NTA Forum

Perspectives, Ideas and News from the National Tax Association Summer, 1991

From the Editor

From time to time it is advisable to step back and take a fresh look at some perennial issues. In a rapidly changing world, accustomed perspectives quickly become out of date. New researchers take different and innovative approaches to old problems. Their insights must be listened to and taken into account if progress is ever to occur.

All NTA programs try to be on the cutting edge, but the planners of this year's Spring Symposium made a special effort to feature new ideas and perspectives and the results of new research.

To start with, the federal budget process has been radically changed by the new Budget Enforcement Act, with the result that traditional macroeconomic policy models are of doubtful relevance. Three very provocative papers examined the changed, and greatly diminished, role for tax increases or decreases in the new fiscal policy context.

New perspectives on the significance of progressivity in the tax structure were presented in papers on the distribution of benefits from federal expenditures and on the differences between the use of *annual* income or *lifetime* income in analyzing tax incidence.

The Symposium also featured new insights on the effects of federal actions on state tax policies and fiscal conditions, tax policies with respect to tax exempt organizations, and pension tax policy.

As usual, the papers given at the Symposium will be published in the September issue of the *National Tax Journal*. To give those who were un-

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Highlights of NTA Spring Symposium

The 1991 Spring Symposium of the National Tax Association, held May 9-10 in Arlington, VA, focused on the theme New Perspectives in Tax Policy. The Symposium, chaired by Thomas S. Neubig, featured some of the nation's most innovative thinkers on subjects of emerging and long range significance. The September issue of the National Tax Journal will contain their papers in full.

The New Budget Process and the Role of Taxes in Macroeconomic Policy

The Symposium opened with an analysis by Stan Collender, Director for Federal Budget Policy at Price Waterhouse, of the new Budget Enforcement Act, which replaced the Gramm-Rudman budget procedure. He noted that the new budget process is very different and should not be called "Gramm Rudman II, as both Gramm and Rudman voted against it. The new budget rules significantly reduce the prospects for future deficit driven tax increases, since the allowable deficit is adjusted for changes in economic conditions and technical changes, such as higher projected spending on the savings and loan bail-out, which caused the budget crisis last year.

the effects of monetary policy are now more widespread and more divisible, and they involve lower transaction costs than most fiscal policy changes.

Collender analogized the change in the budget process rules to George Orwell's *1984*, where the enemy was changed without anyone realizing it. The deficit is no longer the enemy; the President's State of the Union message did not mention the deficit even once. New legislative spending is now the enemy. The mini-sequester procedures for new discretionary spending programs, for example, require additional domestic discretionary spending to be paid for only through reductions in other domestic discretionary spending programs. The PAYGO rules for entitlement spending and taxes require that any changes be deficit neutral.

Any major deficit reducing tax bill would require significant reductions in Medicare spending. Instead, Collender predicted, tax bills will be smaller and will focus on technical corrections, simplification, expiring provisions, and modest members' amendments.

Joe Minarik, Executive Director and Chief Economist of the House Budget Committee, contrasted the actual process of enacting tax legislation with the textbook model of an omniscient dictator who can fine-tune government policy.

In the real world, implementing government stabilization policy has always encountered problems of timing. Stimulative action has often been implemented after a recession is al-

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most over, so the effect is pro-cyclical rather than counter-cyclical. The annual budget process tends to delay fiscal policy more than monetary policy.

Minarik disputed the conventional wisdom that fiscal policy is superior to monetary policy in combating recession. One of the main criticisms of monetary policy is its substantial impact on interest-sensitive sectors of the economy. Due to regulatory changes, the effects of monetary policy are now more widespread and more divisible, and they involve lower transaction costs than most fiscal policy changes.

The large federal deficit, Minarik argued, makes stimulative fiscal policy very risky. Higher deficits could trigger higher inflation expectations and higher real interest rates, which would be counter-productive, as temporary tax reductions are hard to reverse.

David Berson, Vice-President and Chief Economist of Fannie Mae, in a review of government fiscal policy during the 1980's, distinguished four lines of thinking: Monetarist, Neo-Classical, Neo-Keynesian, and Supply Side.

Monetarists believe that fiscal policy has no long-run effects, possibly some short-run allocative effects, and that monetary policy affects growth rates. Neo-classical economists believe that any anticipated stimulative fiscal policy will be offset by changes in household borrowing. Neo-Keynesians believe that stimulative government spending will result in significant crowding-out of private sector activity through higher interest rates. Supply-side economists want to shift resources from the public sector to the private sector.

Most of the major econometric models, said Berson, employ a variant of the neo-Keynesian model, where increased government deficits result in some stimulative effect, but with some crowding out of private sector investment. Fiscal policy, even in a high deficit environment, would have some stimulative effect. Berson agreed with Minarik's concern over timing of fiscal policy intervention.

> ***For programs for which benefits were calculated, 36 percent accrued to the lowest quintile, 18 percent to the second, 11 percent to the third, 12 percent to the fourth, and 22 percent to the upper quintile.***

Progressivity

Leading off the session on progressivity of the tax structure, Al Davis of the House Budget Committee discussed practical issues of measuring distributional effects of tax changes for the Congress. Some of the issues addressed were the use of static tables, the use of the one-year accounting period, problems with timing when provisions produce very uneven effects over time, methods of classifying income, and how results are presented.

Davis suggested that a relatively simple static approach of recalculating taxes produced reasonable distributional results in the case of the capital gains taxes, but in other cases such as changing the tax treatment of tax exempt bonds, economic relationships need to be taken into account. He also noted that reporting of results can be very misleading unless the baseline information on numbers of taxpayers and current income and tax liabilities are also reported. Tax changes are best expressed as percentage changes in after tax rates of return. There is a need for alternative measures of the permanent or life cycle effects of tax proposals.

Paul Menchik, of Michigan State University, presented new data allocating the benefits of Federal expenditures by income class. While a great deal of attention is devoted to the distribution of taxes by income class, there is relatively little attention to the distribution of expenditure benefits. His paper estimated distribution of transfer payments (such as OASDI and food stamps) as well as a variety of other direct spending programs such as highways, agriculture, and forestry.

As to transfer payments, 49 percent of the benefits are estimated to go to the lowest quintile and 25 percent to the second lowest. These aggregates are heavily influenced by OASDI and Medicare. The benefits of welfare programs are even more heavily skewed to the lowest quintile — 84 percent of housing assistance, 77 percent of food stamps, 77 percent of AFDC, 73 percent of SSI, and 68 percent of medicaid. Programs like workers compensation and unemployment compensation are spread more evenly over the population.

For programs for which benefits were calculated, 36 percent accrued to the lowest quintile, 18 percent to the second, 11 percent to the third, 12 percent to the fourth, and 22 percent to the upper quintile. Benefits in the uppermost quintile reflect largely the benefits of transportation expenditures for highways, air travel, and train travel. Farm subsidies also heavily benefit high income individuals.

Menchik suggests that an annual accounting framework, as opposed to a lifetime framework, may be more reasonable in the case of expenditure distribution. He notes one important caveat with respect to social security — that lifetime poor individuals do not live as long as lifetime rich individuals, suggesting that social security is not as redistributive as may be thought.

Lifetime v. the annual perspective of tax incidence was considered by Diane Lim Rogers, of Penn State University, in a paper coauthored with Don Fullerton, of the University of Virginia. Since incomes vary with life stage, some individuals are classified as relative low income simply because they are in a stage (young or old) where incomes are low; others characterized as relatively well off simply are in their peak earning years.

Their model of lifetime income allows Rogers and Fullerton to sort individuals into lifetime deciles, which can be compared to annual deciles. Their findings suggest that the uppermost and lowermost deciles of annual incomes correspond closely to the uppermost and lowermost deciles of lifetime income but that deviations are sizable in the middle deciles. The overall incidence of taxes appears to be close to proportional, with slightly heavier burdens in the upper and lower tails, very similar to annual incidence measures.

Lawrence Summers on "Corrective Taxation"

In a most provocative luncheon address Lawrence H. Summers, on leave from Harvard serving as Vice President and Chief Economist at the World Bank, made the case for more extensive use of "corrective taxation". These are taxes that internalize the marginal social costs of, for example, pollution-generating activities.

Summers focused his argument on the environmental effects of carbon emissions. We need not await a full understanding of the Greenhouse Effect. Enough is known already to make a compelling case for a tax of, say, $10 per ton of carbon content. Summers estimated that such a tax would raise some $13 billion in revenue and boost the price of gasoline about three cents per gallon.

The efficiency case for such a tax, Summers argued, is overwhelming, and criticisms on equity grounds are not persuasive. There would be some short-run dislocation due to the (small) increase in oil and coal prices but, he pointed out, when discouraging activities that are harmful, the objective is to create a certain dislocation. In all, he concluded, the case for doing something of modest size soon is one that cannot be denied.

Symposium Papers Available for Classroom Use

Papers from the NTA Symposium are an excellent set of supplementary readings in Public Finance courses, illustrating the expert application of analytical concepts and empirical measures to the most significant public finance issues of the day.

Professors who wish to order copies of the September issue of the *National Tax Journal* for classroom use should place orders with the NTA office as soon as possible.

The Symposium issue is expected to be available around September 25.

Quantity discounts are available.

State Tax Policy and the Federal Government

The session on State Tax Policy and the Federal Government opened with a paper by Jerry Goldberg, Executive Office of the California Franchise Tax Board, who cited almost a dozen bills introduced in the 101st Congress that would substantially erode states' ability to raise revenue. Such legislation, because it does not impact federal revenues or other direct federal interests, is often not the focus of intense scrutiny and yet can cause severe budgetary problems for the states.

One bill (H.R. 131) would prevent California from taxing pension income of individuals who made pension contributions in California but retire outside of California. Goldberg argued that these individuals, while living in California, were able to defer tax on the portion of their salaries and wages contributed to their pension plans. H.R. 131 would prevent California from recapturing that deferral if the pensioner leaves California. Other special interests seeking federal legislative "relief" from state taxation include foreign corporations, pipeline companies and telecommunication companies.

Goldberg also described the fiscal problems currently experienced by states. California's budget deficit, for example, is currently in excess of 30 percent of the state budget. States have been harmed by reductions in federal grants. Goldberg cited a GAO report showing that between 1978 and 1988 federal aid to state and local governments shrank by about one-third. However, at the same time, state and local governments became subject to hundreds of new program standards and regulations that significantly increased their cost of compliance.

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Next Dan Bucks, Executive Director of the Multistate Tax Commission, discussed IRC Section 482 transfer pricing, calling it a problem that seriously impacts on states.

He argued that there is significant evidence, both conceptual and practical, that the use of separate accounts to allocate income among separate taxing jurisdictions does not work. From a conceptual standpoint, it has been shown that in many circumstances it is not possible to calculate a specific transfer price in a related party transaction. From a practical standpoint, the IRS has found transfer pricing extremely difficult to administer. Audits consume thousands of hours of staff time and produce marathon litigation.

Bucks maintained that it is time to explore alternative methods of taxing businesses that function in an increasingly global marketplace.

Steve Pollack of KPMG Peat Marwick, offered two reasons why there has not been a greater movement by states to income taxes since elimination of the itemized deduction of sales taxes.

The first focuses on the relative change in the tax price of the sales tax versus the income tax. The tax price measures the portion of the tax that is not offset by reductions in federal tax liabilities. Pollack calculates that TRA86 increased the tax price of the income tax by 14.9 percent, while the tax price of the sales tax went up by only 8.2 percent. The increase in tax price for state income tax is due primarily to reductions in federal marginal tax rates. The increase in tax price for the sales tax is due to elimination of the federal itemized deduction for individuals and tax rate reductions for businesses.

Pollack's second reason focused on the possibilities for "exporting" the sales tax by forward shifting to nonresident consumers and backward shifting to nonresident owners of capital.

Tax Policy and Tax Exempt Organizations

Tax exempt organizations were relatively untouched by the Tax Reform Act of 1986, according to Dennis Zimmerman, of CBO, but Congress remains concerned about their current tax treatment. Questions arise as to whether nonprofits are using their tax exempt status to compete unfairly with for-profit firms, and whether they are providing social benefits commensurate with the value of the tax benefits they receive.

Zimmerman finds that suspicion abounds that some tax revenues are being wasted without commensurate provision of social benefits.

Market forces provide no guarantee that social benefits are produced by such firms. Zimmerman noted several ways in which nonprofit organizations might fail to provide adequate social benefits, including "philanthropic paternalism" (a tendency for voluntary sector activity to reflect preferences of the wealthy rather than the needs of the community as a whole); and violation of the nondistribution constraint (using funds for private gain rather than for the exempt purpose.)

Evidence of such "voluntary sector failure" is largely anecdotal. Yet Zimmerman finds that suspicion abounds that some tax revenues are being wasted without commensurate provision of social benefits. Pending federal legislation would increase the social benefits obligations of nonprofit hospitals.

Richard Steinberg, of Virginia Polytechnic Institute, addressed the issue of "unfair" competition by nonprofits. Here also (as with the issues considered by Zimmerman) adequate theoretical models remain to be developed and empirical evidence is sketchy, leaving us uncertain of the impact of tax and regulatory differentials on the behavior and performance of competing for-profit and not-for-profit firms. Such differentials are necessary, Steinberg asserted, if nonprofits are to play a distinctive role in the economy, e.g. through providing goods that for-profit firms cannot supply or providing price breaks for the needy.

Kevin Barrett, also of VPI, presented an empirical analysis of the effect of federal tax policy on charitable giving. Taxation has two effects: by reducing available income it tends to reduce charitable giving; but the deduction offers a price subsidy to giving. As to which effect predominates, past studies have produced conflicting results, depending largely on analytical methods used.

Using a method that tracks a panel of taxpayers over a period of years, Barrett found that current tax laws tend to stimulate charitable giving. He also found that tax changes can have significant effects in inter-year shifting of charitable contributions.

Pension Tax Policy

Katherine Utgoff's paper on Public

Policy and Pension Regulation identified as a major problem the "stagnation" in pension coverage. Since 1970 there has been virtually no increase in the percentage of labor force covered by employer-funded pensions.

Pension coverage is a function of firm size; virtually all workers in large firms are covered, far fewer in small firms. One explanation, in her opinion relatively minor, lies in the lower wages (and therefore less demand for deferred income) of employees in small firms.

The more significant explanation lies in the high administrative cost of private pension plans. For defined benefit plans, Utgoff cited illustrative data (1991) for per-employee costs of administration of $54 for firms with 10,000 or more employees compared with $455 for firms with fewer than 15 employees. Such costs for firms of all sizes have increased several fold between 1981 and 1991.

Complex regulations and frequent changes frustrate employers and discourage their provisions of pensions. Particularly troublesome in this connection are the nondiscrimination provisions. She supported as eminently reasonable the Labor Department proposal that would "allow employers with 100 or fewer employees to adopt a retirement plan that would be exempt from nondiscrimination testing if the employer contributes 2 percent of pay for all employees and maintains no other retirement plans."

Alicia Munnell, in Private Pensions: Are They Worth the Cost?, began by noting that there is a broad public interest in the so-called private pension plan structure, as the favorable income tax treatment accorded private pensions results in an estimated annual revenue loss of around $50 billion.

We must ask whether public benefits justify this large revenue loss. Do we get more saving? No, says Munnell. While no precise estimates are possible, it is clear that some fraction, probably 65-70 percent, of pensions saving is offset by lower saving in other forms. So, of the $150 billion of annual pension saving, only about $50 billion is net new personal saving. This just about offsets the $50 billion or so of revenue lost by favorable tax treatment.

Do we get a good pension structure? Again, Munnell answers No. Less than half the labor force is covered by private pensions, and the coverage ratio has "stagnated". Moreover the system has systematic biases. It covers mainly higher income workers, seriously penalizes mobile workers, and in most instances protects retirees inadequately against inflation.

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Munnell concluded that while the case for private pension plans may be strong, the case for special favorable tax treatment is not. Therefore she recommends a 2 percent annual tax on pension fund assets, which would just about recoup the revenue forgone by favorable tax treatment.

Daniel Ippolito's paper, How Recent Tax Legislation Has Affected Pension Plans, focused on the provision of the Omnibus Budget Reconciliation Act of 1987 that limits tax exempt contributions to defined benefit plans. Over time, this limitation will make defined benefit plans less desirable than defined contribution plans, which continue to receive full consumption tax treatment.

It is generally accepted that productivity is enhanced through long-tenure commitments of workers, which are encouraged by defined benefit programs. Ippolito pointed out that a tax policy that discriminates against this form of deferred wage contract tends to reduce productive efficiency. He recommended that the new limitations either be repealed or at least relaxed. ◆

From the Editor, (continued from page 1)

able to attend an advance look, this issue of the NTA Forum is devoted to summarizing the major points that were brought out. Unfortunately, it has not been possible to summarize the lively discussion that followed each set of papers. Only through personal attendance can one taste the full flavor of the Symposium. ◆

Future NTA Annual Conferences

November 10-13,1991
Williamsburg, VA
The Williamsburg Inn

October 11-14, 1992
Salt Lake City, UT
Little America Hotel

November 7-10, 1993
St. Paul, MN
Radisson St. Paul

November 13-16, 1994
Charleston, SC
Omni Hotel Charleston

International Tax Policy Papers Available

The proceedings of the April 20-21, 1990 invitational conference "International Tax Policy: Agenda for the Nineties" are available in Vol. 8, No. 2, and Vol. 9, No. 12 of *The American Journal of Tax Policy*. The National Tax Association was cosponsor of this conference, along with the American College of Tax Counsel and the ALI-ABA Committee on Continuing Professional Education.

The proceedings consist of papers and commentaries by many of the most distinguished authorities on international tax policy, including:

Charles E. McLure,
"International Aspects of Tax Policy for the 21st Century"

David R. Tillinghast,
"International Tax Simplification"

Sijbren Cnossen,
"Tax Harmonization in the European Community"

John S. Nolan,
"US Taxation of Foreign Investment in the United States"

Charles I. Kingson,
"Moving from a Credit/Deferral System fo an Exemption System"

H. David Rosenbloom,
"US Treaty Policy"

Joel Slemrod,
"Effect of International Tax Policy on International Competitiveness: A Study of the US and Japan"

Copies of these two issues may be ordered from the James D. Bryce, Editor, The American Journal of Tax Policy, P.O. Box 870382, Tuscaloosa, AL 35487. The cost is $11.00 per issue, $13.00 foreign.

Nelson Receives Distinguished Research Award

The Workshop on Valuation of Railroad and Public Utility Property, which has been cosponsored for the past 20 years by NTA and Wichita State University, offers an annual Distinguished Award in Applied Research. This $5,000 award, made on a competitive basis, is designed to encourage applied research in areas related to the appraisal of public utility and railroad property for ad valorem taxation.

This year, in the third annual competition, the winner is Thomas H. Nelson, for research on "The Impact of Regulation on Valuation of Public Utility Property for Ad Valorem and Just Compensation Purposes."

Nelson is Partner in the Portland, Oregon, firm of Stoel, Rives, Boley, Jones & Grey. His practice includes the areas of utility law, condemnation of utility facilities, and utility property tax.

Last year's award went to Michael Bell, of Johns Hopkins University, whose research on "Appraising Investor Owned Electric Utilities: How Important is 'Goodwill' ", will be presented at the Twenty-First Annual Program to be held at Wichita State University July 29 - August 1.

NTA Information Retrieval Service: A Handy Research Aid

NTA members who have tried out the year-old NTA Information Retrieval Service give the system high grades for promptness, completeness, accuracy and convenience. And the cost is very modest.

By a phone call, members can obtain a computerized search for information on any tax topic covering sources of all kinds — journal articles, dissertations, books, government publications, court opinions, news articles and conference papers.

To access this service, you simply phone 614-261-7099, identify yourself as an NTA member, and tell them what you want. They can help you define and delimit the search, which can be as detailed and comprehensive, or as cursory, as you wish. You will receive a bibliography listing the items available which you can then retrieve from your local library or other source, or order from the Service.

Cost to you, which reflects a 20% NTA discount, depends on the scope of the search and the time required. Usually it runs between $40 and $100.

For more information phone the above number, or NTA headquarters.

25 Years Ago with the NTA

Counter-Cyclical Fiscal Policy

"The individual income tax would probably be the most suitable vehicle for implementing short-run tax changes. Because of the withholding feature of the tax, the sensitivity of which has been increased through the recent adoption of a graduated withholding system, a quick impact on disposable income of individuals can be achieved. In turn, the influence of disposable income on consumption is probably the most prompt and reliable influence on aggregate demand that fiscal policy has to work with . . ."

Melvin I. White, then Deputy Assistant Secretary of the Treasury for Tax Policy, at the Fifty-Ninth Annual Conference, Denver, September 26-30, 1966.

New Members

The Association is pleased to welcome the following new members who have joined between March 31, 1991 - May 31, 1991.

NAME	STATE OR COUNTRY	NAME	STATE OR COUNTRY	NAME	STATE OR COUNTRY
J. Henry Ambrose	VA	H. M. Herath	Sri Lanka	David Reishus	MA
Susan Anderson	TX	Thomas M. Hoatlin	MI	Douglas B. Roberts	MI
James Barrese	NY	Steven J. Huddard	CA	David L. Rudd	MI
William C. Beck	CO	Lorraine Kennedy	VA	Debra Sanders	WA
Glenda Brock	TN	Stephen R. Kinnier	VA	Richard C. Sansing	CT
Bill Buckner	CO	Rebecca Koenzig	NC	Michael Schalewald	TX
Jane O. Burns	TX	Kommunalwissenschaftliches	Austria	Dennis R. Schmidt	WY
Nicholas Catalano	NJ	Karen B. Lanese	FL	Mark A. Segal	AL
Frank Coccaro	NY	Ebenezer Ligorji	GA	William M. Shobe	NC
Karen S. Cravens	TX	David C. Ling	FL	Paul Simko	TX
Thomas A. Dalton	TX	Michael H. Lippman	DC	Judith Lo Slykhouse	MI
James A. Dieleruterio, Jr.	NJ	James B. Mackie, III	VA	Mike Sobul	OH
Michael D. Doyle	TX	Fannie L. Malone	TX	Jan Sweeney	NY
Cynthia Eakin	FL	Frances McNair	MS	Judyth A. Swingen	NY
Ted D. Englebrecht	GA	Tod Middle	CO	Barbara A. Thiesen	MI
Stephen Fasano	NY	Thomas Moncada	IL	Robert K. Thompson	NJ
Arthur A. Feder	NY	Mrs. Oscar N. Mongoh	Cameroon	Mark A. Turner	TX
Carol M. Fischer	PA	Mark J. Nigrini	OH	Deborah H. Turner	GA
Ismail Ghazalah	OH	Walter O'Connor	NY	Robert G. Vandermark	MI
Lucy Glover	TX	Robert R. Oliva	FL	Melvin E. Van Vorst	MI
Sheryll A. Goedert	FL	Ronald W. Olive	NH	Richard A. White	SC
Ron Granner	CO	Cril Payne	TX	James C. Young	MI
Terri Gutierrez	NM	Tom Plaut	TX	Min Zhu	MD
Stan Hansen	IA	Thomas J. Purcell	NE		

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