

CHAPTER XLIII

STATE FINANCE

THE financial systems in force in the several States furnish one of the widest and most instructive fields of study that the whole range of American institutions presents to a practical statesman, as well as to a student of comparative politics. It is much to be wished that some person equipped with the necessary special knowledge could survey them with a philosophic eye, and present the results of his survey in a concise form. From such an attempt I am interdicted not only by the want of that special knowledge, but by the compass of the subject, and the difficulty of obtaining in Europe adequate materials. These materials must be sought not so much in the Constitutions of the States as in their statutes, and in the reports presented by the various financial officials, and by the special commissions occasionally appointed to investigate the subject or some branch of it. All I can here attempt is to touch on a few of the more salient features of the topic, and to cull from the Constitutions some illustrations of the dangers feared and the remedies desired by the people of the States. What I have to say falls under the heads following:

Purposes for which State revenue is required.

Forms of taxation.

Exemptions from taxation.

Methods of collecting taxes.

Limitations imposed on the power of taxing.

State indebtedness.

Restrictions imposed on the borrowing power.

I. The budget of a State is seldom large, in proportion to the wealth of its inhabitants, because the chief burden of administration is borne not by the State, but by its subdivisions, the counties, and still more the cities and townships.

The chief expenses which a State undertakes in its corporate capacity are — (1) The salaries of its officials, executive and judicial, and the incidental expenses of judicial proceedings, such as payments to jurors and witnesses; (2) the State volunteer militia; (3) charitable and other public institutions, such as State lunatic asylums, State universities, agricultural colleges, etc.;¹ (4) grants to schools;² (5) State prisons, comparatively few, since the prison is usually supported by the county; (6) State buildings and public works, including, in a few cases, canals; (7) payment of interest on State debts. Of the whole revenue collected in each State under State taxing laws, a comparatively small part is taken by the State itself and applied to State purposes.³ In 1882 only seven States raised for State purposes a revenue exceeding \$2,000,000. In 1891 the gross revenue of New York was \$21,243,639 (pop. in 1890 6,000,000); of Ohio, \$3,419,000 (pop. 3,680,000). These are small sums when compared either with the population and wealth of these States, or with the revenue raised in them by local authorities for local purposes. They are also small in comparison with what is raised by indirect taxation for federal purposes.

II. The National government raises its revenue by indirect taxation, and by duties of customs and excise,⁴ though it has the power of imposing direct taxes, and used that power freely

¹ The Constitutions of Louisiana and Georgia allow State revenue to be applied to the supplying of wooden legs and arms to ex-Confederate soldiers; Mississippi directs pensions to be provided for them or their widows.

² All States have set apart for the support of schools, agricultural and mechanical colleges, and other educational or benevolent institutions, often including universities, a considerable fund derived from the sale of Western lands granted for the purpose by the Federal government at various times, beginning from 1785, and derived in some cases also from lands appropriated originally by the State itself to these objects. Down to 1888, 77,488,192 acres had been granted by the United States government for educational purposes.

³ In the State of Connecticut (population in 1883 about 650,000) the total revenue raised by taxation in 1883-84 was \$8,524,776 (£1,800,000), which was collected by and for the following authorities and purposes:—

The State	.	.	.	.	.	\$1,462,328
Counties	.	.	.	.	.	1,131,766
Towns	.	.	.	.	.	2,808,682
Cities and boroughs	.	.	.	.	.	1,636,957
School districts	.	.	.	.	.	1,485,043

⁴ Stamp duties were also resorted to during the Civil War, but at present none are levied by the National government.

during the Civil War. It has now again (1894) imposed an income tax, exempting, however, smaller incomes. State revenue, on the other hand, arises almost wholly from direct taxation, since the Federal Constitution forbids the levying of import or export duties by a State, except with the consent of Congress, and directs the produce of any such duties as Congress may permit to be paid into the Federal treasury. The chief tax is in every State a property tax, based on a valuation of property, and generally of all property, real and personal, within the taxing jurisdiction.

The valuation is made by officials called appraisers or assessors, appointed by the local communities, though under general State laws.¹ It is their duty to put a value on all taxable property; that is, speaking generally, on all property of whatever nature which they can discover or trace within the area of their authority. As the contribution, to the revenues of the State or county, leviable within that area is proportioned to the amount and value of taxable property situate within it, the local assessors have, equally with the property owners, an obvious motive for valuing on a low scale, for by doing so they relieve their community of part of its burden. The State accordingly endeavours to check and correct them by creating what is called a Board of Equalization, which compares and revises the valuations made by the various local officers, with the aim of having taxable property in each locality equally and fairly valued, and made thereby to bear its due share of public burdens. Similarly a county has often an equalization board to supervise and adjust the valuations of the towns and cities within its limits. However, the existence of such boards does not overcome the difficulty of securing a really equal valuation, and the honest county or town which puts its property at a fair value suffers by paying more than its share. Valuations are generally made at a figure much below the true worth of property. In Connecticut, for instance, the law directs the market price to be the basis, but real estate is valued only at from one-third to three-fourths thereof.² Indeed

¹ The account in the text does not, of course, claim to be true in all particulars for every State, but only to represent the general usage.

² The special commission on taxation in Connecticut in their recent singularly clear and interesting report (1887) observe:—"One great defect in the practical execution of our tax laws consists in inequalities of assessment and

one hears everywhere in America complaints of inequalities arising from the varying scales on which valuers proceed.

A still more serious evil is the fact that so large a part of taxable property escapes taxation. Lands and houses cannot be concealed; cattle and furniture can be discovered by a zealous tax officer. But a great part, often far the largest part of a rich man's wealth, consists in what the Americans call "intangible property," notes, bonds, book debts, and Western mortgages.¹ At this it is practically impossible to get, except through the declaration of the owner; and even if the owner is required to present his declaration of taxable property upon oath, he is apt to omit this kind of property. The Connecticut commissioners report that

"the proportion of these intangible securities to other taxable property has steadily declined from year to year. In 1855 it was nearly 10 per cent of the whole, in 1865 about 7½ per cent, in 1875 a little over 5 per cent, and in 1885 about 3¾ per cent. Yet during the generation covered by these statistics the amount of State railroad and municipal bonds, and of Western mortgage loans has very greatly increased, and our citizens have, in every town in the State, invested large sums in them. Why then do so few get into the tax list? The terms of the law are plain, and the penalties for its infringement are probably as stringent as the people will bear. . . . The truth is that no system of tax laws can ever reach directly the great mass of intangible property. It is not to be seen, and its possession, if not voluntarily disclosed, can in most cases be only the subject of conjecture. The people also in a free government are accustomed to reason for themselves as to the justice and validity of the laws, and too apt to give themselves the benefit of the doubt when they have in any way the power to construe it for themselves. Such a power is practically given

valuation. This shows itself especially as between the different towns. . . . It is notorious that in few, if any, towns do the assessors value real estate at what they think it is fairly worth. On the contrary, they generally first make this appraisal of its actual value, and then put it in the list at a certain proportion of such appraisal, varying from 33¼ to 75 per cent. Similar reductions are made in valuing personal property, though with less uniformity, and so perhaps with more injustice" (p. 8). "Household furniture above \$500 in value constitutes an item of only \$9500 in one of our cities, while a neighbouring town of not more than half the population returns \$12,900" (p. 16).

¹ The difficulty does not arise with stock or shares even when held in a company outside a State, because all States now tax corporations or companies within their jurisdiction, and the principle is generally (though not universally) adopted, that where stocks in a corporation outside the State have been so taxed, they shall not be again taxed in the hand of the holder of the stock, who may reside within the State. State laws and tax assessors can in each State succeed in reaching the property of the corporation itself.

in the form of oath used in connection with our tax lists, since it refers only to such property of the parties giving them in as is taxable according to their best knowledge, remembrance, or belief. The man who does not believe that a western farm loan or foreign railroad bond (*i.e.* bond of a company outside the State) ought to be taxed, is too often ready to swear that to the best of his belief it is not liable to taxation. . . . As the law stands, it may be a burden on the conscience of many, but it is a burden on the property of few, not because there are few who ought to pay, but because there are few who can be made to pay. Bonds and notes held by an individual are for the most part concealed from the assessors, nor do they in most towns make much effort to ascertain their existence.¹ The result is that a few towns, a few estates, and a few persons of a high sense of honesty, bear the entire weight of the tax. Such has been the universal result of similar laws elsewhere."

A comparison of the tax lists with the probate records convinced the commissioners that, whereas in 1884 more than a third of the whole personal property assessed in the State of Connecticut escaped taxes, the proportion not reached by taxation was in 1886 much greater; and induced them to recommend that "all the items of intangible property ought to be struck out of the tax list." The probate inventories of the estates of deceased persons, and the last returns made to the tax assessors by those persons, "show, to speak of it mildly, few points of contact." Connecticut is a commonwealth in most respects above the average. In every part of the country one hears exactly the same.² The tax returns sent in are rarely

¹ "A person, formerly assessor in one of our leading cities, reported that he had made efforts when in office to get this kind of property into the 'grand list,' and succeeded during his last two years in finding out and adding over \$200,000 of it; but he adds, 'That may have had something to do with my defeat when election came around.'" So in West Virginia when an assessor objecting to a merchant's declaration threatened to swear the merchant, the latter replied, "If you swear me, I'll vote against you next time."

² The West Virginian tax commission, in 1884, says, "At present all taxes from invisible property come from a few conspicuously conscientious citizens, from widows, executors, and from guardians of the insane and infants; in fact, it is a comparatively rare thing to find a shrewd trader who gives in any considerable amount of notes, stocks, or money. The truth is, things have come to such a condition in West Virginia that, as regards paying taxes on this kind of property, it is almost as voluntary and is considered pretty much in the same light as donations to the neighbourhood church or Sunday school." Reports of commissioners in several other States are to the same effect. See, especially, the Report of the Tax Commission of Baltimore, 1886; and the supplementary Report of one member of the Maryland Tax Commission, Mr. Richard T. Ely, in which much instructive evidence as to the failure in various States of the efforts made to tax intangible property has been collected and set forth (Bal-

truthful; and not only does a very large percentage of property escape its lawful burdens, but "the demoralization of the public conscience by the frequent administration of oaths, so often taken only to be disregarded, is an evil of the greatest magnitude. Almost any change would seem to be an improvement."¹

There is probably not a State in the Union of which the same thing might not be said. In Ohio, for instance, the Governor remarks in a special message of April 1887:

"The great majority of the personal property of this State is not returned, but entirely and fraudulently withheld from taxation. The idea seems largely to prevail that there is injustice and inequality in taxation, and that there is no harm in cheating the State, although to do so a false return must be made and perjury committed. This offence against the State and good morals is too frequently committed by men of wealth and reputed high character, and of corresponding position in society."

In New York there was a shrinkage in the valuation of personalty from 1871 to 1884 of \$107,184,371, and in 1888 personalty paid only 10 per cent, realty 90 per cent, of the State taxation. In California personal property was assessed at \$220,000,000 in 1872, and at \$164,000,000 in 1887, while in the same fifteen years real estate rose from \$417,000,000 to \$791,000,000.

I have dwelt upon these facts, not only because they illustrate the difficulties inherent in a property tax, difficulties

timore, 1888). A Boston commission reported, in 1891, in favour of taxing real estate only; arguing that under the laws of Massachusetts taxing personalty, much property was really twice taxed.

¹ Judge Foster, in the case of *Kirtland v. Hotchkiss*, 42 Conn. Rep., p. 449. So Mr. David A. Wells, in his report as Special Tax Commissioner to the New York Legislature, says: "Oaths as a matter of restraint or as a guarantee of truth in respect to official statements have in great measure ceased to be effectual; or in other words, perjury, direct or constructive, has become so common as to almost cease to occasion notice. This is the all but unanimous testimony of officials who have of late had extensive experience in the administration of both the national and State revenue laws."

Professor E. A. Seligman, in a valuable article in the *Political Science Quarterly* for March 1890, sums up the case against a property tax as follows:

"The property tax of to-day, because of its attempt to tax intangible as well as tangible things, sins against the cardinal rules of uniformity, of equality, and of universality of taxation. It puts a premium on dishonesty and debauches the public conscience. It reduces deception to a system and makes a science of knavery. It presses hardest on those least able to pay. It imposes double taxation on one man and grants entire immunity to the next."

of course greater where such independent taxing authorities as the several States are close together, but also because they help to explain the occasional bitterness of feeling among the American farmers as well as the masses against capitalists, much of whose accumulated wealth escapes taxation, while the farmer who owns his land, as well as the working man who puts his savings into the house he lives in, is assessed and taxed upon this visible property. We may, in fact, say of most States, that under the present system of taxation the larger is the city the smaller is the proportion of personalty reached by taxation (since concealment is easier in large communities), and the richer a man is the smaller in proportion to his property is the contribution he pays to the State.¹ Add to this that the rich man bears less, in proportion to his income, of the burden of indirect taxation, since the protective tariff raises the price not merely of luxuries but of all commodities, except some kinds of food.²

¹ In Iowa the State Auditor reported some years ago that "the class of property that escapes taxation most is that which pays the largest dividend"; and in Kentucky that "the property of the small owner is as a rule valued by a far higher standard than that of his wealthy neighbour."

² An experienced Massachusetts publicist writes to me *apropos* of the passage in the text: "If one State compels a man to make a full declaration of his personal property for taxation and another does not there will be a tendency for capital to flow from the former to the latter. In Vermont, for instance, a law has been passed requiring every person under penalty to make sworn returns of his moveable property, and the result is that capital seems to be leaving that State."

"In New York the law taxes personal property, but if a person makes no return the assessors are instructed to 'doom' him according to the best of their knowledge and belief; and the amount becomes a matter of 'trade.' Returns are practically made only by trustees and corporations, not by capitalists. It is a case of bad law tempered by violation."

"In Massachusetts the practice in each town depends mainly upon the assessors. In Boston the chief office having resolved to let no one escape, has for twenty years gone on increasing the assessment each year till the victim makes a return. At first, men had some scruple about leaving the city before 1st May (the date of residence when taxes are assessed), but these were soon overcome, and now nearly all the capitalists have country places where they retire at a still inclement season, and are received with open arms by the local assessors, who accept just what they choose to pay, while their political influence, their taxes, and their public donations are lost to the city. Occasionally the assessors in a country town take it into their heads to apply the screw after the fashion of the city authority, and then there is a fine turmoil. As the rich men generally live in one quarter of the (country) town, the next step is to apply to the legislature to get the town divided, and the vicinity of Boston is thus being gradually cut up into small pieces."

Besides the property tax, which is the main source of revenue, the States often levy taxes on particular trades or occupations,¹ sometimes in the form of a licence tax, taxes on franchises enjoyed by a corporation, taxes on railroad stock, or (in a few States) taxes on collateral inheritances. Comparatively little resort has hitherto been had to the so-called "death-duties," *i.e.* probate, legacy, and succession duties, nor is much use made of an income tax. Five States, however, authorize it. As regards poll taxes there is much variety of practice. Some State Constitutions (*e.g.* Ohio) forbid such an impost, as "grievous and oppressive"; others direct it to be imposed, or (*e.g.* North Dakota) allow the legislature to impose it, while about one half do not mention it. Where it exists, there is sometimes a direction that it shall be applied to schools or some other specified useful purpose, such as poor relief, so as to give the poor, who perhaps pay no other direct tax, a sense of their duty to contribute to public objects, and especially to those in whose benefits they directly share. The amount of a poll tax is always small, \$1 to \$3: sometimes (as in Tennessee) the payment of it is made a pre-requisite to the exercise of the electoral franchise. It is scarcely ever imposed on women or minors.

In some States "foreign" corporations, *i.e.*, those chartered by or domiciled in another State, are taxed more heavily than domestic corporations. New Hampshire, by taxing "foreign" insurance companies, succeeded in driving them out of its limits.

Instances are beginning to appear of a progressive inheritance duty, and of a progressive income tax such as some of the Swiss

¹ North Carolina empowers its legislature to tax all trades, professions, and franchises. Arkansas in 1868 (Article x. § 17) directed its general assembly to "tax all privileges, pursuits, and occupations that are of no real use to society," adding that all others shall be exempt. But having apparently found it hard to determine which occupations are useless, she dropped the direction in her Constitution of 1874, and now merely empowers the taxation of "hawkers, pedlers, ferries, exhibitions, and privileges."

The persons or things on whom licence taxes or occupation taxes may be imposed are the following, some being mentioned in one State Constitution, some in another—Pedlers, hawkers, auctioneers, brokers, pawnbrokers, merchants, commission merchants, "persons selling by sample," showmen, jugglers, innkeepers, toll bridges, ferries, telegraphs, express agents (*i.e.* parcels' delivery), grocery keepers, liquor dealers, insurance, vendors of patents, persons or corporations using franchises or privileges, banks, railroads, destructive domestic animals, dealers in "options" or "futures."

cantons have imposed. California in her famous Constitution of 1879 has attempted to tax the same property twice over.

There is always a desire to hit incorporated companies, especially banks and railroads.¹ The newer Constitutions often direct the legislature to see that such undertakings are duly taxed, sometimes forbidding it ever to deprive itself of the power of taxing any corporation, doubtless from the fear that these powerful bodies may purchase from a pliant legislature exemption from civic burdens. The methods, however, of taxing corporations vary greatly from State to State, and are at present in a wholly chaotic condition.

III. In most States, certain descriptions of property are exempted from taxation, as for instance, the buildings or other property of the State, or of any local community, burying grounds, schools and universities, educational, charitable, scientific, literary, or agricultural institutions or societies, public libraries, churches and other buildings or property used for religious purposes, cemeteries, household furniture, farming implements, deposits in savings banks. Often too it is provided that the owner of personal property below a certain figure shall not pay taxes on it, and occasionally ministers of religion are allowed a certain sum (as for instance in New York, \$1500) free from taxation.

No State can tax any bonds, debt certificates, or other securities issued by, or under the authority of, the Federal government, including the circulating notes commonly called "greenbacks." This has been held to be the law on the construction of the Federal Constitution, and has been so declared in a statute of Congress. Many intricate questions have arisen on this doctrine; which, moreover, introduces an element of difficulty into State taxation, because persons desiring to escape taxation are apt to turn their property into these exempted forms just before they make their tax returns.

IV. Some of the State taxes, such, for instance, as licence taxes, or a tax on corporations, are directly levied by and paid to the State officials. But others, and particularly the property tax, which forms so large a source of revenue, are collected

¹ As to banks, see Ohio Constitution of 1851, Article xii. § 3, and an article on the taxation of corporations by Mr. E. A. Seligman in *Political Science Quarterly* for June 1890. Banks were an object of as much popular dislike fifty years ago as railroads are now.

by the local authorities. The State having determined what income it needs, apports this sum among the counties, or in New England, sometimes directly among the towns, in proportion to their paying capacity, that is, to the value of the property situate within them.¹ So similarly the counties apportion not only what they have to pay to the State, but also the sum they have to raise for county purposes, among the cities and townships within their area, in proportion to the value of their taxable property. Thus, when the township or city authorities assess and collect taxes from the individual citizen, they usually collect at one and the same time three distinct sets of taxes, the State tax, the county tax, and the city or township tax. Retaining the latter for local purposes,² they hand on the two former to the county authorities, who in turn retain the county tax, handing on to the State what it requires. Thus trouble and expense are saved in the process of collecting, and the citizen sees in one tax-paper all he has to pay.

V. Some States, taught by their sad experience of reckless legislatures, limit by their Constitutions the amount of taxation which may be raised for State purposes in any one year. Thus Texas in 1876 forbade the State property tax to exceed one half per cent on the valuation (exclusive of the sum needed to pay interest on the State debt), and has since reduced the percentage to .35.³ North Dakota (1889) fixes .4, Montana .3, as the percentage. A similar provision exists in Missouri, and in some other Southern or Western States. We shall see presently that this method of restriction has been more extensively applied to cities and other subordinate communities. Sometimes we find directions that no greater revenue shall be raised than the current needs of the State require, a rule which Congress would have done well to observe, seeing that a surplus revenue invites extravagant and reckless expenditure and gives opportunity for legislative jobbery.⁴

¹ As ascertained by the assessors and board of equalization.

² Sometimes, however, the town or township in its corporate capacity pays the State its share of the State tax, instead of collecting it specifically from individual citizens.

³ In spite of this Texas had in March 1888 a surplus of \$2,000,000 in her State treasury, so that the Governor was obliged to summon the legislature in extra session to dispose of this surplus and prevent the growth of another.

⁴ Sir T. More in his *Utopia* mentions with approval a law of the Macarians forbidding the king to have ever more than £1000 in the public treasury.

It may be thought that the self-interest of the people is sufficient to secure economy and limit taxation. But, apart from the danger of a corrupt legislature, it is often remarked that as in many States a large proportion of the voters do not pay State taxes, the power of imposing burdens lies largely in the hands of persons who have no direct interest, and suppose themselves to have no interest at all, in keeping down taxes which they do not pay. So far, however, as State finance is concerned, this has been no serious source of mischief, and more must be attributed to the absence of efficient control over expenditure, and to the fact that (as in Congress) the committee which reports on appropriations of the revenue is distinct from that which deals with the raising of revenue by taxation.

Another illustration of the tendency to restrict the improvidence of representatives is furnished by the prohibitions in many Constitutions to pass bills appropriating moneys to any private individual or corporation, or to authorize the payment of claims against the State arising under any contract not strictly and legally binding, or to release the claims which the State may have against railroads or other corporations. One feels, in reading these multiform provisions, as if the legislature was a rabbit seeking to issue from its burrow to ravage the crops wherever it could, and the people of the State were obliged to close every exit, because they could not otherwise restrain its inveterate propensity to mischief.

VI. Nothing in the financial system of the States better deserves attention than the history of the State debts, their portentous growth, and the efforts made, when the people had taken fright, to reduce their amount, and to set limits to them in the future.

Sixty to seventy years ago, when those rich and ample Western lands which now form the States of Ohio, Indiana, Illinois, Michigan, and Missouri were being opened up and settled, and again forty years ago, when the railway system was in the first freshness of its marvellous extension, and was filling up the lands along the Mississippi at an increasingly rapid rate, every one was full of hope; and States, counties, and cities, not less than individual men, threw themselves eagerly into the task of developing the resources which lay around them.

The States, as well as these minor communities, set to work to make roads and canals and railways; they promoted or took stock in trading companies, they started or subsidized banks, they embarked in, or pledged their credit for, a hundred enterprises which they were ill-fitted to conduct or supervise. Some undertakings failed lamentably, while in others the profits were grasped by private speculators, and the burden left with the public body. State indebtedness, which in 1825 (when there were twenty-four States) stood at an aggregate over the whole Union of \$12,790,728 (£2,500,000), had in 1842 reached \$203,777,916¹ (£40,000,000), in 1870 \$352,866,898 (£70,000,000).

A part of the increase between the latter years was due to loans contracted for the raising and equipping of troops by many Northern States to serve in the Civil War, the intention being to obtain ultimate reimbursement from the national treasury. There was also a good deal, in the way of executed works, to show for the money borrowed and expended, and the States (in 1870 thirty-seven in number) had grown vastly in taxable property. Nevertheless the huge and increasing total startled the people, and, as everybody knows, some States repudiated their debts. The diminution in the total indebtedness of 1880, which stood at \$290,326,643, and was the indebtedness of thirty-eight States and three Territories, is partly due to this repudiation. In 1890 the total (now of forty-four States and two Territories) stood at \$223,107,883.² Even after the growth of State debts had been checked (in the way to be presently mentioned), minor communities, towns, counties, but above all, cities trod in the same path, the old temptations recurring, and the risks seeming smaller because a municipality had a more direct and close interest than a State in seeing that its money or credit was well applied. Municipal indebtedness has advanced, especially in the larger cities, at a dangerously swift rate. Of the State and county debt much the largest part had been incurred for, or in connection with, so-called "internal improvements"; but of the city debt,

¹ In 1838 it was estimated that of the total debt of the States, then calculated at \$170,800,000 (say £35,000,000), \$60,200,000 had been incurred for canals, \$42,800,000 for railroads, and \$52,600,000 for banking.

² I take these figures (which are *minus* sinking fund) from the bulletin of the census of 1890.