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TF Economist Says Mandated Tax Lids Are Ill-Advised

Rigid constitutional or statutory limits on public expenditure may be ill-advised, Tax Foundation's Director of Research Elsie M. Watters told the Nebraska Legislative Conference on Property Taxation.

Speaking as a panelist at the Conference's June 8 meeting in Lincoln, Nebraska, Dr. Watters conceded that hers might be a minority view. There is, she admitted, a prevailing feeling that special-interest groups, not the general public, gain favors from lawmakers and a growing awareness that inflation now raises government receipts—and, probably, spending—without legislative action. She said that she saw a number of valid reasons for opposing writing tax or spending limits into the law books:

- Mandatory lids on state and local taxes and/or spending offer simplistic solutions to complicated problems. Automatic regulators cannot substitute for hard thought.
- Any formula is necessarily arbitrary, based on questionable assumptions, and could lead to perverse effects.
- Ceilings can easily become floors.
- Ceilings may not be needed, as there has already been a slowing trend in the rate of growth of state and local general expenditures.

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'Facts & Figures' Revision Updates U.S. Fiscal Profile

The debate over the major concerns of our national life, writes Thomas M. Macioce, Chairman of the Tax Foundation, in his foreword to *Facts and Figures on Government Finance, 20th Edition*, "must be underpinned by the soundest possible data, must be carried on within the context of a clear understanding of the fundamental facts about the size and scope of government." He describes the purpose of the Foundation's widely used handbook, first published in 1939, as an effort to aid that understanding and provide that data.

Assessing the size and scope of matters of public finance is a formidable task. Even a quick survey of the highlights covered by the publication's 213 statistical tables indicates the broad range of data which combines to form our national fiscal profile:

- *Spending is growing, but the growth is slowing down.* Spending by all levels of government—Federal, state, and local—has been growing at 10.7 percent annually since 1969. Growth rates averaged 8 percent in the fifties and 8.2 percent in the sixties. Allowing for inflation, though, the trend is actually downward. Adjusted for consumer price increases, government spending rose 5.9 percent annually in the fifties, 5.5 percent in the sixties, and 4.0 percent in the seventies through 1977.
- *Public-sector jobs are on the increase and it pays to work for the Federal government.* For every 100 employees in the private sector, there are 25 employees of Federal, state, or local government. The average civilian worker in the Federal government in 1977 made $16,936, compared to $12,230 for state and local government employees, and $12,239 for men and women in private industry.
- *All taxes are growing, and state taxes have really taken off.* Over the last decade, local taxes have grown just as rapidly as Federal taxes. In 1978, both were up about 160 percent from the 1968 amounts. State-level taxes, however, have witnessed a much sharper jump—215 percent. In 1978, Federal taxes are estimated at $382 billion, state taxes at $123 billion, and local taxes at $80 billion.
- *Federal taxes claim almost twice as much as state-local taxes.* For every dollar the Federal government collects in taxes, state and local governments collect an additional 53 cents. In 1978, per capita tax payments to all governments are estimated at $2,686, of which $1,754 will go to the Federal government and $932, to state and local governments.
- *Federal debt is three times as large as state-local debt.* For every dollar of Federal debt, state and local governments owe just 36 cents. Total government indebtedness in 1978 amounted to $4,811 for every U.S. man, woman, and child.
- *Government is no monolith.* There are 80,171 units of government in the

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Salaries and Benefits Climb As Federal Job Rolls Shrink

Between 1978 and 1980, Federal employee compensation and benefit costs are estimated to increase from $97.5 billion to more than $112.2 billion—or about 15 percent. These costs account for more than one-fifth of total budget outlays.

This sharp growth in the cost of salaries and benefits for Federal workers will take place despite a relatively modest reduction in the number of workers receiving Federal paychecks, from 4.92 million as of September 30, 1978 to 4.86 million by September 30, 1980.

Mounting costs in the face of shrinking employee rosters are one facet of the personnel side of the 1980 Federal budget assessed in "Proposed Federal Budget for Fiscal Year 1980: III. Federal Employment and Personnel Costs," just published by the Tax Foundation. The study also details total Federal employment, Executive Branch employment, and the growth of personnel compensation and benefits costs for the period 1970-1980.

"Federal employment data as reported in the budget, by the Office of Personnel Management and other governmental sources, by no means include all workers whose salaries are paid by the Federal government," notes the Foundation's analysis. "An unknown, but certainly very large, number of persons outside the Federal service are employed under grant programs and a variety of contractual arrangements."

The Foundation reprints excerpts from testimony by the Secretary of Health, Education, and Welfare, before a Senate appropriations subcommittee in 1978, which shows that in addition to some 145,000 HEW employees on staff, HEW may have employed as many as 980,000 additional workers through an elaborate system of grants to state governments. Such "outside" employees are also widely used by the Labor Department, the Defense Department, and the National Science Foundation, among others, the Tax Foundation reports. A large number of consultants, part-time or per diem, do not show up in estimates of Federal personnel costs, which document only "direct" employment in the departments and agencies.

While numbers employed have remained fairly stable, compensation and benefit costs have increased significantly, according to Foundation researchers. In 1970, when Executive Branch employment totaled 5.99 million—more than a million above the present level—personnel compensation and benefit costs totaled $53.1 billion. By 1978, these costs had hit $97.5 billion, with an estimated $104.6 billion price tag for 1979 and $112.2 billion for 1980.

The average salary for civilian employees in the executive agencies is currently estimated at just under $19,000, the Foundation reports, and is expected to top that figure in 1980. Pay and benefit costs for civilian employees in the executive departments and agencies continue to account for more than half of total personnel costs in the Executive Branch, rising from $35.7 billion in 1975 to $53.0 billion in 1979 and $57.0 billion in 1980—an increase of almost 60 percent in five years. Over the same period, military personnel costs will increase about 36 percent, and Postal Service costs will climb about 38 percent above the 1975 level. (See the table accompanying this article.)

"Proposed Federal Budget for Fiscal Year 1980, III. Federal Employment and Personnel Costs" is available from the Tax Foundation, single copies free of charge.

Federal Personnel Compensation and Benefit Costs
(1970-1980; Billions of dollars)

	Actual			Estimated	
	1970	1975	1978	1979	1980
Civilian personnel costs:					
Executive Branch:					
Direct compensation	21.3	29.0	37.5	40.1	40.8
Personnel benefits	1.8	6.7	11.5	12.9	14.5
Allowance for civilian pay raise	—	—	—	—	1.7
Subtotal: Civilian personnel costs	23.1	35.7	49.0	53.0	57.0
Military personnel costs:					
Direct compensation	16.7	21.3	23.9	25.0	25.2
Personnel benefits	4.0	1.8	1.7	1.8	1.9
Payments to military retirees	2.8	6.4	9.2	10.3	11.5
Allowance for military pay raise	—	—	—	—	1.4
Subtotal: Military personnel costs	23.5	29.5	34.8	37.1	40.0
Postal Service personnel costs:					
Direct compensation	6.0	9.4	11.7	12.0	12.6
Personnel benefits	.5	1.7	2.0	2.5	2.7
Subtotal: Postal Service personnel costs	6.5[a]	11.1	13.7	14.5	15.3
TOTAL PERSONNEL COSTS	53.1	76.3	97.5	104.6	112.2

[a] In 1970, prior to full implementation of the Postal Service Reorganization Act, Postal Service personnel costs were included within the Executive Branch totals; Postal Service costs have been removed from Executive Branch totals for 1970 to provide data comparable with that shown for later years.

Mandatory Lids

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• State legislators and governors are already acting to reduce spending, as reported in Tax Foundation's *Tax Review* for November 1978 and February 1979.

• The basic reason, though, according to Dr. Watters, is that arbitrary formulas to control spending and taxes go "against the grain." They imply that representative government does not work well, that elected officials cannot be expected to make wise decisions, and that, in the area of tax policy, representative government should be done away with and voters should make their own tax laws directly.

Having presented her "minority case" against mandated spending/taxing limits, Dr. Watters gave the Conference some guidelines for formulating such limitations, should such indeed prove to be the will of the majority.

Limits should be comprehensive, she said, not reserved for one area of spending or taxation as was done in California with the passage of Proposition 13. She said that she preferred a statutory limit to a Constitutional one. But if a Constitutional one was chosen, she counseled that it should be couched in the broadest possible language to give the legislature as much flexibility as it might need for a wide range of situations.

Finally, she advised that any mandatory limit contain a provision to protect local governments from bearing the cost of new or expanded programs mandated by the state.

Recognizing that fiscal equity was often the motive behind such limits, Dr. Watters reminded the Conference that those seeking to weigh the fairness of tax policy must look at both sides of the fiscal exchange: who pays the taxes and who benefits from them. "Public perception of who pays the taxes and who gains from their use," she said, "may be inaccurate." In support of this contention, she cited a Tax Foundation study, currently being updated, which showed that the "benefits of government expenditures exceeded the tax burden by a ratio of more than four to one for families in the lowest income group," while the situation was reversed for families in the top income group. "Taxes for this group," she said, "were more than two and one-half times as large as the benefits they received from all government programs."

VAT of 1% Nets $11 Billion TF Study Shows

Tax Foundation's latest study entitled "A Value-Added Tax for the United States? Selected Viewpoints" presents an overview of the VAT and its implications for the U.S. economy. Beginning with a brief background history, the study highlights advantages and disadvantages of a VAT as perceived by different economists, and discusses its revenue potential as well as its possible use for social security financing.

The VAT is not a new concept. Its principles were developed in Germany and the United States shortly after World War I. It was considered for use at the state level as early as the 1930s. In the past decade, the VAT has been considered at the Federal level as a device for reducing or totally eliminating the Federal corporate income tax, as a substitute for residential school property taxes, and as a means of alleviating the rising burden of social security payroll taxes.

The study includes a broad review of literature on the VAT, citing such proponents as Dan Throop Smith (Harvard University, emeritus), R. W. Lindholm (University of Oregon), C. Lowell Harriss (Columbia University and economic consultant to the Tax Foundation), and Gerard M. Brannon (Georgetown University).

Among opponents of VAT whose work is reviewed are Stanley S. Surrey (Harvard University and former Assistant Secretary of the Treasury), Dr. Richard E. Slitor (formerly with the U.S. Department of the Treasury), and Joseph A. Pechman (Director of

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Brown Sees Tax Cut If Recession Hits

Congress will cut taxes—both individual and corporate, Robert C. Brown, executive vice president of the Tax Foundation, told Kansas City business leaders on June 4.

Speaking at a luncheon meeting hosted by Foundation Trustee Paul H. Henson, Chairman of United Telecommunications, Brown said that such cuts would come if the expected recession hits, as a growing number of economists are beginning to predict.

"If there is a greater economic slowdown and if we continue at our double-digit rate of inflation," he said, "I think we'll see corporate and individual tax cuts to get the economy rolling again." He also said he expected the cuts "in advance of the 1980 presidential election."

The Tax Foundation executive said he sensed a growing realization in Washington that there is a need "to improve the climate for capital formation and encourage savings." The impact of government also must be rolled back, he asserted. "The concern is," he said, "that there is too much money coming out of the private sector."

Prospects for the value-added tax (VAT) are also growing, Brown told the Kansas City businessmen. Both Senate Finance Committee Chairman Russell Long and House Ways and Means Committee Chairman Al Ullman have raised the possibility of using a VAT to help cover sharply increased social security costs starting in 1981.

"And VAT is a big money raiser," Brown said. "At just 1 percent, it would raise $11.5 billion." He also cautioned that any VAT passed by Congress should be to replace an existing tax and not simply in addition to levies which are already on the law books.

"There will also be a windfall profits tax," Brown stated, "probably stricter than the one advocated by President Carter."

'F&F' Update

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United States—including Federal, state, and local jurisdictions. (Tax Foundation economists estimate that some 67,831 of these have the power to tax.) Most numerous are special districts (see next item), with 26,140 counted in all states, followed by 18,856 municipalities; 16,822 townships and towns; 15,260 school districts; 3,042 counties; 50 state governments; and, of course, 1 Federal government. Illinois has the most units (2,764), followed by California (2,243), and Pennsylvania (2,121).

• *Governments are proliferating.* The number of special districts has been growing, up 8.2 percent between 1972 and 1977. These are units formed to perform a single function (soil conservation, drainage, fire protection, urban water supply, housing and urban renewal, cemeteries, sewerage, etc.) Alaska is the only state in which there are no special districts.

• *How U.S. tax picture compares.* The United States ranks seventh from the top among the 23 OECD countries in the degree of reliance on income and profits taxes. In 1976, latest year reported, 43.34 percent of total U.S. tax collections at all levels were from taxes on income and profits. New Zealand, Australia, Finland, Canada, Sweden, and Switzerland relied more heavily than the United States on such taxes. Japan and the United Kingdom were only slightly below the U.S. in this regard, while France, Italy, and West Germany made significantly less use of income and profits taxes.

• *Households—more, but smaller.* The number of U.S. households has increased by 25 percent in the last decade, while population growth has increased only 9.6 percent. This means smaller average households: 4.76 persons per household in 1900; 3.37 in 1950; 3.14 in 1970; and 2.86 in 1977.

• *100 million workers.* The U.S. civilian work force passed the 100 million mark for the first time in 1978.

• *Personal income climbs.* Per capita disposable income rose to $6,640 in 1978, up 10.5 percent from 1977.

• *Family income climbs, too.* The median income of all families in the United States in 1977 was $16,009. In 1960, only 7.4 percent of U.S. families had income of more than $25,000 in terms of its 1977 buying power. By 1970, 18.2 percent of all families had this much or more, and by 1977, the share had risen to 22.4 percent.

• *Deficits—a national way of life.* In the last 50 years, the Federal budget has been in surplus only eight times—1947, 1948 and 1949; 1951; 1956, 1957; 1960; and 1969. The largest surplus ($12 billion) was in 1948. The largest deficit ($66 billion) occurred in 1976.

• *Corporate "fat cats" not so fat.* In 1977, the average manufacturing corporation earned after-tax profits equal to 5.3 cents per $100 of sales and 14.2 cents per $100 of stockholders' equity.

• *The age of the 50-cent dollar.* For 1978 as a whole, the dollar was worth only 51 cents in the consumer market relative to its value in 1967. Since 1978, the value of the dollar has dropped to less than 50 cents, measured in 1967 purchasing power.

• *Spending—out of control.* In 1979, three-fourths of Federal budget outlays were classified as "relatively uncontrollable under present law."

• *Social Security—a big ticket item.* Under present law, the social security tax in 1987 will be levied on earnings up to $42,600. (It is currently imposed on earnings up to $22,900.) The combined employer-employee rate will rise to 14.3 percent, from its present level of 12.3 percent. For persons earning the maximum covered in 1987, the tax will be $3,046 a year, compared to a present ceiling of $1,404, with an equal amount being paid by the employer.

Facts and Figures on Government Finance, 20th Edition, is available from the Tax Foundation. Single copies are $10.

Value-Added Tax

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Economic Studies for the Brookings Institution).

Among the claimed advantages of the VAT, highlighted in the Tax Foundation's Special Report, are that it would:

- Be based on consumption, and thus provide a stable revenue base;
- Be "neutral";
- Provide incentives for businesses to control costs;
- Encourage savings;
- Have potential for raising large amounts of revenue at a low tax rate;
- Help bring about a better balanced tax system.

On the other hand, perceived drawbacks of the VAT include claims that it would:

- Be regressive;
- Lead to excessive spending;
- Be harmful to new and marginal business activities;
- Set off inflationary tendencies;
- Be a "hidden tax";
- Conflict with present state and local sales taxes.

The report goes on to discuss the major issues, providing a look at arguments on both sides. A final section develops new estimates of the revenue potential of a VAT.

According to the Tax Foundation study, a "consumption type VAT"—the model most commonly used in countries levying a VAT—would have a revenue potential (in 1978) of $11 billion for each 1 percentage point of its rate.

Single copies of "A Value-Added Tax for the United States? Selected Viewpoints" are available from the Tax Foundation for $2.00.

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