MONTHLY TAX FEATURES

Tax Foundation, Inc.

Toward better government · Founded 1937

50 Rockefeller Plaza □ New York, New York 10020 □ 212-582-0880 □ **Volume 21, Number 4, May 1977**

Federal Grants to States on the Rise

Federal Grants-in-aid to State and Local Governments and Estimated Tax Burden of Federal Grants[1]—Fiscal Year 1976

State	Grants (millions)	Estimated tax burden for grants[2]	Tax burden per dollar of aid: Amount	Tax burden per dollar of aid: Rank
TOTAL	$57,354.5	$57,354.5	$1.00	—
Alabama	979.7	711.2	.73	38
Alaska	312.3	172.1	.55	49
Arizona	528.2	527.7	1.00	21
Arkansas	610.9	407.2	.67	42
California	5,777.0	6,366.3	1.10	13
Colorado	636.4	676.8	1.06	17
Connecticut	723.7	1,049.6	1.45	1
Delaware	160.4	189.3	1.18	10
Florida	1,525.5	2,145.0	1.41	2
Georgia	1,418.4	1,084.0	.76	36
Hawaii	309.0	258.1	.84	32
Idaho	259.0	177.8	.69	41
Illinois	2,794.7	3,538.8	1.27	6
Indiana	995.6	1,365.0	1.37	3
Iowa	658.7	785.7	1.19	9
Kansas	516.9	625.2	1.21	8
Kentucky	1,011.3	722.7	.71	40
Louisiana	1,133.1	820.2	.72	39
Maine	367.7	223.7	.61	45
Maryland	1,119.4	1,273.3	1.14	11
Massachusetts	1,820.3	1,634.6	.90	28
Michigan	2,615.0	2,523.6	.97	23
Minnesota	1,087.0	1,020.9	.94	25
Mississippi	778.1	390.0	.50	50
Missouri	1,035.4	1,175.8	1.14	12
Montana	280.4	177.8	.63	44
Nebraska	395.6	430.2	1.09	16
Nevada	192.3	200.7	1.04	18
New Hampshire	212.0	206.5	.97	22
New Jersey	1,860.6	2,420.4	1.30	5
New Mexico	400.9	240.9	.60	46
New York	6,416.3	5,488.8	.86	31
North Carolina	1,272.8	1,164.3	.91	26
North Dakota	203.5	160.6	.79	35
Ohio	2,134.1	2,833.3	1.33	4
Oklahoma	687.2	648.1	.94	24
Oregon	709.2	613.7	.87	30
Pennsylvania	3,117.8	3,229.0	1.04	19
Rhode Island	311.1	252.4	.81	33
South Carolina	695.0	556.3	.80	34
South Dakota	227.1	149.1	.66	43
Tennessee	1,052.5	952.1	.90	27
Texas	2,602.2	3,148.8	1.21	7
Utah	353.1	258.1	.73	37
Vermont	176.6	103.2	.58	47
Virginia	1,184.3	1,296.2	1.09	14
Washington	963.2	1,049.6	1.09	15
West Virginia	689.3	390.0	.57	48
Wisconsin	1,163.9	1,170.0	1.01	20
Wyoming	130.8	114.7	.88	29
Dist. of Columbia	749.0	235.1	.31	51

[1] Excludes shared revenues; includes general revenue sharing, and trust fund aids.
[2] The total tax burden for aid payments is assumed to equal aid payments.
Source: Data on grants from Treasury Department; tax burdens estimated by Tax Foundation.

Federal grants-in-aid to state and local governments rose in 1976 to $57 billion from $48 billion in 1975—an increase of 19 percent.

The tax burden of the 1976 grants borne by taxpayers across the nation ranged from a high of $1.45 per dollar of grants in Connecticut to a low of 50 cents in Mississippi and 31 cents in the District of Columbia.

In between there were 20 states that paid more than they received; one, Arizona, broke even; and the rest got more than they paid for.

Florida, which led the list in 1975 at $1.46, dropped into second place at $1.41. Indiana, which was in second place the previous year, dropped to third. Its burden per dollar of grants was $1.37.

Connecticut jumped up into the most-burdened position from fourth place a year earlier, receiving Federal grants in fiscal year 1976 totaling $724 million, for which it had an estimated tax burden of $1,050 million.

The Tax Foundation formula for allocating tax burden is designed to show where the tax dollars actually originate. U.S. Treasury figures show where taxes are *collected*. For example, tobacco taxes are collected in a few southern states, but the burden of the tax falls on smokers in all states. The formula to derive these tax estimates has been in use for more than two decades; it is updated annually to reflect changes in the tax structure and tax base. The data on grants-in-aid are the actual amounts paid, as recorded by the U.S. Treasury Department.

(Continued on Page 4)

People Pay High Price For Heavy Corporate Taxes

In this decade the interest cost of the Federal debt will apparently reach a rate of $1 billion a week.

The implications of this for tax reform, deficit spending and inflation were discussed by Robert C. Brown, Tax Foundation executive vice president, in a paper prepared for delivery at a chapter meeting of the American Statistical Association in New York on April 28.

The idea that Federal deficits are not so bad has become fashionable in recent years. But tolerance for large deficits year after year invites expenditures whose benefits to the American people will not be worth the cost, said Bob Brown. A crucial consideration for tax policy must be the control of the rise in government expenditure.

In this regard Mr. Brown pointed out that when corporate marginal tax rates are around 50 percent, the private sector loses more than the government treasury receives. Corporations are not helped to serve us well. Americans bear a heavier load than is essential. There is misallocation of resources. As a result, business decisions are made on the basis of tax considerations; they are not really the most productive choices.

Heavy corporate income taxes force corporations to reject many investment projects which would be fruitful for "us, the people." Although the weight of taxes may be reduced by rising debt-to-equity ratios, they are no satisfactory substitute for equity capital.

"Our lawmakers," said Mr. Brown, "without deliberate intent and with the consent of an uninformed public, have developed an economically wasteful means of financing government. The many things people want, including jobs that pay well, could be provided more fully if corporate investments could be made on the basis of the full productivity of capital rather than on the basis of yield after tax on the company.

"The remedy? Reduce the corporate tax rate. How much? A lot. How soon? Quickly," Mr. Brown declared.

Constructive tax revision will have as a goal reduction of the obstacles to capital formation. The future we want for ourselves and our children requires enlargement of the capital base. But capital formation has a powerful rival in the collective consumption in the form of "public" expenditures. The rivalry is especially serious when the growth in such expenditures leads to deficits that are financed by Federal borrowings of tens of billions a year, Mr. Brown concluded.

His paper, which was presented in his absence by C. Lowell Harriss, Tax Foundation's economic consultant, is the subject of the May issue of *Tax Review*.

Inflation, Corporate Income Tax Reviewed at Columbia Dean's Day

In his capacity as Professor of Economics at Columbia University, C. Lowell Harriss was called upon to address two separate convocations on the same day recently. The first was a Dean's Day Symposium at the Columbia University Law School where he discussed the corporate income tax. The other was Dean's Day at Columbia College where he addressed colleagues and students on the fight against inflation. A brief review of each address follows.

The corporate income tax was first imposed in 1909 at one percent. Since 1964 it has been fixed, in general, at 48 percent. The yield of this tax to the Treasury in the current fiscal year is $58 billion. Though hidden from most of us, it is we, the consumers and investors, who bear the burden.

The tax, according to Professor Harriss, is an obstacle to increased production, increased employment, and increased income. The tax creates an incentive for the owners of businesses to cast aside otherwise desirable investment opportunities. Society suffers needless losses.

And because there is less capital for investment in new equipment for industry, consumers get less than the best possible output of goods and services. Our lawmakers have developed an economically wasteful means of financing governmental spending.

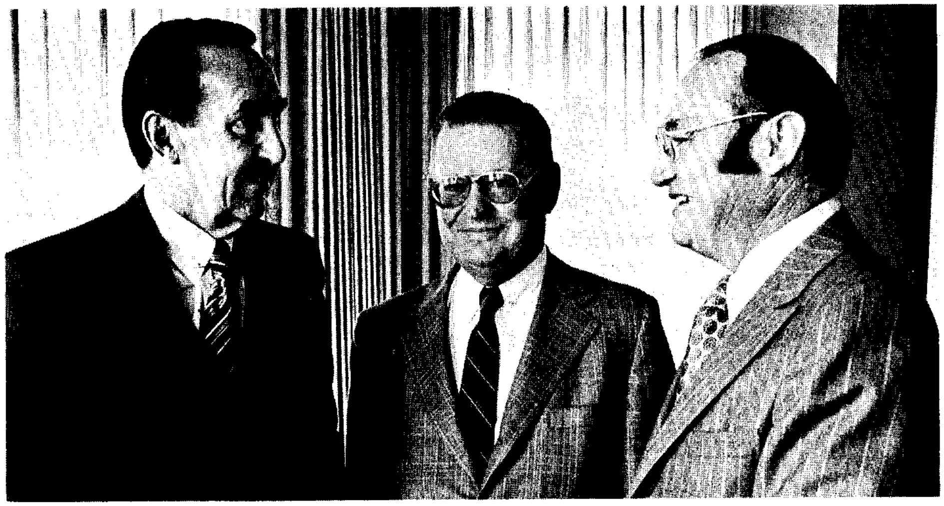
All of us are burdened in ways we cannot see. Reduction in the 48 percent Federal rate on corporate earnings—to perhaps the 12 to 15 percent level of the 1920's and 1930's—would, says Professor Harriss, benefit everyone. More capital would be available for the most fruitful uses, with advantages widely distributed to consumers, investors, and employees.

Inflation is a result of government action, one which has crucial significance for the quality of life. It robs us all, distorts the economy, and burdens us with uncertainty about the future. The dollar has lost over 40 percent of its purchasing power in the last 10 years and in another four years or so, will lose another fifth or more—even if anti-inflation policies are *successful*.

In starting our third century, an old truth should have high priority: Protect the worth of the dollar. Failure of the government to do so testifies to human failure. The makings of inflation are so easy. The power of the government to create dollars without taking them in taxes is so tempting, yet it inflicts needless distress over the long run, with vast

(Continued on Page 3)

Estes Speaks At Los Angeles Members Meeting



Jack K. Horton, center, chairman, Southern California Edison Company, who served as acting chairman of Tax Foundation's Los Angeles membership meeting April 27, greets E.M. "Pete" Estes, left, president of General Motors, who was the day's speaker, and Robert C. Brown, executive vice president, Tax Foundation.

Longstanding government interference in the market mechanism is the No. 1 culprit in today's energy mess, General Motors President E.M. "Pete" Estes told a Tax Foundation meeting of Southern California business leaders at Los Angeles April 27.

Government, as it grows, he said, interferes with increasing frequency in the workings of the free market.

"Distortions begin to appear," he noted, "because what would normally be the finely tuned workings of the laws of supply and demand are short circuited."

Referring to President Carter's energy plan, Mr. Estes commended the President for "his courage in telling the American people the unpleasant truth —that the domestic shortage of energy is real, it is getting worse, and everybody is going to have to contribute if we are to solve it.

"For our part," he added, "we would like to see a lot more emphasis on increasing the domestic supplies of both conventional and unconventional energy in this country. And rather than rely just on taxes to dampen demand for motor fuel, we would prefer it if he relied more on the free market.

"Taxes alone—unless they are somehow used to subsidize exploration and development, and that doesn't seem likely—won't contribute to the vast amounts of capital that are needed to do this job," Mr. Estes said.

The Tax Foundation membership meeting was presided over by Jack K. Horton, chairman of Southern California Edison Company.

Inflation...

(Continued from Page 2)

disruption not out of the question.

"An impulse to try to alter events seems not uncommon among human beings," Professor Harriss observes, "and those who get elected to public office, along with those in a bureaucracy, may often be inclined to prefer to run matters."

In the decades after 1776 there was a reduction in the use of the compulsions of government to limit people. The absence of obstacles to the use of human ability had a role of incalculable importance in the rise of American levels of living. Our Founding Fathers were dedicated to the expansion of liberty and human freedom, not as a matter of theology, but because of results.

A result of a free market economy is that day in and day out, scores of millions vote with their dollars. Things which people judge not to be worth their cost fall by the wayside. While those things that we judge to suit us better than the alternatives will survive and prosper.

Getting rid of unsatisfactory results in the governmental sector proves to be more difficult. It is a paramount challenge for the new third century of our Republic.

About Tax Features

Original material in *Monthly Tax Features* is not copyrighted and may be reproduced freely by the news media and others. Please credit Tax Foundation.

Tax Foundation, Inc., is a publicly supported, non-profit organization engaged in non-partisan research and public education on the fiscal and management aspects of government. Members of Tax Foundation are urged to pass their copies of *Tax Features* along to editors of their house publications.

For additional information write to *Tax Foundation, 50 Rockefeller Plaza, New York, N.Y., 10020, or call (212) JU 2-0880.*

'Facts & Figures' Ready June First

Although the 19th edition of *Facts and Figures on Government Finance* won't be available until the first of June, orders for the authoritative handbook of government fiscal data are reaching the Tax Foundation in substantial quantities.

The new edition of the biennial classic includes 213 tabulations of statistics on Federal, state and local government and a selected economic series, plus a glossary, an index, and notes. The 288 pages are arranged in six sections, each with its own table of contents.

A foreword by Willard F. Rockwell, Jr., chairman of Tax Foundation, points out that government expenditures will average $9,607 for each household in the U.S. in 1977, a significant figure when placed beside the average household income of $20,400. The ratio of spending to income per household is 47 percent.

"Is the money being spent," asks Mr. Rockwell, "in ways that best promote our national goals?"

Cost of the new edition is $10 and there is a 10 percent discount for cash received with the order.

Government Reorganization, ZBB Have Top Priority in New Administration

Management of the "horrible bureaucratic mess" in Washington was the continuous theme of President Carter's election campaign. Some people thought it was just rhetoric, said a high official of the Carter administration, but in fact the President has made reorganization of the government his first order of business.

He began, said Donald Haider, special assistant to the director, Office of Management and Budget, with the White House.

Dr. Haider spoke at a session of the 35th Annual Taxpayers Conference in Washington. Tax Foundation hosted the four-day meeting of delegates from 21 state taxpayer organizations.

The Office of Management and Budget will have the leading role in the government-wide reorganization, said Dr. Haider. Budget for 1977 for the operation has been set at $1.7 million and for 1978 at $2.3 million. OMB has added only 32 people to work on it. Their job will be "to flush out the facts as to who is responsible for what functions, what tasks, and what does it cost."

The fact-finding stage will be followed by evaluation and filtering stages.

The reorganization group will be formed into six teams covering: energy and natural resources, national security, foreign policy, economic development, regulatory reform, and an overall government-wide team. Another group will deal with labor practices, paperwork, and administrative management. And still another will look at intergovernmental relations, federalism, in other words, or the whole state and local stream.

The President has put White House reorganization up front. He wants the EOP proposal to go to Congress in June, said Dr. Haider. Other plans will be ready for Congress in the fall.

Finally, said Dr. Haider, there will be a "sales stage," where the reorganization plans will be presented to the public.

George Strauss, chief of the Resources Systems Branch, Budget Review Division, Office of Management and Budget, outlined the new procedures for zero-base budgeting to be followed by OMB.

"Zero-base budgeting will make a significant change in the administration of the Federal budget," Mr. Strauss declared.

Key to ZBB are the justification documents that will now come to OMB with the budget recommendations of each department and agency of the Administration. They form the basis of the decision-making process in the OMB director's recommendations which will in turn be the basis for the President's budget recommendations to Congress next January.

So where does the zero in "zero-base budgeting" come in? It comes, explained Mr. Strauss, in the decision package. If the justification for its program doesn't support the program sufficiently, or if the cost/benefit ratio is "too horrible," then the program should come on at a minimum package level, or else it ought to be zeroed out entirely.

The zero also applies in the ranking process. When all the packages in a departmental budget program are assembled, there may be as many as 200 decision packages. So a manager is asked to rank them. The manager's ranking sheet shows not only the explicit rank, but in the right hand column it shows the cumulative dollar total of all the programs. Each package has its own dollar add-on above the minimum. One can then draw a line under the package where the dollar total reaches a desired maximum, and all below falls out. OMB will ask each department or agency for one consolidated ranking. And this will reflect the manager's measurement of any increment of a program in relation to all the programs that he is responsible for.

"It is not a mechanical process, but the mechanics are there," Mr. Strauss pointed out. The President can look up and down above and below cutoff lines to see what may be more or less desirable relative to other programs.

ZBB won't make it any easier to lay off civil servants. The President has stated he does not want to have reductions in force. The RIF problem is "manageable," Mr. Strauss believes.

Federal Grants Rising...

(Continued from Page 1)

California has the largest dollar tax burden to support grant programs—$6,366 million. That's 11.10 percent of the total burden. California receives $5,777 million in grants. The ratio of burden to grants is $1.10. New York is next with a burden of $5,489 million, or 9.57 percent of the national total, and grants of $6,416 million, a ratio of 86 cents.

The tax-aid computations include amounts for grants from Federal funds, which include general revenue sharing, and for trust fund aids. Federal fund taxes include individual and corporate income; alcoholic beverages; tobacco; and estate and gift taxes. The trust fund taxes are for old-age, survivors, disability and hospitalization insurance; railroad retirement, and Federal unemployment; state unemployment insurance taxes deposited with Treasury; highway trust fund, gasoline, etc.; trucks, buses, parts, etc., and airport and airway trust funds.

The comparisons do not actually indicate the entire costs which state and local governments incur for obtaining Federal grants. The costs to these governments of administering the programs for which the aid is granted, are not taken into account, nor are the amounts of matching funds which they must make available out of their own revenue in order to qualify as recipients of the grants. In the last three years it is estimated that state and local governments provided approximately $1.00 of matching funds for $3.00 of Federal aid.