local governments and their representatives. Another basic consolidational argument is that, since it is the budget agency, the Office of Management and Budget controls the most important source of Presidential leverage on the activities of the departments. Although OMB's record in this regard has not been that good, it frequently is argued that only the budget review function provides the "clout" necessary to support a President's managerial and intergovernmental objectives. Moreover, the budget process is not simply a source of bureaucratic authority, it also incorporates significant intergovernmental features and impacts. Hence, over the past three years. top OMB budget officials have met regularly with State and local governmental leaders to consider budgetary problems and priorities. The continuation and institutionalization of such interchanges is a key component of this proposed strategy.

A fifth and final basic argument favoring this approach centers on the difficulties of an "independent" Domestic Council. The Domestic Council has not functioned for more than limited periods as the top-level deliberative body which was orginally intended. The Council has been dominated or bypassed by Presidential counselors or aides, special working groups, and even its own top staff. New Cabinet-level organizations have assumed some of its functions, while some older rivals have continued to operate.

Formal meetings of the Council have been held very infrequently, and the body (like the Cabinet in some previous Administrations) is regarded as too large and diverse for useful deliberations. Some critics argue that it was and is fanciful to expect that the Council could ever perform adequately as a deliberative body. The heads of major departments, after all, usually must act as "advocates" for the program concerns and organizational interests of the departments they head. Hence, the counsel they offer may be special

interest, short-term, or even spurious in nature. Moreover, they may have little interest (and little information) in areas outside their direct responsibilities. Whatever worth the Council has, these critics claim, stems from its staff and the aid that it renders the President. Assistance of this kind, however, could be provided with equal or greater effectiveness by the OMB, these critics contend, a much larger unit with more professional and specialized personnel and a longer institutional "memory." Little would be lost then by the abolition of the Domestic Council.

Another consolidationist strategy -- Alternative B -- proposes that the central management mechanism be built around the Domestic Council. This could be accomplished by the creation of an "Office of Domestic Policy and Management" under the Executive Director of the Domestic Council. This Office then would assume all of the OMB's non-budgetary functions as well as other activities which strengthen the Council in its new role.

The basic point of contrast with the first alternative is the reliance upon the multi-member Domestic Council as the central policy and assignment body. This unit, rather than a staff unit responsible directly and solely to the President, would be the major focal point of policy initiatives and management improvements. Another significant difference involves the relationship of policy and management to the budgetary process. While the OMB-centered approach would consolidate the three in one organization, this second alternative would seek their separation. The OMB would be redesignated merely as the "Office of the Budget" and, budgeting would be treated as an activity distinct from policy formulation and management, rather than as a component of them.

The OMB's legislative reference services, which are clearly of a "policy" nature, would be among those transferred to the new Office of Domestic Policy and Management. One side issue, not to be ignored here, is that this legislative review process now also examines proposals in the national security and foreign relations area, although the preponderance of proposals involve domestic policy. Some other organizational adjustment would be required. Most likely, the National Security Council would continue to be a primary center for policy review in this field.

The ODPM would also assume the OMB's management improvement activities, including those related specifically to grants management. Thus, a closer link between policy-making and the administrative implementation of that policy would be created. Those favoring this alternative maintain that a diversified multi-member body provides for the most thorough representation of different points of view and a better recognition of relevant alternatives. Each Council member could be expected to develop, advocate, and critique policy proposals which impact upon his department's activities. Similarly, the Council, because of its composition, would certainly be very sensitive to the political commitments and realities which must be reflected in policy development in a representative democratic system.

The additional responsibilities placed upon the Council, and the substantial increase in its staff, which is contemplated, would strengthen its operations, advocates of this approach contend. Yet, a number of additional actions would increase the effectiveness of the Council in the development and analysis of domestic policy, including the preparation of the report on national growth. Other policy bodies with memberships and functions which overlap or are similar to those of the Council would be merged with it. Meetings of the entire membership would be held on a more regular basis.

In brief, this alternative would constitute a major revitalization of the old Cabinet system. It would fuse domestic policy and management functions and some other related activities. The budgeting function would remain apart, but be heavily conditioned by ODMP's influence and actions. Above all perhaps, this option recognizes that policy, central management, and legislative reference actions rarely relate to each other or to OMB's budgeting function.

* * *

A third approach, calling for a separate Office of State and Local Governmental Affairs, would provide a clear, tangible recognition of the close interrelations among Federal, State, and local activities. Such an Office would have liaison, management, coordinative, and also <u>operating</u> responsibilities in the areas which have the most direct bearing upon the conduct of intergovernmental relations. Program operations would include general revenue sharing and other management and planning assistance programs including HUD's 701 and programs established under the Intergovernmental Personnel Act.

Such an Office would have the advantage of a singleness of purpose and a major intergovernmental consitutency. No other activities (for example, budget preparation or domestic policy formulation) would present a distraction from its basic intergovernmental mission and this would be its major asset as well as its biggest liability. Such an Office would function as a champion of the interests and concerns of State and local governments to the national Chief Executive and within the national executive branch.

Although the organizational changes required to create such an Office would be substantial, this alternative would leave both the Office of Management and Budget and Domestic Council in place and intact. OMB would retain its budgetary, legislative review, and management functions except as they are specifically concerned with intergovernmental relations. The Domestic Council would continue as the primary policy analysis agency. Many of the other activities to be shifted, many critics argue, are now improperly located. General revenue sharing, the Department of the Treasury's only grant program, has little relation to the Department's primary mission. And the Domestic Council's liaison role seems an unusual responsibility for a unit concerned with broad policy development matters.

In contrast to the two earlier alternatives, the Office of State and Local Governmental Affairs would not dominate the entire domestic policy and management process. Yet, the Office would be represented on the Domestic Council and in other relevant bodies. Its Director would have full access to the President, especially if he were appointed as the Counselor to the President for Intergovernmental Relations, as is proposed here. Most importantly, the Office would be able to speak with a single voice on matters which concerned it directly.

Some have proposed that a unit of this type should be a Cabinet-level department, rather than an independent agency, and this is a possible variation. Yet, a clear defect with this option is that it would be difficult for its Secretary to exert the necessary coordinative influence over his peers to improve grant management procedures and intergovernmental relations. The argument for locating the agency within the Executive Office of the President is more persuasive then.

To sum up, this strategy avoids a domestic reorganization of either the OMB or the Domestic Council. It is rooted in a definition of intergovernmental relations that includes basically grants, grant-related activities, liaison, and programs of support for general governments, but excludes broader domestic budgeting, policy development, and management responsibilities. It builds on the record of other independent units located within the Executive Office of the President with all the risks and potential that this record suggests. At the same time, it must be classed as a consolidationist strategy, in that all the specifically government-wide activities of an intergovernmental nature are brought together in one agency.

* * *

A fourth possible approach builds around the acceptance and a strengthening of the division of functions between the existing Domestic Council (the policy unit) and the Office of Management and Budget (the management unit) which was established in Reorganization Plan #2 of 1970. It accepts the thesis then that there is a fundamental distinction between "policy" and "management." Basic reforms would involve a review of the organization, staffing, and internal operating procedures of the OMB, with a view toward making its performance consonant with the objectives set forth in the executive order establishing it. Full responsibility for the range of grants management procedures, including TC 1082 and Circular A-85, would be assumed. An upgrading of the Domestic Council also is contemplated through the elimination of other Cabinet-level units with similar or duplicative objectives and membership. Meetings of the entire Council would be held much more frequently, and the importance of the intergovernmental liaison function be reaffirmed and better staffed.

Moreover, the legislative reference activities of the Office of Management and Budget would be transferred to the Domestic Council. This activity, after all, involves a review of legislative proposals submitted by the various departments and others for their consistency with Presidential policies. While it can be argued that some of this activity is routine in nature, it clearly involves policy rather than managerial issues. Hence, this responsibility should be reassigned to the primary Presidential policy analysis unit. Such a move would give the Domestic Council a major and direct means of strengthening its role and helping to implement its policies.

Advocates of this dual approach stress the basic distinction between "policy" and "management" activities, each of which requires special organizational features if it is to be executed properly. Policy formulation is necessarily a "political" activity, to be conducted at the highest levels with full participation by the President himself and the Secretaries of major departments. The issues raised in this area have both technical and basically political aspects, and the policies developed must properly reflect the President's personal commitments and his mandate from the electorate. Management or administration, on the other hand, is viewed as essentially a technical and professional activity, requiring only that pre-established programs be implemented with efficiency, economy, and effectiveness. In this sphere, "politics" should have no major role.

* * *

The fifth alternative approach is concerned primarily with strengthening the most important specific activities which have a bearing upon intergovernmental relations, rather than the overall organizational design.

Among these activities are intergovernmental liaison, the government-wide grants circulars, related management activities, and the development of domestic policy. Alternative approaches to their improvements are recognized, as is the necessity for some general monitoring and some overall consistency in approach. This might most readily be supplied through the adoption of a general intergovernmental administrative policy and the appointment of a Presidential Counselor for State and Local Governmental Affairs, whose prime job is to oversee for the President the activities of the various executive branch units involved in one or another of the activities affecting Federal-State intergovernmental relations.

The performance of intergovernmental liaison roles might be improved by either re-establishing an Office of Intergovernmental Relations within the Executive Office of the President or bolstering the Domestic Council's existing role in this area. Advantages are apparent in both alternatives. The past record of separate liaison offices appears, on balance, to be somewhat better than that of the Domestic Council in the most recent period. The abilities of the staff and degree of commitment to the liaison process, however, are important conditioning factors in either case. Advocates of assigning the activity to a separate unit believe that the Domestic Council probably will continue to give priority attention to its other, more fundamental missions. On the other hand, proponents of the Domestic Council claim that using it for liaison purposes has the advantage of providing much stronger integration of intergovernmental liaison and the ongoing processes of policy development and review. They also point out that this strategy avoids "cluttering" the Executive Office of the President with additional special-purpose agencies.

Improvement of the inter-program and interdepartmental management functions could be achieved by either creating a new Office of Executive Management within the Executive Office of the President or strengthening significantly these activities within the Office of Management and Budget. The choice here would seem to rest upon two basic considerations. The first is the importance of the tie between the "clout" of the budget review function and implementing the managerial procedures. The second relates to the adequacy of the OMB's current performance in the intergovern= mental management area and whether or not it can be improved by further reorganization, altered internal operating procedures, and increased staffing.

Opponents of a separate executive management office argue that the budget process provides the only real leverage which can be used to coordinate the departments and agencies. For this reason, they argue that a separation of the budget and management function would be "disastrous." In addition, some in this school point to the past when BOB's management efforts were considered creditable and claim the present management problems within the OMB are chiefly a product of top-level indifference or hostility, not of any basic internal organizational defects.

The critics, on the other hand, believe that the OMB has never made much use of its budgetary "clout" for management objectives. Some of them argue that a separate management unit having the full and visible support of the President would be preferable. Despite its many difficulties, the record of the GSA's Office of Federal Management Policy, which was located outside the Executive Office itself, was, in general, quite satisfactory, they emphasize. These arguments suggest that an independent management agency could be made to work and a proposal of this kind is currently receiving serious consideration by a committee of the prestigious National Academy of Public Administration.

Finally, a number of steps might be taken to increase the effectiveness of the Domestic Council in the development and analysis of domestic policy as reflected in the report on national growth and in its other actitivies. Among these are actions discussed previously: the elimination of duplicative policy bodies, more frequent Council meetings, an expansion of staff, and the transfer of the legislative reference function from the OMB to the Domestic Council.

These then are some of the diverse ways under this fifth alternative of revamping the cluster of activities that now either directly or indirectly affect the Federal executive branch's role in intergovernmental relations. They are based on the belief that these activities basically are discrete and not really suited to complete or even partial consolidation under one or two units within the Executive Office of the President. Yet, improvements in each of them are imperative, according to this view, and a Presidential proctor is a necessity.

RECOMMENDATION 3: THE FEDERAL REGIONAL COUNCILS

1 Alternative (A): The Commission recommends that the Federal
2 Regional Councils not be relied upon as primary instruments for the
3 improved and coordinated management of Federal assistance programs, the
4 provision of information to State and local governments regarding such
5 programs and other Federal policies and activities, and liaison
6 between the States, localities, and the Federal government. Such
7 responsibilities should instead be clearly assigned to the (central
8 management unit selected under Recommendation 2).

A MINIMUM REFORM PACKAGE

9 Alternative B (1): The Commission recommends that the President,
10 (central management unit selected in Recommendation 2), and the Under
11 Secretaries Group for Regional Operations move aggressively to eliminate
12 the impediments to a more effective operation of the Federal Regional
13 Councils by (a) fully familiarizing policy-level officials of State and
14 local governments with the purposes and activities of the Councils;
15 (b) analyzing the political and administrative factors that permit
16 decentralization of grant sign-off authority in some assistance programs
17 and not in others and securing the decentralization of the former under
18 the direction of the principal regional official of each appropriate
19 Department and agency; (c) obtaining greater conformity to the
20 standard administrative regions and field office locations set forth
21 in OMB Circular A-105; (d) assuring the assignment by each FRC member
22 agency of the staff members required for ongoing Council operations,
23 including the A-95 review and comment procedure, joint funding, and special
24 task forces; (e) providing to Council staff such special training as is
25 required for the effective performance of their duties; and (f) assuring

1 continuing communications with and support from Washington, largely
2 through a more active Under Secretaries Group.

ORE GGRES-IVE EFORMS

3 Alternative B (2): The Commission further recommends that the
4 Congress enact legislation:
5 -- formally establishing the Federal Regional Councils with
6 basic responsibilities for intergovernmental liaison as well as for
7 inter-program and interdepartmental coordinative management in
8 the field and
9 -- Alternative (a): authorizing the position of Council staff
10 director to be filled on a full-time, continuing basis by an individual
11 selected by and directly accountable to the membership of each FRC.
12 -- Alternative (b): requiring that a full-time, continuing
13 chairman be appointed to each Federal Regional Council by the President
14 on a nonpartisan, professional basis and be responsible to (the
15 central management unit selected in Recommendation 2) and providing
16 the necessary authorization and appropriation for this position and
17 necessary staff, (including a full-time continuing staff director).
18 -- establishing in each standard Federal region mechanisms or
19 procedures for the joint consideration by the Federal Regional Councils
20 and appropriate representatives of State and local government of the
21 needs, policies, and issues pertaining to regional growth and develop-
22 ment; intergovernmental finances; the more effective management of
23 Federal, State, and local service activities; the development of the
24 report on national growth required under Title VII of the Housing

1 and Urban Development Act of 1970; [and for the full coordination of
2 Federal, State and local actions to meet such needs to implement
3 such policies as may be developed.]

The ten Federal Regional Councils, described in Chapter IV of this report, have been the object of considerable attention and discussion. Several evaluations have been prepared by governmental and non-governmental agencies. In addition, some of their activities have brought them into contact with a considerable number of governmental officials at all levels and these have offered assessments based upon their experiences. Out of this comparatively intense examination emerged a number of alternative approaches to improving Council operations, especially as they relate to intergovernmental relations.

In general, three basic strategies may be identified. First, some would propose that the Councils no longer be relied upon as a basic means for strengthening relationships within the Federal system and for more coordinated, uniform administration of grant-in-aid programs. A second group suggests certain fairly limited changes for the FRCs that would enhance their capacity to handle presently assigned responsibilities. These changes would be initiated by executive order and not involve any major organizational alterations.

A third group proposes a more rugged series of reforms including some or all of the following: placing the FRCs on a firm statutory basis; establishing a real executive capacity within the councils,

and expanding their functions by law to include a range of added liaison and multi-state regional activities.

These differing schools of thought clearly have different assumptions about the politics and purposes of the Councils. The first would restrict their use to internal Federal management improvement, not intergovernmental relations. This change is called for because its proponents are convinced that program politics, Congressional politics, and public interest groups politics are combined to make a mockery of decentralized program authority, of improved inter-program coordination in the field, and of more constructive contacts with State and local governments. The second group seeks to strengthen the performance of the Council's current agenda of activities, largely because it views an expansion of their services or a major reorientation of their role as unlikely. Hence, they are willing to settle for the forum formula for the moment. The third group, while somewhat divided, believes that the basic weaknesses of the FRCs will never be overcome by a series of band-aid applications. Fundamental systemic challenges confront the FRCs, they contend, and the opposing forces must be confronted head on. Hence they frown on the Congress, on the nature and authority of the FRCs' leadership, and on their present potential mission.

The alternatives and options presented in this recommendation reflect these diverse views.

As was the case with the preceding recommendation, most of the discusion will focus on arguments supporting the various alternatives. Each of these arguments after all, constitutes a position that opposes and, in effect, criticizes the others.

* * *

The harshest assessments of the FRCs' performance and promise lead to the suggestion that the FRCs no longer be relied upon for improvements in intergovernmental relations. While the Councils could be retained for other Federal management purposes, many of their strongest critics contend that the strategy of administrative decentralization and the related efforts at improved interlevel program coordination and communications through the FRCs should be discontinued.

The underlying argument is that, despite several years' effort, the Councils have not become very useful to State and local governments. Decentralization of grant administration--the requisite for Council success--is still incomplete and, according to some, will never be completed. Moreover, the Councils lack real authority, they contend; yet, State and local officials still must deal with them even as they are forced to continue their Washington-based efforts. In addition, not all of the grant-awarding agencies have fully conformed to the boundaries of the ten standard administrative regions, adding to these State and local difficulties.

The prospects for real improvement in the operation of the FRCs is small, these critics argue. Some believe that the administration of certain grant programs has actually been re-centralized in recent years.

The leadership and positive pressures that would render the Councils more effective has been lacking, they maintain, and changes here should not be expected. Congressional opposition to steps that would sanction the FRCs, give them authority, and provide them with a permanent chairman and staff is not likely to disappear, they allege. Hence, lasting reforms of this kind should not be anticipated, since an executive order is not a substitute for a statute in matters of this type.

Some of the critics believe that the goal of administration decentralization was ill-conceived in the first place. They hold that Federal regional officials have less understanding of the real problems of State and local governments than many of their Washington counterparts. Moreover, administrative decentralization, they explain, can work at cross-purposes, rather than in tandem, with a policy of devolution of actual decision-making responsibility to States and localities through revenue sharing and block grants. Finally, they note that the public interest groups which represent State and local governments are organized on a national, rather than regional, basis and many of these have established national offices. Thus, it is easier for them to deal with Washington headquarters rather than with regional agencies, especially when many of them lack the power to make many final decisions.

Since the Federal Regional Councils have been involved in a variety of other Federal management activities, they might be retained for these programs. For example, the co-location of several

Federal agencies in one building in the city of Seattle made it possible for a number of departments to utilize the same basic support services, thus realizing economies of operation. The Councils also have played a useful role in such activities as the Vietnamese refugee resettlement program, and special "emergency" projects, such as coordinating the Federal response to a flood or tornado. Their involvement in the day-to-day operation of intergovernmental programs, however, would be terminated.

* * *

Others believe that the FRCs should be retained, but acknowledge that they must be strengthened. A wide range of reforms, some limited, some very aggressive, are suggested. One group proposes a number of actions which, while not altering the FRCs in any important way, would reaffirm their roles and objectives and enhance their ability to achieve them. More vigorous leadership and better management on the part of the Under Secretaries Group for Regional Operations, the Office of Management and Budget, and the FRCs themselves could bring about marked improvement, this moderate group contends.

The Under Secretaries Group, particularly, has offered inadequate guidance and support, these critics claim. Yet, continuing pressure on the FRCs to come to grips with the problems of interagency coordination should force a more affirmative response on their part. Similarly, the USG and OMB should attempt to build the foundations of the Councils by obtaining full decentralization of grant administration wherever possible, securing more rapid conformity to the standard regional boundary

system, and assuring that each member agency provide the full-time staff member for FRC work which current policy requires, plus additional staff for special projects.

This group of critics claims other steps also are necessary. Too often, FRC staff have proven to be unfamiliar with the full range of Federal assistance programs and with the organizations and operations of State and local government in the areas which they serve. These weaknesses, some argue, could be largely overcome if intensive training were provided. An effort also should be made to familiarize all officials of State and local governments--especially those in the smaller jurisdictions--with the purposes and services which the FRCs should offer. Too frequently a lack of such knowledge deprives them of useful assistance and the FRCs of much of its potential constituency.

In short, this group of critics maintains that much could be done to enable the FRCs to achieve their existing mandate. And the effort, they believe, is well worth it. In effect, they feel the present format has not been given a full opportunity to prove itself and some of them believe no expansion of the FRC's role should be contemplated until their existing role is fully realized.

* * *

A more ambitious group, while endorsing steps like those described above, believe that they do not go far enough. They urge, that in addition, FRCs be provided with a stronger legislative foundation, a greater continuity through the addition of independent staff, a better basis for leadership, and, for some, a broader range of responsibilities.

Some within this group insist that each FRC have a permanent staff director, responsible to the Council itself. Others would authorize full-time, permanent Council chairmen, responsible to the OMB, Domestic Council, or any new central management unit that might be established.

A permanent staff director, if properly selected and with expertise built up "on the job," would certainly become familiar with the questions and issues most frequently brought to the Councils by State and local governments. This group of reformers believesthat such a person would be an important source of information, and provide an element of continuity in Council operations. As it stands, they point out, no single FRC staff member may be able to deal properly with the range of inquiries that an FRC may receive. The continuity offered, they argue, will be even more important in the future than it has been in the past, as the composition of the Councils changes. Moreover, recent executive orders have exempted most Federal regional directors from the competitive civil service and this suggests that future Council members--and Council chairmen--will have even less extensive backgrounds than their predecessors. Hence, stronger staff support will be crucial.

In the past, however, the Congress has shown considerable opposition to the creation of regional representatives of the President. Such field offices, the Congressional analysts argue, would weaken the

lines of accountability of executive agencies to the Congress. While the full reaction to this permanent staff directorship proposal has not been determined, this basic criticism probably would be apply to this arrangement.

The creation of a permanent staff director would require authorizing legislation providing for such an appropriation to the Councils for the position of director and related services.

Some feel this could be achieved without Congressional authorization and appropriation. One of the executive orders enlarging the Councils has cited the authority provided by Section 401(d) of the Intergovernmental Cooperation Act of 1968 as its authority. This Section, which provides that Federal agencies administering assistance programs shall "consult with and seek advice from" other affected departments to assure fully coordinated programs, may be an ample basis for the Council system. Yet, many believe that this is not a specific Congressional endorsement of decentralization or even of existing Council operations.

New legislation, these reformers maintain, would offer a strong, clear base for more aggressive action on the part of the OMB and Under Secretaries Group in obtaining compliance with Council-related directives and policies. Moreover, it would force the Congress itself to come to grips with its own ambivalence in this field. Certain of its substantive and appropriations committees have staunchly resisted the administrative decentralization of grant programs. This, the reformers point out, has been a basic constraint on the success

of this policy. Others within the legislative branch have been supportive of the FRC system. Both factions, these reformers contend, need to confront, and come to grips with these difficult issues if real FRC success is ever to be achieved.

A far more extensive reform proposed by some would provide the Councils with a permanent, full-time chairman responsible to the Federal government's central management unit (currently the Office of Management and Budget or perhaps the Domestic Council). By inserting a degree of hierarchic authority into Council operations, the permanent chairman would greatly alter the basic nature of the Councils. They would become, to some degree, regional representatives of the President. This proposal, of course, is wholly consistent with what the BoB sought originally and what many others have advocated: the re-creation of BoB field offices.

The basic point made is that a full-time, permanent chairman, acting as the representative of the President, would be able to force the Councils to come to grips with and assist in resolving inter-department conflicts. In addition, he would provide a stronger link to the Washington-based central management unit, and assure that its policy directives are complied with properly. The substantial discontinuities in FRC leadership (and, hence, in performance) then would be avoided.

Some critics of this proposal contend that the FRC chairmanship does not require full-time attention. The present rotation of chairman

is thought to be advantageous in that it forces the member agencies to be fully involved in Council operations, and brings them into direct contact with the problems of interagency and intergovernmental relations. Moreover, there are those who believe that a permanent chairman would not prove effective, since the real authority still lies in the departments. Most importantly, the permanent chairman would tend to weaken the lines of accountability between the Congress and the operation of programs it authorizes. For this reason, some view the proposal as undesirable and politically unacceptable.
Some among these bold reformers argue that legislation should be enacted to provide for the development in each region of mechanisms or procedures for the joint consideration by the Councils and State and local leaders of problems of mutual concern relating to intergovernmental finance, service delivery and management, and regional growth and development. Such mechanisms might be advisory, or subsume important planning, coordinative, and operating responsibilities.

While liaison with State and local governments is now a function of the Councils, this group concedes there is currently no orderly procedure through which views and positions can be exhanged on an intergovernmental and interagency basis. Similarly, no single forum exists in which the States and communities within a region can consider the general trends and problems which affect them all.

The need for this sort of activity, they stress, may be greatest in the area of growth and development. It is unlikely that a national growth policy can be effectively implemented unless adequate provision

is made for joint Federal-State-local action, some of these reformers argue. The Federal government, acting alone, has limited influence over many locational decisions, while many important "levers" are in the hands of State and local authorities. Additionally, none of the levels can be expected to succeed in its purposes if they work in opposition to those of the others. Hence, the better communication and coordinated efforts are indispensible and the FRCs afford an excellent means for furthering their goals in this central area of national growth development.

A variety of possible approaches might be tailored by the Congress to meet this need. The FRCs, for example, might be given an explicit role in the preparation of the report on national growth, to be executed in consultation with the State and local governments within their jurisdiction. Hearings or other sorts of meetings, together with the exchange of staff reports, also might meet this need. Formal State and local government advisory committees could be formed in each region, composed of the Governors and representatives of State legislatures, local governments, and regional planning agencies. All these and other devices might be brought into play--all with a view toward implementing the provision within Title VII of the Housing and Urban Development Act of 1970 which calls for consultation with State and local governments in the development of the growth report.

A possible major extension of this liaison for growth policy purposes involved would bring the Governors and key local officials in a region into a coordinate and continuing relationship with each FRC. This

would permit a better linking of multi-state regional Commission efforts in the economic development and water resources areas with that of the Councils, not to mention the multiple Federal, State, and local efforts at the substate regional level.

Procedures also might be adopted for exchanges concerning management problems. In some regions, these might lead to Council support for units patterned upon the successful New England Municipal Center. Elsewhere, the Councils might be able to establish special "task forces" for the provision of technical assistance to particular jurisdictions. The advice of State and local governments also could aid in the development of Federal priorities for grant administration or in the creation of new assistance programs.

To sum up, this band of bold reformers feel that much more could and must be done to give the FRCs a real piece of the intergovernmental action. This further means facing the Congressional issue head on. correcting these defective conditions of the FRC's chairman and staff, and moving for a more ambitious Council mandate.

Part III

Possible Procedural Reforms

The remaining ten draft recommendations, one way or another, are all geared to improve the procedural response of the Federal government to the challenges of better grants management and improved intergovernmental relations.

The review in Chapters III and V of experience with the simplification and standardization of grant requirements, new mechanisms for intergovernmental communication, and Federal procedures for strengthened State and local coordination and discretion suggests what is needed to make these procedural reforms more effective. Preeminent are recognition by Congress and the President of the importance of grants management and their willingness to take steps to improve it. Recommendations 2 and 3 have addressed this issue by providing for Congressional and Presidential action to strengthen the central management and field office components of the Federal government's grants management capability. These recommendations also provide another ingredient required for strengthening procedural reforms: adequate staff. The President and Congress can clearly signal their support for effective grants management by assuring adequate manpower for the coordinating and directing agencies on which these recommendations focus. Certainly one of the principal weaknesses in securing compliance with the procedural

reforms adopted over the past decade has been the understaffing of central management agencies and key grants management offices in the Federal Regional Councils and the departments and agencies.

Recommendation 4 that follows seeks to strengthen the Departmental management of the governmentwide circulars and that which follows seeks to put interagency agreements on a firmer foundation.

RECOMMENDATION 4: ASSIGNMENT OF RESPONSIBILITY FOR INTERPROGRAM GRANTS MANAGEMENT WITHIN INDIVIDUAL DEPARTMENTS AND AGENCIES:

1 The Commission recommends that the President require the heads of
2 Federal grant-administering departments and agencies to assign leadership
3 responsibility for interprogram grants management activities to a single
4 unit with adequate authority, stature, and staff in their respective
5 departments or agencies. Such activities, at a minimum, should include
6 oversight of the agency's compliance with OMB Circulars A-85, A-89, and
7 A-95 and management circulars (including FMC 74-7, FMC 74-4, FMC 73-2,
8 and OMB Circular A-105), and responsibility for leadership and compliance
9 with regulations under the Joint Funding Simplification Act of 1974.

The departments and agencies administering domestic programs are numerous, complex, and powerful. To some degree they possess separate lives of their own and -- short of a massive transfer of responsibility for day-to-day operational direction to the Executive Office of the President -- there is no way that a central management agency can command performance by the line departments and agencies and by that command alone expect to see it happen. The program allegiances of grants administrators, fortified by their strong linkages to clientele and other interest groups and to their allies in the appropriations and subject-matter committees of Congress, give them formidable power to challenge and often determine whether a centrally-directed effort will succeed or fail. Hence, it is of key importance to the success of efforts to improve grants management that the departments and agencies support the objectives of the circulars and make a dedicated effort to achieve them as they apply to their own fields of operation.

Just as effective implementation requires a focusing and strengthening of management responsibility in the Executive Office of the President, adequate recognition and manifested support in the top administration of the departments and agencies is just as critical. This should take the form of clear assignment by the departmental Secretary or agency head of leadership responsibility for interprogram grants management activity to a single unit with adequate authority, stature, and staff. This does not mean that responsibility for day-to-day administration of all circulars should be vested in the same organizational unit -- usually this is not the case at present. It does mean that a single unit in the department or agency is responsible for seeing that the various activities under the circulars are being discharged effectively. The key words are "leadership" and "responsibility." It also requires that whichever units have day-to-day responsibility for one or more of the circulars be sympathetic to and have knowledge of the circulars as well as be dedicated to seeing that the affected program offices understand their importance and meaning and are committed to seeing that they are carried out.

ACIR staff interviewed grants management coordinators in the major grants-administering agencies. Most of these officials were responsible only for FMC 74-7, the circular on standardization and simplification of administrative requirements. Most, but not all, held management positions of substantial authority in their agencies. In one department, the responsibility for monitoring FMC 74-7 had been shifted among several organization units during the effective life of the circular, indicating that the matter was not assigned very high priority within the department.

Several of the grants coordinators expressed concern over the lack of understanding and awareness on the part of agency personnel. To what degree this was due to lack of interest or failure of the central coordination office to provide orientation and consultation is not known. It does suggest the need for these offices to take steps to see that the circulars are understood by all those who have a role in carrying them out.

It goes without saying that field staff awareness of the circular is highly important. They are the ones who deal on a daily basis with the State and local grant recipients who are the beneficiaries of improved grant administration procedures. This study did not survey field staffs by questionnaire as it did Federal program administrators and State and local officials. However, an interview with one departmental regional representative who happened also to be the chairman of a Federal regional council revealed that he was not very familiar with FMC 74-7. This suggests a need for greater departmental effort to educate field staff on the objectives and importance of the management circulars.

Policies and practices with respect to assignment of headquarters oversight responsibility vary among the four other grants management procedures: OMB Circulars A-85, A-89, and A-95 and the Joint Funding Simplification Act. A number of agencies currently do not assign such responsibility for A-85 or A-89 to a position or office with enough stature and authority to do the job. In rare cases is the same office also charged with oversight of the management circulars, joint funding, or A-95. A similar

situation exists with regard to A-95. Agencies have appointed liaison officers but their stature in the organization structure varies widely and the position is usually not the same as the other management oversight positions. The proposed regulations implementing the Joint Funding Simplification Act of 1974 require agency heads to designate an official within headquarters to coordinate intra-agency implementation and serve as the primary point of contact for other Federal agencies and prospective applicants with respect to agency joint funding activities and policies under the Act. There is no assurance that this official will be linked to his agency counterparts with similar duties under A-85, A-89, A-95, and the management circulars.

Vesting the responsibilities for all these activities in the same oversight unit would bring together related grants management activities. The broad scope of responsibilities would warrant the staff and position in the agency hierarchy necessary to assure more effective agency compliance with these intergovernmental grant procedures.

RECOMMENDATION 5: INTERAGENCY AGREEMENTS

The Commission concludes that existing Federal-aid legislation and administrative regulations establish duplicative planning and application processes as well as overly complex and confusing rules for applicants to follow. They also create duplicative Federal reviews of State and local planning, waste of Federal funds, and lost opportunities for one Federal-aid program to reinforce the benefits of another. These problems are often susceptible to amelioration by interagency agreements. While such agreements have been in use for many years, there is a continuing and growing need for greater emphasis on their use and for creating the means to strengthen them. Hence...

1 The Commission recommends that the (central management unit selected
2 under Recommendation 2) be given responsibility for compiling and updating
3 a list of the interagency agreements in effect, for evaluating them and
4 initiating new ones or improvements to existing ones as needed to effec-
5 tively further and support maximum feasible coordination among the various
6 Federal-aid programs. The (central management unit selected under
7 Recommendation 2), acting through the Under Secretaries Group for
8 Regional Operations and the Federal Regional Councils, also should be
9 given responsibility for monitoring and supporting the proper and full
10 implementation of these agreements. All new and amended interagency
11 agreements having a significant intergovernmental impact on the manage-
12 ment of Federal-aid programs should be reviewed and commented upon at
13 the draft stage by State and local governments through the A-85

1 consultation process, and after approval by each participating department and agency should be promulgated [by Executive Order of the President] [by a Presidential grant management coordination plan subject to Congressional veto].

Working relationships among different Federal agencies administering related Federal-aid programs have been established in a number of ways over the years--by legislation, by Presidential direction, by formal interagency agreements, and by informal agreements. In addition, working relationships have been established between units within agencies and departments both by legislative and administrative means. Such relationships are quite common, and in fact affect in one way or another almost all Federal-aid programs. These agreements and working relationships have been used to (1) economize on the use of specialized government personnel, (2) share application review responsibilities in an effort to help coordinate physical development activities more fully, (3) consolidate planning requirements to reduce duplication by applicants, and (4) jointly or cooperatively fund applicant activities of interest to more than one Federal department or agency, thereby using one program to reinforce another. Such agreements often can be more satisfactory and appropriate than more general coordinating mechanisms, because they are specifically tailored to the detailed characteristics of each program involved and to any special legislative circumstances which govern their administration.

Nevertheless, a large share of these working relationships,

laboriously developed and agreed upon, have only been half-heartedly pursued on a day-to-day basis, or have actually fallen into disuse. The less formal the agreements are, the more they need constant attention from sympathetic staff in each agency, and the more dependent they are upon continuity in both political and professional staff leadership. Too frequently, this cannot be counted upon. There is then a need to more firmly institutionalize such working relationships and the interagency agreements which underlie them.

The interagency agreements covered by this recommendation would be systematically developed with the assistance of the (central management unit selected under Recommendation 2) to help cover many of the major grant coordination programs created by the separateness of programs which have interrelated objectives. This would help to overcome the hit or miss way in which such agreements are currently arrived at. With central assistance, the Federal agencies involved would reach agreement about how needed coordination could be achieved, and then while still tentative, the proposed agreement would be submitted for consideration by affected State and local governments (including affected areawide units and special districts). This State-local review would be achieved through the existing A-85 Federal aid regulation clearance process which is used by the individual Federal agencies in developing administrative regulations for their own grant programs. Although the types of interagency agreements referred to here are presently subject to A-85 review, they are not being submitted now. Once cleared by all parties, the President would establish them (by Executive Order) (or by

a Presidential interagency grant management plan approved by Congress if not vetoed within 90 days after submission to both Houses). This procedure would institutionalize the needed interagency working relationships and consolidate appropriate Federal aid requirements, while assigning specific responsibilities for seeing that these agreements are lived up to. Using the (central management unit selected under Recommendation 2) in cooperation with the Under Secretaries Group for Regional Operations and the FRCs for this latter purpose, introduces an element of central management, while retaining the participation of affected departments and agencies, and designating a field staff for actual follow through.

The need to reduce the number of separate and duplicative planning requirements imposed on those recipients of Federal aid who deal with more than one Federal aid program has been recognized for years. The Planning Assistance and Requirements Coordinating Committee (PARC Committee), originally established by HUD in 1967 and given new emphasis under the Nixon Administration, identified this need in great detail. Yet its recommendations went largely unheeded for lack of practical means to accomplish them. Interagency agreements, systematically sought and systematically implemented, provide a means for simplifying the planning work which is done in the field by Federal aid recipients, for making best use of scarce Federal aid funding, and for coordinating plans and project proposals by having them result from a single planning process. A greater institutionalization of these agreements would help to avoid their usual fate whereby they have fallen into disuse after

their original authors have moved on to other jobs, or after Administrations have changed.

Adoption of this recommendation would create the first systematic attempt to initiate those agreements which are needed for coordinating appropriate Federal aid programs. No longer would the government have to depend upon sporadic initiatives by individual agencies, initiated because of the individual interests of certain officials who happen to occupy appropriate positions at one time or another in those agencies. It also would give such arrangements continuing stature, so that they could be monitored and enforced over a substantial period of time. Where certifications of common plans, common geographic areas, and common recipient agencies are needed to help coordinate Federal aid activities below the Federal level, the FRCs would be in a position to act in a consistent way on behalf of all the concerned Federal agencies.

If Presidential Executive Orders are to be used for providing greater stature to these interagency agreements, legislation would not be needed. However, Presidential power to propose plans for grant management coordination would require legislation providing that such plans be laid before the Congress for 90 days subject to veto by either house, after which if the veto is not exercised the plan would have the effect of law. This Congressionally sanctioned procedure would have a stronger potential for institutionalizing the coordination processes agreed to, and could effectively adjust conflicting provisions of prior legislation which otherwise would remain as significant impediments to coordination, since they could not be overcome by Presidential action alone.

This Presidential grants management proposal may be seen as a counterpart to the Presidential reorganization powers which have been authorized by Congress from time to time over a period of many years, and as a complement to the Presidential grant consolidation power which has been proposed for several years by this Commission and others as a part of the amendments to the Intergovernmental Cooperation Act. These three types of Presidential power, taken together, would allow the President to either consolidate agencies and programs, or to provide coordination among them, as best fits the individual circumstances. In the Commission's view, all three options are needed.

Those opposing this proposal argue that the long established use of interagency agreements makes it unnecessary to make a new recommendation on this subject. If such agreements do not spring up naturally from the bureaucracy, they may not be needed at all. Furthermore, the new power recommended may give the President and his central management agency too much of an edge over Congressionally enacted programs which were meant by Congress to be separate and to be separately administered. Despite some overarching concerns of Congress expressed in existing legislation on such matters as civil rights and environmental protection, the present pluralistic mixture of individual programs may provide greater opportunity for getting quick and effective action in each of the program areas without the slowdowns often associated with coordination activities. Also, it may be unnecessary, perhaps even counterproductive, to mandate coordination on a broader basis, especially since many of the coordination activities may result in only minor program improvements, if any

at all. In other words, the cost of additional coordination may outweigh the benefits achieved. The basic position of the opponents then is that interagency agreements of this nature are ad hoc, voluntary, and bilateral in nature and any attempt to force, foster, or formally institutionalize them defeats their essential purpose and value.

RECOMMENDATION 6: CONGRESSIONAL SUPPORT FOR CIRCULARS.

1 The Commission recommends that Congress provide specific statutory
2 authorization for OMB circulars A-85 and A-95 and existing and future
3 circulars issued by (the central management unit selected under recommenda-
4 tion 2) directed toward standardization, simplification, and other
5 improvements of grants management.

6 The Commission further recommends that Congress enact legislation

ALTERNATIVE A

7 placing primary responsibility for compliance with the circulars on
8 grants-administering agencies, with (the central management unit selected
9 under recommendation 2) responsible for developing the circulars and
10 assisting the agencies with compliance. Monitoring by (such unit)
11 of agencies' compliance with the circulars should include review and
12 comment on agency regulations and related documents implementing these
13 circulars.

ALTERNATIVE B

14 clearly vesting in (the central management unit selected under recommendation
15 2) the responsibility for developing the circulars, interpreting them, and
16 otherwise enforcing compliance by the grants-administering agencies.
17 Monitoring by (such unit) of agencies' compliance with the circulars should
18 include (review and comment on) (approval of) agency regulations and
19 related documents implementing these circulars.

20 Finally, the Commission recommends that Congress enact legislation
21 requiring submission of periodic evaluation reports to the Congress by
22 (the central management unit selected under recommendation 2).

The management circulars and OMB circulars A-85 and A-95 are addressed to the Federal departments and agencies, placing certain requirements on them. These sometimes call for agencies to adopt new procedures or otherwise alter their patterns of behavior. When agencies resist the requirements or otherwise delay in following them, compliance problems arise. Responsibility for trying to achieve compliance falls on the central management agency. Its leverage on the grant administering agencies to get them to comply depends on several factors. A key one is the source of the authority for the circular being implemented and specifically, the extent to which Congress has specified support for the procedure in legislation.

Grant program administrators often have strong and direct ties to Congress and its appropriations and subject matter committees. Administrators' responsiveness to those committees is well-known. With that power relationship, any central management agency, whether OMB or some other, attempting to compel a Federal agency to follow a certain practice knows the danger of antagonizing the cognizant Congressional committees. Preferably, it should have the clear support of those committees for whatever it wishes to have the agencies do.

At present, of the three Federal management circulars only the one on standardization and simplification (FMC 74-7) is based to any extent on specific statutory authorization. The others are based on general authority granted by the Budget and Accounting Act of 1921 and the Budget and Accounting Procedures Act of 1950. In the case of FMC 74-7, moreover, the statute (the Intergovernmental Cooperation Act of 1968) relates narrowly to three kinds of requirements: deposits of grants-in-aid, scheduling of fund transfers to the States, and waivers

of single State agency requirements. The general thrust of the circular--for simplification and standardization of a wide array of administrative procedures--is not given specific recognition in law.

OMB Circular A-85 states that it is "in accordance with certain general purposes of Title IV of the Intergovernmental Cooperation Act of 1968." That title of the Intergovernmental Cooperation Act and Section 204 of the Demonstration Cities and Metropolitan Cooperation Act of 1966 are also the principal statutory basis for OMB Circular A-95. In both instances, fairly broad statutory language is cited as the basis for quite specific administrative procedures.

The lack of specific statutory endorsement of the circulars gives recalcitrant or dilatory grantor agencies a powerful reason for a casual attitude toward compliance. They know that their cognizant Congressional committees have not explicitly sanctioned the objectives of the circulars; they may indeed fear that the committees actually are antagonistic to the circular. Providing a specific statutory basis for the circulars would therefore lend needed support to the central office responsible for administering the circulars. It would also be an explicit acknowledgement of Congressional interest in and concern for administrative improvement.

Statutory authorization could take either of two forms. It could place the burden of interpreting and complying with the circulars directly on the grants-administering agencies, reserving to the central management unit the supportive role of advising, coaxing and otherwise backing up the agencies in carrying out the intent of the legislation.

Alternatively the statute could direct the central management unit to administer the circular, making it plain that this means the power to interpret the provisions of the circular and otherwise see that agencies comply.

The first alternative leaves the basic authority in the hands of the individual agencies, which would feel that they had discretion to comply with the mandate of the legislation at their own pace. OMB Circular A-85 illustrates this approach. Subsection 401(b) of the Intergovernmental Cooperation Act, the authority for the A-85 consultation requirement, provides that "All viewpoints -- national, regional, State, and local -- shall, to the extent possible, be fully considered and taken into account in planning Federal or federally assisted development programs and projects." Unlike subsection 401(a) of the Act which directs the President to establish rules and regulations to the end that certain Federal programs and projects most effectively serve basic objectives set forth in the subsection, subsection (b) does not mention the President. This provision of the law addresses the administrators of Federal or federally assisted development programs and projects, placing the obligation for compliance directly on them, subject to the requirement of section 403 that "The Bureau of the Budget or such other agency as may be designated by the President is hereby authorized to prescribe such rules and regulations as are deemed appropriate for the effective administration of this title." This vagueness of the consultation language in the statute, plus the absence of specific direction to the President in the relevant section, indicates a legislative intent that first responsibility for

implementation rests with the departments and agencies, not with the President and his designated central management agency.

This weakness could be avoided under Alternative B by specific authorization for the circulars and -- most importantly -- by a clear vesting in the central management unit of authority to prescribe, interpret, and otherwise enforce rules and regulations. Agencies would then be unable to "self-exempt" themselves from the application of the circulars by means of their own interpretations. The central management unit still might have problems in achieving compliance because of insufficient staff or lack of top level support in disputes with agencies. But those would be administrative problems and not matters of fundamental authority.

From the standpoint of achieving Congressional endorsement, however, the attractiveness of the two approaches is reversed. Long-standing Congressional suspicion of vesting too much power in OMB and strong linkages to categorical program administrators dispose Congress to shy away from giving OMB this kind of authority, and the staff needed to carry it out, which would be required under the second alternative. The issue becomes one then of balancing the likely superior effectiveness of Alternative B against the greater feasibility of Alternative A.

Under either alternative, it is vital that the central management unit play a positive monitoring role. The limitations of staff in OMB and GSA assigned to the management circulars have undoubtedly contributed to their restricted monitoring activity. Thus strengthening of central management staff, called for in Recommendation 2, should help strengthen the central monitoring capacity.

Another shortcoming of current central monitoring is major reliance on responding to complaints rather than positively seeking out and correcting non-compliance. The principal exception is that new forms used by the departments in implementing the various administrative procedures covered by the circulars must be cleared through OMB's general forms control process.

Along the lines of the forms control review, monitoring would be strengthened if the circulars required that agency regulations, guidelines, and other policy, plans and procedural documents issued to implement the circulars be submitted in advance to the central management unit for review and comment. This would give the central management unit an opportunity to head off potential misinterpretations of the circulars.

In the case of the stronger central management unit monitoring role (Alternative B), moreover, the circulars might require approval of that unit, as well as review and comment. There are two negative aspects in requiring approval. The first is that it would require more personnel than mere review and comment, since approval authority carries with it a greater share of responsibility for success or failure. This suggests the other negative aspect: if the initiating department or agency does not have authority for approval, it can readily shunt responsibility to the circular management agency, placing much more of a burden on that agency, and it can engender an attitude of not feeling compelled to prepare viable, effective implementing procedures.

Regardless of where authority to approve implementing policy and procedure documents is placed, the review and comment function would give the central management agency a more thorough coverage of department and agency implementation activities. This is vital to more effective monitoring. In addition, funneling implementation instruments through the central management agency helps to regularize its opportunities for providing advice and assistance to the departments and agencies in living up to the requirements of the circulars. In light of the unawareness of the circulars that now exists in some agencies, assistance activities also need strengthening in the central management office.

A final measure for strengthening management of the circulars involves evaluation. The statute authorizing the circulars should include provision for periodic evaluation reports to the Congress by the central management office. In addition, Congress should arrange for appropriate Committees to undertake prompt review of these and other reports prepared by the General Accounting Office on any aspects of the management and implementation of the circulars.

RECOMMENDATION 7: POSSIBLE MODIFICATIONS OF STANDARDIZATION REQUIREMENTS

1 The Commission recommends that (the central management unit
2 selected under recommendation 2) organize and head an interagency review
3 of FMC 74-7 for the purpose of determining whether additional areas of
4 administrative requirements should be standardized and whether existing
5 standardized requirements should be modified. Representatives of State and
6 local governments should be given the opportunity to review and comment on any
7 revisions recommended by the interagency group.

Circular FMC 74-7 has been in effect since October 1971. During that period the number of standardized administrative requirements has remained constant at 15. These are mainly in the field of financial administration. The generally satisfactory experience with the circular suggests the need for considering other requirements for possible addition to the list.

Two such areas arousing criticism among many recipients because of program-to-program variations are environmental impact statements and civil rights compliance requirements.

In undertaking a re-examination of the circular and its coverage, attention should also be focused on an opposite question: whether certain existing standardized requirements should be modified. Chapter III noted that some administrators felt that the standardization requirements of FMC 74-7 force a uniform approach which ignores real differences among grants, differences that matter in assuring the achievement of specific program objectives. One example was the limitation of fiscal reporting to one time per quarter.

This provision was criticized as unduly restraining for a new block grant program (CETA) which needed more up-to-date progress reports in order to satisfy the monitoring demands of Congress. Another example was DOT, in which certain programs such as highways are long-standing formula grant programs in which over many years the Federal government has developed working relationships on a rather routine basis with State highway departments for the carrying out of the Federal objectives; whereas other programs, such as mass transit, are newer programs of project grants for which eligible recipients are a host of local or regional bodies, some of them with little experience, with whom DOT has had less frequent contact in the past. DOT feels less need of firm project control for its highway grants than for its mass transit grants though both are covered by similar procedural requirements under the circular. Finally, GSA's assessment of the Integrated Grant Administration (IGA) experiment found that uniform application and report forms required by FMC 74-7 were not completely adaptable to IGA projects.

The uneasiness over standardization was evidenced by Federal grant administrators' answers to the survey questionnaire. Nineteen percent of those responding said standardization of preapplication procedures had had a negative effect on their programs, and 40 percent reported such an effect from standardized procedures for payments, determining matching shares, budget revisions, reporting grants close out, and record retention.

Several responses are made to the charge that too much emphasis is placed on achieving uniformity and simplification. First, FMC 74-7 permits agencies to request and be granted exceptions, and a dozen

or so have actually been granted. One of these -- a temporary one -- was to permit CETA to require monthly reporting. A second response is that objections to standardization should be expected. No one likes to make changes, but changes are the name of the game if the vast array and variety of requirements covering essentially the same administrative procedures are to be reduced in any appreciable degree and made easier for the recipients. Such simplification is after all the primary reason for undertaking the effort in the first place.

A third response to the criticism of over-standardization and simplification in the circulars is that it may not be the circulars that are at fault, but rather the way in which they are interpreted and applied by the central management agency. Several grants coordinators expressed the view that GSA's Office of Federal Management Policy was too rigid in applying the terms of the circulars. Some thought that one of the virtues of returning management responsibility to OMB would be to make application of the circulars more flexible due to the greater opportunity for infusion of realism from closer association with budget staff.

A final rebuttal is that the central management staff has been conscious of the need for constant examination of the circulars and their execution, as evidenced by the establishment of a special group to examine possible changes in the procurement provisions which have been among the most frequently criticized components of FMC 74-7. Three amendments to FMC 74-7 have been promulgated in the past year.

A concerted review of FMC 74-7, as suggested here, would offer the opportunity to explore the validity of the contentions that the pendulum has been allowed to swing too far in the direction of uniformity. Such a review can be successful, of course, only if the complaining agencies can give persuasive evidence of the hardships caused by existing provisions and can help in developing suitable modifications. Representatives of State and local governments should be assured a chance to participate in such a review to assure that the practical effects at the receiving end of the grants are fully taken into account.

RECOMMENDATION 8: THE STATES AND THE MANAGEMENT CIRCULARS:

1 The Commission recommends that the States examine their legislative
2 and administrative policies and practices applicable to the expenditure of
3 Federal grant funds by the States or their political subdivisions,
4 including conditions attached to the pass-through of Federal funds to
5 localities, with a view toward resolving in cooperation with the Federal
6 (central management unit selected under recommendation 2) any conflicts
7 between those policies and practices and the provisions of Federal grants
8 management circulars. Such examination should include problems involved in
9 claiming allowable overhead costs in performance of audits by non-Federal
10 agencies.

State governments are involved in implementation of the management circulars, both in their role as "passers-through" of Federal funds to their political subdivisions and as direct spenders of Federal funds. Their actions in these roles can have significant effects on the manner in which the management circulars are implemented.

One of the criticisms voiced by local governments in the application of the allowable costs circular, FMC 74-4, is that State governments impose interpretations of indirect costs in the expenditure of pass-through funds which conflict with those of the Federal government under FMC 74-4. The criticism is commonly made in connection with the Safe Streets program. Thus, localities claim that Federal policies are nullified or at least compromised, and the localities are not able to recover the costs that they are entitled to under FMC 74-4. In response to the localities' requests for the Federal government to forbid such State interpositions, OMB has adopted the view that this is a matter between the States and their subdivisions in which the Federal government traditionally does not interfere.

This seems like a defensible Federal position. On the other hand, if State actions endanger the effectiveness of the Federal allowable costs concept, at a minimum the Federal government should take the initiative to work with the States to see if a procedure can be developed whereby both the Federal and State objectives can be achieved. Since the National Association of State Budget Officers had a lot to do with instigating the Federal allowable cost circular, and cooperated in its development, they would be a logical group to cooperate with the central management office to see what could be worked out.

State action could also be helpful in getting better mileage out of the auditing circular, FMC 73-2. An important part of the circular encourages use of non-Federal audits as a way of satisfying the Federal requirement that grant programs be audited at least every two years. Use of non-Federal audits offers economies in the use of limited audit resources. Experience to date has revealed several obstacles to wider employment of State, local, or private auditing firms for performance of the Federal audit requirements. Federal agencies complain about the unreliability of State auditors, and States charge that Federal requirements are not as standardized as is claimed. State audit agencies also are inhibited by the difficulty of getting reimbursed for performing audits on behalf of Federal agencies. This relates to the unwillingness of program officials, both Federal and State, to use funds for other than direct program purposes (overhead), and the tendency of State legislatures and budget offices to credit any such reimbursements to general revenues rather than to the State auditing agency.

GAO has proposed that Federal agencies contract directly with State auditors to perform Federal audits as a way of avoiding some of these problems

and GSA agreed to explore that possibility. Another possibility which would make better use of the State audit function as is intended by the circular, is for State legislatures and budget offices to examine their policies for allowing State audit agencies to be credited for work performed by the Federal government. In addition, States could direct greater attention to adopting the Comptroller General's "Standards for Audit of Governmental Organizations, Programs, Activities and Functions" as guidance for performing audits for Federal programs.

States could take positive steps in still another way to improve the administration of Federal grants. The Federal interagency study of ways of implementing the Procurement Commission's recommendations on simplification of Federal contract and assistance relationships proposed a classification of Federal assistance according to degree of Federal involvement in financing and administration of each assistance award. The classification of a grant would serve to let potential recipients know in advance the degree of Federal involvement in financing and administration that they could expect. Thus forewarned, they would be better prepared to cope with Federal administrative requirements.

The interagency study pointed out that adoption of the recommended Federal system would not be effective or helpful for local governments which receive Federal aid as a pass-through from the States or other local governments. State governments passing Federal aid on to local governments would be free to use their own instruments and establish their own degree of involvement in the programs To fully realize the objectives of clarifying Federal involvement in assistance programs, the interagency study asked Federal agencies to urge State governments to achieve more consistent patterns of State involvement. In addition, they recommended that Federal agencies require the States to communicate specifically the intended Federal involvement in subgrantees' and subcontractors' activities.

RECOMMENDATION 9: A-85 AND THE PUBLIC INTEREST GROUPS.

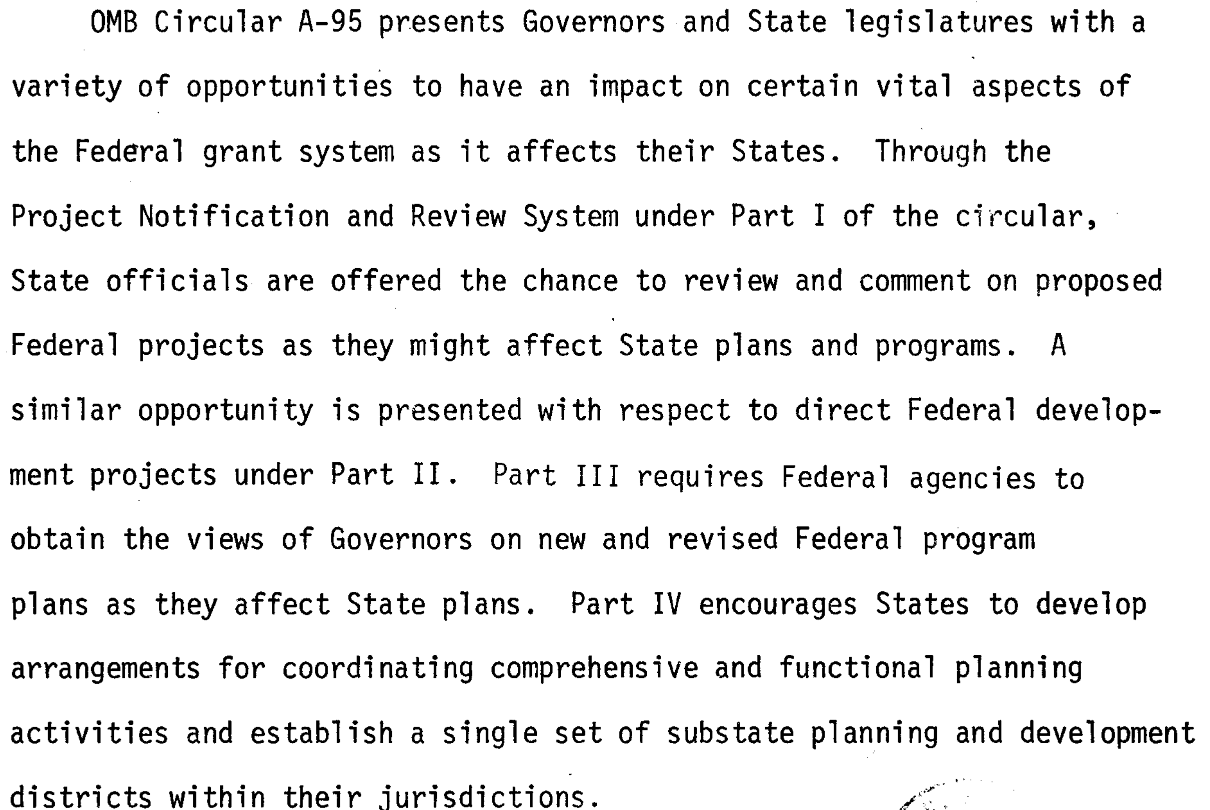
1 The Commission recommends that the public interest groups involved
2 in OMB Circular A-85 re-examine their internal A-85 procedures and the
3 resources they deploy to them and take steps necessary to assure more
4 fully responsive participation in the process.

Implementation of Recommendation 6 would enhance the central management unit's authority to administer OMB Circular A-85 and Recommendation 4 would bolster departmental implementation efforts. A serious question would still remain regarding the effective use of the circular's opportunities by the public interest groups. They share in the causes of its ineffectiveness, as was noted in Chapter III.

To assure that efforts to strengthen the Federal government's consultative role are not wasted, and indeed to counter arguments that the whole process is little more than a time-consuming paper-shuffling exercise, the public interest groups need to examine their own procedures for reviewing and commenting on proposals sent to them. This would include providing additional staff resources as needed. The public interest groups naturally resist the abandonment of any channel of communication between them and the Federal government, particularly when they have had a key role in getting it established. They should be certain that they are bearing their share of the burden of seeing that it continues to be worthwhile.

RECOMMENDATION 10: THE STATES AND A-95.

The Commission recommends that States upgrade their participation in the Circular A-95 process. Specifically, the Commission recommends that Governors and/or legislatures take steps to assure that Federal program plans are reviewed for their conformity with State policies and plans pursuant to Part III of the Circular; that the legislatures enact statutes or the Governors issue executive orders making State grants to political subdivisions subject to the A-95 clearance process; and that States examine all Federal assistance programs listed in the Catalog of Federal Domestic Assistance with a view toward requiring referral to State and areawide clearinghouses of Federal programs not now included in the official A-95 list of programs.



OMB Circular A-95 presents Governors and State legislatures with a variety of opportunities to have an impact on certain vital aspects of the Federal grant system as it affects their States. Through the Project Notification and Review System under Part I of the circular, State officials are offered the chance to review and comment on proposed Federal projects as they might affect State plans and programs. A similar opportunity is presented with respect to direct Federal development projects under Part II. Part III requires Federal agencies to obtain the views of Governors on new and revised Federal program plans as they affect State plans. Part IV encourages States to develop arrangements for coordinating comprehensive and functional planning activities and establish a single set of substate planning and development districts within their jurisdictions.

Properly used, these procedures can help Governors and State legislatures influence the impact of Federal grant programs upon their jurisdictions, build up their central coordination, planning, and policy-making capabilities, and, as a fallout of the latter, bolster their ability to impose generalist considerations on program decisions that frequently give too much weight to narrow functional concerns. Yet States have lagged in exploiting the opportunities offered by A-95. A recent study of State planning conducted by the Council of State Governments found that in many States there is little effective coordination of federally-mandated functional plans with State plans. Evidently program officials obtain routine sign-offs from Governors on plans and plan amendments, and thereby Governors pass up a key opportunity to exercise policy control over functional specialists and to strengthen their central planning and coordination capacity. The same study found that few States were availing themselves of the opportunity to review a broad spectrum of Federal grants beyond the limited list required by A-95.

This recommendation calls on Governors and/or State legislatures to better exploit the opportunities offered by A-95 in several ways. First, it urges that they take steps to assure that Federal program plans are carefully reviewed for their consistency with State policies and plans, pursuant to Part III of the circular. Effective use of this tool can have three beneficial effects: it can influence the direction of Federal program policy; it can give the Governor a weapon for exercising direction and control over State programs; and it can

heighten the importance of State comprehensive planning, thereby strengthening general policy and planning processes in the State government.

The other parts of the recommendation deal with ways that States can make better use of the Project Notification and Review System under Part I of the circular. First it proposes that States piggyback the notification and referral system for Federal grants by making the same procedure apply to local applications for State grants. This might be done by legislative mandate or executive order. While State grants are less important numerically than Federal grants, they generally have a substantial fiscal effect on State, areawide, and local development and this cannot be ignored. From the standpoint of State planning and program policies, this procedure would provide a mechanism for assuring that all affected State agencies are consulted when any one agency is asked to make a grant to a political subdivision. This provides support for interagency, interprogram coordination and again should help emphasize the importance of comprehensive planning. It is also another way by which the chief executive can exercise control over specialized program influences.

Finally, this recommendation proposes that States take further advantage of the Project Notification and Review System by requiring applications for Federal grants not now covered by A-95 to be put through the system for State purposes. A common complaint from States about the A-95 process has been the limited program coverage of the circular. This has been remedied to some extent by OMB revisions, but the number

covered still is only about 200 out of a total of many hundreds more. The circular itself offers States the chance to subject additional Federal grant programs to review for State purposes and several States have done this through legislation, including Texas. Other States should similarly examine the list of Federal programs in the Catalog of Federal Domestic Assistance and ascertain which ones not now required to be subjected by the circular to the A-95 process, should be so required for State purposes. Such an extension of the review process can further strengthen the State's procedures for coordinating the impact of Federal grant programs and emphasize the precedence of general over special program and policy considerations.

RECOMMENDATION 11: FRC'S AND A-95*

The Commission concludes that (1) there is a need for better co-ordination within the Federal establishment itself with respect to Federal-aid programs and project funding decisions; without such co-ordination, program and project conflicts may go unidentified and un-resolved, and opportunities for one program to reinforce another may be lost; (2) the A-95 project review and comment process recognizes this need already by requiring that individual Federal agencies considering the funding of projects which may affect other Federal agencies should consult with such other agencies, but these consultation opportunities are limited only to those identified by one "interested" agency; (3) applying the A-95 notification, review, and comment procedures within the Federal government itself (rather than only at the State and area-wide levels) could meet this recognized need for Federal interagency coordination more fully than it is presently being met; and (4) FRCs already have an A-95 role for monitoring Federal agency compliance with the State and areawide processes. Hence...

1 The Commission recommends that (the central management unit selected
2 under Recommendation 2) designate the Federal Regional Councils as Federal
3 clearinghouses under Circular A-95, making them responsible for notifying
4 affected Federal agencies of grant applications, preparing comments con-
5 cerning the interprogram effects of proposed projects, and transmitting

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*Note this conflicts with Alternative A in Recommendation 3.

1 individual agency reviews to the Federal action agency, in addition to
2 enforcing Federal agency compliance with provisions related to the State
3 and areawide clearinghouses. In addition, the Commission recommends that
4 its earlier recommendation with respect to strengthening the A-95 process
5 by providing the means for resolving issues raised in the review at State
6 and areawide levels be applied also to the Federal interagency review
7 process.

This action would complete a three level system of Federal-aid review clearinghouses consisting of well over 400 areawide clearinghouses, 50 State clearinghouses, and 10 Federal clearinghouses. Such action probably could be taken without additional legislation, but an amendment to the Intergovernmental Cooperation Act specifically calling for Federal clearinghouses would be most helpful in sanctioning their legitimacy and confirming their continuing role. At present, the FRC's are not Congressionally recognized, and they are subject to unilateral abolition by the Chief Executive. The lack of stability in their underpinning makes it difficult for them to move aggressively in pursuing any of the responsibilities given to them. Their continuity is simply not assured, and like voluntary councils of governments at the areawide level, they tend to avoid controversial issues.

The A-95 Federal-aid review and comment process, as it has been established at the State and areawide levels under the provisions of Section 204 of the Demonstration Cities and Metropolitan Development Act of 1966 and Title IV of the Intergovernmental Cooperation Act of

1968, has proved itself to be a very useful information tool for the exchange of views among the various levels of government and for applying areawide planning analysis and recommendations to the process of making funding decisions on Federal-aid programs. Not only has this process achieved much greater contact among and between the various units of State and local government, but it also has created significant pressures for these diverse bodies to do more planning and adopt more comprehensive sets of interrelated and consistent public policies than they ever had before. This pressure results from the need for a research and policy base to use in commenting on the likely affects of individual projects.

Nevertheless, A-95 as presently conceived is an alternative to Federal interagency coordination rather than a spur to it. Its basic reliance is on a delegation of Federal program coordination responsibilities to the State and areawide clearinghouses, and a lack of recognition of interagency and interprogram coordination responsibility at the Federal level itself.

The Commission believes that it is essential to delegate a share of the Federal program coordination responsibility to States and to areawide clearinghouses, but is equally strong in its belief that the Federal government should retain a significant share of the responsibility for coordinating its own programs. Cross fertilization among Federal agencies and coordination of their programs with one another ultimately must rest with the Federal government, simply because the Federal government in most cases reserves Federal aid funding decisions to itself.

Applying the A-95 process within the Federal establishment could

be expected to have many of the same effects that it has had at the State and areawide levels. It would increase the contacts and communication among Federal agencies. It could make the FRC's significant parties in Federal aid decision-making processes (just as it has done with the areawide planning agencies which have been designated as Federal aid clearinghouses and with the governor's designated State clearinghouses). It also could be expected to reinforce the intergovernmental and interprogram coordination concepts of the Intergovernmental Cooperation Act of 1968 and the national growth policies planning concepts spelled out in Title VII of the Housing and Urban Development Act of 1970 as they relate to Federal aid project funding considerations.

On a much more limited basis, EPA's involvement in interagency reviews of environmental impact statements provides a precedent for the broader interagency reviews recommended here. In fact, the environmental impact reviews themselves might be strengthened through broader interagency participation in the Federal A-95 clearinghouse process. Additionally, the FRC's would be in a good position to aggregate State and areawide plans, and coordinate Federal agency planning at the regional level, as a basis for strengthening the preparation of the President's National Growth Report.*

The additional recommended A-95 activity within the Federal government would undoubtedly take some additional Federal effort, but it would not have to take additional time in the processing of grant

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*See Recommendation 3, Alternative B.2.

applications. If the Federal agency reviews were going on at the same time as the local government and State agency reviews under the existing circular, and subject to the same time limits, there would be little, if any, difference in total lapsed times for application processing. Those things that State and areawide clearinghouses now are required to do at their levels of government, would also be required by the FRC's. Yet, gearing up the FRC's and the Federal agencies for these new tasks should be considerably easier than it was at the State and areawide levels, because of the experience gained in trying it first outside the Federal government.

Finally, there is the issue of whether the existing A-95 process should be strengthened to provide some means of resolving any conflicts or interagency issues raised by the review process. The Commission has recommended that such means be provided in A-95 as it relates to State and areawide levels, and believes therefore that a similar strengthening should take place at the Federal level, with the FRC's taking on the responsibility for resolving any identified conflicts or issues.

Those opposing this proposal advance several arguments. Among large segments of the Federal establishment, some point out, Federal interagency coordination is considered impossible. This is one of the basic reasons why the A-95 process as it relates to State and local levels of government has been embraced by the Federal establishment. Moreover, they emphasize, the lack of success in many previous interagency coordination attempts stands as eloquent testimony to the soundness of this position.

Others warn that applying A-95 within the Federal establishment may do little more than insert another layer of coordination and another opportunity for slowing down the making of grant decisions. It would only produce one or more additional sets of comments on individual projects, they claim, thus creating additional chances for issues to be raised which might have to be laboriously resolved before grants are made.

Still others stress that the FRC's are not now capable of administering the recommended A-95 process. They have little if any staff of their own, and what staff they do have (as well as the Councils themselves) are parochially oriented toward the concerns of the individual members. Moreover, the record of State and areawide clearinghouses, they assert, is uneven enough to suggest that the record of FRC's as Federal clearinghouses would not be any better. Some might do a good job, but others would not.

Finally, some of these critics caution that just as the State and areawide clearinghouses often lack any overarching policies to guide their clearinghouse reviews and the preparation of comments, the FRC's also would lack such a policy base. The national growth policies called for by the Housing and Urban Development Act of 1970 are considerably further from realization than most areawide and State plans. Thus, Federal clearinghouses, they maintain, may have little to offer except their assistance as a notification and information mechanism in fostering additional contacts among Federal agencies. The benefits then which might reasonably be expected from Federal clearinghouses could be substantially less than the costs imposed.

RECOMMENDATION 12: JOINT FUNDING AND RECIPIENTS.

1 To strengthen State and local support for and use of the Joint
2 Funding Simplification Act, the Commission recommends that States and
3 larger units of general local government assign to a single agency
4 leadership responsibility for participation by their respective jurisdic-
5 tions in jointly funded projects. Such responsibility should include
6 the development of proposed projects and coordination of the joint
7 funding activities of participating departments.

As the name indicates, joint funding is a process that draws together separately funded programs. As such, it seems logical that the structure set up to administer the process should emphasize the capability to integrate diverse elements. This was certainly the emphasis in the title of the predecessor experimental program: "Integrated Grant Administration." It is also the emphasis in the Federal procedure set forth in the proposed regulations implementing the Joint Funding Simplification Act. That procedure requires Federal grant-administering agencies to designate one office or official within headquarters to coordinate intra-agency implementation of joint funding activities and a parallel single official or unit in each regional office. Upon receipt of a preapplication for a joint funding project, the FRC or a Federal agency designated by the FRC appoints a coordinating officer to oversee preapplication review. If the project receives favorable preapplication review, the FRC designates a lead agency to chair a project task force of representatives from each agency participating in the project. And the regulation goes on to provide for further

fixing of responsibility in a single official, office or group for seeing that the Federal side of the joint funding process can be made accountable at every step of the way. The lack of such precise fixing of accountability gave rise to many of the criticisms of vagueness and inconsistency directed at the Integrated Grant Administration demonstration phase of the joint funding experience.

At the local level there is similar need for providing a focal point of responsibility among the larger jurisdictions that are expected to assemble joint funding projects. Initiative must come largely from the potential applicants, which in most cases will be local governments. Localities will be better able to exercise that initiative if one individual or office is responsible for surveying the community's needs and identifying the possible ways in which they might be met through a project drawing together individual Federal programs that commonly contribute to meeting those needs.

The logic of concentrating general leadership and coordination responsibility also extends to other parts of the joint funding process. One office or official can do a better job for the city or county in maintaining contact with the various officials at the Federal regional and central offices. In turn, one office makes it easier for those Federal offices to maintain easy communication with the grantee. It also facilitates the development of an "institutional memory," which can be invaluable in perfecting the locality's skill in playing the joint funding game as time goes on. That office is also the natural agency

for keeping abreast of all new developments in Federal grants, particularly those that seem likely candidates for joint projects. This aspect of its responsibilities suggests certain advantages of the joint funding coordinator's being closely allied with, if not identical to, a grants coordinator, in assuming the locality has one.

All these considerations clearly apply at the State level, if the State itself initiates joint funding proposals. Yet, the State may have an additional involvement in joint funding which fortifies the case for its centralizing responsibility for leadership and coordination. This additional involvement stems from the possibility of a project drawing together both State and Federal funds. In such cases, Federal regulations provide for State representatives to join the Federal agencies in reviewing and passing on preapplications and applications for a project. For this reason, the proposed Federal regulations urge Governors to designate a single State agency or function to receive and coordinate all requests for State participation in the jointly funded projects. It seems reasonable that the same office should have responsibility for initiating and overseeing the processing of proposals from State agencies for integrating federally-funded projects.

RECOMMENDATION 13: IMPROVING GRANT INFORMATION

1 The Commission recommends that Congress and the Administration take
2 steps to improve information that is available on grants-in-aid through
3 the Catalog of Federal Domestic Assistance and other sources. Specifically,
4 the Commission recommends that:
5 (a) Congress amend Section 201 of the Intergovernmental Cooperation
6 Act of 1968 to require Federal agencies, upon request of the chief
7 executive or legislative body of larger cities and counties, to inform
8 them of the purpose and amounts of grants-in-aid that are made directly
9 to such localities;
10 (b) (the central management unit selected under recommendation 2)
11 publish annually, prior to the conclusion of each calendar year, a list of
12 grant-in-aid programs that are scheduled to terminate in the following
13 calendar year;
14 (c) (such unit) assume the initiative for assuring that all authorized
15 programs are listed in the Catalog of Federal Domestic Assistance instead
16 of relying on grantor agencies to identify such programs; and
17 (d) (such unit) revise the format of the Catalog of Federal Domestic
18 Assistance so that each listing represents not more than one discrete program
19 or clearly identifies the separate programs included under that listing; that
20 all authorized programs are listed whether or not funds are appropriated
21 therefor; that each annual issue clearly identifies the programs that
22 have been added to or deleted from the previous issue; and that the program
23 titles in the State and local government indexes show the code for the
24 type of assistance provided (for example, formula grants, project

1 grants, direct loans, technical assistance, training).

2 The Commission further recommends, in connection with paragraph
3 (a) above, that States explore the possibility of providing their
4 larger localities with information on the purpose and amounts of grants-
5 in-aid which the State sends to such localities. Such information
6 should cover both direct grants from the State and Federal grants
7 passed-through the State government.

The review of Federal efforts to improve intergovernmental communication and consultation found that there has been movement along a broad front in the past decade, but with mixed results. This recommendation seeks to bolster some of the weaker points in the communication process.

Part (a) of the recommendation is concerned with section 201 of the Intergovernmental Cooperation Act of 1968. While that section calls for Federal agencies to provide States with information about grants awarded to the States and their jurisdictions, it carries no parallel mandate for reporting to localities on grant awards made within their boundaries. Yet, the larger cities and counties also have difficulties in coordinating grants-in-aid within their jurisdictions and therefore could profit from having the kind of information on Federal grants which States are now entitled to under section 201.

Localities' need for such information has been recognized in other Federal grants management procedures. One of these is the A-95 process of review and evaluation of grants for their consistency with local or areawide plans. Another was the Chief Executive Review and

Comment (CERC) part of the Planned Variations experiment that preceded the Community Development block grant. CERC provided the chief executive with information on all Federal grants having an impact on his community, whether they were going to a city agency outside his control, to a county or special district, or to a public or private nonprofit agency. The purpose was to increase the ability of local general purpose government to set local priorities and to carry out federally assisted programs in accord with those priorities. The chief executive was not only informed about applications for Federal assistance within his community, but he was given the right to review and comment on them.

CERC was closed out with the termination of the Planned Variations experiment. However, the January 1976 revision of OMB Circular A-95 requires areawide clearinghouses to send notifications of all projects affecting his jurisdiction to the chief executive of every general local government if he requests them. The list of programs subject to the A-95 process has now risen to 200 but is still far short of all the programs providing funding within local areas. Inasmuch as Treasury Circular 1082 requires that State governments be provided information on all programs sending money to their jurisdictions, which includes many more than the 200 affected by A-95, a good case can be made for the same service being provided to the chief executives of local governments. This requires amending section 201 of the Intergovernmental Cooperation Act.

It would be wasteful and of dubious utility to have such grant information sent to chief executives of all general local governments, regardless of size. A population cutoff should be established based on analysis of the numbers of direct Federal grants and their dollar amounts that go to localities of different sizes. Also, the requirement should be limited only to direct Federal-local grants, since Federal agencies have no quick and reliable way of knowing which grants to States are passed through to which localities and in what amounts.

The latter provision raises an important question about the large amount of Federal grants that reach localities via State governments. The last paragraph of the recommendation urges States to explore the possibility of plugging this gap by furnishing the larger localities with information on such pass-through funds, as well as on grants that are strictly State-funded.

Part (b) of the recommendation addresses the general problem of helping State and local grant recipients, not to mention the Congress, anticipate possible changes in Federal grant policy. Federal failure to give States and localities more forewarning of such changes is one of the most persistent criticisms of the present system. Part (b) would serve to give them official notice of which specific grant programs would come up for renewal or termination within the next year and enable them to adjust their plans accordingly.

Parts (c) and (d) of the recommendation are directed at improving the Catalog of Federal Domestic Assistance. The stated purposes of the Catalog are to aid potential beneficiaries in identifying and obtaining available assistance, and to improve coordination and

communication on Federal program activities among Federal, State, and local governments as well as to coordinate programs within the Federal Government. At present, the Catalog is compiled by OMB from information submitted by each agency providing Federal domestic assistance. While OMB compiles, edits, and publishes the document, responsibility for accuracy and completeness rests in the first instance with the reporting agencies. This means that those agencies decide what they think meets the definition of the programs to be included. In these judgments, the agencies probably reflect other factors than a central desire to provide potential recipients with the most complete inventory of Federal programs. They are, therefore, less likely to include all the programs that should be included than would a central office for which the Catalog is the sole or principal responsibility and which can focus more completely on meeting the primary purpose of such a document. It seems that publication of a truly inclusive document would, therefore, be more likely if the compiling and editing agency were made responsible for centrally determining what programs should be included. This would mean a careful monitoring of all Congressional actions on assistance programs. It would probably require an expansion of staff over the one person now assigned the Circular responsibility in OMB. Such expansion should come about as part of the general expansion of the central management unit proposed in recommendation 2.

Part (d) of the recommendation identifies three shortcomings of the present Catalog which make it less than a comprehensive, authoritative source of information on Federal assistance programs now

on the books and the changes that occur from year to year. First, the Catalog often conceals within one listing a number of discrete programs that are available to potential recipients. For example, the Child Abuse Prevention and Treatment Act (single Catalog listing--13.628) includes three programs and the Housing and Community Development Act of 1974 (two Catalog listings--14.218 and 14.219) covers 14 programs. Apart from the serious effect this has on applicants wanting clear and precise knowledge about what is available, this practice has contributed to the uncertainty and confusion surrounding the number of Federal assistance programs that actually exist. Part of that confusion arises from failure to distinguish the all-inclusive term "assistance" from the more limited term "grant." But in part, it stems from the inconsistent practices with regard to the separate identification of discrete programs. This recommendation would help to end that confusion.

Another shortcoming of the Catalog as a comprehensive listing is its failure to include programs that are authorized, but currently not funded by Congress. These should be included because they at least indicate that Congress has acted in these areas, although it has not seen fit to provide money for them in the current fiscal year.

To help readers of the Catalog keep abreast of what changes occur from year to year, the editors should provide in each edition a brief summary of what changes occur from edition to edition. Currently this information is provided in the mid-year revisions but not in the annual editions. The Catalog is a voluminous document, currently

running to 782 pages with various detailed indexes and appendices. Users need all the help they can get to use it effectively and keep abreast of its changes from year to year.

In this connection another change is suggested to make the catalog easier for State and local officials to use. The ACIR-ICMA questionnaire on Federal grants asked city and county chief executives what improvements, if any, were needed in the Catalog. Most frequently mentioned was information on actual funds available. Several said that the estimated amount of grants available for the year and the range and average of assistance actually granted in the past are of little help. They want to know as precisely as possible how much money is likely to be available when their application is at the point of approval or disapproval. They are frustrated when they take their application through the often tortuous approval process only to be told finally that funds are exhausted.

Discontent with the currency and accuracy of fiscal information is understandable, yet doing something basic about it through the Catalog raises real problems. On one hand are the uncertainty of the legislative and appropriations process and budgetary actions, such as impoundments and rescissions. On the other hand is the difficulty of publishing with sufficient frequency (say monthly) such data on hundreds of individual programs. It is highly questionable that the product would be worth the effort even if the resources were available to maintain such currency and accuracy.

A number of the questionnaire respondents volunteered that, because the Catalog was not very useful on fiscal data, they relied on their

contacts with the regional representatives of the agencies from whom they sought grants. Others suggested developing more of a fiscal information capability under the aegis of the Federal regional council. One said that he relied on the National League of Cities for updates on grant monies available.

Even though the Catalog does not seem a likely vehicle for the kind of up-to-the-minute funding data needed, it could be more useful in steering people to the right sources. It might make it plain that such information should be sought from field or central office representatives or Federal regional councils, if they are prepared to provide that service. To back up those directions (the central management unit selected under recommendation 2) should work with grantor agencies to see that they make the sources identified in the Catalog fully capable of providing the kind of current information sought.

The second most common suggestion for improving the Catalog received from city and county executives was that there be more frequent updates. Currently, the Catalog is published in June and updated in December. Again, considering the size and detail of the volume and the number of copies published, more frequent revision would be questionable on cost/effectiveness grounds. And again, if potential applicants use the Catalog as a "first screen" with regard to programs they may be interested in, they can turn next to the individual grantor agency to verify the currency of the information they find in the Catalog.

A number of comments reflected a wish for a Catalog which is easier to use, particularly for smaller jurisdictions which have limited staff time to become familiar with the 1030 programs listed and are likely to be interested in only a relatively few programs. Some coupled this wish with a suggestion that more be done in the Catalog to identify the programs keyed to the interests of State and local potential recipients. The Catalog now contains a separate index of programs for which local governments are eligible and a similar one for State governments. These lists do not distinguish which of the 16 kinds of assistance are available under each of the programs: formula grants, project grants, loans, technical assistance, training, etc. That information is found in the listing of programs by agency. It would simplify the task of State and local governments if the code for the type of assistance were carried opposite the program title in the State and local government listing as well as in the agency listing, as is called for in this recommendation.

D

ADVISORY
COMMISSION ON INTERGOVERNMENTAL RELATIONS
WASHINGTON, D.C. 20575

February 20, 1976

MEMORANDUM

TO : Members of the Advisory Commission on Intergovernmental Relations

FROM : Wayne F. Anderson
Executive Director
WFA

SUBJECT: Inflation and the Income Tax

As one part of its overall study on Growth in the Public Sector, the staff has been investigating unlegislated tax rate increases caused by inflation. More specifically, we are examining the process by which inflation automatically pushes taxpayers into higher Federal and State personal income tax brackets.

Although we have not proceeded far enough to submit a final report with policy recommendations, we have made sufficient progress to warrant Commission discussion of this issue.

The executive summary and the preliminary report point up the public sector, intergovernmental and tax equity questions raised by unlegislated income tax increases caused by inflation. The preliminary report also briefly describes "indexation"--a process for taking the inflationary wind out of the personal income tax sails.

INFLATION AND THE INDIVIDUAL INCOME TAX

I. Introduction: Purpose and Scope

The United States is currently experiencing its most prolonged severe inflation in the last quarter century. Indeed, since 1972 the Consumer Price Index has risen by an average of 9.6 percent annually--a clear departure from the historically mild 2 to 3 percent for the U.S. since 1950. Moreover, rates of inflation well above the historical average are expected to continue.[1/]

There are several undesirable economic effects of such a sustained, high rate of increase in the general price level. One of the most important of these effects, and one which is gaining an increasing amount of attention from economists and policymakers at all levels of government, is the distorting effect on the personal tax burden which results from the interplay of inflation and the progressive individual income tax.

In a period when personal incomes are rising, a progressive income tax will generate automatic, non-legislated increases in tax revenue which are proportionately greater than the growth in personal income. This occurs because inflation exposes a larger fraction of total income to higher marginal tax rates. The result is that after a period of inflation, average effective tax rates (tax due ÷ income) rise.

1/ Congressional Budget Office, Five-Year Budget Projections Fiscal Years 1977-81, Washington, D.C., January 26, 1976.

Indeed, this increase in effective tax rates occurs regardless of whether a taxpayer's income increases as a result of real growth or due only to inflation. Either way effective tax rates rise. However, from the taxpayer's point of view the "real" vs "inflationary" growth distinction is important since it affects his after-tax income levels. For example, assume that a taxpayer's income increases just enough to keep pace with inflation--that is, he maintains a real before-tax income. But, because the income tax now subjects a larger fraction of that higher nominal (but constant real) income to taxation, the taxpayers after-tax income actually falls below its pre-inflation level. Indeed, the only way for the taxpayer to realize a larger after-tax income during a period of growth is to experience a growth in total income that is sufficient not only to offset inflation, but also to pay for the additional automatic tax increase.

Many individuals have suggested--and some governments have implemented--a procedure to eliminate automatic tax increases from inflation and to force legislative action to raise taxes in order to collect additional real tax revenue. This procedure--indexation of the income tax--is currently under consideration both at the Federal level and in several States.

Accordingly, the ACIR staff is currently examining the inflation--personal income tax issue. The staff report focuses on the following topics:

- identification of the automatic inflation induced real increases on effective income tax rates;
- the economic implications of these "inflation tax" increases on the distribution of individual income tax liabilities, the allocation of resources between the public and private sectors, and the fiscal relationships among Federal, state, and local governments;
- alternative policies designed to "correct" (or at least explicitly recognize) the inflation tax. Particular emphasis here is placed on the evaluation of the proposal to "index" (provide for automatic inflation adjustments) the major statutory provisions of progressive personal income taxes.

II. The Effects of Inflation on Income Tax Revenue: Implications for Public Sector Growth

Since we have argued that the nature of a progressive income tax is to generate real tax increase in times of general inflation, it is important to examine the implications of this potential revenue gain for the allocation of resources between the public and private sectors. Specifically, we must determine under what conditions the interaction of inflation and income taxes will lead to a larger public sector and secondly, what effects indexing the personal income tax might have on such a trend.

A simple example can highlight the issue. Suppose in a given year that personal income is $1,000,000 and that the income tax claims 20% or $200,000. If personal income increases to $1,100,000 in the following year, the progressive income tax would take a larger fraction of income, say for example 21% or $231,000. Thus, a 10% increase in nominal income has automatically generated an automatic 15.5% increase in income tax. If the general level of prices also increased by 10% during this year--so that there was no increase in the purchasing power--income tax revenue increased $11,000 more than was necessary to maintain a real value of income tax collections.

In short, any government that relies on a progressive income tax can gain an automatic, nonlegislated real increase in tax revenue from inflation induced (non-real) increases in income.

Although these automatic real revenue increases generated by inflation are only potential gains (i.e., they can be eliminated by *ad hoc* tax reductions), one school of thought argues that they bias the political process in favor of a larger public sector than otherwise is desired. This can occur for either or both of two reasons: i) individuals may not perceive this automatic increase in taxes from inflation because it does not result from lengthy and detailed public debate of the type that surrounds legislated tax changes, or/and ii) individuals cannot easily pinpoint particular public officials who are the source of the tax increase upon whom they can impose a political penalty

for the tax hike. Thus, proponents of this view suggest that public officials will collect the real increase in income taxes from inflation and use that revenue to enlarge the public sector.

This approach is subject to criticism. One can argue that people are aware of such automatic tax hikes and thus demand periodic *ad hoc* tax reductions that serve to reduce the real tax increases from inflation. In fact, Joseph Pechman 2/ and Emil Sunley of the Brookings Institution report that, over the period 1960-1975, such *ad hoc* tax reductions more than eliminated the increase in effective Federal income tax rates that could have occurred because of inflation.

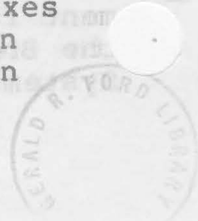
One must be cautious, however, in projecting this experience over the last 15 years forward to the next six. The Federal income tax cuts since 1960 very possibly were motivated to a large extent by national growth and stability factors. This was a period of strong real national growth; tax cuts were necessary to avoid a "fiscal drag" on the economy. The current period, and that projected through 1981, is somewhat different. There was no or very little real national growth last year; unemployment is near 8%; the Federal deficit projected for fiscal 1976 is about $76 billion. With this economic condition it appears more doubtful that tax reductions sufficient to offset real tax increases from inflation will be made.

2/ Emil M. Sunley, Jr. and Joseph A. Pechman, "Inflation Adjustment for the Individual Income Tax," a paper presented to the Brookings Conference on Inflation and the Income Tax System, Washington, D.C., October 30-31, 1975. p. 7.

Therefore to evaluate the importance of inflation-induced real income tax increases in the immediate future, we must look at the environment in which national economic decisions will be made in these years. In short, there are a number of alternatives open to policymakers. If the real increases in income tax from inflation are eliminated--either by ad hoc tax reductions or by an automatic mechanism such as tax indexation--then adjustments in other taxes or expenditures or borrowing are required. Some preliminary evidence suggests that at the 5-7% annual inflation and 5-7% real growth rates projected through 1981, the inflation caused real income tax increases at the Federal level could be substantial; perhaps $6-8 billion in 1977 and $50-60 billion by 1981.[3/]

At the State government level similar implications can be drawn. At present, 34 states and the District of Columbia have progressive income tax rate structures which will generate real revenue increases from inflation. However, there are also important differences in the fiscal situations of the States compared to the Federal government. Over the years when the Congress has reduced income taxes, the States have been enacting new income taxes and raising rates (or at least not reducing them) on existing ones. Thus, while tax cuts were feasible at the Federal level, tax increases were chosen by the States.

3/ Recall that the concern is increases in effective tax rates or real tax increases due to inflation, i.e., increases in taxes due to inflation more than proportionate to the increase in prices. Thus, these estimates are significantly lower than total income tax revenue projections.



This preliminary discussion of the issues concerning inflation, progressive income taxes, and the size of the public sector identifies many questions that need to be examined empirically. Evidence showing the projected effects of inflation on real income tax increases at both the Federal and State levels over the next few years can be developed. These automatic increases in real tax revenues can be compared with proposed tax cuts and expenditure demands. Through the examination of past evidence and future trends, the implications of the inflation effect on income tax revenue, including the impact of eliminating those increases by indexation, can be suggested.

III. The Effects of Inflation on Income Tax Revenue: Implications for Intergovernmental Fiscal Relations

In considering the impact of inflation induced real increases in income tax revenue on the economy we desire to be particularly conscious of any implications for the fiscal relationships between the various levels of government. The concerns in this area are less clearly defined than they were for public sector growth, and thus can only be presented as problematic arguments, i.e., as potential implications of eliminating the "inflation income tax." In addition, the issues of intergovernmental fiscal balance and about the political environment of tax decisions are based upon implicit assumptions about the effects of inflation and income taxes on public sector size.

Of major interest is the comparative political stress which indexing would impose on States compared to the Federal government. With indexation legislative action is required in order for a government to increase its real tax collections in excess of that which is automatically induced by real economic growth. But, due to periodic fiscal crises which have characterized state budgets in recent years, most states have already been forced to make *ad hoc* increases in their income taxes. Thus, because indexation would reduce the automatic revenue growth in progressive income tax states, these jurisdictions would be likely to experience even greater political stress. The intensity of this added stresss would, of course, also be a function of future expenditure demands and overall revenue structure elasticity of these governments.

One must also consider the important role of Federal aid to the State-local sector since an important argument upon which the case for such aid was built is a sharing of the growth-and inflation-responsive Federal personal income tax. It is by no means clear that removing the real increases in Federal income taxes caused by inflation through indexation would force a cutback in Federal intergovernmental aid. However, since indexation is designed to create fiscal stress through tax accountability, it might force closer evaluation of alternative Federal expenditures, including aid.

Another concern rests on the argument, previously outlined, that taxpayers perceive legislated tax increases more readily than automatic, non-legislated ones. With this type of behavior one can argue that recent Federal income tax action has served to create a political atmosphere in which State tax action has been more difficult. This occurs because the Federal government has been able to grant income tax "cuts" while States have not. If one accepts this argument then indexation would at least be a force toward placing tax increases in the political arena at both levels of government.

Finally, because the Federal government utilizes the highly inflation sensitive progressive income tax more intensively than most (but not all) states and localities, some observers argue that inflation will lead to an unintended greater centralization of our system of federalism. To the extent that this unintended increase in the overall elasticity of the Federal tax structure occurs relative to the subnational sector, it may become necessary to adjust the scope of utilization of various revenue sources by level of government.

In sum this section considers the interaction of the political stress (at each level of government) imposed on the revenue system by indexation. Particularly we are interested in comparison of how indexation might impact on the growth of State vs Federal government and with its impact on the behavior of each level toward the others.

Thus, while both States and the Federal government have potential income tax increases because of the interaction of inflation with progressive income taxes, there is reason to believe that indexing personal income taxes would not impact uniformly on both levels of government. It is a purpose of this report to make these comparisons in at least a qualitative sense and to add some relevant quantitative evidence when it exists and where it accurately clarifies discussion.

IV. Inflation and Distribution of the Tax Burden

The Conceptual Issue

When most of the current U.S. Internal Revenue code provisions were enacted, inflation was not a serious problem. As a result, most major tax code provisions are specified in nominal dollar amounts--e.g., tax brackets, exclusions, exemptions, the percentage standard deduction limit and the low income allowance, and the per capita credit for personal exemptions. On the other hand, some tax code provisions do allow, albeit indirectly, for either a *de facto* partial or full inflation adjustment. For example, one can argue that provisions such as income averaging and long term capital loss carryover and carryback do incorporate partial adjustments since they mix dollar amounts from different years--though even these provisions fail to fully account for price changes since these dollars also have

different values at different times. Similarly, certain provisions which permit year to year current dollar reductions in the tax base (e.g., itemized deductions) can be viewed as a form of full automatic inflation adjustment.

To illustrate how inflation leads to non-legislated tax increases, consider a married taxpayer with a 1975 adjusted gross (wage only) income of $10,000 and four exemptions. This taxpayer files a joint return, uses both the $750 personal exemption and the $30 per capita credit for personal exemptions, and the standard deduction (the higher of a flat $1900 deduction or of 16% of AGI up to a limit of $2,600.) Under these conditions the taxpayer's 1975 tax bill will be $709, giving an effective individual income tax rate (tax due ÷ current income) of 7.1 percent.

Now assume that the economy will sustain an average 7 percent rate of inflation for the next five years and that the taxpayer is able to maintain a constant real income during that time. After three years (to 1978) of inflation, the taxpayer's money income rises to $12,250--a 22.5% increase, just enough to maintain real before tax income. But the tax bill rises by nearly 58.7%, over 1975 levels and, as a result, the effective tax rate jumps by 2.1 points from 7.1% to 9.2%.

Why is the relative increase in the tax bill twice that of nominal income--even though real income is unchanged? Because the tax code provisions <u>do not allow for the full price level adjustments</u>. For example, in this case, the real value

of the specific dollar personal exemption, the per capita credit, and the standard deduction declined--even though the taxpayer did not change tax brackets. In addition, a higher fraction of adjusted gross income became taxable at the highest applicable marginal rate--even though there may be no move to a higher tax rate bracket. The combined result is that, in terms of 1975 dollars, the taxpayer's after-tax real income is reduced from $9,291 to $9,081.[4/]

The Special Case of Capital Gains

Capital gains are also measured in money terms. The value of capital assets will increase during a period of inflation and thus taxable income will be created when these assets are sold --even though there may be no increase, or even a decrease, in real value of these assets. For example, assume an individual buys stock for $10,000, and a year later sells those assets for $11,000. If prices were stable during the year, the gain is real and is fully subject to taxation at rates ranging up to the 25% statutory rate. If subject to the 25% maximum rate, the tax bill is $250, and the effective tax rate on the real gain is 25%. If, however, there had been a rate of inflation of 5% during the year, half of the $10,000 gain would be inflationary. But, after applying the same 25% statutory rate, taxes would

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4/ This does not imply, however, that the taxpayer is "worse off." Since the likely result is an increased level of public service spending, the taxpayer may, indeed, prefer this after tax position.

now take 50% of the real gain. In short, without an adjustment for inflation, real tax burdens increase without a corresponding increase in the real income of the taxpayer. Again we have a non-legislated tax increase which will be imposed among taxpayers arbitrarily as long as it is impossible to isolate the real from the illusory (inflation) components of capital gains income.

SUMMARY

Clearly inflation induced changes in personal income tax rates do not effect all taxpayers or governments equally. Rather, the change in the distribution of the tax burden will vary widely and arbitrarily among taxpayers according to their particular circumstances *vis-a-vis* the major non-indexed features of the personal tax code. Thus, the inflationary impact on personal tax burdens will be determined according to differences among taxpayers such as family size, level of before-tax income, type of income (e.g., the mix of earned vs. unearned income) received, ability to itemize deductions, and the degree to which the various dollar limitations in the code affect tax bills. Moreover, the effects on various taxpayers are uneven because persons move into higher brackets at different rates due to the fact that the brackets themselves have varying widths.

Tax liabilities due to the bracket effect will rise most rapidly for persons whose taxable income rises through ranges where tax brackets are narrow and increases in tax rates from one bracket to the next are relatively great. In general the increases in tax burdens are larger for the high income groups. But these distortions are not limited to those created by the gradual movement into higher brackets. If incomes increase during inflation while the allowances for personal exemptions, the per capita credit, and the standard deductions remain unchanged, the proportion of total income (AGI) subject to tax increases. These non-legislated tax increases will be proportionally larger for those families which have low incomes and many dependents.

The likely combined effects of these inflation induced tax changes are that the low and the high income families are most likely to be taxed by inflation. Those in the lowest income levels experience smaller after-tax incomes due to the fact that much of their income goes from the zero to the 17% marginal bracket--technically, in percentage terms, an infinite tax increase. This jump, of course, is in large part due to the fact that, as prices rose, the nominal values of the personal exemption and per capita credit were eroded. As noted earlier the effect of a given dollar value erosion here

is greatest for those who have low incomes. At the high end of the income scale, the exemption-per capita credit-deduction erosion effect is minimized, but the narrow bracket effect becomes increasingly important. The middle income group, however, avoids the worst of both the exemption-credit-deduction and the bracket effects. The reduction in the real dollar value of exemptions and credits is relatively less than it is for the low income taxpayer and, yet, the middle income family enjoys a wider tax bracket than does the wealthier family.

Inflation-induced individual income tax increases may, however, be partially or wholly offset by _ad hoc_ Congressional action. Thus, this report must show both what type of taxpayers are most disadvantaged by income tax increases from inflation and which taxpayers have benefited most from _ad hoc_ tax code changes in the past.

V. Indexing the Individual Income Tax as a Means of Eliminating the Real Increases in Tax Revenue from Inflation

One mechanism to eliminate non-legislated effective income tax rate increases from inflation is indexation of the tax structure. The procedure is to adjust rate brackets, personal exemptions and deductions that are measured in fixed dollar terms for changes in the general price level. These adjustments eliminate the effect of inflation that are generated through the

tax structure which tend to increase real tax burdens. The policy goal of indexing an income tax structure then is to maintain constant real tax burdens on a constant real income.

Consider the following example: Suppose that before indexation a personal income tax allows a personal exemption of $1,000 and subjects the remaining net income to these rate brackets: 0 - 10,000, 10%; 10,001 and up, 15%. If an individual earns $10,000, his tax is $900 or an effective rate of 9%. If in a subsequent year there is 10% inflation and the individual earns just $11,000, his tax would be $1,000 or an effective rate of 9.09%

If this tax were indexed, both the personal exemption and the bounds of the tax rate brackets would be adjusted upwards by the 10% inflation rate. The personal exemption becomes $1,100 and the tax rate brackets: 0 - $11,000, 10%; $11,000 and up, 15%. The individual with $11,000 income would then pay a tax of $990 [($11,000 - $1,100) x 10%]. The effective rate would again be 9%. Note that the tax liability has increased proportionally with inflation.

It should be recognized that some features of individual income taxes are already, in effect, indexed. All deductions, exemptions or credits that are measured in current dollars (such as itemized deductions) or as a percentage of income (such as the standard deduction below the maximum) are automatically adjusted for inflation by their definition. Beyond

the tax system, there are other forms of indexation currently used in the United States. Many private labor contracts call for "cost-of-living" increases in wages. Federal government pensions are adjusted annually to keep pace with inflation.

In 1973, Canada indexed both its personal income tax and all old age and retirement pensions. In 1974, indexing was expanded to include all family allowance payments. The income tax is indexed by adjusting rate brackets and personal exemptions upward by the inflation rate over the 7 to 30 months before each taxable year. [For taxable year 1975, for example, the income tax index factor was 10.2%].

It must be noted that these inflation adjustments to the income tax structure do not correct for the inflation effects on the taxation of capital gains income. Rather capital gains can be adjusted for inflation effects by inflating the purchase price of the asset to current dollars, so that both purchase and sales price are measured by the same units. This can be accomplished by multiplying original cost by an index of consumer price changes (such as the CPI). Real capital gains are then the difference between sale price and replacement cost.[5/]

5/ For example, if an individual buys stock for $10,000 and a year later sells for $11,000 while during that year there was a 5% increase in the price level, the purchase price would be adjusted upwards by 5% to $10,500. The difference between this value and the sales price, $500, would be the real capital gain for tax purposes. If the maximum 25% rate applies, the tax would be $125.

In sum, then, indexing the income tax--both by adjusting the structure and by redefining income--can serve as an automatic mechanism to eliminate real tax increases because of inflation. As such it would in part be a substitute for periodic legislated tax cuts, i.e., _ad hoc_ tax cuts to eliminate part of the "inflation tax." In fact it is argued that the greatest value of indexing is in removing automatic tax increases and requiring the legislative body to directly legislate any tax increases it considers necessary. However, some individuals would not go so far as indexing the income tax. Rather, viewing the problem as a misconception or lack of information about tax increases, they propose that the amount of the increase in real taxes due to inflation be calculated and made public annually. Whether this adjustment to the status quo would generate substantial public pressures to eliminate the inflation tax is not known.

Finally, one should recognize that either indexation or public disclosure--to the extent that they eliminate the inflation tax and that it is not returned by legislative action--would have effects on other economic variables. Specifically, one must determine the potential effects of indexation on the "built-in stabilizer" aspect--the tendency for increasing taxes to reduce aggregate demand of the Federal personal income tax,

on the value of Federal deductibility of State-local taxes, on the piggy-backed nature of State personal income taxes and on the impact of State deductibility of Federal income tax liability. To examine these issues and those relating to the process of indexing the tax system, our forthcoming report will review the Canadian experience with indexation and will outline the adjustments necessary to make income taxes in the U.S. inflation neutral.

E

ADVISORY
COMMISSION ON INTERGOVERNMENTAL RELATIONS
WASHINGTON, D.C. 20575

February 24, 1976

MEMORANDUM

TO: Members of the Advisory Commission on Intergovernmental Relations

FROM: Wayne F. Anderson, Executive Director WFA

SUBJECT: THE GOVERNMENT ECONOMY AND SPENDING REFORM ACT OF 1976

On February 3, 1976 Senator Muskie introduced a bill in the Senate entitled "The Government Economy and Spending Reform Act of 1976." As summarized by the Senator, the bill would do the following things:

> First, it would put all government programs and activities on a four-year reauthorization schedule. All would have to be reauthorized every four years, or be terminated. The sole exceptions to this mandatory termination provision would be payment of interest on the national debt, and programs under which individuals make payments to the Federal government in expectation of later compensation--i.e., Railroad Retirement, Social Security, Civil Service retirement, and Medicare.
>
> Second, the bill would establish a schedule for reauthorization of government programs and activities on the basis of groupings by budget function. Programs within the same function would terminate simultaneously, so that Congress would have an opportunity to examine and compare Federal programs in that functional area in its entirety, rather than in bits and pieces. The schedule would be set up so that all of the functional areas would be dealt with within one four-year cycle.
>
> Third, the bill would reverse the assumption that old programs and agencies deserve to be continued just because they existed the year before, by incorporating a zero-base review into the reauthorization process.
>
> Fourth, the bill would make maximum use of the timetable for authorization bills already required by the Congressional Budget Act, and it would encourage Congress to make better use of the program review already undertaken by the General Accounting Office.

Finally, the bill would set up a one-time procedure under which the GAO would identify duplicative and inactive programs so that Congressional committees would be encouraged to eliminate or consolidate them.

Details of these proposals are provided in the attached summary and copy of the bill.

This bill (S. 2925) incorporates and builds upon two policies which ACIR has urged for a number of years. The first is periodic review of Federal-aid programs (originally adopted by the Commission on June 15, 1961 in Report A-8 entitled Periodic Congressional Reassessment of Federal Grants-In-Aid to State and Local Governments), and the second is grant consolidation (originally adopted by the Commission as Recommendation No. 2, in Volume I of Report A-31 entitled Fiscal Balance in the American Federal System). However, the present bill differs from adopted ACIR recommendations in certain ways.

S. 2925, on the other hand, would apply automatic termination to a much wider group of grant programs as well as to most other expenditures of the Federal government. It also would reduce the termination period from five years to four, and would schedule the re-evaluation of each group of programs for a definite time. Of course, the Congressional Budget Reform and Impoundment Control Act establishes a whole new framework for this kind of activity which did not exist when ACIR originally studied the issue.

On the subject of program consolidation, S. 2925 encourages it by grouping similar programs together for review prior to their expiration. This allows possible consolidations to be considered in the evaluation process. The main difference between this proposal and the Commission's own 1967 recommendation is that S. 2925 establishes a Congressionally oriented and initiated review process, whereas the Commission's recommendation proposed Presidential powers to initiate "grant consolidation plans." Under ACIR's proposal, the President would develop such plans based upon operating experience in existing programs, and submit such proposals to Congress for a 90 day review period; after which, if the Congress did not disagree, the proposal would take effect.

The Commission's limited periodic review of Federal grant programs has been partially implemented by the Intergovernmental Cooperation Act of 1968, and the grant consolidation recommendation has been embodied in amendments to this Act which have been pending in Congress for several years.

S. 2925 moves well beyond existing ACIR policy in its attempt to apply zero-based budgeting at the Federal level. A few States and local governments have tried this technique, but it has not yet been generally applied throughout the nation. It does have considerable

workload implications for the budget process but, on the other hand, it offers the potential for gaining better control of expenditures--a worthy objective at this time.

Insofar as S. 2925 applies to grant-in-aid programs and the issues of periodic review and consolidation, it is being evaluated now by the staff as part of its overall study of intergovernmental grant programs. However, this evaluation will not be complete until the next Commission meeting.

As background for completion of its work on this study, the staff would welcome a Commission discussion of this bill.

ATTACHMENTS

SUMMARY AND EXPLANATION OF THE GOVERNMENT ECONOMY AND SPENDING REFORM ACT OF 1976

The Government Economy and Spending Reform Act of 1976 is designed to improve the degree of control which Congress exercises over the actual delivery of services to the American people, by requiring regular review and reauthorization of Federal programs and activities. It is designed to expand the budgetary options available to the Congress by redefining or eliminating ineffective and duplicative programs and permitting more creative and flexible planning of Federal efforts.

It would put government programs and activities on a four-year reauthorization schedule. All government programs and activities -- permanent and otherwise -- would have to be reauthorized every four years. Programs not so reauthorized would be terminated.

The only exceptions to mandatory reauthorization or termination are provided for programs under which individuals make payments to the Federal government in expectation of later compensation (Social Security, Railroad Retirement, Civil Service retirement, Medicare, etc.), and interest payments on the national debt.

Those programs and activities exempted from the reauthorization or termination provisions of the bill would still have to be reviewed every fourth year, with the exception of debt interest payments.

The schedule established by the bill for reauthorization of Federal programs and activities would follow groupings according to budget function. Programs within the same function would be reconsidered simultaneously, so that the Congress would have an opportunity to examine and compare Federal programs for a particular functional area in their entirety, rather than in bits and pieces. The schedule would be set up so that all of the functional areas would be dealt with within one four-year cycle.

This measure reverses the assumption that old programs and agencies deserve to be continued just because they existed the year before, by incorporating the concept of zero base review into the reauthorization process.

It would make maximum use of the timetable for authorization bills already required by the Congressional Budget Act, and it would encourage Congress to make better use of the program review already undertaken by the General Accounting Office.

And the bill would set up a one-time procedure under which the General Accounting Office would identify duplicative and inactive programs so that congressional committees would be encouraged to eliminate or consolidate them.

Scheduled Termination of Federal Programs

The requirement that all government programs terminate at least once every four years, with the exceptions listed above, is designed to give Congress a procedure for conducting a working oversight of all Federal programs and activities.

Even programs costing comparatively little would be subject to this process. It is especially important that programs such as entitlements be covered because those programs often escape thorough review of their effectiveness.

The four-year limitation on authorizations should allow a sufficient accumulation of experience for testing the results and effectiveness of government programs. However, it is short enough to allow Congress to examine programs before they get out of control.

While the thrust of this legislation is to encourage congressional committees to review and reauthorize all of their programs on a four-year cycle, committees would have the option of authorizing programs for less than four years.

Scheduling of Program Termination

The legislation would change the date of authorization of all but a very few Federal programs, by limiting reauthorization to a maximum of four years. It would schedule termination, review and reauthorization of programs by budget function or subfunction. Beginning September 30, 1979, and over the subsequent four-year period, all programs and activities would be scheduled for reauthorization or termination, with those budget functions entailing the lightest work load scheduled first, and the more difficult ones scheduled toward the end of the four-year period. (See the schedule attached to this summary.)

The purpose of establishing the schedule by budget function would be to allow the Congress to take a close look at what the Federal government is doing in an entire policy area, rather than in bits and pieces as is the norm now. Programs and functions which overlap not only Executive agencies but also congressional committees would therefore be reviewed as a whole, instead of individually as Congress now reauthorizes most programs and activities.

To account for the possibility that certain legislative committees may be unable to meet the reauthorization deadlines because of the workload involved in particular functional areas, the legislation would authorize the Budget Committee of either house to report legislation providing for adjustments of the scheduled deadlines.

Provisions for Permanent Authorizations

Under the bill all existing government programs and activities with permanent authorizations -- excluding the exceptions mentioned above -- would terminate according to the schedule of budget functions and subfunctions between September 30, 1979 and September 30, 1983 unless reauthorized, and would then be subject to the four-year limitation on authorizations.

The legislation does recognize that in some cases it may be difficult to identify permanent authorizations, and in others the four-year limitation on authorizations may be impractical. As a result, the legislation would require that by April 1, 1977, the General Accounting Office submit to the House of Representatives and the Senate a list of all provisions of law which establish permanent authorization for government expenditures.

That list should break permanent authorizations down by committee of jurisdiction, and for those funded in the appropriations process, by appropriations bills in which they are included. To the extent practicable, the GAO should also determine the amount appropriated for each permanently authorized program or activity over the preceding four fiscal years.

Zero Base Review of All Programs Before Reauthorization

This legislation requires that the standing committees of the Senate and the House conduct a zero base review and evaluation of all programs and activities within their jurisdiction every fourth year. The zero base review and evaluation must be conducted during the 12-month period ending on March 15 of the year in which that program is scheduled for reauthorization.

Unlike the practice which often governs present budget planning, the zero base review and evaluation would not assume that programs are to be funded in the next budget merely because they were included this year. As part of the zero base review, congressional committees would first make an assessment of the impact of having no new expenditures for a particular program, and then make an assessment of what level of program quality and quantity could be purchased at particular incremental levels of expenditures. For example, the evaluation may include an assessment of what level of program activity could be purchased at 75 percent of this year's expenditures as well as what level of program activity could be purchased at each additional 10 percent increment of expenditure.

In addition, in a zero base evaluation, congressional committees would be required to include:

1) An identification of other government programs and activities having the same or similar objectives, along with the comparison of the cost and effectiveness of such programs or activities and any duplication of the program or activity under review.

2) An examination of the extent to which the objectives of the program or activity have been achieved in comparison with the objectives initially set forth by the legislation establishing the program or activity and an analysis of any significant variance between the projected and actual performances.

3) A specification to the extent feasible in quantitative terms of the objectives of such program or activity during the next four fiscal years.

4) An examination of the impact of the program or activity on the national economy.

Each standing committee must submit a report to its House detailing the results of its zero base review and evaluation of a program on or before March 15 of the year in which the review occurs. Whenever a committee recommends authorization of a program similar to others it has identified, its report must include a detailed justification for the program it is authorizing and explain how it avoids duplication with other existing programs.

To assist the authorizing committees in conducting their zero base review and evaluations, the General Accounting Office would be required by December 31 of the year preceding to send those committees the results of audits and reviews and evaluations the GAO has conducted on the program to be reviewed. In addition, the committees could call upon the GAO or the CBO for whatever assistance they may render in the conduct of the zero base evaluation.

Enforcement of Zero Base Review Requirement

This legislation would require that congressional committees conduct a zero base evaluation of all government programs and activities scheduled for termination in a given year prior to reporting out legislation to reauthorize them.

To enforce that requirement, any bill which authorizes expenditures for any government program or activity would not be in order in either House unless the committee reporting it had submitted its zero base review and evaluation report on that program or activity.

This only exception to this rule would be in those cases in which a committee chooses to authorize a program or activity for less than four years. In those cases, every authorization bill would not have to be accompanied by a zero base evaluation. But the committee would still be required to undertake a zero base evaluation every four years, at the time of the program's scheduled termination and review, and must report a reauthorization bill in the year it completes that review.

Executive Zero Base Budgeting

The legislation requires that prior to submission of the President's budget message, the Executive Branch must conduct a zero base review and evaluation of all Federal programs and activities scheduled for termination in the upcoming year. The President would be required to submit the results of this review and evaluation along with his regular budget message.

Timetable for Zero Base Review and Evaluation

The timetable for the zero base review and evaluation of a government program or activity would be as follows:

December 31 of preceding year	GAO reports results of its previous audits and evaluations as well as requested information and analyses to standing committees.
December 31 of preceding year	CBO reports requested information and analyses to standing committees.
15th day after Congress meets in the year	President submits budget message, accompanied by results of zero base review and evaluation by Executive departments of programs scheduled for termination during upcoming fiscal year.
March 15 of the year	Standing committees complete zero base review and evaluation of program or activity and report to House or Senate.
May 15 of the year	Standing committee, under Congressional Budget Act, must report authorization legislation to its House.

Continuing Review and Evaluation

The legislation would require the Comptroller General to make follow-up evaluations at least once every six months of any program that the General Accounting Office has reviewed and had found to have fallen short of its objective. Those follow-up reports must be submitted to the Appropriations Committees of both Houses and to the standing committee of each House which has jurisdiction over the program.

In addition, the legislation would require that the Comptroller General furnish both Appropriations Committees and the appropriate standing committees of each House summaries of any audits or evaluations the General Accounting Office has conducted involving programs or activities under their jurisdiction.

Finally, the legislation will require the President to include in his annual budget specific objectives for each program or activity and an analysis of how that program or activity achieved the objectives set out for it in previous budgets.

Early Elimination of Inactive or Duplicative Programs

The legislation directs the Comptroller General to submit a report to Congress before July 1, 1977, identifying those government programs and activities for which no outlays have been made for the last two completed fiscal years and those programs and activities which have duplicative objectives.

The legislation further requires each standing committee of the House or Senate to follow-up on that report on or before May 15, 1978 with a view toward eliminating inactive programs and activities and eliminating programs and activities which duplicate other programs and activities or to consolidating duplicate programs and activities.

SCHEDULE FOR TERMINATION AND REVIEW OF FEDERAL PROGRAMS

Category Number	Functional or Subfunctional Category	Termination Date
050	National Defense	
150	International Affairs	
250	General Sciences, Space, and Technology	
750	Law Enforcement and Justice	9/30/79
350	Agriculture	
400	Commerce and Transportation	
450	Community and Regional Development	
501	Elementary, secondary, and vocational education	
502	Higher education	
503	Research and general education aids	
604	Public assistance and other income supplements (Public housing only) . . .	9/30/80
300	National Resources, Environment, and Energy	
550	Health	
600	Income Security (Except public housing in subcategory 604)	
700	Veterans Benefits and Services	9/30/81
504	Training and employment	
505	Other labor services	
506	Social services	
800	General Government	
850	Revenue Sharing and General Purpose Fiscal Assistance	9/30/82

94TH CONGRESS
2D SESSION

S. 2925

IN THE SENATE OF THE UNITED STATES

FEBRUARY 3, 1976

Mr. MUSKIE (for himself, Mr. ROTH, Mr. GLENN, Mr. BELLMON, Mr. HUDDLESTON, Mr. NUNN, and Mr. GOLDWATER) introduced the following bill; which was read twice and referred to the Committee on Government Operations

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A BILL

To provide for the elimination of inactive and overlapping Federal programs, to require authorizations of new budget authority for Government programs and activities at least every four years, to establish a procedure for zero-base review and evaluation of Government programs and activities every four years, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 That this Act may be cited as the "Government Economy and
4 Spending Reform Act of 1976".

5 DEFINITIONS AND SPECIAL RULES

6 SEC. 2. (a) For purposes of this Act—

7 (1) The term "budget authority" has the meaning

1 given to it by section 3(a)(2) of the Congressional
2 Budget Act of 1974.
3 (2) The term "permanent budget authority" means
4 budget authority provided for an indefinite period of time
5 or an unspecified number of fiscal years, but does not
6 include budget authority provided for a specified fiscal
7 year which is available for obligation or expenditure in
8 one or more succeeding fiscal years.
9 (3) The term "Comptroller General" means the
10 Comptroller General of the United States.
11 (b) For purposes of this Act, functional and subfunc-
12 tional categories are those set forth in the Budget of the
13 United States Government, Fiscal Year 1977, transmitted
14 to the Congress by the President on January 21, 1976.
15 (c) For purposes of this Act, the first review date
16 applicable to a program or activity is the termination date
17 applicable to such program or activity under section 101
18 (or in the case of a program or activity, which is included in
19 subfunctional category 551, 601, or 602 and which is funded
20 through a trust fund, the termination date which would apply
21 but for the exception provided by section 101(b)), and
22 each subsequent review date applicable to a program or

1 activity is the date four years following the preceding review
2 date.

3 (d) For purposes of this Act, the Members of the Sen-
4 ate who are members of the Joint Committee on Atomic
5 Energy shall be treated as a standing committee of the
6 Senate, and the Members of the House of Representatives
7 who are members of the Joint Committee shall be treated
8 as a standing committee of the House.

9 TITLE I—AUTHORIZATIONS OF NEW BUDGET 10 AUTHORITY

11 TERMINATION DATE OF LAWS AUTHORIZING OR PROVIDING 12 NEW BUDGET AUTHORITY

13 SEC. 101. (a) All provisions of law in effect on the
14 effective date of this section which authorize the enactment
15 of new budget authority for a Government program or
16 activity or which provide new budget authority (including
17 permanent budget authority) for a Government program or
18 activity for a fiscal year beginning after the termination
19 date applicable to such program or activity under the fol-
20 lowing table shall terminate on such date and shall have no
21 force or effect after such date:

Programs and activities included within functional or subfunctional category		Termination date
050	National defense	
150	International Affairs	
250	General Sciences, Space, and Technology	
750	Law Enforcement and Justice	September 30, 1979.
350	Agriculture	
400	Commerce and Transportation	
450	Community and Regional Development	
501	Elementary, secondary, and vocational education	
502	Higher education	
503	Research and general education aids	
604	Public assistance and other income supplements (public housing only)	September 30, 1980.
300	National Resources, Environment, and Energy	
550	Health	
600	Income Security (except public housing in subcategory 604)	
700	Veterans Benefits and Services	September 30, 1981.
504	Training and employment	
505	Other labor services	
506	Social services	
800	General Government	
850	Revenue Sharing and General Purpose Fiscal Assistance	September 30, 1982.

1 (b) Subsection (a) shall not apply to programs and
2 activities which are included within subfunctional category
3 551 (Health care services), 601 (General retirement and
4 disability insurance), or 602 (Federal employee retirement
5 and disability) and which are funded through trust funds.
6 (c) Subsection (a) shall not apply to new budget
7 authority initially provided for a program or activity for a
8 fiscal year beginning before the termination date applicable
9 to such program or activity which is available for obligation
10 or expenditure in a fiscal year beginning after such date.

1 BILLS AND RESOLUTIONS AUTHORIZING OR PROVIDING
2 NEW BUDGET AUTHORITY

3 SEC. 102. (a) On and after the effective date of this
4 section, it shall not be in order in either the Senate or the
5 House of Representatives to consider any bill or resolution
6 (or amendment thereto)—

7 (1) which authorizes the enactment of new budget
8 authority for a program or activity for a fiscal year be-
9 ginning after the next review date applicable to such
10 program or activity, unless the report required under
11 section 311 on the zero-base review and evaluation of
12 such program or activity preceding such review date
13 has been submitted to the Senate or the House of Rep-
14 resentatives, as the case may be;

15 (2) which changes any program or activity which
16 is included within subfunctional category 551, 601, or
17 602 and which is funded through a trust fund, if such
18 change is to take effect after the next review date ap-
19 plicable to such program or activity, unless the report
20 required under section 311 on the zero-base review and
21 evaluation of such program or activity preceding such
22 review date has been submitted to the Senate or the
23 House of Representatives, as the case may be; or

Programs and activities included within functional or subfunctional category		Termination date
050	National defense	
150	International Affairs	
250	General Sciences, Space, and Technology	
750	Law Enforcement and Justice	September 30, 1979.
350	Agriculture	
400	Commerce and Transportation	
450	Community and Regional Development	
501	Elementary, secondary, and vocational education	
502	Higher education	
503	Research and general education aids	
604	Public assistance and other income supplements (public housing only)	September 30, 1980.
300	National Resources, Environment, and Energy	
550	Health	
600	Income Security (except public housing in subcategory 604)	
700	Veterans Benefits and Services	September 30, 1981.
504	Training and employment	
505	Other labor services	
506	Social services	
800	General Government	
850	Revenue Sharing and General Purpose Fiscal Assistance	September 30, 1982.

1 (b) Subsection (a) shall not apply to programs and
2 activities which are included within subfunctional category
3 551 (Health care services), 601 (General retirement and
4 disability insurance), or 602 (Federal employee retirement
5 and disability) and which are funded through trust funds.
6 (c) Subsection (a) shall not apply to new budget
7 authority initially provided for a program or activity for a
8 fiscal year beginning before the termination date applicable
9 to such program or activity which is available for obligation
10 or expenditure in a fiscal year beginning after such date.

1 BILLS AND RESOLUTIONS AUTHORIZING OR PROVIDING
2 NEW BUDGET AUTHORITY

3 SEC. 102. (a) On and after the effective date of this
4 section, it shall not be in order in either the Senate or the
5 House of Representatives to consider any bill or resolution
6 (or amendment thereto)—
7 (1) which authorizes the enactment of new budget
8 authority for a program or activity for a fiscal year be-
9 ginning after the next review date applicable to such
10 program or activity, unless the report required under
11 section 311 on the zero-base review and evaluation of
12 such program or activity preceding such review date
13 has been submitted to the Senate or the House of Rep-
14 resentatives, as the case may be;
15 (2) which changes any program or activity which
16 is included within subfunctional category 551, 601, or
17 602 and which is funded through a trust fund, if such
18 change is to take effect after the next review date ap-
19 plicable to such program or activity, unless the report
20 required under section 311 on the zero-base review and
21 evaluation of such program or activity preceding such
22 review date has been submitted to the Senate or the
23 House of Representatives, as the case may be; or

1 (3) which provides permanent budget authority for
2 a program or activity for which a termination date is
3 applicable under section 101, unless such bill, resolu-
4 tion, or amendment has been reported to the Senate
5 or the House of Representatives, as the case may be,
6 by the Committee on Appropriations of that House.

7 IDENTIFICATION OF PROGRAMS AND ACTIVITIES BY
8 FUNCTIONAL OR SUBFUNCTIONAL CATEGORIES

9 SEC. 103. (a) On or before July 1, 1977, the Com-
10 mittees on Appropriations and the Committees on the
11 Budget of the Senate and the House of Representatives,
12 acting jointly, shall submit to their respective Houses a
13 report setting forth, with respect to each program or ac-
14 tivity—

15 (1) the functional or subfunctional category in
16 which such program or activity is included; and

17 (2) the committee or committees of that House
18 which have legislative jurisdiction over such program
19 or activity.

20 The informaton required by paragraphs (1) and (2) shall
21 be cross-indexed so as to provide information to the com-
22 mittees of the Senate and the House of Representatives as
23 to the termination dates and review dates of programs and
24 activities under their jurisdiction.

25 (b) At the request of the Committee on Appropria-

1 tions or the Committee on the Budget of the Senate or the
2 House of Representatives, the Comptroller General shall
3 furnish to such committee such assistance as it may request
4 in carrying out its functions under subsection (a).

5 IDENTIFICATION OF PERMANENT AUTHORIZATIONS AND
6 PERMANENT BUDGET AUTHORITY

7 SEC. 104. (a) On or before April 1, 1977, the Comp-
8 troller General shall submit to the Senate and the House of
9 Representatives a report setting forth each program or
10 activity—

11 (1) which is carried on under a provision of law
12 which permanently authorizes the enactment of new
13 budget authority for such program or activity (includ-
14 ing programs or activities for which permanent authori-
15 zations are implied); and

16 (2) which is carried on under a provision of law
17 which provides permanent budget authority for such
18 program or activity.

19 (b) The report submitted under subsection (a) shall
20 also set forth—

21 (1) the law or laws under which each such pro-
22 gram or activity is carried on;

23 (2) the committee or committees of the Senate and
24 the House of Representatives which have legislation
25 jurisdiction over each such program or activity;

1 (3) in the case of programs and activities to which
2 paragraph (1) of subsection (a) applies, the annual
3 appropriation bill which provides new budget authority
4 for each such program or activity; and
5 (4) the amount of new budget authority provided
6 for each such program or activity for each of the last
7 four completed fiscal years ending before April 1, 1977.
8 The information required by this section shall be cross-
9 indexed so as to provide information to the committees of
10 the Senate and the House of Representatives with respect to
11 programs and activities under their jurisdiction which are
12 carried on under permanent authorizations or permanent
13 budget authority.
14 (c) On or before April 1, 1978, and each year there-
15 after, the Comptroller General shall submit to the Senate
16 and the House of Representatives a report setting forth the
17 amount of new budget authority provided for each of the
18 last four completed fiscal years for each program or activity
19 identified in the report submitted under subsection (a)
20 which, as of the date on which such report is submitted,
21 is carried on under a provision of law which permanently
22 authorizes the enactment of new budget authority for such
23 program or activity or which provides permanent budget
24 authority for such program or activity.

1 JURISDICTION OVER LEGISLATION CHANGING TERMINA-
2 TION AND REVIEW DATES

3 SEC. 105. All proposed legislation, messages, petitions,
4 memorials, and other matters relating to changes in the
5 termination dates and review dates applicable to programs
6 and activities under this Act shall be referred in the Senate
7 to the Committee on the Budget of the Senate, and shall be
8 referred in the House of Representatives to the Committee
9 on the Budget of the House, and each such committee shall
10 have jurisdiction to report to its House, by bill or otherwise,
11 proposed changes in such dates.

12 EFFECTIVE DATE

13 SEC. 106. Sections 101 and 102 shall take effect on the
14 first day of the first session of the Ninety-fifth Congress.

15 TITLE II—EARLY ELIMINATION OF INACTIVE
16 AND DUPLICATE PROGRAMS

17 STUDY AND REPORT BY GENERAL ACCOUNTING OFFICE

18 SEC. 201. (a) The Comptroller General shall promptly
19 conduct a study of all Government programs and activities
20 for the purposes of identifying—
21 (1) those programs and activities for which no
22 outlays have been made for the last two completed
23 fiscal years; and

1 (2) those programs and activities which have
2 duplicate objectives.

3 (b) The Comptroller General shall submit interim re-
4 ports to the Senate and the House of Representatives on the
5 results of the study conducted under subsection (a), and
6 shall submit a final report on or before July 1, 1977.

7 (c) The Comptroller General shall transmit a copy
8 of each report submitted under subsection (b) to the stand-
9 ing committees of the Senate and the House of Representa-
10 tives which have legislative jurisdiction over the programs
11 and activities included in such report.

12 ACTION BY CONGRESSIONAL COMMITTEES

13 SEC. 202. Each standing committee of the Senate and
14 the House of Representatives shall give prompt considera-
15 tion to each report transmitted to it under section 201 (c)
16 with a view to—

17 (1) eliminating inactive programs and activities;
18 and

19 (2) eliminating programs and activities which
20 duplicate other programs and activities, or consolidating
21 such duplicate programs and activities.

22 To the extent possible, action shall be taken by each such
23 standing committee on all reports transmitted to it on or
24 before March 15, 1978.

1 TITLE III—QUADRENNIAL PROGRAM REVIEW
2 AND EVALUATION

3 PART 1—TIMETABLE; DEFINITION

4 TIMETABLE

5 SEC. 301. The timetable for zero-base review and evalua-
6 tion of a Government program or activity the review date
7 for which is on September 30 of a year is as follows:

On or before—	
December 31 of preceding year.	General Accounting Office reports results of prior audits and reviews and evaluations and reports other requested information and analyses to standing committees.
December 31 of preceding year.	Congressional Budget Office reports requested information and analyses to standing committees.
15th day after Congress meets in the year.	President submits budget accompanied by results of zero-base review and evaluation of the program or activity.
March 15 of the year	Standing committee completes zero-base review and evaluation of the program or activity and reports to its House.

8 DEFINITION

9 SEC. 302. For purposes of this title, the term "zero-base
10 review and evaluation" means, with respect to any Govern-
11 ment program or activity, a comprehensive review and
12 evaluation to determine if the merits of the program or
13 activity supports its continuation rather than termination
14 and to reach findings as to what incremental amounts of new
15 budget authority for the program or activity should be

1 authorized to produce correspondingly larger levels of service
2 output.

3 PART 2—CONGRESSIONAL REVIEW AND EVALUATION

4 REVIEW AND EVALUATION BY STANDING COMMITTEES

5 SEC. 311. (a) (1) The standing committees of the
6 Senate and the House of Representatives shall conduct a
7 zero-base review and evaluation of all Government programs
8 and activities within their jurisdiction every fourth year.
9 The zero-base review and evaluation of each program or
10 activity shall be conducted during the twelve-month period
11 ending on March 15 of the year in which occurs the review
12 date for such program or activity.

13 (b) Each zero-base review and evaluation of a program
14 or activity conducted under subsection (a) shall include
15 but not be limited to—

16 (1) an identification of other Government pro-
17 grams and activities having the same or similar objec-
18 tives, along with a comparison of the cost and effective-
19 ness of such programs or activities and any duplication
20 of the program or activity under review;

21 (2) an examination of the extent to which the ob-
22 jectives of the program or activity have been achieved
23 in comparison with the objectives initially set forth for
24 the program or activity and an analysis of any signifi-
25 cant variance between projected and actual performance;

1 (3) a specification, to the extent feasible, in quanti-
2 tative terms of the objectives of such program or activity
3 during the next four fiscal years; and
4 (4) an examination of the impact of such program
5 or activity on the national economy.
6 (c) A report of the results of each zero-base review and
7 evaluation of a program or activity conducted under sub-
8 section (a), and of the recommendations of the committee
9 with respect thereto, shall be submitted to the Senate or the
10 House of Representatives, as the case may be, on or before
11 March 15 of the year in which occurs the review date for
12 such program or activity. Such report shall include an identi-
13 fication of other programs or activities having the same or
14 similar objectives and the recommendations of the committee
15 with respect to the elimination or consolidation of such
16 other programs or activities. Whenever a committee has
17 identified a comparable program or activity and recommends
18 authorization of new budget authority for the program or
19 activity under review and evaluation or the establishment
20 of a new comparable program or activity, the report shall
21 state with particularity the justification for the authorization
22 of new budget authority, or for the establishment of a new
23 comparable program, and explain the manner in which it
24 avoids duplication of other efforts.

1 ASSISTANCE BY GENERAL ACCOUNTING OFFICE AND
2 CONGRESSIONAL BUDGET OFFICE

3 SEC. 312. (a) The Comptroller General shall furnish
4 to each standing committee of the Senate and the House
5 of Representatives the results of prior audits and reviews
6 and evaluations of each Government program or activity
7 which is the subject of a zero-base review being conducted
8 by that committee under section 311. At the request of any
9 such standing committee, the Comptroller General shall
10 furnish to such committee such information and analyses
11 as it may request to assist in its conduct of any such zero-
12 base review and evaluation. Assistance authorized by this
13 subsection shall be in addition to assistance authorized by
14 section 204 of the Legislative Reorganization Act of 1970.
15 (b) Consistent with the discharge by the Congressional
16 Budget Office of its duties and functions under the Congres-
17 sional Budget Act of 1974, the Director of the Congressional
18 Budget Office shall, at the request of any standing commit-
19 tee of the Senate or the House of Representatives, furnish to
20 such committee such information and analyses as it may
21 request to assist in its conduct of a zero-base review and
22 evaluation of a Government program or activity under sec-
23 tion 311.
24 (c) Information required to be furnished to a standing
25 committee under subsection (a) and information or analyses

1 requested by a standing committee under subsection (a)
2 or (b) with respect to a program or activity shall be fur-
3 nished to such committee on or before December 31 of the
4 year preceding the year in which occurs the review date
5 for such program or activity.

6 PART 3—EXECUTIVE REVIEW AND EVALUATION

7 REVIEW AND EVALUATION BY THE PRESIDENT

8 SEC. 321. (a) Prior to transmitting the Budget for a
9 fiscal year, the President shall conduct a zero-base review
10 and evaluation of each Government program or activity the
11 review date for which is September 30 preceding the begin-
12 ning of such fiscal year. Each such review and evaluation
13 shall include the matters described in section 311 (b).

14 (b) Section 201 of the Budget and Accounting Act,
15 1921 (31 U.S.C. 11), is amended by adding at the end
16 thereof the following new subsections:

17 "(j) The Budget transmitted pursuant to subsection (a)
18 for each fiscal year shall include a report of the results of the
19 zero-base review and evaluation conducted under section
20 321 (a) of the Government Economy and Spending Re-
21 form Act of 1976 of each Government program or activity
22 the review date for which is September 30 preceding the
23 beginning of such fiscal year, together with the recommen-
24 dations of the President with respect thereto.

25 "(k) Estimated expenditures and proposed appropria-

1 tions under subsection (a) for any Government program or
2 activity for a fiscal year shall be based on the most recent
3 zero-base review and evaluation of such program or activity
4 conducted under section 321 (a) of the Government Econ-
5 omy and Spending Reform Act of 1976.".

6 ## TITLE IV—CONTINUING REVIEW AND
7 ## EVALUATION

8 ### ADDITIONAL FUNCTIONS OF GENERAL ACCOUNTING
9 ### OFFICE

10 SEC. 401. (a) Whenever, in the judgment of the Comp-
11 troller General, any audit conducted by the General Account-
12 ing Office discloses any substantial deficiency in achievement
13 of the objectives of any Government program or activity,
14 he shall conduct subsequent audits of such program or ac-
15 tivity periodically at such times as he deems necessary, but
16 not less often than every six months, until he determines
17 that the deficiency or deficiencies in such program or ac-
18 tivity have been eliminated. The Comptroller General shall
19 report the results of each such subsequent audit, together
20 with his findings as to progress made to eliminate the defi-
21 ciency or deficiencies in such program or activity, to the
22 Committees on Appropriations of the Senate and the House
23 of Representatives and to the standing committees of the
24 Senate and the House which have legislative jurisdiction
25 over such program or activity.

1 (b) The Comptroller General shall furnish to the Com-
2 mittees on Appropriations of the Senate and the House of
3 Representatives, and to the standing committees of the Sen-
4 ate and the House which have legislative jurisdiction over
5 any Government program or activity, a summary of each
6 audit conducted by the General Accounting Office involving
7 such program or activity.

8 INCLUSION OF PROGRAM INFORMATION IN PRESIDENT'S
9 BUDGET

10 SEC. 402. (a) Section 201 of the Budget and Account-
11 ing Act, 1921 (31 U.S.C. 11), is amended by adding after
12 subsection (k) (as added by section 321 (b) of this Act)
13 the following new subsection:

14 "(l) The Budget transmitted pursuant to subsection (a)
15 for each fiscal year shall include information, with respect to
16 each Government program or activity, on the specific ob-
17 jectivies of such program or activity for such fiscal year, and
18 a comparison of the achievement of the objectives of such
19 program or activity for the last completed fiscal year with the
20 planned objectives of such program or activity for such fiscal
21 year.".

22 (b) The amendment made by subsection (a) shall
23 apply with respect to the fiscal year beginning on October 1,
24 1978, and succeeding fiscal years.

1 TITLE V—MISCELLANEOUS

2 EXERCISE OF RULEMAKING POWER

3 SEC. 501. The provisions of this section and sections 101,
4 102, 103 (a), 105, 202, and 311 of this Act are enacted by
5 the Congress—
6 (1) as an exercise of the rulemaking power of the
7 Senate and the House of Representatives, respectively,
8 and as such they shall be considered as part of the rules
9 of each House, respectively, or of that House to which
10 they specifically apply, and such rules shall supersede
11 other rules only to the extent that they are inconsistent
12 therewith; and
13 (2) with full recognition of the constitutional right
14 of either House to change such rules (so far as relating
15 to such House) at any time, in the same manner, and to
16 the same extent as in the case of any other rule of such
17 House.

94TH CONGRESS
2D SESSION

S. 2925

A BILL

To provide for the elimination of inactive and overlapping Federal programs, to require authorizations of new budget authority for Government programs and activities at least every four years, to establish a procedure for zero-base review and evaluation of Government programs and activities every four years, and for other purposes.

By Mr. MUSKIE, Mr. ROTH, Mr. GLENN, Mr. BELLMON, Mr. HUDDLESTON, Mr. NUNN, and Mr. GOLDWATER

FEBRUARY 3, 1976
Read twice and referred to the Committee on Government Operations

F

ADVISORY
COMMISSION ON INTERGOVERNMENTAL RELATIONS
WASHINGTON, D.C. 20575

February 25, 1976

MEMORANDUM

TO: Members of the Advisory Commission on Intergovernmental Relations

FROM: Wayne Anderson
Executive Director

SUBJECT: Study of National Forest Shared Revenue Program

The purpose of the information which follows is to introduce the Commission to the key issues raised by the National Forest Revenue Sharing Study. The Commission approved undertaking this study at its meetings on September 11 and 12, 1975 (item E in the Docket Book of that meeting). The work commenced about November 1. The study is financed by an eighteen month contract with the U.S. Forest Service, so that this subject will come before the Commission for action probably early in 1977.

At this stage of the study we are able to outline the major issues concerning the payment system the study will face, the likely range of options for final recommendations and criteria for making judgements among the options. This is done on the following table. It is a matrix showing some of the alternative bases for the payment system and their impact on a variety of policy issues.

The table focuses on the payment system which is surely the major subject the study will examine. In addition, the final report will also examine other issues of an intergovernmental nature such as the proper role for state governments.

TABLE 1

FOREST SERVICE REVENUE SHARING STUDY KEY ISSUES

Basis for Payment[1]	General Description of Local Government Beneficiaries	Federal Perception	Local Perception	Administrative Ease
Share of Revenue Receipts (the present system) provides aid because of the fiscal impact of Federal ownership and in order to retain local goodwill. Congress determines the percentage of the receipts that are shared	Counties and School Districts Where Timber is Harvested Extensively	Continues problems of local government dissatisfaction where revenues are low, especially when they are low due to Forest Service decisions	Except in areas of high timber production most arbitrary because no local input on decisions affecting payment and unrelated to fiscal impact of Federal ownership	Easiest of Administration, but leads to friction over (a) Method of calculating shareable receipts and (b) Federal decisions to reduce revenues, such as declaring a National Forest a "Wilderness Area"
Share of Revenue Receipts plus Guaranteed Minimum endeavors to retain local goodwill regardless of the fiscal impact of the National Forests (for example, HR 9719 currently in Congress)	All Counties with National Forest Land within their borders	Arbitrary in relation to fiscal impact yet easy to administer. Federal Government would be concerned if the additional costs had to be met within the existing appropriation level, in which case, other objectives, such as building roads to increase access to the National Forest would have to be sacrificed	Some local financial support is better than none but depends on level of minimum guaranteed	Relative ease because data required are those used in management decision making
Tax Equivalency model would conpensate State and local governments for tax revenues foregone due to tax immunity of Federally owned property	In comparison to current program, localities where current harvests do not yield much revenue, or where tax rates are high, especially where both conditions exist	Opens Pandora's Box of state-local tax practices and of valuation theory and practice. Also may set unwanted precedent since it has the effect of waiving Federal tax immunity	Simple justice for localities whose present payments are less than tax equivalency	Complex task depending on degree of accuracy desired in application of value concept and number of Governments whose tax claims are considered
Expenditure Reimbursement model would compensate State and local governments for the additional expenditures imposed on them by the presence of the National Forests	In comparison to current program, localities where current harvests do not yield much revenues; in general most places probably would receive reduction in payments	May be seen as being fair because it neutralizes the net fiscal impact of National Forest; however, complexity and arbitrariness of administration may also make it undesirable	Probably unpopular both because of lack of objective way to determine true level of expenditures imposed and because of likelihood of reduction in payments	Complex task depending on degree of accuracy desired in measuring expenditures imposed and number of Governments whose claims are considered

[1]For each of the options above, a "benefit adjustment" could be made. Such a modification would account for the beneficial financial effect of Federal ownership in calculating payments. For example, the Forest Service provides its own fire protection, a responsibility which would otherwise necessitate local outlays. The benefit adjustment modification would result in a payment based on the net fiscal effect of Federal ownership.

G

ADVISORY

COMMISSION ON INTERGOVERNMENTAL RELATIONS

WASHINGTON, D.C. 20575

February 24, 1976

MEMORANDUM

TO : Members of the Advisory Commission on Intergovernmental Relations.

FROM : Wayne F. Anderson
Executive Director WFA

SUBJECT: ACIR Information Report--Understanding the Market for State and Local Debt

At our last meeting, Mayor Poelker urged the staff to prepare a primer on borrowing by State and local governments--an information report that would, among other things, point up the difference between short-term financing to overcome temporary cash flow problems and long-term financing to underwrite the construction of major capital facilities.

We were able to move expeditiously on Mayor Poelker's request because essentially the same facts had to be gathered for our current FDIC study--The Impact of Increasing Insurance for Public Unit Deposits.

This information report was prepared by Professors Hempel and Patton in collaboration with the ACIR staff.

UNDERSTANDING THE MARKET FOR STATE AND LOCAL DEBT

A Summary Study

Prepared for the

Advisory Commission on Intergovernmental Relations

by

James M. Patton
Assistant Professor of Business Administration
University of Pittsburgh

and

George H. Hempel
Professor of Finance
Washington University
St. Louis

January, 1976

Summary

1. The market for State and local debt is quite large. During 1975, $58.2 billion of new State and local debt were issued in about 8,000 separate issues. That is about 10 times the dollar volume of 1950 and more than double the volume of 1968.

2. State governments account for nearly one-third of State and local debt outstanding. Incorporated municipalities account for roughly 29 percent, while school and special districts account for about 13 percent and 16 percent of such debt, respectively. The remaining State and local debt is the obligation of counties and unincorporated municipalities.

3. Short-term debt is usually issued in anticipation of revenue or other receipts or to cope with expenditure requirements that are not covered by operating revenues. The financing of current operating expenditures with debt that is not retired by the end of the fiscal year may be a signal of potential future financial difficulties. Prior to 1975, short-term State and local debt had been increasing more rapidly than long-term debt and in most recent years exceeded the annual dollar volume of long-term debt issued. This phenomenon has led to some refinancing problems and may lead to more in the future.

4. State and local governmental units' long-term borrowing is usually used to finance large outlays (usually for capital projects or for refunding debt) that are not covered by their revenue sources (which are fairly inflexible). Non-guaranteed or limited liability debt has increased as a proportion of total long-term State and local debt. Furthermore, the debate over the precise meaning of full faith and credit backing has intensified because of the well-publicized financial problems of New York City and the State of New York.

5. The profile of State and local bond ownership has changed over time. The most important factor influencing ownership has been the Federal tax position of potential owners. Commercial banks currently own about 50 percent of all State and local securities outstanding. Their demand is influenced by many factors that make their purchase of such securities fairly erratic. There is reason to question whether they will continue to absorb the majority of State and local debt issues in the latter 1970's.

6. The cost of borrowing has been increasing for State and local governmental units. One common indicator, the 20-bond Bond Buyer Index, went above the 7.5 percent mark for the first time ever in 1975. The longer the maturity and the lower the quality of a municipal issue, the higher the interest rate cost.

7. A comparison of market yields on Treasury vs municipal securities shows that State and local debt is perceived as relatively more risky in periods of recession and less risky in more prosperous periods. A recent study concluded that the introduction of Federal general revenue sharing cut the relative cost of State and local borrowing. The recent financial problems of New York City and New York State may have affected the interest costs of other State and local governmental units. The distribution of bond ratings assigned to long-term municipal debt issues since 1945 shows that the overall quality of municipal debt increased in the early 1950's and deteriorated in the late 1950's and 1960's.

Municipal defaults have occurred in periods of good and bad economic conditions, reaching significant magnitudes only during period of major

economic depression. Only a small percentage of municipal defaults have been resolved through the bankruptcy process. Only 18 municipal bankruptcy cases have been filed under Title IX of the Federal bankruptcy laws since 1954.

8. Most long-term municipal issues must, by law, be offered through competitive bidding. The winning underwriter (syndicate of investment bankers and commercial banks offering the lowest net interest cost) reoffers the bonds to the public at prices that cover the underwriter's expenses and compensate him for his risks. Many short-term municipal issues are negotiated with local banks or other institutions, the interest rate paid being determined through negotiations.

After they are issued, State and local issues are traded in the over-the-counter market. An active secondary market is important for a State and local issue because investors are more likely to be willing to purchase securities when initially issued if they believe they can liquidate their holdings when they want to. Most short-term and smaller municipal issues do not have well developed secondary markets.

The Securities Act Amendments passed in 1975 have already caused substantial changes in the operation of the market for State and local debt instruments. Recent proposals could cause this market to undergo even further fundamental changes.

Introduction

Over the last several decades, Americans have come to assume that borrowing at a reasonable cost would be an available method of financing for nearly all State and local governmental units. This assumption has been challenged in recent years. The higher level of all interest rates and increased borrowing by many State and local units have meant that some units have been unable to borrow because of statutory ceilings on interest rates they can pay or on the amount they can borrow. By the late 1960's the rising cost of municipal services coupled with slower increases in tax bases began placing stress on many municipal budgets. In 1971, President Nixon raised the question of the health of the State and local sectors to national prominence with his statement ". . .if we do not have it [revenue sharing], we are going to have States, cities, and counties going bankrupt over the next two or three years."[1] The passage of Federal general revenue sharing in 1972 helped to alleviate some of the pressures in the State and local debt market; however, the recent default by the Urban Development Corporation (an agency of New York State) and the severe financial problems of New York City and State have again raised serious questions about the ability of state and local governments to obtain the debt financing they may need in coming years. Legislation that has been proposed to alleviate these concerns includes: (a) having a Federal agency (similar to the Federal Deposit Insurance Corporation) insure State and local issues; (b) authorizing, as an option to the tax-exempt municipal bond, a "taxable, subsidized bond" on which the Treasury would pay a portion of the interest; (c) having the Federal government guarantee State and local debt; (d) requiring State and local borrowers to register new issues with the Securities and Exchange Commission and meet prescribed full disclosure reporting requirements, and (e) revising the current municipal bankruptcy laws.

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[1] Weekly Compilation of Presidential Documents, VII-w, January 1971, p. 41.

This summary study is designed to assist the reader in understanding various aspects of the market for state and local debt (also called the municipal bond market). The presentation is organized around eight topics: (1) Size of the Market, (2) Who Borrows, (3) Short-term State and Local Borrowing, (4) Long-term State and Local Borrowing, (5) Who Owns State and Local Debt, (6) Cost of Borrowing for State and Local Units, (7) The Quality of State and Local Debt, and (8) Operation of the Market for State and Local Debt Instruments. It is hoped that the factual material presented on these eight topics will enable the reader to place into context the current problems in the municipal debt market and will be useful in considering legislation proposed to deal with these problems.

1. Size of the Market

One important characteristic of the municipal debt market is the substantial increase in its size over the last 25 years. Exhibit 1 documents the rise in annual volume as measured by the dollar value and the number of State and local debt issues. The annual dollar amount of debt issued by State and local governmental units in the early 1970's is more than double the amount issued in the late 1960's, and about 10 times greater than in the early 1950's. However, the growth in the annual volume of State and local debt financing has been irregular. Because of various market conditions (high interest rates, low investor demand, etc.), there have been several periods in which the annual amount issued has fallen or risen only moderately.[2] Finally, the average dollar

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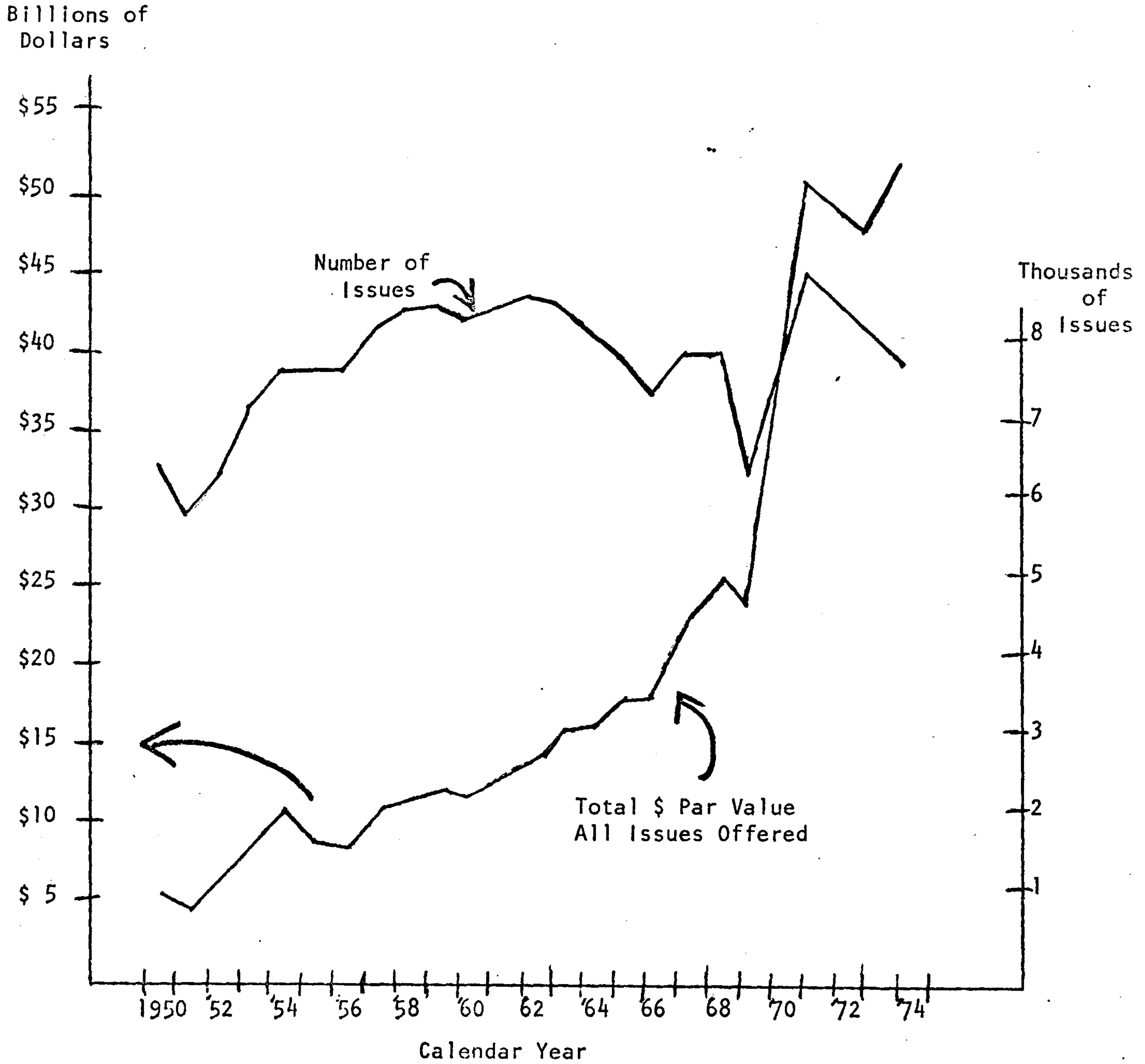
[2] Paul F. McGouldrick and John E. Petersen, "Monetary Restraint and Borrowing and Capital Spending by Large State and Local Governments in 1966," Federal Reserve Bulletin, July 1968, pp. 552-554; Wayne E. Etter and Donald R. Fraser, "Broadening the Municipal Market: A Neglected Issue," MFOA Special Bulletin, September 1974, pp. 3-4.

Exhibit 1

ANNUAL VOLUME OF NEW STATE AND LOCAL BORROWING



Source: Exhibit A-1 in Appendix A.

amount per issue has been increasing--$6.74 million in 1974, $4.69 million in 1970, $2.21 million in 1965 and $1.11 million in 1955.

The increased annual volume of new State and local debt issues is also reflected in the total amount of State and local debt outstanding. Exhibit 2 reveals the increases in the State and local components of the total municipal debt outstanding. This exhibit shows that both components have risen dramatically in the last 20 years. However, State governments have increased their relative share of the municipal debt outstanding; State debt now comprises nearly one-third of all State and local debt.

Another way of describing the growth of State and local debt is to compare it with the growth of other forms of debt. Exhibit 3 shows that State and local debt has remained between 7 and 8 percent of total public and private indebtedness since the early 1960's. During the same period, State and local debt has been a growing proportion of total public debt. Immense Federal deficits in Fiscal 1976 and 1977 may, however, change this trend.

Exhibit 2

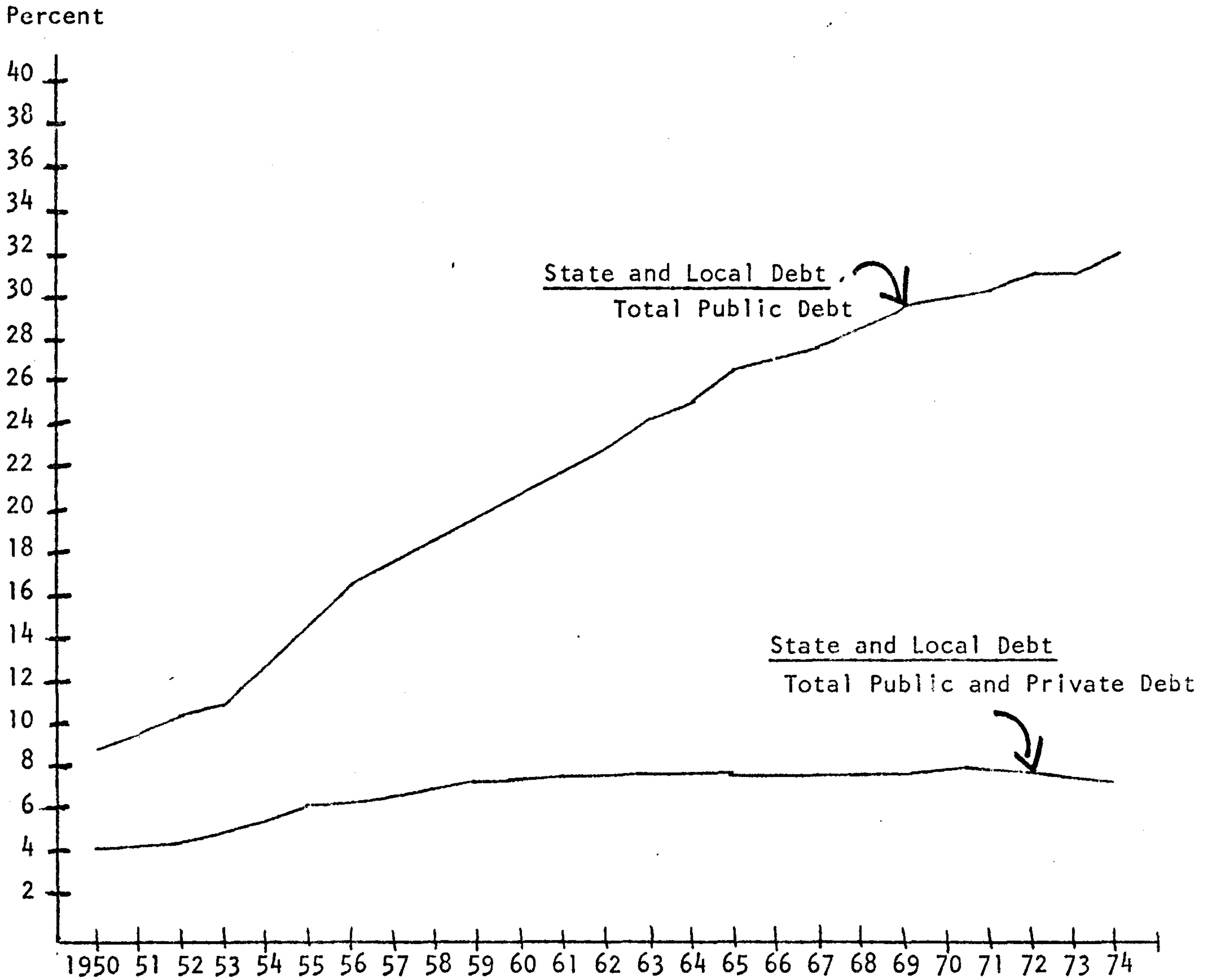
TOTAL STATE AND LOCAL DEBT OUTSTANDING

Year	Total: Billions of Dollars	Total: Percent of Total	State: Billions of Dollars	State: Percent of Total	Local: Billions of Dollars	Local: Percent of Total
1952	$ 30.1	100%	$ 6.9	23%	$ 23.2	77%
1957	52.7	100	13.7	26	39.0	74
1962	81.3	100	22.0	27	59.3	73
1967	114.6	100	32.5	28	82.1	72
1968	121.2	100	35.7	29	85.5	71
1969	133.5	100	39.6	30	93.9	70
1970	143.6	100	42.0	29	101.6	71
1971	158.8	100	47.8	30	111.0	70
1972	174.6	100	54.5	31	120.1	69
1973	188.5	100	59.4	32	129.0	68
1974	206.6	100	65.3	32	141.3	68

Source: Adapted from Municipal Finance Statistics, p. 8 and "Governmental Finances" (Washington: U. S. Government Printing Office, Census Bureau).

Exhibit 3

STATE AND LOCAL DEBT AS PERCENTAGE OF TOTAL DEBT AND TOTAL PUBLIC DEBT



Source: Exhibit A-2 in Appendix A.

2. Who Borrows

Another method of describing the market for State and local debt focuses on the basic types of governmental units which borrow in this market. Exhibit 4 presents the Census Bureau's classification of the types of governmental units for various years. The most obvious trend revealed in this exhibit is that the total number of local units has decreased significantly in the past 25 years. In particular, the number of school districts has declined dramatically over time. The reduction in school districts is a result of consolidation and reorganization of districts. The number of special districts has increased. Most of these are single-purpose entities--over 50 percent of them are concerned with fire protection, natural resources or water supplies.[3]

Exhibit 5 shows a percentage distribution of State and local debt outstanding classified by type of governmental unit. The most obvious change is that State debt increased gradually throughout the two decades. Several other gradual shifts have occurred over the last 20 years. General purpose local governmental units (counties, municipalities and townships) constituted a slightly lower percentage of total State and local debt outstanding in 1974 than they did in 1955. This is the net result of a gradual increase in the percentage of debt originated by counties and a larger decrease by municipalities. One cause of these trends may be the assumption of urban-type functions by some counties. An examination of single-purpose governmental units shows that school districts' percentage decreased, while special districts contributed a larger increase. Thus, both the number of units (Exhibit 4) and the relative amount of indebtedness of special districts have been increasing. These phenomena may be due in part to the existence of borrowing limits that were placed on many general purpose local governments during the 1930's.

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[3] U.S. Bureau of the Census, Census of Governments, 1972, Vol. 1, Governmental Organization, U. S. Government Printing Office, Washington, D.C., 1973.

Exhibit 4

NUMBER OF STATE AND LOCAL GOVERNMENTAL UNITS BY TYPE

Type of Unit	1952*	1957*	1962	1967	1972
State	50	50	50	50	50
County	3,052	3,050	3,043	3,049	3,044
Municipality	16,807	17,215	18,000	18,048	18,517
Township	17,202	17,198	17,142	17,105	16,991
School District	67,355	50,454	34,678	21,782	15,781
Special District	12,340	14,424	18,323	21,264	23,885
Total	116,806	102,391	91,236	81,298	78,268

*Adjusted to include Alaska and Hawaii.

Source: Moody's Municipal and Government Manual, 1975.

Exhibit 5

STATE AND LOCAL DEBT OUTSTANDING BY TYPE OF GOVERNMENTAL UNIT

(expressed as percent of State and local debt outstanding)

Year	State	County	Municipality	Township	School District	Special District	Total
1955	25%	7%	36%	2%	17%	13%	100%
1962	27	7	33	2	17	14	100
1967	28	7	32	2	16	15	100
1968	29	7	31	2	16	15	100
1969	30	7	30	2	16	15	100
1970	29	8	30	2	16	15	100
1971	30	8	30	2	15	15	100
1972	31	8	30	2	14	15	100
1973	32	8	30	2	13	15	100
1974	32	8	29	2	13	16	100

Source: Adapted from Municipal Finance Statistics, p. 33 and "Governmental Finances," published annually by the Governments Division, U. S. Bureau of the Census (Washington, D.C.: U. S. Government Printing Office, 1955-74).

3. Short-term State and Local Borrowing

Short-term State and local borrowing (defined as debt having an average maturity of less than one year) is generally used for one of four purposes. First, over one-third of short term State and local borrowing is for public housing or urban renewal projects.[4] A second common use of short-term municipal borrowing is as an aid in synchronizing the flows of current disbursements with current tax receipts. Many municipal units use tax anticipation notes (TANS)-- short-term debt issued to meet current expenditure needs and repaid as current taxes are collected--to smooth out seasonal expenditure and revenue imbalances.

Another use of short-term municipal debt is for the purpose of reducing the financing costs associated with capital projects. Bond anticipation notes (BANS) are issued in order to avoid borrowing the amount required to finance an entire capital project before all of the funds are needed and/or in hopes of financing the project at lower long-term interest rates than are available when the project is being constructed. In many States there are laws which require the issuer to refinance BANS with long-term debt within a period of one or two years of the date of issue.

State and local units have also used short-term borrowing to finance expected and unexpected current operating deficits--current operating expenditures in excess of current revenues. If continued over several years, this type of financial strategy may cause severe financial strains as the governmental unit attempts to refinance its rising short-term indebtedness by issuing new debt to replace maturing obligations. The dangers of this form of short-term borrowing were pointed out in an earlier ACIR report, <u>City Financial Emergencies: The</u>

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[4] <u>Municipal Finance Statistics</u>, p. 5. In 1974, 38 percent of state and local short-term borrowing was in the form of Public Housing Authority Issues or Urban Renewal Preliminary Loan Notes, both of which are backed by a Federal guarantee of payment.

Intergovernmental Dimension. This report concluded that borrowing to refinance operating deficits is an early warning signal of potential future financial difficulties.[5]

Exhibit 6 demonstrates that the total dollar amount of short-term State and local debt issues has been increasing very rapidly recently. The annual dollar amount of short-term municipal debt issued, which was about half the amount of long-term State and local debt in the 1950's, has exceeded or equalled the amount of such long-term debt issued in each of the last five years. This trend is important because the ability of some State and local governments to refinance large amounts of short-term debt has come under question in the last few years. As the New York crisis has painfully demonstrated, unforeseen negative market conditions can make such refinancing difficult and costly for even financially strong State or local governmental units.[6]

The growth in short-term debt outstanding is less noticeable because short-term debt is retired or turned-over (a maturing issue repaid by a new one) so frequently. However, Exhibit 7 demonstrates that short term debt has even increased as a percentage of total outstanding indebtedness.

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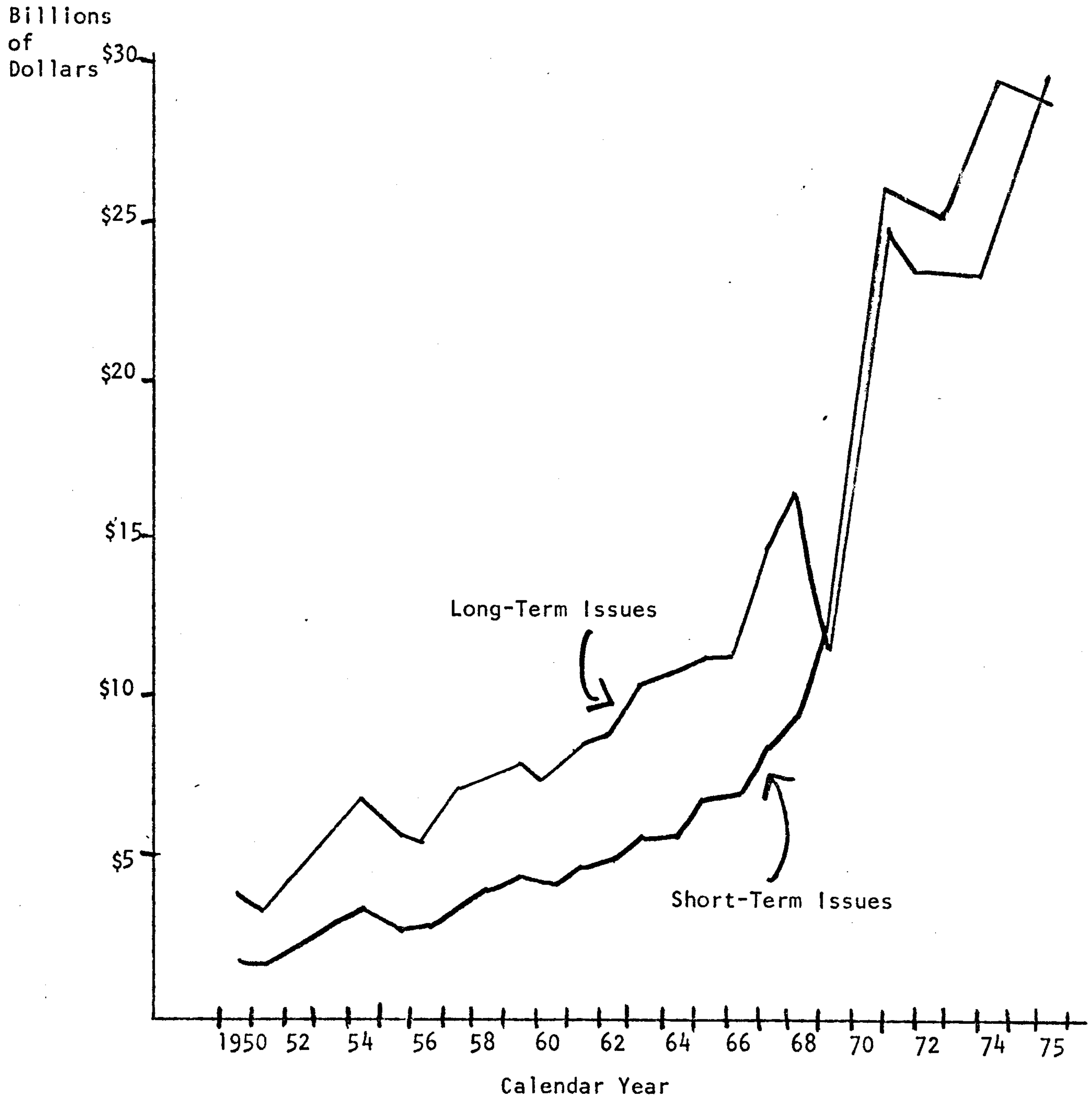
[5]Advisory Commission on Intergovernmental Relations, City Financial Emergencies: The Intergovernmental Dimension, Commission Report A-42 (Washington, D.C.: U. S. Government Printing Office, 1973).

[6]Ibid., pp. 5-6.

Exhibit 6

ANNUAL DOLLAR VOLUME OF STATE AND LOCAL BORROWING
LONG-TERM VS SHORT-TERM



Source: Exhibit A-3 in Appendix A.

STATE AND LOCAL DEBT OUTSTANDING BY CHARACTER

	Total		Long-Term				Short-Term	
			General Obligs.		Ltd. Liab. Obligs.			
Year	Billions of $	Percent of Total	Billions of $	Percent of Total	Billions of $	Percent of Total	Billions of $	Percent of Total
1952	$ 30.1	100%	$ 23.4	78%	$ 5.3	18%	$ 1.4	4%
1957	52.7	100	32.7	62	17.8	34	2.2	4
1962	81.3	100	48.3	59	29.2	36	3.8	5
1967	114.6	100	62.8	55	44.8	39	7.0	6
1968	121.2	100	65.1	54	47.6	39	8.5	7
1969	133.5	100	70.9	53	52.6	39	10.1	8
1970	143.6	100	75.3	52	56.0	39	12.3	9
1971	158.8	100	84.0	53	59.6	38	15.2	9
1972	174.6	100	95.9	55	63.0	36	15.7	9
1973	188.5	100	102.9	55	69.7	37	15.9	8
1974	206.6	100	111.0	54	79.0	38	16.7	8

STATE DEBT OUTSTANDING BY CHARACTER

Year	Billions of $	Percent of Total	Billions of $	Percent of Total	Billions of $	Percent of Total	Billions of $	Percent of Total
1952	$ 6.9	100%	$ 4.9	71%	$ 1.7	25%	$ .3	4%
1957	13.7	100	6.5	47	7.0	51	.2	2
1962	22.0	100	10.3	47	11.3	51	.4	2
1967	32.5	100	13.6	42	17.6	54	1.3	4
1968	35.7	100	14.7	41	18.9	53	2.1	6
1969	39.6	100	16.2	41	20.7	52	2.7	7
1970	42.0	100	17.7	42	21.1	50	3.2	8
1971	47.8	100	21.5	45	22.8	48	3.5	7
1972	54.5	100	25.3	46	25.3	46	3.9	8
1973	59.4	100	28.4	48	27.3	46	3.7	6
1974	65.3	100	30.9	47	30.8	47	3.6	6

LOCAL DEBT OUTSTANDING BY CHARACTER

Year	Billions of $	Percent of Total	Billions of $	Percent of Total	Billions of $	Percent of Total	Billions of $	Percent of Total
1952	$ 23.2	100%	$18.5	79%	$ 3.6	16%	$ 1.1	5%
1957	39.0	100	26.2	67	10.8	28	2.0	5
1962	59.3	100	38.0	64	17.9	30	3.4	6
1967	82.1	100	49.2	60	27.2	33	5.7	7
1968	85.5	100	50.4	59	28.7	34	6.4	7
1969	94.0	100	54.7	58	31.9	34	7.4	8
1970	101.6	100	57.6	57	34.9	34	9.1	9
1971	111.0	100	62.5	56	36.8	33	11.7	11
1972	120.1	100	70.6	59	37.7	31	11.8	10
1973	129.1	100	74.5	58	42.4	33	12.2	9
1974	141.3	100	80.1	57	48.2	34	13.1	9

Source: Adapted from Municipal Finance Statistics, p. 8 and "Governmental Finances" published annually by the Governments Division, U. S. Bureau of the Census (Washington, D.C.: U. S. Government Printing Office, 1952-75).

It is also interesting to note in Exhibit 7 that local governmental units have a higher proportion of their total debt outstanding in the form of short-term obligations (9%) than do States and State agencies (6%).

4. Long-Term State and Local Borrowing

In their book, Concepts and Practices in Local Government Finance, Moak and Hillhouse suggest that the primary purpose of municipal borrowing is to permit governments to achieve timely financing of needed expenditures without causing unsettling fluctuations in tax rates and charges.[7] Long-term State and local borrowing (average maturity exceeding one year) most often serves this objective by financing capital projects or refunding maturing debt.

Exhibit 8 reveals some additional information on the purposes for which State and local units issued long-term debt in various years. This table shows that there has been a drop in the percentage of long-term State and local issues devoted to education and transportation. Pollution control, a new category, has become an important reason for State and local borrowing. One explanation is that recent environmental legislation permits companies to borrow through State and local agencies (allowing them to enjoy lower interest rates because of the tax-exempt status of interest on State and local debt) for pollution control purposes.

Exhibit 7 introduced a second method of classifying long-term State and local debt--the extent of the backing or commitment supporting the debt service payments. The two major classifications are general and limited

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[7] Lennox Moak and Albert Hillhouse, Concepts and Practices in Local Government Finance (Chicago: Municipal Finance Officers Association, 1975), pp. 249-50.

Exhibit 8

STATE AND LOCAL LONG-TERM DEBT CLASSIFIED BY PURPOSE

(in %)

Year	Schools	Utilities	Trans-portation	Public Housing	Industrial Aid	Pollution Control	Other	Total
1959	30%	15%	12%	4%	--%	--%	39%	100%
1962	35	15	14	4	1	--	31	100
1967	31	14	8	3	9	--	35	100
1968	29	12	10	3	10	--	36	100
1969	28	12	14	3	0[a]	--	44	100
1970	28	13	8	1	0[a]	--	50	100
1971	24	15	11	4	1	--	45	100
1972	23	13	9	4	2	--	49	100
1973	21	15	6	5	1	9	43	100
1974	22	14	4	2	2	10	46	100

[a]Less than .5 percent.

Source: Adapted from Municipal Finance Statistics, p. 8.

liability obligations. General obligation debt is secured by the full faith, credit and taxing power of the issuing governmental unit. As the name implies, a limited liability obligation does not pledge the full resources of the government to pay the interest and principal requirements of the debt. The debt service payments are generally secured by a specific tax, a specific fee, or some other specified source of revenue.

While both categories of State and local long-term debt have increased in absolute terms over the last 20 years, Exhibit 7 shows that the relative growth has been significantly different. In the early 1950's, limited liability obligations were approximately one-fourth of total State and one-sixth of total local debt outstanding. By the latter 1950's, non-guaranteed debt had risen to roughly half of total State debt and one-third of local debt. These percentages have remained relatively steady since that time. Moak and Hillhouse note that one of the primary reasons for the increased use of limited liability obligation debt is to circumvent restrictions on general obligation borrowing.[8]

Since limited liability debt is backed by fewer resources, most issues of this kind are considered to be more risky than general obligations and, therefore, require a higher return (net interest yield to the holder).

The priority of holders of general obligations (full faith or credit) has itself been a subject of considerable controversy in the last year or so. Previously, it was assumed that debt service charges would be paid before any other obligation was met. At the present time, it is not completely clear what rights and obligations are possessed by the holders of such debt, the municipal employees, and the citizens of the defaulting municipality. The problems with New York City's debt moratorium illustrate the uncertain nature of such rights and obligations.

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[8]Moak and Hillhouse, op. cit., p. 316.

This situation is even less clear with respect to "moral obligation" debt issued by an authority or agency of a State or local unit. In this form of indebtedness, the unit is morally (but not legally) obligated to appropriate funds if the authority's or agency's revenues are not sufficient to cover its debt service requirements. The extent of the backing or commitment required by such "moral obligation" has not been clearly defined.[9]

Another way of classifying long-term State and local debt issues is based upon the repayment pattern of the debt. Most long-term State and local debt is in the form of serial maturity, i.e., portions of the principal come due periodically. However, many limited liability municipal bonds are basically term bonds, i.e., the entire principal is liquidated in a single payment at the maturity of the debt. Serial bonds have the advantages of (1) attracting investors with different preferences concerning the maturity date of their investments and (2) avoiding the need for a large (balloon) payment at maturity. Term bonds can be used in a manner similar to serial issues by retiring portions of the principal as funds become available. The retirements can be accomplished by purchasing the debt in the market place or by inserting a call provision in the bond indenture.

5. Who Owns State and Local Debt

Because of the tax-exempt status for Federal income tax purposes of interest income from State and local securities, they are most attractive to firms or individuals subject to high Federal income tax rates. Exhibit 9 shows the increase

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[9] According to data reported in Business Week (November 17, 1975, p. 116), there are about $9.5 billion of such moral obligations bonds outstanding, three-fourths of which have been issued by agencies or authorities associated with the State of New York.

Exhibit 9

NET PURCHASES OF STATE AND LOCAL DEBT
(billions of $)

Year	Households	Commercial Banks	Fire & Casualty Insurance Companies	Other*
1963	.8	5.2	.8	(.7)
1964	2.3	3.6	.4	(.5)
1965	2.1	5.1	.4	(.2)
1966	2.7	1.9	.7	.4
1967	(1.6)	8.9	1.5	.2
1968	1.0	8.5	.9	(.1)
1969	4.3	.2	1.1	1.5
1970	3.7	10.5	1.5	(1.0)
1971	4.3	12.8	3.4	1.2
1972	0.0	7.1	4.4	1.3
1973	7.1	3.9	3.6	(.5)
1974	6.4	5.7	2.2	.2
1975[e]	3.2	5.1	2.4	2.7

*Corporations, life insurance companies, mutual savings banks, and State and local retirement funds.

( ) = decrease.

e = estimated.

Source: Supply and Demand for Credit in 1970, 1976 (New York: Salomon Bros.).

(decrease) in ownership of State and local debt securities, classified by type of purchaser, for various years. This exhibit demonstrates that annual net purchases have varied greatly among the primary owners of State and local debt. For example, commercial banks had a net increase of less than $1 billion in 1969 and over $10 billion in the next two years. The cumulative effect of the purchasing patterns revealed in Exhibit 9 is reflected in the data in Exhibit 10 which shows the proportion of total outstanding debt owned by each group type at the end of selected years from 1950 through 1975.

Exhibits 9 and 10 show that commercial banks were the major purchaser of State and local debt in the 1960's, increasing their proportion of ownership from 25 percent to 49 percent. Liquidity considerations and loan demand have, however, significantly influenced commercial bank demand for such investments. Therefore, commercial banks' pattern of purchasing municipal debt issues has been fairly erratic. The exhibits also show a declining trend in percentage of ownership of municipal issues by commercial banks in the last three years. Reasons include increases in loan losses of banks (reducing their tax liability) and the availability to banks of other low or no-tax investment alternatives such as leasing. There is no reason to question whether commercial banks will be able or willing to continue absorbing the majority of state and local issues in the future, especially if there are other strong demands on their resources.

Changes in exposure to high income tax rates have influenced the demand of casualty insurance companies and households for municipal debt securities. Individuals' taxable incomes have risen (due, in part, to inflation) and the average effective tax rate for casualty insurance companies has also increased. Therefore, both of these groups have shown greater interest in the

Exhibit 10

HOLDERS OF OUTSTANDING STATE AND LOCAL DEBT
(in %)

Year	Households	Commercial Banks	Fire & Casualty Insurance Cos.	Other*	Total
1950	40%	33%	4%	23%	100%
1960	44	25	11	20	100
1965	36	39	11	14	100
1966	38	39	12	11	100
1967	33	44	12	11	100
1968	30	48	12	10	100
1969	35	45	12	8	100
1970	31	49	12	8	100
1971	28	51	13	8	100
1972	26	53	14	7	100
1973	27	51	15	7	100
1974	31	48	15	6	100
1975	34	45	15	6	100

*Mainly corporations and life insurance companies.

Source: Adapted from Municipal Finance Statistics, p. 17.

municipal debt market in the 1960's and early 1970's. Large insurance losses reduced demands by fire and casualty insurance companies in 1974 and 1975, while the increased holdings in the "other" category in 1975 reflected purchases of New York related issues by some State and local retirement funds. Recent increases in the effective income tax rates paid by life insurance companies should make the tax exemption feature of State and local debt more attractive to these institutions. Nevertheless, some of our fastest-growing financial intermediaries, e.g., pension funds and savings and loan associations, pay little or no income taxes and generally find the lower rates on State and local debt less attractive than alternative taxable securities.

6. Cost of Borrowing for State and Local Units

An important element of the municipal debt market is the cost (from the issuer's standpoint) or the return (from the holder's standpoint) required for the issuing unit to obtain funds from investors. The most important factors influencing the State and local interest rates are: (1) the level of interest rates in general, (2) the perceived general quality of municipal debt issues relative to alternative investments, (3) the tax-exempt status of interest income received from state and local debt securities, (4) the maturity of the debt issue, and (5) the quality of the individual issue.

Exhibit 11 compares average market yields for 20-year municipal bonds with those on Treasury bonds of the same maturity. The basic reasons for the differences between the yields are quality differences (probability of default, liquidity, etc.) and the value of the Federal income tax exemption of the interest income from State and local debt issues. This spread is also affected by changes in business conditions, tax rates, and other factors. Finally, while these two yield indices have moved in similar general patterns, the yields on State and local debt have fluctuated more than the yields on Federal debt. This phenomenon is partially caused by changes in commercial banks' demand for

Exhibit 11

YIELDS ON 20-YEAR TREASURY BONDS AND BOND BUYER "11-BOND" INDEX

Percent

9
8
7
6
5
4
3
2
1

20-YEAR TREASURY BOND

BOND BUYER MUNICIPAL INDEX

1950 1952 1954 1956 1958 1960 1962 1964 1966 1968 1969 1970 1971 1972 1973 1974 1975

Annual Yields

Monthly Yields

GERALD R. FORD LIBRARY

*The Treasury yield index was changed in February, 1973 to be based on issues with coupons of 6 3/4 percent and higher rather than 3 1/2 to 4 1/4 percent.

Source: An Analytical Record of Yields and Yield Spreads (New York: Salomon Brothers, 1976).

new State and local issues.

Exhibit 12 demonstrates the effect on the interest yield of the maturity of an issue in the municipal debt market. The longer the maturity, the higher the yield tends to be. In addition, the yields on short-term municipals are more volatile than those for longer-term municipals, although the prices of short-term issues are less volatile because the principal will be repaid in a shorter time. These characteristics are also common to most other types of debt instruments.

Exhibit 13 shows the average yields on 20-year municipal bonds in three rating categories--prime, good, and medium quality. The data in this exhibit will support the conclusion that the municipal market distinguishes among municipal debt issues on the basis of their relative quality. The market yields for issues with high quality bond ratings are less than those required for lower rated issues. Also, the yield differential between lower and higher quality municipal debt appears to widen in times of great fiscal pressure and narrow when such pressure eases.

7. The Quality of State and Local Debt

One of the primary problems in understanding the quality of State and local debt is determining exactly what is meant by "credit quality" or simply "quality." Two distinct approaches to measuring quality are examined in this summary study --ex ante and ex post quality. Ex ante (or prospective) quality is concerned with the likelihood of payment of principal and interest when they come due. Because ex ante quality purports to measure the prospective incidence of future events, it is a less certain measure than ex post quality. Ex post quality involves a com-

EXHIBIT 12

YIELD ON 1-YEAR AND 20-YEAR GOOD GRADE MUNICIPALS

Percent

8 7 6 5 4 3 2 1

20-Year Municipals

1-Year Municipals

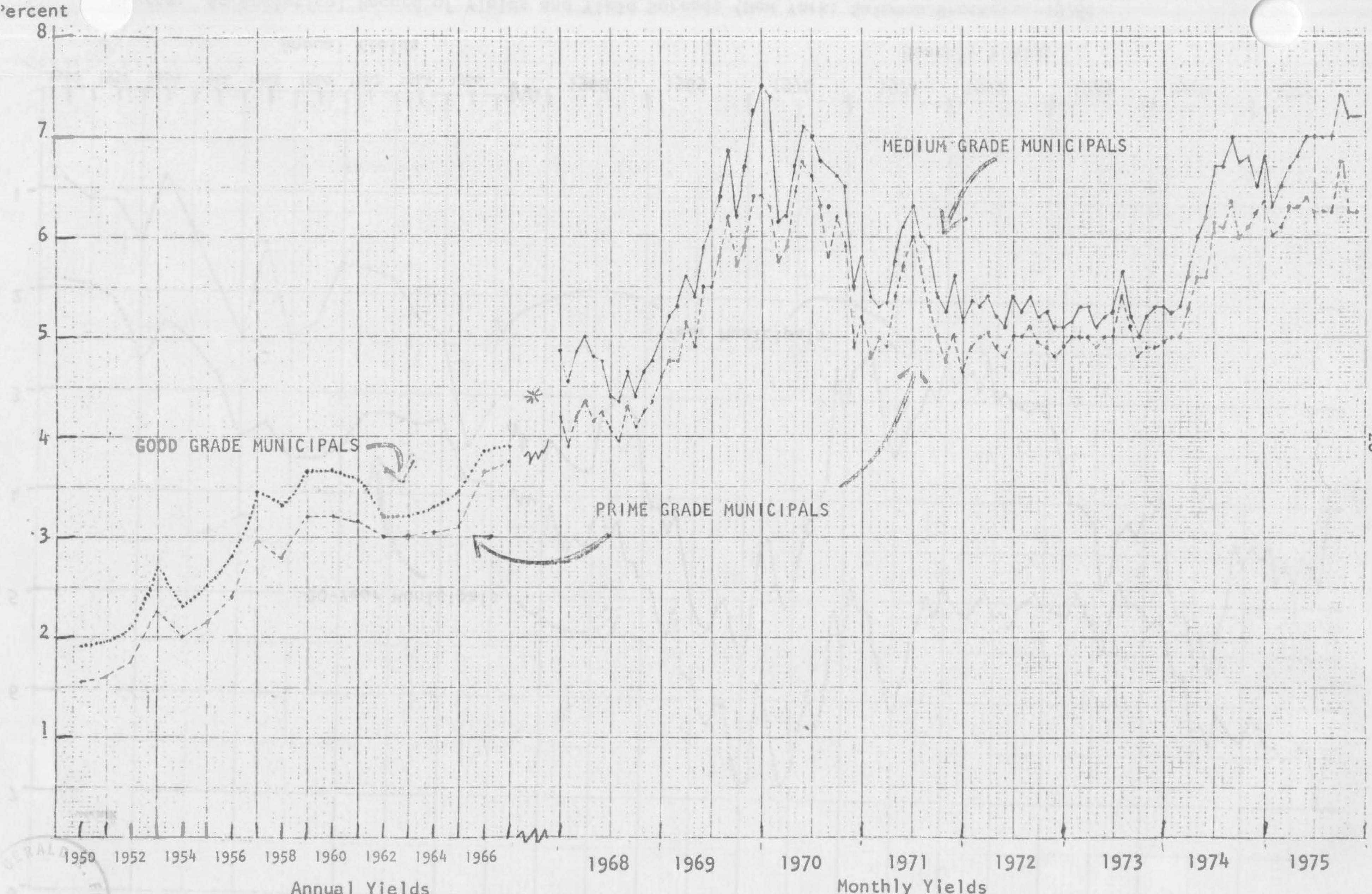
1950 1952 1954 1956 1958 1960 1962 1964 1966 1968 1969 1970 1971 1972 1973 1974 1975

Annual Yields

Monthly Yields

Source: An Analytical Record of Yields and Yield Spreads (New York: Salomon Brothers, 1976).

Exhibit 13



*NOTE: Good grade municipals were used for annual data, 1950-67; medium grade were used for monthly data, 1968-75.
Source: An Analytical Record of Yields and Yield Spreads (New York: Salomon Brothers, 1976).

parison of the actual incidence of payment of interest and principal with that promised by the State and local debt being studied. Therefore, ex post quality can be measured only after interest and principal payments are due. Two measures of ex ante quality--yield differentials and bond ratings--as well as two measures of ex post quality--estimated defaults on interest and principal and results of municipal bankruptcies filed--are examined in this study.

One potential approach to measuring the ex ante quality of municipal debt was introduced in Section 6, where comparisons were made between the market yield on Treasury and municipal securities of similar maturity. Although factors other than basic credit quality also affect these yield comparisons, the risk factors associated with municipal debt appear to become less of a consideration in intervals of prosperity than in recession periods. If generally high interest rates accompany prosperity, however, the burden of the added debt service costs may lead to higher municipal default risks and relatively greater State and local interest costs, especially for cities whose debt issues receive fairly low bond ratings.

Other factors can also have an impact on the relationship between the quality of Federal and municipal debt issues as measured by their relative interest costs. One recent influence was the introduction of the Federal general revenue sharing program. Recent empirical work[10] has found that a struc-

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[10] Jess B. Yawitz, "Risk Premiums on Municipal Bonds," unpublished working paper, Graduate School of Business, Washington University, St. Louis.

tural change in the relationship between risk premiums on Federal vs State and local debt issues occurred in the early 1970's. While interest rates rose generally in the early 1970's, the relative rise in State and local rates since the introduction of general revenue sharing was less than might have been expected. This change in the relationship between the interest rates may be traced to improvements in the overall revenue-expenditure situation of State and local governmental units because of the receipt of general revenue sharing funds. The availability of these funds appeared to have changed investors' subjective perceptions of State and local governments' ability to pay debt service requirements. By decreasing the estimated probability of municipal financial problems, general revenue sharing lowered (relatively) the cost of State and local borrowing. Unfortunately, recent uncertainties about the permanence of general revenue sharing now appear to have negated much of its earlier positive effect on yields.

Another special factor has influenced the relationship between Treasury and municipal yields in the last year or so. The scope of the financial problems of New York City began to emerge in late 1974, when it was revealed that New York's financial position was worse than previously anticipated and that the City might not be able to raise the additional external financing it needed. For the 15 months preceding November 1974, the differential between Treasury and the 11-bond Bond Buyer municipal yield index averaged about 210 basis points (2.10%). In November 1974, the differential fell significantly (about 70 basis points). This lower level of yield differential has since persisted through December 1975. This narrowing of the average yield gap indicates that the market perceived a change in the relative quality of the two types of securities. While many other factors may be involved, the bad fiscal news from New York City and, more recently, New York State during this period appears to have had a significant

negative effect on the relative financing costs of other State and local governments. However, testing the validity of this assertion will require further observations and investigation of the events and relative yields from late 1974 through early 1976.

A second potential way of investigating the ex ante quality of municipal debt focuses on the ratings that such debt issues receive from the two major rating agencies, Moody Investors Services and Standard and Poor, Inc. Although there is some debate over the reliability and validity of ratings as a measure of credit risk (quality), they are often cited as a standard for comparison among quality levels in municipal debt issues (for those being rated). Exhibit 14 presents the distribution of ratings from Aaa (smallest degree of investment risk) to Ba (greatest risk of non-payment among those issues having a rating) which have been assigned by Moody's to long-term municipal debt issues in various years since 1945. The data represent the percentage of the total dollar volume of rated municipal bonds which received a given rating in that year. The data in Exhibit 14 show that the quality of municipal debt, as measured by rating agency classifications, increased in the early 1950's, and deteriorated somewhat in the late 1950's and 1960's. The fact that the major rating agencies began charging governmental units for assigning ratings to their debt in the late 1960's may make comparisons between current ratings distributions and those of earlier periods less valid.[11]

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[11] From 20 to 25 percent of the annual amount of debt issued in the mid-1960's was not rated, when as a matter of policy the two primary municipal rating agencies refused to rate issues under a certain size. The proportion of issues not rated fell to under 10 percent of the annual amount of debt issued by the mid-1970's, apparently because most cities of any size which felt they would be in the top three or four rating categories were willing to pay the price to have their issue rated.

Exhibit 14

PERCENTAGE DISTRIBUTION OF RATED LONG-TERM STATE AND LOCAL BONDS ISSUED, BY DOLLAR VALUE IN YEAR OF ISSUE

(% in rating category)

Year	Aaa	AA	A	Baa	Ba & Below
1945	4.2%	16.2%	46.1%	27.0%	6.4%
1946	7.6	22.7	47.6	19.2	2.8
1947	16.4	50.2	20.2	11.6	1.4
1948	33.9	23.2	31.2	10.5	1.1
1949	9.4	30.2	38.3	20.1	2.0
1950	12.6	41.2	32.6	12.0	1.5
1951	27.0	31.4	28.6	11.6	1.5
1952	23.5	21.2	42.5	10.6	2.1
1953	24.4	31.9	32.1	11.0	.6
1954	22.4	27.0	38.1	11.0	1.5
1955	22.2	29.6	35.0	12.2	1.0
1956	11.7	32.5	42.0	12.3	1.5
1957	11.3	38.2	38.9	11.0	.5
1958	16.4	36.1	35.0	10.8	1.7
1959	15.3	29.9	41.0	13.0	.9
1960	14.6	30.0	39.6	14.4	1.3
1961	12.5	36.4	37.4	12.8	.9
1962	17.3	22.6	45.6	13.2	1.3
1963	17.5	21.2	42.5	16.7	2.1
1964	13.2	28.2	41.6	15.5	1.5
1965	12.3	29.7	37.9	18.8	1.3
1966	10.0	32.5	32.2	24.1	1.3
1967	12.5	32.7	30.3	22.8	1.6
1968	8.7	27.9	40.3	22.1	.9
1969	13.3	31.1	37.0	18.0	.6
1970	9.5	29.2	41.1	19.8	.4
1971	12.5	29.9	38.1	18.9	.6
1972	14.4	26.8	40.9	17.7	.2
1973	13.3	22.3	51.8	12.5	.1
1974	15.7	23.2	51.6	9.4	.1
1975*	16.2	23.7	54.6	5.5	.0

Due to rounding, may not add to 100%.
*First ten months.
Source: Postwar Quality of State and Local Debt, p. 118.
Municipal Market Developments (New York: Security Industry Association), various issues.

One method of measuring ex post quality, an examination of recorded municipal defaults, is presented in Exhibit 15. Three general conclusions may be made from the data in this exhibit. First, defaults have occurred under both good and bad economic conditions. Second, it was only in major depression periods (1837-43, 1873-79, 1893-99, and 1929-37) that the defaults on State and local indebtedness reached significant magnitude. Third, defaults occurred in every major type of governmental unit and in every geographical region.

Annual data on the amount of municipal debt in default and permanent losses of principal and interest are not available. However, it has been estimated that 7.2 percent of the total amount of municipal indebtedness outstanding was in default at the height of the 1929 depression period, but that only .4 percent of the total municipal indebtedness in the early 1970's was in default.[12]

Another approach to measuring ex post credit quality involves an examination of municipal bankruptcy data. Exhibit 16 presents a summary of the governmental units which have filed under Chapter IX of the Federal bankruptcy laws from fiscal 1938 through 1975. The data in Exhibit 16 show that admitted losses constitute about one-third of the $223 million of total admitted debt in the bankruptcy cases filed. However, it is particularly noteworthy that only 18 new cases have been filed since 1954, and that most recent cases have been concluded with little or no permanent losses to creditors. Finally, a comparison

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[12] City Financial Emergencies, op. cit., p. 16.

Exhibit 15

RECORDED DEFAULTS FROM 1839 THROUGH 1969, BY TYPE OF GOVERNMENTAL UNIT AND GEOGRAPHICAL REGION

	1839 -49	1850 -59	1860 -69	1870 -79	1880 -89	1890 -99	1900 -09	1910 -19	1920 -29	1930 -39	1940 -49	1950 -59	1960 -69	Total Defaults	Number of State & Local Gvts. in 1972[a]
By Type of Unit:															
States	9	2	1	9					1					22	50
Counties and parishes		7	15	57	30	94	43	7	15	417	6	12	24	727	3,044
Incorp. munics.	4	4	13	50	30	93	51	17	39	1434	31	31	114	1911	18,517
Unincorp. munics.		4	9	46	31	50	33	5	10	88	7	4	26	313	16,991
School districts				4	5	9	11		14	1241	5	23	60	1372	15,781
Other districts				2	1	12	11	7	107	1590	30	42	70	1872	23,885
By Geographical Region:															
New England States[b]	1		1	1	1	2		1	1	7			4	19	3,102
Middle Atlantic States[c]	2	5	6	19	11	13	13	4	4	251	9	4	10	351	10,263
Southern States[d]	6		2	40	29	36	25	9	51	1863	16	33	76	2186	10,203
Midwestern States[e]	4	10	28	84	46	89	68	6	18	1152	18	34	76	1633	33,624
Southwestern States[f]			1	20	7	79	27	5	25	707	25	36	112	1044	9,742
Mountain States[g]				2		17	2	8	17	270	6	4	3	329	4,244
Pacific States[h]		2		2	3	22	14	3	70	520	5	1	13	655	7,091
Totals	13	17	38	168	97	258	149	36	186	4770	79	112	294	6195	78,268

[a]The number of government units has changed rapidly. For example, in 1932 there were 127,108 school districts, 8,580 other districts, and 175,369 State and local governmental units.

[b]Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, and Vermont.

[c]Delaware, District of Columbia, Maryland, New Jersey, New York, and Pennsylvania.

[d]Alabama, Arkansas, Florida, Georgia, Kentucky, Louisiana, Mississippi, North Carolina, South Carolina, Tennessee, Virginia and West Virginia.

[e]Illinois, Indiana, Iowa, Michigan, Minnesota, Missouri, Nebraska, North Dakota, Ohio, South Dakota, and Wisconsin.

[f]Arizona, Kansas, New Mexico, Oklahoma, and Texas.

[g]Colorado, Idaho, Montana, Nevada, Utah, and Wyoming.

[h]Alaska, California, Hawaii, Oregon, and Washington.

Sources: Default Information in The Daily Bond Buyer, The Commercial and Financial Chronicle, and The Investment Bankers' Associations Bulletin: default lists from Federal Deposit Insurance Corporation, Life Insurance Commission, and U.S. Courts; and Albert M. Hillhouse, Defaulted Municipal Bonds (Chicago: Municipal Financial Officers Association, 1935). Number of local government units from: U.S. Department of Commerce, Bureau of Census, Census of Governments, 1969, Vol. 1"Governmental Organization"(Gov't Printing Office, 1974).

Exhibit 16

SUMMARY OF RESULTS OF CASES FILED UNDER CHAPTER IX OF THE FEDERAL BANKRUPTCY LAWS

Fiscal Year	Cases Filed	Cases Concluded	Cases Dismissed	STATISTICS FOR CASES CONCLUDED: Admitted Debts	Amount Paid or to be Paid as Extended	Admitted Losses
1938	35	2	0	$ 67,675	$ 67,675	$ -0-
1939	71	17	0	6,587,012	3,924,149	2,662,863
1940	104	22	7	15,500,000	6,674,000	8,826,000
1941	19	37	8	28,466,000	16,332,000	12,134,000
1942	43	46	3	33,704,000	24,458,000	9,246,000
1943	13	40	23	26,633,000	16,032,000	10,601,000
1944	5	18	2	18,014,000	11,457,000	6,557,000
1945	8	14	3	39,816,000	27;185,000	12,631,000
1946	7	8	1	13,086,555	9,594,984	3,491,571
1947	7	8	4	4,651,168	2,715,234	1,935,934
1948	7	12	1	2,464,215	1,632,987	831,228
1949	2	2	0	224,361	136,525	87,836
1950	4	5	5	1,253,183	464,094	789,089
1951	3	3	0	1,308,687	582,868	725,819
1952	15	17	1	10,043,648	8,424,662	1,618,986
1953	0	2	2	2,183,413	1,163,615	1,019,798
1954	2	4	14	934,733	353,562	581,171
1955	1	0	0	---	---	---
1956	1	1	1	639,095	211,300	427,795
1957	0	2	0	2,171,448	1,629,448	542,000
1958	2	1	0	16,124	16,124	-0-
1959	3	3	0	2,077,382	544,668	1,532,714
1960	0	2	0	306,500	148,500	158,000
1961	0	0	0	---	---	---
1962	1	3	1	972,642	891,701	80,941
1963	0	0	0	---	---	---
1964	0	0	2	---	---	---
1965	2	0	0	---	---	---
1966	2	0	0	---	---	---
1967	1	1	0	2,599,700	2,599,700	-0-
1968	2[a]	1[a]	0	-0-[a]	-0-[a]	---
1969	0	0	1	---	---	---
1970	0	0	0	---	---	---
1971	2	2[b]	0	3,714,500[b]	3,714,500[b]	-0-
1972	0	1	0	230,000	95,000	135,000
1973	0	0	0	---	---	---
1974	1	1	1	5,450,000	5,450,000	-0-
1975	0	0	0	-0-	-0-	---
	363[c]	275[c]	80[b]	$223,115,041	$146,499,296	$76,725,745

[a] Reopened case (final decree same year) to clear up outstanding issue; no additional adjustment (debt amounts included in 1942 figures).

[b] Includes a reopened case (final decree same year) to clear up an outstanding issue.

[c] Eight cases were still open in 1976 (five of these are cases opened prior to 1953).

Source: Authors' investigation of cases given to them by Administrative Office of the U. S. Courts.

of the figures in Exhibits 15 and 16 shows that only a small proportion of municipal defaults have been resolved through the bankruptcy process. Other alternatives, such as no action, direct agreement between a defaulting unit and its creditors, and agreements reviewed, approved, and supervised by other courts (e.g., State courts) or administrative bodies appeared to be more popular methods for settling defaults.[13]

8. Operation of the Market for State and Local Debt Instruments

The most important distinction to make in describing the operation of the State and local debt market is the difference between the primary and secondary markets.

The primary market for State and local debt refers to the process of initial issuance of such debt. The first step for the State or local governmental units is to receive authorization (voter referendum, existing statute, etc.) to issue debt. A summary of the results of recent State and local bond elections is presented in Exhibit 17. Although the results

[13] These alternatives are discussed in George H. Hempel, "An Evaluation of Municipal Bankruptcy Laws," Journal of Finance, XXVIII, No. 5 (December, 1973), pp. 1339-51.

RESULTS OF STATE AND LOCAL BOND ISSUE ELECTIONS

Year	Approved Amount	Percent	Defeated Amount	Percent
1950	$1,537,517,326	76%	$ 497,983,399	24%
1951	2,249,602,957	88	301,174,640	12
1952	2,383,970,390	84	458,278,500	16
1953	1,851,594,537	83	388,769,450	17
1954	2,781,901,503	84	544,154,550	16
1955	2,885,666,121	65	1,524,453,871	35
1956	4,642,488,809	87	665,689,492	13
1957	2,733,435,486	77	806,795,602	23
1958	3,728,455,966	75	1,263,754,101	25
1959	2,752,942,464	72	1,087,633,605	28
1960	5,916,951,404	85	1,007,889,410	15
1961	2,544,327,858	67	1,263,606,943	33
1962	4,263,609,903	70	1,850,443,358	30
1963	3,626,886,529	63	2,156,807,833	37
1964	5,715,400,806	78	1,582,926,248	22
1965	5,611,653,628	73	2,095,491,659	27
1966	6,515,833,687	77	1,944,831,423	23
1967	7,365,194,080	74	2,549,704,766	26
1968	8,686,075,169	54	7,459,875,274	46
1969	4,286,542,050	40	6,534,047,453	60
1970	5,366,441,359	63	3,194,042,145	37
1971	3,142,846,335	35	5,862,362,912	65
1972	7,875,500,983	64	4,445,857,080	36
1973	6,306,039,592	52	5,800,848,114	48
1974	8,021,389,589	62	4,865,370,237	38
1975	3,392,270,729	29	8,184,238,481	71

Source: Municipal Finance Statistics, p. 22.

vary from year to year, since the mid-1960's there appears to be relatively less voter support for bond issues than existed previously. The shock-waves from the severe financial problems of New York City and State were felt in the voting booths across the nation during 1975, as voters approved only 29.3 percent of the $11,575,599,210 submitted in 1,835 bond financing programs by 1,539 State and local governmental units. This is the lowest approval percentage ever recorded since The Bond Buyer began compiling this data in 1926.[14]

After the State or local debt issue receives the appropriate authorization, the issuer determines the details (e.g., dollar amounts, maturities, coupon rates) of the issue. For some short-term issues and most long-term issues, the next step is competitive bidding for the issue. The basic description of the issue is normally placed in The Bond Buyer and other financial publications. This advertisement sets in motion the underwriting process and frequently (nearly always for larger, long-term issues) the debt rating process. The rating agencies contract with the issuer to rate the debt issue and publish the ratings. The rating agency collects the information it requires for the analysis and then publishes the rating a week before the sale of the debt issue. Instead of requiring formal competitive bidding, many short-term municipal issues (Federally guaranteed issues being a notable exception) and some long-term issues are privately placed with local commercial banks or other institutions, the interest rate paid being determined through negotiations.

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[14] "With Default Imprinted on the Voters' Minds, Only 29.3% of Bond Issues are Approved in 1975," The Money Manager (January 12, 1976), p. 41.

Nearly all long-term State and local debt issues are originally sold to underwriters (usually investment bankers or commercial banks), who generally form syndicates or groups to purchase the issue and then re-offer it to investors. The syndicate submits a bid stating net interest cost to the municipality and if it is successful, (accepted because it has the lowest net interest cost to the governmental unit), the syndicate then owns the securities.

The underwriters then try to sell the securities to institutional and individual investors at prices that cover their underwriting expenses and provide them with an adequate profit for their risk. The margin between the issuer's proceeds and the amount received by the underwriter has averaged around 1 percent.[15] Thus, in the primary market, the municipality sells its issue to underwriters who act as wholesalers by re-offering the debt issue securities to the public or sometimes holding the securities in their own inventory. If the underwriters have misjudged the yield that the market will require on such issues, or if the market deteriorates before the issue is sold out, they may have to sell them at a loss to avoid the costs of carrying the securities in their own inventories.

The secondary market refers to all transactions in an issue that occur after the original underwriting and sale. A good secondary market is important for a debt issue. Investors are more likely to be willing to purchase State and local debt securities if they believe they can easily liquidate their holdings when they want to. Liquidity is a more important factor for long-term than short-term municipal debt since most short-term debt seems to be purchased and held to maturity. Data on the size

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[15] Herbert E. Dougall and Jack E. Gaumnitz, Capital Markets and Institutions, 3rd ed. (Englewood Cliffs: Prentice-Hall, Inc., 1975), p. 156.

of the secondary market for State and local debt are scarce since the market is conducted over-the-counter, i.e., the securities are not listed or traded on a formal exchange. This means that participants dealing in the secondary market are not required to report on their transactions. Thus, little is known about the size of the market or the characteristics of the participants in the market. However, since a round lot in this market is generally $50,000, one might infer that the participants are concentrated in those categories of investors who can marshal fairly large amounts of money. There is continuing concern for the fact that the market does not always function well for holders of small blocks of municipal issues.

Recent Changes

In late June 1975, as New York City was floundering, Congress enacted the Securities Act Amendments of 1975. These Amendments brought municipal bond dealers under Federal regulation. At the same time, there was increasing concern over possible legal exposure resulting from the fact that municipal bonds are subject to the anti-fraud provisions of the Securities and Exchange Act. This Act makes it "unlawful...to make any untrue statement of a material fact or to omit to state material fact" in public sale of securities. The Amendments, while not reducing the obligations of issuers under the anti-fraud provisions, continued to exempt State and local units from the registration and reporting requirements of the securities laws.[16]

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[16]See John E. Petersen and Robert W. Doty "Regulation of the Municipal Securities Market and its Relationship to the Governmental Issuer," Analysis, Municipal Finance Officers Association, December 5, 1975.

Underwriters of municipal issues warned that few bids would be submitted for issues on which full disclosure was even a potential problem, that marketing such issues would become a lengthy and costly procedure, and that some potential borrowers might even lose access to the market. In late 1975, underwriting syndicates decided not to bid for $9.5 million of New York State bonds; furthermore, Richmond failed to sell $25 million of bonds and Suffolk County (New York) was stymied in selling a $54 million issue, reportedly because of disclosure problems. As 1976 progresses, it seems likely that the operation of the market for State and local debt instruments will continue undergoing fundamental change, as a result of both recent and possible future laws and pressures on the market.[17]

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[17] Ibid. For an interesting survey of municipal financial officers' opinions about municipal financial reporting see James M. Patton, Usefulness of Municipal Financial Reporting, a dissertation at the Washington University Graduate School of Business, 1975.

APPENDIX A

Supporting Tables for

Text Exhibits 1, 3, 7, 11, 12, and 13

Exhibit A-1

ANNUAL VOLUME OF NEW STATE AND LOCAL BORROWING
(basis for Exhibit 1 in text)

Year	$ Amount (in millions)	Number of Issues
1950	$ 5,304.7	6,533
1951	4,914.9	5,885
1952	6,450.5	6,410
1953	8,314.5	7,263
1954	10,318.9	7,747
1955	8,569.4	7,732
1956	8,152.7	7,689
1957	10,231.7	8,242
1958	11,359.3	8,523
1959	11,859.7	8,568
1960	11,235.7	8,397
1961	12,873.7	8,490
1962	13,321.7	8,689
1963	15,587.5	8,574
1964	15,967.4	8,138
1965	17,621.6	7,977
1966	17,612.5	7,430
1967	22,313.3	7,964
1968	25,032.9	7,887
1969	23,243.4	6,395
1970	35,641.6	7,604
1971	50,651.0	8,811
1972	48,162.6	8,420
1973	47,620.0	8,147
1974	51,864.6	7,701
1975	58,197.1	8,080

Source: Bond Buyers' Municipal Finance Statistics, Vol. 13, June 1975, p. 7. 1975 figures from The Bond Buyer.

Exhibit A-2

STATE AND LOCAL DEBT AS A PERCENTAGE OF NET TOTAL DEBT
AND NET PUBLIC DEBT
(in billions of $)

(basis for Exhibit 3 in text)

Year	Total Private & Public	Total Public	Total State & Local	Total Private	State & Local % Total	State & Local % Total Public
1950	$ 490.3	$239.4	$ 20.7	$ 250.9	.042%	.086
1951	524.0	241.8	23.3	282.2	.044	.096
1952	555.2	248.7	25.8	306.5	.046	.104
1953	586.4	256.7	28.6	329.7	.049	.111
1954	612.0	263.6	33.4	348.4	.055	.127
1955	665.8	273.6	41.1	392.2	.062	.150
1956	698.4	271.2	44.5	427.2	.064	.164
1957	728.3	274.0	48.6	454.3	.067	.177
1958	769.6	287.2	53.7	482.4	.070	.187
1959	833.0	304.7	59.6	528.3	.072	.196
1960	874.2	308.1	64.9	566.1	.074	.211
1961	930.3	321.2	70.5	609.1	.076	.219
1962	966.0	335.9	77.0	660.1	.077	.229
1963	1,070.9	348.6	83.9	722.3	.078	.241
1964	1,151.6	361.9	90.4	789.7	.079	.249
1965	1,244.1	373.7	98.3	870.4	.079	.263
1966	1,341.4	387.9	104.8	953.5	.078	.270
1967	1,435.5	408.3	112.8	1,027.2	.079	.276
1968	1,582.5	437.1	123.9	1,145.4	.078	.283
1969	1,736.0	453.2	133.3	1,282.9	.077	.294
1970	1,868.9	484.9	145.0	1,384.0	.078	.299
1971	2,045.8	528.2	162.4	1,517.6	.079	.307
1972	2,270.2	557.6	175.0	1,712.7	.077	.314
1973	2,525.8	593.4	184.5	1,932.4	.073	.311
1974	2,777.3	642.9	205.6	2,134.4	.074	.320

Source: Survey of Current Business, various issues.

Exhibit A-3

Annual Dollar Volume of State and Local Borrowing
(basis for Exhibit 7 in text)

Year	Long-Term $ Amount	Short-Term $ Amount
1950	$ 3,963.6	$ 1,611.1
1951	3,278,1	1,636.8
1952	4,401.3	2,049.2
1953	5,557.9	2,756.6
1954	6,968.6	3,350.2
1955	5,976.5	2,592.9
1956	5,446.4	2,706.3
1957	6,958.2	3,273.5
1958	7,448.8	3,910.5
1959	7,681.0	4,178.6
1960	7,229.5	4,006.2
1961	8,359.5	4,514.2
1962	8,558.2	4,763.5
1963	10,106.7	5,480.8
1964	10,544.1	5,423.3
1965	11,084.2	6,537.4
1966	11,088.9	6,523.5
1967	14,287.9	8,025.3
1968	16,374.3	8,658.6
1969	11,460.2	11,783.1
1970	17,761.6	17,879.9
1971	24,369.5	26,281.5
1972	22,940.8	25,221.8
1973	22,952.6	24,667.4
1974	22,824.0	29,040.7
1975	29,224.3	28,972.8

Source: Municipal Finance Statistics, p. 7.
1975 figures from The Bond Buyer.

Exhibit A-4

SELECTED YIELD INDEXES
(basis for Exhibits 11, 12, 13 in text)

Year	20-Year Treasury Bonds	Bond Buyer's 20-Bond Index	Municipals: 1-Year Good Grade	Municipals: 20-Year Good Grade	Municipals: 20-Year Prime Grade	Municipals: 20-Year Medium Grade	Bond Buyer's 11-Bond Index
1950	2.39%	1.76%	.90%	1.90%	1.55%	n.a.	1.75%
1951	2.60	1.94	1.10	1.95	1.60	n.a.	1.77
1952	2.68	2.18	1.10	2.10	1.75	n.a.	1.99
1953	2.92	2.73	1.50	2.70	2.25	n.a.	2.54
1954	2.57	2.40	.85	2.30	2.00	n.a.	2.25
1955	2.83	2.47	1.35	2.50	2.15	n.a.	2.33
1956	3.07	2.75	1.90	2.80	2.40	n.a.	2.62
1957	3.45	3.29	2.45	3.45	2.95	n.a.	3.16
1958	3.45	3.16	1.50	3.30	2.80	n.a.	3.04
1959	4.12	3.55	2.45	3.65	3.20	n.a.	3.42
1960	4.13	3.54	2.30	3.65	3.20	n.a.	3.40
1961	3.90	3.45	1.70	3.55	3.15	n.a.	3.34
1962	4.02	3.17	1.75	3.20	3.00	n.a.	3.10
1963	4.04	3.16	1.85	3.20	3.00	n.a.	3.10
1964	4.18	3.22	2.25	3.30	3.05	n.a.	3.15
1965	4.23	3.25	2.40	3.25	3.10	3.45%	3.19
1966	4.72	3.81	3.50	3.85	3.65	4.05	3.72
1967	4.93	3.92	3.10	3.90	3.75	4.25	3.83
Month/Year							
Jan. 1968	5.57	4.38	3.75	4.45	4.20	4.85	4.27
Feb.	5.37	4.16	3.45	4.10	3.90	4.55	4.04
Mar.	5.39	4.49	3.55	4.40	4.20	4.85	4.38
April	5.59	4.31	3.65	4.55	4.35	5.00	4.19
May	5.47	4.44	3.70	4.40	4.15	4.80	4.32
June	5.47	4.51	3.75	4.50	4.25	4.75	4.40
July	5.31	4.48	3.70	4.25	4.10	4.40	4.36
Aug.	5.12	4.11	3.15	4.15	3.95	4.35	4.00
Sept.	5.20	4.44	3.10	4.40	4.30	4.65	4.32
Oct.	5.29	4.36	2.95	4.25	4.10	4.40	4.25
Nov.	5.40	4.56	3.10	4.60	4.25	4.65	4.44
Dec.	5.55	4.76	3.20	4.65	4.35	4.75	4.65
Jan. 1969	5.92	4.85	3.85	4.90	4.60	5.00	4.72
Feb.	6.00	4.96	4.10	4.90	4.75	5.20	4.77
Mar.	6.08	5.19	4.10	5.20	4.75	5.30	5.05
April	6.20	5.25	4.35	5.35	5.15	5.60	5.12
May	5.92	5.10	4.20	5.10	4.90	5.40	4.99
June	6.29	5.73	4.60	5.75	5.50	5.90	5.61
July	6.17	5.68	5.05	5.80	5.50	6.10	5.57
Aug.	6.17	5.80	5.25	6.10	5.80	6.40	5.69
Sept.	6.21	6.37	5.30	6.25	6.20	6.85	6.27
Oct.	6.70	6.19	5.10	6.05	5.70	6.20	6.08
Nov.	6.52	6.11	5.00	6.05	5.90	6.70	5.98
Dec.	6.80	6.72	5.40	6.60	6.40	7.25	6.56
Jan. 1970	6.81	6.61	5.60	6.85	6.40	7.50	6.42
Feb.	6.84	6.54	5.30	6.80	6.30	7.40	6.30
Mar.	6.41	6.00	4.55	5.85	5.75	6.15	5.88
April	6.48	6.11	4.40	6.10	5.90	6.20	5.99
May	6.90	6.89	4.85	6.60	6.45	6.70	6.76
June	7.42	6.92	5.10	6.85	6.75	7.10	6.80
July	7.15	6.79	4.90	6.70	6.60	7.00	6.66
Aug.	6.75	6.25	4.50	6.30	6.30	6.75	6.08
Sept.	6.90	6.16	4.20	5.90	5.80	6.30	5.99
Oct.	6.74	6.39	4.15	6.25	6.20	6.60	6.23
Nov.	6.80	6.28	3.75	6.00	5.90	6.50	6.08
Dec.	6.22	5.41	2.70	5.10	4.90	5.50	5.14
Jan. 1971	6.30	5.58	3.15	5.45	5.20	5.80	5.29
Feb.	5.97	5.16	2.70	4.90	4.80	5.40	4.88
Mar.	6.11	5.34	2.60	5.10	5.00	5.30	5.11
April	5.73	5.15	2.50	5.10	4.90	5.35	4.93
May	5.98	5.69	2.90	5.50	5.40	5.75	5.46
June	6.13	5.86	3.35	5.80	5.70	6.10	5.65
July	6.30	6.23	3.55	6.10	6.00	6.30	6.04
Aug.	6.30	6.05	3.40	5.80	5.70	6.00	5.84
Sept.	5.94	5.39	3.20	5.40	5.30	5.90	5.14
Oct.	5.80	5.24	3.10	5.20	5.00	5.40	4.98
Nov.	5.75	5.11	2.85	4.95	4.75	5.25	4.90
Dec.	5.79	5.44	3.00	5.15	5.00	5.60	5.21

Exhibit A-4 contd.

		Municipals					
Month/Year	20-Year Treasury Bonds	Bond Buyer's 20-Bond Index	1-Year Good Grade	20-Year Good Grade	20-Year Prime Grade	20-Year Medium Grade	Bond Buyer's 11-Bond Index
Jan. 1972	5.81%	5.02%	2.55%	4.85%	4.65%	5.15%	4.82%
Feb.	5.90	5.35	2.85	5.00	4.90	5.35	5.14
Mar.	5.85	5.29	2.75	5.10	5.00	5.30	5.00
April	5.98	5.40	2.70	5.15	5.05	5.40	5.20
May	5.98	5.20	2.90	5.00	4.90	5.20	5.00
June	5.81	5.10	2.60	4.90	4.80	5.10	4.92
July	5.86	5.43	3.00	5.15	5.00	5.40	5.25
Aug.	5.73	5.43	2.90	5.10	5.00	5.25	5.17
Sept.	5.70	5.38	3.00	5.20	5.10	5.40	5.21
Oct.	5.85	5.30	3.05	5.05	4.95	5.20	5.12
Nov.	5.73	5.13	3.10	5.00	4.90	5.25	4.99
Dec.	5.59	4.99	3.00	4.90	4.80	5.10	4.86
Jan. 1973	5.83*	5.11	3.10	5.00	4.90	5.10	5.01
Feb.	6.85	5.16	3.30	5.05	5.00	5.15	5.06
Mar.	6.88	5.22	3.60	5.10	5.00	5.30	5.11
April	6.85	5.26	4.00	5.10	5.00	5.30	5.15
May	6.88	5.14	4.00	4.90	4.90	5.10	5.03
June	7.03	5.22	4.10	5.10	5.00	5.20	5.10
July	7.09	5.25	4.20	5.20	5.00	5.25	5.14
Aug.	7.57	5.59	4.85	5.50	5.40	5.65	5.45
Sept.	7.31	5.34	4.70	5.15	5.10	5.20	5.19
Oct.	7.02	5.00	4.30	4.80	4.80	5.00	4.07
Nov.	7.27	5.17	4.20	5.00	4.90	5.20	5.05
Dec.	7.11	5.15	4.30	5.00	4.90	5.30	5.03
Jan. 1974	7.30	5.16	4.10	5.05	4.95	5.30	5.03
Feb.	7.38	5.20	4.10	5.20	5.00	5.25	5.08
Mar.	7.49	5.26	3.90	5.10	5.00	5.30	5.15
April	7.80	5.57	4.80	5.45	5.30	5.60	5.45
May	8.14	5.91	5.10	5.70	5.60	6.00	5.78
June	8.06	6.08	5.10	5.70	5.60	6.20	5.89
July	8.06	6.33	5.50	6.25	6.15	6.70	6.13
Aug.	8.32	6.70	5.30	6.20	6.10	6.70	6.44
Sept.	8.51	6.91	5.70	6.40	6.35	7.00	6.59
Oct.	8.39	6.62	5.30	6.10	6.00	6.75	6.27
Nov.	7.72	6.65	5.00	6.20	6.10	6.80	6.31
Dec.	7.70	6.71	4.40	6.30	6.25	6.50	6.36
Jan. 1975	7.65	7.08	4.60	6.35	6.35	6.80	6.62
Feb.	7.64	6.54	3.90	6.10	6.00	6.30	6.17
Mar.	7.60	6.55	4.00	6.20	6.10	6.50	6.24
April	8.01	6.95	3.90	6.40	6.30	6.70	6.54
May	8.35	6.95	4.25	6.40	6.30	6.80	6.55
June	8.17	7.09	4.10	6.50	6.40	7.00	6.71
July	7.97	7.00	4.25	6.50	6.25	7.00	6.58
Aug.	8.09	7.09	4.00	6.40	6.25	7.00	6.65
Sept.	8.36	7.18	4.10	6.40	6.25	7.00	6.72
Oct.	8.48	7.54	4.25	7.00	6.75	7.40	7.09
Nov.	8.02	7.36	3.80	6.40	6.25	7.20	6.77
Dec.	8.12	7.39	3.50	6.40	6.25	7.20	6.78

n.a. = not available.

*The Treasury yield index was changed in February, 1973 to be based on issues with coupons of 6 3/4 percent and higher rather than 3 1/2 to 4 1/4 percent.

Source: An Analytical Record of Yields and Yield Spreads (New York: Salomon Brothers, 1976).

APPENDIX B

Other Potentially Relevant Information

1.) New Municipal Debt Offerings by Month (1965-1974)

2.) Tax Rates and 20-Bond Index (1912-1974)

3.) Issues, Retirements and Ownership of State and Local Debt (1969-1975)

4.) Statutory Interest Rate Ceilings on State and Local Debt

5.) State Constitutional and Statutory Limitations on Local Government Power to Issue General Obligation Long-Term Debt (1971)

Exhibit B-1.

NEW MUNICIPAL DEBT BY MONTH (1966-1975)

A DECADE OF MUNICIPAL FINANCING

This table, compiled from data collected by "The Daily Bond Buyer" of New York, shows at a glance the sales by months of both bonds and short-term notes of states and municipalities in the United States and insular possessions and municipalities therein during the past 10 years.

LONG-TERM LOANS

	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975
January	$ 1,176 494,299	$ 1,4[illegible]0,438 673	$ 1,161,547,499	$ 1,244,252,741	$ 1,314,286,835	$ 2.613.800.300	$ 1,737,200.373	$ 1,887,144,456	$ 2,268.309,191	$ 2,158.545 904
February	845,458,533	1,1[illegible]479,873	1,133,597,200	974,215,189	1,193,316,047	1,622 913,919	1,942,359,360	1,445,342,221	1,970,423,036	2,308,830,657
March	847.592 788	1,426,791,214	1,362,883,810	519,622,041	1,504,144,844	2,103,516,097	2,185,040.732	2,296,817,220	2 091,451,394	2,037,837,364
April	1 181,137,970	1,1[illegible]643	1,276,549,376	1,627,198,334	1,624,564,944	1,858 566,804	1,962 524,835	1,637,660.121	2,321,869,205	2,263,123,526
May	877,421,169	1,[illegible]392,144	1,133,687,149	1,638,345,723	973,907,768	2,114,198,837	1,923,925,001	1,870,018,032	2,176,946,282	2,532,416 757
June	1 118,458,628	1 [illegible]664 740	1,360,253 654	710,256,404	1,057,960,924	1,988,122,574	2,222,403,920	2,030,899,127	1,941,610.160	3,051,043 037
July	677 605,556	924,497,876	1,422,627,497	1,052,032,575	1,309,669 559	1,950,531,857	1,783,604,609	1,991,596,623	1,380,752,870	3,434,120 352
August	764,097,306	840,495 663	1,665,948,629	793,656,034	1,318,022,457	1,849,841,632	1,897,964,807	1,474,455,168	1,055,926,295	2,692,033 390
September	971,851,334	1,273,202 380	1,493,173,273	530,769 278	1,549,862,884	2,044,463,963	1,701,046,242	1,629,554,255	1,625,716,737	2,112 225 585
October	735,993,837	991,329 320	2,260,216 412	1,254 172,626	1,882,158,414	1,679,251,863	1,969,681,285	2,222,243,798	2,318 666,796	2,275,713,102
November	949,619,420	1,230 176 808	1,636,770,929	853,539,233	1,683,794,335	2 236,253,36[illegible]	1,814,154,500	2 223,783,079	2,245,085,770	2,358,378,469
December	923,002,509	1,052,981,992	1,137,677,532	812,368,525	2,245,067,772	2,058 074 963	1,800,937,720	2,193,132,666	1,407,220,458	2,047,952,344
Total	$11,083,938,349	$14,237,949,346	$16,374,232,960	$11,460,251,103	$17,761,645,833	$24,369,536,105	$22,940,843,384	$22,952,646,766	$22,823,968,194	$29,224,313,546
Number of Issues	5,594	5,829	5,711	4,032	4,701	5,461	5,103	4,741	4,287	4 697
Negotiated	....	....	....	....	....	....	....	$5,915,882,698	$ 6,265,568,382	$11,212,634,063
*Revenue (Inc. Refunding)	$ 4,076 022,500	$ 5,096 087,618	$ 6,762,806,850	$ 3,413,416,400	$ 5,958,564,402	$ 8,129,060,950	$ 8,820,053,343	$10,126,053,500	$ 9,792,845,100	$14,230,704,700
*Refunding Total	$ 220,573,500	$ 173,609,200	$ 137,997,900	$ 51,314,600	$ 56,220,500	$ 452,583,000	$ 1,568,537,000	$ 1,234,808,000	$ 581,466,500	$ 927,695 995
General Obligation	$ 43 375,500	$ 60 243,200	$ 74,889,000	$ 31,932,600	$ 29,376,000	$ 155,086,000	$ 237,645,000	$ 371,460,000	$ 296,764,000	$ 686,895 995
Revenue	177,198,000	113,265,000	63,108,900	19,382,000	26,844,500	297,497,000	1,330,892,000	863,348,000	284.702,500	240,799,000

*Included in yearly totals

SHORT-TERM LOANS (12 months or less)

	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975
January	$ 354,701,600	$ 453 640 000	$ 569,264,000	$ 640,229,500	$ 877,685,500	1,551,894,000	$ 1,593,523,923	$ 1,621,659,692	$ 1,859,600.563	$ 2,265,877,509
February	382,495,750	756,461,225	563,093,000	837,340,000	1,444,149,676	1,885,735,920	1,751,944,000	1,130,498,000	2,116,795,053	2,269,843,763
March	607 672,100	654,103,000	1,070 057,000	783,416,000	1,210,938,442	2 452,530,500	3,406,870,590	1,637,715,115	1,785,548,545	2,852,491,198
April	1,060,846,000	1,197,193,000	669,019,323	1,291,510,487	1,045 608,200	2,482,262,481	1,516,354,774	2 061,855 460	2,155,433 685	3,093,592 683
May	864,674,000	951,138 000	971,871,000	904,557,500	1,387,480,000	1,839,598 447	2,726,161,645	2,491,843,610	2,797,099,895	3,801,201,072
June	383,544,000	520 617,000	422,157,600	1,072,432,500	2,034,653,300	2,932,420,000	2,704,795,635	2,517,150 840	3,803,778,140	2,698,507,589
July	173,809,000	276,107 000	673,461,000	626,657,600	1,113,290,000	1,353,139 000	1,215,198,481	1,923,295 617	2 058 878,949	1,490,683 152
August	620 474,900	751 662,800	835 218,727	1,139,724 527	1,726,187,350	1,882,224,582	1,839,885,577	1,740,221,613	1,496,818,390	1,376,655 945
September	361,837,000	652,974 000	458,553,600	1,023 320,625	2,048,857,000	2,781,406,034	2,475,025,500	2,750,340 600	3,525,697,176	2,426,887,502
October	266,381,000	762 866,046	855,751,000	795,095,585	1,215,606,325	1,843,287,800	1,587,478,258	2,500,967,122	2,364,952,759	2,623 428,780
November	988,717,000	767 158 800	974,516,000	1 438,962,300	2,021,772,000	2,784,702 700	2,764,055,950	1,784,590,231	2,540,401,664	2,065,523 496
December	458,382,195	330,411,000	575,595,000	1,229,850,500	2 253,725,000	2,492,266,075	1,640,474,000	2,507,219,390	2,535,676,707	1,828,116 234
Total	$ 6,523,534,545	$ 8,025,321,071	$ 8,658,556,650	$11,783,127,124	$17,679,952,793	$26,281,467,539	$25,221,768,335	$24,667,357,290	$29,040,681,526	$28,972,825,923
Number of Issues	1,836	2,135	2,173	2,343	2,903	3,350	3,317	3,406	3,414	3,383
Grand Total	$17,612,472,894	$22,313 280,417	$25,032,889,610	$23,243,378,227	$35,641,598,626	$50,651,003,644	$48,162,611,719	$47,620,004,056	$51,854,649,720	$58,197,137,469
Total Number of All Issues	7,430	7,964	7,887	6,395	7,604	8,811	8,420	8,147	7,701	8,080

PUBLIC HOUSING AUTHORITY ISSUES: Included in this table are Public Housing Authority bond and note issues, which in effect are backed by Federal guarantee of payment. Amounts included in the above table are as follows: 1966—Bonds: $439,705,000; Notes: $1,740,227,000; 1967—Bonds: $447,510,000; Notes: $1,779,678,000; 1968—Bonds: $524,810,000; Notes: $2,061,681,000; 1969—Bonds: $397,885,000; Notes: $2,675,184,000; 1970—Bonds: $130,790,000; Notes: $4,[illegible]3,243,000; 1971—Bonds: $1,000,435,000; Notes: $5,960,964,000; 1972—Bonds: $958,960,000; Notes: $6,482,926,000; 1973—Bonds: $1,029,240,000; Notes: $6,638,023,000; 1974—Bonds: $460,985,000; Notes: $6,804,186,000; 1975—Notes: $7,244,142,000.

PRELIMINARY LOAN NOTES: Also included in this table are Preliminary Loan Notes Issued by Local Public Agencies to finance Urban Renewal projects. These are secured by the full faith and credit of the United States Government. Amounts included as short-term loans in the above table are: 1966—$1,806,432,000; 1967—$2,431,768,000; 1968—$2,812,014,000; 1969—$3,229,758,000; 1970—$3,832,950,000; 1971—$4,014,348,000; 1972—$4,237,040,000; 1973—$4,406,302,000; 1974—$4,621,853,000; 1975—$4,111,491,000.

Federal Income Tax Rates and 20-Bond Index Since 1912

The table below compares individual and corporate Federal income tax rates with The Bond Buyer's 20-Bond Index since 1912.

Year	INCOME TAX RATES: Individual Top Normal and Surtax Rate	INCOME TAX RATES: Top Corporate Tax Rate	The Bond Buyer's 20 Bond Index*
	%	%	%
1975	70	48%	7.08%
1974	70	48	5.18
1973	70	48	5.08
1972	70	48	5.03
1971	70	48	5.74
1970	71.75	49.2	6.61
1969	75.25	52.8	4.85
1968	75.25	52.8	4.38
1967	70	48	3.76
1966	70	48	3.53
1965	70	48	3.07
1964	77	50	3.26
1963	91	52	3.05
1962	91	52	3.37
1961	91	52	3.39
1960	91	52	3.78
1959	91	52	3.40
1958	91	52	2.97
1957	91	52	3.23
1956	91	52	2.56
1955	91	52	2.38
1954	91	52	2.54
1953	92	52	2.40
1952	92	52	2.11
1951	85.63	50.75	1.66
1950	84.357	42	2.07
1949	82.1275	38	2.19
1948	82.1275	38	2.36
1947	86.45	38	1.85
1946	86.45	38	1.42
1945	94	40	1.62
1944	94	40	1.77
1943	93	40	2.17
1942	88	40	2.24
1941	81	31	2.14
1940	79¶	24	2.59
1939	79	19	2.78
1938	79	19	3.16
1937	79	15	2.62
1936	79	15	3.25
1935	63	13¾	3.81
1934	63	13¾	5.48
1933	63	13¾	4.61
1932	63	13¾	4.87
1931	25	12	4.12
1930	25	12	4.23
1929	24	11	4.17
1928	25	12	3.87
1927	25	13½	4.13
1926	25	13½	4.23
1925	25	13	4.16
1924	46	12½	4.37
1923	58	12½	4.16
1922	58	12½	4.38
1921	73	10	5.06
1920	73	10	4.56
1919	73	10	4.44
1918	67	4	4.62
1917	77	12	3.92
1916	15	2	4.08
1915	7	1	4.26
1914	7	1	4.16
1913	7	1	4.45
1912		1◈	4.01

* Figure is as of the first Thursday in January from 1946 to date. For the years 1915 through 1945, the yield is as of the first trading day in January and for the years 1912 through 1914 the yield is the average for the year.

¶ Does not include 10% Defense Tax.

◈ This was an excise tax on the privilege of doing business, but tax was measured by income.

Exhibit B-2

TAX RATES AND 20-BOND INDEX (1912-1974)

GERALD R. FORD LIBRARY

Exhibit B-3.

ISSUES, RETIREMENTS, AND OWNERSHIP OF STATE AND LOCAL DEBT
(1969-1975)

	Annual Net Increases in Amounts Outstanding							
	1969	1970	1971	1972	1973	1974	1975e	1976p
Gross New Bond Issues	11.5	17.8	24.4	22.9	23.0	22.8	27.8	26.5
Refundings[1]	0.0	0.1	0.2	0.3	0.3	0.2	0.3	0.4
Maturities (est.)	6.7	7.1	7.6	8.3	9.2	10.4	11.5	13.0
Net Sinking Fund Purchases (est.)	0.2	0.2	0.2	0.2	0.2	0.3	0.3	0.3
Net Increase in Bonds	4.6	10.4	16.4	14.1	13.3	11.9	15.6	12.8
Gross New Note Issues	11.8	17.9	26.3	25.2	24.7	29.0	28.0	22.0
Maturities (est.)	9.3	13.6	21.0	26.5	23.9	26.4	30.2	25.1
Net Increase in Notes	2.5	4.3	5.3	-1.3	0.8	2.6	-2.2	-3.1
Total Net Increase	7.1	14.7	21.7	12.8	14.1	14.5	13.4	9.7
Ownership:								
Mutual Savings Banks	0.0	0.0	0.2	0.5	0.0	0.0	0.6	0.5
Life Insurance Companies	0.1	0.1	0.1	0.0	0.0	0.2	0.4	0.5
Fire & Casualty Companies	1.1	1.5	3.4	4.4	3.6	2.2	2.4	2.7
State & Local Retirement Funds	-0.1	-0.3	-0.1	-0.2	-0.4	-0.6	1.1	1.0
Total Non-Bank Investing Institutions	1.1	1.3	3.6	4.7	3.2	1.8	4.5	4.7
Commercial Banks	0.2	10.5	12.8	7.1	3.9	5.7	5.1	4.5
Business Corporations	1.5	-0.8	1.0	1.0	-0.1	0.6	0.6	0.8
Residual: Individuals & Misc.	4.3	3.7	4.3	0.0	7.1	6.4	3.2	-0.3
Total Ownership	7.1	14.7	21.7	12.8	14.1	14.5	13.4	9.7

[1] Omits advanced refundings.

[e] Estimated.

[p] Predicted.

Source: Supply and Demand for Credit in 1976 (New York: Salomon Brothers, 1975) p. 16.

Exhibit B-4.

Statutory Interest Rate Ceilings on State and Local Bonds

	State GO (%)	State Revenue (%)	State Agency (%)	State Notes (%)	Local GO (%)	Local Revenue (%)	Local Agency (%)	Local Notes (%)	Urban Renewal Notes (%)	Low-Rent Housing Notes (%)
ALABAMA[1]	V	U	V	U	V	V	V	V	0	0
ALASKA[2]	7	8	V	V	V	V	V	V	0	7
ARIZONA[3]	0	0	0	0	0	0	0	0	8	8
ARKANSAS[4]	U	U	V	V	6	V	V	V	8	8
CALIFORNIA[5]	8	V	8	8	7	V	7	0	7	7
COLORADO[6]	0	0	0	0	0	0	V	0	0	0
CONNECTICUT	0	0	0	0	0	0	U	0	0	0
DELAWARE	0	0	0	0	V	V	V	V	6	0
FLORIDA[7]	7½	7½	7½	7½	7½	7½	7½	7½	7½	7½
GEORGIA	0	0	0	0	0	9	9	0	8	8
HAWAII[8]	8	0	N	8	7	7	N	7	6	8
IDAHO	7	U	0	6	0	U	0	6	0	0
ILLINOIS[9]	0	0	V	N	V	V	V	V	7	7
INDIANA[10]	N	N	0	N	0	0	0	0	0	0
IOWA	7	7	U	U	7	7	7	7	7	7
KANSAS[11]	N	5½	8	U	7	8	8	U	8	8
KENTUCKY	0	0	0	0	0	0	0	N	0	0
LOUISIANA[12]	0	0	8	0	6	6	6	0	8	8
MAINE	0	0	V	0	0	0	V	0	6	8
MARYLAND	0	V	0	0	V	V	V	V	6	8
MASSACHUSETTS	0	0	0	0	0	0	0	0	0	0
MICHIGAN[13]	6	8	8	0	8	8	8	8	8	8
MINNESOTA[14]	0	U	U	0	7	0	0	0	7	7
MISSISSIPPI[15]	6	6	6	U	6	6	6	U	8	8
MISSOURI[16]	8	8	8	U	8	8	8	U	8	8
MONTANA	0	0	6	U	7	9	7	U	0	0
NEBRASKA[17]	0	0	0	0	0	0	0	0	0	0
NEVADA	8	8	N	8	8	8	0	8	8	8
NEW HAMPSHIRE	0	0	0	0	0	0	0	0	8	8
NEW JERSEY[18]	6	6	0	N	0	0	U	0	0	0
NEW MEXICO	8	8	8	U	8	8	8	U	8	8
NEW YORK[19]	0	N	8	0	0	N	8	0	0	0
NORTH CAROLINA	0	0	8	0	0	0	0	0	0	0
NORTH DAKOTA[20]	0	0	0	0	0	0	0	0	0	0
OHIO[21]	0	0	0	0	8	0	8	8	0	0
OKLAHOMA[22]	6	8	V	U	7½	N	O	N	0	8
OREGON	8	U	U	N	8	U	U	N	7	7
PENNSYLVANIA[23]	0	0	6	5	6	0	6	6	0	6
RHODE ISLAND	0	0	0	0	0	U	0	0	0	0
SOUTH CAROLINA	7	7	7	7	7	7	7	7	7	7
SOUTH DAKOTA	0	U	6	U	8	U	6	U	8	8
TENNESSEE[24]	10	10	10	10	10	10	V	10	8	8
TEXAS[25]	10	10	10	U	10	10	10	U	0	8
UTAH	7	7	7	7	8	8	8	8	8	8
VERMONT	0	U	0	0	0	0	U	0	0	0
VIRGINIA[26]	0	0	0	0	0	0	0	0	0	0
WASHINGTON	0	0	0	U	0	0	0	U	6	6
WEST VIRGINIA	0	7	7	0	8	7	7	0	0	0
WISCONSIN[27]	0	U	0	0	0	C	0	0	0	0
WYOMING	0	0	0	0	0	0	0	0	10	0

O = none; U = none issued; N = none authorized; V = various.

1 Alabama: Sect. 60 of Title 8 of Alabama code sets 8% statutory ceiling, but respective statutes authorizing particular bonds set various limits, i.e., 2% on sinking fund bonds and rates up to 15% on loans of $100,000 or more by non-profit corporations, the State Board of Education and trustees of State educational institutions. While bonds of local agencies are subject to 8% statutory usury limitation, bonds of local industrial development boards and medical clinic boards are exempt and may bear unlimited rates.

2 Alaska: Ceiling on state bond anticipation notes is 7% that on state revenue anticipation notes is 5%. No municipal bond or note may bear interest exceeding the legal usuary rate which is fixed at four percentage points above the discount rate of the 12th Federal Reserve District. A contract or loan commitment in which the principal amount exceeds $100,000 is exempt from this limitation.

3 Arizona: Maximum interest rate must be specified on ballot. If political subdivision has authority to issue bonds without an election, there is 8% ceiling. There is $300,000 ceiling on amount of bonded indebtedness State may incur.

4 Arkansas: School district bonds have 7% ceiling. About 20 types of bonds for street and parking facilities, public building corporations formed to construct municipal facilities, municipally sponsored bonds for waterworks, sewer, parks, recreation agencies, convention centers, and construction and refunding bonds for eight State-sponsored colleges and universities, and county and municipal bonds for hospitals, nursing and rest homes may be issued for 8%. County and municipal industrial development revenue bonds, airport revenue bonds for cities, metropolitan (multi-jurisdictional) port revenue bonds may be issued at 10%. Municipal Improvement Districts may issue bonds for, among other purposes, drainage with a ceiling of 8%.

5 California: Any rate permitted on specific issue approved by two-thirds vote of each house of Legislature and by Governor. Municipalities' GOs have 8% limit in some instances.

6 Colorado: Maximum interest rate must be part of proposal submitted to voters along with amount of authorization.

7 Florida: Some local, county, municipal authority bond authorizations have an interest rate above 7½% or no interest ceiling. Upon request of issuing unit, State Board of Administration may authorize a rate of interest in excess of maximum rate set by law.

8 Hawaii: 8% limitation for State bonds effective until April 1, 1975 at which time it will revert to 6%.

9 Illinois: Municipal, school and district bonds, except for isolated instances, have 7% limit. When bonds are voted, ballot is permitted to set maximum rate within the 7% rate. Home rule units may establish own maximum, but may not exceed 8% usury rate — not to be confused with 9½% home mortgage ceiling.

10 Indiana: Certain town bonds, Barret Law assessment bonds and grade separation taxing district bonds have 6% ceiling, airport authorities except Indianapolis have 7% ceiling; school bus notes and security agreements have 5% ceiling.

11 Kansas: Interest on universities and colleges limited to best competitive bid rate in lieu of statutory rate.

12 Louisiana: Most local bond issues have constitutional ceilings of 6%, although statutory ceiling is 8%.

13 Michigan: 8% maximum on municipal bonds. On state bonds the ceiling is set at the time voters approve the individual authorizations. Currently there is no ceiling on state GO bonds or operating notes with the exception of authorized and unissued water resources and recreation bonds voted with a 6% ceiling. State Housing Finance Agency and state college and university bonds have no rate ceiling.

14 Minnesota: Highway bonds have constitutionally fixed ceiling of 5%.

15 Mississippi: Local GOs issued for industrial purposes have 6% ceiling Local industrial revenue bonds have 8% limit. Under 1973 statute, public school building bonds have 7% ceiling.

16 Missouri: Bonds cannot be sold less than 95% of par. Negotiated sales cannot exceed 6%, except industrial aid bonds which have 8% ceiling.

17 Nebraska: No state public debt.

18 New Jersey: 6% ceiling suspended through June 30, 1975 for counties, municipalities, school districts, State agencies and other public authorities and agencies.

19 New York: 5% ceilings suspended for state and local bonds and notes until July 1, 1975. Public authority obligation ceiling is 8% until July 1, 1975 except housing authority obligations on which there is no ceiling until July 1, 1975.

20 North Dakota: Obligations sold privately are subject to 8% ceiling.

21 Ohio: Some state agencies, such as the Ohio Turnpike Commission and State Underground Parking Commission have 8% limit. Urban Renewal project notes, if GO, have 8% limit. Low rent Housing notes have 8% limit.

22 Oklahoma: Some state agencies such as public trusts have no interest ceiling. Ceiling on turnpike bonds is 6%. Local industrial development bonds have 8% ceiling and state industrial development bonds have 6½% ceiling.

23 Pennsylvania: 6% ceiling on obligations of state and local governments, or their authorities, suspended until June 30, 1976. Philadelphia does not come under Municipal Borrowing Act and thus has no ceiling on interest costs, except for 6% limitation on port, transit and street bonds.

24 Tennessee: Local utility districts are limited to 8%. All others have 10% ceiling.

25 Texas: Bonds sold by Water Development Board, Veterans Land Development, Park Development and Wildlife bonds hav 4½% ceiling on NIC.

26 Virginia: Ceiling reverts to 6% after June 30, 1976.

27 Wisconsin: Local notes can run for 10 years.

SOURCE: Advisory Commission on Intergovernmental Relations, Significant Features of Fiscal Federalism (Washington, D.C.: ACIR, 1975).

Exhibit B-5.

STATE CONSTITUTIONAL AND STATUTORY LIMITATIONS ON LOCAL GOVERNMENT POWER TO ISSUE GENERAL OBLIGATION LONG-TERM DEBT, 1971

State and types of local government	Citation[1]	Rate Limit: Percent	Rate Limit: Applied against[2]	Provisions for exceeding limit[3]	Remarks
Alabama:					
Counties	C-S	3.5 to 5	LAV	None	aMany exceptions are provided by constitutional amendments and statutes applicable to individual local governments.
Municipalities	C-S	20a	LAV	do	
Alaska		No limitations	No limitations		
Arizona:					
Counties	C	4	EAV	M a	aBut in no case to exceed 10 percent of equalized assessed valuation.
Municipalities	C	4	EAV	M b	bUp to 15 percent additional for water supply, sewers, and lighting.
School districts	C	4	EAV	M a	
Arkansas:					
Counties		No limitationsa	No limitationsa		aLimited only as to the maximum allowable property tax rate for debt service.
Municipalities		doa	doa		bBy permission of State Board of education limit may be raised to not exceed 13 percent of total assessed valuation.
School districts	S	15	LAV	(b)	
California:					
Counties	S	5a	LAV	None	aMay go to 15 percent for water and road purposes.
Municipalitiesb	S	15	LAV	do	bChartered municipalities may establish their own limits. c5 percent for elementary, high school, and community college districts; 10 percent for unified districts not maintaining a community college; 10 percent f for high school districts that maintain a community college; 15 percent for unified districts with community college.
School districts	S	5 to 15c	LAV	do	

STATE CONSTITUTIONAL AND STATUTORY LIMITATIONS ON LOCAL GOVERNMENT POWER TO ISSUE GENERAL OBLIGATION LONG-TERM DEBT, 1971 (Cont'd)

State and types of local government	Citation[1]	Rate Limit: Percent	Rate Limit: Applied against[2]	Provisions for exceeding limit[3]	Remarks
Colorado:					[a]Constitutional limits repealed, effective Jan. 1, 1972.
Counties	C-Sa	0.6-1.2[b]	EAV	do	[b]0.6 percent for counties having over $5,000,000 assessed valuation; 1.2 percent for counties with less than $5,000,000 assessed valuation.
Municipalities[c]	C [a]	3[d]	EAV	do	
School districts	S	No limitations	No limitations		[c]Chartered and home rule municipalities may establish their own limits. [d]Water boards are excluded from limit.
Connecticut		No rate limitations[a]	No rate limitations[a]		[a]Debt restricted to 2 1/4 times the latest tax receipts. This limit can be increased for certain purposes (e.g. sewers, school building projects and urban renewal projects). Certain kinds of debt (e.g. for water supply, gas, electric and transit) are excluded from this limit.
Delaware:					
New Castle County[a]	S	3	LAV	None	[a]Requires 75% approval of County Council.
Sussex County[b]	S	12	LAV	None	[b]Requires 80% approval of County Council.
Kent County		No limitations			
Florida:					
Counties		do	do		
Municipalities	S	10[a]	LAV	None	[a]May be modified by individual charters.
School districts		No limitations	No limitations		
Georgia:					
Counties	C	7	LAV	M[a]	[a]Up to 3 percent additional debt may be authorized by general assembly, subject to approval by a majority of voters, but such additional debt must be retired in 5 years.
Municipalities	C	7	LAV	M[a]	
School districts	C	7	LAV	M	
Hawaii:					
Counties	C-S	15	MV	None	

STATE CONSTITUTIONAL AND STATUTORY LIMITATIONS ON LOCAL GOVERNMENT POWER TO ISSUE GENERAL OBLIGATION LONG-TERM DEBT, 1971 (Cont'd)

State and types of local government	Citation[1]	Rate Limit: Percent	Rate Limit: Applied against[2]	Provisions for exceeding limit[3]	Remarks
Idaho:					
Counties	--------	No limitations[a]	No limitations[a]	-----------	[a]Debt incurred in any year cannot exceed revenue for fiscal year without approval by a 2/3 majority of the voters on the issue.
Municipalities	S	15[a]	MV	None	
School districts		No limitations[a]	No limitations[a]	-----------	
Illinois:					
Counties	C-S	5	EAV	None	
Municipalities	C-S	5	EAV	---do---	
School districts	C-S	5	EAV	---do---	
Townships	C-S	5	EAV	---do---	
Indiana:					
Counties	C	2	LAV	---do---	
Municipalities	C	2	LAV	---do---	
School districts	C	2	LAV	---do---	
Townships	C	2	LAV	---do---	
Iowa:					
Counties	C	5	MV[a]	---do---	[a]By judicial interpretation.
Municipalities	C	5	MV[a]	---do---	
School districts	C	5	MV[a]	---do---	
Kansas:					
Counties	S	1[a]	EAV	---do---	[a]Debt incurred for hospitals, and for other specified purposes is excluded from limit.
Municipalities	S	8 to 20[b]	EAV	---do---	[b]Basic rates are: 8 percent for 1st class cities, except such cities with less than 60,000 population for which there is no rate limit; 15 percent for 2d- and 3d-class cities; and 20 percent for certain 3d-class cities (population over 2,600 in county with population between 8,000 and 40,000). These rates can be raised to a percentage that is specified for each class for bonds payable from special assessments.
School districts	S	7[c]	EAV	(d)	[c]10 percent for common school districts in counties with population of 125,000 to 200,000. [d]With approval of State Board of Education (subject to subsequent election to vote on the question of issuing the increased amount of bonds).

STATE CONSTITUTIONAL AND STATUTORY LIMITATIONS ON LOCAL GOVERNMENT POWER TO ISSUE GENERAL OBLIGATION LONG-TERM DEBT, 1971 (Cont'd)

State and types of local government	Citation[1]	Rate Limit: Percent	Rate Limit: Applied against[2]	Provisions for exceeding limit[3]	Remarks
Kentucky:					
Counties	C	2[a]	MV	None[b]	[a]Plus 5 percent for roads
Municipalities	C	3 to 10[c]	MV	do	[b]Unless emergency public health or safety should require.
School districts	C	2	MV	do	[c]1st- and 2d-class cities, and 3d-class cities with more than 15,000 population, 10 percent; 3d-class cities with less than 15,000 population, and 4th-class cities and towns, 5 percent; 5th- and 6th-class cities and towns, 3 percent.
Louisiana:					
Parishes (counties)	C	10	LAV	None	
Municipalities	C	10	LAV	do	
School districts	C	25	LAV	do	
Maine:					
Counties		No limitations	No limitations		
Municipalities	C	7.5	LAV	None	
Maryland:					
Counties (chartered)	S	15	LAV	(a)	A maximum of 25 percent of local assessed valuation is allowed for sewerage and sanitation treatment facilities bonds.
Counties (nonchartered)		No limitations	No limitations		
Municipalities		do	do		
Massachusetts:					
Counties		No rate limitations[a]	No rate limitations[a]		[a]Each county bond issue is subject to State legislative authorization.
Municipalities	S	5[b]	EAV	(c)	[b]Debt incurred for certain purposes is expected, in some cases with separate rate limits (for example, 10 percent for water supply).
School districts	S	2 1/2[b]	EAV	(c)	[c]An additional 5 percent for towns and 2 1/2 percent for cities with approval of the emergency finance board.

Exhibit B-5, contd.

STATE CONSTITUTIONAL AND STATUTORY LIMITATIONS ON LOCAL GOVERNMENT POWER TO ISSUE GENERAL OBLIGATION LONG-TERM DEBT, 1971 (Cont'd)

State and types of local government	Citation[1]	Rate Limit: Percent	Rate Limit: Applied against[2]	Provisions for exceeding limit[3]	Remarks
Michigan:					
Counties	C	10	EAV	None	[a]Plus 3/8 of 1% in home rule cities and 1/4 of 1% in fourth class cities for relief of victims of fire, flood or other disaster.
Municipalities	S	10	EAV	do	
School districts	S	15	EAV	do	
Minnesota:					
Counties	S	20	EAV	do	[a]Limitation does not apply to 1st-class cities (St. Paul, Minneapolis, Duluth).
Municipalities[a]	S	20	EAV	do	[b]Where at least 20 percent of the local tax base consists of railroad property (which is exempt from local taxation) special provisions apply.
Townships	S	20	EAV	do	
School districts	S	10	MV[b]	M	
Mississippi:					
Counties	S	10[a]	LAV	None	[a]15 percent for debt incurred to repair flood damage to roads and bridges.
Municipalities	S	10[b]	LAV	do	[b]15 percent for debt incurred for water, sewer, gas electric, and special improvements.
School districts	S	15	LAV	do	
Missouri:					
Counties	C-S	5	EAV	2/3[a]	[a]Additional 5 percent.
Municipalities	C-S	5	EAV	2/3[b]	[b]Cities may incur an additional 5 percent for streets and sanitation and/or for waterworks and electric plants, but total debt outstanding cannot exceed 20 percent. In addition, cities, incorporated towns and villages with less than 400,000 population may issue industrial development bonds up to 10 percent.
School districts	C-S	10	EAV	None	
Montana:					
Counties	C	5	EAV	do	[a]Additional 5 percent for water and sewer debt only (statutory provision).
Municipalities	C-S	5	EAV	M[a]	
School districts	C	5	EAV	None	
Nebraska	--------	No limitations	No limitations	-------------	

Exhibit B-5, contd.

STATE CONSTITUTIONAL AND STATUTORY LIMITATIONS ON LOCAL GOVERNMENT POWER TO ISSUE GENERAL OBLIGATION LONG-TERM DEBT, 1971 (Cont'd)

State and types of local government	Citation[1]	Rate Limit: Percent	Rate Limit: Applied against[2]	Provisions for exceeding limit[3]	Remarks
Nevada:					
Counties	S	10	LAV	None	
Municipalities	S	10[a]	LAV	do	[a]Some variation authorized.
School districts	S	15	LAV	do	
New Hampshire:					
Counties	S	2	LAV	None	[a]10 percent for cooperative school districts.
Municipalities	S	1.75	EAV	do	
School districts	S	7[a]	EAV	do	
New Jersey:					
Counties	S	2	EAV	(a)	[a]Approval of State local finance board.
Municipalities	S	3.5	EAV	(a)	[b]8 percent in cities of first class with population over 350,000.
School districts	S	4[b]	EAV	(a)	
New Mexico:					
Counties	C	4	LAV	None	
Municipalities	C	4	LAV	do	
School districts	C	6	LAV	do	
New York:					
Counties[a]	C	7[b]	MV	None	[a]Excludes the 5 counties comprising New York City. See[e]
Municipalities	C	7[c]	MV	do	[b]Except Nassau County where the limit is 10 percent.
School districts	C-S	5 to 10[d]	MV	3/5[e]	[c]10 percent for New York City, and 9 percent for other cities over 125,000 population, including debt for school purposes. The 7-percent limit for all other municipalities excludes school debt. [d]5 percent for school districts in cities under 125,000; 10 percent for noncity school districts with assessed valuation over $100,000. No limit for noncity school districts with assessed valuation under $100,000. [e]Subject to approval by the State board of regents and/or the State comptroller.

STATE CONSTITUTIONAL AND STATUTORY LIMITATIONS ON LOCAL GOVERNMENT POWER TO ISSUE GENERAL OBLIGATION LONG-TERM DEBT, 1971 (Cont'd)

State and types of local government	Citation[1]	Rate Limit		Provisions for exceeding limit[3]	Remarks
		Percent	Applied against[2]		
Michigan:					
Counties	C	10	EAV	None	[a]Plus 3/8 of 1% in home rule cities and 1/4 of 1% in fourth class cities for relief of victims of fire, flood or other disaster.
Municipalities	S	10	EAV	---do---	
School districts	S	15	EAV	---do---	
Minnesota:					
Counties	S	20	EAV	---do---	[a]Limitation does not apply to 1st-class cities (St. Paul, Minneapolis, Duluth).
Municipalities[a]	S	20	EAV	---do---	
Townships	S	20	EAV	---do---	[b]Where at least 20 percent of the local tax base consists of railroad property (which is exempt from local taxation) special provisions apply.
School districts	S	10	MV[b]	M	
Mississippi:					
Counties	S	10[a]	LAV	None	[a]15 percent for debt incurred to repair flood damage to roads and bridges.
Municipalities	S	10[b]	LAV	---do---	[b]15 percent for debt incurred for water, sewer, gas electric, and special improvements.
School districts	S	15	LAV	---do---	
Missouri:					
Counties	C-S	5	EAV	2/3[a]	[a]Additional 5 percent.
Municipalities	C-S	5	EAV	2/3[b]	bCities may incur an additional 5 percent for streets and sanitation and/or for waterworks and electric plants, but total debt outstanding cannot exceed 20 percent. In addition, cities, incorporated towns and villages with less than 400,000 population may issue industrial development bonds up to 10 percent.
School districts	C-S	10	EAV	None	
Montana:					
Counties	C	5	EAV	---do---	aAdditional 5 percent for water and sewer debt only (statutory provision).
Municipalities	C-S	5	EAV	Ma	
School districts	C	5	EAV	None	
Nebraska	--------	No limitations	No limitations	-------------	

Exhibit B-5, contd.

STATE CONSTITUTIONAL AND STATUTORY LIMITATIONS ON LOCAL GOVERNMENT POWER TO ISSUE GENERAL OBLIGATION LONG-TERM DEBT, 1971 (Cont'd)

States and types of local government	Citation[1]	Rate Limit: Percent	Rate Limit: Applied against[2]	Provisions for exceeding limit[3]	Remarks
North Carolina:					
Counties	C-S	5 to 10[a] [b]	LAV	M[b]	[a]5 percent for school purposes (8 percent where county has assumed debt for all school units within county); 5 percent for nonschool purposes and community colleges. [b]An additional limitation is imposed by the constitution: Voter approval is required for bonds issued if (1) the amount of the issue exceeds 2/3 of the net debt reduction for the preceding fiscal year or (2) the purpose of the issue is for "non-necessary" expense (i.e., airports, hospitals, etc.). All local bond issues are subject to approval of the State local government commission.
Municipalities	C-S	8[b]	LAV	M[b]	
North Dakota:					
Counties	C	5	EAV	None	[a]Additional debt may be incurred for water-works, up to 4 percent.
Cities	C	5[a]	EAV	2/3[b]	[b]Additional 3 percent
School districts	C	5	EAV	M[c]	[c]Additional 5 percent
Ohio:					
Counties	S	(a)	LAV	None	[a]Net indebtedness shall never exceed 3 percent of first $100,000,000 of taxable value plus 1 1/2 percent of taxable value in excess of $100,000,000 and not in excess of $300,000,000, plus 2 1/2 percent of taxable value in excess of $300,000,000.
Municipalities	S	10[b]	LAV	do	[b]Subject to voter approval. Lower limits are set without voter approval.
Townships	S	2	LAV	do	
School districts	S	9[b]	LAV	(c)	[c]"Special needs" districts may exceed limit if approved by the State Superintendent of Public Instruction.
Oklahoma:					
Counties	C	5[a]	LAV	do	[a]Amount incurred in any year may not exceed revenue for the year, except by a 3/5 majority vote.
Municipalities	C	5[a]	LAV	do	
School districts	C-S	5[a]	LAV	3/5[b]	[b]Additional 5 percent.

STATE CONSTITUTIONAL AND STATUTORY LIMITATIONS ON LOCAL GOVERNMENT POWER TO ISSUE GENERAL OBLIGATION LONG-TERM DEBT, 1971 (Cont'd)

State and types of local government	Citation[1]	Rate Limit: Percent	Rate Limit: Applied against[2]	Provisions for exceeding limit[3]	Remarks
Oregon:					
Counties	S	2	MV	None	[a]0.55 percent for grades 1-8; 0.75 percent for grades 9-12; 1.5 percent for community college or area education district.
Municipalities	S	3	MV	do	
School districts	S	(a)	MV	do	
Pennsylvania:					
Counties	S	15[a]	LAV	(a)	[a]Up to 5 percent without referendum; any debt incurred beyond the 5 percent limit, up to 15 percent, requires a simple majority approval of the electorate. [b]For Philadelphia, the upper limit is 13.5 percent with up to 3 percent without referendum (constitutional provision).
Municipalities	S	15[a] [b]	LAV	(a)	
School districts	S	15[a]	LAV	(a)	
Rhode Island:					
Municipalities	S	3	LAV	None	
South Carolina:					
Counties	C	8	LAV	None	[a]Where 2 or more municipalities or school districts overlap, aggregate limit is 15 percent.
Municipalities	C	8[a]	LAV	do	
School districts	C	8[a]	LAV	do	
South Dakota:					
Counties	C	5	EAV	M[a]	[a]Up to an additional 10 percent (18 percent for for cities over 8,000 population) for specified purposes.
Municipalities	C	5	EAV	M[a]	
School districts	C	10	EAV	M[a]	
Tennessee	--------	No limitations[a]	No limitations[a]	-------------	[a]Except that industrial building bonds are limited to 10 percent of assessed valuation, and require a 3/4 majority in referendum.
Texas:					
Counties	----------	No limitations[a]	No limitations[a]	--------------	[a]Inclusion of debt service in property tax limits has the effect of limiting debt incurrence as well.
Municipalities	----------	do	do	--------------	
School districts	S	10[b]	LAV	None	[b]0.2 percent for junior college districts.

STATE CONSTITUTIONAL AND STATUTORY LIMITATIONS ON LOCAL GOVERNMENT POWER TO ISSUE GENERAL OBLIGATION LONG-TERM DEBT, 1971 (Cont'd)

State and types of local government	Citation[1]	Rate Limit: Percent	Rate Limit: Applied against[2]	Provisions for exceeding limit	Remarks
Utah:					
Counties	C	2[a]	MV[b]	None	[a]Debt incurred in any 1 year may not exceed amount of taxes raised for the year without a simple majority approval of the electorate (property taxpayers). [b]By judicial interpretation. [c]1st and 2d class cities are granted an additional 4 percent, 3d class cities and towns an additional 8 percent debt for construction of water, lights, sewer facilities.
Municipalities	C	4[a]	MV[b]	(c)	
School districts	C	4[a]	MV[b]	None	
Vermont:					
Municipalities	S	10[a]	LAV	do	[a]The statutory limit is "10 times the grand list of the municipal corporation." The "grand list" is 1 percent of the locally assessed valuation.
Virginia:					
Counties		No limitations	No limitations		[a]Including counties that elect to be treated as cities.
Municipalities[a]	C-S	18	LAV	None	
Washington:					
Counties	C	5[a]	LAV	(a)	[a]Debt incurrence that would bring total above 1.5 percent subject to approval by 60 percent majority vote, but in no case may it exceed 5 percent. However, an additional 5 percent is authorized for municipally owned utilities. [b]Debt incurrence that would bring total above 1.5 percent subject to approval by 60 percent majority vote, but in no case may it exceed 5 percent. However, a constitutional amendment authorizes an additional 5 percent for "capital outlays."
Municipalities	C	5[a]	LAV	(a)	
School districts	C	10[b]	LAV	(b)	
West Virginia:					
Counties	C-S	5	LAV	None	
Municipalities	C-S	5	LAV	do	
School districts	C-S	5	LAV	do	

Exhibit B-5, contd.

STATE CONSTITUTIONAL AND STATUTORY LIMITATIONS ON LOCAL GOVERNMENT POWER TO ISSUE GENERAL OBLIGATION LONG-TERM DEBT, 1971 (Cont'd)

State and types of local government	Citation[1]	Rate Limit		Provisions for exceeding limit	Remarks
		Percent	Applied against[2]		
Wisconsin:					
Counties	C-S	5[a]	EAV	do	[a]No more than 4 percent for county buildings or 1 percent (by sole action of the county board) for highways.
Municipalities	C-S	5[b]	EAV	(b)	[b]Municipalities operating schools, except Milwaukee, may incur additional 10 percent for school purposes.
School districts	C-S	5[c]	EAV	(c)	[c]10 percent for school districts offering no less than grades 1-12 and which are eligible for highest level of State aid ("integrated" districts).
Wyoming:					
Counties	C-S	2	EAV	None	[a]Additional 4 percent authorized for sewer construction.
Municipalities	C	2[a]	EAV	(a)	
School districts	C	10	EAV	None	

[1]The citation is either the State 's constitution (C), statutes (S), or both (C-S).

[2]Percentage debt limitations are generally applied against property values, as follows: Full or market value (MV); locally established assessed value, or State established assessed value in the case of State assessed property such as utilities (LAV); or State equalized assessed value (EAV).

[3]Other than by amendment of the constitution or statutes. A simple majority (a favorable majority of 50 percent plus one of all votes subject to counting on the question) is indicated by "M;" where more than a simple favorable majority is required, the required percentage is entered.

Note.-- This table deals only with limitations that affect generally the amount of general obligation debt that counties, municipalities, and school districts can issue. In a number of States general obligation debt issued for specified purposes is excluded from the general rate limitations either by constitutional or statutory provisions. In addition, specific debt limitations are often imposed upon special districts. No attempt has been made to treat the exceptions or the special district limitations because of their great variety. Also excluded from this table are provisions that set maximum interest rates or time periods for which bonds may be issued.

SOURCE: Advisory Commission on Interngovernmental Relations, Significant Features of Fiscal Federalism (Washington, D.C.: ACIR, 1975).

APPENDIX C

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