Three, the bloc grant plans will provide relatively more assistance to the residents of the poorer States.

Four, the tax credit plan will provide relatively more benefits for poorer people.

The relative effect on expenditures is basic to the whole argument. I believe that the amount State and local governments spend on public services is primarily determined by two things. The first is the amount of resources upon which they can draw, which consists essentially of a pool containing the incomes of their citizens after paying Federal taxes, plus Federal grants. The second determinant is the relative costs and benefits of public and private expenditures, as evaluated by their citizens weighted by their political influence. These costs and benefits are influenced by interstate competition and by the spillover of benefits between States.

For the average State, the three plans would all cause an equal increase in the resources available, whether in the form of a Federal grant or in the form of a reduction in the Federal taxes of its citizens. In recent years, as the available resources of the States have increased, the expenditures of States and localities have increased by about 20 percent of the total increase in resources. I would expect as a first approximation that if a bloc grant, of a tax credit, of, say $5 billion a year were provided, the resulting increase of State and local expenditures would be something like $1 billion. In the case of the bloc grant without an effort formula that first approximation is probably all we get. But with the tax credit, or with the effort formula, there is another force at work, which could be powerful. These plans change the relative costs of public and private expenditures. The credit says to the people of the State that spending another million dollars on public services financed through the income tax will cost them only $800,000, if the credit is 20 percent, ignoring the effects of deductibility. This will make them willing to devote a larger proportion of their resources to public services. We have no doubt that if we gave an income tax credit for expenditures in restaurants there would be more eating out and less eating at home. Similarly, we should have no doubt that if we give a credit for the costs of State expenditures financed in a certain way, those expenditures will increase relative to other expenditures. The effort formula would have a similar effect.

Since this conclusion seems to be the opposite of the intuitive expectation, I would like to illustrate it further. Suppose the Governor of the State is sitting in his office with his budget director, his finance director, and his legislative leaders, drawing up the budget for next year. They have just decided that their urgent expenditure needs are so large that they must ask for $100 million of additional taxes. They have had to cut out of the budget another $10 million of expenditure that they, or the taxpayers, don't think is worth $10 million of the taxpayers' money. Suddenly there is a knock at the door, and a gasping messenger breaks in with the news, "The President has just signed the Heller-Pechman plan and we are going to get $20 million." Perhaps I should say the Javits plan.

Senator JAVITS. I am glad I stayed.

Mr. STEIN. "Great, says the Governor. Now we can spend that extra $10 million."

"Oh, No," says the budget director, who has studied cost-benefit analysis,"if the taxpayers would rather have had $10 million than