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When the Reagan Administration took office in 1981, it concentrated its domestic efforts upon national government spending, deficits, and inflation. Its major proposed remedies have consisted of "supply-side" economics, cuts in the rates of federal spending on non-military programs and a return to greater state/local responsibility for public policy initiatives and financing. It is with this last aspect of the Reagan proposals that the present work is concerned: the impact and policy implications of federal decentralization on Arkansas. The option of a state tax increase is explored as Arkansas' response.

### States' Situation

States have vastly increased their spending, e.g., 335 percent in 1966-1979, while federal aid to the states was doubling during the last 20 years, reaching a 25 percent average of state expenditures.<sup>1</sup> Arkansas' 343 percent increase in spending (1966-1980) was at a 3 percent greater increase than the state's per capita income increase (13 percent compared to 10.3 percent, 1974-1979). To make up for this, Arkansas has become more dependent than the average state on federal funds: some 34.6 percent of Arkansas' general revenues are federal funds.<sup>2</sup>

The federal funds have, of course, been used to fund state public goods and services that would have otherwise necessitated state/local increases, or not offering the services. Four areas of expenditures are in especially vital state services and have exhibited rapid expenditure increases during 1960-1980: public welfare (587 percent); education (94 percent); highways (41 percent); and health and hospitals (779 percent). Federal aid in these areas has averaged 71 percent of public welfare, 18 percent of education, 34 percent of highways, and 25 percent of health and hospital expenditures.<sup>3</sup> These four areas constitute 70 percent of Arkansas' expenditures in 1982 and the state is obviously going to be hard-pressed to replace an estimated 22 percent reduction in federal funding in 1983.<sup>4</sup>

### A Possible Response in Arkansas

The Arkansas response to the loss of federal aid and lowered federal spending for domestic programs may involve several combinations of alternative spending. The alternative examined in this paper is a tax increase.

<sup>1</sup>U.S. Department of Commerce (1966 and 1977).

<sup>2</sup>U.S. Department of Commerce.

<sup>3</sup>*State Government and Finances*, (1960-64 and 1966-80).

<sup>4</sup>State of Arkansas' *Annual Financial Report for 1982; State of the States, 1983*.

## Arkansas Revenue Situation

General revenues for the State of Arkansas fall into three categories: taxes, current charges, and miscellaneous general revenue. For the purpose of this study, emphasis will be placed only on major revenue sources. The major revenue sources are: general sales and gross receipts taxes, motor fuels taxes, alcohol and tobacco taxes, corporate net income taxes, individual income taxes, and motor vehicle and operator license taxes.<sup>5</sup>

General revenues for the State of Arkansas have experienced consistent increases in the past fifteen years. Total general revenues increased by 318 percent between 1966 and 1980. During the same period, taxes comprised an average of 57 percent of total general revenue, while federal aid accounted for 34 percent of total general revenues (Table 1).

Sales taxes have consistently been Arkansas' main source of tax revenue over the past fifteen years (Table 2). Between 1966 and 1980, sales taxes accounted for about one-third of the state's total tax revenue. It was thought that the adoption of a sales tax would place a portion of the cost of running the government on those persons who remained relatively unaffected by income and property taxes. The result was a highly regressive tax which has been shifted forward to the consumer as a portion of product costs (Oldman and Shoettle, 1974, p.3).

Between 1967 and 1980 Arkansas increased its motor fuels tax rate from 7.5 cents to 9.5 cents per gallon of gasoline. During that period, the revenues from the tax increased by 115 percent. Although the motor fuels tax is still a major revenue source, the amount of revenue generated from the tax has steadily declined as a percentage of total tax revenue.

Alcohol and tobacco taxes are another major source of tax revenue. Revenues from alcohol and tobacco taxes increased by 216 percent between 1966 and 1979, yet declined in importance as a percentage of total tax revenue. Alcohol and tobacco taxes may be raised in the name of the public health by arguing that high taxes on these products are an incentive for people to avoid such harmful habits. Yet, alcohol and tobacco taxes do not dissuade consumers as much as they provide a consistently large flow of funds into the state treasury (Sharkansky, 1972, p.54).

Another major source of revenue, second only to the sales tax as a percentage of total tax revenue, is the individual income tax. Unlike the motor fuels and alcohol and tobacco taxes, revenues from the individual income tax have increased as a percentage of total tax revenue over the past fifteen years. Perhaps the most astounding fact about revenues from individual income taxes is that between 1966 and 1979, they increased by 1535 percent. This tremendous revenue increase can be attributed to several factors, such as: population increases, increases in individual income due to economic growth, industrial development, and inflation.

<sup>5</sup>Arkansas Legislative Council (Oct. 15, 1981, pp.1-10.



Table 1. Revenue Increases and Federal Aid in the State of Arkansas  
1966-1980

	Total Revenue (Millions)	Federal Aid As Percentage Of Total Revenue	Annual Percentage Increase In Total Tax Revenue	Revenue Sharing (Millions)
1980	\$1,933.	35.9%	10.7%	\$22.6
1979	1,798.	35.4	10.6	22.2
1978	1,599.	36.4	11.9	22.9
1977	1,395.	33.	10.7	23.3
1976	1,321.	35.9	11.	22.3
1975	1,139.	27.	7.9	21.9
1974	994.	30.5	15.7	22.8
1973	914.	34.6	13.7	\$24.8
1972	812.	35.2	21.	
1971	669.	34.2	8.3	
1970	613.	33.8	10.4	
1969	563.	34.5	9.6	
1968	519.	36.2	2.1	
1967	500.	35.8	7.2%	
1966	\$ 462.	35.5%		

1. Percentage increase in Total Revenue between 1966 and 1980: 318%  
Annual percentage increase in Total Revenue: 8.9%
2. Percentage in Federal Aid between 1966 and 1980: 324%  
Annual percentage increase in Federal Aid: 11.6%
3. Percentage increases in State tax collections by type of tax,  
1966-1979: General sales and gross receipts - 310%; Motor fuels -  
115%; Alcohol and Tobacco - 216%; Individual income - 1,535%; Cor-  
porate net income - 304%; Motor vehicle and operator license 106%.

Source: Compiled from data in U.S. Bureau of the Census, *Statistical Abstracts*, State Tax Collections, By Type of Tax--States: 1964-1980, and Revenue, Debt, and Expenditures--States: 1967-1980.

Table 2. Arkansas Major Tax Sources (As a Percentage of Total Tax Revenue)

	General Sales & Gross Receipts	Motor Fuels	Alcohol & Tobacco	Individual Income Tax	Corporate Net Income Tax	Motor Vehicle & Operator License
1979	34.8%	13.%	7. %	23. %	8.4%	5.3%
1978	34.	14.	7.5	22.	9.1	5.4
1977	34.	15.	8.	20.5	8.3	5.4
1976	33.	16.	8.5	20.5	7.7	6.1
1975	32.	17.	8.9	19.3	8.3	6.3
1974	29.5	18.	9.3	19.3	7.6	6.4
1973	32.	18.	10.	17.	7.3	6.9
1972	31.5	19.	10.5	15.2	7.	7.4
1971	31.6	21.	10.3	11.6	6.8	8.4
1970	31.1	21.	10.	12.3	7.4	8.5
1969	32.6	22.	8.2	12.	7.	8.2
1968	32.	23.	8.3	11.	6.7	10.3
1967	31.2	22.	8.	11.	8.8	9.5
1966	<u>32.</u>	<u>22.</u>	<u>8.3</u>	<u>10.4</u>	<u>7.9</u>	<u>9.8</u>
	*32. %	*19. %	*9. %	*16. %	*8. %	*7.5 %

\*Average percentage of total tax revenue during the period

Source: Compiled from data in U.S. Bureau of the Census, *Statistical Abstracts*, vols. 100-87, State Governments--Revenue, Debt, and Expenditures--by State, 1967-1980.



Arkansas' individual income tax is by far more progressive and elastic than any other variety of tax used by the state.

Corporate net income tax is another major source of state revenues. Between 1966 and 1979, corporate net income tax revenues rose by 304 percent and managed to account for an average of about 8 percent of total tax revenues during the period. Like individual income taxes, corporate net income taxes are progressive up to a point, but impose a constant tax rate of 6 percent on income of \$25,000 or more.<sup>6</sup>

The final state revenue sources to be discussed are the motor vehicle and operator license taxes. Although the revenue from these taxes rose by 106 percent between 1966 and 1979, the taxes decreased as a percentage of total revenue during the period.

All of the preceding tax revenues are affected by population growth. Arkansas, as a leading destination for sunbelt migration, has experienced an 18 percent growth between 1970-1980 (Biggar, 1979, p.33). The population is projected to reach 2.39 million by 1990 (Biggar, 1979, p.33).

### Possible Sources of Tax Revenue

To compensate for losses in federal aid, Arkansas will be required to generate additional revenue, assuming that expenditures are not cut and continue to increase at a constant rate. Between 1982 and 1987, population and tax revenues are expected to increase by 4 percent and 66.3 percent, respectively (Table 3). These increases will cause a corresponding increase in per capita tax burden during the period of 59.9 percent. As shown by Table 4, even greater increases in per capita taxes can be expected in response to decreases in federal aid. An overall tax increase of 25 percent over the next five years will mean an increase in current per capita tax burden of 81 percent.

When considering a tax system, attention should be focused on the amount of revenues collected as compared to the revenue potential of the taxing sources. A 1977 review of tax capacity and effort in the fifty states shows that Arkansas' taxing system collected \$279.4 million dollars less than its tax revenue potential. Those taxes which did not meet their revenue potential included the general sales tax, individual income tax, license tax, residential, commercial/industrial, farm, and public utilities property taxes, death and gift tax, and severance tax (Halsted and Weldon, 1979, pp.26-27). If taxes are to be raised, it would seem reasonable to give those underutilized taxes first consideration in deciding which taxes should be increased and by how much.

Currently, one of Arkansas' major sources of tax revenue is the general sales and gross receipts tax. Eighteen states, including Arkansas, have a sales tax of 3 percent or less. The remaining thirty-two states

<sup>6</sup>"A Summary of Taxes in Arkansas" (Revised, 1981). (June, 1981, pp.3-11).

Table 3. Arkansas Population, Tax Revenue, and Per Capita Burden  
1966-87

	Population (Millions)	Tax Revenue (Millions)	Per Capita Tax Burden (Dollars)
1987	2.328 *	\$2,244. *	\$964. *
1986	2.310 *	2,027. *	877. *
1985	2.292 *	1,831. *	799. *
1984	2.274 *	1,654. *	727. *
1983	2.256 *	1,494. *	662. *
1982	2.238 *	1,349. *	603. *
1981	2.220 *	1,219. *	549. *
1980	2.202	1,101.	500.
1979	2.180	995.	456.
1978	2.167	853.	394.
1977	2.143	803.	375.
1976	2.117	725.	342.
1975	2.112	653.	309.
1974	2.062	605.	293.
1973	2.035	523.	257.
1972	2.008	460.	229.
1971	1.965	380.	193.
1970	1.932	351.	182.
1969	1.913	318.	166.
1968	1.902	290.	152.
1967	1.901	284.	149.
1966	1.909	265.	139.

\*Estimated

<u>Per Capita Tax Burden</u>	
Percentage increase 1966-87	594.0%
Percentage increase 1966-80	260.0%
Average annual percentage increase	9.2%

Source: Compiled from data in U.S. Bureau of Census, *Statistical Abstracts, Revenues, Debt, and Expenditures--States, 1967-1981*, and U.S. Dept. of Commerce, *Historical Statistics of the United States - Colonial Times to 1970, Part 1, Population*, p. 209.



Table 4. Possible Increases in Per Capita Tax Burden in Arkansas to Offset Losses in Federal Aid

	Estimated Population (Millions) <sup>1</sup>	Estimated Total Tax Revenue (Millions) <sup>2</sup>	Total Tax Revenue Needed To Fully Compensate For Percentage Loss In Federal Aid (Millions)				Per Capita Burden As Increased By Percentage Loss In Federal Aid (Dollars) <sup>3</sup>			
			5%	10%	15%	25%	5%	10%	15%	25%
1987	2,328.	\$2,244.	i \$2,304.	i \$2,364.	i \$2,424.	i \$2,543.	i \$990.	i \$1,015.	i \$1,041.	i \$1,092.
1986	2,310.	2,027.	2,083.	2,137.	2,192.	2,302.	901.	925.	949.	997.
1985	2,292.	1,831.	1,881.	1,932.	1,982.	2,083.	821.	843.	865.	909.
1984	2,274.	1,654.	1,700.	1,746.	1,792.	1,884.	748.	767.	788.	828.
1983	2,256.	1,494.	1,536.	1,579.	1,623.	1,706.	681.	700.	719.	756.

<sup>1</sup>Based on an estimated population increase of 18,000 people annually. This figure is derived from a population estimate for Arkansas for 1990 found in U.S. Dept. of Commerce, *Historical Statistics of the United States Colonial Times to 1970, Part 1, Population*, p. 209.

<sup>2</sup>Figures based on a 10.7% average yearly increase derived from increases in total tax revenues between 1966 and 1980.

<sup>3</sup>Per capita tax burden will increase by 118% between 1980 and 1987 (assuming a 25% loss in federal aid in 1987).

have sales tax rates ranging from 3.125 percent to 7.5 percent. In 1979 Arkansas collected \$346 million from sales and gross receipts taxes. (This amount of collection was based on \$11.55 billion of retail gross receipts.) A one percent sales tax increase based on the 1979 level of retail gross receipts (a conservative estimate) would yield an increase in total general tax revenue of \$115.5 million. The revenue potential of the sales tax in Arkansas' budding economy is obvious. A sales tax increase of one percent might alleviate many of the problems caused by the loss of federal aid.

The revenue potential of a sales tax increase is much easier to predict than would be the political incidence or the public reaction to such an increase. Although tax increases usually mean political suicide for those officials who propose them, a sales tax increase of one percent may not be as politically devastating as one might think. The sales tax tends to be less obvious to consumers. Further, opinion polls indicate that the public feels that the sales tax is one of the fairest of taxes. In fact, 59 percent of those Arkansans recently polled said they would support a one percent statewide sales tax increase if food were excluded (prescription drugs and other products and services are already excluded). However, without the food exemption, only one in four indicated support for such a tax. In the presence of a current local sales tax obligation, support slipped even further.<sup>7</sup> The loss in potential tax revenue caused by the food exemption could be compensated for, at least partially, by removing from exemption some products and services which are currently exempt from sales tax such as cigarette and tobacco products, gasoline, manufacturing and processing materials, barges, and several other goods and services.<sup>8</sup>

An alternative, similar to the sales tax increase, to compensate for a loss in federal aid is the value added tax (VAT). A value added tax is applied to products at each stage of production. The manufacturer pays the value of the output less the cost of the material. Wholesalers then pay tax on the difference between the wholesale price and the manufacturer's price for the product. Retailers pay tax on the difference between retail and wholesale prices. Consumers pay no sales tax but do pay a higher price for the product reflecting the previous taxes levied on producers.

Proponants of the VAT suggest that its revenue be used to reduce government debt and free funds for the capital market. This, they say, will result in lower interest rates which will offset higher rates that occur when the Federal Reserve tightens the money supply. However, the VAT is only a short-run remedy. The VAT stabilizer is not appropriate for permanent distribution of income because it provides only temporary bursts of revenue during inflationary periods.

Inflation has become the taxpayer's true enemy by causing bracket creep and eroding the real value of personal exemption. In fact, many taxpayer revolts are brought on, not because the level of taxes is so high,

<sup>7</sup>*Arkansans' Attitude Toward Taxes* (1981, p. 17).

<sup>8</sup>*Report on Comparative Revenues and Revenue Forecasts* (Oct. 28, 1981, p. 9).



but because taxes have increased so rapidly (Lile, et. al., 1978, p.204-211). One tax, whose incidence has been magnified by inflation, is the state personal income tax. The effect of inflation on the tax burden on the Arkansas tax payer is relatively great, as indicated by the .80 Pearson's "r" correlation.

One remedy for inflation's adverse effect on state income tax is the indexing of personal income taxes. Indexing is proposed as an automatic adjustment which widens the tax brackets in an attempt to avoid inflation-caused tax increases (Lile, et.al., 1978, pp.204-211). This remedy is of no help to the state which must not only raise enough revenue to meet the rising costs of providing public goods and services caused by inflation, but must also produce more revenue to compensate for losses in federal aid.

In general, income taxes are progressive throughout most income classes but are regressive at the very top. Higher income classes are subject to less income taxes at the federal and state levels (Pechman and Okner, 1974, p.57). Arkansas' personal income tax system is progressive and elastic but only to a point. The system is progressive up to the \$25,000 income level. Any income over \$25,000 is taxed at a flat rate of 7 percent.<sup>9</sup> Thus, revenue from income taxes could be greater if the progressive rate schedule were extended to a higher level of income. An extended rate schedule would serve to offset the loopholes and exemptions available to higher income classes. An extension of this type could possibly draw support from those many Arkansans under the \$25,000 income level. This support would have to be generated from income classes that have had low voter turnouts, historically.

Another taxing option to increase revenue would be to levy a state property tax (Oldman and Schoettle, 1974, p.137). Currently, only counties, municipalities, and school districts collect property taxes.<sup>10</sup> There is no doubt that a state property tax would bolster state revenues. The proposed amendment 59 mandated a reappraisal of property and an assessment of 20 percent of market value (for urban property) and 20 percent of "use" value for agricultural real estate.<sup>11</sup> Thus, even a slight state property tax millage at current assessment levels could produce several million dollars in state revenues.

The revenue potential of a state property tax is far outweighed by political disadvantages. Generally, property taxes place the burden on the owners, unless the property is used in business and then the costs are passed on (shifted forward) to renters or consumers (Oldman and Schoettle, 1974, p.98). The elderly population in Arkansas would be adversely affected by this tax measure, because they are generally "land rich and income poor."<sup>12</sup> Further, many citizens object to the tax because of the annual

<sup>9</sup>"A Summary of Taxes in Arkansas," (p. 1).

<sup>10</sup>"A Summary of Taxes in Arkansas," (p. 1).

<sup>11</sup>*Where the Money Is: Tax Estimates for 100 Arkansas Cities* (1981, p.31).

<sup>12</sup>Adam Smith referenced in *Tax Philosophers*, (1974, p. 22).



"bill" that is sent to each property owner. In a recent poll of Arkansans, almost one-half believed that Arkansas' property taxes were about the same or higher than property taxes in other states, when in fact, it is currently 49th in per capita state and local property tax.<sup>13</sup>

Another possible revenue producer is the severance tax. An increase in this tax, coupled with the recent excavation projects for oil and natural gas in the state, and the possible future use of Arkansas' water resources by Texas and Oklahoma, could mean a substantial revenue increase for the state. Currently, Arkansas' severance tax is extremely low compared to our border states and is responsible for only 1.3 percent of the state's total tax revenue (approximately \$12.5 million in 1979). In a recent poll of Arkansans, six out of ten people thought Arkansas should have a severance tax and of those people, eight out of ten believed that Arkansas' severance tax should be about the same as those states around us.<sup>14</sup>

Other possible sources of increased revenue include revenues from lotteries and parimutual taxes. Twenty-nine states held state lotteries or collected parimutual taxes in 1979. The gross revenues generated from these sources ranged from \$.3 million in Nevada to \$442 million in Michigan. Arkansas collected \$14.7 million in parimutual taxes in 1979.<sup>15</sup> In recent years, horse racing has become a favorite pastime for many Arkansans causing the horse racing industry in Arkansas to boom. An extension of the racing season or an expansion of the horse/dog racing industry could generate substantial revenues for the state.

The other form of gambling that could serve as a state revenue source is the state lottery. Thirteen states conducted state lotteries in 1979. Revenues from state lotteries ranged from \$6.6 million in Maine to \$415.6 million in Michigan. Currently, Arkansas does not have a state lottery.<sup>16</sup> However, a state lottery could provide the state with millions of dollars in revenue without raising taxes. The fact that a lottery does not impose a tax obligation on those who do not wish to participate would be appealing to both the public and elected officials. The main disadvantages of a state lottery are a possible revenue loss, possible corruption, and regressivity (Suits, 1977, p.432).

Of the other two underutilized taxing sources of the state, death and gift taxes produce less than one percent of state tax revenues. The other source, license tax fees, are probably not a feasible source of increased revenue at this time. The taxpayers of Arkansas still have a very negative view of possible license tax/fee increases. Governor Bill Clinton proposed substantial license tax/fee increases for road construction and maintenance

<sup>13</sup>Arkansans' Attitude Toward Taxes, (p. 8).

<sup>14</sup>Arkansans' Attitude Toward Taxes, (pp. 10-11).

<sup>15</sup>U.S. Department of Commerce, (1980, p. 432).

<sup>16</sup>U.S. Department of Commerce, (p. 432).



during his term in office in 1979. Public reaction to the license fee increase bordered on the hostile.

In summary, a one percent increase in the sales tax, an increase in the severance tax, an increase in the parimutual racing industry, and the creation of a statewide lottery may be Arkansas' prime revenue-generating possibilities for supplanting the loss in federal resources. Although some of these sources are highly regressive and others are not capable of generating large amounts of revenue, they are more readily accepted by the general public than are other options. Also, public officials would be quicker to support possible tax increases from these sources because they would not be detrimental to their political futures. Personal income taxes and property taxes from individual, commercial/industrial, and farm sources have the potential to produce large amounts of revenue. However, these taxes are not particularly popular with the general public and public officials would be reluctant to propose increases in these taxes because of the political incidence of such an action.

Tax strategy is also very important when attempting to raise an already established tax or establishing a new tax. Public support is critical if any tax initiative is to be considered seriously. First, the public must be provided with sufficient evidence which shows that there is a need for the increase. Secondly, the tax should be called for in the name of the program or service which is popular with the general public (e.g., education, or aid to the needy) (Penniman, 1976, p.432). If the program or service is popular with the public, then the regressivity or incidence of the tax may not be the determining factors in the public's decision about the fairness of the tax. By the same token, if the tax to be increased is one which the public views as fair, then the tax increase will be more readily accepted by the general public. Even this strategy may not avoid compromises, reductions, or adjustments which may be needed to gather sufficient support for the tax increase. In which case, tax increases which also include special exemptions (e.g., sales tax exempting food) may be more appropriate (Penniman, 1976, p.432).

### Taxpayers and Taxing

Moreland's Third Law of Human Behavior and Economics states, "taxes are always too high."<sup>17</sup> Nationwide polls have shown that the federal income tax and the local property tax are consistently ranked first and second, respectively, as the taxes which respondents felt were too high. State sales tax and state income tax tend to be ranked third and fourth.<sup>18</sup> A recent survey of Arkansans indicates that they considered the federal income and local property taxes to be the least fair taxes. Arkansans considered the best, or most fair taxes, to be the state sales and income

<sup>17</sup>Arkansans' Attitude Toward Taxes, (p. 19).

<sup>18</sup>Surveys by Louis Harris referenced in *Public Opinion*, (July-Aug., 1978, p. 29).

taxes. Federal income and local property taxes were ranked third and fourth, respectively. Concerning state and local budget cuts, Arkansans chose parks and recreation, tax-supported colleges and universities, and streets and highways, respectively, as the expenditure areas that should be cut the most if cuts are needed. Arkansans chose public schools and aid to the needy as the budget items that should receive the least cuts. Arkansans also chose public schools and aid to the needy as services which they would be willing to pay more taxes to improve.<sup>19</sup>

Regrettably, few people have an understanding of taxes. Arkansans' lack of knowledge about taxes is demonstrated in a recent statewide survey on taxes. The Arkansans polled believed that the property tax and taxes from the federal government given to city hall were the types of taxes that brought the most money into their community. Arkansans were also incorrect in their belief that the property tax and federal taxes given to school districts were the taxes which brought in the most money for their school districts. Once again, it is actually the state which brings in the most money through state taxes which are given to school districts. Finally, Arkansans were incorrect in their belief that the state sales tax followed by the individual income tax were the two taxes which brought the most money to the state government. Individual income taxes bring the most money to the state government, followed closely by the state sales tax.<sup>20</sup>

### The Burden of Raising Taxes

A tax may be defined as, "a contribution for the support of a government required by persons, groups, or businesses within the domain of that government..." To taxpayers, however, a tax might be accurately defined as, "a burden or excessive demand: a strain..."<sup>21</sup>

Tax burden is normally measured in one of three ways: (1) as a percentage of individual or family income, (2) as a percentage of income by income classes, or (3) as a relationship between total taxes and total income of the state. The overall level of state and local taxes in a state in relation to overall personal income is usually identified as the total tax burden of the state.<sup>22</sup> Put another way, tax burden is "the decline in real income that is suffered as a result of the tax" (Allan, 1971, p.23). An accepted maxim in economics is that the burden or incidence of the entire tax system is roughly proportional to income. The slightly progressive federal tax system is offset by the slightly regressive state and local tax systems (Browning, 1978, pp.649-671).

<sup>19</sup>Arkansans' Attitudes Toward Taxes, (pp. 2-3).

<sup>20</sup>Arkansans' Attitudes Toward Taxes, (pp. 6-8).

<sup>21</sup>"Tax," American Heritage Dictionary of the English Language, (1975).

<sup>22</sup>Arkansans' Attitudes Toward Taxes, (p. 439).



Since the mid 1970's, inflation has served to increase expenditures, revenues, and per capita tax burden while simultaneously decreasing the buying power of the dollar. During a period of inflation, tax increases are not necessary in a progressive tax system in order to increase revenues. Inflation forces income upward automatically pushing taxpayers into a higher tax bracket (bracket creep) (Dye, 1981, p.260). The relationship between tax burden and inflation yielded a Pearson's "r" of .79. This moderately high "r" reflects the possibility that an increasing tax burden may fuel an inflationary spiral. Recently, there has been a trend in support of automatic fiscal-monetary adjusters (e.g., automatic cost-of-living increases and tax bracket adjustments), rather than discretionary fiscal and monetary adjusters (White, 1980, pp.227-232).

Per capita tax burden may also increase by a shift of the tax burden from persons or businesses selling tangible personal property and selected taxable services to the consumers. Usually, tax shifting occurs when prices are involved (e.g., sales tax, motor fuels tax, alcohol and tobacco taxes). Personal income tax is not susceptible to shifting because no price is involved (Oldman and Schoettle, 1974, p.80).

Between 1970 and 1974, per capita income in Arkansas increased by 56 percent while per capita tax burden during the same period increased by 61 percent (Clayton, 1980, pp.160-165). However, between 1974 and 1979, per capita personal income and per capita tax burden increased by 63 percent and 56 percent, respectively. As Table 5 shows, the annual percentage increase in the per capita tax burden has not kept pace with that of per capita personal income. It can be argued that much of the increase in personal income is due to inflation and, therefore, tax burden is actually rising faster than personal income as expressed in constant dollars. Per capita tax burden as a percentage of per capita personal income has maintained a relatively stable yearly average of 6.75 percent throughout these inflationary times. Increases in per capita tax burden have resulted far more from inflation than from legislation.

Surveys of state and local tax burden between fiscal years 1973-1974 and 1978-1979 show that Arkansas ranked 50th five times during the period and 49th once.<sup>23</sup> While Arkansans continue to complain about the amount of tax they have to pay, studies show that, although Arkansas' per capita tax burden is rising, Arkansas is consistently ranked very low in per capita tax burden as compared to other states.

### Tax Capacity and Utilization

Almost all governments levy taxes that either underutilize or overutilize the government's "taxable capacity." Taxable capacity is enhanced when used for purposes considered essential to the public welfare (Kimmel, 1950, p.10). As a general rule, the more productive and acceptable the

<sup>23</sup>*State Tax Review*, (Vol. 36-42, 1975-1981).

Table 5. Comparison Between Per Capita Personal Income and Per Capita Tax Burden in Arkansas with the Consumer Price Index

	Per Capita Personal Income	Per Capita Tax Burden	Increase in Consumer Price Index (1967=100.0)		Tax Burden as a Percentage of Income
1979	\$6,953.	\$456.	13.8	--- 1978-79	6.6%
1978	6,182.	394.	11.0	--- 1977-78	6.4
1977	5,464.	375.	9.3	--- 1976-77	6.9
1976	4,933.	342.	13.5	--- 1975-76	6.9
1975	4,527.	309.	14.6	--- 1974-75	6.8
1974	4,274.	293.			6.9
----	-----	---	----	-----	---
1970	2,740.	182.	6.5	--- 1970-71	6.6
	<sup>1</sup> 153.8%	<sup>1</sup> 150.5%	<sup>3</sup> 12.4%		<sup>4</sup> 6.75%
	<sup>2</sup> 10.3%	<sup>2</sup> 9.3%			

<sup>1</sup>Percentage increase between 1970 and 1979

<sup>2</sup>Average annual percentage increase between 1974 and 1979

<sup>3</sup>Average annual increase between 1974 and 1979

<sup>4</sup>Average during the period (1974-1979)

Source: Sarah Breshears and Jane N. Morehead, *Arkansas Personal Income Handbook*, prepared by the Industrial Research and Extension Center, U.A.L.R., 1981, p. 12, and *Sharing State Revenues with Cities and Counties*, (Little Rock: Local Government Institute Center for Urban and Governmental Affairs, 1981), p. 11.



revenue sources available, the greater the tax capacity. Three reasons support this generalization. First, after a certain point, further increases in tax rates yield less than proportionate returns (diminishing returns). Secondly, there is no perfect tax. This is primarily true due to the imperfections in the applications of taxes. Finally, administrative and enforcement problems occur when one tax, or a few taxes, are imposed at high rates (Kimmel, 1950, p.10).

In a report published by the Southern Regional Education Board, Kenneth Quindry and Niles Schoening state, "The South is the only region in the country where tax capacity, ... is found to be underutilized in every state in the region" (Quindry and Schoening, 1980, pp82-85; 88-89). In a similar report on state and local tax effect, Quindry and Schoening point out those state and local taxes labeled as underutilized, such as: alcohol tax, public utility tax, selected sales taxes, death and gift taxes, property tax, corporate and individual income taxes, and parimutual taxes. The report also identified the percentage of tax ability utilized for the state as well as several selected taxes. The percentage of utilized tax ability for the state in 1979 was 74.8 percent. Percentage of tax ability utilized for selected taxes were: general sales tax--9.3 percent, property tax--53.7 percent, individual income tax--65 percent, corporate income tax--80.1 percent. Net unutilized per capita tax ability amounted to \$204 (Quindry and Schoening, 1980, pp.81-84; 89-90).

### Conclusion

The Arkansas State Government no longer serves the functions of simple housekeeping and patronage as in the 19th Century. Arkansas is faced with the challenge of compensating for losses in federal aid and an increase in state fiscal and administrative responsibilities brought on by Reaganomics and New Federalism. Dependent on federal resources for many of the public services currently enjoyed, Arkansas must cut services, locate other funding sources, or both. Arkansas, over the last fourteen years, has depended on the federal government for approximately 34 percent of total expenditures on average. Federal expenditures in public welfare (71 percent), education (18 percent), highways (34 percent), and health (34 percent), have been substantial over the past two decades.

Undertaxed in comparison to other states, Arkansas may increase taxes to replace funding lost through federal cutbacks. Arkansas has been increasing total tax revenue at an annual rate of approximately 10.7 percent. This increase, though substantial, has been largely attributed to population growth, increased industrial/commercial activity, and inflation rather than legislated increases in taxes. Quindry and Schoening, in their 1978 study of the tax capacity/effort of the fifty states, indicate that Arkansas is utilizing its tax capability at only about 74.0 percent of capacity. Further, Halsted and Weldon indicate that all major tax categories are underutilized in Arkansas, particularly general rates, individual income, property, severance, and public utilities taxes. Given this information, Arkansas is undertaxed.

Opinion polls and elections have indicated an historic resistance on the part of taxpayers to react to the need for increased revenue in the state. Few state representatives and senators are willing to support tax increases in the face of aggravating the voter, therefore, the prognosis for a possible tax increase is guarded.

However, if Arkansas chooses to maintain current service levels by raising taxes, then Arkansas will be most successful by increasing existing tax rates rather than creating new taxes. If taxes were to be increased, the most likely category would be the general sales tax. The state legislature, in 1980, refused to enact legislation that would initiate a 1 percent sales tax increase, but the legislators did provide for an optional city-county increase provided that the public voted in favor of such an increase on the municipal-county level. Many city-county governments have enacted the 1 percent option indicating to the state legislature that a 1 percent increase in the statewide sales tax might be less objectionable than previously thought. Further, a recent statewide poll indicated that an increase in the sales tax would be acceptable if food were exempted. The major problem in attempting to pass new tax legislation, especially since Proposition 13, is the openly hostile attitude of the public.

The taxpaying public of Arkansas must realize that the state government can provide adequate services only for those programs and services that the public has labeled as necessary to their relative quality of life and for which they have also agreed to pay the necessary price. Other revenue sources must be found to replace lowered federal aid if services are to be adequately provided.



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