

the basis of population and with few strings attached. This distribution would be over and above existing and future conditional grants. The essential features of the plan are as follows:

A percentage set-aside.—The Federal Government would each year set aside and distribute to the States an eventual 2 percent of the Federal individual income tax base (the amount reported as net taxable income by all individuals). This would mean that, under the existing rate schedule, the Federal Government would collect 2 percentage points in each bracket for the States and 12 to 68 percentage points for itself.

Use of a trust fund.—The sums collected for the States would be placed in a trust fund from which periodic distributions would be made. The trust fund would be the natural vehicle for handling such earmarked funds, just as it is in the case of payroll taxes for social security purposes and motor vehicle and gasoline taxes for the highway program. It would underscore the fact that the States receive the funds as a matter of right, free from the uncertainties and hazards of the annual appropriation process.

The Federal commitment to share income tax revenues with the States would be a contractual one in the sense of being payable—at whatever percentage Congress provided—through thick and thin, through surplus and deficit in the Federal budget. The plan could hardly have its claimed advantages of stiffening and strengthening State and local governments if they were always fearful that Federal deficits would deprive them of their share of the Federal income tax.

Per capita distribution.—The States would share the income tax proceeds on the basis of population. Per capita sharing would transfer some funds from States with high incomes—and therefore high per capita income tax liabilities—to low-income, low-tax States. If the modest equalization implicit in per capita sharing were deemed too limited, a small portion of the fund could be set aside for supplements to States with low per capita income or with a high incidence of poverty and dependency.

Pass-through.—Whether to leave the fiscal claims of the localities to the mercies of the political process and the institutional realities of each State or to require a pass-through to them is not an easy question. Previously, we have left this question open, but we now conclude that the legitimate—and pressing—claims of local government require explicit recognition in the basic formula of revenue sharing.

Few strings.—Constraints on the use of the funds would be much less detailed than those applying to conditional grants. However, the funds would not be available for highway construction, since there is a special Federal trust fund with its own earmarked revenue sources for this purpose. An audit of the actual use of the funds would be required, as well as certification by the appropriate State and local officials that all applicable Federal laws, such as the Civil Rights Act, have been complied with in the activities financed by the grants.

Revenue impact.—The Federal individual income tax base will reach the \$300 billion mark in 1967. Accordingly, each percent of the base would provide the States with \$3 billion a year. If 2 percent of the income tax base were being distributed in 1967, the grant would be \$6 billion, or roughly \$30 per capita. Without taking account of special equalization features, this would mean, for example, grants of about \$60 million for Arkansas, \$560 million for California, \$60 million for Colorado, \$320 million for Illinois, \$180 million for Massachusetts, \$110 million each for Louisiana and Minnesota, \$120 million for Missouri, \$20 million for Montana, \$560 million for New York, \$150 million for North Carolina, \$360 million for Pennsylvania, \$30 million for Utah, \$130 million for Virginia, and \$120 million for Wisconsin.

The income tax base, to which the allotments are keyed, has grown from \$65 billion in 1946 to \$128 billion in 1955, \$210 billion in 1963, and the estimated \$300 billion in 1967—and has risen from 31 percent of GNP in 1946 to an estimated 38 percent in 1967. By 1972, the base should grow to \$425 billion (assuming a 6-percent annual growth in money GNP, and the base growing 20 percent faster than GNP). On this base, the 2-percent to be set aside for the states would reach \$8.5 billion by 1972. Truly, a share in the Federal income tax would be a share in U.S. economic growth.

The competing claims of Federal tax cuts and expenditure increases would probably require that the plan start modestly (perhaps at one half of 1 percent or 1 percent) and build up gradually to 2 percent over three or four years. This gradual build-up would moderate the impact of the new plan on the Federal budget during the first few years after its adoption and enable the States to program their fiscal affairs more efficiently.