The difficulties in coordination and broad policy planning by Federal, State, and local governments that result from the fragmentation of grants and appropriations.[1]

These problems suggest that there are limits, in terms of efficiency in practical application, to increased reliance on central direction of resources through conditional Federal grants. They obviously call for reforms internal to the grant-in-aid system. To conclude that the categorical grant-in-aid system needs to be scuttled not only goes too far, but misses the point.

Categorical grants are needed because the benefits of many public services "spill over" from the community in which they are performed to other communities. Expenditures for such services would be too low if financed entirely by State-local sources, because each State or community would tend to pay only for the benefits likely to accrue to its own citizens. States have a well-developed system of categorical grants to local governments for this reason. Unless the Federal Government steps in to represent the national interest in the benefits derived from State-local services, the latter will be badly undernourished. So categorical grants-in-aid must continue to be our *major* reliance in transferring Federal funds to the States.

General purpose or block grants are justified on substantially different grounds. In the first place, all States do not have equal capacity to pay for local services. Even though the poorer States make a larger relative revenue effort, they are unable to match the revenue-raising ability of the richest States. Second, Federal use of the best tax sources leaves a substantial gap between State-local need and State-local fiscal capacity. Moreover, no State can push its rates much higher than the rates in neighboring States for fear of placing its citizens and business enterprises at a disadvantage. This justifies some Federal assistance even for purely State-local activities, with the poorer States needing relatively more help because of their low fiscal capacity.

The categorical grant system cannot perform these functions. Though they admirably serve the national purpose, they often put State-local finance at cross-purposes. In drawing on a limited supply of resources to finance and staff particular activities, the matching grant may siphon resources away from nonaided programs. The poorer the State, the greater the tax effort that must be made to achieve any given amount of matching, and hence the less that is left over for purely State-local functions. To some extent, then, the State-local government trades fiscal freedom for fiscal strength.

In contrast, general-purpose grants would combine flexibility with strength. On the one hand, the funds would not be tied to specified national interests, bound by detailed controls, forced into particular channels and subject to annual Federal decisions. On the other, it would not have to be wrung out of a reluctant State-local tax base at great political risk to innovative governors and legislators. In short, revenue sharing would provide a dependable flow of Federal funds in a form that would enlarge, not restrict, the options of the State and local decision-makers.

For these reasons, the general-purpose grants are needed to supplement the categorical grants, but not to replace them. Considering the large unmet needs throughout the country for public programs with large spillover effects, the adoption of revenue sharing should not be the occasion for reducing categorical grants. It is a well-known axiom of logic that two objectives cannot be satisfied by using only one instrument.

Question.—We have been told that the major domestic problem is the plight of our cities. How can you make sure that the cities will get a fair share of the revenue sharing funds?

Answer.—Per capita revenue sharing would miss its mark if it failed to relieve some of the intense fiscal pressures on local, and particularly urban, governments. Indeed, it is in and through the metropolitan area that most of our aspirations for a greater society will be achieved or thwarted. Revenue sharing cannot be expected to break the bottlenecks of tradition and vested interest that stand in our path. But it can be expected to provide some of the financial resources needed for that battle, always bearing in mind that it will be a supplement to Federal programs for model cities, for urban redevelopment, for community action against poverty, and the like.

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[1] Charles L. Schultze, Hearings before the Subcommittee on Intergovernmental Relations of the Committee on Government Operations, U.S. Senate, 89th Cong., 2d sess.; Part I: The Federal Level, pp. 390–391.