TAX FOUNDATION

TAX FEATURES

May 1993 Volume 37, Number 4

Administration's Energy Tax to Hurt Some States, Households Far More than Others

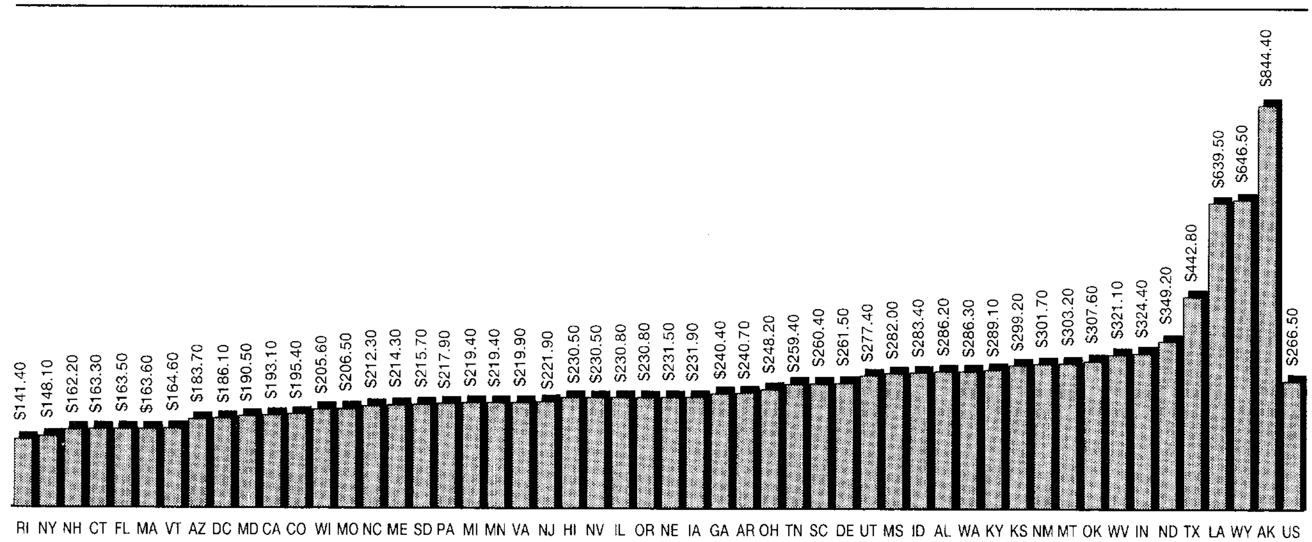
If the Clinton administration's broad-based energy tax proposal is enacted by Congress, it would hit some states far harder than others, according to a new analysis by Dr. Arthur Hall, Senior Economist at the Tax Foundation. The tax—based on British thermal units, or Btu's—would have an especially harsh impact on Texas and California, where average annual energy tax burdens would be twice the level of the third hardest hit state, Ohio.

In fact, in 1996—the first year the tax is phased in fully—Texas could pay over 75 times more in energy taxes than Vermont, the least-affected state. Other states that would bear a disproportionate amount of the total energy tax burden include New York, Pennsylvania, Illinois, Louisiana, and Florida.

The analysis was based on the Department of Transportation's most recent assessment of

Energy Tax Plan continued on page 2

1996 Btu Tax Burden Per Household By State



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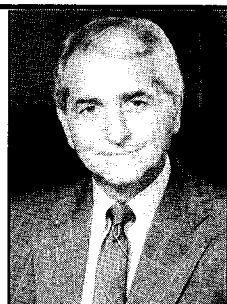

Doing More With Less At the State Level

Lieutenant Governor Nick A. Theodore
(D-South Carolina)

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Energy Tax Plan

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energy consumption by state and on the Tax Foundation's projection of tax burden by state in 1996. The analysis is based on the administration's goal of raising $73 billion over a five-year period.

States with large industrial and transportation sectors will be hit especially hard. As seen in the accompanying table, the industrial sector in Texas will shoulder over half the state's Btu tax burden. In California, it's the transportation sector that carries the inordinate load, yielding almost 40 percent of California's energy tax revenue in 1996. Combined, the industrial and transportation sectors in Louisiana will likely account for 85 percent of that state's energy taxes. And in Tennessee and Washington state, the industrial and transportation sectors will yield over two-thirds of the new revenues.

But the residential and commercial sectors are not immune. For example, those sectors will account for almost half the Btu tax burden in Florida and well over half the burden in New York state.

The Tax Foundation also produced figures showing how the energy tax will affect the average household and individual in each of the 50 states. Of the households across the country, those in Alaska are far and away the hardest hit by the new tax (see the chart on page 1). The average household in Alaska will pay $844.40 in energy taxes in 1996. Households in Wyoming and Louisiana will bear the second and third largest burdens, paying an estimated $646.50 and $639.50, respectively, in additional taxes. Texas ($442.80) and North Dakota ($349.20) round out the top five. The average Btu tax burden in 1996 for households across the nation is estimated at $266.50.

Dr. Hall predicts those living in Alaska will also pay the most in 1996 on a per capita basis—$280 per person. Residents of Wyoming and Louisiana will again be the second and third hardest hit,with the new energy tax adding $237.50 and $225.50, respectively, to the per capita tax bill in those states. For the nation as a whole, the 1996 Btu tax per person will run $97. ●

Estimated 1996 Btu Tax Burden By State and Sector ($Millions)

	Residential Sector	Commercial Sector	Industrial Sector	Transportation Sector	Total	State Rank
Alabama	$ 77.6	$45.5	$197.7	$110.5	$431.3	17
Alaska	13.2	16.3	82.8	47.2	159.6	36
Arizona	54.7	57.2	50.1	89.4	251.4	29
Arkansas	44.2	28.1	79.4	62.8	214.5	33
California	350.4	357.0	518.4	779.1	2,004.9	2
Colorado	56.4	62.9	56.8	74.4	250.5	30
Connecticut	61.0	47.3	36.2	56.4	200.9	34
Delaware	12.3	9.3	25.7	17.3	64.6	47
D.C.	9.0	21.0	9.1	7.4	46.5	50
Florida	221.5	189.5	116.9	311.5	839.4	8
Georgia	118.7	88.4	174.5	187.4	569.0	12
Hawaii	6.9	12.4	19.8	43.0	82.0	45
Idaho	20.5	19.0	37.8	24.9	102.3	41
Illinois	227.9	177.9	328.9	235.4	970.0	6
Indiana	113.0	73.3	324.3	159.1	669.8	10
Iowa	55.7	37.2	89.7	64.1	246.7	31
Kansas	49.2	44.8	111.3	77.4	282.7	26
Kentucky	69.9	46.9	178.8	103.4	399.0	19
Louisiana	80.0	58.9	623.3	196.5	958.6	7
Maine	21.8	15.9	30.3	31.6	99.7	42
Maryland	84.3	44.8	113.3	90.8	333.2	24
Massachusetts	106.2	91.1	59.7	111.0	368.0	22
Michigan	183.5	129.5	250.6	186.4	750.0	9
Minnesota	82.2	53.1	133.6	92.7	361.6	23
Mississippi	45.8	28.6	101.2	81.2	256.9	27
Missouri	102.1	77.8	94.8	130.2	405.0	18
Montana	16.1	13.8	40.1	22.7	92.8	43
Nebraska	32.7	30.0	35.2	41.4	139.4	38
Nevada	22.6	18.7	29.8	36.4	107.4	40
New Hampshire	19.2	11.2	16.3	20.0	66.6	46
New Jersey	129.2	128.8	143.8	218.4	620.2	11
New Mexico	20.5	25.8	54.4	63.1	163.8	35
New York	260.5	278.0	191.7	253.2	983.3	4
North Carolina	121.2	91.1	174.6	147.5	534.5	14
North Dakota	13.6	10.6	42.0	18.0	84.2	44
Ohio	214.2	157.7	424.3	218.5	1,014.7	3
Oklahoma	70.5	52.9	153.2	94.3	371.0	21
Oregon	55.7	44.9	76.5	77.5	254.6	28
Pennsylvania	218.8	142.1	387.6	231.3	979.7	5
Rhode Island	16.5	11.3	9.8	15.8	53.5	49
South Carolina	63.8	43.9	135.1	84.7	327.5	25
South Dakota	14.4	8.6	14.8	18.0	55.9	48
Tennessee	102.0	54.4	197.6	126.9	481.0	16
Texas	312.9	270.1	1,507.5	597.6	2,688.1	1
Utah	26.9	22.9	58.2	41.0	149.0	37
Vermont	10.5	6.5	6.2	11.6	34.7	51
Virginia	111.2	102.0	131.4	159.5	504.1	15
Washington	102.9	79.3	196.5	157.1	535.9	13
West Virginia	34.3	23.7	123.4	39.9	221.3	32
Wisconsin	92.0	62.8	126.4	93.5	374.7	20
Wyoming	9.4	10.5	66.7	22.7	109.3	39
United States	$ 4,359.5	$3,535.3	$8,189.7	$6,182.1	$22,266.7	

Source: Tax Foundation computations using Commerce Department energy consumption data.

New Study Shows Imbalance of Federal Tax Burden by State

The uneven nature of federal tax payments among the fifty states is highlighted in Economist Chris R. Edwards' latest *Special Report*, "The 1993 Federal Tax Burden by State." Some states' residents pay over $6,000 per capita to the federal Treasury each year, while others pay less than $3,000.

On the flip side, different states receive different levels of federal spending on everything from defense contracts to Social Security payments to residents. A comparison of federal taxes and federal spending by state will be presented in the June issue of *Tax Features*.

Significant variations in federal tax burden occur between the states because of differences in income and other factors—including variations in consumption rates of federally taxed goods like gasoline.

By far the largest payment to the federal Treasury is made by residents of California, who will shoulder $148 billion, or 13.2 percent of all federal taxes in fiscal 1993. It would take the taxes attributable to all of the bottom-ranked 25 states and the District of Columbia to equal the amount of tax revenue generated from this single state. In contrast, Wyoming's $1.9 billion tax bill amounts to only 0.2 percent of the total.

A different picture emerges when taxes paid by each state are considered on a per capita basis. Connecticut residents have the highest per capita federal tax burden in the nation at $6,647. New Jersey residents are not far behind and face a per capita federal tax burden of $6,302.

At the other end of the scale, a number of mostly western and southern states have the lowest levels of per capita federal taxation. With a per capita tax burden of $2,703, Mississippi is the only remaining state where residents pay under $3,000, on average, to the federal Treasury. Mississippi is joined by West Virginia, Utah, New Mexico, and Arkansas to round out the five states that were lowest in per capita federal taxes. The gap between the highest-ranked state (Connecticut) and lowest-ranked (Mississippi) is close to $4,000 per person.

Over the past decade, Connecticut ranked as either the first or second highest-taxed state each year, while Mississippi managed to hold its place as the lowest-taxed state throughout the period. Some states, however, have moved substantially in the rankings. Texas, which had the 18th highest tax burden per capita in fiscal 1984, will fall to 32nd by fiscal 1994. North Dakota, originally ranking 23rd, will move down to 37th in the nation by fiscal 1994. The residents of Hawaii have moved in the opposite direction, from 24th in fiscal 1984 to 10th highest currently.

The accompanying chart shows the 10-year change in federal taxes per capita in constant dollar terms. Federal taxes per capita for the country increased 23 percent over the decade. Differential changes in the tax burdens of each state primarily reflect changes in each state's economy and residents' incomes.

Only three states, Alaska, Oklahoma, and Wyoming, saw their real federal per-capita tax burden fall over the period. A common factor for these states, as well as for Texas and Louisiana— states which also did not see increases in real federal tax burden—is the importance of the oil and gas industry to the states' economies.

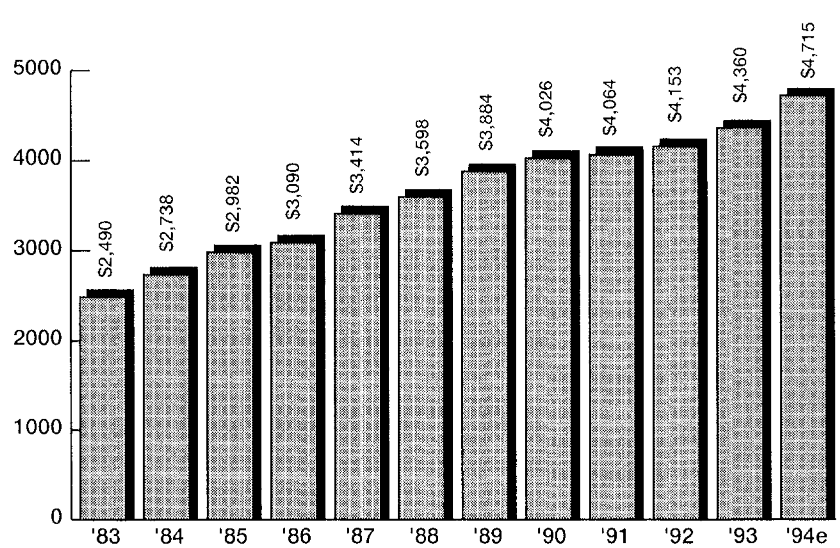
In contrast, high-income states in the East, including New Jersey, Connecticut, Delaware, New York, Massachusetts, and New Hampshire, all saw their real per capita federal tax burdens increase by over 35 percent during the decade. •

FY93 Federal Tax Burden Per Capita
Top and Bottom Ten States
($Millions)

State	Amount	Rank
Connecticut	$6,647	1
New Jersey	$6,302	2
Alaska	$5,502	3
Delaware	$5,463	4
Massachusetts	$5,316	5
New York	$5,290	6
Maryland	$5,120	7
Illinois	$5,018	8
Hawaii	$4,880	9
New Hampshire	$4,757	10
Alabama	$3,348	41
Louisiana	$3,325	42
Kentucky	$3,316	43
South Carolina	$3,288	44
Idaho	$3,249	45
Arkansas	$3,189	46
New Mexico	$3,153	47
Utah	$3,080	48
West Virginia	$3,078	49
Mississippi	$2,703	50

Source: Tax Foundation.

Federal Tax Burden Per Capita (Fiscal Years 1984 - 1994)



Source: Tax Foundation; U.S. Bureau of Census.

Doing More with Less at the State Level

Lieutenant Governor Nick A. Theodore (D-South Carolina)

Lieutenant Governor Theodore presented the keynote address at the Tax Foundation's fiscal policy seminar in Columbia, S.C., in April. The following was excerpted from his remarks.

Grass roots efforts are alive and well in the United States, and even more active right here in South Carolina, thanks to your participation and the work of the South Carolina Policy Council and the Tax Foundation.

The public and private sectors must ensure a cooperative spirit to improve the operations of government so that South Carolina remains competitive and viable nationally, as well as internationally. And even more important, so that South Carolina citizens enjoy an enhanced quality of life.

Budget reform in South Carolina is a number one priority for our state, for if we cannot manage properly our fiscal affairs in the present, South Carolina will be left standing in a financial backwater in the future.

Groups like yours are one of the most dynamic elements of the American political system, and through your help and involvement at every sector of the community we can ensure that elected representatives are indeed representative—and more importantly, that we are representing the issues important to you.

The 1993 legislative session promises to be an historic one, provided we continue the momentum toward making South Carolina government more efficient and more effective.

And, as part of this momentum, state government needs your input to help provide the direction and feedback required to make informed, progressive decisions designed to work for all of us.

Business and community leaders have identified education, health care, government restructuring, and the environment as top priorities for the 1993 legislative session.

State developments will likely follow these lines, but will also depend on new initiatives pending at the federal level.

This morning, however, in order to focus our discussion, I would like to talk to you about a fiscal battle I have been fighting since last September, before the legislature even convened—the South Carolina budget. If you've followed the press over the last couple of months, you have undoubtedly read about the loss of South Carolina's Triple-A credit rating.

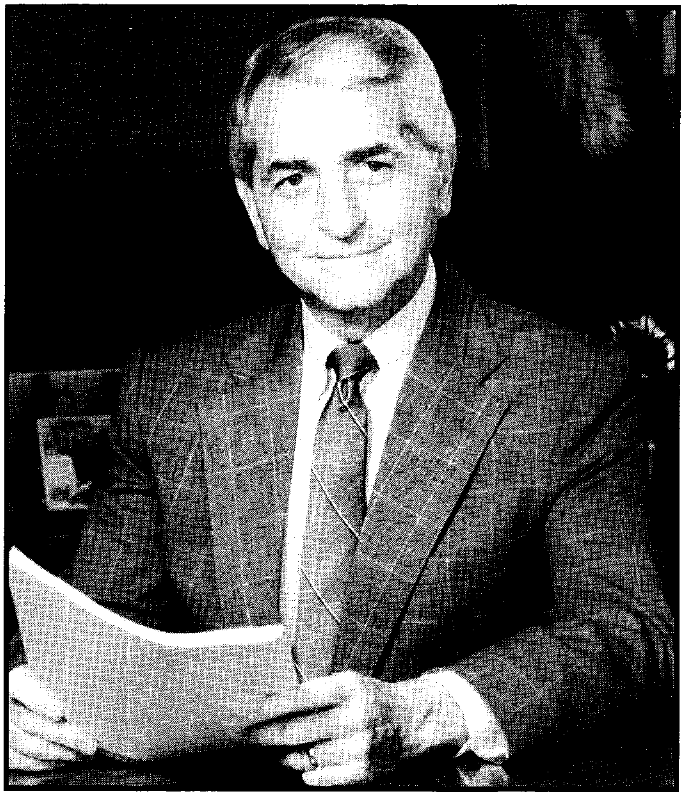
Friends, this is more than a cosmetic label. It is a final blow to a year of budgetary mayhem. For the first time in 30 years, our credit rating has been downgraded, and it is all of us taxpayers who will be forced to foot the bill! The only Triple-A we have now is the American Automobile Association, and—whether through behind-the-back tax increases or reduced services—the taxpayers of South Carolina are getting the shaft.

One of Standard & Poor's reasons for lowering our credit rating was that the state's efforts at budget reform haven't gone far enough since March of 1992 when the South Carolina government was placed on alert.

Budget reform in South Carolina is a number one priority for our state, for if we cannot manage properly our fiscal affairs in the present, South Carolina will be left standing in a financial backwater in the future.

As I addressed the opening session of the General Assembly in January: Before the state government can responsibly spend taxpayers' money, it needs to know where the money is going.

Last year, I single-handedly vetoed



South Carolina lags far behind the rest of the nation in allowing the private sector to perform certain services.

over $40 million in additional behind-the-back taxes, making many legislators furious, but protecting the pockets of all of us, the taxpayers.

Last fall, after the Budget and Control Board's budget fiasco, I thought long and hard about changes we need right here in South Carolina, particularly with regards to how state government conducts its fiscal management.

The Supreme Court of South Carolina agreed unanimously with this position, and in November I published "South Carolina's Budget Process: In Need of Repair." I have outlined several items which should prove helpful in steering the discussion of how to ensure greater benefit from scarce and hard-earned tax dollars.

First, the 1993 assembly must prioritize our funding in order to deliver to South Carolina's citizens the services they most desire.

My report, the only one of its kind, outlines in detail a method of prioritization in which we decide whether the education of your children and your grandchildren is more important than using state aircraft to fly your elected officials around.

We simply do not have enough money to satisfy everyone's wish list, and it's time somebody stepped up to the plate and said, "No! You cannot have any more of our tax dollars!"

Second, we need mission statements for our agencies to show us where we ought to be going, and benchmarks to measure our success or failure in achieving these goals.

The overall premise of my plan is that state government and state agencies must learn to do more with less, and leadership must be exerted in determining where scarce resources must be spent in order to meet more comprehensively the needs of South Carolina's citizens.

Would you believe that almost 95 percent of the state budget funds services that have not been examined in years? Currently, we are shooting in the dark when we fund agencies. We simply cannot afford to slash valuable educational, medical, and human services any further without shortchanging the long-term future of South Carolina.

Third, the legislature needs to give agencies incentives to save state money. Under the present approach of "use-it-or-lose-it" spending, total agency equipment expenditures rise an astonishing six times above their monthly average at the end of each fiscal year.

If we allow agencies to carry forward a greater portion of what they save, the state benefits because the agency will need that much less money in the upcoming years.

Fourth, South Carolina lags far behind the rest of the nation in allowing the private sector to perform certain services. If state government can provide these services more effectively and efficiently, then fine. If not, then we need to seek out the experts who can perform these services more cost-effectively for you and for me, the taxpayers.

As a final point, the Legislative Audit Council and others have pointed out steps for immediate cost savings: unused state land to sell, reducing subsidies to out-of-state students, limiting spending allowances for many of your state officials, just to name a few. We need to examine the advice of the Audit Council, and work quickly to implement some of its suggestions for a more cost-effective government that governs well.

The time has passed for any more studies. We've already done our homework, and the handwriting is on the wall. Armed with this ammunition, 1993 must be the year for action, and not a session of dialogue. Simply stated, the buck stops here. So I urge you to keep me informed. •

Foundation Signs Protocols with Russian, Kazakhstani leaders

On March 19, the Tax Foundation signed a cooperative protocol with Kazakhstani officials which laid the groundwork for greater cooperation between the former Soviet republic and American and European businesses. The protocol, signed by Kazakhstan's Minister of Finance and chief of the Central Tax Inspectorate, contains major statements of principle that business leaders feel are needed to create a tax climate more favorable to foreign investment. It also highlights areas in which Kazakh officials need Western assistance, such as education, computerization, and economic policy development.

In Moscow a week later, the Foundation signed a memorandum of understanding with officials from the Ministry of Finance, and another with members of the Supreme Soviet. The memoranda outlined a set of guidelines for future cooperation and for laws governing the taxation of foreign investment in Russia.

The Kazakhstan visit is considered the first formal meeting on tax and trade policy between American and European executives and Kazakhstani officials. The central Asian country is rich in natural resources, particularly oil and natural gas, and has attracted much attention from businesses in the West. However, Kazakhstan's current system of taxation poses serious hurdles to firms considering making an investment.

As a follow-up to the March trip, the Tax Foundation invited key Kazakhstani tax and finance officials to Washington, D.C., in mid-May to participate in a full-day conference, "Tax and Legal Aspects of Foreign Investment in Kazakhstan." Leading the delegation: Minister of Finance E.Z. Derbisov.

The Russian leg of the trip was the fourth meeting between the Tax Foundation and top Russian officials. Earlier in March, some of Russia's top officials—including the Acting Chairman of the State Tax Service—were featured at a Tax Foundation-sponsored conference that examined obstacles to foreign investment in Russia. •

In March, the Tax Foundation signed two memoranda of understanding with top Russian officials. Seated, from left: Clyde Tyree Crook, Baker Hughes; Dan Witt, Tax Foundation; V.V. Gusev, Acting Chairman of Russian State Tax Service; and Linda Senat, British Gas PLC. Standing, from left: David Tomney, Citicorp/Citibank, USA; Dr. Charles McLure, Jr., Hoover Institution; Jack Barbanel, The East-West Trade and Commerce Group, Inc.; and Marlen Lawson, Bechtel Group, Inc.

Members of the Tax Foundation delegation confer with Kazakhstani officials before signing protocol. From left: E.Z. Derbisov, Minister of Finance; M.T. Ospanov, Chief of the Central Tax Inspectorate; Gennady Bekhterer, interpreter; Bill Frenzel, delegation leader and Tax Foundation Distinguished Fellow; Dan Witt, Tax Foundation; and Charles McLure, Jr., Senior Fellow at the Hoover Institution.

UPDATE

The Tax Foundation launched its third annual series of state seminars on tax and fiscal policy in April, with a seminar in **Columbia, S.C.**, April 6 and another in **Boston, Mass.**, April 20.

Featured speakers at the South Carolina seminar included Lieutenant Governor Nick A. Theodore; Secretary of State Jim Miles; State Senators John E. Courson and John Drummon; and Luther F. Carter, Executive Director of the S. C. Budget and Control Board.

The seminar in Massachusetts featured Lieutenant Governor Argeo Paul Cellucci; Rep. Thomas Finneran, Chairman of the General Court's Ways and Means Committee; and Mark Robinson, Secretary of Administration and Finance for the state. Also, Herman B. "Dutch" Leonard, Baker Professor of Public Sector Financial Management at Harvard's John F. Kennedy School of Government, presented the keynote address.

• • •

Dr. J.D. Foster, Chief Economist, traveled to **New Orleans** May 3-4 to take part in the Wall Street Tax Association's Annual Seminar. Dr. Foster joined the panel titled "1993 and 1994 Tax Legislative Outlook." Other participants on the panel included moderator Anthony Cetta, First Boston Corporation; Fred Goldberg, former Assistant Secretary, Treasury Department; and James Miller, former Tax Legislative Council, Treasury Department.

• • •

The Tax Foundation was well represented at a tax conference for journalists at the **University of Cincinnati** in April. The event was part of this year's George L. Strike Journalism Program.

Floyd Williams III, Chief Tax Counsel, spoke on the outlook for enactment of President Clinton's tax proposals and the likelihood of comprehensive tax reform in the future. Dr. Patrick Wilkie, Assistant Professor of Taxation at George Mason University and a Tax Foundation Visiting Professor, gave an address on the issue of tax fairness. Finally, Gene Wells, Vice President of Taxes at Procter & Gamble and a member of the Tax Foundation's Program Committee, spoke on the issue of U.S. international taxation and how U.S. tax policy can create burdens for its multinational corporations. ●

FOUNDATION MESSAGE

Journey of a Thousand Miles Begins with a Single Step

I've discussed in this space before the journey of the former Soviet republics from totalitarianism toward a pluralistic democracy and market economy. Obviously, the opening of these markets has created enormous new opportunities for American businesses and American trade in general.

But taking full advantage of these opportunities will require the political leaders of those countries to establish new relationships between consumers, domestic and foreign businesses, and government agencies. The Tax Foundation has been in an excellent position to assist in this process. Since December 1991, we've brought together senior American financial and tax executives with senior Russian government officials four times to discuss the tax aspects of improving Russia's investment climate. In March of this year, we sponsored a visit by top Russian tax and finance officials to Washington, D.C., which allowed them to participate in a week-long series of meetings examining investment in Russia.

Dan Witt
Executive Director

Three weeks later, we led a delegation back to Moscow to sign two memoranda of understanding with officials in the executive and legislative branches of Russia's government [see related story, page 6]. The documents called for ongoing and regular information exchange, training, and education.

On that same trip, we signed a protocol with key government officials in the Republic of Kazakhstan. We believe this was a first for the U.S. private sector. We then invited those officials to this country in May, to participate in a conference titled "Tax and Legal Aspects of Foreign Investment in Kazakhstan."

The relationships we have developed during this process have provided the Tax Foundation a unique opportunity to assist the Russian and Kazakhstan governments in developing tax systems conducive to economic growth and the foreign investment essential to that growth. It has also facilitated U.S. investment in both countries, offering American workers the possibility of expanded job opportunities through increased exports to these countries.

These and several proposed activities in Russia are natural applications of the Tax Foundation's mission. Through them, we hope to help establish institutions abroad that will encourage free market practices and promote economic growth—to the benefit of Russian, Kazakhstani, and American businesses, consumers, and workers, at virtually no cost to the American taxpayer.

Of course, there is always the chance that political circumstances overseas will intervene to damage our prospects for real tax and finance reform in the former Soviet Union. But we are willing to bet it won't. The Russians and Kazakhstanis—as well as citizens of other developing economies—rely on foreign investment to provide much-needed capital and technological assistance. The most astute officials know they won't get a steady flow of trade and investment unless they can provide a stable tax and economic climate.

This doesn't just apply to Russia and Kazakhstan. It's a principle we believe U.S. politicians should also take to heart.

Finance Committee Hears from Foundation on President's Tax Plan

TAX FEATURES

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The Tax Foundation's Chief Economist and Director, Dr. J.D. Foster, testified before the Senate Finance Committee April 30 on the Clinton administration's tax program and the proposals to increase the personal and corporate income tax rates in particular.

It was the second time in a month that the Tax Foundation had been invited to present testimony before a tax-writing committee in Congress. Dr. Foster appeared before the House Ways and Means Committee to discuss President Clinton's tax plan on April 1.

Chief Economist J.D. Foster appears before the Finance Committee of the United States Senate.

In his statement to the Finance Committee, Dr. Foster reminded members that there were good reasons for reducing tax rates in the 1981 and 1986 Tax Acts, reasons as valid today as they were then, and that the Committee had played a pivotal role in writing these laws.

"The basic laws of economics governing how individuals respond to incentives have not been repealed," he stated. "The reasons for keeping tax rates as low as practicable have not changed in seven years. What has changed is the focus of our attention."

He advised that raising the tax rates on upper-income individuals would merely serve as a disincentive to save and to invest. By raising rates, the government discourages "those individuals who are most capable of making discretionary saving decisions, and who, in fact, do most of the saving at the individual level. Make no mistake—private saving will decline if tax rates rise."

Dr. Foster told Committee members that the U.S. faces a fundamental economic problem: low productivity growth. "A deficit-reduction program such as the one proposed by the Clinton administration, which relies on large tax increases, defense spending cuts, and a reshuffling of domestic spending programs, does not offer any hope of addressing the decline in American productivity," he said. "In fact, it will probably do more harm than good."

"The [proposed] program is likely to reduce both the rate of saving per dollar of income, and the rate of economic expansion, thereby assuring a reduction in private saving which may exceed the amount of actual deficit reduction." •

Tax Foundation
1250 H Street, NW
Suite 750
Washington, DC 20005-3908

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