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Practical Solutions to Financial Problems Created by the Multilevel Political Structure

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1. Introduction

THIS paper examines ways and means of increasing the financial capabilities of state governments through adjustments in federal-state-local fiscal relations. Federalism, to be sure, creates problems at the federal level as well, but these do not relate primarily to fiscal capability. In a sense our primary concern is for the financial capabilities of local governments, since much of the initial impact of rising civilian governmental costs is on them. However, cities, counties, towns and school districts are the wards of the states and their problems the states' problems.

During the last five years for which official data are available, 1953–57, state and local "general government" absorbed nearly $200 billion for direct general expenditures, capital outlay for local utilities, debt redemption, employee-retirement systems and increases in fund balances (Table 1).

To finance these expenditures, state and local governments raised $149 billion from their own revenue sources—from taxes, fines, fees and licenses, interest earnings and the operation of utility and other business enterprises. This left a gap of about $49 billion, bridged by financial aid from the federal government (about $16 billion) and and by borrowing (about $33 billion).

This gap—about $10 billion per annum—is one quantitative approximation of the fiscal problem of state and local governments with which we are here concerned and for which solutions are sought. It is, however, little more than an approximation of that problem.

The magnitudes cited measure state and local performance—the amounts spent—and not the amounts that would have been spent if adequate resources had been available to finance a level of governmental service consistent with need. No measure is available of the

Note. This paper does not necessarily reflect the views of the above agencies.

TABLE 1

State and Local "General Government" Operations, 1953–57

Use of funds:	*In millions*
Direct general expenditure	$169,484
Capital outlay for local government utilities	5,146
Debt redemption	12,037
Contribution to employee retirement systems	5,116[a]
Increase in cash and security holdings (exclusive of insurance trust funds)	7,095
Total (net of duplication)	$198,003[b]
Source of funds:	
General revenue from own sources	$144,229
Net current surplus of utilities and liquor stores	4,407[c]
Intergovernmental revenue from Federal Government	16,140
Borrowing	33,057
Total	$197,833

SOURCE: Bureau of the Census, Governments Division.

[a] Derived by subtracting from the total increase ($6,427 million) in retirement fund assets, the excess ($1,311 million) of their receipts from employee contributions and investment earnings over their payments of benefits and withdrawals.

[b] Less than the sum of detail by $875 million, representing employer contributions by local governments to state administered employee retirement systems, included above in both "Direct general expenditure" and "Contributions to employee retirement systems."

[c] The excess of aggregate utility revenues over expenditures for utility operations and utility interest.

degree to which state and local performance fell short of need, apart from such fragmentary information as classroom shortages, deficient instruction programs, substandard health and recreation facilities, etc.

Moreover, the magnitudes cited pertain to the past. They have been increasing and will continue to increase. During these five years alone, the size of the annual gap as here defined, i.e., the amounts borrowed and obtained as federal aid, increased from $6.4 billion to over $10 billion. The projections presented to this conference and other forecasts suggest continuing increases in future years.

The magnitudes shown in Table 1 understate the problem also because they are global for the country as a whole, and conceal substantial deviations from the average in individual jurisdictions. Despite the upgrading of the less productive sections of the country, economic inequality continues to characterize the states and the political subdivisions within individual states. As subsequent discussion indicates, this uneven geographic distribution of resources is the genesis of many problems in federal-state fiscal relations.

In posing the problem in terms of state-local financial requirements, there is no intention to suggest that it exclusively or primarily concerns only state and local governments. Problems at the state level quickly become matters for national and federal concern. Current preoccupation with the inadequacy of the states' public education systems provides a timely illustration, but one no more dramatic than national concern in earlier years with the inability of state governments to cope adequately with unemployment or the inadequacy of their resources for the payment of unemployment benefits during the 1957-58 recession. Neither is it our intention to suggest that the problem of federalism is primarily one of dollars and cents. The philosophical values involved are indeed important and their implications for the functioning of the political institutions —for democratic government itself—recognized.[1] It is, however, in financial terms that the problem of intergovernmental relations is generally presented. It is in financial terms that it will be relieved.

One or two additional stipulations. Intergovernmental problems in a federalism do not admit of absolute solutions. A system of government wherein the several states with unequal economic resources undertake to conduct many of their affairs as one nation while retaining an important measure of sovereignty with respect to large sectors of governmental activity, can never be free of problems. If some of these do not lend themselves to neat solutions, they do lend themselves to accommodation.[2] Such accommodation, moreover, is likely to involve the established tools of intergovernmental relationships, rather than new arrangements still uninvented. The tools are familiar; the debate concerns largely the use to be made of them, how and when and under what circumstances? This paper answers very few of these questions. It aims to be constructive, not by providing new answers—but rather, by examining old ones and by disposing of some misconceptions. This accounts for the uneven allotment of space among the subjects treated, frequently at variance with their relative revenue importance. The purpose here is not to treat federal-state-local relations comprehensively and systematically. We limit ourselves to problems which we can illuminate with the quantitative data we have been able to assemble.[3]

[1] For a constructive formulation of the philosophy of contemporary American federalism see the *Report* of the Commission on Intergovernmental Relations, GPO, June 1955, and William Anderson, *The Nation and the States, Rivals or Partners?*, University of Minnesota Press, 1955.

[2] Committee on Intergovernmental Fiscal Relations, *Federal, State, and Local Government Fiscal Relations*, Senate Doc. 69, 78th Cong., 1st sess., GPO, 1943.

[3] The presentation is unbalanced even in this restricted sense, because our examination has proceeded further on some phases of the subject than on others.

The sections which follow examine a variety of suggestions for augmenting the financial resources of state and local governments through intergovernmental action. The areas of taxation, debt financing, and federal financial aid are discussed in this order.

2. *Revenues of State and Local Governments from their Own Sources*

In fiscal year 1957, taxes produced $29 billion for state and local governments and financed approximately 70 per cent of their general government expenditures. Borrowing, federal aid and miscellaneous charges and receipts, including utility and liquor store profits, provided the balance. Our concern in this section is with tax revenues; how adjustments in federal-state relations would affect them. The revenue import of the several components of the state and local tax structure is summarized in Table 2.

TABLE 2
State and Local Tax Revenues, 1953 and 1957
(amounts in millions)

Item	*1953*	*1957*[a]	*Percentage Increase*	*1957 Distribution*
Taxes, total	$20,908	$29,042	38.9	100.0%
Property	9,375	13,097	39.7	45.1
Individual income	1,065	1,767	65.9	6.1
Corporation income	817	984	20.4	3.4
Sales and gross receipts	6,927	9,461	36.6	32.6
General sales and gross receipts	2,860	4,027	40.8	13.9
Motor fuel	2,019	2,851	41.2	9.8
Alcoholic beverage	465	591	27.1	2.0
Tobacco products	469	604	28.8	2.1
Other selective taxes	1,114	1,388	24.6	4.8
Death and gift	226	346	53.1	1.2
Other, including licenses and permits	2,497	3,387	35.6	11.6
Motor vehicle and operator licenses	1,012	1,462	44.5	5.0
All other taxes	1,485	1,924	29.6	6.6

SOURCE: Bureau of the Census, *Summary of Governmental Finances.*
[a] *The 1957 Census of Governments* reports total state and local taxes of $28,817 million. The property tax accounts for most of the $225 million reduction.

A. PROPERTY TAX

The number one revenue producer is still the long-maligned property tax. It supplies 45 per cent of the tax revenues of state and local governments and since it has become principally a local as distinguished from a state tax, its contribution to local revenues is relatively much larger, 87 per cent.[4]

Despite its well-publicized limitations, including alleged unresponsiveness to changing levels of employment and economic activity, the property tax is holding its own. Between 1953 and 1957, when total state and local tax collections increased 38.9 per cent, the property tax yield increased 39.7 per cent. By virtue of its dominant role in state-local tax systems, the property tax influences appreciably the behavior of total tax collections. Several factors are contributing to the rising revenue yield of property taxes. The large volume of new construction and the steady upward trend in the level of tax rates are the principal ones. Lesser, but nonetheless significant contributors are improved assessment techniques and reduced tax delinquencies. State legislatures are taking an increased interest in up-dating tax assessments to relieve the pressure for state financial aid to local jurisdictions, and where distribution of state aid is partially based on local need, to curb the tendency to reduce local assessments in order to demonstrate greater local need.

Since the federal government levies no property taxes, problems of overlapping do not arise. Note should be taken, however, of deductibility of property taxes for federal income tax purposes, since it reduces the net burden of local property taxes for federal income taxpayers who itemize deductions. Deductibility of property taxes is especially important for the larger corporations, since it effectively shifts approximately half of their tax to the federal government.

A problem of major importance for a limited number of local jurisdictions is the immunity of federal property from local taxation, and for a substantially larger number of communities, the tax exemption of properties owned by the state and by religious, educational, charitable and similar nonprofit organizations. Federal-state relations are involved in only the first of these.[5]

Under the doctrine of reciprocal tax immunity first enunciated by

[4] As used in this document, the term "states" excludes Alaska and Hawaii.

[5] In view of the dominant role of the property tax in the fiscal capabilities of local governments and the impairment of these capabilities by deficient tax administration, an examination of possibilities for enhancing local fiscal capacity through federal action should properly explore opportunities available at the national level for influencing the quality of property tax administration. The data on assessment practices (ratios) assembled in connection with the *1957 Census of Governments*, underscore the urgency of this problem and could serve as the basis of a nation-wide effort to improve assessment practices through the dissemination of information and technical assistance, or possibly through matching grants to finance state-wide assessment procedure studies.

Chief Justice Marshall in 1817 and still generally maintained, property owned by the federal government or its instrumentalities is not subject to state or local taxation without explicit congressional consent. Congress has consented in only a few instances, notably with respect to the real property of the now-liquidated Reconstruction Finance Corporation and certain other lending agencies. More often but still infrequently, Congress has authorized payments designated as "in lieu of taxes," and in a few situations, federal grants in recognition of the tax immunity of federal properties. For the fiscal year 1955, aggregate payments associated with the nontaxability of federal property were estimated at $276 million and consisted of:

	In millions
Property taxes	$2.9
Payments in lieu of taxes	13.8
Revenue-sharing	52.4
Other related payments:	
Federally affected school districts,	
for construction	121.1
for operation and maintenance	81.9
Indian education and welfare (off-reservation tuition)	3.5
Total	$275.6[6]

The vast bulk of federal property, whether measured by acreage, number of parcels, or value, is at present immune from payments directly or indirectly associated with the prevailing property tax system for financing local government. While its current value is not known, it clearly is substantial. The accumulated historical cost of real property owned by the federal government within the continental United States was estimated in 1958 at approximately $55 billion for land and improvements. The accumulated cost of federally owned tangible personal property was probably over $150 billion. The bulk

[6] Senate Committee on Government Operations, 84th Cong., 2d sess., *Payments of Taxes, or in Lieu of Taxes, to State or Local Taxing Units*, Hearings on S. 826 . . . (and other bills), part 2, pp. 337–41, April 19 and 20, 1956.

of the land acreage is in the public domain and never was in taxable ownership; moreover, it includes vast areas with little present market value.[7]

Many of the government's most valuable properties—and those most nearly resembling in physical characteristics and use typical privately owned taxable properties—were acquired or built during and after World War II. Federal properties sold to private users and turned to otherwise taxable business use have been held off the tax rolls until title passed from the federal government or payments under purchase contracts were completed. Moreover, some federal agencies, such as the military services and the AEC, have taken title and thus have extended the federal tax immunity to much personal property acquired and used or held by private contractors under their direction.

Questions concerning payments to state and local governments on account of federal government properties have been the subject of long controversy, numerous studies, voluminous documentation, dozens of legislative proposals, and a few limited statutory enactments over the last two decades.

Investigators generally agree that the central question is one of equity—equity between the taxpayers of the federal and of the several local governments. As in most questions of equity, the disagreement arises over what constitutes a fair arrangement for action. The broad practical question is essentially this: How can the national government carry on its operations and hold property without imposing special burdens upon the taxpayers of communities where the operations or properties are disproportionately large?[8] There are, however, subsidiary practical questions. One relates, for example, to the like treatment of similarly used properties where the use of the federally owned property is in competition with taxable private property. This and other collateral issues complicate any effort to draft a concrete program or policy.

Canada has tried a solution involving payments, in a limited category of cases, for disproportionate amounts of national government property. A somewhat similar proposal, but with a "hardship

[7] House Committee on Government Operations, 85th Cong., 2d sess., *Federal Real and Personal Property Inventory Report as of June 30, 1958*, pp. 11, 139. The real property total includes $9 billion public domain realty estimated at approximate current value.

[8] Council of State Governments, *Federal-State Relations*, Senate Doc. 81, 81st Cong., 1st sess., pp. 114–20.

test" attached, was received by the Congress without enthusiasm or action.[9]

Court decisions have highlighted some issues. One group of three interrelated Supreme Court decisions, rendered in 1958, is of particular current interest. The Court ruled that:

1. Leased realty exempt to the United States as owner may, nevertheless, under a Michigan statute relating to tax-exempt property, be taxable to a private corporate lessee (the Borg-Warner Corporation) using the property in a business conducted for profit. Two justices dissented. (*U.S. et al., v. City of Detroit*, March 3, 1958, 355 U.S. 466.)

2. Real property exempt to the United States as owner but used by a private corporation (the Continental Corporation) under a use-permit, without rental payment, in performing supply contracts for the government may, under the same Michigan statute, be taxable to the private user. In this case, also, the decision was 7 to 2. (*U.S. v. Township of Muskegon, et al.*, March 3, 1958, 355 U.S. 484.)

3. Personal property owned by the United States and used by a subcontractor under a prime contract between two other private companies and the United States may be taxable under the Michigan personal property tax law to the party in possession. In this decision, in which the Court was divided 5 to 4 [but a rehearing was later denied], the tax was considered by the majority to be a tax "for the privilege of using or possessing" the personal property, rather than a tax on the government's interest in the property. (*City of Detroit, et al., v. Murray Corporation of America, et al.*, March 3, 1958, 355 U.S. 489.)

Mr. Justice Black's majority opinion in the Continental case included this comment:

"The case might well be different if the government had reserved such control over the activities and financial gain of Continental that it could properly be called a 'servant' of the United States in agency terms. But here Continental was not so assimilated by the government as to become one of its constituent parts." (355 U.S. 486.)

Mr. Justice Black observed for the majority in the Borg-Warner decision:

"Today the United States does business with a vast number of private parties. In this Court the trend has been to reject immunizing these private parties from nondiscriminatory state taxes as a matter of constitutional law. Cf. *Penn-Dairies v. Milk Control System*, 318 U.S. 261, 270. Of course, this is not to say that Congress, acting within the proper scope of its power, cannot confer immunity by statute where it does not exist constitutionally. Wise and flexible adjustment of intergovernmental tax immunity calls for political and economic considerations of the greatest difficulty and delicacy. Such complex problems are ones which Congress is best qualified to resolve." (355 U.S. 474.)

In his prevailing opinion in the Murray case, Mr. Justice Black added:

"We find nothing in the Constitution which compels us to strike down these state taxes. There was no discrimination against the federal government, its property or those with whom it does business. There was no crippling obstruction of any of the government's function, no sinister effort to hamstring its power, not even the slightest

[9] Senate Committee on Government Operations, 84th Cong., 2d sess., Hearings on S. 826 . . . , part 2, pp. 327–33.

interference with its property. Cf. *McCulloch v. Maryland*, 4 Wheat, 316. In such circumstances, the Congress is the proper agency, as we pointed out in *U.S. v. City of Detroit*, to make the difficult policy decisions necessarily involved in determining whether and to what extent private parties who do business with the Government should be given immunity from state taxes." (355 U.S. 495.)

If inferences are warranted from the 1958 decisions and recent congressional consideration of the subject, they may perhaps be summarized in this way:

1. In certain circumstances, even in the absence of explicit congressional consent to taxation, the Supreme Court is disposed to uphold the authority of the states to levy nondiscriminatory taxes upon private industrial users of government-owned property, real or personal, and to permit the amount of the tax to be measured by the value of the property. There is a greater division over personal property than over real property.

2. Congressional action will be required if there is to be any marked shift of policy from the present prevalent pattern of immunity of federal property from both actual taxes and the payment of amounts "in lieu of property taxes."

3. The interest generated by World War II and the Korean property acquisitions brought forth many proposals but no comprehensive congressional action. At present there is nothing to suggest that Congress will soon be disposed to lay down a general policy providing comprehensively for payments either of property taxes or in lieu of property taxes on account of federally owned properties. Doubtless there will continue to be piecemeal enactments dealing with selected problems, much as the court decisions will continue to resolve particular cases or to focus attention upon the complexities of the problem.

As controversy continues, both the local governments and the property-owning federal agencies publicize estimates of tremendous amounts of property tax revenue that are supposed to be involved in the issue of federal immunity. Often, however, these estimates make little or no allowance for prevailing practices of underassessment and nonassessment and for other institutional characteristics of the property tax system which would—or, at least, should—be invoked to assure equitable treatment of the federal government. As a result, the relative fiscal importance of even the broadest proposals is often exaggerated. Currently active legislative proposals are of relatively limited proportions—to relieve communities genuinely damaged.[10]

[10] S. 910, 86th Cong., 1st sess.

Substantially broader programs appear unlikely at this time in view of the widespread, almost emotional attachment to the concept of constitutional immunity and the unyielding attitude of state and local governments to the income tax immunity of their own securities.

In summary, then, a significant modification of the tax immunity now generally applicable to property of the federal government does not appear to be among the reasonable expectations for near-term practicable solutions to the revenue needs of local governments. Indeed, there is no visible prospect for an accommodation or innovation that would still the continuing controversy in this area of inter-level fiscal relations.

B. INDIVIDUAL INCOME TAX

The classic example of tax overlapping is the individual income tax, now employed at all three governmental levels, federal, state, and local.

Individual income taxation was introduced at approximately the same time by the federal government and some states. Most of the states, however, entered the field a decade or more after adoption of the federal income tax in 1913. City and county levies are largely a World War II phenomenon.

Thirty-one states (and the District of Columbia) now tax individual incomes.[11] All but two of these use broaldy based taxes applying generally to all income. The two exceptions, New Hampshire and Tennessee, limit their taxes to interest and dividends. Local governments in five states levy income taxes. In only two (Ohio and Pennsylvania), however, are local taxes widespread and neither of these has a state-wide tax. Of the other three in which the local tax overlaps the state tax, in Alabama and Missouri the local tax occurs only once each; in Kentucky five times. Local taxes are uniformly imposed at low flat rates and typically apply only to salaries, wages and net profits of unincorporated businesses and professions. Some local tax bases include rental income; none is believed to include investment income.

In 1957 individual income taxes produced about 6 per cent of state and local tax revenues. This represented some increase since 1953, when they accounted for about 5 per cent, and presumably is attributable to the rise in the level of personal income and to tax rate

[11] The descriptions of state tax systems throughout this chapter are as of January 1, 1959, as reported by Commerce Clearing House, *State Tax Reporter*. Significant changes can be anticipated in 1959 since revenue problems confront many of the 46 States in which the legislatures meet in regular sessions this year.

increases. More effective enforcement, notably the introduction of withholding at the source by eleven states, has also been a factor. Significantly, not a single new state individual income tax has been enacted in twenty years and more than one-third (36.3 per cent) of the United States population is still free of income taxation in its home state. Significantly, also, these people are concentrated in the older industrial states; Connecticut, Illinois, Michigan, New Jersey, Ohio, and Pennsylvania.

On a national scale and measured in terms of tax dollars collected, federal-state tax overlapping in individual income taxation is relatively small. All individual income taxes collected by state governments in 1958 aggregated $1.6 billion, equivalent to 4.5 per cent of federal tax collections from this source. In other words, the aggregate impact of all state imposed taxes is of the general magnitude of a 1 1/4 percentage point change in the first bracket rate of the federal tax. In the 31 states with income taxes, 1958 state collections averaged about 8 per cent of federal collections. However, as will be noted by reference to Table 3, the weight of state income tax collections, as measured by the amount of federal tax collections, has been increasing steadily, if slowly, during the past few years (reflecting in part federal tax reductions and in part the sharper graduation of state rate schedules).

The relative weight of state income taxes varies widely. In seven states the ratio of state to federal collections in 1958 was less than 5 per cent and in another twelve less than 10 per cent. In twelve states, this percentage exceeded 10 percent and in five of these, 15 per cent (Table 4).

These percentages, it should be emphasized, serve only as approximations of the relative weight of state taxes. Federal tax collections are tabulated on the basis of states in which they were paid, which in some cases does not conform to liability for state taxes. Moreover, since federal tax collection statistics combine the individual income tax with the OASI employment taxes, the amount of federal income tax collections had to be estimated. This was done by applying the national ratio of income tax collections to combined income and payroll tax collections for the particular year to the combined collections reported for each state. As a result, federal collections in the less industrialized states are probably somewhat understated.[12]

[12] However, a state-by-state comparison of state tax collections with federal tax liabilities reported on unaudited income tax returns (as reported in *Statistics of Income*) does not provide too much support for this generalization.

TABLE 3

Individual Income Tax: State Collections as Percentage of Federal Collections, 1953–58

STATE	FISCAL YEARS ENDING IN 1953	1954	1955	1956	1957	1958	1953–1958
Alabama[a]	5.2%	4.9	5.6	7.7[c]	8.0	7.8	6.7
Arizona[a]	6.6	7.6	7.9	10.1	9.0	6.5	7.9
Arkansas	4.0	4.1	4.7	4.8	4.7	6.3	4.8
California	3.3	3.4	4.0	4.1	4.1	4.3	3.9
Colorado	3.6	3.8	4.7[c]	4.6	4.9	4.9	4.5
Delaware	1.5	5.3[c]	6.1	6.7	6.2	9.0	5.8
Georgia	4.2	4.0	4.9	6.3	6.6	6.7	5.5
Idaho	9.3	7.8	8.5	12.9[c]	12.1	13.8	10.9
Iowa	6.0	6.7	7.2	7.9	8.5	8.3	7.5
Kansas	4.4	4.6	5.4	5.0	4.9	5.4	4.9
Kentucky	8.4	8.6	14.8[c]	11.8	16.3	17.1	13.0
Louisiana[a]	4.6	4.2	4.8	5.6	5.9	5.8	5.2
Maryland[b]	2.8	3.3	3.8	7.1[c]	7.3	7.8	5.3
Massachusetts	7.9	7.5	8.5	10.7	10.2	10.0	9.2
Minnesota	10.0	10.5	11.8	11.9	11.5	12.7	11.4
Mississippi	6.2	6.0	4.6	4.6	5.6	5.9	5.5
Missouri[a]	1.9	2.0	2.3	2.7	2.8	3.1	2.5
Montana	6.3	6.6	7.2	9.7[c]	8.9	11.0	8.4
New Hampshire[d]	1.8	1.8	2.0	1.9	1.8	1.8	1.8
New Mexico[a]	3.6	3.9	4.3	4.8	4.8	4.9	4.4
New York	6.8	6.9	7.4	6.1	8.1	8.7	7.7
North Carolina	11.1	11.6	12.5	12.9	13.2	13.8	12.6
North Dakota	6.9	5.8	6.2	6.0	6.1	6.1	6.2
Oklahoma	3.2	3.4	3.8	4.2	4.0	4.2	3.8
Oregon	15.3	15.5	16.5	23.5[e]	29.4	28.7[e]	21.7
South Carolina	9.0	9.4	9.7	10.9	10.8	11.2	10.2
Tennessee[d]	1.2	1.2	1.3	1.3	1.3	1.4	1.3
Utah	6.4	6.9	8.0	9.1	9.7	11.1	8.7
Vermont	15.0	14.1	15.3	20.9	20.6	21.6	18.1
Virginia	9.3	10.8	12.1	11.4	24.3[f]	14.0	14.0
Wisconsin	11.4	12.5	13.8	16.0	16.7	17.4	14.8
Total (31 states)	5.7	6.0	6.6	7.6	8.0	8.1	7.1
Total (U.S.)	3.2	3.3	3.7	4.2	4.3	4.5	3.9

Caution: These data are subject to important limitations and the reader is urged to consider the qualifications noted in the accompanying text in interpreting them.

SOURCE: Federal collections from Annual *Report*(s) *of the Commissioner of Internal Revenue*. State collections from Bureau of the Census, *State Tax Collections*.

[a] Since reported state income tax collections include both the individual and corporate tax, the computation is based on state and federal collections from both taxes.

[b] Includes District of Columbia.

[c] Includes more than one year's liabilities incident to the introduction of withholding.

[d] The state tax is limited to interest and dividends.

[e] Reflects increases in the rate of withholding.

[f] Includes more than one year's liabilities resulting from advancement of tax due dates.

TABLE 4

Individual Income Tax: State Collections as a Percentage of Federal Collections, 1953 and 1958

FREQUENCY DISTRIBUTION

Under 5 Per Cent		*5 Per Cent to 10 Per Cent*		*10 Per Cent to 15 Per Cent*		*15 Per Cent and Over*	
			1953				
Arkansas	4.0	Alabama[a]	5.2	Minnesota	10.0	Oregon	15.3
California	3.3	Arizona[a]	6.6	North Carolina	11.1	Vermont	15.0
Colorado	3.6	Idaho	9.3	Wisconsin	11.4		
Delaware	1.5	Iowa	6.0				
Georgia	4.2	Kentucky	8.4				
Kansas	4.4	Massachusetts	7.9				
Louisiana[a]	4.6	Mississippi	6.2				
Maryland[b]	3.7	Montana	6.3				
Missouri[a]	1.9	New York	6.8				
New Hampshire	1.8	North Dakota	6.9				
New Mexico[a]	3.6	South Carolina	9.0				
Oklahoma	3.2	Utah	6.4				
Tennessee	1.2	Virginia	9.3				
13		13		3		2	
			1958				
California	4.3	Alabama[a]	7.8	Idaho	13.8	Kentucky	17.1
Colorado	4.9	Arizona[a]	6.5	Massachusetts	10.0	Oregon	28.7
Missouri[a]	3.1	Arkansas	6.3	Minnesota	12.7	Vermont	21.6
New Hampshire	1.8	Delaware	9.0	Montana	11.0	Virginia	14.0
New Mexico[a]	4.9	Georgia	6.7	North Carolina	13.8	Wisconsin	17.4
Oklahoma	4.2	Iowa	8.3	South Carolina	11.2		
Tennessee	1.4	Kansas	5.4	Utah	11.1		
		Louisiana[a]	5.8				
		Maryland[b]	7.8				
		Mississippi	5.9				
		New York	8.7				
		North Dakota	6.1				
7		12		7		5	

Caution: These data are subject to important limitations and the reader is urged to consider the qualifications noted in the accompanying text in interpreting them.

SOURCE: Federal collections from Annual *Report*(s) *of the Commissioner of Internal Revenue*. State collections from Bureau of the Census, *State Tax Collections*.

[a] Since state income tax collections include both the individual and corporate tax, the computation is based on state and federal collections from both taxes.

[b] Includes District of Columbia.

Despite these limitations, the computed percentage relationships between state and federal income tax collections demonstrate a striking variation in the relative weight of state income taxes, explained largely by differences in tax rates and personal exemptions. Two-thirds of the states with relatively low state collections allow the federal tax as a deduction for state income tax purposes. This, however, is only a partial explanation of the variation in the productivity of state income taxes since about the same proportion of relatively high-yield state taxes also allow this deduction.

These statistics illuminate the divergence in state attitudes toward the personal income tax as a source of state revenue. Seventeen states choose not to use the income tax and have held to this view even in the last twenty years, when the pressure for revenue was great; two choose to tax only income from intangibles; the remaining 29 states employ broadly based taxes but employ them with varying degrees of intensity, ranging from about 3 per cent of federal tax liabilities in Missouri to over 25 per cent in Oregon. (The yield of the New Hampshire and Tennessee taxes restricted to income from intangibles is less than 2 per cent of federal collections.)

This divergence in state attitudes toward income taxation, quite apart from the States' desire to preserve freedom of action with respect to the structure of their respective income taxes, makes impracticable some frequently proposed devices for federal-state income tax coordination.

It has been suggested, for example, that the federal government share a part of its individual income tax revenue with the states in return for the states discontinuing their own income taxes. Such an arrangement would necessarily have to be voluntary on the part of all the 31 states since, in the absence of a constitutional amendment, it could not be forced upon states and would probably be workable only if elected by all the states. It follows that the sharing would have to be on a scale adequate to reimburse the state which currently is making the most intensive use of this tax. Oregon, for example, with individual income tax collections approximating one-quarter of federal collections could not be expected voluntarily to surrender its own tax for substantially less than a corresponding proportion of federal income tax collections reported from that state. Since practical political considerations would probably prescribe uniform sharing with all the states,[13] it would require (at current federal collection levels) an additional federal tax levy of the general magnitude of $10 billion to finance this coordination device. In other words, the federal government would have to distribute to the states, on the average, about $6 for every $1 of their own tax they abandoned. This is the general magnitude of the federal cost of a sharing basis adequate to

[13] Uniform treatment of all the states is assumed to be one of the essential differences between a shared tax and a grant-in-aid. In an exchange of state income taxes for a federal grant, it would, of course, be possible to relate the amount of the grants to the income tax revenues abandoned by the individual states.

compensate fully every state for giving up its own individual income tax. Inevitably most states would receive windfalls, relatively the largest accruing to those which now impose no income taxes or employ them at relatively very low effective tax rates. The largest windfalls would accrue to the older industrial states without individual income taxes.

Another coordination device occasionally suggested for possible use in the individual income tax area is the tax supplement. It involves the states imposing their taxes on the federal income tax base and the federal government collecting them at the time it collects its own tax. Each state would be free to determine its own tax rate, expressed preferably as a percentage of the federal tax liability. The tax supplement technique has had some acceptance in the joint collection of state and local sales taxes, pioneered by Mississippi in 1950 and now in widespread use in California and Illinois, and to a lesser degree, in New Mexico. The supplement differs from the use of an identical tax base by two independent taxing jurisdictions discussed below only in that the tax supplement involves one jurisdiction collecting the taxes of both.

The applicability of the tax supplement to income taxation presents difficulties quite apart from the reluctance of the states to surrender the privilege of administering their own taxes. The federal taxpayer can file his tax return and pay his taxes either at his place of residence or his place of business. Whatever place he chooses, his tax return must cover all his income wherever derived—in the state of filing, in any of the other 48 states or in a foreign country. States generally follow a similar rule; their residents are taxable on all their income, from whatever geographic source. In the case of nonresidents, however, states limit their jurisdiction to income originating within their own borders. Use of the tax supplement for collecting state income taxes from nonresidents would pose problems, because federal administrative agencies would be reluctant to undertake the determinations necessary to differentiate between income derived within and without a state on the basis of varying state rules. For this reason the tax supplement device would probably be practicable only if the states abandoned the taxation of nonresidents.[14]

The tax supplement is closely akin to the utilization of similar tax bases and methods of tax computation by two or more independent

[14] Assuming univeral state income taxation, this would leave the total income subject to state taxation unchanged, but would alter its distribution among the states.

taxing jurisdictions. An advanced form of this coordination has been proposed in New York. It contemplates the state utilizing the federal provisions governing the definition of taxable income, subject only to such adjustments as the state legislature prescribes. New York's corporation franchise tax has long been geared to the federal tax base.[15]

Use of the federal tax base for state tax purposes can take several forms depending upon the degree of coordination and simplification desired. In its most complete form, the state tax is simply expressed as a percentage of the federal liability. The outstanding example is the territorial income tax of Alaska imposed at 14 per cent of federal tax liability. In this way Federal Revenue Code revisions affecting tax liability were automatically applicable for purposes of the Alaskan tax. Questions of constitutionality may be involved since it can be interpreted as a delegation of state legislative powers to the Congress. New Mexico avoided the constitutional question by making the use of this device optional. Between 1953 and 1955 it gave its taxpayers (with adjusted gross incomes under $10,000) a choice between 4 per cent of Federal tax liability and liability computed under New Mexico's own tax law.

A second possibility is for the state to utilize the federal definition of taxable net income under current law, to which its own independently determined tax rates apply. Alternatively, the state may employ the federal definition of taxable income as of a certain date, disregarding subsequent changes in the Federal Code.

State use of federal definitions of taxable income is not untried. Between 1953 and 1955 Utah's taxpayers with adjusted gross income under $5,000 were permitted to compute their taxes either on the basis of the Utah statute or on the basis of federal taxable income reduced by the amount of federal income tax paid. Currently, Vermont taxpayers have the option to employ definitions under the Federal Revenue Code in effect on April 26, 1957. Kentucky permits its taxpayers to compute their tax on the basis of the Federal Code in effect on January 1, 1956. Iowa bases its tax on the 1954 Code as enacted (disregarding subsequent amendments). Specifically it defines net income for Iowa state purposes as adjusted gross income under the 1954 Code (plus interest from municipal bonds and Iowa income taxes deducted on the federal tax return, and minus interest and dividends from federal securities).

[15] Peter Miller, "Proposal for a Federally Based New York Personal Income Tax," *Tax Law Review*, January 1958, pp. 183–209.

Adoption of federal definitions of the tax base for purposes of the states' taxes would simplify the preparation of tax returns and state enforcement of the tax laws. Presumably it would involve some loss of revenue to the states since their own statutes do not generally provide as many exceptions to the general rule (for the benefit of selected groups of taxpayers) as does the Federal Code. This revenue loss could possibly be more than offset, however, by the increased revenue the states could derive by capitalizing on the results of the more effective federal tax enforcement.

In the interest of completeness, mention should be made of the widespread and growing practice of state legislatures to adopt Federal Code provisions pertaining to one or more details in the computation of tax liability for purposes of their own taxes. Capital gains and losses and loss carryover provisions are examples.

In terms of national aggregates and in relation to federal tax magnitudes, state income taxes would appear to have substantial potential for expansion. The deductibility of state taxes for federal income tax purposes contributes to this potential, since it shifts a part of the increased state tax burdens from the taxpayer to the federal government. In effect, the federal treasury absorbs a share of the burden of any increase in the state tax (of a taxpayer who itemizes deductions) corresponding to the marginal federal tax rate applicable to the taxpayer in the absence of the increased deduction. An extreme example of this approach was rejected by the California electorate in November 1958.[16] The threat of driving residents and their activities to other low income tax states effectively inhibits movement in this direction, although experience appears to lend little credence to the argument that variations in tax rates significantly influence decisions concerning the location of industries.

C. CORPORATION INCOME TAX

The corporate income tax generally occupies a prominent place in the list of overlapping taxes but has not figured prominently among coordination proposals. It has on occasions been singled out for such proposed arrangements as revenue sharing but few appear to regard it a pressing problem.

Corporate net income is now taxed in 34 states and the District of

[16] Proposed constitutional amendment (Proposition 17) which would have reduced the sales tax and the lower range income tax rates and substantially increased tax rates in the higher income ranges.

TABLE 5

State Corporation Income Tax Rates

1. FLAT RATE TAXES

Under 2 Per Cent	2 Per Cent	3 Per Cent	4 Per Cent	5 Per Cent	6 Per Cent	Other
New Jersey, 1.75%	Iowa	Alabama	California	Colorado	North Carolina	Idaho, 8%
	Missouri	Kansas, 3.75%	Georgia	Delaware	Oregon	Minnesota, 7.3%
	New Mexico	Connecticut, 3.75%	Louisiana	District of Columbia	Pennsylvania	
		Tennessee, 3.75%	Oklahoma	Maryland	Massachusetts, 6.765%	
			Utah	Montana		
				South Carolina		
				Vermont		
				Virginia		
				New York, 5.5%		
				Rhode Island, 5.5%		

2. GRADUATED RATES

State	Rates	Number of Brackets	Maximum Rate Applies Over
Arizona	1%–5%	7	$ 6,000
Arkansas	1%–5%	5	25,000
Kentucky	5%–7%	2	25,000
Mississippi	2%–6%	5	25,000
North Dakota	3%–6%	4	15,000
Wisconsin	2%–7%	7	6,000

Columbia and produces about $1 billion annually for the states. This represents about 6.6 per cent of state tax collections and less than 4 per cent of combined state and local tax collections. It is equivalent to about two-thirds of the revenues the states derive from individual income taxes.

Most (31) of the state corporate income taxes predate World War II; nearly half of them (15) came into existence during the depressed 1930's; only 2 states (Delaware and New Jersey) joined the ranks during the present decade, both in 1958. Recent years have witnessed, however, extensive legislative activity in states with established corporate income taxes to increase revenues, frequently through rate increases.

The rate structure of the states' corporate taxes are summarized in Table 5 above. Most states (28) and the District of Columbia employ flat rates; six impose graduated rates. The flat-rate state taxes range from 1.75 per cent in New Jersey and 2 per cent in Iowa, Missouri, and New Mexico, to 8 per cent in Idaho. Five per cent rates are most frequent. Of the six graduated rate structures, Kentucky uses only two brackets and differentiates, as the federal government, at $25,000 of net income. Arkansas and Mississippi employ five brackets in their rate structure, the maximum rate applying to the excess over $25,000. Arizona and Wisconsin employ seven brackets and North Dakota four (Table 5).

In relation to the federal tax, the weight of the overlapping state taxes is moderate. In the 32 states which taxed corporate income during the six years, 1953–58, state revenues averaged about 6.9 per cent of federal corporate income tax collections and in the aggregate now equal about 2 1/2 percentage points of the federal tax rate. The net cost of state taxes to corporations, allowing for the deductibility of state taxes for federal tax purposes, was of the general magnitude of about 1 1/2 percentage points of the federal tax rate. This is one measure of the extent to which state corporate income taxes overlap the federal tax (Table 6).

On the basis of federal tax returns filed in 1955–56, the states with corporate income taxes accounted for 66 per cent of all corporations filing federal income tax returns, for 61 per cent of these corporations' reported net income and for 60 per cent of their federal income tax liability. The two new state taxes enacted in 1958 raise these respective percentages by about five points. About 28 per cent of corporations with net income, accounting for one-third of all corporate net income and federal tax liability, have their main offices in one of the fourteen states without a corporate net income tax. Some of these corporations, however, pay income taxes in one or more additional states since they derive income from them.

The obstacles to replacing the 34 state corporation income taxes with a share of the federal government's collections from this source are akin to those discussed above with reference to the individual income tax, but are here found in a more exaggerated form. They

TABLE 6
Federal and State Corporation Income Tax Collections, Fiscal Years 1953–58 (in millions)

YEAR	FEDERAL	STATE AND LOCAL *Amount*	STATE AND LOCAL *Percentage of Federal*
1953	$21,238	$817	3.85
1954	21,101	778	3.69
1955	17,861	744	4.17
1956	20,880	890	4.26
1957	21,167	984	4.65
1958	20,074	981	4.89

SOURCE: Bureau of the Census, *Summary of Government Finances*. The 1956–58 totals exclude local collections which averaged $7 million in the earlier years.

stem from the uneven use the states make of this tax. Fourteen do not tax corporate net income. The other 34 states have relatively similar tax structures and employ tax rates of the same general magnitude (largely concentrated within the 4 per cent to 6 per cent rate range) but the revenue produced varies widely both in relation to the states' total tax revenues and more particularly in relation to federal revenues. In 1958 the corporate income tax supplied 17.2 per cent of New York's but only 1.3 per cent of Iowa's tax collections.

The evaluation of the relative weight of the states' corporate income taxes in terms of the federal tax presents even more difficulties than in the individual income tax area (Tables 7 and 8). The tabulation of federal collections by states is based on federal returns filed and taxes collected. Corporations typically file a single federal tax return at their headquarters or principal place of business, although a substantial number of them derive income in more than one state. Because their main offices are generally in urban industrial areas,

TABLE 7

Corporation Income Tax: State Collections as a Percentage of Federal Collections, Fiscal Years 1953–58

STATE	FISCAL YEARS 1953	1954	1955	1956	1957	1958	1953–58
Alabama[a]	5.5	5.3	6.0	7.9	8.3	7.8	6.9
Arizona[a]	6.6	7.6	7.9	10.1	9.0	6.5	7.9
Arkansas	22.5	23.7	22.8	24.5	31.4	31.6	25.8
California	10.3	10.4	12.4	12.6	13.1	14.6	12.2
Colorado	4.2	4.7	5.3	4.8	3.4	8.9	5.2
Connecticut	5.2	6.0	7.5	8.6	8.9	9.3	7.5
Georgia	7.5	7.2	7.2	10.7	11.5	10.5	9.2
Idaho	14.0	14.2	11.1	16.2	20.4	18.6	15.5
Iowa	1.6	1.9	1.8	2.3	2.9	2.4	2.2
Kansas	2.1	2.7	3.0	3.4	3.8	5.2	3.3
Kentucky	6.3	5.5	7.9	7.7	10.5	11.4	8.2
Louisiana[a]	4.6	4.2	4.8	5.6	5.9	5.8	5.2
Maryland[b]	8.5	7.2	8.9	11.5	10.3	11.8	9.6
Massachusetts[c]	4.5	5.1	5.3	5.4	5.8	6.2	5.4
Minnesota	5.4	4.7	5.8	6.5	6.6	8.3	6.2
Mississippi	33.9	45.4	49.2	41.1	46.5	48.0	43.8
Missouri[a]	1.9	2.0	2.3	2.7	2.8	3.1	2.5
Montana	6.9	8.6	7.1	12.8	10.2	10.3	9.4
New Mexico[a]	3.6	3.9	4.3	4.8	4.8	4.9	4.4
New York	4.4	4.0	4.5	4.2	4.6	4.9	4.4
North Carolina	14.3	14.8	16.1	16.3	16.1	16.8	15.8
North Dakota	11.6	12.3	12.3	15.2	14.7	13.1	13.2
Oklahoma	4.6	4.7	5.2	5.4	5.6	6.1	5.3
Oregon	18.7	19.0	19.2	17.0	22.8	35.3	21.5
Pennsylvania	9.4	7.7	8.4	9.3	11.5	10.1	9.4
Rhode Island	8.7	9.0	9.8	11.3	10.7	11.7	10.1
South Carolina	18.5	19.3	17.8	24.2	24.5	23.1	21.2
Tennessee	12.4	13.6	13.6	11.2	14.3	14.9	13.3
Utah	8.3	11.4	7.0	9.2	19.9	13.8	11.8
Vermont	11.2	9.2	11.0	14.7	15.9	18.1	12.7
Virginia	9.2	11.5	12.4	13.0	11.7	11.5	11.5
Wisconsin	10.4	11.8	12.7	12.9	13.2	13.5	12.3
Total 32 States	6.3	6.0	6.7	7.1	7.6	7.9	6.9
Total (U.S.)	3.9	3.8	4.2	4.4	4.9	5.1	4.4

Caution: These data are subject to important limitations and the reader is urged to consider the qualifications noted in the accompanying text in interpreting them.

SOURCE: Federal collections from Annual *Report*(s) *of the Commissioner of Internal Revenue*. State collections from Bureau of the Census, *State Tax Collections*.

[a] Since the state income tax collections include both the individual and the corporate tax, the computation is based on combined federal and state collections from both taxes.

[b] Includes District of Columbia.

[c] State collections do not include corporation excise taxes and surtaxes measured in part by net income and in part by corporate excess, which are classified as licenses.

TABLE 8

Corporation Income Tax: State Collections as a Percentage of Federal Collections, Fiscal Years, 1953–58

FREQUENCY DISTRIBUTION							
Under 5 Per Cent		*5 Per Cent to 10 Per Cent*		*10 Per Cent to 15 Per Cent*		*15 Per Cent and Over*	
Iowa	2.2	Alabama[a]	6.9	California	12.2	Arkansas	25.8
Kansas	3.3	Arizona[a]	7.9	North Dakota	13.2	Idaho	15.5
Missouri[a]	2.5	Colorado	5.2	Rhode Island	10.1	Mississippi	43.8
New Mexico[a]	4.4	Connecticut	7.5	Tennessee	13.3	North Carolina	15.8
New York	4.4	Georgia	9.2	Utah	11.8	Oregon	21.5
		Kentucky	8.2	Vermont	12.7	South Carolina	21.2
		Louisiana[a]	5.2	Virginia	11.5		
		Maryland[c]	9.6	Wisconsin	12.3		
		Massachusetts[b]	5.4				
		Minnesota	6.2				
		Montana	9.4				
		Oklahoma	5.3				
		Pennsylvania	9.4				
Number of states	5		13		8		6

Caution: These data are subject to important limitations and the reader is urged to consider the qualifications noted in the accompanying text in interpreting them.

SOURCE: Federal collections from Annual *Report*(s) *of the Commissioner of Internal Revenue*. State collections from Bureau of the Census, *State Tax Collections*.

[a] Since state income tax collections include both the individual and the corporate tax, the computation is based on federal and state collections from both taxes.

[b] State collections do not include corporation excise taxes and surtaxes measured in part by net income and in part by corporate excess, which are classified as licenses.

[c] Includes District of Columbia.

federal tax collection statistics understate the contribution of the nonindustrial and noncommercial states.

Since the states invariably tax all income derived within their borders, the less industrialized jurisdictions generally derive a large share of their corporate tax revenue from nonresident corporations which pay their federal taxes in another state. In consequence, the ratio of state to federal collections generally exaggerates the relative weight of state taxes in rural sections, and undervalues it in industrialized states. As Table 7 indicates, the ratio of state to federal collections (1958) is highest in Mississippi (48 per cent) where the corporate tax structure is not materially different from that of the other states. It will be noted that its ratio of state to federal collections has been consistently high over the years. This suggests that a large share of Mississippi's tax revenue is attributable to corporations which file their federal returns outside the state. This explanation may apply also to Arkansas. In Oregon, on the other hand, the high percentage (35.3 per cent) may in part be explained by high rates.

While the ratio of state to federal corporation income tax collections is not a meaningful measure of the absolute weight of a state's tax, it is indicative of the relative weight of the tax in comparable states. The existence of wide interstate variations is compelling with regard to the proposal that the states exchange their taxes for a share of federal corporate income tax revenues. During 1953–58, it would have required about 40 per cent of federal collections in Mississippi to compensate that state for giving up its own corporate tax. A sharing on this scale with all of the states would have produced large windfalls for all other states and entailed a vast cost to the federal treasury.

A noteworthy feature of federal-state corporate tax relations is the growing reliance of the states on the tax base computed for federal income tax purposes. Significantly, all three state taxes enacted since World War II (Rhode Island in 1947, Delaware and New Jersey in 1958) base their own tax on income computed for federal tax purposes. This is the practice in seven other states as well. The adjustments made in the federal tax base are relatively few. Each of the states requires that state income taxes excluded from the federal base be added back and that interest on federal obligations included for federal purposes be subtracted. Only two of the ten states (Iowa and Kentucky) which employ the federal tax base allow the federal income tax as a deduction. In fifteen of the remaining twenty-four states the deductibility of the federal income tax reduces the base of the state corporate income tax by nearly half. The states' reliance on federal definitions of taxable income, coupled with some standardization of rules for allocating multistate income among the participating states, has appreciably eased the compliance burdens of corporate taxpayers.[17]

D. ESTATE AND INHERITANCE TAXES[18]

A major performer on the stage of intergovernmental tax relations is the tax on the transfer of property at death. The taxation of such property transfers either to the estate or to the heirs of the decedent has a long history, as do the efforts to bring order into federal-state relationships in this tax area.

[17] Recent developments in the allocation of multistate income among the states merit more than passing reference but fall outside the scope of a paper concerned with federal-state relations.

[18] The gift tax, an integral part of the federal property transfer tax system, is not treated here. Twelve states now have gift taxes which collectively produced less than $7 million in 1958.

Inheritance and estate taxes are typically state, as distinguished from local levies, although a number of states share some of these revenues with local governments. Over the years, largely as a result of rising property values, the annual yield of this state tax source has risen. Collections aggregated $344 million in 1958 and $340 million in 1957, compared with $168 million in 1950 and $244 million in 1955. These totals include state imposed taxes retained by local jurisdictions in ten states (about $10 million in 1957).

In most of the states the institution of a tax on transfers of property at death was well established when, in 1916, the Congress enacted what proved to be a permanent estate tax. Similar impositions (1798 to 1802; 1861 to 1870; 1898 to 1902) associated with earlier national crises were retained only temporarily.

Objections to the entry of the federal government into a tax area pre-empted by the states and a simultaneous concern for the survival of state taxes in the face of overt interstate tax competition for wealthy residents stimulated the invention in 1924 of the credit against the federal estate tax for inheritance and estate taxes paid to the states. At first the credit was limited to 25 per cent of federal tax liability but in 1926 was raised to 80 per cent. This enabled the states, through appropriate legislation, to have in effect death taxes as high as 80 per cent of federal tax liability without adding to the net tax burden of their taxpayers. Within this limit state taxes merely pre-empted revenues which otherwise would be payable to the federal government. The credit provision was interpreted by many as congressional consent to share with the states the revenue yield of death taxes approximately in the ratio of 20 per cent federal and 80 per cent state.

Subsequent federal tax developments altered this relationship. In successive efforts to increase federal revenues the estate tax exemption was reduced (1932, 1935, 1942) and tax rates increased (1932, 1934, 1935, 1941), while the amount of credit remained geared to liabilities under the 1926 Act. This reduced the ratio of the state credit to federal tax liability in proportion to the increase in the latter.[19] Today the relative importance of the credit is least in the brackets where the post-1926 increases in tax liability were greatest; it is relatively largest where the increase in federal tax has been relatively

[19] The adoption by the federal government of the marital deduction in 1948 left the relationship of the maximum credit to federal tax liability unchanged, but reduced its dollar value by reducing the size of the taxable estate which determines the size of the credit.

TABLE 9

Credit for State Death Taxes as a Percentage of Federal Estate Tax Liability, Returns Filed During 1957
(amounts and size classes in thousands)

Net Estate before Specific Exemption Classes	*Credit for State Taxes*	*Federal Estate Tax Liability before State Credit*[a]	*Credit as Percentage of Federal Liability*
Taxable Returns:			
60–80	–	4,296	–
80–100	–	16,890	–
100–150	439	68,406	0.6
150–200	2,428	71,393	3.4
200–300	5,815	120,570	4.8
300–400	5,891	88,452	6.7
400–500	5,633	72,617	7.8
500–600	5,056	58,906	8.6
600–700	4,543	49,514	9.2
700–800	3,596	36,815	9.8
800–900	4,002	38,902	10.3
900–1,000	3,115	28,621	10.9
1,000–2,000	25,377	200,395	12.7
2,000–3,000	13,521	94,233	14.3
3,000–4,000	7,758	50,809	15.3
4,000–5,000	7,542	49,147	15.3
5,000–7,000	10,325	62,196	16.6
7,000–10,000	7,153	37,620	19.0
10,000–20,000	11,932	62,811	19.0
20,000 or more	22,643	110,824	20.4
Total taxable returns	146,769	1,323,417	11.1

SOURCE: Internal Revenue Service, *Statistics of Income, 1956.*
[a] Before state but after other tax credits.

smallest. The state credit varies from zero on net estates below $100,000 and from less than 1 per cent of gross federal tax liability on net estates between $100,000 and $150,000, to 20 per cent on net estates above $20 million (Table 9).

In fiscal year 1957, the credit allowed for death taxes paid to states aggregated about $147 million, or approximately 11 per cent of federal estate tax liability (before the state credits). An approximately 10 per cent relationship between the credit for state taxes and federal tax liability has prevailed for more than a dozen years, a period of stability in federal estate tax rates. For several years preceding 1932, the credit approximated 75 per cent of federal tax liability (Table 10).

As a result of the dissatisfaction of the states with their reduced share of this revenue, the terms of federal-state relations in the death

TABLE 10
Federal Estate Tax Liability and State Credit, for Returns Filed During 1929–57
(dollar amounts in thousands)

YEAR	FEDERAL ESTATE TAX LIABILITY BEFORE STATE DEATH TAX CREDIT[a]	STATE DEATH TAX CREDIT: *Amount*	STATE DEATH TAX CREDIT: *Percentage of Federal Tax Liability before Credit*
1929	$165,414	$122,110	73.8
1930	152,391	113,388	74.4
1931	182,202	137,663	75.6
1932	84,006	61,642	73.4
1933	87,725	28,295	32.3
1934	129,053	33,769	26.2
1935	197,664	43,864	22.2
1936	239,486	44,218	18.5
1937	364,018	58,252	16.0
1938	374,230	59,842	16.0
1939	329,202	53,111	16.1
1940	295,654	45,337	15.3
1941	345,342	53,636	15.5
1942	353,933	45,626	12.9
1943	398,120	35,966	9.0
1944	450,888	46,285	10.3
1945	595,562	64,517	10.8
1946	n.a.	n.a.	n.a.
1947	691,817	69,850	10.1
1948	797,432	82,725	10.4
1949	633,250	65,831	10.4
1950	532,459	48,940	9.2
1951	641,935	64,535	10.1
1952	n.a.	n.a.	n.a.
1953	n.a.	n.a.	n.a.
1954	864,346	85,842	9.9
1955	864,591	86,249	10.0
1956	n.a.	n.a.	n.a.
1957	1,323,479	146,769	11.1

SOURCE: Internal Revenue Service, *Statistics of Income.*
[a] After other credits.
n.a. = not available.

tax area have been reviewed with much frequency, if not regularity. Resolutions on the subject have become a standard feature of gatherings of state officials. The inheritance-estate taxes have become a symbol of the need for federal-state tax coordination entirely out of proportion to the contribution—less than 2 per cent—they make to the revenues of all governments in the United States.

In fiscal year 1957 about 40 per cent of the $340 million collected by state and local governments from inheritance and estate taxes was offset as a credit against federal tax; the remaining 60 per cent did not qualify for the credit. These are national averages and submerge wide interstate differences. In the five states where the state tax is limited to and determined by the maximum credit allowed under present federal law, about 100 per cent of the state tax qualifies by definition for the credit. In the remaining states this percentage falls below 100 per cent, depending upon the degree to which the state-imposed tax exceeds the allowable credit. In some states, only about a fourth (possibly even less) of the state tax appears to be offset by a credit against the federal tax. In these cases state-imposed taxes are, on the average, about four times as large as the maximum credit allowed under federal law.

To increase their revenues from this source, states have lowered exemptions, imposed taxes on small estates exempt from federal tax or ineligible for a credit, and raised their tax rates in excess of the maximum credit. The resulting structure is characterized by much diversity. Several types of death taxes are in use. The simplest of these are the five estate taxes (Alabama, Arizona, Arkansas, Florida, and Georgia) which correspond precisely to 80 per cent of tax liability under the 1926 federal law. Two other states (Mississippi and New York) also have estate taxes which are patterned on the 1926 federal law but depart from it in significant detail. Mississippi retains tax rates corresponding to 80 per cent of the 1926 federal rates, but uses a $60,000 (in lieu of a $100,000) exemption. It imposes also a temporary surtax equal to 14 per cent of liability under its permanent tax. New York's rates are 25 per cent in excess of the allowable credit. Its exemption varies with the relationship of the heirs to the decedent and is deductible from the first taxable bracket. Five other states (North Dakota, Oklahoma, Oregon, Rhode Island, and Utah) also have estate taxes but their rate and exemption structures bear no resemblance to federal law (Table 11).

Three-fourths of the states (37) employ inheritance taxes with diverse rates and exemptions, but all except two of these (Oregon and West Virginia) also have "pick-up" estate taxes which absorb any part of the allowable credit left unused by the inheritance tax. Oregon supplements its inheritance tax with an independent estate

TABLE 11

Types of State Death Taxes

State	*Inheritance Tax*	*Estate Tax Based on Federal Levy (1926)*	*Independent Estate Tax*	*Differential Estate Tax*
Alabama		X		
Arizona		X		X
Arkansas		X		
California	X			X
Colorado	X			X
Connecticut	X			X
Delaware	X			X
Dist. of Col.	X			X
Florida		X		
Georgia		X		
Idaho	X			X
Illinois	X			X
Indiana	X			X
Iowa	X			X
Kansas	X			X
Kentucky	X			X
Louisiana	X			X
Maine	X			X
Maryland	X			X
Massachusetts	X			X
Michigan	X			X
Minnesota	X			X
Mississippi		X		
Missouri	X			X
Montana	X			X
Nebraska	X			X
Nevada	–	–	–	–
New Hampshire	X			X
New Jersey	X			X
New Mexico	X			X
New York		X		X
North Carolina	X			X
North Dakota			X	
Ohio	X			X
Oklahoma			X	X
Oregon	X		X	
Pennsylvania	X			X
Rhode Island	X		X	X
South Carolina	X			X
South Dakota	X			
Tennessee	X			X
Texas	X			X
Utah			X	
Vermont	X			X
Virginia	X			X
Washington	X			X
West Virginia	X			
Wisconsin	X			X
Wyoming	X			X
Total	38	7	5	38

tax and West Virginia's inheritance tax rates are so high that tax liability in almost all situations exceeds the maximum credit. There are important interstate variations also in the structural features of state death taxes, especially in deductions allowed in determining the net estate. A fourth of the states (13) for example, allow a marital deduction for property passing to the surviving spouse, and half allow the federal estate tax to be deducted in determining the amount of the taxable estate for state tax purposes.

Since the inheritance and estate tax affects relatively few taxpayers, it is a tax area which arouses relatively little public interest. Proposals for coordination and more particularly for increasing the states' share of revenues have emanated largely from state officials, scholars and tax practitioners. Some are concerned primarily with increasing the states' revenues; others with tax simplification for the benefit of taxpayers and tax administrators.

Coordination Proposals

The most frequent proposal for increasing the states' share of death tax revenues is to raise the credit allowed against federal tax liability for taxes paid to states. It is commonly supported by the argument that the Congress is obligated to honor the 1926 principle which earmarked approximately 80 per cent of this revenue for the states.

It is not generally understood that an increase in the credit would not automatically increase the revenues of the great majority of the states; that for many states it would be difficult to benefit from the higher credit and the net result would be federal tax reduction.

As noted above, state imposed death taxes generally exceed the maximum credit allowed against federal tax. In the five recent years for which data are available, the credit claimed on federal estate tax returns represented 34 per cent of state inheritance and estate tax collections. In other words, the average estate could claim only $1 of credit against federal tax for every $3 it paid in state taxes. This relationship, however, varies widely among the states (Table 12) reflecting interstate variations in tax burdens. It varies also between different size estates within any one state. It follows that an increase in the credit would, in the first instance, enable the estate to take a credit against federal tax for a larger share of taxes paid to the states than hitherto (even though the state tax remained unchanged). Net federal tax liability and federal revenues would be reduced but

TABLE 12

Credit for Inheritance and Estate Taxes Claimed on Federal Estate Tax Returns as a Percentage of State Estate and Inheritance Tax Collections for Five Fiscal Years, 1949–51 and 1954–55[a]

FREQUENCY DISTRIBUTION

Under 25 Per Cent		*25 Per Cent to 50 Per Cent*		*50 Per Cent to 75 Per Cent*		*Over 75 Per Cent*	
Colorado	16.3	California	32.1	Alabama	64.4	Arkansas	80.4
Idaho	16.1	Connecticut	37.8	Arizona	70.7	Florida	86.9
Indiana	17.1	Delaware	31.6	Georgia	73.4	Nebraska	159.3
Iowa	7.0	Illinois	45.6	New York	56.4	South Carolina	81.8
Kansas	24.9	Louisiana	33.8	Ohio	69.8		
Kentucky	15.9	Maryland	30.3	Texas	58.4		
Maine	14.6	Massachusetts	27.0				
Minnesota	20.6	Michigan	29.1				
Montana	9.4	Mississippi	40.9				
New Hampshire	21.4	Missouri	36.2				
North Dakota	18.5	New Jersey	27.1				
Oklahoma	21.0	New Mexico	26.9				
Oregon	17.1	North Carolina	25.4				
Pennsylvania	22.1	Rhode Island	44.3				
South Dakota	13.8	Virginia	49.9				
Tennessee	20.7	Wyoming	30.3				
Utah	7.7						
Vermont	23.6						
Washington	10.7						
West Virginia	12.6						
Wisconsin	17.8						
21		16		6		4	

SOURCE: Credits claimed from Internal Revenue Service, *Statistics of Income*; State collections from Bureau of the Census, *State Tax Collections.*

[a] These percentages provide only an approximate indication of the share of state taxes claimed as credit on federal returns because they are based on unaudited federal returns. Audited returns would show a larger federal tax liability with a corresponding increase in the maximum limitation on the credit. On the other hand, however, these computations are based on state tax collections only (excluding local) and in ten states (notably in Nebraska, Ohio, Illinois, and North Dakota) a part of state taxes is retained by local jurisdictions and is not included in state revenues.

would not be offset by increased state liability. State tax liabilities and revenues would be increased only to the extent that the increased credit was accompanied by state tax increases. This poses difficulties except in the very few states whose present taxes are limited to the credit and include "pick-up" provisions which would operate automatically if the credit limitation were raised.

An increase in the federal credit for taxes paid to states could take several forms, depending upon the objective sought. It is possible, for example, to leave the credit tied to the 1926 federal rate and exemption structure and raise the 80 per cent limitation to 100 per cent or more of the federal tax liability calculated under that structure.

This could be accomplished by appropriate adjustment in the credit schedule which the Congress in 1954 converted into equivalents of the current federal estate tax rates (Section 2011). An increase in the credit limitation to 100 per cent of 1926 liabilities would, in each case, raise the credit by 25 per cent; an increase to 200 per cent of those liabilities would raise it by 150 per cent, etc. Such proportionate increases in the credit would perpetuate all current variations in the relationship of the credit to federal tax liability among estates of different size. In other words, it would continue to deny any credit to net estates under $100,000, and, in all other cases, would increase the credit in the same ratio. As a result, the relative importance of the credit to federal tax liability would continue to increase as the size of the estate increases. The handful of states whose present taxes are determined by and limited to the maximum credit, would automatically raise their own taxes to pick up the exact increase in the credit. All other states, whose taxes exceed the present credit, would be free to choose between passing all of the increased credit to the benefit of their taxpayers or adjusting their rate structure (possibly through a "pick-up" tax) with a view to retaining it for the benefit of state revenues. Because the details of state tax structures typically vary substantially from the structure of the federal estate tax, that objective could at best only be approximated, and would necessarily entail net tax reductions for some taxpayers and net tax increases for others.[20]

Another possibility is to leave the present credit unchanged and to supplement it with a second credit based on net federal tax liability under current law. The credit would in each instance be increased in proportion to federal tax liabilities. This not only would perpetuate the complexity inherent in the 1926 rate structure, but also would aggravate it by superimposing an additional, albeit relatively simple, credit computation. Since the difference between tax liabilities under the 1926 and the current federal tax structure is relatively largest at the lower end of the rate schedule, this would increase the credit for small estates relatively more than for large estates. States could appropriate the increased credit for the benefit of their tax collections by enacting an additional pick-up tax measured by an appropriate

[20] The credit is a function of federal tax liability and bears no uniform relationship to state tax liability. For this reason, it is not possible to adjust state tax rates so as to increase the tax liability of each estate by an amount exactly equal to the increase in the federal credit, unless each state enacted an additional pick-up tax measured (for each estate) by the excess of the new credit over the old.

percentage of net federal tax liabilities, with attendant further complexities.

A third alternative is to scrap the present credit entirely and replace it with one based on current federal tax liabilities. It would require a credit equal to 20 per cent of gross federal tax liability to double the revenue significance of the present credit. The relative increase in credit would be greatest for small estates and would decline gradually as the size of the estate increased. Since, however, federal tax liability varies both in relation to the 1926 credit and state tax burdens, some states would experience great difficulty in matching the increased federal credit with an increase in state liabilities. None could achieve it completely; only approach it approximately. This arrangement, however, would ease taxpayers' compliance and tax administration problems by displacing the present credit calculations which vary bracket by bracket, with one consisting of a constant percentage of federal tax liability.

Technically, it is possible also to vary a credit based on federal tax liability with the size of the taxable estate, or bracket by bracket. A proposal advanced years ago would have allowed a 100 per cent credit up to $100,000 of taxable estate and 20 per cent on the balance. Such variations would add to the complexity of the credit computation and, depending upon the extent of the differentiation, would affect the relative importance of the credit for different size estates.

A favorite proposal of some state officials is that the federal government surrender the estate tax field for the exclusive use of the states. They support it on the grounds that the transfer of property at death is a privilege controlled by state law, that states provide for the administration of estates and were first to develop estate taxes, and that they have a relatively greater need for revenue than the federal government. The opponents point out that private wealth is derived, for the most part, through interstate commerce fostered by national programs and policies, that a transfer tax limited to the state of domicile of the decedent or the situs of the property would discriminate against other states which contributed to the creation of wealth, and that State taxation alone would enable the wealthy industrial states to monopolize an unduly large share of the revenue. It is feared also that if the tax were reserved for the states, their revenue take would only be temporary because competitive tax reductions would soon be revived.

Advocates of tax simplification suggest the reverse of the above proposal: that the states surrender this tax area to the federal government in return for an appropriate share of federal collections. They point to the multistate origin of family fortunes. This suggestion, however, elicits little sympathy from those who regard this to be historically a state tax.

Since the states currently obtain about $350 million of revenue from death taxes and desire to increase it substantially, they could be expected to be willing to give them up only on terms entailing a sizable net revenue cost to the federal treasury. Present state death tax revenues correspond to about 25 per cent of federal estate tax liabilities before credits for state taxes. In other words, they exceed the credits allowed by about $200 million a year. However, substantially more than 25 per cent of federal liabilities would be required to compensate the states for the revenue they would forego by abandoning their own levies, if distributions among the states were based on state of origin of federal collections.

States typically obtain a large part of their revenue from small estates which are either entirely exempt from federal tax or are subject to relatively low rates. While theoretically the federal tax take from this group of estates could be increased to replace state taxes, practical administrative considerations would militate against such a course. Moreover, since federal taxes are necessarily uniform in all 48 states, the substitution of a federal tax for the several state taxes would significantly alter the tax burdens on small estates. In those states which now limit their death tax to the credit allowed under federal law, any increase in federal tax would represent an increased tax burden; in the states with relatively very heavy state taxes, the substitution of an increased federal tax would not prevent some tax reductions.

A significant change in burdens would be an inescapable consequence of substituting a uniform federal tax for diverse state taxes, irrespective of whether an effort were made to recoup part of the federal cost by increasing federal tax rates. This would prevail even if federal revenues were distributed among the states in proportion to the states' own collections, rather than shared on the basis of the origin of federal collections.

Still another possibility is to divide the death tax area among the states and the federal government, giving the states exclusive tax jurisdiction over small and medium sized estates and the federal government over large estates. What is a "large estate" would presumably be determined by the amount of the revenue it is desired to leave with the federal government. If, for example, the federal government exempted from estate taxation all net estates below \$500,000 (but retained the present specific exemption for those above this level), net federal estate tax liabilities would be reduced by about \$315 million (at 1955 estate tax levels). If, in return, the federal government were relieved of the need to grant credits for taxes paid to states on returns subject to federal tax (above \$500,000, exempted from state taxes) net federal tax liabilities on those estates would be increased by \$70 million, resulting in a net revenue loss of approximately \$250 million. This is a measure of the initial cost to the federal treasury of a division at the \$500,000 level (at 1955 estate tax levels); not necessarily the ultimate cost.[21]

Since present state taxes on large estates frequently exceed the maximum credit allowed under present law, the exemption of these estates from state taxes would result in a corresponding reduction in the tax burden borne by them. An upward adjustment in federal rates to offset such reductions would reduce the federal cost below the \$250 million level. This, however, would involve a tax increase for estates in those few states where the state tax above the \$500,000 net estate level does not exceed the present federal credit.

Under this kind of federal-state division, the states would be left with complete tax autonomy with respect to smaller estates, while the federal government would be left with exclusive jurisdiction over the taxation of large estates, which presumably are likely to have multistate origins and in that respect provide a more appropriate basis for federal than for state taxation. To the extent inheritance and estate tax considerations are of relatively secondary importance in the case of small estates, the states would be free to shape their tax policies without fear of interstate tax competition for wealthy residents.

Under this division, the number of taxable federal estate tax returns would be reduced by more than 90 per cent (from 30,000 to about 2,000 at 1956 estate tax levels). The administrative task of the states might be increased, since they would be deprived of such assistance as they now obtain from access to valuations and related data available in the Internal Revenue Service. In other respects, however,

[21] Since the number and size of large estates can vary widely from year to year, a similar calculation based on another year's returns would probably show a different result.

the states' administrative task would be eased. They would be freed of the specialized problems typically associated with large estates, such as the valuation of contingent interests, especially complex under inheritance taxes since it is not certain at the time the tax is determined to how many beneficiaries and to what class of beneficiaries these interests will pass. Taxpayers' and practitioners' burdens would be eased by the division of this tax area on the basis of the size of the estate, since each estate would be subject to either federal or state taxes, not to both.[22]

E. EXCISE TAXES

Since World War II, a widespread point of view has developed with respect to the handling of sales and excise taxes in the rearrangement of federal-state tax relations: that the federal government relinquish those suitable for state or local administration for exclusive use by these governments. State and local governments are agreed that the federal government should relinquish them. Local governments add the qualification that the states, too, should relinquish them; that excises so relinquished be reserved for exclusive local use. In two or three recent instances, the federal government has moved in the direction urged by the states but this has contributed little, if at all, to the solution of their problems.

The federal taxes most frequently selected for transfer to state/local governments are these:

TABLE 13

Federal Excises Proposed for Transfer to the States

Federal Excise Tax	*Collections, f.y. 1958* (in millions)
Gasoline	$1,637
Cigarettes	1,668
Admissions	54
Local telephone service	371
Sales of electrical energy	[a]
Club dues and initiation fees	60
Coin operated devices	18
Bowling alleys, pool tables	3
Safety deposit box rentals	6
Total	3,817

SOURCE: *The Budget of the U.S. for Fiscal Year 1960*, Special Analysis B, pp. 933–9.

[a] Repealed in 1951 when it yielded about $100 million.

[22] *The Second Report* of the Joint Federal-State Action Committee, December 1958, pp. 32–44, contains estimates of the effect of alternative increases in the credit for state death taxes on federal revenues and the state-by-state distribution of credits.

It is argued in support of the transfer of excises to the states that the federal government can dispense with them because its needs can be met from income taxation, while state-local governments, precluded from intensive use of income taxes, necessarily rely heavily on consumer taxes. Local governments see in some excise taxes an opportunity to supplement local property taxes without encountering intercommunity competition. In motor fuel taxation, the states base their claim on historical priority in the field and on their responsibility for building and maintaining streets and highways.

Spokesmen for the federal government have on at least one occasion (1949) accepted this objective conditionally "when budgetary conditions permit." Since federal budgetary conditions have rarely been propitious, such federal taxes as have been relinquished were picked without specific relationship to the objective of increasing the taxing resources of state and local governments. The proposal to transfer federal revenue sources to the states has recently been infused with fresh blood by the recommendation of the Joint Federal-State Action Committee to trade the states' tax sources for federal grant-in-aid programs.

Motor Fuel

The outstanding example of a federal excise coveted by the states is the gasoline tax. During the immediate postwar years, proposals for repeal of the federal gasoline tax had been frequent. Originally introduced in 1932 as a depression emergency revenue measure, this tax had remained in continuous use at rates of one to two cents per gallon for 25 years.

Repeal of the federal tax has had strong support from the states, the petroleum industry, highway organizations, and some members of Congress. While the imposition of the tax coincided with a substantial federal highway aid program, federal administrations regularly went to great lengths to explain that the two were unrelated; that gasoline was taxed for general revenue purposes and the size of the highway program was determined by need and not the yield of this tax. In 1953, advocates of repeal combined that proposal with the recommendation to discontinue federal grants for highways except to those states which would lose by it. Three years later, in the context of a concerted Administration effort to greatly improve and enlarge the nation's highway network, jurisdictional claims to the gasoline tax were removed from the arena of debate. The federal government relinquished use of the gasoline tax for general fund purposes and reserved it for the highway trust fund, to be expended through the states' highway departments. The Federal-Aid Highway Act of 1956 increased the tax rate from two cents to three cents per gallon, and together with the yield of some other automotive taxes, earmarked its proceeds for the Highway Trust Fund, reserved for financing an expanded, long-range highway program.[23] This assured the states collectively that the proceeds of a three cent tax were theirs to spend for highway construction, over and above the proceeds of their own taxes. Had the federal tax been repealed, its revenue equivalent would have been available for highway construction only to the extent that each state legislature made a corresponding increase in its own tax rate.

By relinquishing the gasoline tax (together with the new tax on tread rubber and the weight tax on trucks and buses, the revenue from an increased tax on tires, and half of the revenue from the increased tax on trucks and buses) from its general fund, the federal government has provided financing for 90 per cent of the cost of the enlarged interstate highway system. The states' highway financing problems have been relieved, but not solved. Several, particularly those with extensive mileage and relatively low-traffic loads, are finding it difficult to match (in the ratio of 1 : 9) their allocations from the highway trust fund, and to finance their other highway needs as well. During the past three years, ten states have raised their own tax rates which now range from three cents per gallon in one state to seven cents in ten, and other states are considering increases. The average state rate is now six cents, not including local gasoline taxes in seven states, typically at a one cent rate, but in a few cases as high as three cents per gallon.

Electrical Energy

Another federal excise long desired by local governments was that on the sale of electrical energy, originally imposed in 1932 at a 3 per cent rate and increased to 3 1/3 per cent in 1940. Sales of electrical energy, as other utility services, have long been taxed by state and local governments. In the years following World War II the Congress was urged to repeal the federal tax because it was particularly suitable for local collection. In 1951 the tax was repealed, not in response to

[23] In his January 1959 Budget Message the President recommended an increase in the gasoline tax rate from three cents to four and one-half cents.

local governments' pleas, but to remove the discrimination against private enterprise created by the tax exemption of electrical energy sold by publicly owned plants. Since its repeal at the federal level, state and local governments have shown little disposition to make increased use of the tax—at least not on a scale comparable to what the federal tax had been.

In 1956, the Municipal Finance Officers Association tallied some 215 separate municipal taxes on electrical utility gross receipts.[24] However, it did not segregate their revenue yield from the revenue produced by all utilities, which aggregated $98 million for gross receipts taxes on all public utilities in 341 cities. Inspection of the detailed data suggests that the cities may have collected as much as $30 million from the gross receipts of electric utilities, as compared with about $100 million produced by the federal tax on electrical energy sales of privately owned power plants six years earlier, at the time the tax was repealed.

Admissions

A timely illustration of local governments' failure to enter tax areas vacated by the federal government is the admissions tax. This tax area has long been sought by spokesmen for municipal governments, who have been seconded by those speaking for the states and the professional associations.

In the years following the war, the federal admissions tax provided nearly $400 million a year. The estimated yield is $30 million for the fiscal year 1960. During the interval, the rate of the tax was cut from 20 to 10 per cent and the larger part of the tax base was eliminated by increases in exemptions. Municipal taxation of amusements has been unaffected by these developments. In 1955 approximately 200 cities raised about $22 million from admissions taxes. The Municipal Finance Officers Association reported that "the tax has been confined to the same states in which it has been used in the past and has not spread to other states despite a decline in federal admissions tax rates from 20 per cent to 10 per cent that occurred in 1954. This is contrary to expectations of advocates of this type of tax for municipalities. It had been anticipated that the tax would be utilized more extensively by municipalities if federal taxes were reduced or eliminated."[25]

[24] Municipal Finance Officers Association, *Municipal Nonproperty Taxes*, 1956 Supplement to "Where Cities Get Their Money," p. 29.
[25] *Ibid.*, p. 20.

Anticipating that cities would have difficulty in imposing admissions taxes, the American Municipal Association suggested in 1952 that, in lieu of repeal, the federal government allow a credit for locally imposed admissions taxes. This suggestion received little consideration from a Congress interested in relieving a depressed industry; that objective would not have been served by a credit for local taxes.

Cigarettes

The cigarette tax now produces about $1.7 billion of federal revenue, approximately $200 million for each one cent of tax. Cigarettes are taxed also by state and local governments. In 1958, state revenues from tobacco products (mostly cigarettes), aggregated about $600 million; local revenues, an additional $50 million.

Cigarettes are taxed by 43 states. In six of these, some local taxes are added. In two others, the states' collections are distributed among local governments; Wyoming earmarks its tax for this purpose and Florida allows a credit for locally imposed cigarette taxes against the state tax. Currently only five states do not have cigarette taxes. In two, Colorado and Virginia, there are some local levies. Oregon, California, and North Carolina have neither state nor local taxes. In the latter two, the general sales tax applies to the sale of cigarettes.

These variations in state taxation reflect differences in attitudes toward consumer taxes in general and taxes on smoking in particular. In Oregon, where consumer taxes are given no quarter, the electorate has twice rejected a cigarette tax. North Carolina and Virginia are large tobacco producers and apparently labor under the misapprehension that a cigarette tax would adversely affect local tobacco growers, even though their produce is destined very largely for out of state consumers.

Given this heterogeneous attitude toward cigarette taxation, what basis is there for presuming that a reduction of the federal tax would be followed by a corresponding increase in state cigarette taxes? Some state rate increases would no doubt follow, but not on a scale which would add to state revenues an amount even approaching the federal loss. If some states failed to pick up all of the federal tax, interstate shipments to avoid tax could again become an important consideration. This problem, it will be recalled, arose in the past and created a need for the Jenkins Act which requires persons, who sell cigarettes in interstate commerce and ship them to other than a licensed distributor in a state imposing a cigarette tax, to forward to the tobacco tax administrator of that state monthly information on cigarette shipments.[26]

The federal government could place its revenue at the disposal of the states by utilizing the credit device—at least for a period of years until the state tax was well established. This would be state taxation by congressional compulsion, more akin to the credit in the unemployment insurance program than in the estate-inheritance tax areas, where it was invented to halt interstate competition. A tax forced on the states by the tax credit route varies from a grant-in-aid only in degree. Indeed, the grant has the virtues of economical administration since the federal tax is collected from a relatively few manufacturers, whereas state taxes have to be collected from a very large number of wholesalers and retailers. Moreover, its distribution among the states can be designed to favor jurisdictions with relatively greater revenue needs, whereas, under the crediting arrangement, benefits vary in proportion to cigarette consumption which tends to be correlated with income levels.

Local Telephone Service

The tax on local telephone service figures prominently in current tax coordination discussions as a result of the proposal of the Joint Federal-State Action Committee to transfer to the states four-tenths of the 10 per cent federal tax, in compensation for the termination of federal vocational education and waste treatment construction grants.[27]

The original proposal contemplated a credit against the federal tax for a 4 per cent state tax imposed over and above existing state rates. The proposal was subsequently modified to meet the objections of those states which would have lost through the exchange because the yield of a 4 per cent tax would have fallen short of their share in these grants. In a later version the credit was limited to a 3 per cent tax but the revenue equivalent of another 1 per cent is to be distributed among the states so as to produce for each a surplus in excess of the amount it now receives from these grants. However, repeal of this tax as of 1960 by the Rate Extension Act of 1959 has effectively shelved this proposal.

The proposal illustrates the technical difficulties encountered in

[26] P.L. 363, 81st Cong. 1st sess.
[27] *Progress Report No. 2*, December 1958.

compensating states for the termination of grants by transferring tax resources to them. Grants tend to reflect need (at least in part) and need generally varies inversely with the distribution of tax bases.

F. COORDINATED TAX ADMINISTRATION

This discussion should appropriately take note also of the potentials of coordinate federal and state tax administration although its contribution to state and local revenues, the object of this inquiry, can have only secondary importance. Where it has been adopted, administrative cooperation has improved state-local revenues by improving tax enforcement. In some instances, this has been at little or no cost, but if carried far, the terms of cooperation are likely to entail an increased investment in enforcement somewhere along the line.

As the foregoing discussion makes clear, the rearrangement of federal and state tax structures into neat packets which would leave each level of government with revenue resources in strict correspondence to revenue requirements, without overlapping, is not realizable. Interstate diversities in economic resources, perverse relationships between revenue resources and needs, fondness for independent tax structures, and lack of machinery for crystallizing a unanimous state viewpoint illustrate the objections.

In these circumstances administrative coordination can afford some relief and the dedication of tax administrators at all levels of government to tax enforcement objectives should contribute to it. As Professor William Anderson observed ten years ago:

"Within each group handling a function of government there develops a fellow-feeling, an *esprit de corps*, a concern for good results in performing the functions, that cut across geographical boundaries. . . . The function, not the unit of government, becomes the concern, and in the handling of the function, the various staff members even develop some resistance to interference by the units of government of which they are a part . . . the intrafunctional group loyalty tends to gain the ascendancy over the loyalty to a particular entire unit of government, such as the state, county, or city."[28]

Administrative coordination by two governments can range from very loose, almost casual relations to comprehensive integration of

[28] "Some Trends in Federalism and Intergovernmental Relations," American Political Science Association, December 30, 1948, Chicago.

enforcement activities. Two tax administrators with a high degree of mutual purpose and freedom could conceivably allocate their separate resources among the several phases of tax enforcement, so as to achieve essentially the results of a singly administered tax. Indeed, acting in concert they could develop a more efficient procedure than acting separately, improving the products of both.

Congressional recognition of the case for administrative cooperation dates from 1935 when disclosure of information from federal income tax returns to the states was authorized. It required the Internal Revenue Service, in response to the request of a governor, to open federal income tax returns for inspection by state officials for the purpose of facilitating the administration of state tax laws. The current version of that provision [Section 6103(b) of the 1954 Code] is the authority under which the Internal Revenue Service has developed its exchange information program with the states.

Before 1950, the program consisted largely of a transcript service to provide copies of federal tax returns to requesting state governors. It engendered little enthusiasm in the federal Revenue Service because it encroached on its already limited facilities. While the states reimbursed the Service for clerical expenses, their payments accrued to the credit of the general fund and not to the Revenue Service.[29]

In 1949, representatives of federal, state and local governments, meeting under treasury auspices, agreed to develop the potentials of administrative coordination, specifically through the exchange of audit information. Soon thereafter, arrangements were made for the exchange of audit information with Wisconsin and North Carolina (1950), with Kentucky and Montana (1951), and with Colorado (1952). While these pilot projects served the essential purpose of breaking ground in a field that previously had had only scattered attention, they did not prove to be a great success. Although all participating states derived some benefit, the federal Revenue Service found it to be a one-way street in all but one of the states. The information furnished by the other four states was poor in both quality and quantity and yielded little additional federal revenue.

In response to the recommendation of the President's Commission

[29] Some states have apparently found the program very productive from the viewpoint of additional revenue collected. See Federation of Tax Administrators, "State programs for photostating Federal income tax returns," RM-350, May 1958. Effective January 1, 1959, the charge for preparing abstracts of federal income tax returns and documents for state governments has been increased from $1.50 to $2.50 per hour. (IRB 1943–58, p. 47.)

on Intergovernmental Relations that income tax administrative cooperation be expanded, the Revenue Service redesigned the program to improve its value and attain a better balance between the benefits it receives and the costs it incurs. With these objectives in view, an exchange program has been concluded with Minnesota (1957) and the agreement with Wisconsin has been renegotiated (1958).

These two new agreements have given the program a new lease on life. The Revenue Service, plagued perennially with inadequate budgets, understandably has little enthusiasm for a program which drains its resources and contributes little in return at a time when an additional dollar invested in tax enforcement can produce several dollars of additional collections. To improve the prospects of federal-state audit exchange, the agreements have been expanded to include other aspects of income tax administration such as detecting delinquencies and unreported refunds, and embrace exchange of information on other types of taxes. The agreements also move in the direction of trying to encourage joint planning, joint action, and limited sharing of work.

Even assuming encouraging results from the broadened exchange effort, the bulk of duplicate costs in both compliance and administration would remain: dual receipt and processing of returns, dual accounting and collection, separate space, machine facilities and management. In the individual income tax field the federal government has moved predominantly to a refund basis with the mass of taxpayers, while many states continue on a tax-due basis. This means that the same taxpayer may be receiving a refund check from the federal government and almost simultaneously making payment to his state, instead of having the two transactions handled on a net basis. Interest in avoiding dual and parallel transactions with separate governments has produced a few straws in the wind. One recent example was the legislative proposal (reportedly introduced at the instance of some states anxious to protect their strict refund procedures), that the states process both federal and state gasoline tax refunds with lump sum federal reimbursement of the several states.

While the expanded audit exchange program affords a new attack on overlapping problems, the rate of progress does not promise large budgetary relief for the near future. Those probing for larger dividends from administrative coordination, whether in the form of additional revenue or economy in operation, are faced with numerous and substantial barriers. Some of these are primarily technical and could be removed with the adoption of strong policy positions fostering concerted action. As things stand, however, tax administrators have much concern and little precedent for their authority to join forces. General authority to exchange information is fairly well established by statute at both federal and state levels, but specific steps, whether aimed at enlarging revenues or saving costs, face questions of interpretation. Two procedural problems that have not been surmounted are the use by one jurisdiction of evidence (audit) provided by the other level of government, and authority for use of appropriated funds to do the work of another level of government. Of minor but more immediate irritation is the priority of liens for collection which now seems to be accorded to the federal government.[30]

A more imposing barrier to larger strides towards closer cooperation is the unequal quality of tax enforcement in the several states. Another, especially relevant in this instance at the federal level, is the compulsion every tax administrator feels to demonstrate the highest possible revenue return per dollar appropriated for his activity. Still another is to be found in the general framework in which coordination efforts are conducted. There is no organized channel for continuous dealing with intergovernmental tax relations on a comprehensive basis, only *ad hoc* commissions, committees, and forums. Such progress as has been made by interstate groups engaged in promoting state community of interests has found no focal point in the federal hierarchy where planning, legislation and execution of policies can be responsive. The recently created Office of the Deputy Assistant to the President for Intergovernmental Relations could remedy this situation.

The survival of administrative duplication can in part be explained by a lack of pressure. The era of expanding revenue bases since World War II has submerged the duplication problem. But the effect of full employment in filling revenue coffers has also been reflected in increased cost of tax administration and the difficulty of competent staffing. The search for administrative economies at both federal and state levels may bear fruit in bringing about more cooperative use of resources on enforcement work. The adoption of high-powered mechanization is also likely to highlight obvious duplication and suggest more joint planning at the management level. Moreover,

[30] National Association of Tax Administrators, "Federal Tax Liens and the Administration of State and Local Taxes," B-460, September 3, 1957.

different levels of government may come to appreciate that they are not competitive in the sense of business units competing for a share of the market, but can profitably pool their knowhow, training facilities and programming work. Here no preponderance of progress exists on one side, since there is strong evidence that both state and federal levels of government have lagged behind the business community in streamlining their operations.

With the rapid pace inherent in technological applications today those who would benefit therefrom must move fast. Internal Revenue is well along toward area-processing in three major centers servicing sixty-four district offices. Heretofore the district offices provided units of operation coinciding with state boundaries in most instances. Unless mechanization of state processing operations takes into account the changed federal setup, opportunities for coordination may continue to go by the board.

The testing now under way can provide a valuable feedback. Through more intimate association with each other's problems, state and federal administrators can bring up to the legislative and executive levels the kind of action necessary to clear the way to greater mutual benefits. But halfway coordination without support from topside can consume much effort while leaving benefits mostly unrealized.

3. Debt Financing

Since state and local governments are finding it necessary to cover a significant portion of their expenditures by borrowing—a condition expected to continue—and since many, particularly among local governments, cannot always borrow as cheaply as they may wish, this examination of ways and means to facilitate local government financing through intergovernmental action should logically embrace this problem as well. Time limitation precludes our doing here little more than assemble a partial inventory of suggested approaches to the problem.

State and local borrowing has averaged more than $7 billion during the last several years, raising the volume of outstanding debt from $30 billion in 1952 to about $57 billion by the middle of 1958. These totals compare with about $16 billion at the end of World War II. In 1957, the only recent year for which data are available, the combined state and local net long-term debt ranged from $42.69 per $1,000 of personal income in South Dakota to $219.25 in Washington.

TABLE 14

State and Local Tax Revenues and Interest Payments on General Debt, Each per $1,000 of Personal Income, 1957

TAX REVENUES PER $1,000 OF PERSONAL INCOME	FREQUENCY DISTRIBUTION — Number of States with Interest Payments per $1,000 of Personal Income of: $0.72–$1.57	$1.66–$2.39	$2.40–$2.77	$2.85–$3.18	$3.23–$3.76	$3.80–$5.93	ALL STATES
$48.96–$73.29	–	2	1	1	2	2	8
73.83– 79.95	1	–	1	3	1	2	8
81.88– 89.22	–	–	2	3	3	–	8
89.31– 93.98	–	4	1	–	1	2	8
93.99– 97.04	4	–	2	1	1	–	8
97.06–116.38	3	2	1	–	–	2	8
All States	8	8	8	8	8	8	

SOURCE: Bureau of the Census, *State and Local Government Finances in 1957.*

Interest charges on the general debt of state and local governments for that year ranged from 72 cents per $1,000 of personal income in South Dakota to $5.39 in Louisiana.[31] Since 1952, annual interest costs of all state and local governments have increased from about $725 million to nearly $1.5 billion, and annual debt redemption from about $1.8 billion to about $3.2 billion. Debt service on the general debt alone is now equivalent to about one-seventh of tax collections. Compared with earlier years these are striking magnitudes. They support the contention that variations in the cost of borrowing may appreciably affect state-local capacity to finance capital improvements.[32]

Some interpret the rapid postwar rise in state-local debt as evidence that these governments are finding it easy enough to borrow; that perhaps borrowing ought to be made more difficult to encourage more capital outlay financing out of current income, i.e., taxes. Others, on the other hand, are preoccupied with the problems of those jurisdictions which have been unable to borrow despite pressing needs for capital improvements substantially in excess of capacity to finance out of current income. They are concerned also with jurisdictions obliged to pay relatively high interest rates, whose borrowing potential would be enhanced by a rate reduction. As

[31] Bureau of the Census, *State and Local Government Finances in 1957.*

[32] For example, the savings in financing charges resulting from a reduction in interest rates from 3.5 per cent to 3 per cent on one year's $7 billion issue of serial bonds maturing over 25 years, would finance $392.5 million of additional borrowing.

Table 14 indicates, the debt burdens assumed by state and local governments appear to bear an inverse relationship to the tax efforts they are making. The states exerting the highest tax efforts—generally the low income states—report relatively small interest payments, even in relation to their low personal incomes. Since these states generally provide a relatively low level of government service (despite their high tax effort), the data can be interpreted as support for the view that a reduction in interest rates would facilitate capital improvements in the states where the need is greatest.

A. FEDERAL TAX SUBSIDIES

Exemption from federal income taxes has been a factor in the demand for state and local obligations since 1913. During most of this period, municipals shared this favorable position with federal securities, some wholly and some only partially exempt from federal income tax. After 1941, when the issuance of tax-exempt federal securities ceased, the relative tax position of municipals improved as federal obligations outstanding in 1941 gradually matured and were retired.[33]

The high level of federal tax rates which has prevailed for nearly two decades and the growing number of investors in the higher income brackets combined to enhance the value of the privileged tax position of state and local obligations. However, forces tending in the opposite direction have also been at work. State and local governments have poured an unprecedented supply of tax-exempt obligations into the market, a supply substantially in excess of the growth in savings seeking this type of investment.[34] An increasing proportion of savings has been channeled through institutional organizations to whom the tax exemption is of little or no value. Thus, exemption from income taxation is, and has been, of little immediate moment to mutual or cooperative financial institutions and qualified pension funds, and has had relatively little value to life insurance companies that have been subject to special low rates. It is of no interest also to regulated investment companies, precluded from passing the exemption privilege on to their members.

[33] Two small tax-exempt issues are still outstanding: $1,485 million in partially tax-exempt 2 3/4 per cent Treasury Bonds (1960–65) and $50 million in wholly tax-exempt 3 per cent Panama Canal Bonds (1961).

[34] Roland Robinson, *Postwar Market for State and Local Government Securities*, Princeton University Press for the National Bureau of Economic Research, 1960.

With a view to broadening the market for state and local obligations, the President has recommended legislation to permit special regulated investment companies with assets in state and local securities to pass on to their stockholders the tax-exempt status of the income they receive from these securities. This recommendation envisages a special class of regulated investment companies which invest substantially all of their assets in municipals and have both the facilities and the incentive to seek out the obligations of small jurisdictions unknown to most investors. This would channel into municipal obligations the savings of investors in mutual funds, a class of investor who presently does not purchase municipals.[35]

Those in quest of devices to broaden the demand for municipal obligations, mindful that some investment institutions' lack of interest in tax-exempt municipals at this time is explained by the preferential tax treatment they enjoy irrespective of the composition of their income, view with interest proposals to restrict the favorable tax treatment of these institutions.

It has been suggested that state and local governments could preserve a larger share of the value of the exemption of their securities from federal income tax if they exchanged this exemption for a federal interest subsidy commensurate with the government's present revenue loss.[36] If, for example (and these numbers are illustrative only), the annual federal revenue loss from tax exemption is equivalent to 1 per cent of state-local debt and the savings to state and local governments due to the exemption amount to only 0.5 per cent, state and local governments would find it profitable to forego their exemptions for a federal subsidy equal to more than 0.5 per cent of their future debt offerings. This would divert to state-local governments a corresponding part of the surplus which now accrues to high bracket taxpayers at the expense of federal revenues. It would involve state and local governments voluntarily foregoing their tax exemption privilege. In the process, an income tax problem would be eliminated, but only after the lapse of a number of years. During the interval, the supply of tax exempts already outstanding and held by investors to whom tax exemption is of relatively little value would gradually drift to high rate taxpayers (for a gradually increasing price).

[35] H. R. 1222, H. R. 4380, and H. R. 8811 introduced during the Eighty-fifth Congress incorporate the President's recommendation.

[36] *Federal, State and Local Government Fiscal Relations*, Senate Doc. No. 69, 78th Cong., 1st sess., 1943, p. 28.

B. SUBSIDIES FOR FINANCIAL STUDIES AND IMPROVED REPORTING

Part of the borrowing problems of state and local governments stem from their operating methods—more correctly, from the fact that some of them operate without methods. Many local governments typically function without benefit of professional staffs knowledgeable in the financial markets of which none is more complex than that for municipals. Moreover, their governing bodies are generally composed of lay citizens also unversed in the technicalities of complex money markets. They lack the specialized skills required to manage a community's borrowing operations with a view to the most favorable credit terms; they lack the know-how of debt management. Their inability to promote investor understanding of the quality of their obligations by informative reporting contributes to the alleged inaccessibility to money markets experienced by some, particularly small, borrowers. The situation has been partially relieved in some states by machinery developed for assisting political subdivisions in debt management problems, including the marketing of offerings. Our host state, Virginia, for example, has a State Commission on Local Debt which assists cities and counties in this way.[37] Some states provide facilities for pooling the separate small offerings of a number of borrowers into a single offering more likely to interest the market. Some states use their sinking, trust, and investment funds to bolster the demand for local issues. Many obtain technical advice on the timing and handling of their borrowings from their bankers.

Part of the blame for inadequate investor interest in municipals is related to poor and disorganized financial reporting by borrowing jurisdictions. Potential investors find it difficult to ascertain the credit condition of a particular security offering and of necessity make their bids on the basis of the least favorable assumptions. The need for improved and more standardized financial reporting on the part of borrowing governments, and for channeling of such information to potential investors is recognized by all concerned with reducing borrowing costs. To facilitate this end, it has been suggested that the federal government support and encourage efforts to improve the quality of municipal financial reporting through the dissemination of guides to good reporting and possibly by sharing in its costs.

[37] The Commission is authorized to advise political subdivisions on the planning, preparation and marketing of bonds and to assist in the sale of such bonds. (*Code of Virginia* 15-590.2 and .3.)

In some states, obstacles to borrowing encountered by local jurisdictions stem from constitutional or statutory limitations which have grown out of improvident borrowing practices in former epochs. Necessity has fathered various devices to circumvent these prohibitions. Limitations expressed as a percentage of assessed valuation, for example, have been side-stepped by raising the ratio of assessed to market value of property. The public "authority" has been invented, adding to the complexity of the governmental structure. In still other places, "public spirited citizens" have organized nonprofit corporations to act on behalf of their local governments. They have undertaken to construct the required facility, lease it to the community, and finance its construction by debt secured with a long-term lease. School buildings, utility enterprises, and athletic facilities have been financed in this way.

These are half-way measures lacking in forthrightness. Direct solutions are preferred by most students of the problem: the revision of statutory and constitutional provisions to accord with present day needs.[38] With this in mind, suggestions have been made for federal financial aid to assist and encourage the states to finance studies looking to the updating of constitutional and statutory provisions, the development of more meaningful norms for debt limitation purposes, and to ensure widespread distribution of their findings to facilitate the public understanding prerequisite to bring about these changes. The grants for urban planning provided small communities under Section 701 of the Housing Act of 1954 illustrate this kind of federal assistance to enable local governments to help themselves.[39]

C. INSURANCE PROGRAMS

Proposals have been advanced also to insure state and local obligations. The excellent risk performance of these obligations suggests that this would entail a very low premium charge. Since a mandatory program is not compatible with the conventions of a federal-state relationship, such a program would presumably be offered on an optional basis. This, however, would tend to limit insurance coverage to the poorer quality obligations, and such adverse risk selection would markedly increase premium costs. Mandatory

[38] *Report* of the President's Commission on Intergovernmental Relations, June 1955, p. 98.

[39] Section 320 of the Housing Act of 1959, S. 7, 86th Cong., 1st sess., as passed by the Senate, would broaden eligibility for these grants.

coverage presents no problem for individual states with respect to their own political subdivisions. It is not known, however, whether any of the states has actively considered operating such an insurance program, or whether it would be practicable to provide facilities for sharing such state risks through a national reinsurance agency. Federal statutes contain a variety of insurance programs which are summarized annually in a special analysis of federal credit programs included as a regular feature of the President's Budget and need not be detailed here.[40]

D. FEDERAL GUARANTEES

With a view to reducing the cost of borrowing for various public objectives, such as housing and school construction, proposals have been considered on various occasions in the past that the federal government guarantee the particular obligations. In recent years this form of assistance has been urged to facilitate the construction of public school and college facilities. Such a guarantee applied to a municipal obligation would create a super security which possessed the safety of a federal obligation and the tax exemption privilege of a state or local obligation. The local public housing authority bonds backed by a government commitment to cover debt service costs in excess of the income from the property have been criticized for this reason. To avoid this result, the Administration's program to encourage the construction of college facilities makes the proposed guaranty of the principal of and interest on the bonds of educational institutions conditional upon the income from such bonds being subject to federal taxation.[41]

E. FEDERAL PURCHASE OF MUNICIPALS

To complete this inventory, mention should be made also of the suggestion that either through the treasury or through a specially created corporation the federal government stand ready to purchase municipal obligations when financing terms available in the market are unsatisfactory. These obligations would then either be resold under appropriate market conditions or held to maturity. A national credit agency could conceivably finance the purchase of state and local obligations by public offerings of its own obligations secured by its portfolio of municipals. Depending upon the terms of purchase,

[40] See, for example, *The Budget for Fiscal Year 1960*, Special Analysis E, pp. 957–69.
[41] Section 2(a) of S. 1017, 86th Cong., 1st sess.

this could assist some borrowing jurisdictions and incidentally curtail the flow of tax-exempt obligations to private investors.

In lieu of purchasing local obligations, the federal and state governments could jointly undertake to meet the debt service cost on obligations issued by needy jurisdictions under conditions that the community maintain a reasonable tax effort, and so long as it is unable to meet this obligation. This is a feature of the Administration's school construction assistance program under which the federal government would advance half of the cost of debt service on school construction bonds issued by needy jurisdictions, if the state undertakes to advance the other half.[42]

The problem of marketing municipal obligations is generally believed to be due in part to the absence of an adequate secondary market for municipal obligations, which tends to restrict the purchase of these obligations to investors prepared to hold them until maturity.[43] This suggests that an inventory of possible aids to state and local borrowing should include also possibilities for developing a more adequate secondary market. Conceivably this would then take any one of several forms, such as a national organization on the pattern of the Federal National Mortgage Association or regional organizations akin to the federal land banks.

Some of the devices here catalogued, employed singly or in combination, could probably facilitate state and local borrowing. Analysis is required to determine which, if any, would on balance serve the national interest. It is essential to keep in view, however, that the limitations on the borrowing capacity of a jurisdiction stem more from the limitations of its economic capacity to support debt than from technicalities of the money market or the jurisdiction's lack of skill to exploit it. This is not to deny that money market conditions affect credit operations, both public and private. If, for example, national credit policies pursued in the interest of economic stability increase borrowing costs, it is no more possible and desirable to insulate state and local governments than the federal government from such increases. Moreover, the effectiveness of national policies in achieving stable economic growth may, in the long run, have a more significant impact on the capacity of state and local governments to provide public services than factors within their own control.

[42] S. 1016, 86th Cong., 1st sess.
[43] Robinson, *op. cit.*

4. *Financial Aids to State and Local Government*

In terms of net federal budgetary expenditures federal aid to state and local governments in cash and in kind equalled early in the 1950's about 9 per cent of total state-local general revenues. Recently, federal aid (including grants from the new highway trust fund) has declined to about 7 per cent, as direct revenues have increased more rapidly. Early in the decade, too, these payments equaled some 3 to 4 per cent of total federal cash payments to the public; currently they are running at 5 or 6 per cent, and the budget estimates for 1959 and 1960 indicate federal aid equaling 7 and 8 per cent of federal payments to the public.

Measured on the basis of the state-local accounts, the cash grants-in-aid and all other intergovernmental payments received from the federal government were just over one-tenth of all state-local general revenues for the five years 1953–57, inclusive. They financed 9.5 per cent of direct general expenditures of the state and local governments during the 5 years.

The importance of these aids in state-local finance varies greatly among the states and among particular programs. For federal finance, likewise, the differences between programs are substantial. Each type of variation will be reviewed.

First it should be noted, however, that we are dealing here with relationships that are only partly measurable in pecuniary terms—and for which, even in the measurable area, different figures are reported depending on the point at which data are compiled.

Some aid received from the federal government is not reflected in the financial accounts of state and local governments. This contributes to an understatement of the magnitude of state-local operations and perhaps to some understatement of the fiscal support they receive from the federal government.

Already noted is the indirect aid afforded by the deductibility of state and local income, property, and other taxes from personal and corporate incomes in computing federal income tax liability, and by the federal tax exemption of interest-income from municipal bonds. Also, the development of a direct federal program may provide indirect aid by relieving state and local units of related needs for expenditure; this is illustrated by the federal old-age, survivors, and disability insurance system in relation to federal-state-local public

TABLE 15

Federal Aid to State and Local Governments,
as Shown in the Federal Budget: 1951–60
(millions of dollars)

Fiscal Year	*Total, Net Budget Expenditures*[a]	*Grants-in-Aid*[b]	*Shared Revenues*	*Loans and Repayable Advances, Net*[c]
1951	2,434	2,256	31	147
1952	2,604	2,393	38	173
1953	2,857	2,781	51	25
1954	2,657	2,986	66	−395[d]
1955	3,124	3,126	78	−80[d]
1956	3,753	3,642	82	29
1957	4,111	3,943	96	72
1958	5,072	4,831	101	140
1959 estimated	6,695	6,266	106	323
1960 estimated	7,148	6,851	119	178

SOURCE: *Budget of the United States*, fiscal years 1953–60, special analyses.

[a] Includes grants paid from highway trust fund and loans from unemployment trust fund, fiscal years 1957–60.

[b] Includes grants paid from the highway trust fund, as follows:

1957	$ 953
1958	1,493
1959 estimated	2,425
1960 estimated	3,015

[c] Includes loans from the unemployment trust fund, as follows:

1958	$ 3
1959 estimated	116

[d] Repayments received exceeded new loans by the amount of negative expenditures shown here.

assistance. Similarly, federally sponsored fellowships and traineeships in public service fields of special concern to state and local governments—particularly health, education, and science—may promote the productivity and efficiency of state and local program operations. Indeed, federally sponsored research and development sometimes affects profoundly the content and objectives of public programs at all levels.

Even among direct federal aids, those involving cooperative administration, exchanges of personnel and services, and grants-in-kind usually leave no financial tracks in the state and local accounts. The various grants-in-kind are, however, included in the federal budget analyses of expenditures for aids to state and local governments. Of greater significance in the totals is the fact that the federal data include loans on a net basis. That is, in the federal government accounts, the amounts lent to state and local governments (whether through purchases of their securities or through other types of advances) are considered expenditures and any repayments received are deducted from expenditures. In recent years, repayments received have largely offset the loans made. In fact, in 1954 and 1955 the repayments exceeded the new loans, producing "negative expenditures" in this category of federal aid.

A ten-year summary of the federal budgetary totals is given in Table 15.

A. GEOGRAPHIC COMPARISONS RELATING FEDERAL AID TO PERSONAL INCOMES

This section gives particular attention to interstate or interregional differences in the relative importance of federal aids because, as was noted early in this paper, the uneven geographic distribution of resources is the genesis of most problems in federal-state fiscal relations. These geographic variations have greatly complicated the task of the Joint Federal-State Action Committee which was set up in 1957 to develop practical proposals for increasing the fiscal resources available to state-local governments while reducing the volume of federal grants-in-aid. The Committee, after surveying intensively the broad problem of equalization, has suggested the possible necessity of "block" grants—i.e., grants for an unassigned general purpose in place of grants for specific purposes.[44] Some aspects of the Joint Committee's work, as well as the earlier report of the Commission on Intergovernmental Relations, are noted below.

A definite tendency for the existing federal grants to help equalize fiscal means relative to personal incomes and to state-local general revenues is evident in gross geographical comparisons for recent years. The summary data will be given for the fiscal year 1957.

In the broad groupings of Table 16, per capita federal grants in the aggregate and for each of several problem categories are highest in the group of low-income states and lowest in the high-income group. The inverse relationship exhibited in these broad groupings of states and of programs is sufficiently pronounced that if judgment were based on these data alone the pattern might seem creditable to design

[44] Cf. *Second Report of the Joint Federal-State Action Committee to the President of the United States and to the Chairman of the Governors' Conference*, Progress Report No. 2, December 1958, pp. 8, 47.

TABLE 16

Federal Grants to State and Local Governments in Amounts Per Capita, by Function, as Related to Personal Income Levels in Three Groups of States: Fiscal Year 1957

Program or Other Category	*Continental U.S.*[a]	*16 Highest-Income States*[b]	*17 Middle-Income States*	*16 Lowest-Income States*
Per capita federal grants, 1957:				
Total	$23.11	$18.76	$26.43	$30.54
Public assistance	9.23	7.29	10.07	13.38
Employment security[c]	1.89	2.22	1.47	1.41
Health services	.93	.60	1.06	1.58
Other welfare services	1.18	1.04	1.17	1.58
Education	1.18	1.01	1.46	1.31
Highway construction[d]	5.73	4.33	8.18	6.46
All other	2.97	2.27	3.02	4.82
Per capita personal income—annual average during calendar years 1954–56:				
Median State	$1,851[e]	$2,178	$1,670	$1,308
Range:				
Highest in group	2,630	2,630	1,827	1,546
Lowest in group	926	1,874	1,560	926

SOURCE: Adapted from Sophie R. Dales, "Federal Grants to State and Local Governments, 1956–57," *Social Security Bulletin*, June 1958, pp. 13–18, Tables 2 and 3, with additions as noted.

[a] Omits Alaska and Hawaii; includes District of Columbia.

[b] Includes District of Columbia.

[c] Includes distribution of certain federal tax collections to state accounts in unemployment trust fund.

[d] Included with "all other" in *Social Security Bulletin*. To make this separation, highway grants per capita were calculated approximately for each of the three groups of states and for the continental total, and deducted from the corresponding per capita amount of "all other" grants as shown in the *Bulletin*. The highway grants, by state totals, are from Secretary of the Treasury, *Annual Report on the State of the Finances*, 1957, p. 578, col. 13; population for the per capita averages, from Table 2 in the *Social Security Bulletin*.

[e] Per capita average for Continental U.S.

and intention. In fact, of course, the pattern is only in part a product of design; moreover, the broad groupings cancel out many internal deviations, and closer inspection of underlying data emphasizes that the progression is not regular or fully balanced. But the general picture is coherent enough to warrant further description.

The use of per capita averages and ratios to personal incomes for some of these comparisons is not meant to suggest that the need for or the level of particular services is best measured in this way. In some fields, such as highway construction or forest fire prevention, a simple population count (or a comparison of income levels) may be almost irrelevant to program objectives.

Yet there is logic in the use of such measurements for assessing the broad impact of federal aid. In our society, at any given time, the overall magnitude of the needs of a state for public services is more directly affected by the size and affluence of the population than by most of its other attributes, and the fiscal capability of the state and local units is clearly dependent on the relative affluence of their constituencies. Apart from the stimulation of particular programs, the primary general purpose of assistance from the federal government is to assure support everywhere for some minimum standards in selected public services; and the need for the federal aid arises from variations in the fiscal capabilities of the states and their subdivisions. Almost certainly, the best general, comprehensive measurement of differences in the need for such aid is to be found in population and personal income differences. Moreover, the averages and ratios do afford a rough-and-ready basis for comparison—a point of departure for more thorough analysis.

Federal grant-in-aid objectives, it has often been observed, are not directed explicitly toward interstate equalization of per capita personal incomes.[45] A federal-aid system intended to redistribute income would be quite different from the heterogeneous, multi-purpose arsenal of many-sized aids presently included in the federal budget. Nevertheless if a by-product of these programs is some interstate redistribution of means, that tendency may be significant for an examination of interlevel fiscal problems, whatever the justifications that were advanced for establishing the individual programs.

Data for the fiscal year 1952, as analyzed by Selma Mushkin, support a conclusion that in that year at least, although federal government expenditures taken as a whole "appear to result in

[45] As Miss Mushkin has cautioned:

"Equalization of state (per capita) income and equalization of minimum program levels, paralleled by more uniform state and local taxing effort, are two different things. Moreover, they have different purposes. The design of federal grants to achieve a national minimum program level, without requiring disproportionate state and local tax burdens, needs to be considered without being confused with equalization of state income."

Selma Mushkin, "Federal Grants and Federal Expenditures," in *National Tax Journal*, September 1957, p. 197. Cf. Howard G. Schaller (whom Miss Mushkin quotes), "Federal Grants-in-Aid and Differentials in State Per-Capita Incomes, 1929, 1939, and 1949," in *ibid.*, September 1955, pp. 287–99.

redistribution of income additional to that effected by federal taxes," the federal grants as a group had "negligible equalizing effects."[46] Howard Schaller found that "all grants-in-aid combined reduced the relative difference in state per capita incomes by 2 per cent in 1949 and 1 per cent in 1939," whereas they had "negligible" effects in 1929. His measurements indicated that grants under the Social Security Act alone "significantly affected the relative differences, reducing them by 1 per cent in both 1949 and 1939."[47]

It may be that federal grants now exhibit somewhat greater equalizing tendencies relative to personal incomes than they did a few years ago.[48] This could well reflect both the narrowing of the range of interstate differences in per capita incomes and some increase in the ratio of aggregate federal aid to personal incomes. In 1929 and 1939, the highest state average of personal income per capita was more than four times the lowest, and in 1952 the ratio was 2.8 to 1; by 1957 the difference again had widened slightly, to a ratio of 3 to 1.[49] Aggregate federal-aid payments in 1929 equaled about one-eighth of 1 per cent of personal incomes; in 1952, just under 1 per cent; and in 1957, 1.2 per cent.[50]

Over the last 30 to 50 years, the rise in the relative magnitude of federal aid has certainly substituted federal taxes (with emphasis on the taxation of personal incomes at progressive rates) for the more

[46] Mushkin, *loc. cit.*, pp. 205, 208.

[47] Schaller, *loc. cit.*, p. 298.

[48] We have not equated our data directly with the series compiled by Miss Mushkin and Mr. Schaller in their articles.

Likewise we have not attempted to ascertain whether our observation as to present tendencies toward equalization relative to personal incomes indicates a change in the situation described by V. O. Key, Jr., in 1942, when he found that "the dominant form of grant compels the states and localities to bear a share of the cost of the aided programs that as between states becomes more burdensome from state to state as resources decline." (*The Matching Requirement in Federal Grant Legislation in Relation to Variations in State Fiscal Capacity*, preliminary draft; Federal Security Agency, Social Security Board, Bureau of Research and Statistics, Bureau Memorandum No. 46, February 1942, p. 57.) Key's analysis was based on interstate comparisons of the burdens involved in matching federal grants. Our analysis is based on the aggregate amounts of federal aid actually paid.

Also pertinent for its discussion of issues and objectives in equalization is Byron L. Johnson, *The Principle of Equalization Applied to the Allocation of Grants in Aid*, *ibid.*, Bureau Memorandum No. 66, September 1947.

[49] Cf. Department of Commerce, Office of Business Economics, *Personal Income by States since 1929, A Supplement to the Survey of Current Business*, by Charles F. Schwartz and Robert E. Graham, Jr., 1956, Table 2, pp. 142–3; and *Survey of Current Business*, August 1958, p. 13.

[50] Personal income totals from *ibid.*; federal aid totals from Census compilations and federal *Budget*.

diversified state and local tax systems as the means of financing a substantial volume of expenditures.

As a central objective of policy or as a qualifying consideration, the promotion of interstate equalization in personal incomes is several degrees less remote for federal aid programs than for the geographic incidence of federal taxes and the benefit or incidence distribution of aggregate federal expenditures, to which Miss Mushkin referred. Indeed, it seems evident that the federal-aid system, especially the grants-in-aid and the loans, grew up as one type of practical accommodation to problems that confront a multilevel political structure in which the subdivisions exhibit diverse economic, as well as political and social, characteristics.

Over the years, per capita personal income averages by states have been specified as factors in an increasing number of the statutory formulas for grant apportionment and grant matching. The language of hearings and debates suggests that the purpose—at least the expressed purpose—has usually been to improve upon simple head counts as a measure of relative need for a particular public service and relative capacity to finance it from state and local resources.

Not even in the consideration and approval of the successive statutory increases in the large public assistance grant program has interstate redistribution of incomes been identified as a purpose of the program. The case has been made almost wholly in terms of the fiscal inability of state and local governments to meet the particular, apparently irreducible, need. Still, the pressures for larger grants and for less state-and-local matching have been so persistent and so repeatedly successful as to warrant an inference that they derive some of their persuasive force from considerations outside the public assistance program itself.

The case is reminiscent of the origins of large state-aid funds for public schools in various states, where the stated interest of many proponents was to transfer the support of a major item of expenditure from local property taxpayers to state taxpayers. Public education was a program with wide popular support and of state-wide concern; a large measure of property-tax relief could be accomplished with state aid covering only a fraction of the cost.

It would be difficult to demonstrate that an analogous purpose has influenced congressional legislation for public assistance grants. The tendency to increasing reliance on financing by federal taxation is, however, evident in the results.

The commission on Intergovernmental Relations, in its report in 1955, said it did not believe that "the 'equalization' of the general fiscal capacities of the states is by itself a proper objective of National policy."[51] The Commission flatly rejected, without dissent, proposals for federal grants "to reduce fiscal disparities" among the states and the alternative of "a comprehensive subsidy program for general governmental purposes."[52]

More recently the Joint Federal-State Action Committee has raised anew the question whether it would be practicable to make interstate equalization a specific objective of policy. The Committee has therefore undertaken to study:

> (1) the *feasibility* of replacing grants for *specific* purposes by an unassigned general purpose (*block*) grant as an alternative approach to revenue source adjustment; and (2) the practicability of revising grant formulas to relate grants to per capita incomes.[53]

Against this background of policy discussion, a description of existing relationships is of some interest. The geographic comparisons are summarized first in terms of aggregates and then by program categories.

In the aggregate. Taking all the federal grants together (but omitting other types of federal aid), the national per capita average in fiscal 1957 was $23.11. (Table 16.)[54] The over-all averages for three

[51] Commission on Intergovernmental Relations, *A Report to the President for Transmittal to the Congress*, June 1955, p. 135.

[52] *Ibid.*, pp. 110–15.

[53] Joint Federal-State Action Committee, *2d Report*, December 1958, p. 8 and appendix vi. (Italics in original.) Informal discussions suggest that the Commission's interest subsequently shifted from unassigned general purpose grants to functional block grants, e.g., a single grant for public health.

[54] This average and the statistics immediately below are from the *Social Security Bulletin*, June 1958, pp. 15 and 16, Tables 2 and 3, with some modifications. The payments represent grants only, and the total of $3,933 million shown for fiscal 1957 is very close to the $3,943 million reported in the federal Budget as actual grant-in-aid expenditures (see Table 15).

A per capita average of $22.57 is reported in the Census of Governments for 1957 for all intergovernmental payments from the federal government. Comparable detailed amounts for functional or program categories are not available from the Census.

All state and local government data in this section, unless attributed to another source, are from publications of the Department of Commerce, Bureau of the Census, Governments Division. Data for 1957 are from 1957 Census of Governments Advance Releases, No. 8, *State and Local Government Finances in 1957* (issued February 1959). Data for the period 1953–57, inclusive, are from the annual *Summary of Governmental Finances* for these years.

groups of states (including the District of Columbia but omitting Alaska and Hawaii) are as follows:

1. In the sixteen states with the lowest per capita personal incomes, the federal grants averaged \$30.54 per capita—32 per cent *above* the national average. The median state in this group was 29 per cent *below* the national average for personal incomes.
2. In the sixteen states (including the District of Columbia) with highest per capita personal incomes, the federal grants per capita averaged \$18.76—19 per cent *below* the national average. The median state in this group was 18 per cent *above* the national average for personal incomes.
3. In the seventeen middle-income states, average federal grants at \$26.43 per capita were 14 per cent *above* the national average. The median state was 11 per cent *below* the national average for personal incomes.

Irregularities in the progression come to light in Tables 17 and 18, where 48 states (excluding the District of Columbia, Hawaii, and Alaska) are divided on the basis of per capita personal incomes into eight groups of six states each.[55] Table 17 reports for each six-state group the average annual personal income per capita during the four years 1954–57 and the share of each group in the 48-state total for 1957 of personal incomes, population, state-local general revenues (including revenue from the federal government), and state-local general expenditures. In Table 18 these revenue and expenditure data are converted to index numbers or relatives, with the 48-state average for each series taken as the base, or 100.

Thus, if state-local general revenues from the federal government were distributed among the eight groups of states in the same proportions as personal incomes, the index number for the series would be 100 for each six-state group. Instead, the range shown is from 70 in the next-to-highest income group (group 2) to 214 in the sixth group (comprising states that ranked 31st to 36th in per capita incomes—namely, Utah, Maine, Vermont, Idaho, Oklahoma, and New Mexico). State-local general revenues from their own sources and general expenditures for all purposes (including the federally financed expenditures) cluster much more narrowly about the average relationship to personal incomes than does the federal aid.

[55] These Tables are derived from data in the 1957 Census of Governments.

TABLE 17

Personal Incomes, Revenues, and Expenditures, by Groups of States: 1957

Groups of 6 States Each (Based on Rank-Order of Per Capita Personal Incomes, Annual Average for 1954-57 Inclusive)	Personal Income Per Capita, Annual Average for 1954–57		Personal Incomes, Aggregate 1954–57	Population (1954–57)	State-Local General Revenues, 1957			State-Local General Expenditures, 1957				
									For Selected Functions			
					Total, All Sources	From Federal Government	From State-Local Sources	Total, All Purposes	Education	Highways	Public Welfare	Health, Hospitals
Group	*Amount*	*Relative*[a]	*Percentage of Forty-eight-State Total*									
1 (highest incomes)	$2,393	126	28.5	22.6	28.6	21.8	29.4	28.6	27.1	22.9	25.6	32.4
2	2,157	113	24.8	21.9	21.9	17.3	22.4	22.8	22.4	23.5	20.9	24.1
3	1,924	101	13.7	13.6	11.9	11.6	12.0	11.7	12.3	10.9	11.7	11.0
4	1,783	94	6.7	7.2	7.7	8.1	7.7	7.8	7.9	9.6	8.5	7.5
5	1,669	88	11.4	13.0	12.2	13.6	12.0	12.0	12.7	14.1	10.3	9.8
6	1,560	82	2.8	3.5	3.6	6.0	3.3	3.5	3.7	4.1	5.1	2.5
7	1,364	72	5.8	8.1	7.0	10.0	6.7	6.8	6.8	7.1	9.6	6.5
8 (lowest incomes)	1,189	62	6.3	10.1	7.0	11.6	6.5	6.8	7.1	7.7	8.3	6.2
48-State Total	1,906[b]	100[b]	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

SOURCES: Personal incomes and population based on data in *Survey of Current Business*, August 1958, p. 13. State-local general revenues and general expenditures based on 1957 Census of Government advance releases, No. 8, *State and Local Government Finances in 1957*, February 1959.

[a] 48-state average equals 100.

[b] Average.

TABLE 18

Relationship of General Revenues and Expenditures to Personal Incomes, by Groups of States: 1957
(Average relationship for the 48 States = 100 for each column)

Groups of 6 States Each (Based on Rank-Order of Per Capita Personal Incomes, Annual Average for 1954–57, Inclusive)	State-Local General Revenue, 1957			State-Local General Expenditures, 1957				
					For Selected Functions			
	Total, All Sources	From Federal Government	From State-Local Sources	Total, All Purposes	*Education*	*Highways*	*Public Welfare*	*Health, Hospitals*
Group								
1 (highest incomes)	100	76	103	100	95	80	90	114
2	88	70	90	92	90	95	84	97
3	87	85	88	85	90	80	85	80
4	114	121	114	116	118	143	127	112
5	107	119	92	105	111	124	90	86
6	129	214	118	125	132	146	182	89
7	121	172	116	117	117	122	166	112
8 (lowest incomes)	111	184	103	108	113	122	132	98
48-State Average	100	100	100	100	100	100	100	100

Based on Table 17, with the percentage for each column of revenues or expenditures divided by the corresponding percentage for aggregate personal incomes and the product multiplied by 100.

For general expenditures and for nonfederal revenues, as for federal aid, the highest ratio to personal incomes is in the sixth group of states.[56]

Revenues received from the federal government in 1957 tended not only to be highest per capita in the states with lowest personal incomes; they also tended, on the whole, to be greatest in states that drew most heavily on their own taxable resources.[57] To illustrate:

1. Of the twelve states with the highest ratios of nonfederal state-local general revenues to personal incomes, ten were among the top twelve in the ratio of revenues from the federal government to personal incomes. In this group of states, state-local general revenue from nonfederal sources ranged from a maximum of 15.9 per cent of personal income in North Dakota to 11.8 per cent in Oklahoma. The federal payments ranged from 4.2 per cent of personal income in Wyoming to 1.3 per cent in Minnesota. In North Dakota, the federal payments equaled 2.2 per cent of personal income.

2. Of the twelve states with the lowest ratios of nonfederal state-local general revenues to personal incomes, eight were among the lowest twelve for the ratio of revenues from the federal government to personal incomes. In this group of states, state-local general revenue from nonfederal sources ranged from a minimum of 6.8 per cent of personal income in Delaware to 9.4 per cent in Nebraska. The federal payments ranged from 0.4 to 1 per cent of personal

[56] The Census statistics on which these tabulations are based combine all types of revenue received from the federal government. An analysis confined to grants-in-aid alone (as are the preceding comparisons for three broad groups of states, based on the *Social Security Bulletin* Tables) might show a stronger tendency for federal assistance, insofar as it takes the form of grants, to be associated inversely with the level of personal incomes. However, emphasis upon public lands, total land area, and road mileage as factors in the distribution of the large federal grants for highway construction is a qualifying factor.

The high index number of 214 for the relationship between federal aid and personal incomes in the sixth group of states (in Table 18) is considerably affected by the highway grants. In this six-state group, highway construction grants received in 1957 averaged about $12.67 per capita, compared with a 48-state average of $5.74.

Shared revenues are more important in certain other groups of states. This is illustrated by data for the third group, which includes Wyoming—16th among the 48 states in personal income per capita. Wyoming derived under the Mineral Leasing Act between one-third and one-half of all state-local general revenues received from the federal government in 1957, whereas this category accounted for less than 1 per cent of all federal aid payments to all state-local governments. Federal payments to Wyoming state-local general revenues for all purposes in 1957 averaged $84.88 per capita.

[57] The frequency groupings that underlie this paragraph are derived from the 1957 Census of Governments.

income in New Jersey—the lowest among the 48 states—to 1.6 per cent in Missouri. For Nebraska, the federal payments equaled 1.3 per cent of personal income.

3. Among the middle twelve states in terms of the ratio of non-federal state-local general revenue to personal incomes, only five were among the middle twelve in the ratio of revenues from the federal government to personal incomes. In this median group, the range of state-local general revenue from their own sources was narrow—from 11.1 per cent of personal income in Florida to 10.0 per cent in Michigan. The range of federal government payments in the twelve states was not so narrow; it varied from 2.5 per cent in Arkansas to 0.6 per cent in New York. For Florida, the federal payments were 1.2 per cent of personal income—approximately at the nation-wide average; and for Michigan, 0.9 per cent.

Regional tendencies also are pronounced, as Table 19 indicates. Relative to personal incomes, state-local revenue from the federal government is lowest in the New England, Mideast, and Great Lakes states. With the exception of Vermont and Maine, the sixteen states in these three regions all rank from 34th to 48th in the ratio of federal revenue to personal income. It is highest in the Far West, Rocky Mountain, and Southwest states, where nine of the thirteen states are in the top one-third. In the Plains and the Southwest, the relationship is less evident.[58]

By program categories[59]—Taking the grants by separate functional or program categories shown in Table 16, the 1957 arithmetic means for three broad groups of states (including the District of Columbia but omitting Alaska) were as follows:

1. For public assistance, the average per capita federal grant in the sixteen lowest-income states was 45 per cent *above* the national average; in the sixteen highest-income states, it was 21 per cent *below* the national average.

2. For health services, the grant average in the lowest-income states was 70 per cent *above* the national average, and in the highest income states, 35 per cent *below*. Grants for all health programs were one-tenth as much as for public assistance.

3. For "other" welfare services, the per capita grant average in

[58] The data underlying this paragraph are from the 1957 Census of Government.
[59] Based on details in *Social Security Bulletin, loc. cit.*

TABLE 19

State and Local Government General Revenue from the Federal Government—

Total and Per Capita Amounts and Relationship to Personal Incomes and Total State-Local Revenues, by States and Regions: 1957

GEOGRAPHIC REGION AND STATE	STATE-LOCAL GENERAL REVENUE FROM FEDERAL GOVERNMENT, 1957				RANK ORDER FOR REVENUE FROM FEDERAL GOVERNMENT	
	Total Amount (millions)	*Per Capita Amount*	*Per $1,000 of Personal Incomes*	*As Percentage of all State-Local General Revenue*	*Per Capita Amount*	*Per $1,000 of Personal Incomes*
48-State total	$3,808.1	$22.47	$11.10	10.0%		
New England:	$182.1	$18.45	8.03	7.8	(6)	(6)
Maine	22.1	23.49	14.07	11.7	29	26
New Hampshire	10.5	18.24	9.81	9.3	37	36
Vermont	11.0	29.72	17.57	13.0	18	18
Massachusetts	87.9	18.21	7.74	7.2	38	40
Rhode Island	20.2	23.52	11.75	12.2	26	34
Connecticut	30.4	13.38	4.78	5.4	45	47
Mideast:	510.0	13.89	5.80	5.9	(8)	(8)
New York	254.2	15.74	6.21	5.6	43	43
New Jersey	56.0	9.97	3.97	4.7	48	48
Pennsylvania	139.9	12.70	6.00	6.4	46	46
Delaware	8.1	18.78	6.79	9.1	35	42
Maryland	51.8	17.90	8.30	8.6	39	39
Great Lakes:	555.4	15.85	7.16	7.4	(7)	(7)
Michigan	142.9	18.55	8.56	7.9	36	37
Ohio	147.2	15.99	7.10	8.0	42	41
Indiana	56.5	12.54	6.21	6.8	47	44
Illinois	146.1	15.06	6.20	6.9	44	45
Wisconsin	62.7	16.24	8.46	7.0	41	38
Plains:	$409.3	$26.74	$14.66	12.3	(4)	(4)
Minnesota	79.2	23.88	12.90	9.8	25	29
Iowa	62.0	22.27	12.26	9.7	30	31
Missouri	128.2	30.24	15.52	16.7	16	23
North Dakota	20.6	31.96	22.31	12.3	14	12
South Dakota	27.5	39.73	25.61	16.4	7	5
Nebraska	33.8	23.50	12.79	12.0	27	30

Southeast:	930.6	25.02	17.53	14.1	(5)	(3)
Virginia	66.2	17.29	10.50	9.6	40	35
West Virginia	37.6	19.13	12.23	12.7	34	32
Kentucky	66.5	21.87	15.95	14.5	31	22
Tennessee	80.9	23.50	16.88	14.2	28	20
North Carolina	117.4	26.25	19.81	16.1	22	15
South Carolina	46.8	19.76	16.74	13.2	33	21
Georgia	97.1	25.75	17.96	14.3	23	17
Florida	89.4	21.25	11.89	9.7	32	33
Alabama	101.7	32.16	24.38	19.9	13	10
Mississippi	59.1	27.28	28.23	17.0	21	3
Louisiana	117.4	38.28	24.43	14.7	9	9
Arkansas	50.5	28.38	24.83	18.8	19	8
Southwest:	413.6	30.91	17.65	14.5	(3)	(2)
Oklahoma	92.0	40.75	24.94	17.5	5	7
Texas	233.7	25.47	14.28	12.8	24	25
New Mexico	54.2	66.68	38.75	22.5	2	2
Arizona	33.7	31.25	16.95	12.8	15	19
Rocky Mountain:	$177.6	$42.84	$22.97	16.4	(1)	(1)
Montana	32.8	48.84	25.95	17.7	4	4
Idaho	23.4	36.27	22.43	16.0	10	11
Wyoming	26.9	84.88	41.78	24.8	1	1
Colorado	66.6	40.02	19.93	14.8	6	13
Utah	27.9	33.25	19.37	14.5	12	16
Far West:	629.5	33.70	14.00	11.1	(2)	(5)
Washington	81.0	29.73	13.99	11.2	17	27
Oregon	67.1	38.53	19.84	13.9	8	14
Nevada	16.3	62.36	25.25	17.4	3	6
California	465.1	33.51	13.24	10.7	11	28

SOURCES: Bureau of the Census, Governments Division, 1957 Census of Governments advance releases, No. 8, *State and Local Government Finances in 1957*, February 1959, Tables 3–6, with 48-state and regional amounts per capita and per $1,000 of personal income supplied by using regional totals in *Survey of Current Business*, August 1958, p. 13. Regional percentages computed from Table 3 of the Governments Division compilation.

the lowest-income group was 34 per cent *above* the national average, and in the highest-income group, 12 per cent *below*.

4. For highway construction, per capita grants tended to be highest in the middle-income states. In the seventeen middle states, the average grant was 43 per cent *above* the national average. In the sixteen lowest-income states the grant average was 13 per cent *above* the national average. In the sixteen highest-income states, it was 24 per cent *below* the national average. The greatly increased grants for the 41,000-mile interstate network began in fiscal 1957.

5. Employment-security also reveals a special pattern. These grants are primarily for the full administrative expenses of the state unemployment compensation system and employment services. Their expense runs highest, relative to total population, in the more industrialized states—and these are the states with the highest per capita incomes. Thus, the federal grants for employment-security in the sixteen lowest-income states averaged 25 per cent *below* the national per capita average, and the average for the middle-income group was almost as low. In the sixteen highest-income states, the grants averaged 17 per cent *above* the national average.

6. In grants for education, the largest amount of federal aid in recent years has been for school districts especially affected by federal government activities, such as military installations. Education grants in the aggregate in the sixteen lowest-income states averaged 11 per cent *above* the national per capita average but they were still higher in the middle-income group—24 per cent *above* the national average. For the sixteen highest-income states, grants for education fell *below* the national average by 14 per cent.

7. All other grants, for a variety of programs taken as a group, exhibited some general tendency toward equalization relative to personal incomes. In the sixteen lowest-income states, the average per capita was 62 per cent *above* the national average, and in the sixteen highest-income states it was 24 per cent *below*. The middle-group average was close to the national average.

B. FUNCTIONAL OR PROGRAM DIFFERENCES

The foregoing comparisons relate federal aid in the fiscal year 1957 to per capita personal incomes. The pattern of federal aid may also be usefully described in terms of geographical or other variations in the direct, quantitative importance of federal support for the several functions of state and local governments. The following general and somewhat tentative account is drawn from a combination of data already published in Census reports and those available from other sources. It is based on summations for the five years, 1953 through 1957.

The importance of federal financial aid in particular program categories may be assessed from the separate points of view of the state-local and the national governments. The relationship to the state-local programs is described first.

FEDERAL AID RELATED TO STATE-LOCAL EXPENDITURES BY PROGRAM CATEGORIES. The concentration of federal aid upon two or three program categories is evident both in Table 16, giving per capita amounts, and in Table 20, giving aggregates over a longer period. Of

TABLE 20
Federal Financing of State and Local Functions in the Five-Year Period, 1953–57, Inclusive
(millions of dollars)

Category	*Total*	*From Federal Government*	*From State and Local Sources*[a]	*Federal as Percentage of Total*
General revenue, total	$160,369	$16,140[b]	$144,229	10.1
Direct general expenditures:				
Total	169,484	16,158	153,326	9.5
By functions:				
Public welfare	15,692	7,215	8,477	46.0
Health and hospitals	13,131	481	12,650	3.7
Employment security administration	1,050	1,050	0	100.0
Education	59,575	2,644	56,931	4.4
Highways	31,681	3,305	28,376	10.4
Natural resources	4,168	438	3,730	10.5
Other and unallocable	44,187	1,025	43,162	2.3

SOURCE: Compiled from Bureau of the Census, Governments Division, annual *Summary of Governmental Finances*, 1955–56, and 1957, Tables 1 and 8.

[a] By subtraction.

[b] This tabulation reflects the Census classification of all intergovernmental expenditures by the federal government as general revenue to the state and local governments. Thus, the reported general revenue receipts of the states from the federal government in 1957 omit $30 million credited to unemployment trust fund revenues of the states; there was no corresponding item in the preceding years.

the $16 billion paid to state and local governments during the five years that ended with 1957, more than $13 billion, or five-sixths, was for public welfare, highways, and education.

The federal government financed nearly half—46 per cent—of all state and local expenditures for public welfare (and 49.8 per cent of that major segment of public welfare known as "public assistance").

Federal grants financed substantially all state administrative expenses for the employment security system (unemployment insurance and employment services).

Federal payments for highways, though substantial in amount, covered only 10.4 per cent of the \$32 billion that state and local governments spent for highway purposes. The same percentage of natural resource expenditures was financed by federal aid; the dollar-amount of this aid, however, was much smaller.

Federal assistance for education has been dominated by the geographically spotty distribution to selected school districts. The aggregate federal payments covered but 4.4 per cent of the near-\$60-billion total of state-local direct expenditures over the five-year period.

Health and hospital expenditures in the aggregate amounted to \$13 billion in the five years—barely more than a fifth of the amount for education. Federal payments financed 3.7 per cent of state-local expenditures for health and hospitals.

For nearly all other functional categories of state and local service, federal grants were relatively small in aggregate amount and small in comparative importance. Important for particular programs were federal grants for airport construction, slum clearance, urban renewal, low-rent housing, disaster relief, soldiers' homes, and perhaps a few others, but all these programs summed together were a small part of state-local expenditures. Among state and local services entirely without federal assistance, probably the largest financially are police and fire protection. Several writers have pointed out that federal aid has been used to help finance the service programs rather than the regulatory activities of government.[60]

PUBLIC ASSISTANCE. In the public assistance program, the federal grants finance—by a complicated and frequently liberalized formula —the major portion of assistance provided by public agencies to four categories of needy people: the aged, the blind, the permanently and totally disabled, and dependent children. All other needy persons who may be given relief by public agencies are classified as receiving "general assistance," a category that is not federally aided.

[60] Cf. V. O. Key, Jr., *The Administration of Federal Grants to States*, Chicago, 1937, p. 381; Paul Studenski and E. J. Baikie, "Federal Grants-in-Aid," *National Tax Journal*, September 1949, p. 197; Commission on Intergovernmental Relations, *Report* (1955), p. 125.

Until the recent rise in highway construction grants, public assistance was for years the largest single avenue of federal financial aid to state and local governments. The needs for public assistance tend to be proportionately greatest in the less affluent states. Also the formulas for federal matching of state-local expenditures have given greatest weight to the lower average relief payments in those states. Consequently, the public assistance grants have long exhibited an inverse association with average personal incomes in the several states. Extensive amendments enacted in 1958 are strengthening somewhat further this equalizing effect, although their full influence will become apparent only gradually.

The past equalizing tendency, relative to personal incomes, is evident in Table 21, in which the federal grants are shown to have financed during the period 1953–57 about two-fifths of public assistance expenditures in the twelve states with the highest per capita incomes and about two-thirds in the twelve states with the lowest per capita incomes. The progression is not regular, however. Among the six-state groups, the percentages for groups 3 and 6 deviate most noticeably. The high over-all federal percentage of 51.3 for group 3 reflects especially a ratio of 64 per cent federal financing in Missouri. The comparatively low over-all ratio of 54.9 per cent in group 6 is substantially determined by Oklahoma, which accounted for more public assistance expenditures than the other five states combined.

FEDERAL AID RELATED TO FEDERAL EXPENDITURES BY PROGRAM CATEGORIES. As is evident in Table 22, the federal functional categories in which federal-aid payments were most significant during the five fiscal years, 1953–57, were (1) labor and welfare—83 per cent, and (2) commerce and housing—38 per cent.

Labor and welfare as a budget category includes public assistance, a program in which the grant payments accounted for all but one-tenth of 1 per cent of the federal expenditures. It includes also labor and manpower, in which the grants (predominantly for employment security) represented 75 per cent of the federal outlay; and education, in which they were 74 per cent. In the field of public health, including hospital construction grants, federal aid represented less than half—45 per cent—of all federal expenditures for the five years. Of the hospital grants, about half were for private, nonprofit institutions. There was no federal aid for correctional and penal institutions, although there were payments for the use of local jails. There would

TABLE 21

Public Assistance Financing, by Groups of States: Five-Year Totals, 1953–57, Inclusive

GROUP OF 6 STATES (GROUPED IN ORDER OF AVERAGE PERSONAL INCOMES PER CAPITA, 4 YEARS 1954–57)	EXPENDITURES FOR PUBLIC ASSISTANCE,[a] 5 YEARS 1953–57			
	Total	*Federal*	*State*	*Local*
	AMOUNT (MILLIONS)			
Group 1 (highest incomes)	$3,766	$1,543	$1,346	$877
2	3,282	1,341	1,525	416
3	1,660	852	710	98
4	1,297	542	443	312
5	1,485	940	467	78
6	798	438	340	20
7	1,440	927	460	53
8 (lowest incomes)	1,167	838	280	50
48-State total	14,895	7,419	5,571	1,905
	PERCENTAGE OF TOTAL FOR THE GROUP			
Group 1 (highest incomes)	100.0	41.0	35.7	23.3
2	100.0	40.8	46.5	12.7
3	100.0	51.3	42.8	5.9
4	100.0	41.8	34.2	24.0
5	100.0	63.3	31.4	5.3
6	100.0	54.9	42.6	2.5
7	100.0	64.4	31.9	3.7
8 (lowest incomes)	100.0	71.7	24.0	4.3
48-State total	100.0	49.8	37.4	12.8
	PERCENTAGE OF 48-STATE TOTAL			
Group 1 (highest incomes)	25.3	20.8	24.2	46.0
2	22.0	18.1	27.4	21.9
3	11.1	11.5	12.7	5.1
4	8.7	7.3	7.9	16.4
5	10.0	12.6	8.4	4.1
6	5.4	5.9	6.1	1.1
7	9.7	12.5	8.3	2.8
8 (lowest incomes)	7.8	11.3	5.0	2.6
48-State total	100.0	100.0	100.0	100.0

SOURCE: Basic data from *Social Security Bulletin*, Annual Statistical Supplements for 1953–57 inclusive.

[a] Comprises the four federally aided categories, general assistance, and administrative expenses.

TABLE 22

Federal Aid to State and Local Governments as an Element in Federal Finance, in the Five Fiscal Years, 1953–57, Inclusive

MAJOR FUNCTION OR SUBFUNCTION IN FEDERAL BUDGET	AMOUNT (IN MILLIONS) *Total Federal Expenditures*[a]	*Federal Aid Expenditures*[a]	FEDERAL AID EXPENDITURES AS PERCENTAGE *of this Category*	*of all Federal Aid*
Federal Government, Total	$343,555	$16,502	4.8	100.0
Major national security	228,030	–	0	0
International affairs and finance	3,727	–	0	0
Veterans services and benefits	22,560	36	0.1	0.2
Labor and Welfare:				
Public assistance	7,214	7,205	99.9	43.7
Labor and manpower	1,761	1,318	74.8	8.0
Promotion of public health (includes hospitals)	1,703	764	44.9	4.6
Education	1,456	1,084	74.4	6.6
Science, research, libraries, museums	247	1	0.4	[b]
Correctional and penal institutions	144	–	0	0
Other welfare and administration	679	570	83.9	3.4
Total, Labor and Welfare	$13,204	$10,942	82.9	66.3
Commerce and housing:				
Provision of highways	3,593	3,293	91.6	20.0
Promotion of aviation	1,313	90	6.8	0.5
Promotion of water transportation	1,959	1	0.1	[b]
Housing, community development and facilities	295[c]	85	28.8	0.5
Civil defense	272	52	19.1	0.3
Other commerce[d]	1,833[c]	49	2.7	0.3
Total, commerce and housing	$9,265	$3,570	38.5	21.6
Agriculture and agricultural resources	19,399	1,332	6.9	8.1
Natural resources	6,393	419	6.6	2.5
General government	7,332	204	2.8	1.2
Interest	33,645	–	0	0

SOURCE: Compiled from "actual" fiscal year expenditures shown in the federal *Budget* documents for the fiscal years 1955–59, inclusive. Federal aid is the sum of grants, shared revenues, and net loans reported in Special Analysis G or H of the several *Budget* volumes.

[a] "Expenditures" here represent federal "net budget expenditures" plus highway trust fund expenditures for 1957, which was the first year of the trust fund.

[b] Less than one-twentieth of 1 per cent.

[c] After deducting receipts that were credited against expenditures.

[d] Comprises postal service deficits; aids to business; regulation of commerce and finance; and disaster insurance, loans, and relief. For "aids to business," there were $869 million of net receipts (negative expenditures) in the five years.

have been no federal aid for libraries, museums, science, and general-purpose research but for the introduction of demonstration grants for rural libraries in fiscal 1957.

In the commerce and housing category, the outstanding subject of aid is highway construction. For the five-year period, federal grants for state and local highway building took 92 per cent of all the federal expenditures for "provision of highways" (including in 1957 the highway trust fund expenditures). Airport construction grants represented under 7 per cent of federal expenditures to promote aviation. In the promotion of water transportation, only the federal grants to state marine schools are considered intergovernmental aids; these were $1 million in a five-year total of nearly $2 billion of expenditures. The large expenditures for river and harbor development and other navigation improvements are considered direct federal programs, not financial aids to states and their subdivisions.

In the case of housing, slum clearance, and urban redevelopment programs—also part of the commerce and housing category—measurement of the relative importance of federal aids is complicated by the accounting system. In these programs, a large part of the aids takes the form of loans rather than grants; as already noted, the loan disbursements are considered expenditures and any repayments received are considered "negative expenditures." For some parts of the program in some years—and indeed for the public housing programs as a group for the whole five years—the federal expenditures are negative; i.e., receipts exceed expenditures. Thus, neither the $295 million of total federal expenditures nor the $85 million of federal aids shown for housing and community development and facilities is an actual measure of federal financial operations in this field during 1953–57. A different handling of the transactions could easily change the ratio of federal aid to total federal expenditures in this category from the 28.8 per cent shown in Table 22 to some other magnitude. In fact, the same can be said for the over-all percentage of 38.5 for commerce and housing, since the stated amount of federal expenditures (budgetary plus the highway trust fund) is affected not only by the repayments on public housing, slum clearance, and urban redevelopment loans, but also by the deduction of other receipts credited against expenditures. Dependable measurement of the importance of federal aid as a component of this category of the federal budget would require special interpretations of the data.

The purported 6.9 per cent of expenditures classified as federal aid in agriculture and agricultural resource programs must be similarly qualified because the aggregate federal expenditures are a similar composite comprising not only the net amount of loan transactions, but also the net result of commodity purchases and sales. However, the 6.9 per cent certainly gives a correct general impression—that is, that federal aid to state and local governments is relatively a small part of the federal government programs for agriculture. The aids in this category are largely commodity distributions to the school lunch program and other state-local agencies. (Cash grants to the school lunch program are included in "other welfare services" and help explain the high proportion of federal aid in that subfunction of labor and welfare.) Also important are payments for cooperative agricultural extension work and agricultural experiment stations.

The similar magnitude for natural resources—6.6 per cent devoted to aid to state and local governments—is a reasonably clear figure. Direct federal programs dominate this functional category, also. Much of the aid is in shared revenues from mineral leasing, timber sales in the national forests, and TVA operations (the latter distributed as payments "in lieu of taxes"); the rest is largely in grants for wildlife restoration and forestry cooperation.

The reported federal aid for purposes of "general government"—measured at 2.8 per cent of all federal expenditures for general government—can be misleading, since the payments during 1953–57 were exclusively to the District of Columbia and various territories and possessions. None of these expenditures was for assistance to any state or its subdivisions.

Budget expenditures for interest on the public debt were slightly more than twice the total for federal aid in the period 1953–57.

C. SOME FEDERAL PROGRAM DEVELOPMENTS AFFECTING STATE-LOCAL FISCAL NEEDS

In some fields, such as public assistance, major highway construction, slum clearance, and urban redevelopment, the pressures for expanded federal financial assistance to state and local governments have operated inexorably. In others, such as education and resource conservation, pressures have been persistent and strong but the resistance has been stronger. An interpretation of the differences might be enlightening, but it would require more intensive analysis than can be undertaken in this paper, as well as subjective evaluations outside its intended scope. On the other hand, a sketch of some related developments seems necessary to a consideration of factors shaping the next decade.

FEDERAL PROGRAM OPERATIONS THAT RELIEVE STATE AND LOCAL GOVERNMENTS. When the federal government in 1928–30 took direct responsibility for completing the improvement of the Illinois Waterway and for its subsequent operation, it relieved the state of Illinois from the necessity of proceeding with a project on which the state had already expended $16 million. The federal government in the ensuing thirty years invested twice that amount in new work, besides $28 million for operation and maintenance. The Corps of Engineers has reported that in 1957 the original project was 96 per cent completed, but the revised project, which now includes related works even more costly than the original Waterway, was only 18 per cent completed. The revised cost estimate in 1957 was $160 million for project construction, with annual maintenance costs on the completed work averaging $1.8 million a year and expenditures for operation and care running even higher.[61] The state government finances no part of the waterway construction, maintenance, or operation.

Such a dramatic transfer of a specific responsibility, though not unique, is a comparatively rare event. Usually the shift is more generalized. When the program for the federal interstate highway network was enacted, with its provision of federal grants for 90 per cent of the construction costs of toll-free superhighways, one almost immediate result was a cooling off of enthusiasm for additional toll-charging turnpikes under state or special-authority auspices.[62] The toll roads, of course, have been financed by revenue bonds and operated as commercial-type enterprises, but in the Census Bureau statistics they are included in "direct general government." Initiation of the federal program had a strong impact on state and local activities in this field—though it is too soon to say whether the immediate response will prove to have been an acceleration or, as seems more likely, some lessening of the rate of increase in construction outlays from the state and local governments' own sources of revenue. The high standards of construction on the interstate network may permit some postponement of maintenance costs and retention of lower standards on some local roads.

Whatever the first reaction, it seems plausible in the case of the

[61] U.S. Department of the Army, Corps of Engineers, 1957 Annual Report, *Chief of Engineers, Civil Works Activities* (1958), Vol. 2, pp. 1274–5.

[62] Cf. *Business Week*, October 18, 1958, pp. 58–64.

highway program to expect that after a few years state and local financing for maintenance and operation of the road system will have to increase above recent levels—unless, of course, federal aid is broadened to cover these needs. Will future state-local outlays for construction, maintenance, and operation in the aggregate be greater or less than if there had been no special federal program?

In another field, urban renewal and slum clearance projects prosecuted with federal financial assistance may arrest the deterioration of central city areas, ultimately salvaging a significant part of the local tax base and strengthening city finances.

PUBLIC ASSISTANCE AND OASDI. Less direct and obvious, though equally real, is the relationship between the federally operated system of old-age, survivors, and disability insurance and the federal-state local system of public assistance.

As noted earlier, the pressure for increase in federal grants for this program has been practically irresistible. Since 1950 specific provision has been made to finance with federal grants a substantial part of the payments made to vendors of medical care for persons on public assistance. The matching formulas have been liberalized repeatedly. A further increase in the federal share, accompanied by adjustments in the formulas, was enacted in 1958; the effects will not be fully reflected in assistance payments and financing for another year or two.

At the same time, the gradual maturing of OASDI since its inception in 1935–39, coupled with its broad expansion in the decade of the 1950's, has greatly lessened otherwise mounting pressures for public assistance expenditures. So marked has been the effect that even in this era of rapidly growing population, with its especially rapid growth of the proportions who are in the dependent groups of the very old and very young, the number of recipients of public assistance now is somewhat lower than in 1950. In the face of rising personal incomes, living standards, and consumer prices, the aggregate of payments (excluding administrative expense) advanced 28 per cent from 1950 to 1957—an interval in which consumer prices alone advanced 17 per cent.[63]

[63] This is the increase in the average consumer price index for the calendar years. Medical care prices within the consumer price index advanced 36 per cent in the calendar year averages. Medical care is an especially important segment of public assistance expenditures, accounting in 1957 for $224 million of money payments directly to vendors of medical services in the four federally aided categories, to which should be added any direct expenditures by assistance recipients and the medical care expenditures made for recipients of general assistance.

The OASDI program has affected all the categories of public assistance but most significantly the major category, old-age assistance. In fact, the numbers drawing aid to dependent children and the blind rose nearly one-eighth from 1950 to late 1958. The number of the permanently and totally disabled receiving assistance rose also, but in 1950 this category was newly separated from general assistance and was identified in only a few states. The over-all total on public assistance rolls declined because of a 12 per cent decrease in the number of recipients of old-age assistance. Also, despite the recession of 1957–58, the number of persons drawing general assistance was less in late 1958 than in the post-recovery month of December 1950.[64]

For old-age assistance, federal, state, and local expenditures for assistance payments in calendar 1957 were $1,773 million, with 56 per cent of the total provided by the federal government.[65] On an average for the whole country, about one-sixth of the population of age sixty-five and over received old-age assistance payments—168 in each 1,000 in June 1957, and 162 in each 1,000 a year later. In the 1940's the average was 212 in each 1,000.[66] Suppose that proportion had persisted. In that event, the difference in numbers alone would have meant old-age assistance benefit payments in 1957 more than one-fourth greater, some $465 million more, than the actual total of $1,773 million. Moreover, an increasing percentage of the old-age assistance recipients—by June 1957, 571,000 persons, or close to one-fourth—were being given relatively small amounts of public assistance to supplement inadequate OASDI benefits. In the 1940's, relatively few persons drew both old-age assistance and OASDI benefits at the same time. The average assistance payment in 1957 necessarily would have been substantially higher in the absence of OASDI. The difference is not easily estimated, but each $1 additional in the over-all monthly average of old-age assistance payments for the year 1957 would have required $30 million more of federal-state-local expenditure for the 2.5 million persons then on the rolls.

Without OASDI, then, the larger number who would have been drawing old-age assistance and the higher amount of the average individual payment might easily have required some $750 to $850

[64] Data on numbers receiving assistance are from *Social Security Bulletin*, Annual Statistical Supplement, 1957, principally p. 74; and *Social Security Bulletin*, January 1959, p. 27.

[65] These aggregates include the District of Columbia, Alaska, Hawaii, Puerto Rico, and the Virgin Islands. *Ibid.*, Annual Statistical Supplement, 1957, pp. 74 and 84, Tables 105 and 108.

[66] Bureau of Public Assistance, *op.cit.*, p. 56.

million more of assistance payments. With federal grants at the 1957 proportion of 56 per cent—a proportion considerably higher than in the 1940's—an additional total outlay of this magnitude would have called for $330 to $375 million more from state-local sources.[67]

The maturing and expansion of the federal OASDI system has been almost certainly the major change taking pressure off old-age assistance—surely a stronger factor, even, than rising prosperity. This shift to primary reliance on a contributory insurance system was, indeed, an original advantage asserted for the social security law.

Public assistance, then, is an area in which a federal program has relieved the state and local governments of a growing share of a large responsibility. Even without further liberalization of the OASDI system, its effects should be still more pronounced a decade hence. At that time, less than 10 per cent of the aged population will lack eligibility for the insurance benefits.

When the Commission on Intergovernmental Relations examined the public assistance grants several years ago, it recommended that general assistance should continue to be financed and administered by the states and their subdivisions, and that, as total national-state expenditures for old-age assistance decrease, the contribution of the national government to this program be decreased by approximately the same amount. Also, it proposed revision of the formula governing federal financial participation in old-age assistance so that greater equalization of the burden will be achieved.[68]

The 1958 amendments moved in the direction of greater equalization relative to personal incomes. They provided, however, for an increased federal share in financing of the public assistance program as a whole and at the same time raised the insurance benefits.

What additional lessening of potential state-local responsibilities may follow this important legislation? How far can public assistance shrink in relative importance on the basis of the continuing expansion of federally administered social insurance? What other factors will operate in this general area?

Legislation has often been proposed and is currently being urged that would create a new federal-aid category for general assistance or,

[67] If the comparisons were based on averages for December rather than June, the additional outlay to care for the larger number of recipients would be $558 million, rather than $465 million. The wholesale calculation, with its rough allowance for the level of assistance payments, probably understates the aggregate reduction in old-age assistance even though it omits qualifications for the possible impact of the OASDI system on private pensions and savings, as well as refinements for interstate differences.

[68] In the Commission's Report, cited *supra*, cf. pp. 270–1.

in some versions, would wipe out all the categorical distinctions. An advisory council appointed by the Secretary of Health, Education, and Welfare is examining the whole question of public assistance, including its future relation to old-age, survivors, and disability insurance, and the desirable division of financial responsiblity between the federal and the state and local governments.

During the recession of 1957–58, not only were bills introduced in congress to bring the general assistance category under the umbrella of federal aid, but there was strong support for related proposals to pay from general federal revenues unemployment benefits for two groups of unemployed persons: those whose entitlement to insurance benefits under state laws was exhausted and those who had no insurance entitlement. The temporary extended unemployment compensation law that was enacted in 1958 provided for those whose rights were exhausted but not for the uninsured. Moreover, it calls for ultimate repayment of the federal expenditures made in the seventeen states that joined the program.

FEDERAL PROGRAM OPERATIONS THAT GIVE RISE TO SPECIAL NEEDS. Except in periods of war, there appear to be few instances of widespread need for state and local services created by program operations of the federal government. Perhaps the peacetime need for civil defense organization and preparations is one such instance, but it serves also in local and regional civil disasters. Another instance is the provision of schools and other local services for children living on federally owned land or for the children of persons who work in tax-free federal establishments.

Customarily, special federal aids have been provided in such circumstances. Thus there are grants-in-aid for civil defense and for the construction and operation of schools in communities especially affected by federal government activities; there are special schools for some Indian children who are wards of the federal government and special aids to local school systems that accommodate other children living on Indian reservations; there are special services for communities created for the atomic energy program and reclamation projects, and arrangements to help finance state and local governments in the area of the Tennessee Valley Authority.

Whatever may be the complexities or shortcomings of any or all of these special programs, the pertinent fact for the present inquiry is that we have here no policy vacuum. The policy issues that arise, rather, are those relating to consistency and equality that inevitably accumulate in a series of piecemeal provisions for interrelated problems.

OTHER ILLUSTRATIVE CASES. The significance of some federal programs for state-local finance may be real, yet indeterminate in fiscal direction.

A federal reclamation project, making possible the settlement and exploitation of a comparatively arid tract of land, may mean more services from and revenues for the county government or other local units. Whether the added revenues outweigh the added expenses depends on local circumstances.

The federal government has undertaken major research and demonstrations directed toward the production of useable water from saline and brackish sources. These efforts, if successful, may make available lower-cost water supplies for communities where the present or threatened scarcity of an adequate supply of potable water is a subject of concern and expense. Success may also mean more population—and more local government services—in areas that now are settled sparsely or not at all. Similar consequences could flow from weather-modification studies that have been authorized.

In fact, the general environmental situation in which all state and local governments will be operating ten or twenty years hence may be profoundly affected by the findings and the application of federally sponsored or federally stimulated research.

A striking current instance is the transformation of care for the mentally ill—a field worth reviewing in some detail as a case illustrating how a limited program of intergovernmental aid sometimes meets with a substantial response.

About half of the hospital patients in the United States are in mental institutions—most of them in state hospitals. For a century, these hospitals were little more than places of custody and detention—overcrowded asylums offering little hope to the hundreds of thousands of people who were brought within their walls.

In 1854, Congress yielded to the entreaties of that "angel of mercy," Dorothea Lynde Dix, by voting to donate federal lands to aid the states in the care and support of the mentally ill. President Pierce vetoed the bill. He held that this was an improper intrusion of the federal government into a field of local responsibility. There was no federal aid for care of the mentally ill until 1946, when the National Mental Health Act was adopted. That legislation established a National Institute of Mental Health, a research agency, in the Public

Health Service. It provided grants to research workers in state and private institutions; it provided help to medical schools to encourage them to train more professional personnel; and it inaugurated small grants to the states for community mental health services. The grant payments to all the states under the Act were $1.6 million in the first fiscal year, 1948; they are estimated at $4 million annually in the fiscal years 1959 and 1960.

Soon after the National Mental Health Act was adopted, a few of the states began to examine their mental health programs more closely. The major impetus for this reawakening, it has been said, was the federal legislation:[69]

"After the passage of the Act of 1946 the states bestirred themselves. They started to build buildings. They hired more doctors, nurses, and attendants and raised their salaries. They matched federal grants. They reorganized their mental health departments. They established preventive programs—community clinics, child-guidance clinics, out-patient clinics. By 1953 the states were spending three times what they had spent on their state hospitals nine years before—half a billion dollars a year. Some states had multiplied their expenditures fantastically during that same period—Kansas by 610 per cent. Capital outlays became enormous—New York alone spent $350 million building hospitals. New research and training centers were set up. Salaries were increased until in some states mental health officials were earning more than governors. State spending far outran federal."[70]

For the current operating costs of mental institutions, the states alone reported expenditures of $189 million in 1946. By 1953, the total had risen to $498 million and by 1957 to $686 million, with capital outlays approaching $200 million a year. The budget of New York State currently includes a larger amount for mental hospitals than was expended in 1946 by all the 48 states together.[71]

[69] John Bartlow Martin, "A Better Break for the Mentally Ill," in *Harpers*, February 1959, pp. 58–64, tells the story of these developments.

[70] *Ibid.*, p. 59. See, also, the same writer's book-length report, *The Pane of Glass* (Harpers, 1959), from which the magazine article is taken.

[71] Annual totals for state hospital operating expenses are reported on p. 44 in Council of State Governments, *The Mental Health Programs of the 48 States, a Report to the Governors' Conference* (Chicago, June 1950; 377 pages), prepared in response to a resolution of the Governors' Conference of June 1949. Data for 1953 and 1957 are from Bureau of the Census, Governments Division, *Compendium of State Finances*, 1953, p. 35, and 1957, p. 31. The New York State budget as proposed for 1959–60 included $203 million for mental hospital operations and $39 million for construction (*The New York Times*, February 3, 1959).

It may be assumed that the federal legislation, with its effect of prodding the states, was itself an outcome of the same rising medical, economic, and humanitarian concern that was pushing inevitably toward concerted action at all levels of government. The interest of individual states led to discussions in the Governors' Conference, a state-sponsored study of the subject, and the formation of an Interstate Clearinghouse on Mental Health for the exchange of information and ideas.[72]

The application of various new drugs, beginning on a large scale in 1953, has had much influence. This, however, is not directly an outgrowth of federal research and leadership.

Whatever the prime cause, it is clear that federal legislation and action contributed significantly to the mental health revolution of the last dozen years. The nationwide ferment led to further federal action in the form of a law enacted by Congress, the Mental Health Study Act of 1955, giving official sanction to a three-year study by a Joint Commission on Mental Illness and Health—a joint, nonprofit project of the American Psychiatric Association, the Council on Mental Health of the American Medical Association, and a score of national professional and lay organizations. Congress appropriated $1,250,000 for the Joint Commission, and the states and private sources have supplemented this financing. The Commission's interim reports have already influenced public attitudes toward the state programs for preventing and treating mental illness and promoting mental health.

Already the overcrowded mental hospitals have experienced some actual reduction of population—from 558,000 at the end of 1955 to 547,000 two years later.[73] What is more significant in terms of human welfare is that there has been some shortening of the average patient's stay. Between 1945 and 1957, admissions to state and local public mental hospitals increased from 115 to 150 for each 100,000 of

[72] Cf. the Council of State Governments report cited in the preceding footnote; also, by the Council's Interstate Clearinghouse on Mental Health, *State Action in Mental Health: A Summary of Financial, Legal and Administrative Developments in State Mental Health Programs*, 1956–57 (mimeo., 95 pages; April 1958).

[73] Department of Health, Education, and Welfare, Office of the Secretary—Office of Program Analysis, *Health, Education, and Welfare Trends*, 1959 ed., p. 36. Of a total of 623,938 resident mental patients in all United States hospitals at the end of 1957, 547,495 were in state, county, and city hospitals; 60,935 in Veterans Administration hospitals; 1,965 in United States Public Health Service hospitals; and 13,543 in private hospitals. For resident patients in state-local hospitals, the rate per 100,000 of the civilian population reached a peak of 441.0 in 1954 and declined during the next three years to 417.1 at the end of 1957.

civilian population. At the same time, releases rose from 154 a year to 175 a year for each 1,000 resident patients.[74]

Some researchers think schizophrenia and certain other mental illnesses may be linked significantly to the bodily chemistry of the patient; this avenue of research is one of the most hopeful in the whole field of mental health. The expense for each patient-day of residence will clearly be greater if the care is to be more intensive, more professional, and more efficacious. The possibilities in the realm of patient-costs may be suggested by some quick comparisons. The estimated average cost of maintaining a patient in a public nonfederal mental hospital in 1957 was $3.64 a day. This was 38 cents—12 per cent—more than the daily average only one year earlier.[75] It was more than twice the median cost for 1949.[76] The patient-day costs for neuropsychiatric patients in the federal government hospitals for veterans for many years have run far ahead of average patient-day costs in state mental hospitals—and the average length of the patient's stay in the veterans' hospitals has been decidedly shorter. Last year the operation and maintenance costs in the veterans' hospitals averaged $4.01 a patient-day; estimates for fiscal 1960 indicate a rise to $4.37.[77] An average increase from $3.64 to $4.37 for all the patients in state-local mental hospitals in 1957 would have meant something like $146 million a year of additional expenditures.

Suppose the state and local governments undertake to improve care. Will the greater expense for each patient-day mean, in the aggregate, greater or less expense over the hospital stay of each admitted patient? What will be the net effect on state and local finances (let alone the net effect on the national income) of the rehabilitation and renewed productivity of millions of helpless persons who, under present arrangements, are consumers only?[78]

D. SOME EVALUATIONS OF FEDERAL AID

This review has indicated that federal aid is an important source of revenue for state and local governments—a major source for

[74] *Ibid.*, p. 37.

[75] National Institute of Mental Health, *Facts on Mental Health and Mental Illness* (revised May 1958), p. 7.

[76] Derived from median annual cost in Council of State Governments, *Mental Health Programs of the 48 States*, p. 262.

[77] Calculated from operating costs and average daily patient loads shown in federal *Budget* for fiscal year 1960, pp. 217–8.

[78] For a prognostication based on the foreseeable effects of tranquilizers and energizers alone, cf. Rudolph Kieve, "The Chemical Revolution in Psychiatry: Its Effects on

financing certain of their functions, such as public assistance and highways, and a relatively negligible source for others, such as education, natural resources, and agriculture. As a channel for expenditures, federal aid is a sizable but not a major item in the federal budget. In the labor and welfare field, however, it is a dominant channel of expenditure.

Geographic variations in the distribution of federal aid tend to be associated with differences in personal incomes. In the aggregate and for several program categories, per capita federal grants have been highest in the group of low-income states and lowest in the high-income group. The services exhibiting this association are public assistance—the largest grant category and the program for which income-differences may be considered most meaningful; the health services, "other" welfare services, and a catch-all category of other programs taken as a group. In the highway construction, employment security, and education grants there has been no clear tendency for the highest proportionate grants to go to the states with the lowest incomes; each of these categories is a special case.

Over the last two decades, proposals have been advanced from time to time that the fiscal structure of interlevel relations might be simplified, and the independence and strength of the states enhanced by a simultaneous reduction in federal grants and selected federal taxes yielding an equal amount. The Commission on Intergovernmental Relations concluded that it could not support this proposition. It commented as follows:

"This approach would be inadequate in the current situation, since grants serve an essential purpose by assisting in the support of specific functional programs. Moreover, any general or selective reduction or repeal of federal grants coupled with an equivalent reduction in federal taxes would intensify the fiscal problems of the lower-income states, which would lose far more in grants than they would gain in taxes. On the other hand, a tax cut of sufficient magnitude to

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the Care of the Mentally Ill," *State Government*, Spring 1959, pp. 104–8. Dr. Kieve predicts "that, not too far in the future, public mental institutions will not only have little claim for expansion—replacement of indispensable equipment aside—but that many will have to prepare for contraction," and that "it will not be possible much longer to shift so much responsibility—financial, legal, and moral—for the mentally ill from the municipality and county level to the state level," pp. 106–7. He suggests that the productive years of the mentally ill will be greatly increased and the costs of public care may be substantially reduced or recouped.

indemnify fully every state would result in a total loss of federal revenue that would far exceed the grant reductions."[79]

The Joint Federal-State Action Committee has examined various specific approaches to interrelated tax and grant reduction. It has documented one by one the practical difficulties involved in trying to work out such a program, and, as indicated in Section 2 above, has recommended a transfer of part of the federal telephone tax to the states in exchange for withdrawal of federal grants for vocational education and for construction of waste treatment plants, with state assumption of full responsibility for these programs. The tax reduction and distribution were estimated for 1958 at $147.5 million, and the grant reduction at $86.5 million. The President endorsed this proposal,[80] but neither in Congress nor in the states does favorable action appear to be imminent.

The Committee's program, it has been aptly said, makes clear that the practical choices are quite limited. They embrace (1) a choice between a carrot for state-local expenditure programs and a carrot for state-local tax programs, and (2) a choice between equalizing federal program grants and some type of equalizing fiscal grant.[81]

A general evaluation offered by the House Committee on Government Operations may provide a convenient summary for this review. After conducting extensive regional hearings in all parts of the country, after examining hundreds of replies to a comprehensive questionnaire and analyzing detailed statistical data supplied by federal agencies as well as by state and local governments, a subcommittee reported as follows—and the full Committee concurred unanimously:

"With relatively few exceptions, the subcommittee has found a favorable acceptance throughout the nation of the use of grants and of most existing grant purposes. Although a number of witnesses and questionnaire respondents signified that as a general principle their state or local governments would be willing to assume

[79] Commission on Intergovernmental Relations, *Report*, pp. 115–6. Four members of the 25-member Commission dissented, arguing that the tax and grant reductions, "with the reduced grants being more heavily equalized," would be a move in the right direction. They observed that "no nice balance is to be expected; tax and grant reductions should not even be respectively earmarked." (*Ibid.*, footnote.)

[80] Federal *Budget* for fiscal year 1960, p. M65.

[81] Selma J. Mushkin, "Fiscal Capacity of the States," address before the National Tax Conference, Philadelphia, October 29, 1958, published by the National Tax Association in the 1958, *Conference Proceedings* (1959), p. 304.

independent responsibility for aided functions if adequate tax sources were available, comparatively few specific grants were recommended for termination.

"In general, the subcommittee finds the grant a useful device for harnessing cooperative governmental effort in the accomplishment of a national legislative purpose. The opportunity for cooperation between the levels of government for the attainment of common objectives should be recognized as a resource of our federal system. In some circumstances the use of a grant may be the more practical and desirable method of administering an activity than confining complete responsibility to any one level of government."[82]

There is abundant reason, then, to conclude that federal aid in the form of grants, loans, and revenue-sharing—like many other practical expedients devised to meet specific needs—has become an institution firmly established as part of our federal system. As yet, a more efficient acceptable device for interlevel cooperation in the program side has not appeared.

On the other hand, federal aid is not appropriate to all types of interlevel problems. Clearly, each measure of fiscal accommodation must be applied selectively and with specific safeguards, limitations, and objectives.

In such a setting, as Harold Groves said a good many years ago, the pragmatic approach of "nibbling" promises most in the way of progress in what must be a complicated cooperative venture. Hopes for a grand solution of the fiscal coordination problem, or for a single comprehensive plan for immediate adoption, are doomed to disappointment.[83]

COMMENTS

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Authors Ecker-Racz and Labovitz have presented a comprehensive exhibit of the fundamental research upon which the quest for practical

[82] U.S. Congress, House Committee on Government Operations, Federal-State-Local Relations: *Federal Grants-in-Aid—30th Report by the Committee*, 85th Cong., 2d sess., House Report no. 2533, August 8, 1958, pp. 26–7. The subcommittee report was adopted and submitted by the full committee.

[83] U.S. Treasury Department, Committee on Intergovernmental Fiscal Relations, *Federal, State, and Local Government Fiscal Relations: A report submitted to the Secretary of the Treasury*, 78th Cong., 1st sess., Senate doc. 69; 1943, p. 2. Harold M. Groves was chairman of the special committee that made the study; the other members were Luther Gulick and Mabel Newcomer.

solutions in intergovernmental fiscal relations must be based. They have also analyzed some of the practical difficulties involved in alternative suggestions for improvement. This is a first rate accomplishment and a valuable contribution. They have not devoted very much space to an attempt to define the problem. Perhaps this cannot be done without a good deal of "subjective evaluation" which the authors sought to avoid. Perhaps "Defining the Problem" is another paper which might have been on this agenda. Anyway, the discussant finds it difficult to say much about the practical solutions without considerable inquiry or speculation as to what they aim—or might or should aim—to accomplish in the first place. We don't need any practical solutions unless we have a problem.

Mr. Ecker-Racz suggests that the problem or major problem might be overlapping taxes. But it isn't at all clear to me that there is anything very objectionable about overlapping taxes. One tax utilized by two layers of government involves two administrations where one might suffice; but it probably involves less total administration than two different taxes, one designated for the top layer of government and one used by the lower units.

Perhaps the major difficulty is found in the fact that the states are now in considerable financial difficulty, caught in a squeeze between rising responsibilities (especially for education) and disappointing revenues. Mr. Netzer's paper offered some prognostications concerning the long-range aspects of this problem. It can be said on the reassuring side, as Ecker-Racz indicates, that very few if any states have exhausted their tax potential. Less than half the states have both income and sales taxes and very few if any of these, even within rate limits applied in other states, have exhausted these sources. As to recessions, it is true, of course, that the federal government could help the states immeasurably if it could somehow manage the economy to achieve stable prices, rapid growth, and low interest rates. But this surely is another paper. It is also true, of course, that the states' problem would be easier if the federal government did not pre-empt so much of so many taxes. The person who is in a position to do something "grand" about this is not the Secretary of Treasury but the Secretary of State.

Perhaps the problem is interstate and intercommunity competition—legislators caught in the frustration that, while they would like to raise state or local taxes to meet current demands for services, they are constrained lest the tax base or the richest part of it will move out or shun them. After all, if the states need more revenue, they have the same taxpayers in their jurisdiction that the federal government has in its. And the states enjoy all the important legal powers to tax. I expect that the competition factor is at the bottom of a considerable part of the demand—and need—for federal help. Ecker-Racz mentions it, observing that there is no creditable evidence that state taxes have affected industrial development. Whether his observation is valid, and I have no reason to question it, there is a lot of fear that it might not apply in specific cases. The fear cramps the style of the states and municipalities even if it has no valid foundation.

Perhaps the nub of our problem is increasing general property taxes. This raises a host of problems some of which carry us straight into subjective evaluation: How bad is the general property tax anyhow? Does it have any natural or other limits beyond those imposed by the constraints of intercommunity competition? On the sanguine side, we could cite the fact that while the general property tax is a heavy burden on housing, new homes are being built in large numbers. Moreover, it is not clear that property taxes have increased very much in relation to income and wealth. In Wisconsin, average state rates have been rising since 1953, but the rise has amounted to only about 10 per cent and is still less than half of a postwar drop.

Perhaps the federal government has grown too much and too fast, usurping through its aid system functions that had better be left with the states. But as Mr. Labovitz has documented, the Joint Federal State Action Committee working hard on this theme finally developed only the concrete suggestion that a part of the local telephone tax be surrendered by the federal government in exchange for assumption of full responsibility for vocational education by the states. It was a very modest program but it invoked little enthusiasm in Congress. Apparently the federal aid program is firmly established and popular.

Perhaps there is legitimate ground for the concern lest the growing importance of state and local taxes along with the erosion of the federal tax base enfeeble the progressiveness of the over-all tax system. Available data seem to indicate that the role of the tax system as equalizer is not very impressive nor is it becoming more so. However, the egalitarian debate into which this leads can hardly escape a large element of subjective evaluation.

Now, still in search for a cause of complaint or alarm, let us consider briefly some of the several major coordination institutions which our authors have passed in review.

Take for instance deductibility of state and local nonbusiness taxes against the federal income tax base. It is an old institution inaugurated apparently on the ground that income free of personal taxes is the appropriate measure of taxable capacity. The point was compromised however when a few years later federal income taxes were disallowed as a deduction. Currently, deductibility is most often defended as a coordination device. It is open to considerable objection on the grounds that it provides an uneven concession for taxpayers at different levels; it encourages the states to venture into excessive progression, largely at the expense of the federal treasury and it (as to property tax allowance) discriminates between landlords and tenants. This is a fairly impressive bill of indictment. On the other hand, deductibility affords the states some protection at the critical point of interstate competition; it is nominally neutral among state choices in their tax systems; and it has not as a matter of fact been abused. There are considerable difficulties and objections associated with alternatives that might be proposed. It is my personal view that an income tax credit could do the job now assigned to deductibility and do it better, but our authors, apparently, regarded this alternative as so inaccessible that they didn't even give it honorable mention.

Then we have the death tax credit. The person who does not have a large estate but who does favor reform wherever necessary could not examine the death tax and the credit associated with it without concluding that something should be done in this area.

Here again the first step should be an analysis of the purposes the credit is supposed to serve. It was established in the now fairly ancient past as a compromise between federal abandonment of the death tax and federal exploitation of the field with no regard for the states' preestablished interests in it. The credit was also inaugurated to mitigate the tendency of large taxpayers to migrate in contemplation of death. It was observed that it might provide the states some assistance in an area of administration where they were weak. Finally, it is apparent that a credit serves the purpose of directing the pattern of state death-tax institutions.

Suppose, for the exercise, that the last-named factor were given predominant weight in the remodeling program. Suppose the federal government, in conference with state officials, were to accept some model or modal schedule of effective state rates on estates, let us say on those with assets upwards of $20,000, presumably featuring the ideas that the states will exploit the small estates intensively and apply moderate graduation to the remainder of the scale. Suppose the federal government were then to extend the coverage of its tax to include all of these estates. Suppose the federal credit were tied to this model state-scale instead of the 1926 federal scale, and suppose that a high percentage credit—say 80 per cent—were applied to it to constitute the federal assistance to the states in this field. States could go beyond this at their own risk. The suggestion is probably utopian but it would at least have the advantage of a rationale more plausible than historical accident.

Let us turn finally to our federal aid program and inquire whether it meets the criterion of rationality which is one test of the adequacy of our coordination institutions. I find this an extremely elusive subject and I am grateful for the help of Labovitz's data and Musgrave's profound analysis. Aids can be viewed as a manifestation of federal interest in programs which are also of state interest. They can thus be viewed as federal expenditures *per se* and only incidentally a federal-state coordination device. They also may be viewed as a means for territorial equalization and of local tax relief. As presently constituted, they serve these latter purposes incidentally and not very effectively. A block grant on the Australian or British model might serve these latter objectives more advantageously. The block grant would also make more sense than our present program, if it be concluded that differential degrees of federal interest in local activities is indeterminable.

The rationale supporting present federal practice is one case where the benefits-received doctrine is still in vogue. The idea of reciprocation, of taxes justified if not measured by benefits, is the basis of the judicial doctrine that one jurisdiction cannot tax what lies outside its borders. It is only a logical extension of this idea to conclude that an over-all unit of government should not tax one district to relieve the budget of another. This is not to say, however, that a minimum standard for certain public services may not be a matter of general interest.

A community's interest in other communities' amenities has a distance preference somewhat similar to the time preference of individuals in classical theory. This is one reason why we have not only our lowest layers of government but also intermediate ones (counties and states) as well.

This philosophy assumes that it is possible to select amenities of government that are strictly of local interest, varying not only as to the amount of such interest but also as to the area over which it applies. It is a large order but perhaps not more difficult than other similar judgments which underlie the budget of any government in any democratic state. To add a value judgment, I am of the opinion that these distinctions are not so impossible as to warrant abandoning the attempt to make them.

Mr. Labovitz does neglect to cover what seems to me to be a fairly important (potentially) aspect of aids and that is their use to bring the states into the economic stabilization program. For instance, if federal participation in welfare is to be extended to include general relief, this could be done on a basis similar to that used in New York State where the aid is set to vary according to the percentage of population on relief. Replacement of tax-exempt securities by a public works aid tied to an employment index could hardly fail to score for the public interest.

One further desultory comment should be added. I disagree with the inference in one of the papers under review that state apportionment of tax bases and the immunities from state taxation associated with interstate commerce are not federal problems. It is my view, often enough propounded, that Congress should take the ball from the Supreme Court in these areas and that Congress itself should not act without full consultation with the interested parties in the states.

In conclusion, I fear that these remarks are more of a speech of my own than the careful commentary that two excellent papers deserve. The excuse is that I found these papers highly provocative.

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Apportionment for tax purposes of income of businesses engaged in interstate commerce seems to me, as to Professor Groves, to be more of a national problem than Dr. Ecker-Racz indicates. Compliance costs now put business to some sheer waste. The economy suffers from the use of skilled manpower in meeting diverse and intricate compliance requirements of different states. The variety of these requirements serves no useful purpose for the public as a whole. Waste results and seems likely to grow as many more firms will be affected. In terms of national accounts, the wastes cannot be large —but they are avoidable. Congressional action specifying uniform apportionment would yield real savings to the economy. Moreover, the prescription of a formula which conforms to economic reality as well as we can reasonably define it would help the economy a little by encouraging more efficient resource allocation. Formulas like those now in use create at least a slight inducement to distort affairs to save tax. The result is more expense, or a slightly smaller gross income, than if the tax law did not attach more importance to some details than their economic significance warrants.