REVENUE SHARING

Part 4: Recommendations

The folklore of American politics holds that once a Federal program is created and a bureaucracy established it tends to live on forever, often outlasting its usefulness. This has been proven false in recent months, however, as several of the programs of President Johnson’s Great Society have disappeared from the political scene. Next year the Federal revenue sharing program comes up in Congress for renewal. Already opponents of the program have begun efforts to prevent its continuation. One member of the House of Representatives said, “Revenue sharing was a political gimmick dreamed up by the present administration and it is an abdication of the Congress’ responsibility to oversee the expenditure of public funds.”

To be sure, revenue sharing is receiving mixed reviews, even from the leaders of local governments. Most, however, take the attitude put forth by Mayor Richard G. Hatcher of Gary, Indiana, who said, “Although I have problems with the game, I will do what I can to improve the rules. I realize we are dealing with what may eventually become the only game in town.”

The survey of Nebraska mayors, reported in the April issue of Business in Nebraska, found overwhelming support for continuation of revenue sharing but also uncovered many complaints about certain aspects of the program.

SPECIFIC RECOMMENDATIONS

What recommendations, then, can be made to improve the functioning of revenue sharing? Obviously, many things could be done, but probably few are realistic in political terms, at least at present. Nonetheless, several suggestions will be set forth here. The following analysis is based on the assumption that there is a serious imbalance between Federal and state resources and that revenue sharing is the best way to reduce this imbalance.

Recommendation Number One: Define the priority goal of revenue sharing to be that of restoring a balance between state and Federal responsibilities and resources.

This, of course, reflects the bias of a political scientist interested in the overriding question of federalism, rather than in the economic or social questions surrounding state-Federal relations.

This is no doubt one of the Utopian suggestions, for politicians are more concerned about immediate social and economic problems than about abstract questions of the proper relationships in a federal system.

As the program now operates the goals of revenue sharing seem to be in conflict with one another. Indeed, there is evidence that even the members of Congress are unsure as to what the goals of the program are. In a recent survey conducted by the Advisory Commission on Intergovernmental Relations, 73 of the 172 Congressional respondents stressed that a return to local decision making was the primary goal, while 48 replied that revenue sharing was designed to ease local financial pressures. The survey of Nebraska mayors showed an even split, with 33 percent replying that “the best thing about revenue sharing” was the political aspect and another 33 percent stressing the financial advantages.

The primary purpose of revenue sharing ought to be political: to balance the powers in a federal system. This does not mean that other goals should not be part of revenue sharing, such as meeting immediate fiscal crises, but rather that one central goal needs to be established and all others related to it.

Recommendation Number Two: Distribute revenue sharing on the basis of population alone.

Walter Heller, one of the prime movers behind revenue sharing, has argued that if the funds were distributed on a straight per capita basis, equalization would occur naturally because the dollar amount going back to the poorer states would be larger relative to the amount of Federal income taxes collected in the richer states.

Two other reasons can be advanced to support a distribution on the basis of population only: (1) revenue sharing under the present formula does not meet the professed goal of equalization, and (2) data problems confronted in determining per capita income and tax effort are immense.

First, intergovernmental transfers of income appear to be an inefficient means of effecting changes in income distribution. As Richard Wagner has noted, “Any transfer from a political unit with an above-average per capita (Continued on page 2)

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3 *Replies by Members of Congress*, op. cit., p. 6.

4 For a detailed analysis of the distribution pattern, see the August, 1974, issue of *Business in Nebraska*. 
income to one with a below-average per capita income will necessarily produce substantial transfers from poorer citizens residing in the wealthier state to wealthier citizens residing in the poor state."

As for the argument that there are poor governments as well as poor citizens, it should be obvious that poor governments can result from having many poor citizens in the constituency. It would seem to be more appropriate and effective in the long run to place greater emphasis on other efforts to redistribute income, such as a guaranteed annual income program.

At the very least, revenue sharing is a poor use of resources for reducing inequality. To the extent that an equitable means of distributing revenue sharing is needed, however, the population basis would appear to be the better alternative.

Second, the income figures used in calculating revenue sharing are not very reliable. The per capita income figures were derived from a survey conducted by the U.S. Bureau of the Census in 1970. At that time a twenty percent sample of the general population was surveyed, which on a statewide basis may be a reasonably sized sample. But on a local basis in a state where there are so many small towns (and where seven counties have less than 1,000 people) the size of the sample becomes too small to be reliable. And in fact, to overcome this problem, the Bureau of the Census simply assigned the county per capita income figures to all towns in the county with less than 500 persons.

The revenue sharing act recognizes in a general fashion some of the data problems relating to smaller units of government. The law provides that for local units of less than 500 persons the Secretary of the Treasury may at his discretion allocate the entitlement on the basis of population alone (although he has not chosen to do so). This does not seem to be a total answer to the problem; rather it would be more equitable if all governments were allocated on the same basis, preferably that of population alone.

The tax effort factor in the formula also presents problems, both of data definition and of philosophy. Tax effort is based on the ratio of adjusted tax revenues to personal income and is not directly related to fiscal capacity. Furthermore, it does not take into account the kind of state and local taxes used. Generally these tend to be regressive, not progressive. Thus, pressures to maintain or increase tax effort may actually work against the redistributive goal of revenue sharing.

Another problem with the tax effort factor is that it excludes from consideration user fees, even though these may be a desirable way of financing certain public services. As a result of revenue sharing, some communities may choose to finance additional services through general taxes instead of user fees in order to maximize the tax effort.

Water meters are an example. There are some small towns which do not have individual water meters but instead finance the municipal water system through the general mill levy.

Obviously, high water users, such as young families with dishwashers and automatic clothes washers, benefit at the cost of certain other residents, such as the elderly who often live alone and use little water. Under the tax effort factor as it now works, there is little incentive to change from mill levy support to a more equitable user fee. Again, the revenue sharing formula can be accused of actually promoting governmental inefficiency.

The other reason for opposing a tax effort factor is, as noted above, a philosophical one. The tax effort factor favors governments with high public spending. Yet should not local governments be free to determine their own mix of public and private spending? If decentralized decision making is truly a goal of revenue sharing, governments which choose a reduced role for government should not be penalized for their decision.

Recommendation Number Three: Give revenue sharing to the states and allow them to decide what the internal distribution, if any, should be.

The revenue sharing law splits a state's allocation so that one-third of the money goes to the state government and the remaining two-thirds is given to counties, municipalities, towns, and Indian tribes. Eliminating the pass-through requirement is another suggestion which, while theoretically sound, is politically impractical. The large cities especially are strongly opposed to such a proposal.

The main reason for this recommendation is simply this: A federal system consists of a national-state relationship, not national-state-local. The oft-quoted Dillon's Rule holds that cities are creatures of the state, creating a unitary relationship with the state, not miniature federalism as is so often assumed. Indeed, Walter Heller warned that the pass-through requirement "represents a basic realignment of powers in our federalism and should be recognized as such."

Another reason for ending the mandatory pass-through requirement is that it does not take into account the wide variation among states in aiding local governments. In those states which have assumed a large portion of local responsibilities (such as Hawaii), the present two-thirds pass-through represents a windfall for local governments. Furthermore, the pass-through discourages state assumption of certain local responsibilities, when in fact it may be preferable to have the state bear the burden.

The pass-through requirement does not take need into account, a fact often criticized by opponents of revenue sharing. All governments, regardless of financial condition, are recipients.

If the states were given the freedom to decide how the money should be distributed, metropolitan areas would no doubt protest that they are victims of rural-oriented, unresponsive state legislators and that they must work directly with the Federal government to receive a fair hearing. Yet this viewpoint underestimates the capacity of the states to provide public services, most of which are taken for granted by the average citizen. Indeed, state government has shown in the past that it can respond to social problems, often before the Federal government reacts.

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6 While there is obviously some relationship between the two, a recent study demonstrated that in smaller units of government this correspondence is not as likely to be found as in larger units. See ACIR, Measuring the Fiscal Capacity and Effort of State and Local Areas (Washington, D.C.: Government Printing Office, 1971), p. 4.


8 Under the present revenue sharing law, a state legislature may provide for an alternative formula for distributing local revenues, but the formula must include at least one other factor besides population—that is, either tax effort or income. Population alone is not an acceptable formula.
Recommendation Number Four: Remove the spending restrictions on local revenue sharing funds.

Revenue sharing is supposed to decentralize power and allow local governments to determine their own needs and priorities, rather than bending to national demands. It seems clear that as long as the Federal government restricts the use of the money to certain purposes there will be distortion in local spending patterns. Furthermore, the tax effort factor discourages the use of revenue sharing to reduce taxes. But if a unit of government chooses to offer fewer public services and to lower taxes, should it be penalized for this choice? Local governments should be free to make their own decisions, unfettered by restricted uses.

Recommendation Number Five: Continue the Federal categorical grants designed to meet specific national objectives.

Categorical grants, properly administered, can be useful in reducing disparities between rich and poor communities across the nation. The Federal government, it can be argued, does have a responsibility for reducing the spillover costs of local governments.

An efficient way by which to reconcile the state and Federal interests in a federal system is to use revenue sharing for state purposes and grants-in-aid for specific national objectives. Or, if Congress desires, refine the categorical grant system into special revenue sharing programs, but maintain some Federal control in order to assure that national objectives are being met.

Recommendation Number Six: Require greater efforts to secure participation by citizens in determining how revenue sharing should be spent.

This type of effort received attention recently at the hearings on revenue sharing held by the Advisory Commission on Intergovernmental Relations. At that time the Rev. Jesse Jackson of Chicago proposed:

1. That a citizen's audit and citizen's advisory council be established and mandated in the regulations and guidelines for Federal revenue sharing administration.
2. That local and state governmental units be required to report planned expenditures in a document separate from the announcements in the legal notices of the press and that they be required to distribute such reports to the general public.9

If an explicit goal of revenue sharing is the decentralization of political decision making, then certainly greater participation by citizens in decisions of local governments ought to be encouraged.

Recommendation Number Seven: Rely upon the states to set up and enforce any financial controls needed for those revenue sharing funds passed on to local governments.

The present requirements for Federal accounting procedures allow for the direct intrusion of the Federal government into local affairs. If revenue sharing is to be treated truly as state or local money, then Federal audits would seem to be inappropriate. This does not preclude the right of a state government to set forth its own requirements for money passed on to local governments. As a matter of fact, most state governments today have already established budgeting, accounting, auditing, and publication controls over local money. State oversight of revenue sharing would not, in most cases, represent a significant increase in state powers over local governments.

Another reason for preferring state rather than Federal control was uncovered in the survey of Nebraska mayors. According to several towns which have had communications with the Office of Revenue Sharing, the Office is considered to be unresponsive and generally not very helpful. One mayor reported that four letters and one telephone call all went unanswered. As another chief executive put it, "At least we know those people in Lincoln and can work with them directly." Certainly giving the states a larger role in the administration of revenue sharing is compatible with the goal of governmental decentralization.

Recommendation Number Eight: Change the law in Nebraska so that the State Investment Council can invest funds for municipalities.

The survey of revenue sharing in Nebraska municipalities uncovered the fact that many towns have not taken advantage of interest-bearing accounts as a means of holding revenue sharing funds until they are spent. The Nebraska State Funds Investment Act allows the State Investment Officer to "provide assistance and furnish advice regarding the investment of money to any political subdivision of the State of Nebraska whenever such advice is requested by a political subdivision." (Section 72-1259, RRS Nebraska 1943, Reissue of 1971.) The officer, however, does not have the actual right to make investments for counties or municipalities. This would be a most useful service for those small towns which have no finance officer or are unable to secure professional advice regarding investments.

CONCLUSION

The trend of American government in the twentieth century has been toward increasing centralization in the hands of the Federal government. For many years this was supported and encouraged by liberals and opposed and denounced by conservatives.

More recently, however, demands have been rising for greater local participation—demands that are coming not only from conservatives but also from many other groups heretofore considered liberal. Indeed, the liberal-conservative dimension may have little to do with such demands. It may be that the American public in general has become disillusioned with the inability of the Federal government to deal effectively with—let alone solve—many of our pressing national problems.

If the program were properly designed instead of being simply another Federal aid program with strings attached, as it is now, revenue sharing would be an ideal way by which to promote greater decentralization of government. If revenue sharing were truly given a chance to work, we might discover that decentralized decision making is no more effective at solving problems than is centralized power. On the other hand, it just might work.

Marilyn Mertens

New Publication

A new bulletin in the Economic and Business Report series entitled Nebraska Economic Projections has been published by the Bureau. The bulletin contains projections for Nebraska counties and regions of labor force by sex and age, employment by industry and occupation, earnings by industry, and per capita and total income. The projections are for 1975 and every fifth year thereafter through the year 2000.

An article based on the new bulletin appeared in the July issue of Business in Nebraska. Copies of the bulletin are available free upon request.

Review and Outlook

Due to rising prices, the dollar volume of business in Nebraska and the nation is still running ahead of last year, but this month not by as much as last month, and for Nebraska not by as much as for the nation. The figures are in Table 1: 5.2 percent for the state, 8.9 percent for the United States.

The agricultural index was down substantially for Nebraska for June, the first month of the drought. With almost a 20 percent drop, compared with nearly 10 percent for the nation, it might seem that the drought was responsible. Yet the full consequences of the dry spell could not have been operating in June, because the greatest effect will come with the sale of the corn crop and of the corn-fed cattle. Since the dollar volume for agriculture fell much more than the physical volume (which went down only 6 percent), it seems that the main cause of the decline was the fall in agricultural prices (Table 5) rather than the drought.

The nonagricultural index for the state, as compared with last year, was still ahead of the same figure for the nation. This was especially true of the manufacturing and distributive industries, but governmental employment in the state for the first time in a long while increased as much as that for the nation. One of the figures used in estimating the movement of the distributive industry is retail sales. We are still able to obtain retail sales figures for the state as a whole on the same basis as before, although not for the cities or counties (see explanation below).

In the index of production on the (Continued on page 5)

Notes for Tables 1 and 2: (1) The "distributive" indicator represents a composite of wholesale and retail trade; transportation, communication and utilities; finance, insurance, and real estate; and selected services. (2) The "physical volume" indicator and its components represent the dollar volume indicator and its components adjusted for price changes using appropriate price indexes—see Table 5, page 5.

## ECONOMIC INDICATORS: NEBRASKA AND UNITED STATES

### 1. CHANGE FROM PREVIOUS YEAR

<table>
<thead>
<tr>
<th>Indicator</th>
<th>June, 1974 Current Month as Percent of Same Month Previous Year</th>
<th>1974 Year to Date as Percent of 1973 Year to Date</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Nebraska</td>
<td>U.S.</td>
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<tr>
<td>Dollar Volume</td>
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<tr>
<td>Agricultural</td>
<td>80.3</td>
<td>90.7</td>
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<tr>
<td>Nonagricultural</td>
<td>110.4</td>
<td>109.7</td>
</tr>
<tr>
<td>Construction</td>
<td>96.6</td>
<td>101.0</td>
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<tr>
<td>Manufacturing</td>
<td>121.5</td>
<td>116.8</td>
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<td>Distributive</td>
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<tr>
<td>Physical Volume</td>
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<td>98.3</td>
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<tr>
<td>Construction</td>
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<td>90.7</td>
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<tr>
<td>Manufacturing</td>
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<tr>
<td>Distributive</td>
<td>97.8</td>
<td>96.3</td>
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<tr>
<td>Government</td>
<td>104.0</td>
<td>103.4</td>
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### 2. CHANGE FROM 1967

<table>
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<tr>
<th>Indicator</th>
<th>Percent of 1967 Average</th>
</tr>
</thead>
<tbody>
<tr>
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<tr>
<td>Dollar Volume</td>
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<tr>
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<td>144.3</td>
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<td>Nonagricultural</td>
<td>189.4</td>
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<tr>
<td>Construction</td>
<td>196.3</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>201.0</td>
</tr>
<tr>
<td>Distributive</td>
<td>183.9</td>
</tr>
<tr>
<td>Government</td>
<td>194.0</td>
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<tr>
<td>Physical Volume</td>
<td>120.9</td>
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<tr>
<td>Agricultural</td>
<td>98.2</td>
</tr>
<tr>
<td>Nonagricultural</td>
<td>125.4</td>
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<tr>
<td>Construction</td>
<td>116.8</td>
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<tr>
<td>Manufacturing</td>
<td>129.9</td>
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<tr>
<td>Distributive</td>
<td>125.0</td>
</tr>
<tr>
<td>Government</td>
<td>123.4</td>
</tr>
</tbody>
</table>

## RETAIL SALES DATA MISSING

This month we are unable to present net taxable retail sales in Table 3 and the chart, which normally occupy this space, or the retail activity for cities in the second column of Table 4 on the next page. The reason is that the State Department of Revenue is changing its system of recording and releasing these data.

In the past retail sales tax data have been released on the basis of reports received from retailers each month. These included principally sales during the previous month but also included some late reports of sales in earlier months, which usually amounted to about 2 percent of the total. They did not include, of course, delinquent reports on sales actually made in the previous month. Since the two inaccuracies offset each other to a large extent, the figure was reasonably correct.

Under the new system sales tax data will be reported as of the month in which the sales actually took place. Release of the data will be delayed a month to incorporate sales reported a month late. Sales reported more than a month late will still not be included, but they ordinarily amount to only a fraction of one percent.

This change may be an improvement in the accuracy of the data, but it poses a problem for us and for our readers. Shall we show retail sales data as of a different month from the data for the state and nation in Tables 1 and 2? This month, of course, we must omit retail sales data for June entirely, because they are not yet available. If we have them in this space next month, they will be June data, while the remainder, including Tables 1 and 2 and the bank, construction, and power consumption data for the cities in Table 4, will be for July.

Another possible solution would be to delay publication of Business in Nebraska for two weeks each month so that all data for the same month could be incorporated in the same form as in the past. We have not yet decided upon a future course of action. All that has been decided at present is that we must return to the bank debits figure in Table 4 as an index of city business activity instead of using a weighted average of banking activity, retail activity, and power consumption for our city indexes. This will be the practice at least until a decision on date of publication is reached or some other solution is found.
(Continued from page 4) base 1967 (Table 2), the figures are below those shown last month, resuming the decline which characterized the first months of this year. Nebraska fell below the United States in June, largely because of the agricultural situation. So far as Nebraska was concerned, the physical volume of agricultural production was actually below that for the year 1967.

In the city data in Table 4, which are corrected for price changes, two-thirds of the cities declined in banking activity. The state average is pulled down particularly by such cities as Omaha, Falls City, Norfolk, Lexington, McCook, and York. We see no reason for the severity of this decline beyond the general agricultural situation. We note, however, that building activity in the state also declined, although in some cities it rose sharply. Power consumption was down, as it has been since February, no doubt due to fuel conservation. Only Norfolk, despite its decline in banking activity, is increasing its power consumption, in June by 84 percent over a year ago. This city also is active in the building field.

The price situation, as indicated in Table 5, remains dangerously active. Only agricultural prices are falling from last year’s levels, while general consumer prices are up by more than 11 percent and wholesale prices by 14.5 percent. This accelerating inflation remains the greatest threat to American prosperity. Modern industrial civilization depends upon a stable dollar, and money which is sinking in value has a destabilizing effect upon every business.

The government promises to take steps to stop the inflation but is uncertain how to proceed. As we have pointed out previously, the main step to take is to achieve a balanced budget, either by reducing expenditures or by increasing taxes or both—preferably by both. How this is done, however, does make a difference. Increased excise taxes, for example, such as the increase proposed on gasoline, would merely add to inflation.

Governmental expenditures which tend to increase the production of goods and services for sale help to fight inflation by increasing supply. These consist of subsidies and other aids, especially for goods in shortest supply. One such subsidy is the training of unemployed manpower for trades which are underemployed. Expenditures which do not tend to increase production of goods for the market, such as for military purposes, and for subsidies to goods and services which are already abundant (perhaps for air lines), increase the pressure for inflation.

Tax reform and tax deductions should also be examined with the same objectives in mind. The reforms proposed thus far seem to offer little relief to the lower and middle income groups, which are bearing the principal burden of inflation.

E. Z. P.

5. PRICE INDEXES

<table>
<thead>
<tr>
<th>June, 1974</th>
<th>Index*</th>
<th>Percent of Same Month Last Year</th>
<th>Year to Date as Percent of Same Period Last Year*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Consumer Prices</td>
<td>147.1</td>
<td>111.1</td>
<td>110.3</td>
</tr>
<tr>
<td>Wholesale Prices</td>
<td>155.7</td>
<td>114.5</td>
<td>117.1</td>
</tr>
<tr>
<td>Agricultural Prices</td>
<td>United States</td>
<td>163.6</td>
<td>95.8</td>
</tr>
<tr>
<td>Nebraska</td>
<td>147.0</td>
<td>85.2</td>
<td>107.8</td>
</tr>
</tbody>
</table>

*Using arithmetic average of monthly indexes.

New Faculty Members

As a potential investor in corporate stocks, how much credibility would you place in a statement published by a private corporation—and attested to by a CPA—which purported to forecast the firm’s future financial situation? This question was the central focus of a dissertation by Dr. Stevan K. Olson, who recently received a Ph.D. from the University of Wisconsin and is now teaching advanced and introductory accounting classes at the University of Nebraska.

Dr. Olson did his undergraduate work at the University of South Dakota in Vermillion, where in 1969 he earned a B.S. with Highest Honors from the School of Business and was awarded several scholarships and memberships in honorary societies.

Prior to receiving an M.B.A. at the University of Wisconsin in 1972, Dr. Olson was named an American Accounting Association Consortium Fellow and listed in Who’s Who in American Colleges and Universities in 1971. Dr. Olson is a member of the American Accounting Association, as well as Beta Gamma Sigma, Delta Sigma Pi, and Phi Eta Sigma honoraries.

Outside his professional activities, Dr. Olson enjoys participating in basketball and football and keeping up with Brent and Heather, the Olson’s 5- and 2-year-old children. Dr. Olson, his wife Deanna, and the children will live at 4441 Kirkwood Drive.

John Wragge, a native of Fullerton, Nebraska, and 1967 Business Administration graduate of UN, returns to the University to teach managerial accounting and accounting principles. He recently received a CPA certification and expects to be awarded his Ph.D. in Accounting this October from the University of Houston. Mr. Wragge’s work in the field of quantitative management science and management information systems led to his dissertation topic, which involved a study of comprehensive simulation models in the budgeting processes of colleges and universities.

Between 1968 and 1972 Mr. Wragge taught a wide variety of courses at Augustana College in Rock Island, Illinois, including accounting, statistics, data processing, and economics. He also conducted a study for integrating computers into the curriculum and served as chairman of the Computer Advisory Committee.

Prior to his experience at Augustana, Mr. Wragge worked on projections of national demand as a graduate assistant at the University of Missouri, where he also earned an M.A. in Accounting in 1968. In 1967 he worked in Chicago as a summer intern at the International Harvester corporate headquarters.

As evidenced by his eagerness for the football season to begin, Mr. Wragge is an avid sports spectator, as well as a conscientious participant through his daily session on an exercise bicycle. John and his wife Connie, an English and history major, and their 2½-year-old daughter Jennifer will live at 6100 Thornton Drive.

New Bureau Staff Member

After working with the Bureau during most of the past year on a special project involving economic projections and analysis of data sources, Mrs. Vicki Dean Stepp has assumed a permanent position as Research Analyst. In this position she succeeds Mrs. Marilyn Mertens, who will remain with the Bureau as a consultant working on several special projects.

Mrs. Stepp is a native of Lincoln, where she graduated from Northeast High in 1968. She received the B.S. degree with Highest Distinction from the University of Nebraska-Lincoln in 1972 with majors in Economics and Secondary Education. At the University she was awarded three Unicameral scholarships, three Regents scholarships a Haskell award, and two University of Nebraska Foundation awards.

As recipient of the Hollingsworth Fellowship she attended Columbia University and received there the M.A. degree in Economics in 1973. In 1973 also she worked as a summer intern analyst in the U.S. Office of Economic Research.

Mrs. Stepp is a member of Omicron Delta Epsilon, Phi Beta Lambda, and Alpha Lambda Delta honorary organizations. Her hobbies include tennis, swimming, bicycling, photography, and playing the guitar and bridge. She and her husband Larry, who is employed in the Engineering Mechanics Department at the University, live at 5341 Ervin where, after seven months of marriage, she says she is still learning to cook.