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TAX·FEATURES

# Shadow Budget Committee Urges Deficit Reduction upon National Economic Commission

"The National Economic Commission will be judged by its success or failure in mapping a substantial and permanent reduction in the budget deficit," Tax Foundation's Shadow Committee on the Federal Budget asserted in a recent submission to the NEC, adding, "Nothing else it does will amount to much if the Commission fails to achieve this."

Pointing out that the NEC must "come to grips with the staggering general fund deficit that looms ahead," the Shadow Budget Committee indicated a number of specific objectives the NEC should follow to get "the battered Federal budget process" back on track:

- To raise the national savings rate, the Federal government should aim for a surplus in the unified budget.
- The ratio of Federal debt to GNP should be stabilized at once and lowered in the long run.
- The Commission should recommend concrete actions to reduce the annual deficit by at least $100 billion by 1993.
- The balances in the Social Security funds should be preserved to pay future benefits. They should not finance increases in public consumption or be budgeted in ways that mask the underlying deficit.
- The Budget must be free from gimmicks that misrepresent the true size of the deficit.
- The budget process should be strengthened to encourage cooperation between the President and Congress and more orderly action in the House and Senate.

The Shadow Budget Committee's submission to the NEC includes a table that highlights how the "startling contrast between a fairly stable budget deficit and a rising debt will be even more pronounced in the next decade."

In a model package of spending cuts and reve-

(Continued on page 5)

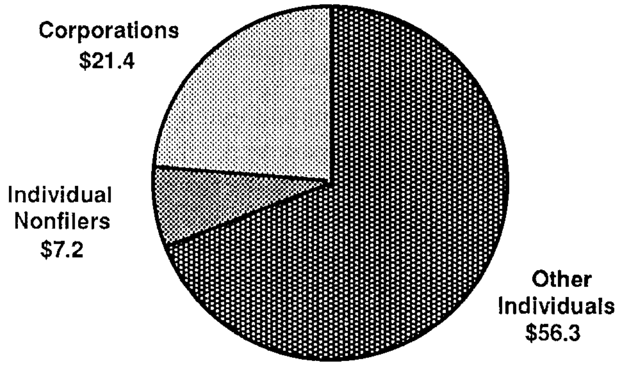
## *Persistent Tax Gap Due Mostly to Individual Underreporting*

Tax evasion continues to be a serious problem despite the increase in tax reforms introduced over the past decade in an attempt to make the system more equitable and efficient. The Internal Revenue Service recently estimated a tax gap of $84.9 billion for tax year 1987 and expects the gap to widen to $114 billion by 1992, exemplifying the continued seriousness of the problem. Tax evasion is as old as taxing itself. However, in terms of real dollar amounts, a 1987 report of the American Bar Association's Commission on Taxpayer Compliance noted that noncompliance has been increasing over time at approximately a 4.1 percent inflation adjusted annual rate.

The income tax system in the United States has one of the highest voluntary compliance levels in the world; approximately 83 percent of taxes owed on legal income is voluntarily reported and paid. However, millions of honest, conscientious taxpayers are carrying the burden of those who choose to evade their tax obligations. A tax gap approaching $90 billion is unacceptable because it redistributes income from honest taxpayers to dishonest taxpayers and aggravates the deficit problem.

(Continued on page 2)

**Total 1987 Tax Gap: $ 84.9 Billion**




## THIS ISSUE:



**The Tax Foundation**
**is sponsoring a seminar entitled**
**"The U.S. Stake in U.S. Foreign Investment"**
**Details on page 8**

(TAX GAP, *from page 1*)

The tax gap represents tax evasion, defined as the reduction of tax liability by illegal or fraudulent means. Tax evasion should not be confused with tax avoidance, which is the reduction of tax liability by taking advantage of provisions offered by law. The income tax gap presented here is only part of the picture. It *does not* include lost revenues from employment and excise taxes or gaps in remittance income. Also excluded are untaxed illegal activities in the so-called "underground economy," estimated to involve an additional $10 billion in lost revenues per year.

Most of the income tax gap for 1987 is attributable to individuals, amounting to $63.5 billion or 74.8 percent of the total gap while the corporate tax gap, estimated at $21.4 billion, represents 25.2 percent. Of the three possible sources of the tax gap—underreported income, overstated deductions and credits, and math errors—underreported income by individual filers contributes by far the largest amount.

In tax year 1987, individuals failing to properly report their income will cause an estimated $56.3 billion loss in revenues. Another $7.2 billion will be lost due to individuals who do not file returns at all. With regard to tax cheating, it is often asserted, "Everyone else is doing it so I'm entitled to do it." Furthermore, many Americans who personally disapprove of tax cheating are willing to condone it in others.

Perhaps tax evasion would be less acceptable when the actual cost to the average taxpayer is highlighted. For 1987, Tax Foundation economists estimate that a $63.5 billion individual tax gap would translate into $607.42 per individual return. For individual returns with taxable income, the allocation would be even greater, reaching $641.81 per return.

### Distribution of the Gross Income Tax Gap by Source
#### Tax Year 1987

| Source of Gap | Tax Gap ($millions) | | Percent Distribution of the Tax Gap | |
|---|---|---|---|---|
| **Total Income Tax** | | **$ 84,874** | | **100.0%** |
| **Individual Income Tax** | | **$ 63,475** | | **74.8%** |
| Filers of tax returns | | $ 56,301 | | 66.3% |
| Underreported income | $ 48,292 | | 56.9% | |
| Wages and salaries | 1,417 | | 1.7 | |
| Interest and dividends | 3,227 | | 3.8 | |
| Capital gains | 6,650 | | 7.8 | |
| Informal suppliers[a] | 7,739 | | 9.1 | |
| Other nonfarm proprietor income | 16,646 | | 19.6 | |
| Farm income | 1,904 | | 2.2 | |
| Partnership and small business income | 3,216 | | 3.8 | |
| Pensions and annuities | 123 | | 0.1 | |
| Rents and royalties | 3,141 | | 3.7 | |
| Estate and trust income | 64 | | 0.1 | |
| State income tax refunds | 86 | | 0.1 | |
| Alimony income | 173 | | 0.2 | |
| Taxable unemployment and social security benefits | 338 | | 0.4 | |
| Other income | 3,566 | | 4.2 | |
| Overstated subtractions | 6,062 | | 7.1 | |
| Adjustments | 545 | | 0.6 | |
| Deductions | 3,478 | | 4.1 | |
| Exemptions | 2,039 | | 2.4 | |
| Credits | 899 | | 1.1 | |
| Math errors | 1,049 | | 1.2 | |
| Nonfilers of tax returns | | $ 7,174 | | 8.4% |
| **Corporate Income Tax** | | **$ 21,399** | | **25.2%** |
| Small corporations[b] | | $ 5,225 | | 6.2% |
| Underreported income | $ 2,519 | | 3.0% | |
| Overstated deductions | 2,706 | | 3.2 | |
| Large corporations[b] | | 15,845 | | 18.7 |
| Other[c] | | 329 | | 0.4 |

[a] Proprietors who operate with informal business styles, e.g. unreported income from roadside or sidewalk vendors, moonlighting craftsmen, unlicensed providers of child or elderly care services, and similar informal operators.
[b] Small corporations = assets under $10 million. Large corporations = assets of $10 million or more.
[c] Consists of $164 million gap for fiduciaries and $165 million gap for unrelated business income of tax exempt organizations.
Note: Details do not add due to rounding.
Source: U.S. Department of the Treasury, Internal Revenue Service.

### 1987 Individual Tax Gap Per Return

| | Millions | Tax Gap Per Return |
|---|---|---|
| Number of Individual Returns | 104.5 | $ 607.42 |
| Number of Individual Returns With Taxable Income | 98.9 | $ 641.81 |

Source: Tax gap estimated by Department of Treasury, Internal Revenue Service. 1987 number of returns and tax gap per return estimated by Tax Foundation.

An individual tax gap amounting to well over $600 per individual return exemplifies the extent of the problem. The tax system itself is jeopardized when individuals are asked to support a system they believe is unfair and permits others to cheat with impunity. Tax evasion clearly threatens the voluntary compliance that is so central to the American tax system.

Experts agree that the tax gap cannot be closed completely. However, collecting taxes owed but not paid is certainly better than piling new taxes on those who do pay. Compliance with tax laws requires a certain amount of taxpayer belief in the system's integrity and ultimate sense of fairness. The Tax Reform Act of 1986 may help to improve the climate

(*Continued on page 5*)

*Budget Watch* By Allen Schick

# The Deficit That Won't Go Away

It wasn't very long ago that federal budgeting was a simple and straightforward matter. Most all revenue was collected in a single fund out of which government's expenses were paid. Nowadays, however, a growing portion of federal revenue is placed in a trust fund and earmarked for specific purposes. The federal tax structure is being transformed into a sort of "boutique" in which Americans pay the cost of services financed by earmarked revenue but not the full cost of the general services provided by the government. As a result, the government must borrow heavily to finance many of its most basic programs.

## Deterioration of the General Fund

The general fund finances all the expenses of the federal government except those paid out of trust funds. The $300 billion spent on national defense comes out of the general fund, as do more than $100 billion in aid to state and local governments, $150 billion in interest payments, and the operating expenses of almost all federal agencies. (The general fund also includes some money earmarked to special funds. The legal distinction between special funds and trust funds is not always clear.)

The general fund is bankrupt; it stays afloat by borrowing more than $200 billion each year. The steady deterioration in its financial condition is displayed in Table 1 which shows general revenue as a percentage of total federal receipts, general outlays, and the gross national product.

**Table 1**
**General Fund Receipts**
**Selected Fiscal Years**

| General Receipts: | 1950 | 1960 | 1970 | 1980 | 1989* |
|---|---|---|---|---|---|
| As a percent of total federal receipts | 90 % | 82% | 74% | 68% | 61% |
| As a percent of general outlays | 92 | 101 | 92 | 81 | 71 |
| As a percent of GNP | 13 | 15 | 14 | 13 | 12 |

* 1989 is an estimate; all other years are actual.
Sources: Tax Foundation, Facts and Figures on Government Finance, except for 1989 which is computed from the U.S. Government Budget.

■ In 1950, 90 percent of all federal revenue was available for the general purposes of government. This percentage has dropped in each subsequent decade; at the present time, barely 60 percent of all federal receipts go to the general fund. With the scheduled growth in social insurance taxes, this percentage is certain to decline even more in the coming decades.

■ As late as the 1970s, general revenues sufficed to cover 90 percent or more of general outlays; now only about 70 percent of these outlays are financed by unrestricted revenue. This means that Americans are paying for less than three quarters of the cost of government. The shortfall is made up by borrowed funds.

■ Despite the overall rise in federal taxation, general revenues have actually declined as a percentage of the gross national product. In fact, they are now a smaller percentage of GNP than they were 40 years ago when the scope of federal programs was much more limited.

This adverse trend portends large, probably rising, general fund deficits as well as a growing debt burden. Table 2 indicates that most of the recent decline in the overall budget deficit (from a peak of $221 billion in the 1986 fiscal year to "only" about $157 billion in the current year) has been due to a buildup of balances in the trust funds. CBO projections for the next five years suggest that the entire improvement in the "baseline" deficit between now and 1993 will be due to the trust funds. The general fund deficit will actually grow. Because of this, there will be a continuing rise in the federal debt. The Office of Management and Budget has estimated that another trillion dollars will be added to the federal debt. With the burgeoning balances in the social security funds conveniently available to finance the general funds shortfall, the debt burden might swell to truly gargantuan size early in the next century.

**Table 2**
**The Budget Deficit and Federal Debt**
**(dollars in billions)**

| | 1986 | 1988 (e) | 1990 (e) | 1993 (e) | Percent Change 1986 - 1993 |
|---|---|---|---|---|---|
| General Fund Deficit | $ 282 | $ 254 | $ 283 | $ 295 | 5% |
| Trust Funds Balances | 61 | 97 | 116 | 163 | 167% |
| Total Deficit | 221 | 157 | 167 | 134 | -39% |
| Federal Debt | 2,130 | 2,582 | 3,053 | 3,654 | 72% |

## Earmarked Taxes—Yes; General Taxes—No

The deterioration in the general fund has occurred at a time when politicians are cross-pressured by citizens who want more benefits from the federal government but do not want to pay higher taxes. While there is nothing new about this inconsistent behavior, high deficits have forced Congress to change the way it responds to demands for expanded programs. In the past when deficits were low and the general fund was in sound condition, Congress could enact new programs without having to be immediately concerned about how to pay for them. But in an age of high deficits, Congress knows that it cannot add to federal spending without also providing

*(Continued on page 4)*

(BUDGET WATCH, *from page 3*)

the means to finance new programs. The expedient solution is to earmark the additional revenues for the programs being expanded. Recent earmarks include the following:

■ The $8.5 billion superfund program enacted in 1986 is financed by a package of earmarked taxes on petroleum, raw chemicals, and U.S. corporations. In addition, more than one billion dollars is to be diverted from general revenues to superfund.

■ A special tax has been levied on pharmaceutical companies in order to compensate persons injured by certain vaccines.

> ***The federal tax structure is being transformed into a sort of "boutique" in which Americans pay the cost of services financed by earmarked revenue but not the full cost of the general services provided by the government.***

■ The omnibus trade bill imposes a small fee on imports to finance retraining programs for workers displaced by imports.

■ The expansion of Medicare's catastrophic illness coverage is to be financed by a sizeable increase in the premiums paid by elderly Americans into the Medicare trust fund.

Earmarking might accelerate in the coming years as Congress faces demands for costly expansion in child care, health care, and other social programs. For example, recent proposals have called for financing home care of the elderly by removing the cap on medicare premiums.

Earmarks enable Congress to generate additional revenue without raising general taxes. But while earmarks link the taxes Americans pay with the benefits they get, this practice has a number of deleterious effects on the federal budget.

*Most earmarked taxes are not user charges.* A distinctive feature of recent earmarks is that they tax a particular segment of the population, but not just the one which directly benefits from the program. Thus, all taxpaying corporations, not only those responsible for pollution, pay earmarked taxes into superfund. All elderly Americans are charged for catastrophic coverage, whether they use this service or not.

*Earmarks erode the capacity of the United States to finance its ongoing operations.* Because they are coupled with spending increases, earmarked taxes do not ameliorate the general fund deficit. In practice, however, they may cause further deterioration in the general fund by (1) making it more difficult to produce revenues to pay general expenses and (2) imposing additional costs on the general fund. In this connection, it bears noting that superfund is financed in part out of general revenue, and that pressure to finance medicare out of general revenue is likely to increase if earmarked taxes prove insufficient to finance catastrophic care.

*Earmarks warp federal budget priorities.* Programs that can tap into earmarked sources can grow even when the budget is tight; less fortunate programs cannot grow, no matter how urgent the need is. This double standard pertains to existing programs as well. With a general fund deficit well in excess of $200 billion, the programs financed out of general revenue face cutback pressures. Virtually all the spending cuts in the 1980s have been in areas of the budget paid for by general revenue.

> ***. . . now only about 70 percent of [general] outlays are financed by unrestricted revenue. . . . Americans are paying for less than three quarters of the cost of government.***

*Earmarks undermine support of government.* Earmarking transforms Americans from citizens into shoppers. A citizen pays taxes in support of the broad purposes of government; a shopper pays for only the things he/she buys. As citizens we pay for the oldest and most basic functions of government such as the maintenance of law and order, the conduct of foreign relations, and the advancement of science. The huge general fund deficit is not just a bookkeeping entry; rather, it measures the extent to which the concept of government has been weakened.

> ***Congress knows that it cannot add to federal spending without also providing the means to finance new programs. The expedient solution is to earmark the additional revenues for the programs being expanded.***

Without a sound government that generates sufficient revenue to finance its operations, future shoppers might find their favorite boutiques closed because the physical and social infrastructure needed to keep them open is lacking.

**Correction**

The June *Budget Watch* should have said that of the JCT's $300 billion estimate of tax expenditures in FY'89, only 12 percent of these benefits, or $37 billion, are provided to corporations; approximately $260 billion go to individuals.

## Tax Features

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(SHADOW COMMITTEE, *from page 1*)
nue adjustments, the Shadow Committee recommended paring at least $100 billion from the unified budget deficit by 1993, and urges that a deficit-neutral rule be enforced to sustain "continuing restraint in discretionary domestic programs." (Under this rubric, any additional spending for new programs must be offset by compensatory cutbacks in other parts of the budget.)

| | $Billions |
|---|---|
| Defense spending cutbacks | $ 25 |
| Non-defense subsidy cutbacks | 20 |
| Restrain entitlement expenditures | 10 |
| Tax 85% of social security benefits | 18 |
| Impose a broad-based tax on energy consumption | 19 |
| Increase user fees | 10 |
| | $ 102 |

### Give Meaning to the Annual Budget Resolution

"The budget resolution has become a symbolic battleground in which small conflicts get magnified into big ones and deadlines are ignored because they have no meaning," the report concludes. "The Shadow Committee urges that the congressional budget process be overhauled by converting the annual resolution into an instrument for deciding revenues and expenditures. As a step in this direction, the budget resolution should be subject to presidential review, and it should be directly linked with revenue legislation and appropriation bills. Congress should make real, not symbolic, decisions when it votes on a budget resolution."

The Tax Foundation's Shadow Committee on the Federal Budget is a citizens' watchdog group acting under the auspices of the Tax Foundation, a Washington-based fiscal policy research organization. Members include The Honorable Harry F. Byrd, Jr., Leif H. Olsen, W. Bowman Cutter, Rudolph Penner, Paul H. O'Neill, and Allen Schick.

The complete report is available from the Tax Foundation for $4.00 plus $1.00 postage and handling.

## THE FRONT BURNER

By Robert C. Brown
President, Tax Foundation

### "The Great Silence"

To look at the Democratic and Republican Party Platforms, you would think we were living in the best of all possible worlds: no mention is made of taxes; no mention is made of deficits; no mention is made of spending cuts.

Although spending continues to run $150 billion higher than taxes, neither presidential candidate addresses the most pressing issues of the decade: tax and fiscal policy and deficit reduction. The "t" word and the "d" word go unspoken.

Quite simply, this is dishonest. We have been plagued for a generation now with a public that expects more from the national government than it is willing to pay for. This public has passed the bill forward to subsequent generations of Americans.

Yet neither candidate dares address this issue openly. By tacit agreement, the deficit reduction question has been finessed, passed to the National Economic Commission, which is not due to report until March 1989. Perhaps this will be a good thing, much like the resolution of the Social Security dilemma earlier in the decade by the Greenspan Commission. Perhaps only a bipartisan group with a mandate from both the Legislative and Executive Branches can muster the independence and courage to ask the hard questions and come up with at least some of the difficult answers.

Even so, one would hope to see a little more candor from those who aspire to the highest elective office in the land. To talk in vague generalities while ignoring the highest, most intractable deficits in our history is unconscionable. It models presidential politics after the race for top ratings in prime time network television. The rule is to air the least offensive programming possible, shows so bland and innocuous that the viewer will not be motivated to make the effort necessary to change channels.

Is that the kind of presidential campaign the United States wants and needs? Should the candidate who runs a campaign sufficiently vanilla-flavored that he antagonizes the fewest voters win the White House by a sort of reverse popularity contest?

One thinks of the great presidents of the past and speculates where the nation would be had they followed the course of least offensiveness. The beige party platforms and generic presidential campaigns now being run stand in pale contrast to the giants of the past who were willing to stand up and be counted *as they were running for office.*

It is saddening, and somewhat frightening, to think that we may be led into the nineties by whichever candidate best succeeds in ducking the tough quesions, by whoever avoids being pinned down on anything that might strike the voters as painful or difficult.

(TAX GAP, *from page 2*)
for compliance by eliminating some perceived sources of unfairness in the tax laws and perhaps more importantly, by lowering the tax rates. The latter, in effect, reduces the marginal dollar "benefit" of cheating. However, the frequent changes in the income tax code themselves foster increased uncertainty, frustration and noncompliance, at least in the short run. If the Internal Revenue Code would remain relatively stable, complexity and uncertainty about the law should become less important as a source of noncompliance.

*Government and Your Tax Dollars*

# The Revenue Side . . . .

Nearly 28 cents of every dollar raised by Federal, state, and local governments in 1986 (latest reported) came from individual income taxes according to Tax Foundation economists. That totaled more than $423 billion of the $1.515 trillion that governments collected that year.

Social security payroll taxes were the second major revenue source, raising 17 cents for every revenue dollar, or $257 billion in 1986. Other major revenue raisers included:

- Current charges, 9.5 cents;
- Miscellaneous general revenue (e.g., interest earnings and government asset sales), 7.8 cents;
- Property taxes levied by state and local governments, 7.4 cents;
- Selective sales and excise taxes, and general sales taxes, 6.0 cents each;
- Corporate income taxes, 5.5 cents; and
- Miscellaneous taxes (death and gift, motor vehicle and operator's licenses, unemployment contributions and others), 4.4 cents.

Individual income taxes have held the top position for over 40 years. However, the dominance of this particular form of tax has waned. Their 27.9 cent share in 1986 is down from 30.3 cents in 1970 and 30.7 in 1980.

Tax Foundation economists attribute the relative decline of the personal income tax to two main factors: social security taxes and nontax revenues have grown more rapidly; and the Economic Recovery Tax Act of 1981 (ERTA) has slowed the rise of Federal income taxes. Similar effects can be expected due to the Tax Reform Act of 1986.

On the other hand, the slower growth in Federal income taxes since 1980 has been partially offset by the steady increase in state/local taxes. Since 1980, Federal individual income taxes have gone up by 43 percent while individual income taxes levied by subnational levels of government have jumped 73 percent.

### Emphasis on Nontax Revenues

Looking at the mix of taxes over the past quarter of a century, Tax Foundation analysts call attention to several major shifts:

- Revenues from nontax sources have risen from 17.3 cents per revenue dollar in 1960 to 25.8 cents in 1986. Nontax revenues primarily consist of current charges (e.g., revenues generated from rents, sales of commodities and services, and government commercial activities); miscellaneous general revenues (includes interest earnings, special assessments, and property sales); employee retirement; and utilities and liquor stores revenue. While nontax revenues have been increasing, tax revenues dropped from 82.7 cents per dollar in 1960 to 72.4 cents by 1986.
- Social security payroll taxes were the fastest growing of all tax sources during the period, rising from 7.0 cents per dollar of revenue in 1960 to 17 cents in 1986. Social security tax collections in 1986 were over 23 times as large as in 1960.
- State and local general sales taxes were the only other source showing a rising trend during the 26 years. Their share of the total increased from 3.5 cents per dollar in 1960 to 6.0 cents in 1986. Fiscal year 1986 revenue from general sales taxes reached $91 billion, 18 times 1960 levels.

Tax sources showing a declining role in the structure were property, selective sales and excises, corporate income taxes, and miscellaneous taxes.

Numbers on government revenues don't tell the whole story, Tax Foundation economists say. In fact, they understate the amount spent by government in 1986 by $182 billion. The Federal government financed $249 billion — almost one-fourth of its outlays by borrowing. State and local governments, on the other hand, took in $65 billion (9 percent) more than they spent, thus reducing the deficit for all governments combined to $182 billion, or 11 cents per dollar of spending. The fiscal 1986 deficit for all governments was almost seven times the amount shown in 1980, and 12 percent larger than the deficit recorded just one year earlier.

Additional details appear in the accompanying table.

**How Federal, State, and Local Governments Raise Each Dollar of Public Funds**
**Selected Fiscal Years 1960-1986**
**(Cents Per Dollar of Total Revenue)**

| Source | 1960 | 1970 | 1980 | 1986 |
|---|---|---|---|---|
| Tax Revenues | 82.7 | 82.4 | 78.2 | 74.2 |
| Individual Income | 28.2 | 30.3 | 30.7 | 27.9 |
| Social Security (OASDHI) | 7.0 | 11.5 | 15.0 | 17.0 |
| Property | 10.7 | 10.2 | 7.3 | 7.4 |
| Selective sales and excises | 12.5 | 9.8 | 6.5 | 6.0 |
| Corporate income | 14.8 | 11.0 | 8.4 | 5.5 |
| General sales | 3.5 | 4.8 | 5.5 | 6.0 |
| Other taxes[a] | 6.0 | 4.8 | 4.8 | 4.4 |
| Nontax Revenues | 17.3 | 17.6 | 21.8 | 25.8 |
| Current charges | 8.1 | 7.9 | 8.6 | 9.5 |
| Miscellaneous general[b] | 3.3 | 4.0 | 6.7 | 7.8 |
| Employee retirement | 1.9 | 2.5 | 3.1 | 4.9 |
| Utilities and liquor stores | 3.2 | 2.6 | 2.7 | 3.1 |
| Other nontaxes | .8 | .6 | .7 | .5 |
| Exhibit ($Billions): | | | | |
| Total Revenues | $153.1 | $333.8 | $932.2 | $1,515.5 |
| Surplus(+) or deficit(-) | +$1.8 | +$.8 | -$26.5 | -$181.5 |

[a] Includes death and gift, motor vehicle and operators' licenses, unemployment contributions, and miscellaneous taxes.
[b] Includes interest earnings, special assessments, sale of property, and other general revenue.
Source: Tax Foundation computations based on data from U.S. Department of Commerce, Bureau of the Census.

# .... And The Spending Side

Social welfare programs consumed 31.8 cents of every government dollar spent in 1986 (latest reported). Nearly one third of all 1986 public expenditures, some $540 billion out of total spending by all levels of government of $1.697 trillion, went to support the social welfare network, Tax Foundation economists report. Other major spending categories are:

- National defense and international relations, 18.4 cents;
- Education expenditures, 13.2 cents;
- Interest costs, 10.7 cents; and
- Environment and housing, 5.8 cents.

## Social Welfare Spending Dominates

Federal social security (OASDHI) was the costliest spending program of all governments, claiming 15.8 cents of every dollar spent. Social welfare programs also include social services and income maintenance (public welfare, health and hospitals, and unemployment insurance), which accounted for 12 cents per dollar of government spending. Other social welfare programs included are government employee retirement, and veterans' programs not elsewhere classified, 4 cents.

As large as these percentages for social welfare spending are, they actually understate what could be considered the "true" social spending total, according to Tax Foundation researchers. Broadly defined, social welfare might include public education (see accompanying table), as well as subsidized housing and many veterans' services that are included in and not segregable from the totals of other spending categories.

## Two Decades of High Growth

During the 1960s and 1970s, spending on social welfare programs underwent a dramatic increase, rising from 20.1 cents per dollar of spending in 1960 to 33.2 cents in 1980. By contrast, national defense and international relations spending dropped from the 1960 level of 32.3 cents to only 15.6 cents in 1980.

Although data for the early 1980s show a modest 2.8 cents-per-dollar increase in the spending share for defense, the growth of this outlay category pales in comparison with what has happened to social spending over the last quarter century: Spending on social programs in 1986 came to 16 times what it had been in 1960, whereas all other programs combined, including defense, increased by just nine times over the same period.

## Education and Transportation Spending Down

Another notable recent trend has been a relative decline in spending for education and transportation. Education spending accounted for 15 cents per dollar in 1980. It now absorbs only 13.2 cents.

Transportation expenditures continue their sharp decline. They now stand at only 3.7 cents, less than half 1960 levels.

## Debt Payments Rise

Fastest growing of all government costs have been debt-related outlays. Interest payments on government debt claimed 10.7 cents of each dollar spent in 1986, compared to a 7.9 cent bite in 1980 and 6.2 cents in 1960. The total cost of serving debt in 1986 was $181.2 billion.

The four largest spending categories — major social welfare programs, defense, education, and interest costs — accounted for nearly $1.3 trillion, or 74.1 cents of every dollar of Federal, state, and local expenditures in 1986.

The accompanying table provides further details.

### How Federal, State, and Local Governments Spend Each Dollar of Public Funds

**Selected Fiscal Years 1960-1986**

(Cents Per Dollar Of Total Spending)

| Source | 1960 | 1970 | 1980 | 1986 |
|---|---|---|---|---|
| Major social welfare programs, total | 20.1 | 25.5 | 33.2 | 31.8 |
| Social Security (OASDHI) | 7.1 | 10.8 | 15.6 | 15.8 |
| Social services and income maintenance[a] | 8.5 | 10.7 | 13.2 | 12.0 |
| Government employee retirement | 2.0 | 2.4 | 3.1 | 3.0 |
| Veterans (not elsewhere cassified) | 2.5 | 1.6 | 1.3 | 1.0 |
| National defense and international relations | 32.3 | 25.3 | 15.6 | 18.4 |
| Education | 12.8 | 16.7 | 15.0 | 13.2 |
| Interest on general debt | 6.2 | 5.5 | 7.9 | 10.7 |
| Environment and housing | 5.4 | 4.4 | 5.0 | 5.8 |
| Utilities and liquor stores | 3.4 | 2.8 | 3.8 | 3.8 |
| Transportation | 7.6 | 6.2 | 4.5 | 3.7 |
| Public safety | 1.8 | 2.0 | 2.3 | 3.3 |
| Government administration | 1.8 | 1.9 | 2.2 | 2.4 |
| Postal service (Federal) | 2.5 | 2.3 | 1.9 | 1.8 |
| Sanitation | 1.1 | 1.0 | 1.4 | 1.1 |
| All other | 5.0 | 6.4 | 7.2 | 4.0 |
| Exhibit ($Billions): | | | | |
| Total spending | $151.3 | $330.0 | $958.7 | $1,697.0 |

[a] Includes public welfare, hospitals, health, social insurance administration, and other insurance trust expenditures.

Source: Tax Foundation computations based on data from U.S. Department of Commerce, Bureau of the Census.

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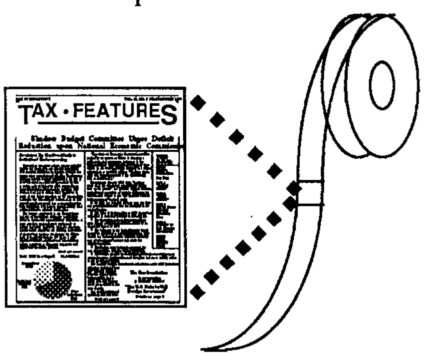


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## Tax Foundation to Hold Seminar on U.S. Foreign Investment and U.S. Tax Policy on Multinationals

The critical role of U.S. dirct investment abroad is the subject of an upcoming Tax Foundation seminar entitled "The U.S. Stake in U.S. Foreign Investment." It will be held September 13, 1988 at the Vista International Hotel in Washington, D.C. After registration at 8:00 a.m. and continental breakfast at 8:15, the seminar's morning session will begin at 9:00.

■ Martin S. Feldstein, President, National Bureau of Economic Research, will describe the impact of investment abroad on the U.S. economy.

■ Walter Mossberg, International Economics Reporter, *The Wall Street Journal,* will discuss public and congressional attitudes.

To conclude the morning session, business views on U.S. competitiveness abroad will be presented by:

■ Robert L. MacNeill, Executive Vice Chairman, Emergency Committee on American Trade;

■ James Riordan, Vice Chairman and Chief Financial Officer, Mobil Corporation; and

■ Kenneth Kermes, Executive Vice President, Corporate Finance, SmithKline Beckman Corporation.

Following a noon reception and a luncheon session—Senator Alan Cranston is invited to speak—an afternoon session will begin at 2:00 p.m. Tax policy as applied to foreign investment will be the subject, and the speakers will be:

■ The Honorable O. Donaldson Chapoton, Assistant Secretary of the Treasury for Tax Policy;

■ Gary Hufbauer, Wallenberg Professor of International Finance, Georgetown University;

■ Ray Haas, International Tax Partner, Arthur Young & Company; and

■ Robert Z. Lawrence, Senior Fellow, Department of Economics, The Brookings Institution.

These speakers will examine the impact of U.S. investment abroad on the U.S. economy, the current confusion in national policy regarding investment abroad, and the type of tax policy that can further U.S. competitiveness in overseas markets.

While the role of U.S. multinational firms has already become a Presidential campaign issue, the campaign tends to ignore vital facts about foreign investment and multinational taxation. This seminar seeks to fill this void.

The cost of the seminar is $250 per registrant; interested parties should call the Tax Foundation by September 5. For a room reservation at the Vista the night of the 12th, call 1-800-847-8232 by August 23.

The proceedings of the seminar will be provided to all attendees.

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