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BUSINESS TAXES AND THE RISING COST OF STATE AND LOCAL GOVERNMENT

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The increases in taxes imposed by the federal government, particularly those based on net income, during the past twenty-five years, and especially since 1940, have received a large measure of the attention directed to American fiscal affairs during this period. The fact that federal budget receipts have been increased from five billion in 1940 to 68 billion in 1956 has been widely publicized. The purposes for which these enormous additional sums have been raised — national security, foreign aid, expenditures for veterans, social benefits, farm aid, interest on the expanding national debt, etc. — are common knowledge. The impact that these exactions have had, and will have, on the national economy has been a subject of study, discussion, and speculation.

The increase in federal taxes from 40% of the tax receipts of all governmental units in this country, in 1940, to almost 75% at the present time has had the natural effect of relegating state and local taxes to roles of diminishing importance. Notwithstanding the decline in their relative position, however, state and local taxes have increased in total amount from \$8.7 billion in 1940 to \$24.8 billion in 1955, with all indications pointing toward a continuation of the sharp upward trend.

In view of the magnitude of the sums involved and the rapidity with which they are growing, it becomes increasingly important that the problems created by, and related to, this rising cost of state and local governments be fully recognized and given the most serious consideration by all concerned.

It is the purpose of this paper to direct attention to certain aspects of the rising cost of state and local governments, which, it is believed, will contribute to a better understanding of some of the problems involved, particularly those which pertain to and affect business operations.

The problems which appear to be particularly pressing and therefore deserving of special attention at this time arise largely from certain characteristics which are in some measure peculiar to state and local taxes which distinguish them from those imposed by the Federal government. An examination of these characteristics therefore seems to be the best approach to the identification of the problems.

*This article is not to be considered the official view of the company with whom the author is associated.

First of all, the purposes for which the revenues of state and local governments are expended must be considered. As contrasted with the Federal expenditures of a national, and even international, scope, state and local tax collections stay at home. They are used to provide schools, local roads, courts, fire and police protection, hospitals, neighborhood recreation facilities, sewerage and sanitation, street lighting, water works, assistance to the unemployed and needy, and for other similar purposes.

In short, state and local taxes are imposed to provide the governmental services that are most used by most of the people. They are services which, for the most part, have come to be regarded as almost indispensable in American life today. And, as modern communication and transportation narrows the distance between different sections of the country, between areas of the same state, and between urban and rural areas, the quantity and minimum quality of the services demanded tend to a common standard in all areas.

Thus, it seems to the writer, any consideration of state and local taxes must recognize from the outset that the desires and demands which they are designed to satisfy are so basic to such a large segment of the population in any area that they must be regarded, for practical purposes, as irresistible and, to a rather considerable extent, irreducible below a certain minimum level.

A second very basic characteristic of state and local taxes is the strength of the forces that are responsible for their growth. Foremost of these is population itself. The rapid increase in total population, the shift from rural to urban, the concentration in certain areas, and the increasing proportion of the population in schools all contribute to the need for additional funds. A second powerful influence in the rising cost of state and local governments is the widespread effort, which is almost universally recognized as essential, to improve our schools by providing more and better buildings, more adequate facilities in those buildings, more and higher paid teachers, and improved transportation for pupils. Another important item is that state and local governments, like businesses, find their costs being increased by higher prices for materials they buy and by necessary upward revisions in the salaries and wages of their employees. A fourth factor, of varying importance at different times and in different areas, is the providing of new types of services¹ or extension of existing services into entirely new areas.²

While there are unquestionably other circumstances which contribute

1. As illustrations, we might mention the establishment of local mosquito control districts and the post-war building of expressways and freeways by municipalities and counties.

2. An example of this would be the furnishing, on a county-wide basis, of such services, heretofore limited to municipalities or to highly urbanized areas, as water, street lighting, garbage collection, etc.

to increasing costs, the ones which have been mentioned would appear to embrace the principal forces in this field.

A third important characteristic distinguishing state and local taxes is the limitation upon the sources of revenue available to any particular governmental area and the variation in the taxpaying potential of these sources between units. Since there is not always a definite correlation between the services to be supplied and the available sources of taxes to pay for them, governmental officials may be confronted with the necessity of finding ways to furnish essential services from the limited potential of a severely circumscribed area.

A fourth characteristic, and the one which may be a cause of much concern to business management, is that the state and local tax bill of any taxpayer, individual or business is the aggregate of a number of individual taxes imposed at different times, often at different places, by officials of different governmental units, having dissimilar, if not actually conflicting, interests. In these circumstances, it is not surprising that there is seldom any conformity to an overall pattern or any real homogeneity in the total of state and local taxes imposed upon a particular taxpayer.

From the foregoing the conclusion is inescapable that because of the nature of the services supplied by state and local governments the fundamental problem to be faced by the governing officials is not whether the services shall be provided but rather the extent or degree to which they shall be furnished. It would further seem that the final answer to this latter question would in most instances involve consideration of such related matters as:

1. Cost of providing all essential services in the minimum quantity or quality that will be considered acceptable.
2. Cost and advantages of providing various services to an extent or degree beyond the minimum.
3. The extent to which each of the various segments of the population and economy will be required, through taxation, to contribute to the cost of providing these services in the governmental area involved.

The wisdom with which the additional taxes are imposed and the thoroughness with which all pertinent considerations are weighed before the final decisions are reached are vitally important both to the individuals and to business management of the area involved. An ever-present danger, and one which is a source of major concern to businessmen, is that under the pressures often associated with the financing of services for which there is great popular demand, certain aspects of the situation, for one reason or another, may be given disproportionate weight while others, of equal or greater long range importance, may receive inadequate attention.

This is especially true when, as is often the case, there is a tendency

to look to the already established businesses of the state or community as the source of the additional needed funds. Such business enterprises are more or less fixed in their location; they are presumably operating at a profit and hence have the cash with which to pay the added tax; and considerable sums of revenue can be obtained from a relatively few sources. It therefore appears that it might be helpful to call attention to some considerations of vital importance in connection with the imposition of new or additional state and local taxes and to ask that the tax levying authorities keep in mind the inequities and harmful consequences that can result if they are not properly taken into account.

1. First of all, and of great importance, is the fact that a tax imposed by any state or local authority is only one of many such taxes. Therefore, the impact of the one particular tax can be evaluated properly only if considered in the light of the total tax burden upon the particular group involved. Failure to recognize and observe this cardinal principle can result in gradual cumulative over-taxation of a particular segment of the economy and, if not corrected, its slow economic strangulation in the particular area.

2. The extent to which taxes, imposed in the first instance upon a business, can be "shifted" or recovered from its customers through higher prices for its product or service, and the promptness with which such a shift can be accomplished, varies greatly between different kinds of businesses. Careful study should be given to the question of the portions of the population upon which any proposed additional impost will actually fall. It is obvious that if adequate consideration is not given to this problem the tax may actually be paid by a group upon which there is no equitable claim for payment either on the basis of benefits received or ability to pay. Also, in this same connection, thought should be given to possible undesirable results of an "indirect" tax, or one which is actually born by those who pay it, in the form of higher costs for goods and services without knowledge on their part that they are paying for services provided by the government.

3. Tax-levying officials must constantly be on guard lest, in spite of every effort to achieve objectivity and impartiality, the tug of conflicting interests results in an inequitable distribution of the local tax burden. Care must be taken to insure that those who protest the least, or in any event with the least effectiveness, are not taxed more heavily than others who may have no justifiable claim to lower taxation.

4. Frequent changes in the tax structure or the constant threat of such changes can be a source of disturbing uncertainty in the business community which can have a retarding effect on expansion of existing business and can be a serious handicap in securing the establishment of new industry. A stable tax policy which is designed to meet the needs of the community for a considerable period without drastic revision, upon which

business can depend and base its plans, will usually serve the best interests of all concerned.

5. Taxes which are imposed without full study of all related facts may unintentionally cause great economic harm. In the competition for the consumer's dollar one type of business may, as a result of unequal taxes, be unable to meet the competition of a more favored business. Or, as between businesses of the same kind, one firm may be placed at a serious competitive disadvantage with a similar business located in a different taxing jurisdiction with a tax structure more favorable to the particular industry. Such disadvantage, if sufficiently serious and long-lived, may lead to relocation of business and eventually result in loss of revenue to the taxing jurisdiction. Mention has been made of the varying abilities of different businesses to shift or pass on to their customers the taxes levied directly upon the business activity. Where a business is operating on a close margin of net earnings and is unable to shift an additional tax readily, any increase in its tax expense will result in reduced earnings and can actually affect the ability of the firm to continue operations.

It may now serve some useful purpose to summarize a few principles that, if adhered to, would seem to contribute to fairness and equity in state and local taxation and will assist in avoiding some of the enumerated dangers that are feared by businessmen.

1. First of all since, for reasons discussed earlier, a continuation of the upward trend in state and local taxes appears inevitable, taxpayers as a group ask that each expenditure, and certainly each additional expenditure, be weighed carefully by the same two standards that the average individual or businessman uses in deciding upon a proposed disbursement:
 - a. Is the expenditure for a necessary or desirable purpose?
 - b. Regardless of the desirability of the expenditure, or of the value that would be received, can it be supported by the tax-paying potential of the area?
2. Next, in the interest of keeping costs at a minimum, the services which are to be furnished by the government should be provided and administered by competent personnel in an efficient and economic manner.
3. Needed revenues should be raised in accordance with sound and established principles of taxation and economics.
4. Major changes in tax policy and tax structure should not be made hurriedly but should be made thoughtfully after due deliberation and consideration of all of the pertinent facts. The opinions of taxpayers should be sought as to the probable effects of proposed

courses of action. Such views should be gladly given, should be received with open minds, and should be carefully weighed.

5. Tax-levying officials should remember that in the last analysis only people pay taxes; that this fact is not changed by the guise of imposing the tax upon business, since a tax imposed upon a business must come ultimately from the customers, the employees, or the owners. Due consideration should therefore be given to the relative tax burden already borne by these groups before any new or additional taxes are imposed upon a particular business or type of business.

In conclusion, it should always be borne in mind by all concerned that taxes are a means by which the people, as a group, purchase services, realize desires, or satisfy needs that could not in most instances be achieved by the individual acting alone. Furthermore, in our modern complex economy the portion of our national income that is being expended by governmental agencies is so large that it has a distinct bearing upon the operation of our economic machine as a whole. So, whether intended so or not, the imposition of taxes will inevitably have important social and economic consequences beyond the mere fact of raising new governmental revenue, and these far-reaching, and often indirect, consequences must receive increasing attention in connection with the financing of the rising cost of state and local government.