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Financing Government in a Federal System

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FINANCING GOVERNMENT IN A FEDERAL SYSTEM. By *George F. Break*. Washington, D.C.: Brookings. 1980. Pp. xi, 276. Cloth, $17.95; paper, $6.95.

When the Brookings Institution published George F. Break's well-received book, *Intergovernmental Fiscal Relations in the United States*,[1] the nation's unemployment rate was 3.9 percent,[2] the inflation rate was 2.9 percent,[3] and Proposition 13 was eleven years from becoming a household word. Dramatic changes in the economy and in public opinion have produced governmental finance structures and problems that differ markedly from those outlined by Break in 1967. Although *Financing Government in a Federal System* follows the format of his earlier effort, it is much more than simply a revised edition.[4] Instead, the book systematically reassesses intergovernmental fiscal relations and "the principles and tradeoffs" that have determined their evolution (p. viii).

Break's fresh look is an excellent single-volume guide to intergovernmental finance in the United States that is accessible to lawyers who have a basic understanding of economics but find much of the current literature too quantitative. Break develops little new theory, but he does present the major issues and reform proposals concisely and impartially. He begins this presentation by explaining a number of recent trends in governmental output, expenditures, and revenues. The discussion highlights a shift in the relative importance of various types of state and local taxes, an increase in federal aid to state and local governments, particularly to the largest cities, and a narrowing of regional disparities in the ratio of federal taxes paid to grants received.[5] The remainder of the book deals with three major

1. G. BREAK, INTERGOVERNMENTAL FISCAL RELATIONS IN THE UNITED STATES (1967). *See* Crouch, Book Review, 373 AM. ACAD. POL & SCI. ANNALS 278 (1967); Oates, Book Review, 57 AM. ECON. REV. 956 (1967); Wright, Book Review, 61 AM. POL & SCI. REV. 1135 (1967).

2. U.S. BUREAU OF THE CENSUS, STATISTICAL ABSTRACT OF THE UNITED STATES: 1979 at 392 (1979).

3. *Id.* at 476.

4. Over three quarters of Break's references are to sources published after 1967. In fact, one has to look carefully to find even paraphrases of sentences from his earlier book.

5. Those living in the frostbelt apparently have a legitimate claim when they object to the heavier spending of federal monies in the sunbelt. The 1974-1976 federal expenditure-to-revenue ratio for the Great Lakes region was only .75, while the Southeast and Far West region had expenditure-to-revenue ratios of 1.11 and 1.13. These regional disparities are nevertheless far below those of the 1950s and 1960s. Pp. 28-29.

areas of public finance — tax coordination, intergovernmental grants, and urban finance.

Although his analysis is primarily economic, Break remains sensitive to the political realities that confront fiscal reformers. For example, he advocates that states tax interstate businesses according to a uniform apportionment formula based on "[s]ome physical presence in the state, measured by property and payroll" (p. 72). But Break realizes that political, as well as legal constraints limit the potential for reform in this area, and he acknowledges that states may insist on including a sales factor that strays from the ideal theoretical solution. Break's skill at measuring the practicality of reform proposals is also apparent in his discussion of intergovernmental grants. For example, Break's analysis reveals that many federal matching funds are fungible and that competitive grants, designed to eliminate existing inefficiencies, can create new ones by increasing complexity and administrative costs. In some cases, however, that complexity may itself be advantageous. Break argues that the complexity of the revenue sharing distribution formula "frustrates attempts by individual recipient jurisdictions to improve their own entitlement qualifications . . . and take advantage of its loopholes" (p. 152).

In the book's final chapter Break studies the acute fiscal needs of urban areas and their increasing dependence on outside sources of income. In 1977, intergovernmental aid to the largest cities amounted to nearly seventy-five percent of own-source revenue, compared with less than thirty percent in 1962 (p. 225). Rather than advocate metropolitan governments and fiscal units as he did in the parallel chapter of his earlier book, Break now focuses on existing fiscal problems. He is particularly troubled by the dilemma of cities that must increase taxes to compensate for continually eroding tax bases despite public pressure to cut taxes and government spending. The traditional benefits-received and ability-to-pay models, which Break calls "beautifully appealing theories in search of a pragmatic solution," cannot resolve this dilemma. In their place, he proposes "a restraining-rules-and-process model" that resembles a "set of ad hoc and unintegrated solutions" designed to keep government spending within the constraints of public opinion (p. 226).

The "restraining-rules-and-process model" assumes that bureaucratic and political processes will not achieve economic efficiency and consumer satisfaction and that "improvement in the process by which public choices are made is a vain hope" (p. 258). Rather than rely on these processes, Break proposes "change[s] in the power relations prevailing in the government sector" (p. 258). Effective reform may require shifting some of the discretionary power of politicians and bureaucrats to the taxpayers. Controls on spending and taxation may produce the desired shift, but questions concerning the effect of such restraints on the quality of life remain. The ultimate question is whether to make a drastic change, as in California, or to move gradually by way of restraining rules and processes. Because the answer will vary with diverse local conditions, Break can offer no definite resolution of this question.

Despite the depressing statistics that he cites, Break communicates the optimism of one who believes that experimentation will be rewarded. As he observes, "One of the great strengths of the U.S. federal system is that it affords vast space for laying out avenues to fiscal reform and ample opportunities for comparing the efficacy of their design" (p. 266). Break's coherent analysis of current fiscal problems and reform proposals should facilitate such productive experimentation.