Advance Copy

THE TAX FOUNDATION
1937 — 1987
THE FIRST 50 YEARS

Toward better government
Founded 1937

Tax Foundation
One Thomas Circle, N.W. — Suite 500
Washington, DC 20005
(202) 822-9050

INTRODUCTION

The Tax Foundation will be 100 years old in the year 2037. Founded in 1937, celebrating its 50th birthday in 1987, the Foundation has stuck to its knitting of providing basic information for individuals, companies, students and citizen organizations on government spending, taxes and debt. "Toward Better Government Through Citizen Understanding" has been its motto from the beginning, and will be its guiding star in its second 50 years.

Who started the Foundation? Why? What has it accomplished? What does it hope to do in the coming decades? How does the Tax Foundation guard its reputation for objective, nonpartisan analysis of Federal finances and tax policy trends?

The Foundation's reputation for reliable data is the root of its unique credibility with Congress, the media, and the loyal sponsors who have kept its lamp lit for five decades.

To those supporters of this experiment in unfettered, non-government, nonprofit oversight of an ever-growing bureaucracy, this story of the Tax Foundation's past -- and its hopes for the future -- is respectfully dedicated.

Hans W. Wanders, Chairman

Washington, DC December 5, 1987

THE IDEA, AND EARLY DAYS

The official birthday of the Tax Foundation is December 5, 1937, when the Foundation was formally organized at a meeting in New York City. But Day One of the Tax Foundation idea actually was an informal lunch at New York's University Club in 1935, where a small group of national business leaders met, pondered, and agreed that a new presence was needed in America to monitor the tax and spending policies of government agencies -- at that time, mainly state and local units, rather than the Federal government.

In that group of Founding Fathers were Alfred P. Sloan, Jr., Chairman of the General Motors Corporation; Donaldson Brown, GM Financial Vice President; William S. Farish, President of Standard Oil Company of New Jersey; and Lewis H. Brown, President of Johns-Manville Corporation, who later became the first Chairman of the Board of the Foundation.

No better account is available on what the Tax Foundation is all about, and what makes it prophetically unique to this day, than the report by Lewis Brown at the first meeting of the Foundation's trustees on April 29, 1939. From his remarks on that occasion:

"In 1935 a group of us around a luncheon table decided that one of the important things to be done was to find out how to bring about efficiency in the spending of government funds. We were alarmed at the velocity of spending and were agreed on one principle. We all believed in democracy and representative government and that the people had a right to spend money on anything they wanted to. But there are more than 175,000 taxing units raising money to be spent. The total amount is 5.5% of the national income and this is rising as taxes are raised. If continued indefinitely, it would come up to one-third of the national income. [Actually, 34% is the Tax Foundation's current estimate for 1987.]

"To repeat, we agreed the people had the right to spend money for anything they wanted to. It was not what they should spend it for that governed our approach, but to arouse the citizen himself to the need of efficiency in government and to find a practical way to bring about the same methods of efficiency in government that people employ in industry or business.

"We thought one of the first things we had to do was to arouse the people as to the need to do something about taxes; to make them tax conscious. We went to an advertising agency and worked for six months trying to evolve a program...Our conclusion was that it wasn't going to be practical to approach it from the standpoint essentially of advertising. The difficulty was there was no follow-through...

"The Tax Foundation was incorporated in 1938. Until then, it was not a formal organization. We just went ahead and operated. In December Alfred P. Sloan, Donaldson Brown and myself issued an invitation to a dinner at the University Club (in New York City). About 50 leaders from industry, banking, and other fields attended. We told them our story and presented some pictures. At the end of the meeting we asked for an underwriting of the support necessary for the coming year. We asked for $140,000 and we got that before we left the room that evening. That was more than had been done in the previous 10 years. They agreed to underwrite the program until we could spread it out into each of the nation's basic industries.

"This enabled us to go ahead. We began to enlarge our staff and proceed with the Westchester County project and the follow-up throughout New York State. A Board of Trustees was formed and papers necessary to carry on were drawn up. We hope the Board of Trustees will grow to be a very outstanding group, and give us the background for the Tax Foundation to go on and spread its program into the different states and regions, tackling those where the tax and spending problems are greatest.

"This is, in brief, the history and background."

SETTING THE PATTERN 1938-41

Federal expenditures in 1937 were $3.1 billion. The national debt was $37 billion. Public spending by all units of government was 5.5% of national income.

Fred Eldean, the first Executive Director of the Tax Foundation, was interviewed for his recollections at his retirement home near Phoenix, Arizona in 1984. He added these details to the story of the Tax Foundation's creation --

"After my boss at the American Petroleum Institute agreed to a leave of absence for me to work on the Tax Foundation program one of the first things I did was to open a little office in New York City. At that point (late summer 1938) we only had $5,000 which came from Mr. Bell (William B. Bell, President, American Cyanamid Co.). He was the first subscriber. Then I went to Mr. Sloan and Donaldson Brown and got $25,000 from them and $25,000 from William P. Farish. So we started with $55,000, and somewhere along there we hired Alfred Parker (later Executive Director) to help us.

"That fall (of 1938) there was a budget controversy in Westchester County just outside New York. The supervisors were going to increase taxes. And a rather fortuitous circumstance happened. F. Arthur Hall came to me. He was something of a genius in his ability to get people doing things. He went up there and organized the taxpayers' association and put some life in it. By the time November came around they made a hell of a big presentation and set the stage for getting the taxes back down. They got a lot of nice publicity out of it. That encouraged them to move on to the New York state scene and the state budget. Our strategy was to leave Albany (the state capital) alone but to go back into the local communities and create interest in tax issues.

"I had 10 field men in the state; really wonderful fellows. They were ingenious. Every Monday one of them would have some new event that would make the paper, like the taxpayer protest in some little town that ran out of government post cards; a typical example of inefficiency. This all came together when we had 7 or 8 thousand people march on Albany. And we had a 10-hour hearing and for the first time in history they cut the state budget $25 million below the previous year.

"We got a kick out of the fact that the Tax Foundation did not appear in all this. Our men were instructed not to get out in front themselves, but to put citizens out there. Their job was to stay in the background.

"This experiment gave Lewis Brown and other executives confidence we could accomplish something for more efficient, less wasteful, government. So we set out to organize state groups and adopted a very unwieldy name -- Citizen Public Expenditure Survey -- which we formed in a number of states.

"We got help from industry. I remember a meeting in Detroit where Knudsen (William S. Knudsen, then-President of General Motors) was speaking for us and a lawyer for Ford says, 'Well, how can we do this?' and Knudsen replied, 'All you guys are going to kick in. That's how we're going to do it.' So that is how we raised money for the Expenditure Survey.

"But we raised money separately for the Tax Foundation. The Survey was action oriented. The Tax Foundation was aimed at research. That had to be the case if we wanted to keep the Foundation as a tax exempt institution."

FIRST GOAL: GETTING THE FACTS

The first goal of the Tax Foundation was to set up and maintain on a continuing basis an expert agency that would gather factual data on government finances, publish this information in readable form, and then encourage grassroots groups of citizens to organize their own state and local units to mount sustained tax and government efficiency drives in their home territories.

"A New Approach to the Tax Problem" was the first major publication issued by the Foundation, in 1939. The New York Expenditure Survey was the role model for state and local reform units. Organized in 1939, the New York organization was soon followed by similar groups in 15 other states. A Foundation cooperative program of graduate training in government management was begun at the University of Denver.

The first of the Foundation's National Conferences on fiscal and tax policies was held in New York City in December, 1940. Public Finance Fellowships were established under Tax Foundation auspices at New York University. The first edition of the Foundation's "Facts and Figures on Government Finance" was published in 1940; a unique compendium of economic and fiscal data not available elsewhere and still being issued as an information service to Foundation members and the general public at a nominal fee.

The Foundation also began a series of national conferences of the Executive Directors of state taxpayer associations. These helped to revive and re-focus a movement that had begun with formation of the Taxpayers Association of New Mexico in 1915. About a dozen other states launched similar movements in the 1920s and early 1930s, but it was not until the advent of the Tax Foundation that their growth took off. By 1943 there were approximately 1,200 local taxpayers associations and 35 statewide groups in operation.

THE WAR YEARS 1942-45

With the outbreak of World War II the Foundation stepped up its research on government spending patterns, with special emphasis on financing for wartime expenditures. "A Wartime Approach to the Tax Problem" revising the 1939 study was published in 1942. Charles C. Bauer was named Executive Director, succeeding Fred Eldean. A Citizens Commission on Non-Defense Expenditures was established as a watchdog against radical governmental forays and expansions that were growing under the cloak of war fervor.

In 1943 the first of a series of 24 studies on state and local spending, taxes and debt was issued. These turned out to be landmark reports that are basic background even today for state and local fiscal policies; an area that in the 1980s is of renewed national interest and concern.

In 1944 a nine-year joint program with the Governmental Research Association was begun. "GRA" was the forerunner (and a survivor) of the Hoover Commission on Reorganization of Government, set up in 1948 under the leadership of former President Herbert Hoover.

In 1945, William B. Warner, president of McCall Corporation, succeeded Lewis Brown as Tax Foundation Chairman. Roswell Magill, a leading tax attorney, as chairman of the Committee on Postwar Tax Policy issued the first volume of "A Tax Program for a Solvent America;" a series of major reports blueprinting future tax, economic and fiscal policies. Much of the research was done by Tax Foundation economists and the reports were widely quoted and utilized in the press, educational institutions and government offices.

RETOOLING FOR RESEARCH 1946-54

The Magill Committee reports opened a new era for the Tax Foundation, marked by much greater emphasis on Federal fiscal affairs. Many of the recommendations in those reports were gradually incorporated into national tax law, drawing heavily on Foundation staff research.

Symbolizing the new orientation was the opening of the first Tax Foundation office in Washington in 1948. That was occasioned by the merger into the Foundation of the Citizens National Committee, a private-sector group established primarily to focus on Federal spending. The Foundation's headquarters remained in New York City. John W. Hanes, a former Under Secretary of the Treasury, was elected Foundation Chairman.

Foundation spokesmen testified frequently on tax measures at the request of congressional committees. In 1951, at one session, the Foundation disclosed for the first time that Congress lacked direct annual control over two-thirds of the Federal budget. Tax Foundation tabulations were incorporated as a Special Analysis of one Federal budget document. In 1952, the Foundation issued a 3-volume study under the title, "Can Federal Expenditures Be Cut?" The late Senator Harry F. Byrd, Sr., of Virginia, cited its findings in one of the first telecasts on a national issue, saying, "Here are a thousand ways to cut the Federal budget," as shown in the Foundation study.

Another outstanding Foundation contribution in this period was development of a formula for allocating the true Federal burden by states -- a more accurate measurement than the statistics on Federal tax collections within a state, which had been the only gauge of Federal tax impact until then. The Foundation data, still being published in its continuing reports, was adopted by other research organizations interested in showing the cost of Federal aid in relation to Federal taxes taken out of each state. It was a Tax Foundation suggestion, backed by research, that led to preparation of the first "U.S. Budget in Brief," which became an annual supplement to the main Federal budget document each year, telling the budget story in simple, understandable language.

In 1954 the Magill Committee issued a "Federal Finances" study in conjunction with passage of the nation's second Internal Revenue Code, which amended and recodified all Federal income tax law passed from its inception in 1913 up to that time. Tax Foundation research had played a part in the congressional deliberations that led up to this historic legislation, much of it behind the scenes -- a Foundation role that was repeated thirty years later when Congress began the preliminaries that led to adoption of the Internal Revenue Code of 1986, also known as the Tax Reform Act of 1986.

Along with research, the Tax Foundation in the Fifties expanded one of its original initiatives: The preparation and publication of novel dramatizations of tax-related ideas and issues. "Tax Bite in an 8-hour Day," a Foundation concept backed by expert research, is one example. The computations are made and publicized on an annual basis to this day, giving the general public a quick snapshot of the tax impact on their personal work and social lives. Another instance of this kind of "macro information" (also known as "weathermaking" in public relations theory) was a brief presentation entitled, "A Hundred Taxes on a Loaf of Bread." This captured the interest and attention of President Dwight Eisenhower, who quoted it -- and that led to extensive references in the press and elsewhere, "arousing more consciousness about tax burdens than a thousand tables of statistics" according to one observer at the time.

A 1952 article by Herbert J. Miller, later Executive Director of the Foundation, articulated a "spending, taxes and inflation" theme that was credited by James Farley, who master-minded President Franklin Roosevelt's first electoral victories, with being the second greatest issue, after the Korean War, in the Eisenhower landslide of 1952.

The Foundation's work was appreciated and noted by the heavyweights on Capitol Hill throughout this period. Senator Harry Byrd, Sr., of Virginia, then Chairman of the Senate Finance Committee and the leading exponent of frugal, efficient government, said on many occasions that the Foundation's research and expert assistance was vital.

Representative Wilbur Mills of Arkansas, Chairman of the House Ways and Means Committee, held the Foundation in high esteem, saying on one occasion: "Without your efforts and those of like-minded citizens, I am sure that our expenditures totals would be much higher than they already are."

Wide ranging activities on the Washington front did not distract the Foundation from one of its original imperatives: Supporting the growth of state and local tax watchdog operations. The first National Conference of State Taxpayer Executives had been set up by the Foundation in 1948; these periodic meetings continue and are still supported by the Foundation.

A typical offshoot of Foundation action came in 1959, when the Advisory Commission on Intergovernmental Relations (ACIR) was established by Congress. The way had been paved for its creation by Foundation testimony on the need to separate Federal and state tax sources and functions. The ACIR has evolved into the leading source of data on all aspects of state and local government finances.

TAX POLICY AND SOCIAL ENGINEERING 1955-77

After the landmark 1954 Act, Federal tax policy began to shift in emphasis toward more and more use -- critics said misuse -- of the tax laws to accomplish broad social and economic goals. The basic idea was to construct a tax system that would not only raise the revenue needed to pay ever-growing government bills, but also re-distribute income from the top down and massage streams of investment into areas favored by the dominant political group of the day.

In this environment the Tax Foundation became increasingly involved in its "watchdog" function at the Federal level. In 1956 the Foundation published "Government Finances" and "Federal Excise Taxes," the first two of eight major studies on Federal taxes and their proper roles in the nation's life. Roswell Magill of Cravath, Swaine & Moore succeeded John W. Hanes as Chairman of the Foundation in 1957, and Herbert J. Miller retired as the Foundation's Executive Director in 1959. Alfred Parker, one of the Foundation's pioneer administrators, fulfilled the Executive Director functions and assumed the title in 1963.

During this period the Foundation played its traditional behind-the-scenes roles in a drive by President Eisenhower to halt the upswing in Federal spending that had begun in 1948, after World War II. It was the last really successful economy effort in Washington, and produced a nearly balanced Federal budget in 1959 and a $3 billion surplus in 1960. In the 27 years since then, there has been only one year of small surplus, 1969, while Federal expenditures have multiplied ten-fold, from $92 billion in 1960 to more than $1.2 trillion in 1987, under Democratic and Republican administrations alike.

With 1962 came the Kennedy tax revisions installing an investment credit and the "class lives" concept for depreciation (replacing the "useful lives" concept employed up to then). These innovative tax experiments split the business community, creating a breach in business ranks that has been exploited ever since.

The 1962 revisions in the Tax Code were the first part of a longer-range Kennedy tax plan that envisaged substantial reduction in income tax rates, to be partially offset by tax increases elsewhere; mainly on business. That was a foreshadowing of what came to pass in the mid-1980s. Sensing the opening of a new tax era, the Tax Foundation set up a Committee on Federal Tax Policy charged with making an independent study of basic changes needed in Federal tax revision, and published in January, 1963, a handbook entitled "Taxes, Economic Stability and Growth." It was widely used by officials and the general public in weighing alternative proposals for revising Federal taxes to achieve "revenue adequacy, fairness and equity, economic growth, simplicity, compliance" -- all themes sounded anew in the 1980s.

Much of the spadework started with the Committee on Tax Policy was reflected in the passage in 1964 of the largest Federal income tax reduction in history up to that time. But the cut was offset to an important degree by an upsurge in state and local taxes.

In November, 1965, the Foundation's Board of Trustees approved a new three-year development plan to increase major research and re-establish a field service. This resulted from an exhaustive review of the Foundation's program, culminating in the Trustees' conclusion that the Tax Foundation has an important role to play as the citizens' representative in tax and fiscal policy.

During the mid-sixties Foundation membership rose sharply. So did the flow of studies and publications, with special emphasis on financing of Social Security and state/local fiscal issues. By the end of the decade the Foundation was a nationally recognized source of information for the print and broadcast press, colleges and schools. More than 600,000 copies of Tax Foundation publications were distributed in 1970, with about one-third going to colleges and schools.

The early 1970s saw the beginning of mammoth Federal deficits, record-breaking spending (only partly due to Vietnam war outlays) and rapid inflation. During this period the Foundation's emphasis shifted to monitoring of government growth in spending and business regulation. Tax Foundation educational efforts "to stress common sense in fiscal policy and the dangers to our freedoms and our economy in tax and expenditure policies pursued without clear direction" played a significant part in laying the groundwork for themes that began to dominate national politics in both major parties in the early 1980s. In 1974, Robert C. Brown, former head of the California Taxpayers Association, succeeded Mr. Parker as Executive Vice President of the Tax Foundation.

Tax Foundation reports in this period included "Congress and the Federal Budget" (1973); "Spending Control Issues and the U.S. Budget" (1973); "Federal Tax Burdens in States and Metropolitan Areas" (1974). They were widely disseminated and formed the basis for hundreds of editorials, speeches, and classroom discussions.

A series of membership meetings in major cities sparked renewed interest in Tax Foundation programs and by the end of 1977 membership rose to an all-time high.

COPING WITH TAX TURMOIL 1978-87

In 1978 the Tax Foundation opened a new chapter in its development, moving its headquarters from New York to Washington, DC. The aim was to bring the Foundation's staff into closer contact with Federal policymakers and research resources, both private and governmental, which were increasingly centered in the national capital.

In 1979, the Tax Foundation entered into an agreement with The Tax Council, a business-supported tax policy group, to provide staff and research services for the Council's program. The Foundation, however, continued its policy of not seeking government funds for any purpose.

At this point, on the threshold of the 1980s, gasoline shortages, escalating oil prices and burgeoning inflation led to money/credit tightening moves that set up the economy for a broad and deep recession, complicated by explosive growth of competition from overseas led by Japan, with fateful impacts on American politics and tax policies. State governments began the decade of the '80s with a wave of tax rollbacks, touched off by the taxpayer revolt in California under the banner of Proposition 13 (limiting property taxes). Tax Foundation researchers reported that in 1979 state governments initiated reductions of over $2 billion in corporate and individual income taxes, sales, and property levies.

The tax-cut movement rolled into and over Congress, producing in 1981 the Economic Recovery Tax Act (ERTA), which promised the largest tax cuts in history up to that time, weighted in favor of capital formation. Foundation staff members contributed heavily to the swirling debates in Congress and the Executive Departments while providing information and guidance to the press and public on this major shift in tax attitudes. The promise of ERTA was short-lived, however.

The 1979-82 recession short-circuited business growth, cutting tax revenues far below expectations. Congress opened the spending spigots to finance anti-recession measures and a costly military re-equipment program. The resulting explosion in Federal deficit spending led to quick take-backs of the 1981 tax cuts. Successive Federal laws in 1982 (Tax Equality and Fiscal Responsibility Act, or TEFRA) and 1984 (Deficit Reduction Act or DEFRA) were unhappy milestones in the most turbulent period of U.S. tax history. The story of that turmoil was told by the Tax Foundation in a Special Report entitled "Tax Uncertainty: As American As Apple Pie -- But It's Getting Ridiculous" published in May, 1985.

The process of tax reduction take-backs also was occurring in the early '80s in many, though not all, states and localities. In September 1981, Tax Foundation economists reported legislatures in 30 states had enacted measures raising revenues by $2.5 billion a year, the largest annual statutory increase in ten years. Higher sales and gasoline taxes accounted for two-thirds of the additional revenues.

To the Tax Foundation and its members the 1982 Federal act (TEFRA) was a special disappointment because it was passed with the understanding that every $1 in additional revenue would be accompanied by $3 in deficit reduction. That "$3 for $1 bargain" was ignored by Congress. Deficits continued to soar until fiscal year 1987, when the Gramm-Rudman-Hollings Deficit Reduction Act slowed -- but did not end -- the flow of red ink.

Responding to the political imperative of voter rebellion against ever-rising tax burdens, Congress went into another spasm of Federal tax revisions. This culminated in passage of the Tax Reform Act of 1986 (TRA-86).

TRA-86 sharply reduced income tax rates on both individuals and corporations, over a two year period. But it also eliminated the investment tax credit, raised the effective rate on capital gains, tightened minimum tax rules, and made numerous other changes whose impact may not be fully realized for several years, and costly economic distortions could result. "At best, TRA-86 was a mixed bag for the nation," observed Foundation President Robert C. Brown.