TAX FOUNDATION

# TAX FEATURES

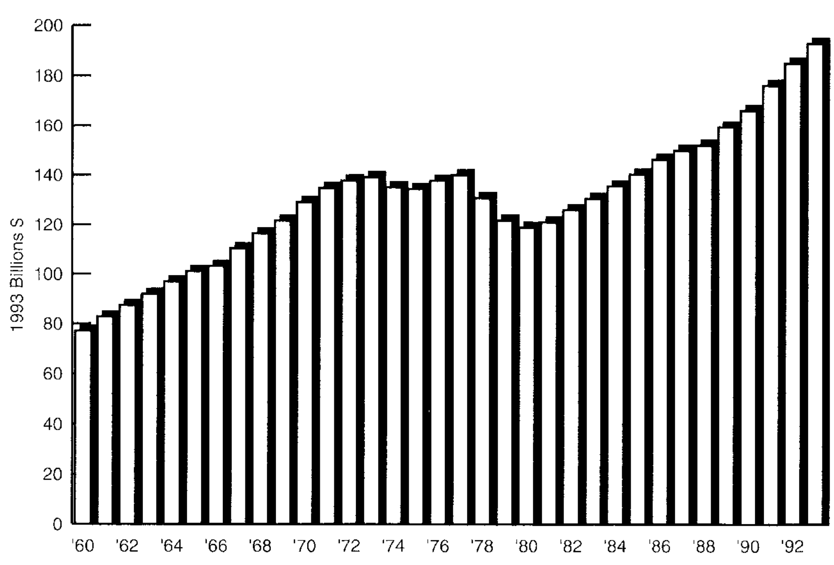
*September 1993 Volume 37, Number 7*

## Property Taxes on the Rise—Again
## *New Study Examines Role of Least Popular Tax*

According to a new study by the Tax Foundation, property taxes rose rapidly over the past decade, reversing a downward trend in collections nationwide during the 1970s.

In his latest *Special Report*, "Property Taxes on the Rise Again Across the Nation," Economist Chris R. Edwards shows that property taxes in the United States have been rising steadily over the past 14 years, from $119 billion in 1980 to $183 billion this year in constant 1993 dollars (see figure below). While the tax revolts of the 1970s, led by California's landmark Proposition 13, caused property taxes to level out during that decade, total property taxes paid by Americans are now 58 percent higher, in after-inflation dollars, than they were in 1980.

**Property Tax Collections Nationwide, 1960–1993**




Source: Tax Foundation.

By 1980, total property tax revenue in the United States had fallen eight percent below property tax revenue in 1970. This fall in revenue resulted from a wave of anti-tax protest across the nation highlighted by California's Proposition 13, adopted in 1978. Other states followed California's lead and property taxes—which had peaked at $140 billion for the country in 1977—fell to $119 billion by 1980. State governments in 33 states now place limits on local property tax rates and 16 state governments place limits on property tax revenues.

The accompanying table (see page 2) documents the increase in state and local per capita property taxes by state during the 1980s, in constant dollars. Property taxes per person increased a staggering 329 percent in the District of Columbia in that time period, compared to a national average of 111 percent. The District was followed in order by Florida, New Hampshire, Virginia, South Carolina, and New Jersey, which

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FRONT & CENTER

## A Retrospective on The Budget Debate

***Sen. Pete Domenci***
*(R-New Mexico)*

## Property Tax

*Continued from page 1*

all had per capita property tax increases of over 150 percent. At the other end of the spectrum, Montanans only experienced a 15 percent rise in property taxes between 1980 and 1991, the smallest increase in the nation. Montana was followed by Alaska, Massachusetts, Wyoming, and South Dakota.

State-level property taxes are levied in 42 states, but only three states, Alaska, Washington, and Wyoming, collect over $100 per capita annually in state property taxes. In contrast, property taxes are the bread and butter of local government finances, providing 75 percent of their tax revenue *(see figure below)*. According to the latest Bureau of Census data, local governments in five states and the District of Columbia now average over $1,000 per capita in local property taxes. The District leads the way at $1,475 per person, followed by local governments in New Hampshire, New Jersey, Alaska, Connecticut, and New York.

Various units of local government may be responsible for property tax hikes. Currently, school districts claim 40 percent of local property taxes, county governments receive 22 percent of local property tax revenue, and municipal governments receive 21 percent. Every year since 1982, county government tax collections have grown more quickly than school district or municipal government collections. County governments have been growing quickly because of fast population growth; rapid growth in health and social services spending, on which counties spend more than cities; and because they have increased their areas of responsibility.

Mr. Edwards notes that, like the corporate income tax, property taxes have a complicated impact on individuals and the economy. Economists have difficulty determining whether property taxes are regressive or progressive—that is, whether they take a larger percentage of the incomes of the poor or the rich.

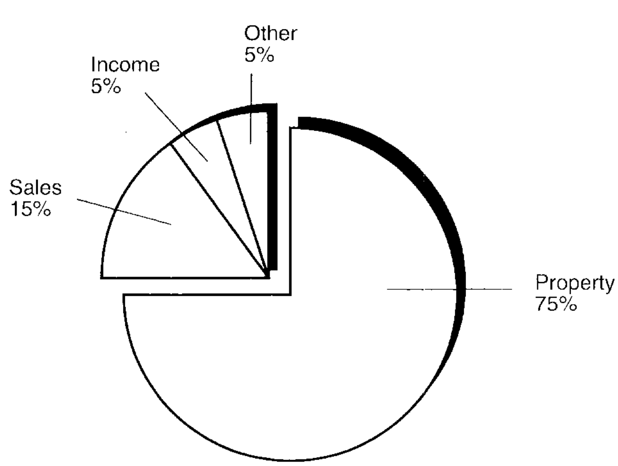
Residential property taxes are generally regressive because home prices typically represent a smaller percentage of income as incomes rise. A recent study in Wisconsin, for example, found that individuals and families with incomes up to $15,000 live in homes valued four times their annual income, whereas individuals and families with incomes greater than $105,000 occupy homes valued only two thirds of their annual income. Therefore, in this example a property tax levy at a certain percentage of home value represents a much higher portion of the lower-income household's paycheck than the higher-income household's paycheck.

Aside from these direct out-of-pocket expenses that property taxes impose, the negative impact that property taxes have on general economic development affects everyone.

The extent of this negative impact is

*Property Tax continued on page 7*

### Local Tax Revenue by Source (1991)




Source: Tax Foundation.

### Per Capita Property Tax Collections by State (In 1991$)

| | 1980 | 1991 | Percent Change |
|---|---|---|---|
| Alabama | $79 | $171 | 116% |
| Alaska | 900 | 1213 | 35 |
| Arizona | 352 | 662 | 88 |
| Arkansas | 134 | 242 | 81 |
| California | 274 | 639 | 133 |
| Colorado | 329 | 690 | 110 |
| Connecticut | 473 | 1138 | 141 |
| Delaware | 167 | 311 | 86 |
| Florida | 224 | 687 | 207 |
| Georgia | 199 | 506 | 155 |
| Hawaii | 193 | 430 | 123 |
| Idaho | 227 | 427 | 88 |
| Illinois | 367 | 785 | 114 |
| Indiana | 246 | 571 | 132 |
| Iowa | 360 | 686 | 91 |
| Kansas | 366 | 691 | 89 |
| Kentucky | 135 | 277 | 105 |
| Louisiana | 111 | 275 | 148 |
| Maine | 319 | 796 | 150 |
| Maryland | 288 | 617 | 114 |
| Massachusetts | 555 | 830 | 50 |
| Michigan | 413 | 894 | 116 |
| Minnesota | 324 | 718 | 122 |
| Mississippi | 141 | 344 | 144 |
| Missouri | 215 | 377 | 76 |
| Montana | 455 | 523 | 15 |
| Nebraska | 401 | 744 | 86 |
| Nevada | 256 | 456 | 78 |
| New Hampshire | 451 | 1341 | 197 |
| New Jersey | 499 | 1257 | 152 |
| New Mexico | 142 | 222 | 56 |
| New York | 501 | 1101 | 120 |
| North Carolina | 171 | 382 | 124 |
| North Dakota | 269 | 505 | 88 |
| Ohio | 281 | 541 | 93 |
| Oklahoma | 151 | 250 | 66 |
| Oregon | 382 | 877 | 123 |
| Pennsylvania | 249 | 562 | 126 |
| Rhode Island | 413 | 880 | 113 |
| South Carolina | 160 | 423 | 164 |
| South Dakota | 351 | 580 | 65 |
| Tennessee | 158 | 329 | 108 |
| Texas | 280 | 679 | 143 |
| Utah | 235 | 416 | 77 |
| Vermont | 377 | 925 | 145 |
| Virginia | 236 | 638 | 171 |
| Washington | 290 | 625 | 116 |
| West Virginia | 137 | 273 | 99 |
| Wisconsin | 361 | 797 | 121 |
| Wyoming | 552 | 912 | 65 |
| Wash., D.C. | 344 | 1475 | 329 |
| U.S. Average | $300 | $666 | 122% |

Source: Tax Foundation.

# Final Budget Shows Upward Trend in Taxes, Spending

The final numbers on the Omnibus Budget Reconciliation Act of 1993 (OBRA '93) sound impressive—$240 billion in tax increases, $256 billion in spending cuts, $496 billion in deficit reduction. But if the Clinton administration's projections from fiscal 1994 through 1998 actually prove accurate, the budget plan will have only a modest impact on the federal government's financial accounts.

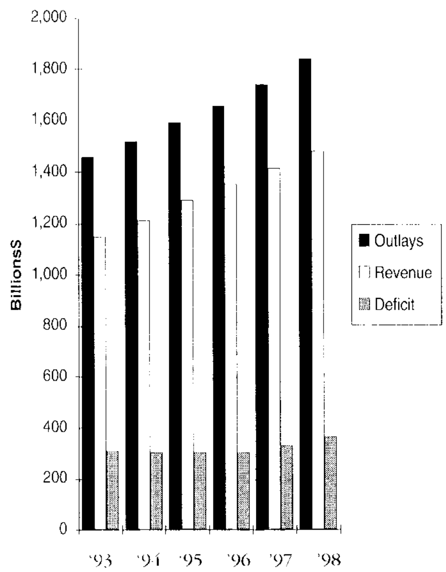
*Chart 1* to the right shows the budget baseline. The baseline represents projections of tax revenues, outlays, and deficits if the government were left on automatic pilot and OBRA'93 were not enacted (that is, no policy changes were passed over the next four years). Notice the strong upward trend in baseline federal spending, driven largely by the automatic increases in entitlement programs. Notice, too, the upward trend in tax revenues projected to take place, even without new taxes.

*Chart 2* shows the spending, taxes, and deficits that are projected to occur under OBRA'93. The upward trends continue for spending and taxes, and although the deficit starts a downward trend, it starts back up again in 1998.

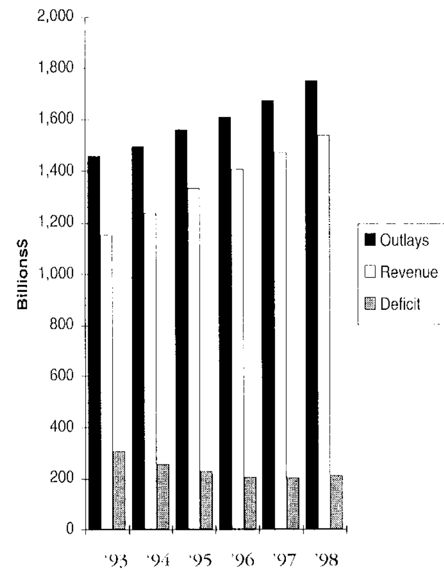
"These two trends taken together illustrate why the deficit problem should be viewed as a spending problem," notes Tax Foundation Senior Economist Arthur Hall. "Even one of the largest tax increases ever does little to alter the underlying trend of perpetual deficits."

Finally, *Charts 3* and *4* show the changes expected to occur from year to year in both baseline projections and OBRA'93 projections. From 1994 through 1998, federal spending under OBRA'93 will indeed grow slower than baseline projections—but it will still rise from $1.5 trillion to $1.75 trillion. Revenues under OBRA'93 will grow faster than baseline projections, jumping $240 billion between fiscal 1994 and 1998. While the cumulative deficits under OBRA'93 will indeed be $496 billion less than baseline projections, but total debt will still grow by $1.1 trillion. The annual budget deficit under OBRA'93 is projected to drop from $255 billion in 1994 to $201 billion in 1997, rising again to $213 billion in 1998.

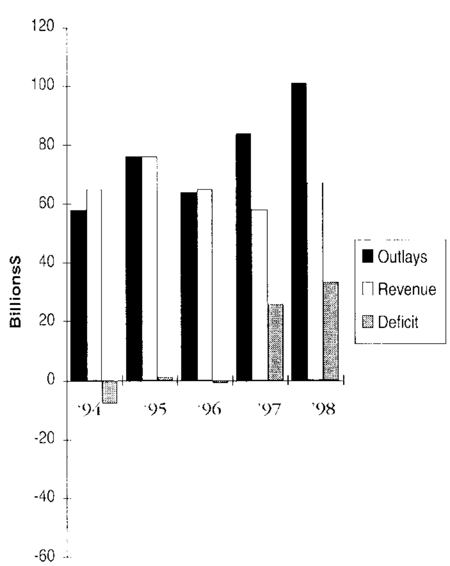
## Chart 1: Baseline Projections



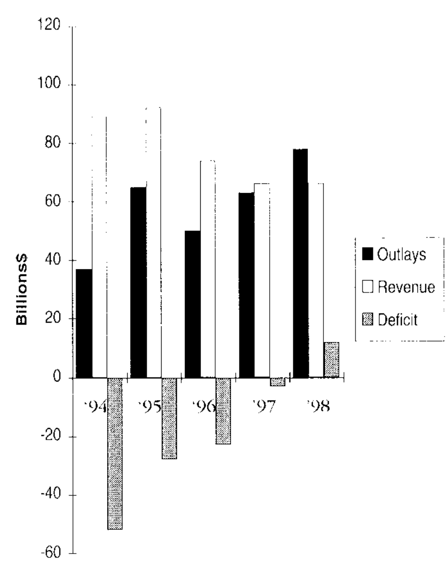

## Chart 2: OBRA'93 Projections




## Chart 3: Year to Year Changes in Baseline Projections




## Chart 4: Year to Year Changes in OBRA'93




Note: Revenue for OBRA 1993 includes revenue from retroactive tax increase.

Sources: Office of Management and Budget; Congressional Budget Office; Joint Tax Committee; House Budget Committee.

# A Retrospective on the Budget Debate

*Sen. Pete Domenici (R-New Mexico)*

I have been through a good many rounds of annual budget debate ordeals in my years in Congress. Each time, an effort is made to control the federal deficit and to do it in a manner that is consistent with economic growth and prosperity.

The recently concluded round of budgetary wrangling was particularly tough, comparable to the most arduous and difficult battles of the past 12 to 14 years.

***While the drama has ended for this year, we cannot tell the American people we fixed the problem called the federal deficit.***

This year's debate began in earnest on February 17 when the President of the United States delivered his address laying out his budget, and his economic priorities and plans. It should be obvious to everyone that President Clinton changed his mind considerably between those early days of his presidency leading up to his speech to his signing into law the budget that eventually passed the Congress. Many choices he argued for, and many of those he argued against, have not turned out as he had originally planned.

Where, for example, is the middle-class tax cut that the president promised during the campaign; the tax cut for which he assured the American people his plan could allow while still reducing the deficit?

Rarely have the members of the Senate, on both sides of the aisle, been better informed about what will and what will not work to regain control over the fiscal stance of the government than they were on August 6, when they were called on to cast their votes in favor or against the Conference Report on the Budget. These were difficult and complex issues of fiscal policy and senators were acutely aware of the choices they were called on to make.

At the same time, the American public has rarely had more information, better information, or a greater interest in understanding the choices senators were called on to make: Where do we really spend our money and what is happening to the money we spend? What needs to be brought under control and what are we controlling well? How much should we tax our people and how much is too much?

In a very real sense, the vote in the Senate on the budget was the end of a long drama, filled with all kinds of events that one might never have expected would occur.

Unfortunately, while the drama has ended for this year, we cannot tell the American people we fixed the problem called the federal deficit. The debate is over for 1993, but the deficit persists. And in about four years, it will start getting worse again and the American people will be entitled to ask, "What happened to our taxes?"

While the deficit drama may be over and the deficit may go on as a major problem, this year's debate served as no debate has in many years to underscore the difference in approach to economic policy between the two parties.

First, the debate has shown a clear preference from members of the Democratic party to raise taxes to reduce the deficit. All the discussion about who is going to pay the higher taxes is secondary. Without the preference to raise taxes, there would be no debate about who was to pay the higher taxes.

The budget plan that was truly skillfully pieced together by the president and the Democratic leadership is basically based on taxes. It puts the first priority on raising taxes, and because 80 percent of the spending cuts will require subsequent congressional action and are going to come after the next presidential election, if at all, for all practical purposes the only priority expressed in this budget is to raise taxes.

***How can deficit reduction based almost solely on tax increases encourage investment and saving, the only true sustainable engines to more rapid economic growth and job creation? It cannot.***

Income taxes are going up, Social Security taxes are going up, corporate income taxes are going up, and virtually no deficit reduction is to be achieved by cutting spending.

Some of the tax increases take effect immediately, but some are retroactive to January 1, 1993, well before the president even took office. Therein lies the irony of this budget: The president's plan calls for taxes to rise 21 days before he took office, but 80 percent of the few spending cuts in the plan will not take effect until the next presidential election, if at all.

Republicans do not believe this approach will work, either to reduce the deficit or to bring about prosperity and more and higher paying jobs. We believe that Job One is to cut spending and reform those programs that are spending us into bankruptcy. Cut spending first; that is what government should be doing, getting smaller.

The second sad truth about the budget plan just enacted is that it is not going to help the economy. How can taxes imposed on the most productive parts of the American economy create jobs? They cannot. How can deficit reduction based almost solely on tax increases encourage investment and saving, the only true sustainable engines to more rapid economic growth and job creation? It cannot.

Many Republicans were willing and eager to join in the debate to develop a bipartisan deficit reduction plan that would reduce the deficit by cutting spending. Instead, the White House told us "No Help Wanted," all the while complaining that congressional Republicans refused to take part in the debate in a constructive manner. The facts say otherwise.

In the course of the debate, Republicans in both houses of Congress offered numerous alternative budgets. In case anyone should think that these were all the acts of lone senators and representatives, I point out that one of these alternatives was supported by every Republican senator. Furthermore, Republicans offered 60 amendments aimed at cutting spending.

These words and opinions could be construed by some as sour grapes. Nothing could be further from the truth. Members from both parties found the recently enacted budget far less than what the nation needed to right its fiscal house. Immediately following the final vote in the House of Representatives on the president's budget, for example, a Democratic member from Minnesota addressed the House to announce he was retiring, to which he added:

"I viewed this as an opportune year to deal seriously with—and in a bipartisan fashion to dramatically reduce—this deficit. We have failed to take advantage of that opportunity."

In fairness, I should point out that this retiring member voted for the plan.

*The views expressed in Front & Center are not necessarily those of the Tax Foundation.*

# Major Tax Provisions of the Fiscal 1994 Budget

## *Impact of OBRA'93 on Federal Revenues from Budget Baseline ($Billions)*

| Proposed Legislation | Fiscal Years 1994 | 1995 | 1996 | 1997 | 1998 | 1994-1998 |
|---|---|---|---|---|---|---|
| | **Revenue Increases** | | | | | |
| **Individuals** | | | | | | |
| Raise income taxes for high-income individuals | 15.4 | 22.8 | 25.7 | 24.6 | 26.3 | 114.8 |
| Repeal health insurance wage cap base | 2.8 | 6.0 | 6.4 | 6.8 | 7.2 | 29.2 |
| Tax 85% of Social Security benefits | 1.9 | 4.6 | 5.3 | 6.0 | 6.7 | 24.6 |
| Reduce deductible portion of business meals | 1.8 | 3.1 | 3.3 | 3.4 | 3.6 | 15.3 |
| Reinstate top estate tax rates at 53% and 55% | 0.5 | 0.5 | 0.6 | 0.6 | 0.6 | 2.8 |
| Reduce acceptable contributions for retirement plans | 0.2 | 0.6 | 0.6 | 0.6 | 0.6 | 2.5 |
| Disallow certain moving deductions | 0.2 | 0.5 | 0.5 | 0.5 | 0.6 | 2.3 |
| Deny deduction for club dues | 0.1 | 0.2 | 0.2 | 0.2 | 0.3 | 1.1 |
| Tax Simplification | -1.9 | 0.0 | 0.0 | 2.6 | 0.0 | 0.7 |
| Deny deductions for executive pay over $1m | 0.0 | 0.1 | 0.1 | 0.1 | 0.1 | 0.3 |
| **Businesses** | | | | | | |
| Increase top corporate income tax rate to 35% | 4.4 | 2.8 | 2.9 | 3.1 | 3.2 | 16.4 |
| Extend corporate estimated tax rules | 2.1 | 0.4 | 0.0 | 4.3 | 0.9 | 7.8 |
| Limit section 936 credit | 0.4 | 0.9 | 0.9 | 0.8 | 0.7 | 3.8 |
| Securities dealers mark-to-market | 0.8 | 0.8 | 0.8 | 0.8 | 0.6 | 3.8 |
| Prohibit double-dip related to FSLIC assistance | 0.3 | 0.1 | 0.0 | 0.3 | 0.4 | 1.0 |
| Deny deduction for lobbying expenses | 0.0 | 0.1 | 0.1 | 0.1 | 0.2 | 0.7 |
| Other business provisions | 0.0 | 0.1 | 0.2 | 0.3 | 0.4 | 1.1 |
| **Energy** | | | | | | |
| Motor fuels tax increase of 4.3 cents | 4.8 | 4.9 | 4.8 | 4.8 | 4.9 | 24.3 |
| Extend 2.5 cent gas tax increase and other | -0.1 | -0.2 | 2.7 | 2.8 | 2.8 | 8.0 |
| **Other Revenue Increases** | | | | | | |
| International tax provisions | 0.5 | 0.4 | 0.6 | 0.6 | 0.7 | 2.8 |
| Amortization of Intangibles | 0.1 | 0.3 | 0.5 | 0.7 | 0.9 | 2.5 |
| Compliance Provisions | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 1.0 |
| Miscellaneous Provisions | 0.2 | 0.1 | 0.1 | 0.2 | 0.2 | 0.8 |
| Total Revenue Increases | 34.9 | 49.5 | 56.9 | 64.7 | 62.0 | 268.0 |
| | **Revenue Decreases** | | | | | |
| **Training and Education** | | | | | | |
| Extend employee-provided education assistance | -0.6 | -0.3 | 0.0 | 0.0 | 0.0 | -0.9 |
| Extend targetted jobs tax credit | -0.3 | -0.2 | -0.1 | 0.0 | 0.0 | -0.7 |
| **Investment** | | | | | | |
| Extend research and experiment credit | -2.2 | -1.2 | -0.8 | -0.4 | -0.3 | -4.9 |
| Increase section 179 expensing | -2.3 | -1.0 | -0.7 | -0.4 | -0.2 | -4.6 |
| Elimination of ACE depreciation adjustment | -0.3 | -1.0 | -1.1 | -1.0 | -0.9 | -4.3 |
| Other investment provisions | -0.1 | -0.1 | -0.2 | -0.3 | -0.4 | -1.2 |
| **Real Estate** | | | | | | |
| Extend low income housing credit | -0.4 | -0.6 | -0.9 | -1.3 | -1.7 | -4.9 |
| Increase recovery period for non-res. real property | 0.1 | 0.3 | 0.6 | 1.0 | 1.4 | 3.4 |
| Passive loss relief for real estate professionals | -0.3 | -0.5 | -0.5 | -0.6 | -0.7 | -2.6 |
| Extend mortgage revenue bonds permanently | -0.1 | -0.1 | -0.2 | -0.3 | -0.3 | -1.0 |
| Other real estate provisions | -0.2 | -0.2 | -0.1 | -0.1 | -0.1 | -0.7 |
| **Other Revenue Decreases** | | | | | | |
| Empowerment Zones and Enterprise Communities | -0.3 | -0.5 | -0.5 | -0.6 | -0.6 | -2.5 |
| Index car luxury tax, repeal other luxury taxes from OBRA'90 | -0.1 | -0.2 | -0.2 | -0.3 | -0.3 | -1.1 |
| Other Provisions | -0.7 | 0.0 | 0.0 | 0.0 | 0.0 | -0.8 |
| Expanded Earned Income Tax Credit* | 0.0 | -0.2 | -0.4 | -0.5 | -0.6 | -1.7 |
| Total Revenue Decreases | -7.6 | -5.8 | -5.3 | -5.0 | -4.7 | -28.4 |
| Total | 26.4 | 43.5 | 51.5 | 60.5 | 58.4 | 240.4 |

* EITC outlays of $0.2, $2.0, $4.4, $6.1, and $6.4 for the years 94-98 not included in totals.

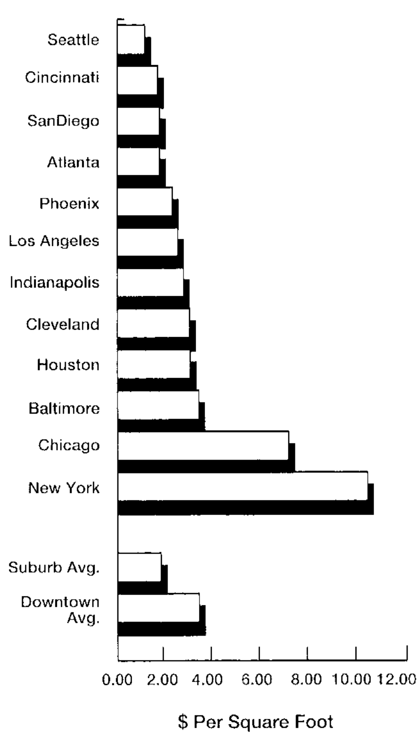
Source: Joint Committee on Taxation.

## Property Tax

*continued from page 2*

subject to research and controversy. Cities which impose particularly high property taxes depress property values and cause a flight of investment capital from the city. How heavy a burden of property taxation a locality can bear before an area is abandoned by developers and renters depends upon the alternatives these groups have available. The pronounced pattern of higher property taxes in city centers clearly drives businesses out in favor of the suburbs. Indeed, the growth in "edge cities" outside of older city cores is partly the result of this tax flight. When this occurs, the tax base and the value of property falls and the city government often enters a vicious cycle of repeatedly raising taxes and driving both business and individuals from the city.

### Municipal Taxes on Downtown Class A Office Space, 1993




Source: CB Commercial Real Estate Group Canada Inc.

# FOUNDATION MESSAGE

## Making the News Again . . . and Again

In the thick of the budget battle on Capitol Hill this summer, Tax Foundation phone lines were ringing off the hook with reporters calling us for our latest economic analyses. We're accustomed to such a reception in the weeks prior to Tax Freedom Day, but it's been a long time since our economists have been in this much demand during a public policy debate.

*Dan Witt*
*Executive Director*

Indeed, from May through July newspapers around the country published over 300 articles citing the Tax Foundation as a source of information on the Clinton administration's budget, and particularly on the energy tax. Syndicated columnists like James Lebherz (*Washington Post*), Donald Lambro (*Washington Times*), and Kathy Kristoff (*Los Angeles Times*) mentioned us prominently. The *Wall Street Journal* published a column on the gasoline tax by our chief economist, Dr. J.D. Foster, and the *Journal of Commerce* published one by our staff economist, Chris Edwards. Our tax and spending analyses and graphs appeared everywhere from *USA Today* to the *Omaha World-Herald*, and made the front page of such notable dailies as the *Boston Globe*, the *Denver Post*, and *Investor's Business Daily*.

Why the recent spate of attention? Much of it is due to some newly acquired technical capabilities. Using a "Tax Impact Model," Tax Foundation economists now can project the tax burden effects of federal and state tax policies at the national and state levels, and can also estimate the impact on taxpayers by income class.

Using this model, our economists were able to follow up quickly on President Clinton's tax package with an assessment of the tax burden by income class and region. Shortly thereafter, using job loss figures released by DRI/McGraw-Hill and American Electric Power, the Tax Foundation published its own job-loss analysis by congressional district. This research was widely cited on the floor of the House of Representatives during the debate in late May, and a similar analysis of job losses by state appeared in the *Wall Street Journal* in early June.

The reason our work has garnered so much attention this summer is that reporters are thirsty for facts, as is the public at large. People hear about $250 billion tax increases and $200 billion deficits and $1.5 trillion budgets, and their eyes gloss over. These numbers are too vast to mean anything significant to politicians, much less to the typical taxpayer. That's why, when our economists break these numbers down, we start getting calls. People are telling us through all their requests that there's a real need for this kind of analysis.

And we're pleased to provide it. With our new capabilities, the Tax Foundation is poised to play a key part in future policy debates at both the federal and state levels. How will a hike in payroll taxes affect businesses? How will a hike in federal or state gasoline taxes affect a family below the poverty line? What kind of impact will higher property taxes in, say, New York, have on residents of that state? We can handle these kinds of questions now, fast and accurately.

The tax code is more complex and the numbers of larger than ever before. Americans need all the information they can get to understand the current public policy debates. This is our way of helping them.

# Facts & Figures 28th Edition Available From Tax Foundation

*TAX FEATURES*

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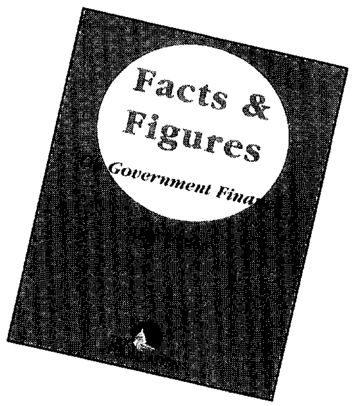
Looking to compare the tax revenues in relation to gross domestic product for different countries? Need to see a table of federal outlays by selected function, from 1789 to the present? Or state and local per capita tax collections, by state, from 1957 to 1990?




It could take hours to track down all that information, piece by piece. But it only takes minutes with the Tax Foundation's newly released book, *Facts & Figures on Government Finance*, a one-stop-guide to government taxation and spending at the federal, state, and local levels.

The price of the limited-edition book is $60, including postage and handling. Book distributors and wholesalers can purchase the book for $40, a 33 percent discount.

*Facts & Figures* has been published regularly by the Tax Foundation for over a half century. The 28th edition of the book contains 283 tables, and is divided into six sections: Federal, State, and Local Governments; Selected Economic Series; The Federal Government; State and Local Government; State Governments; and Local Governments. It combines materials from hundreds of sources, including official government documents and private sources, many of which are inaccessible or out of print. Virtually everything the Foundation publishes on an annual basis—such as Tax Freedom Day and the federal tax burden by state—can be found in the book.

This year's edition also includes an in-depth index of subjects and a glossary of terms used throughout the text.

Individuals interested in ordering the latest edition of *Facts & Figures* can write the Foundation, and include either a check or money order made payable to the Tax Foundation, or include a major credit card number with expiration date, and a daytime telephone number.

## Williams to U.S. Treasury

Floyd L. Williams III, Chief Tax Counsel at the Tax Foundation since 1991, has accepted a political appointment at the U.S. Department of Treasury. Mr. Williams joined Treasury's Office of Legislative Affairs in August.

Prior to joining the Tax Foundation, Mr. Williams served as Staff Vice President and Legislative Counsel at the National Association of Home Builders. He also spent four years at the Internal Revenue Service and seven years at the Joint Tax Committee in Congress.

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