People & Taxes

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Tax Policy Collides with Lax Regulatory Policy

. . . and the result is the Three Mile Island nuclear accident

On March 28, 1979, the Three Mile Island No. 2 Nuclear Generating Unit near Harrisburg, Pennsylvania, suffered the worst accident at a commercial nuclear plant in U.S. history.

In early April, Public Citizen released a study revealing a possible causal link between the accident and federal tax subsidies to utilities. In light of its findings, which are detailed below, Public Citizen has called on the House Ways and Means and Senate Finance Committees to study the possibility of eliminating the utilities' tax subsidies.

Contributing to the Public Citizen investigation were Michael H. Bancroft of the Litigation Group, Robert B. Stulberg of the Health Research Group, and Robert S. McIntyre of the Tax Reform Research Group.

Federal tax considerations may prevail over safety concerns in the decision on when to open a nuclear power facility, according to information recently obtained by Public Citizen. And in the case of the Three Mile Island facility near Harrisburg, Pennsylvania, the irresistable prospect of some $40 million worth of tax breaks for the current tax year may have prompted a premature opening, resulting in the nation's worst nuclear accident in a commercial plant to date.

Three Mile Island Reactor No. 2, the site of the March accident, went into commercial operation last December 30 at 11:00 p.m. By putting TMI-2 into service 25 hours before the year's end, the owners of the plant qualified for investment tax credits and accelerated depreciation

NUCLEAR, see page 2

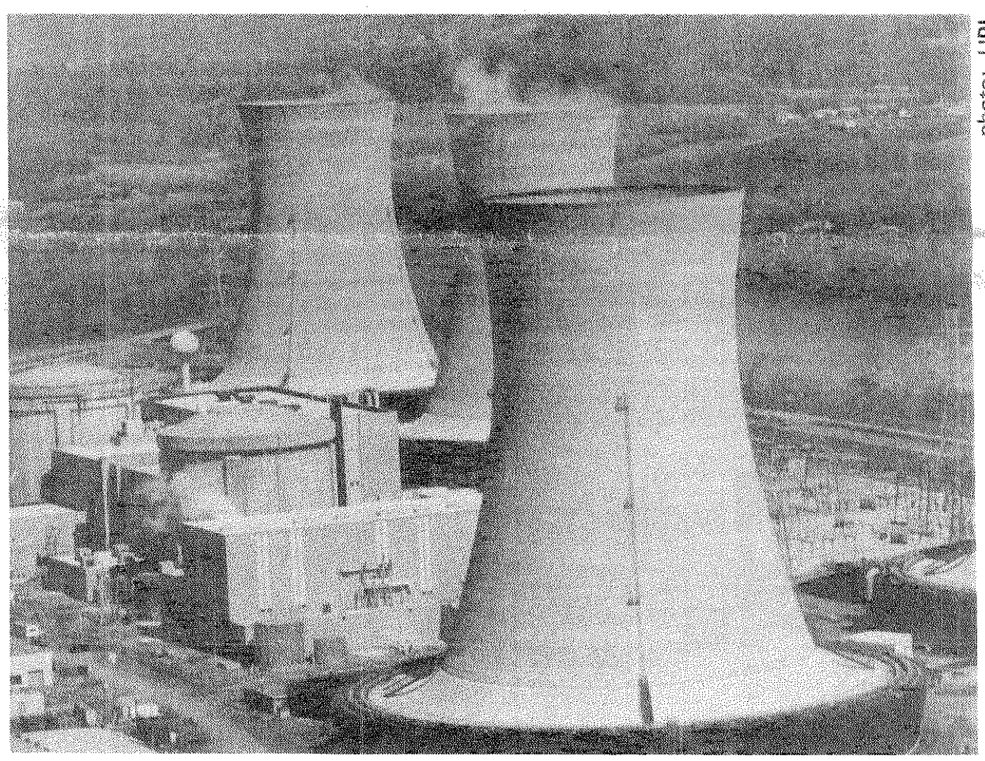

photo: UPI

Three Mile Island nuclear generating plant near Harrisburg, Pennsylvania, site of the March 28 accident. There is evidence that Reactor No. 2 may have been rushed into service before safety was assured in order to qualify the owners for federal tax breaks.

In this issue:

People & Taxes
P.O. Box 14198
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Three Mile Island

NUCLEAR, from page 1

benefits for 1978 tax purposes. Events leading to the startup of the facility, however, indicate that the owners may have rushed the plant into service at that time, in spite of technical difficulties, in order to take advantage of the tax benefits.

TMI-2: The Initial Operation

TMI-2 is owned by General Public Utilities, a giant holding company with three subsidiaries: Metropolitan Edison, with 50% share, and Jersey Central Power and Light and Pennsylvania Electric Co., each with 25% shares. Met Ed operates the plant and holds the Nuclear Regulatory Commission license, which was granted to TMI-2 in February, 1978.

Under the terms of its operating license regulations, before issuing the license, NRC had approved certain Met Ed reports, including detailed operating and startup procedures and tests which were to be performed before the plant could be declared to be in commercial service. Met Ed also was required to report to NRC problems and "reportable events" which had safety consequences, and to submit to NRC investigations and orders.

But the operational control of the plant—and discretion on when to declare the plant in commercial service—was left to Met Ed.

On March 13, 1978, Met Ed informed NRC that it planned to complete its testing and begin commercial operation by May 30, 1978. But on March 29, the day after the plant's reactor achieved a chain reaction for the first time, a fuse blew, causing the reactor to trip off. A relief valve in the primary cooling system's pressurizer failed to close, dropping coolant pressure in the reactor to the point where the emergency core cooling system was activated. The mishap became one of many to plague TMI-2, foreshadowing problems which would be linked to the breakdown of the plant exactly one year later.

In early April 1978, the reactor tripped twice due to spurious instrument signals. Then, on April 23, the plant suffered its most severe malfunction since the operating permit was granted. The reactor tripped again, resulting in a rapid loss of pressure in the primary cooling system. For the second time in 26 days, the emergency core cooling system was activated. The cause of the drop in pressure was found to be inadequate design of the main steam release valves, five of which opened and failed to close. The plant shut down for five months while engineers redesigned and replaced all the steam release valves.

The Tax Incentives

But while Met Ed's engineers were having difficulties with the reactor, the company's accountants were already counting the dollars which the new facility would bring the utility.

Under federal tax laws, the government provides two kinds of subsidies to utilities and other businesses for capital investment. One, the investment tax credit, allows companies to reduce their tax bills by approximately 10% of the cost of new machines and equipment. The other, accelerated depreciation, allows equipment to be written off much faster than it actually wears out. The tax deferral from the accelerated writeoffs is the equivalent of an interest-free loan.

TMI-2, with construction costs totalling about $700 million, was able to generate between $25-$40 million in investment tax credits for Met Ed and the other owners. Under the tax laws, however, most of that credit could only be claimed in the year TIM-2 was placed in service. Therefore, TMI-2's owners had a major financial incentive to put the plant into commercial service before the end of the current tax year—December 31, 1978.

According to documents filed by Met Ed and JCP&L with the Federal Energy Regulatory Commission, the companies were well aware of this tax requirement and were planning accordingly. In April 1978, Met Ed prepared a financial forecast which predicted net investment tax credits in 1978 totalling $10.9 million. 90% of that total was projected after mid-year, when TMI-2 was scheduled to go into service. In July 1978, JCP&L prepared a similar financial forecast which predicted net investment tax credits in 1978 totalling $23.9 million. The forecast showed credits soaring in November and December, when TMI-2 was then scheduled to go into service. Evaluation of these figures indicates that the owners of TMI-2 were anticipating investment tax credits of $17-28 million from the placing in service of TMI-2 in 1978.

Putting the plant in service in December would also permit the owners to take a half year's depreciation deductions on TMI-2. Because, as GPUC stated in its 1978 annual report, the companies "utilize liberalized depreciation methods and the shortest depreciation lives permitted by the Internal Revenue Code in computing depreciation deductions," the half year writeoff could result in a 1978 tax saving of approximately $20 million. This figure, plus the approximately $20 million available in investment tax credits, yields a total of about $40 million that the companies stood to gain by 1978 commercial service.

The lack of this $40 million in tax savings would have had a dramatic effect on GPUC's financial situation in 1978. According to the annual report, it would have reduced internal funds available for investment (after dividend payments) by 19%. It probably would have reduced borrowing capacity by an even greater amount. In addition, GPUC had based its projections in a series of utility rate cases on the prediction that TMI-2 would be in service in 1978 and that the tax benefits would be obtained. Without those benefits, the projections would have to be revised.

The Other Financial Incentives

Aside from the substantial tax incentive for placing the plant into commercial operation by December 31, the owners of TMI-2 had other reasons to move quickly. On May 31 and June 8 the Pennsylvania Public Utilities Commission prohibited the two Pennsylvania-based subsidiaries—Penelec and Met Ed—to raise rates in anticipation of TMI-2 starting commercial service. The commission declared that the companies would have to "begin commercial operation" before they could be eligible for a rate increase.

Another less measurable, but equally compelling incentive was the impact on shareholders and investors of placing TMI-2 on line. By including the plant as an operational asset in the 1978 annual reports, the owners could bolster shareholder and investor confidence.

The Return to Operation

With significant financial benefits at stake, the companies began a race with the calendar in September 1978. However, the plant's mechanical problems persisted.

After the turbine was ready to go again, the reactor went critical on October 17. Three days later, the reactor tripped due to its interaction with the secondary coolant system, which experienced trouble with the feedwater pump.

On October 13, the reactor was shut down to repair a broken valve in the pressurizer.

A faulty bearing which caused great vibration of the turbine on October 28 caused a three and one-half day shutdown for repairs.

An operator error involving improper closing of valves, which led to loss of feedwater, caused a reactor trip on November 3.

Another reactor trip occurred on November 7, again due to reduced feedwater from pump falure. The reactor core was slightly above normal for test purposes. Reduced primary coolant pressure brought in the emergency core cooling system again. Dials indicated that there was below-zero volume of coolant pressure, but Met Ed later reported that its calculations showed that the pressurizer was never empty.

On November 21, Met Ed later reported that the feedwater system was contaminated with turbine lubricating oil. This put the turbine out of service for the 11 days required to clean up the secondary coolant system.

About a week after the contamination occurred, Leonard Belter, an attorney for Penelec, wrote to the Federal Energy Regulatory Commission, where the utility was involved in a rate case. Belter explained that the oil contamination had delayed the date TMI-2 would begin commercial service until December 12, since "extensive efforts were necessary to ensure [the oil] was removed from all systems." Belter assured the Commission, however, that a "start-up and test program" was planned to "identify any deficiencies in design or construction."

The plant started up again on December 2. That day, it experienced persistent feedwater problems, resulting in a turbine trip and two

NUCLEAR, see page 9

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How Not to Balance the Budget

by Gary Robinson
and Robert S. McIntyre

Led on by cynical, unscrupulous, or just plain kooky politicians and national lobby organizations, the American people have become convinced that a constitutional amendment requiring a balanced budget will end big government, high taxes, waste, and inflation. Unfortunately, this just isn't the case.

When the polls show that Americans favor a constitutional amendment to balance the federal budget by a six to one majority, and when 29 of the required 34 states have called for a national convention to consider such an amendment, can the idea be all bad? Can the governor of California be accused of demagoguery for basing his 1980 presidential campaign on the convention issue? Can House and Senate Republicans be condemned as political opportunists for their strident calls for constitutional restrictions on federal overspending?

The answer to all these questions appears rather clearly to be yes.

The fact that attempting to enshrine a particular economic policy in the fundamental law of the land is a constitutional and economic absurdity is recognized by virtually all serious thinkers on the subject, ranging across the political spectrum. More than 400 of the country's leading economists, including three Nobel laureates in economics and seven former presidents of the American Economic Association, have signed an open letter criticizing the amendment as a "dangerous" idea. Walter Heller, who was President Kennedy's chief economist, calls the amendment's supporters "simply wrong." Arthur Burns, who based his career as a leading Republican economist on constantly advising a balanced budget, thinks the amendment is uncalled for.

Senate Budget Committee Chairman Edmund Muskie (D-Maine) says a constitutional requirement is "unworkable, counter-productive, and even irresponsible." House Minority leader John Rhodes (R-Ariz.) described the amendment as "inflexible" and "unworkable" in February, and told the *Washington Star* he continued to hold these views even after joining his Republican colleagues in calling for its adoption. Leading constitutional scholars like Lawrence Tribe of Harvard have condemned the proposal, and even an extremely conservative academic like Yale professor Robert Bork (of Watergate notoriety) has "reluctantly" concluded that an amendment is unfeasible.

If a constitutional amendment requiring a balanced budget is such a poor idea, why do a majority of Americans express support for it? What exactly are the problems with such an amendment? And why are some national leaders arguing for one?

The Public Perception

The American people think that the federal budget is out of control. They feel that excessive spending by the government leads to huge deficits which cause inflation. They believe that if individuals, families, corporations, and state and local governments must balance their budgets, the federal government should be required to do likewise. Led on by cynical, unscrupulous, or just plain kooky politicians and national lobbying organizations, the American people have become convinced that a constitutional amendment requiring a balanced budget will end big government, high taxes, waste, and inflation. Unfortunately, this just isn't the case.

Why It's a Bad Idea: The Convention Issue

Calling a national convention to consider a balanced budget amendment is such a dangerous idea that even the most far out advocates for such a convention, such as the National Taxpayers Union, admit in private that they are endorsing a convention only to put pressure on Congress to propose an amendment for the states to vote on.

There are two methods for amending the constitution. The most familiar is the congressional route: Upon a two-thirds vote of both the House and Senate, an amendment is submitted to the states for ratification. Alternatively, "[t]he Congress ... on the application of the legislatures of two-thirds of the several states, shall call a convention for proposing amendments." A convention has never been called pursuant to this clause, and our only relevant experience is the original constitutional convention of 1787. Called "for the sole purpose of amending the Articles of Confederation," this "runaway" convention ended up junking the Articles and writing an entirely new document — our present constitution.

Were a new convention held today, the overwhelming problem is that there would be simply no way to assure that the delegates would restrict themselves to the budget issue. Almost certainly interest groups would clamor for amendments involving such things as prayer in school, abortion (from both sides), taxation, voting, bussing, antitrust, and so forth. Of course, the convention might refuse to approve any amendments, and whatever it recommends would have to be ratified by three-quarters of the states. But even at best, the result of a convention would be terribly divisive, reopening all the national wounds of the last three decades. The dangers are real enough that minority leader Rhodes says he is supporting a congressionally-proposed budget amendment just to avoid the possibility of a convention.

The scope of the convention question is the biggest problem, but it is not the only one. Among the unresolved issues which would have to be decided are:

What constitutes a valid application by a state legislature for an amending convention? If a convention is called, who would be the eligible delegates? Must they be elected or could they be appointed, and if so by whom? Can Congress prescribe any rules for the convention? These

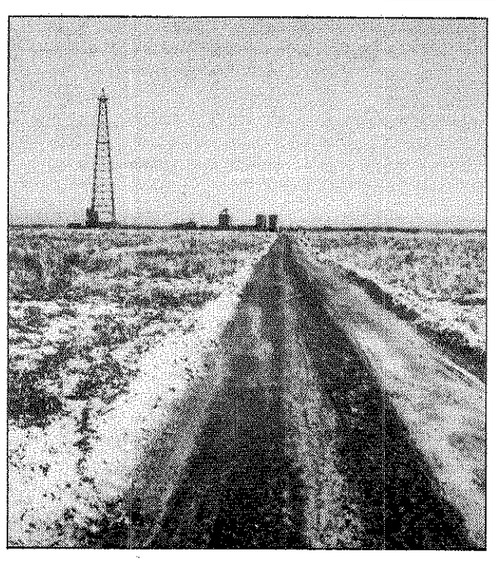
BUDGET, see page 4

"As surely as the sun will rise . . ."

As this issue went to press, President Carter had just released the details of his new energy plan, including the gradual decontrol of the price of oil, and a "windfall profits tax" on oil companies.

But "as surely as the sun will rise," said Carter, "the oil companies can be expected to fight to keep the profits which they have not earned."

The May issue of *People & Taxes* will give a detailed account of the tax aspects of the new energy plan, and a preview of the legislative debate to come.



Budget

BUDGET, from page 3

and many more questions lack answers because of the vagueness of the constitutional provision and the virtual nonexistence of historical guidelines.

A Congressionally-Proposed Amendment

A congressionally-proposed balanced budget amendment does not threaten to rend our basic social contract asunder, but it is still a terrible idea — in both constitutional and economic terms.

The constitutional problems with an amendment are legion. First of all, trying to graft a particular economic theory onto the constitution belittles the document. Fiscal austerity — though it may be sound as a current goal — speaks neither to the structure of government nor to the rights of the people. It fails to express the sort of broad and enduring ideals to which both the constitution and the country can be committed, not just for a decade or two, but for centuries. The only previous attempt to make specific economic policy in the constitution was the sanctioning of slavery — clearly a terrible mistake and since repealed.

Second, it is almost impossible to draft an amendment that works — and certainly impossible to draft one in language consistent with the simple and general language used by the framers of the current document. For example, a clause stating simply "The federal budget shall be in balance annually" has little meaning. Most states have similar constitutional requirements, which are evaded by defining the "budget" to exclude debt-financed capital expenditures. Were such a definition now used to evaluate the current federal budget, it would be in surplus by some $80 billion!

Imagine the task facing the founding fathers trying in the 1780's to define a budget that would be applicable to the 1970's. Should government lending programs be included in the definition of budget expenditures? Should it include off-budget programs that are presently excluded from the budget totals like the Federal Financing Bank, the Postal Service Fund and the Federal Reserve System? These off-budget outlays are expected to total $12 billion in fiscal 1980. What about privately owned government-sponsored enterprises like the Student Loan Marketing Association and the Federal Home Loan Mortage Corporation? It should be noted that until 1968 neither the expenditures nor the receipts of the federal government's huge trust funds (social security, highway, etc.) were included in the budget. If the budget did not include some or all of these things, the deficit could be transferred to them, thus circumventing the balanced budget mandate.

Such evasion problems have led some supporters of constitutional restrictions on federal spending to propose incredibly detailed amendments — one by Milton Friedman and the National Tax Limitation Committee, for example, runs some 430 words of gobbledygook (see box). Such proposals are affronts to the constitution, and even all their detail can still be gotten around, most notably by converting direct spending programs into (usually less efficient) tax expenditures.

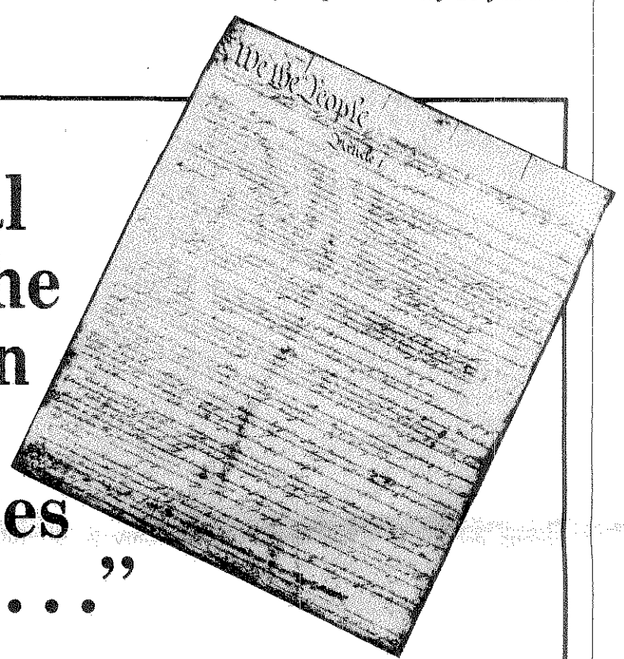
The Economic Issue

Even if an iron-clad amendment could be drafted, it would be very unwise. Suppose, for example, there were such an amendment, it's 1982, and the President's budget actually is in balance. And then suppose, for some reason, halfway through the year the economy starts to slip into a recession. As national income drops, tax revenues go down, too, and transfer payments rise. In order to rebalance the budget, Congress has to either cut spending or raise taxes or both. But such steps slow down the economy even further, causing a worse imbalance, so Congress must again raise taxes. Pretty soon, a mild recession has been converted into a major depression.

Sounds impossible? Take a look at 1974-1976, when President Ford's $4 billion deficit was converted by events into a $66 billion shortfall. If the balanced budget amendment had been the law, the result would have been an unemployment rate of over 12% — the worst since the Great Depression — and GNP would have dropped by 10%.

Over the 75 year span between the Civil War and World War II, the federal budget played little role in fiscal events, due to its much smaller size and the fact that national policy dictated that it be balanced annually. During this time there were five periods in which the unemployment rate exeeeded 9% for at least a year, an average of one major "panic" every 15 years. In

"A proposal to amend the constitution of the United States of America . . ."



If a constitutional amendment to restrict the federal budget should pass, the original language of the constitution might be joined by prose like the following, created by economist Milton Friedman:

Section 1. (a) Total outlays of the Government of the United States during any fiscal year shall not increase by a percentage greater than the percentage increase in the nominal gross national product during the last calendar year ending prior to the beginning of such fiscal year. If the inflation rate for that calendar year is more than three percent, the permissible percentage increase in total outlays during such fiscal year shall be reduced by one-fourth of the percentage by which the inflation rate exceeds three percent.

(b) For purposes of subsection (a),

(1) the inflation rate for a year is the percentage by which the percentage increase in nominal gross national product for that calendar year exceeds the percentage increase in real gross national product for that calendar year; and

(2) total outlays includes both budget and off-budget outlays, but does not include redemptions of the public debt or emergency outlays authorized under section 3 of this article.

Sec. 2. When, for any fiscal year, total revenues received by the Government of the United States exceed total outlays, the surplus shall be used to reduce the public debt of the United States until such debt is eliminated.

Sec. 3. Following declaration of an emergency by the President, the Congress may authorize, by a two-thirds vote of both Houses of Congress, a specified amount of emergency outlays in excess of the limit prescribed by section 1 for the current fiscal year.

Sec. 4. The limit on total outlays prescribed by section 1 may be changed by a specified amount by a three-quarters vote of both Houses of Congress. The change shall become effective for the fiscal year following approval.

Sec. 5. For each of the first six fiscal years beginning after ratification of this article, total grants to state and local governments shall not be a smaller fraction of total outlays than in the last three fiscal years beginning prior to the ratification of this article. Thereafter, if such grants for any fiscal year are less than that fraction of total outlays, the limit on total outlays prescribed by section 1 for such fiscal year shall be decreased by an equivalent amount.

Sec. 6. The Congress may not by law require or authorize any agency of the Government of the United States to require, directly or indirectly, that state or local governments engage in additional or expanded activities without compensation equal to the necessary additional costs.

Sec. 7. This article shall apply to the first fiscal year beginning after the date of its ratification and to each succeeding fiscal year.

Sec. 8. The Congress shall have power to enforce this article by appropriate legislation.

the 34 years since the end of World War II there has been no such downturn. The main reason has been the use of the federal budget to moderate recessions. A workable constitutional amendment mandating a balanced budget would almost assure a repetition of the depressions that plagued the pre-war era.

What then of the public belief that an uncontrolled federal budget is the cause of inflation, that the national government — unlike everyone else — has been living beyond its means, and that the people must demand restraint?

The public perception that the federal budget is out of control has some element of truth in it. In fact, three-quarters of current federal outlays are officially classified by the Office of Management and Budget as "uncontrollable" in the short term—because of past legislation or executive action or because of exogenous factors such as inflation and unemployment rates. But the fact of this short term uncontrollability actually argues *against* rigid solutions like a constitutionally-mandated balanced budget on an annual basis, and instead suggests that Congress and the administration should engage in more long range budget planning — where budget control is much greater. And in fact, both the President and the Congress are beginning to move toward setting multi-year budget goals.

As to the charge that government spending has induced our current inflation, experience shows that federal deficits are not necessarily inflationary. During the Great Depression of the early 1930's, prices declined drastically, despite the government running huge deficits. From 1959 to 1965, when there were big deficits, the inflation rate was little more than 1%. And in the face of huge deficits in 1974-76, price inflation dropped from over 12% to less than 6%. Thus, economists say that federal deficits exacerbate inflation only when used to pump more purchasing power into an already prosperous economy. Yet when the economy is slack or in a recession — when there are idle workers and machinery — a government deficit may be *needed* to help the economy get back on its feet by adding to the demand for goods and services. The ability to run a deficit of the proper size on the proper occasions increases the government's ability to stabilize the economy.

A *Washington Post* survey of the congressional sponsors of constitutional resolutions recently found an embarrassing dearth of specific proposals on how to balance the budget. The most frequent suggestion was to raise taxes, with "don't know" ranking a close second.

Despite the thinking of most Americans, individuals, families, corporations and state and local governments do not run a balanced budget. When people borrow money to buy cars, houses or machinery for their companies, they are doing anything but managing a balanced budget. They run huge deficits relative to their income.

As noted earlier, the states have balanced budgets only because they don't count capital spending. And even so, federal support, like revenue sharing, makes the state surpluses possible. In fact, the federal deficit next year will be about $30 billion—but $83 billion in federal funds is earmarked as aid for state and local governments.

Since World War II the *federal* debt has been the slowest growing major form of debt. While the federal debt is less than 3 times the size it was in 1950, consumer installment debt is nearly 14 times what it was then, mortgage debt 16 times, corporate debt 11 times, and state and local debt 13 times its 1950 level.

Although many opportunistic politicians have been quick to propose constitutional spending limitations or balanced budget requirements, they have been very slow to come up with details on how they would achieve their goals were their amendments adopted. A *Washington Post* survey of the congressional sponsors of constitutional resolutions found an embarassing dearth of specific proposals on how to balance the budget. The most frequent suggestion was to raise taxes, with "don't know" ranking a close second. Recently, a group of conservative House and Senate Republicans had to admit defeat in their attempt to cut a mere $9 billion of President Carter's proposed $29 billion deficit for fiscal 1980. And the National Taxpayers Union, which claims it can balance the budget, cut taxes by a third, and improve government services all at once, retreats behind vague exhortations to "cut the fat" whenever quizzed on specifics.

The point, of course, is that balancing the budget is not as easy as some would make it appear. Close to half the federal budget, for example, consists of benefit programs that respond more or less automatically to inflation. Eliminating or limiting such automatic increases would move us toward a balanced budget, but many Americans might not find the effects palatable. Among other things, the incomes of the elderly and disabled would not keep pace with inflation, defense readiness might be diminished, and less money would be available for health research, space exploration, mass transit, and development of alternative energy sources.

In fact, many of those in Congress who shout most loudly for constitutional curbs on federal spending are the least restrained when it comes to government expenditures through the tax system. These self-styled "fiscal conservatives" are all in favor of multibillion dollar subsidies like tuition tax credits, bigger exclusions for capital gains, investment credits for giant corporations, and the like. The National Taxpayers Union supports "all loopholes, categorically." Yet the total of over $130 billion in such back door spending dwarfs the federal deficit of $30 billion, and is a major reason for high federal tax rates on average citizens.

In the midst of all the often hypocritical rhetoric, programs are being devised and steps are actually being taken by more responsible leaders which will move toward elimination of the country's budgetary imbalance.

As a proportion of GNP, the budget is being reduced from 22.6% in 1976 to 21.2% by 1980. The ratio of the deficit to the GNP has been cut by two-thirds, from 1.6% in 1975 to a projected 1.4% in 1979. According to the Congressional Budget Office staff, President Carter's proposed $531 billion budget for 1980 falls $20 billion short of the amount that it would cost simply to maintain current services. The public certainly has a right to demand a continuation of that process, but it will be ill served by quack remedies like a constitutional budget amendment. □

How to balance a budget? Let us count the ways . . .

Although details vary widely, most of the various proposals adopted by states or proposed in Congress to impose constitutional restrictions on the federal budget fit into one of two categories: balanced budget requirements and spending limitations.

Typical of the balanced budget proposals is the amendment put forward by the National Taxpayers Union, which provides simply that the federal budget must be "balanced" in the absence of a "national emergency." None of the operative words are defined.

Some of the state petitions *have* sought to shed light on the meaning of "balanced budget." For example, ten states have passed applications saying that (in the absence of a national emergency) "the total of all federal appropriations made by the Congress for any fiscal year may not exceed the total of all estimated federal revenues for that fiscal year." Four more states have passed a similar resolution but added a clause which excludes from total revenues all funds derived from borrowing.

Other proposals call for a balanced budget only in years of strong economic growth, while still others merely exhort Congress to "seek to assure" a similitude of outlays and revenues.

Recently, the National Taxpayers Union has encouraged states to make their calls dependent upon the legality of limiting the convention solely to the balanced budget issue.

Spending Limitations

The leading spending limitation amendment is the 430 word monster proposed by Milton Friedman and the National Tax Limitation Committee (see box, opposite page). It would limit each year's percentage rise in total federal outlays to the percentage increase in the GNP during the preceduing year—and the allowable percentage increase would be reduced by one-fourth the rate of inflation above three percent.

Senator Bob Dole (R-Kans.) has proposed an amendment that would restrict federal outlays to no more than 18 percent of GNP. A proposal by Senator James McClure (R-Idaho) would restrict spending to one-third of total national income.

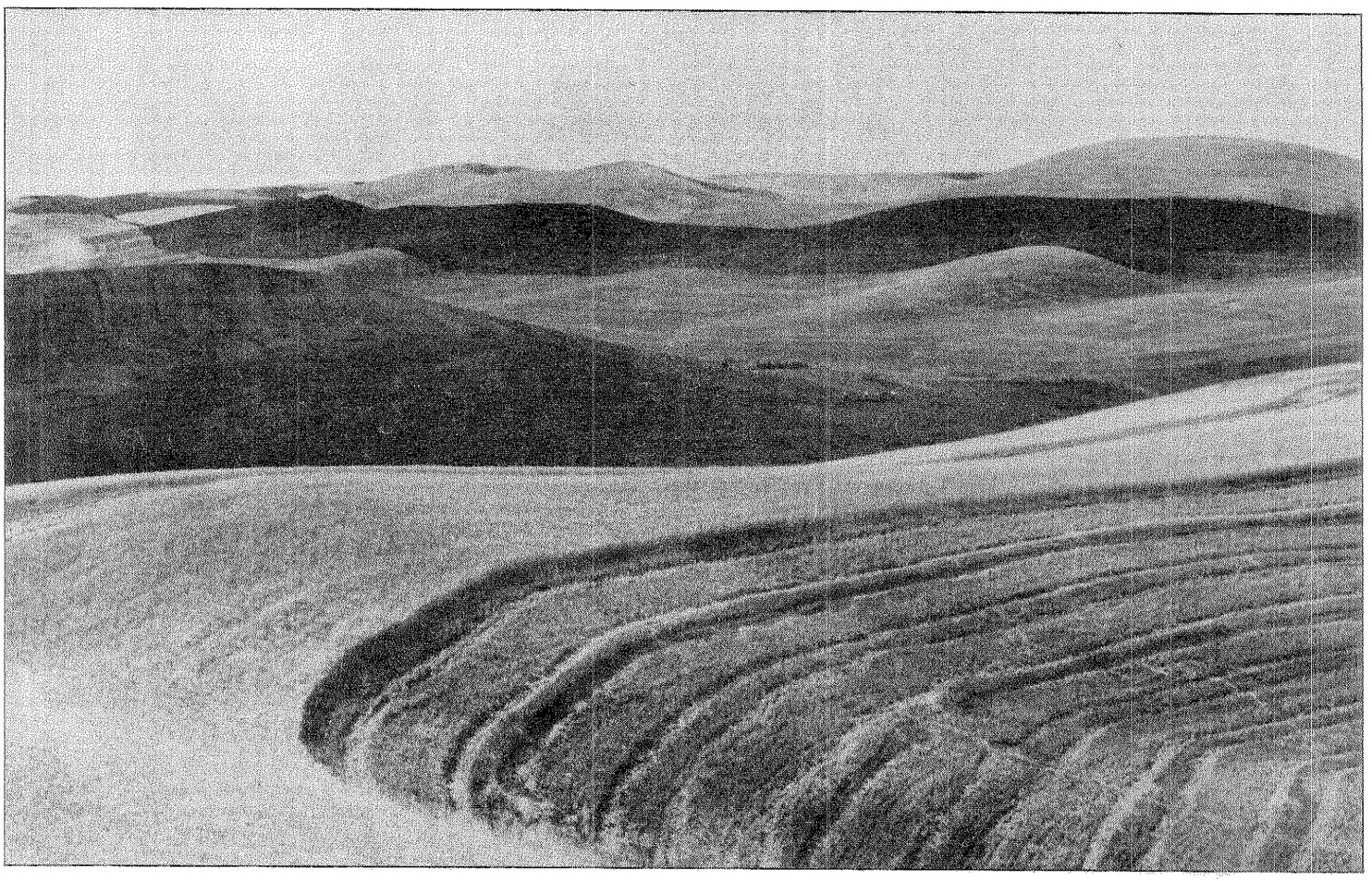


photo: USDA

The Farmland Dilemma

States and localities are trying to save farmland by preferential assessment for tax purposes — but their efforts are backfiring

Editor's note: The following is excerpted from the book Tax Politics, *by Robert M. Brandon, Thomas Stanton, and Jonathan Rowe. See the back page of this issue for details on ordering.*

Over the last twenty-five years the number of farms in the United States has declined from 5.4 million to 2.9 million. Urban sprawl is wiping out 1.5 million acres of farmland a year. If cropland continued to be lost at the rate of the late sixties, there would be none left in one hundred years.

The losses have been even more striking in particular states and regions. California has been losing an estimated 375 acres to development daily. That is the equivalent of 600 generous-sized homes or ten giant discount stores every day. New Jersey, though still calling itself "America's Garden State," has lost about 44 percent of its farmland since 1950, and the federal government predicts that in fifty years only 8 percent of the state will be in farms. Around Washington, D.C. the development since 1960 of Maryland and Virginia farms, forests, and open lands, has exceeded an area twice the size of the District itself. Massachusetts has lost one-half of its farmland in the last twenty-five years.

High agricultural prices and interest rates have combined to slow this trend temporarily. But in the long run, no curbing of our destruction of food-producing land is in sight.

Farm property taxes almost doubled as a percentage of farm income between 1950 and 1968, and the United States Department of Agriculture reports that today the average farmer pays 7.7 percent of his personal income in property taxes while the average homeowner pays 4.4 percent. In suburban areas, where land values are higher, the farmer's taxes are much higher than the national average. Farmland values have gone up over 9 percent per year during the last several years, and the increase between 1973 and 1974 was more than 15 percent. Farmers, and others with large land-holding but small cash incomes, often find themselves hard-pressed to pay their taxes, and sell their land instead.

The connection between rising property taxes and the loss of farmland seems to be so clear that efforts to preserve farmland and open space have centered on property tax breaks for their owners. The reasoning is that farm operations cannot support property property taxes which are levied on normal "fair market value" assessments. The solution appeared simple: change the standard for assessments. Permit assessments based on the value of the land for *farm use* only, as though developers and speculators were not interested in it. Thus the name "use-value" assessment. This is what the special farmland tax laws have done.

In some states land other than farmland can qualify for the breaks: forest land, "horticultural" land, marsh land, flood plains, quarries, and land of scenic beauty.

To lower taxes, three main types of assessment breaks have been enacted.

- **Current-use, use-value or preferential assessment**

In some states any land that meets normally broad standards can receive a special use-value assessment regardless of where it is and who owns it. The land may have to be a minimum size (five acres in Delaware), produce a minimum amount of crops ($500 worth in New Jersey), and/or have been in farm use for a minimum number of years. Owners who later sell the land for development or develop it themselves incur no penalty and are not responsible for paying back any of the taxes they avoided. This is key: under simple use-value assessment there is no deterrent to development. It is a free gift to the landowner.

- **Deferred taxation or use-value assessment with rollback**

In other states the taxes are not completely forgiven. Instead they are *deferred*. Landowners get the use-value assessment as long as they keep their land undeveloped. But when they sell their land for development, or change its use, either they or the buyer have to pay back part of the property taxes they avoided through the low assessment. This rollback pays back the community for the taxes it excused in vain; and deters the owner from developing the land.

In practice, however, the rollback is usually too weak to do either. In New Jersey, a landowner who takes a farmland assessment break and then sells his land or develops it has to pay a maximum of only two years' avoided taxes, plus regular property taxes for the current year. Similarly, in Minnesota the maximum rollback for agricultural land is three years. In some states the rollback includes interest; in others, not. Connecticut takes a slightly different approach. Instead of a rollback, Connecticut imposes a

transfer tax at the time of sale. The tax is 10 percent for land held only one year. But it phases out gradually so that there is no tax at all when land held over ten years is sold.

● **Restrictive agreement**

In some states a landowner seeking a special use-value assessment must sign an agreement promising not to develop the land for a period of years — ten in California, Hawaii, and Washington, eight in New York State. In some cases, such as Pennsylvania, California, and Hawaii, land must be designated for farm or open-space use on a local land-use plan in order to qualify. Penalties are normally severe for landowners who break the contract. Also, landowners who choose not to renew their contract may be subject to rollback taxes. In Hawaii the owner of benefited land who changes its use must pay back all the taxes avoided even if the contract has expired.

As mentioned, commonly there are requirements concerning acreage, agricultural production, income, and/or inclusion in a local plan for use-value assessments. Perversely these can exclude genuine small property owners who want to keep their land unspoiled, while favoring large corporate and conglomerate landholders who have the land mainly for speculation and could probably afford the taxes anyway. In some states the local government can decide whether or not to include particular parcels of land. In California the state compensates local governments for part of the property tax assessment cuts, but in most states local taxpayers have to bear this cost themselves.

Another form of assessment break for farmers is the *classified property tax* system in which property is assessed at different percentages of full value, according to type, with farmland always at the bottom of the scale. Under classified property taxes the assessment break goes to all farmland, regardless of where it is and who owns it. And of course there is no penalty if the owner sells it or changes its use.

Do Assessment Breaks Work?

Even as the use-value assessment programs have spread from state to state, the verdict on them has been clear: They do not work. They have, to be sure, granted temporary property tax relief to some small farmers and rural landowners, perhaps keeping them on the farm a bit longer than they would stay otherwise. But in fulfilling the promises made to voters that they would preserve farmland and open space, they have been failures. New Jersey was losing a larger proportion of its farms each year after its farmland assessment program was enacted in 1965 than before. Even the executive secretary of the New Jersey Farm Bureau, a big booster of the law, had to admit, "whether (it) has been really effective in slowing conversion of farmland to other uses is debatable." In Connecticut land near urban areas has been dropping out of the state's farmland assessment program. After a visit to Maryland to witness the results of that state's farmland assessment program, noted conservationist William Whyte wrote in his book *The Last Landscape:*

> as far as the eyes could see...preferential assessment was not saving open space. Maryland counties were being developed at about the same rate and the same fashion as suburban counties elsewhere; subdivisions were going up in the usual scattered pattern and to judge from the "for sale" signs that were to be seen on farms, the scattered pattern was certainly going to continue.

A candid state official in Rhode Island replied to a U.S. Senate survey by saying that the farmland assessment law there "is largely ineffective in preserving open space, but does provide a tax shelter for land speculators."

It would be bad enough if the farmland assessment programs simply had failed to preserve open space. In fact, they have often intensified development pressures. By encouraging speculators to hold close-in land off the market temporarily, developers have been encouraged to go deeper into the countryside in search of land they can afford. The area of development expands and once the roads and utilities have been extended out to these hinterlands, the closer-in land is doomed. In California, by removing the lower grade farmlands from potential development, the assessment breaks have actually focused development pressures on the state's best and most vulnerable lands.

The farmland assessment laws work as a narcotic, lulling the people into thinking that the countryside is safe and that all is well.

The assessment breaks have made farm real estate a choice investment for developers and all kinds of corporations with extra cash. These bid ever more eagerly for the available land, causing assessments and thus property taxes to increase. The high prices in turn entice more genuine farmers into selling. And as more land is enrolled into the farmland assessment programs, local governments try to attract business and industry to make up for the lost revenues — causing the tax breaks to encourage the very thing they are supposed to prevent.

Finally the farmland assessment laws act as a narcotic, lulling people into thinking that the countryside is safe and that all is well. They heard the grand promises that attended passage of the programs. They see pretty farms, unaware that developers have simply leased them to farmers in order to qualify for the assessment break, while they are waiting for the land value to peak. By the time the bulldozers move in, it is too late to do anything to stop them.

As to the rollback penalties, a Maryland assessor computed that speculators actually would come out better with the rollback tax penalty, since this tax replaced the former transfer tax. A Connecticut assessor reckoned that a speculator who held a parcel more than five years would come out ahead after paying that state's special penalty tax. A land speculator described New Jersey's two-year deferred tax penalty by saying that "It ain't nothing."

A look at the assessment rolls shows just how heavily speculators and corporate sodbusters — as opposed to Farmer Browns — are benefiting from the use-value assessment laws. A moment's reflection suggests why. Before values start escalating, the laws aren't needed. By the time they are, the developers are already in on the action. In New Jersey, a study by the Princeton-based Center for the Analysis of Public Issues showed that International Utilities Corporation (IUC) and Levitt and Sons are getting big tax cuts on thousands of acres under the state's farmland assessment law. In one township, a subsidiary of the Atlantic City Electric Co. has been getting an assessment break of 90 percent per year on a 182-acre tract for which it has had approval to build a planned unit development since 1969.

FARMS, see page 8

photo: USDA

Farmland

FARMS, from page 7

According to Senate testimony, the huge Humble Oil Refinery in Linden, New Jersey, has put 303 acres under the special assessment program.

Of all the corporate land-subsidy programs disguised as property tax breaks for farmers, California's is probably the largest. In 1971 it encompassed over 9.5 million acres, an area larger than New Jersey, Rhode Island, and Connecticut put together, comprising one-quarter of the agricultural land in the state. In 1970 over one-fifth of the land affected by the Williamson Act was held by only ten companies, including Tejon Ranch (Los Angeles Times), Southern Pacific, Kern County Land (Tenneco), Standard Oil of California, the Irvine Co., and Getty Oil. (The second ten on the list are more of the same.) These ten top needy farmers received almost $5 million that year in property tax reductions.

Use-Value Assessments — What Are the Costs?

Paying the largely corporate landowners while they wait to develop their land is costing state and local taxpayers millions of dollars directly. The indirect costs probably run into the billions.

These are costs the local taxpayers must bear. As millions of suburbanites have learned from sad experience, they could almost tell without looking out the window how rapidly the remaining local farmland is being ranch-housed. They need only look at their property tax bill. Ventura County, California, once estimated that by 1980 local farmers would be paying $15.7 million in property taxes while receiving only $.4 *million* in services. (The study apparently omitted, however, the biggest service of all that farmers receive: the increased value of their land, accruing from public expenditures, which they did not realize immediately.) By contrast, the county found that residential areas would cost $96.9 million in services while bringing in only $39.7 million in taxes.

Newcomers moving to these sprawling suburbs have to share the costs, right along with the older residents. They have to pay more for their homes, since the use-value assessment laws enable landowners to hold out until they can get a higher price. Even when such landowners have to pay a "rollback" penalty, in today's tight housing market the levy just gets passed along to the housing consumer. New home buyers have the costs — in time as well as money — of long commutes and of general dependence on the automobile.

Other Problems

The basic problem with the use-value assessment laws is that they deal only with the symptoms of development pressures. We bribe the owners of open land not to develop it. Then we sit back, cross our fingers, and hope they won't. But the bribe works only as long as no one comes along offering a better deal. Any effective plan to save farmland and open space must somehow counterbalance the forces that drive up land values.

Three federal programs – highways, housing-subsidies, and income tax loopholes — are fueling much of the rush for land that is driving up values and property taxes. The federal highway program has devoured about 100,000 acres per year. Where highways go, housing developments, shopping centers, industrial parks, gas stations, and Burger Kings are soon to follow.

Federal housing policies — and FHA-insured loans in particular — have been heavily biased toward new single-family homes in the suburbs. The overall effect of government housing programs since 1934 has been to construct thirteen homes in the suburbs for every public housing unit in the center cities.

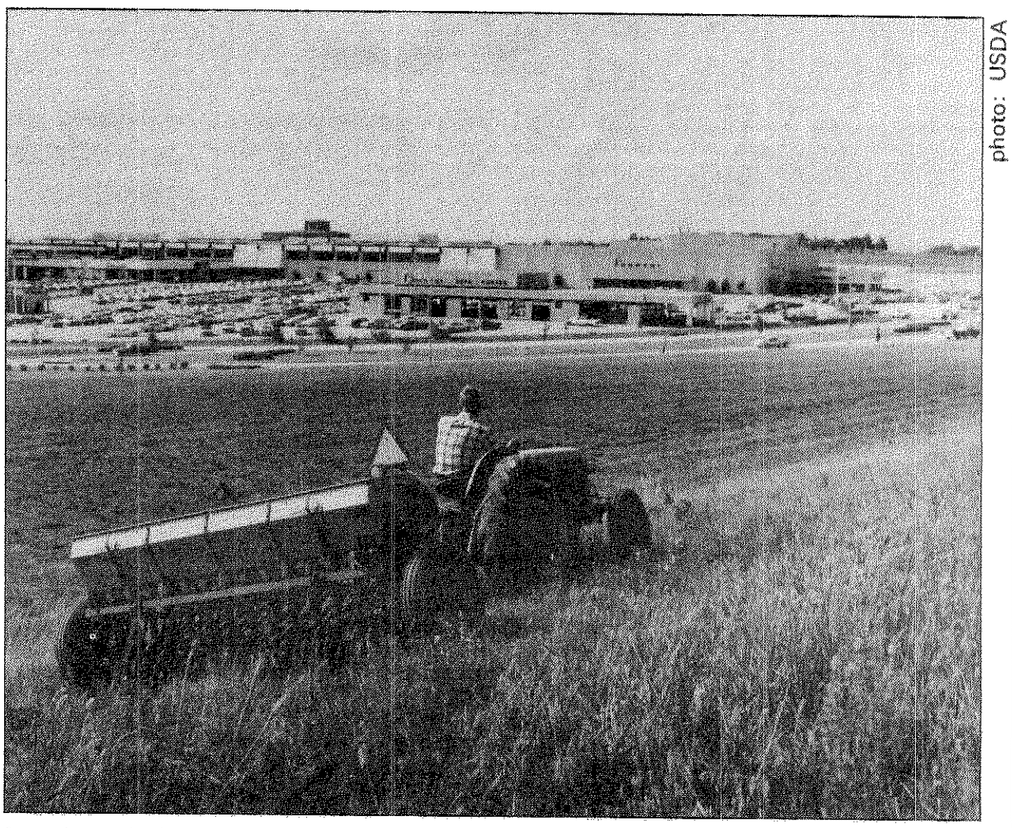


photo: USDA

The federal income tax laws encourage speculators to buy up land, let highways and other publicly financed projects pump up its value, and then sell it and be taxed only at the 40 percent "capital gains" rate. Capital gains often can be combined neatly with the special tax breaks for farmers and tax loss farming. Property taxes and mortgage interest deductions help create the market for houses.

Farmers are using more machinery to farm efficiently, a trend encouraged by the U.S. Department of Agriculture. To justify the cost, farmers have to expand their operations. High farmland values put the purchase of land often beyond their reach and the farmers opt to rent land from a corporation. Thus the use of more machinery helps create a demand for leased land that encourages corporate land buying.

Roads, water, and sewer programs in large measure determine which property is developed and which landowners become rich. They can drive up the land value so that the farmer can no longer afford the property taxes. Front footage assessments drive the nail into the coffin. They are a fee the local government levies on landowners for sewers, water mains or sidewalks that run past or across their property, supposedly because these *improvements* enhance the property's value. A charge per foot of a sewer running alongside acres of farmland can run into thousands of dollars.

Developers and speculators also can drive farmers off the land by using their influence to change property tax assessments. Pressuring the local government to perform a *reevaluation* is one way this is done. Another is to buy a small parcel of rural land at far more than it is worth. The assessor, looking at that sale, assumes that all the land in that area is actually worth that much. He hikes the farmers' assessments, and the "For Sale" signs go up soon thereafter.

State and local governments often harass farmers with or without the encouragement of developers. They cut through their land with highways, sewers, gas mains, and power lines, disrupting farm operations so much that the farmer just throws in the towel. Painful experiences with the government's right of *eminent domain* have conditioned many farmers to bristle at the suggestion of "planning" or interference of any kind with their land.

In short, increased property taxes are just a symptom of the bundle of policies and pressures that are causing the demise of farmland and open space. Nevertheless, they are critical not only for individual farmers, they are a definite inconvenience to speculators. They impose a cost on holding the land until the profit potential peaks, which cuts into ultimate profits and possibly even forces an owner to sell before he wants to. Thus it comes as no surprise that in some states the big-farm and real estate lobbies have financed expensive campaigns to win voter approval of tax-break referendums. The New Jersey campaign, which went under the slogan "Save Open Space in New Jersey," was staffed by top professionals on leave from two agribusiness concerns. In California some of the largest property owners in the state contributed heavily to the 1966 campaign to pass "Proposition 3," a constitutional amendment allowing the state legislature to enact special low assessments for farmland. A California property tax break for exclusive private golf courses, approved by the voters, was similarly decoyed by the slogan "Keep California Green." □

Next month: some alternatives

To the Rescue of the Free Press

by Anne G. Witte

If it ever became apparent that the future of the apple pie was threatened — if, say, bakers found it more advantageous to make Black Forest cherry tarts — no doubt some sentimental legislator would concoct a tax break for bakers and apple growers, dub it the "Golden-Crusted Apple Pie Preservation Act," and promote it as the "only way to guarantee protection of one of the most widely-recognized American traditions."

Subsidizing cherished American traditions through the tax law, it seems, has *itself* become traditional. In 1976 the legislators were concerned about the decline of the family farm, so they enacted changes in the estate tax on farmland. They were concerned, too, about other small family businesses, and allowed them to defer payment of estate taxes. (Last year they extended that tax break to the Gallo wine company — the rationale perhaps being that, although the multi-million dollar enterprise does not qualify as a "small" family business, California wine *is* a cherished American tradition and the government and taxpayers should contribute to its financial well being.)

Now the legislators are worried about another American institution, the independent newspaper. The cause for concern is real enough: Newspaper chains are buying up local independent papers at a rapid rate — according to Rep. Morris Udall (D-Ariz.), about 50 or 60 papers a year. If that rate continues, Udall warns, there may be no independent dailies left in the country in ten years.

Part of the aversion to that trend is for emotional reasons: Seeing the local newspaper sell out to the large chain is as offensive as the corner store falling prey to the supermarket. But with newspapers the problem is more than one of aesthetics. Observers are legitimately concerned about both maintaining the papers' editorial autonomy and promoting journalistic quality over profits. The implications of large numbers of local papers being controlled by a few powerful newspaper chains are not to be taken lightly.

Thus the reasons for wanting to protect the independent papers are sufficiently compelling. The problem is that under the guise of doing so, the legislators are apparently willing to play havoc with the tax code — the estate tax in particular. And there is very little indication that their tampering with the tax will actually help any independent papers.

Originally intended as a means for limiting the transfer of excessive amounts of wealth, the estate tax has recently become so diluted that 98% of all estates are completely exempt. *Any* estate tax relief, then, would accrue to the remaining top 2% of estates, whose need is, to say the least, highly questionable.

Udall and the other apologists for the independent papers, however, rather simplistically point to the estate tax as the reason so many papers are selling out to newspaper chains. They maintain that, since the chains are willing to pay inflated amounts for a paper (as much as 50-60 times the paper's annual earnings, apparently, when a more realistic value would be about 10 or 15 times earnings), and the IRS sometimes values the paper at the higher level for estate tax purposes, it makes more sense for the owner to sell the paper than to saddle his or her heirs with an exorbitant estate tax bill.

Of course, a business can always *prepare* for estate taxes, by saving a portion of its income for that purpose. And Udall wants to encourage the independent papers to do just that. But while any other business would first pay taxes on its earnings and *then* set aside savings, Udall proposes to give newspapers an *incentive* to plan ahead. The independent papers could set up a trust fund for future estate taxes, and any amount put into the fund (up to 50% of the paper's annual earnings) would be tax deductible. In addition, interest earned by the trust would be exempt and the fund itself would be excluded from the taxable estate. Finally, payment of any estate taxes on the paper not covered by the trust could be extended over 15 years, at a low interest rate. This provision already applies to qualifying small businesses — including newspapers — but Udall would extend it automatically to all independent papers regardless of need.

If the estate tax were in fact the only deterrent to the papers' continued operation, Udall's generous proposal could conceivably convince some newspaper owners to keep their papers — albeit with a $10 million cost to other taxpayers. (Another way to achieve the same result, though, with considerably less damage to the tax code, might be to require the IRS to make more realistic valuations of small businesses for estate tax purposes, based on annual earnings instead of artificially high selling prices.)

However, a number of other factors obviously play a roll in an owner's decision to sell — among them the reluctance of the heirs to take over the business and the eagerness of the chains to buy (and the prices they are ready to offer).

But while Udall's bill therefore might not have its desired effect, to discourage owners from selling papers to the chains, it would almost certainly *encourage* other industries to request the same tax treatment. Supporters argue that only papers are allowed the special benefits, because they alone are protected under the First Amendment to the constitution. (The constitution also guarantees the "right to bear arms" but no one is suggesting special tax treatment for gun manufacturers — yet.) But Udall himself has said that, after experimenting with independent newspapers, Congress might extend his proposal to other deserving industries. The question would then become which industries are "deserving." □

Although Udall's bill probably wouldn't have its desired effect — to discourage owners from selling their newspapers to the chains, it would almost certainly encourage other industries to request the same tax treatment.

Nuclear

NUCLEAR, from page 2

reactor trips. The emergency core cooling system kicked in on the last turbine trip.

Continued feedwater problems resulted in shutting off the turbine on December 16 for feedwater pump repair. This consumed six days.

The Eleventh Hour

The plant finally reached 97% power on December 27, permitting scheduling of the required full power trip test for December 28. NRC inspectors were present to witness the test. After successful completion of the test, the unit was shut down to repair steam leaks.

At 11:00 a.m. on December 30, the turbine was shut down to repair more steam leaks. The turbine was reactivated at 2:15 p.m. and the power level was increased. 80% power was reached at 10:20 p.m. With just 25 hours left before the end of the 1978 tax year, TMI-2 was declared to be in commercial service at 11:00 p.m. on Saturday, December 30.

The Aftermath

The owners of TMI-2 quickly began to realize financial benefits from the decision to place the unit in commercial operation. In January 1979, the Pennsylvania Public Utilities Commission granted Penelec an increase of $56.2 million in retail base rates, of which $26.4 million was attributable to TMI-2. Two months later, Met Ed would gain a $49.2 million hike from the Pennsylvania Commission.

In addition, the companies' annual reports all heralded the plants as a "major milestone" contributing to "a memorable year." The annual reports also announced decreases in tax due in part to "the placing in service of the TMI-2 nuclear generating unit in December 1978."

However, the operational problems continued. During a turbine trip test on January 15, 1979, a steam bellows ruptured and power to the pressurizer in the primary coolant system was lost, causing a reactor trip. The reactor was out of service for 17 days for repairs.

On March 28, 1979, improperly closed valves in the secondary coolant system, malfunction of a feedwater pump, a relief valve in the pressurizer sticking open and failure to operate the emergency core cooling system properly led, as far as is now known, to the most serious commercial reactor accident in U.S. history. The accident caused incalculably grave injury to public health, and as yet unmeasured financial cost.

On April 3, 1979, Richard Muranaka, chief of NRC's Operating Data Section, which evaluates the Monthly Operating Reports filed by utilities prior to commercial operation, explained in an interview that the NRC does not get involved in deciding the date a plant can begin commercial operation. "When NRC grants an operating permit, the company is authorized to operate," he said. "When the company puts the plant into commercial operation really depends on their tax structure. There's some tax advantage for a plant to go into operation before the end of the year. This is particularly evident when a plant goes into operation late in the year." □

The Business of Tax Breaks

How big business fights for its tax subsidies

Editor's note: Frank Domurad recently joined the staff of the Tax Reform Research Group as the state and local coordinator. This article begins a series on business and taxes.

by Frank Domurad

While corporate public relations departments would like to have the public believe that "business is at work for America," most realistic observers are fully aware that business is at work for business. Nowhere is that quite as clear as in the federal and state and local tax structures, where for years business has worked steadily at procuring for itself every possible tax preference.

Capital gains provisions, investment tax credits, accelerated depreciation of personal property, depletion allowances, and real property tax abatements are but a few of the rewards it has received for its efforts.

But recently the business community has become uneasy. Since taxes have become an issue of intense public interest, overburdened low and moderate income taxpayers are suddenly curious about why their taxes are so high. They want to know not only how their tax money is being spent but also from whom it is — or is not — being collected. Such public inquisitiveness, as far as big business is concerned, could easily disrupt its tranquil routine for amassing treasure at the nation's expense.

A Roper poll taken last year shortly after the passage of Proposition 13 in California substantiates business' suspicions. Almost half of the people questioned said that what disturbed them most about taxes was the unfairness of the system. Only 14% said that high taxes were the problem, and even less thought it was the way in which money was spent or wasted. But most importantly, nearly three-quarters of the respondents felt that high income families and large business corporations paid too little in taxes.

To protect its interests from public wrath against unfair taxes, business recently has pursued three separate paths of action. It has sought to bury the whole tax issue under a haze of "academic objectivity." It has tried with the help of right-wing allies to shift the terms of the tax argument onto excessive government spending. And finally, it has used its control of the economy and thus jobs and income, to club its opponents into submission.

"The Tax Scholar"

Certainly big business is most comfortable with the first and the last of these alternatives. It would rather deal with matters of taxation in a setting of "objective reason" than engage in "popular hysteria." Its reasoning goes something like this: The fate of the economy depends upon the prosperity of business, and business knows best how to reach prosperity. If it can get the public to accept that, then tax preferences and loopholes suddenly become rational incentives to achieve greater productivity, more jobs, and higher income for the average citizen. Tax reform is thus reduced to less government regulation and lower taxes for large corporations.

One potent ally which business has for this line of argument is the prestigious Tax Foundation, Inc. The foundation describes itself as a publicly supported, non-profit, and non-partisan research organization, and is an unabashed supporter of a "free enterprise economy."

It doesn't attempt to hide its business orientation on tax issues. "Many corporation executives consider Tax Foundation an extension of their own staffs," states one pamphlet describing its activities. Its list of Board of Trustees says even more. Every segment of the big business community is represented: from the board chairman Willard F. Rockwell, of Rockwell International, through, to name just a few — John D. deButts, chairman of the board of AT&T; E. Robert Kinney, chairman and chief executive of General Mills; U. S. Steel president David Roderick; and F. Alan Smith, vice-president of finance, General Motors.

The gist of the tax policy coming from this impressive group can be seen in a speech on sunset legislation delivered to the Foundation by Reginald H. Jones (chairman and chief executive of General Electric, and incidentally, a Foundation trustee). Jones argued that subjecting tax expenditures to periodic review would throw the business community into a state of constant economic uncertainty and retard capital investment "at a time when just about everybody admits we need more, much more, in order to improve productivity, fight inflation, and assure economic growth and the creation of jobs."

A fact Jones failed to mention is that of the $136 billion of tax expenditures in 1979, one quarter will go to corporations. The investment tax credit, alone worth $18 billion; targets 70% of its benefits to the top 1/10 of 1% corporations — those with assets of over $250 million.

So, while the Tax Foundation may consider itself to be a non-partisan research and educational organization working for the public good, its policies actually follow the line that what's good for General Motors is good for the nation. Nor does the Foundation ignore the cultivation of the politically powerful: Last year Al Ulman, chairman of the House Ways and Means Committee was given the Foundation's "Distinguished Public Service Award."

Grass-roots Efforts

Normally business likes to shy aways from entering the political arena at the electoral level. Instead it prefers to put across its message through organizations like the Tax Foundation, and through intensive lobbying and campaign contributions in Congress and state legislatures.

But the recent "tax revolt" from the right has opened irresistable opportunities for business gain. Witness, for instance, the windfall profits which fell into business' hands in California as a result of Proposition 13. Before Prop 13, California homeowners paid 35% of the property taxes, and business 65%. When the new tax measure is fully effective, homeowners will be paying 65%, and business 35%.

Probably the most influential right-wing organization dealing specifically with taxation is the National Taxpayers' Union (NTU). Boasting of membership across the country of 40,000 - 100,000, the NTU touts goals of lower federal income tax rates, reduced capital gains taxes, and a balanced budget amendment to limit federal government spending. Of these, business is most interested in the capital gains measure.

"The economic decline of America," according to the NTU, "can be traced directly to the spending and tax policies of the U.S. government. If those policies are not changed soon, we will bring on even more serious economic and social problems." In short, *opposition* to reducing capital gains taxes is short-sighted and mean-spirited, and stems for the simple fear that "someone, somewhere, somehow may be making money."

(It happens that someone *is* making a lot of money—from capital gains tax cuts. Over 41% of the benefits from the capital gains tax cut passed by Congress last year will go into the pockets of the .1% of the population earning over $200,000—for an average benefit of $18,478. Those taxpayers earning less than $15,000 will average about $46 apiece.)

Still, big business is hesitant about throwing in its lot with right-wing organizations like the NTU on any more than a casual basis. As long as the NTU and other populist movements subscribe to the "trickle-down" line of economics, business is content. But it finds the more extreme stances disquieting.

Take, for instance, the NTU's desire to abolish *all* taxation. "In all seriousness," the NTU recently proposed in its newsletter, "taxation is among the foremost evils to beset humanity." Business, in fact, does not want an end to taxation; it would merely like to push the burden onto someone else. An end to taxes would also mean an end to lucrative government subsidies and other public support for the so-called private enterprises.

The Benevolent Provider

For now, business is apparently willing to stand in the political wings while right-wing groups like the NTU convince the confused voter to support budget limitations and capital gains tax reductions. But when faced with a direct challenge to its preferential tax treament, it responds with a flourish.

Such is the case in Ohio, where the Ohio Public Interest Campaign (OPIC) is pushing a "Fair Tax Initiative" designed to relieve low and moderate income taxpayers by curtailing the more glaring business tax expenditures (see page 11). When the OPIC campaign first got underway, the Ohio Manufacturers' Association reacted by warning that if the plan passed, "the burden on Ohio industry would be so punitive that few if any businesses could afford to establish or relocate in this state. At the same time, much of Ohio's existing industry would have to leave."

But a month later it appeared that OPIC would gather the 85,000 signatures required to submit its initiative to the legislature. The OMA stepped up its attack—insisting that "OPIC must be destroyed" if Ohio is to survive.

Since OMA's membership includes General Motors, Ford, and Republic Steel, its threats to devastate the Ohio economy are not to be taken lightly. Although in fact taxes usually prove to be only peripheral variables in a business' decision to invest, relocate, or stay put, OMA wants the potential petition-signer or voter to think twice before supporting tax reform. And the threat of losing a job and income are powerful deterrents.

The outcome of the Ohio situation is still uncertain. OPIC thinks that, given a chance, the voters will chose tax reform. Business, though, would still like them to think that, when it comes to deciding what is in the economic interest of the people, business knows best. □

State & local briefs

Business battles reform efforts in Ohio

Ohio is witnessing a struggle — between the Ohio Public Interest Campaign and the Ohio Manufacturers' Association — that could have profound consequences for tax reform in the state. Ever since the Public Interest Campaign (OPIC) unveiled its "Fair Tax Initiative" last year, big business has been doing its best to quash the measure and OPIC along with it.

"Who wants to shoot Santa Claus?", queried Thomas Johnson, president of the Manufacturers' Association (OMA). "Sure it sounds good — 'soak that rich fella.' But in the meantime, they don't have that rich fella anymore, because he's already moved out ... The people may get a tax break, but then they don't have a job, so what difference does it make to them? How do they gain anything?"

The answer is simple, states OPIC: The people gain through tax justice. The Fair Tax Initiative limits property taxes for people earning less than $30,000, closes business tax loopholes, and changes the corporate and personal income tax so that its burden does not fall so heavily on small business and the low and middle-income taxpayer. It does not propose "soaking the rich" or driving business from the state.

According to Mary Lynne Cappelletti, legislative director for OPIC's in Columbus, the OMA is merely crying wolf when it claims that the initiative would transform Ohio into an "industrial wasteland."

"The manufacturers' association has raised this same argument in terms of every piece of social legislation that's been passed in this century," she insists. "They said the same thing about child labor laws, the minimum wage, the 40-hour week and all the health and safety legislation.

"They always claim these things would cause the state of the nation to become an industrial wasteland. That seems to be their favorite phrase."

OPIC has currently gathered over 90,000 signatures on its petitions, more than enough to have the initiative placed before the state legislature. But business is still attempting to stall the process as much as possible.

Late last year the OMA filed suit in the Franklin County Court of Appeals, seeking to have the court void all 92,981 signatures on technical charges. When the Appeals judges refused, the OMA dropped the suit and refiled it in the Common Pleas Court. There it suffered a second defeat. Judge Fred J. Shoemaker ruled in favor of the Fair Tax Initiative, arguing that "the people having expressly reserved to themselves the right of initiative, it is not the function of this court to interfere with that right and disenfranchise the voters."

An OPIC spokeswoman described OMA's tactics as a simple attempt to circumvent the power of the people. "The manufacturors' association is trying to squash this power by using lawyers to find an 'i' that wasn't dotted or a 't' that wasn't crossed...

"Instead of addressing the substance of the issue, which is fairness for all taxpayers," she continued, "they're using their lawyers to smash up the process in 'legalese.' "

Indeed, a second tactic business is using to insure that OPIC's initiative never appears before the legislature is to challenge in a piecemeal fashion all the signatures on the petitions. Apparently Secretary of State, Anthony J. Celebrezze, is willing to participate in the game. Despite a contrary opinion from the Attorney General's Office, Celebrezze refuses to submit the petitions to the legislature until all the challenges have been settled, a process which could take months if the OMA has its way.

To prevent this delay, OPIC plans to file suit against the Secretary of State, demanding that the court expedite the petitions, set a time limit for challenges to be presented, and establish a date on which the initiative must be handed to the legislature. OPIC also intends to present the initiative as a separate legislative bill, thereby insuring that the politicians finally confront the issue.

Still, the OMA may prevail, since its influence in the state legislature and with Governor Rhodes is virtually irresistible. If the legislature does *not* pass the Fair Tax Initiative in a form suitable to OPIC, the citizens' group and its allies will have to gather another 85,000 signatures in order to place the measure on the November ballot. OPIC is confident that it could win such a battle. □

Compromise tax plan in Wisconsin

Wisconsin politicians think that they've come up with a hit idea for a tax cut. Working on the assumption that everyone likes a vacation, they have decided to provide voters with a two-month holiday on their personal income taxes. During May and June employers will simply stop withholding the taxes from employees' paychecks, forcing the state to live off its $475 million budget surplus.

While the scheme certainly has voter appeal and, in fact, helped elect the state's new Republician governor Lee Dreyfus; it has very little else to speak for it. Liberal legislators who worked for it did so in order to win passage of their own tax measures, substantial tax reforms.

Originally Dreyfus had requested a three-month tax holiday, something liberal legislators could not accept. A simple income tax moratorium by its very nature skews the benefits towards the wealthier sectors of Wisconsin's population, with the inequity worsening the longer the moratorium continues. So a compromise was reached: In return for Dreyfus's two-month tax festival, major and lasting changes would be made in the Wisconsin tax system. "The governor won the sex appeal contest, but we got the lion's share of policy," said Democratic House Speaker Ed Jacamonis. "I think we won."

In fact, low- and middle- income taxpayers *did* indeed win, with a piece of legislation which one reporter has a bit enthusiastically labeled "the largest tax reform package in Wisconsin's history." The most important change affects property taxes for both homeowners and renters. Itemized deductions for property taxes are replaced with a 12% property tax credit to be provided through the individual income tax. Since itemized deductions normally give greater proportionate relief to high-income taxpayers and do not benefit at all those who simply claim the standard deduction, the credit amounts to a more progressive means of relief to hard-pressed homeowners. Renters, too, receive the 12% credit on a portion of their rent payments, on the assumption that part of rent payments go towards property taxes.

In addition, the legislation expanded the homestead tax credit and granted a one-time property tax refund, up to $100, of 10% of a person's 1978 property taxes. Finally, households receiving general relief or aid to families with dependent children became eligible to file a homestead claim for the months when they were not receiving public assistance. Previous state tax provisions had effectively excluded those poorest sectors of the population from all such tax benefits.

Outside the area of property taxes, other progressive changes contained in the new legislation were frequently offset by measures with more dubious effects for tax reform. While the standard deduction was increased by converting the former percentage deduction to flat amount, thereby following the federal model, a widening of brackets and a lowering of marginal tax rates decreased from 11.4% to 10% the top marginal rate on income in excess of $40,000. In addition, the repeal of itemized deductions for state and local taxes and a sales tax exemption for residential heating fuel and electricity were counterbalanced by income tax breaks for Subchapter S and multi-state corporations. □

Massachusetts reform efforts underway

While Massachusetts Governor Edward J. King's plan to limit local spending and taxes founders in the state legislature, Mass Fair Share has put together a coalition of public employee and private sector unions, citizen organizations, and public interest groups to support its alternative proposal for tax reform.

"The Governor's plan simply means local communities must absorb the costs of inflation, so something's got to go," Carol Lucas, a regional vice-president for Fair Share, observes. "We can take our choice. Some firefighters off the payroll? Close down a library or elementary school? Cut out the local programs for senior citizens?"

The Fair Share proposal would start with tax relief for low- and middle-income households. The effective property tax rate in any community would be held to around 2.9% of total market value, providing about a 20% rollback for two thirds of the state's taxpayers and at least 10% for the rest. Industry, too, would benefit from a 10% cut, but commercial property taxes would be frozen.

The loss in revenue to localities would be offset by closing some major tax loopholes. A 7.5% excise tax on professional services, such as legal and accounting fees, and a small excise tax on commercial bank assets, would

MASSACHUSETTS, see page 12

briefs

MASSACHUSETTS, from page 11

help bring in the funds necessary to maintain public services.

The prospects for passage of the reform legislation are encouraging. The measure is before the Legislature's Joint Committee on Taxation, which, in the words of one Fair Share spokesperson, "is trying to decide if it takes the proposal seriously." Given the alternative offered by Governor King and the substantial citizen support rallied by Fair Share, the politicians seem to have little choice.

Meanwhile, on another front Mass Fair Share has won a major legal victory for taxpayers in each of the state's 351 cities and towns. The Massachusetts Supreme Judicial Court recently ruled that cities and towns must make available to the public the names of tax delinquents. "The public interest in such information," wrote Justice Ruth I. Abrams, "outweighs any invasion of privacy occasioned by the disclosure of the records of tax delinquents."

The amount of delinquent taxes owed local communities is often substantial and primarily involves wealthier taxpayers who enjoy what is in effect interest-free loans at the communities' expense. In the city of Lynn, for instance, Fair Share learned of about $3 million in unpaid back taxes. If the money were paid immediately, Lynn's tax rate of $168 per $1,000 of assessed valuation would be reduced by approximately $12.

In Somerville, a Fair Share member was prompted by the court ruling to request from the city's tax collector the names of the big tax delinquents. The tax official was at first reluctant, initially turning over a list of those who owed the city under $100 each. "We're looking for the *big* landlords," the Fair Sharer replied, and finally a list was provided containing 69 properties, each owing at least $5,000 in back taxes. □

Maryland: Two reactions to Prop 13

When "Proposition 13 fever" was rampant back in November and measures to cut or limit taxes were found on ballots all over the country, two neighboring counties in Maryland reacted in two very different ways. One county resisted the fever, and the other succumbed—and only now seems to be awakening to the consequences.

In the first case in Montgomery County, Maryland, a group call TRIM (for Tax Relief in Montgomery") proposed a charter amendment to cut the county's property taxes by 15%. The opposition warned voters that the measure would benefit businesses rather than homeowners, and that severe cuts in taxes and revenues would lead to severe service cutbacks. The voters responded by defeating the proposal.

In the meantime, in neighboring Prince George's County, another TRIM (for "Tax Relief Initiative for Marylanders") was meeting with little opposition in a similar endeavor to cut taxes. The TRIM proposal there was to limit the county's property tax revenues to its current level of $140 million. By limiting the revenues collected from the tax, supporters reasoned, homeowners' property *taxes* would be frozen as well. The prospect appealed to the voters, who passed the amendment.

Those voters are now discovering that the situation is not as simple and attractive as they had thought. Since inflation will eventually cause the $140 million to be worth less and less in financing services, county officials are already discussing ways to cut back on programs—including programs for the mentally ill and the elderly, school services, and park and recreation facility maintenance.

But while services face cuts, taxes for homeowners apparently do not. Since the TRIM amendment specified nothing about property tax *assessments*, rising home values will continue to lead to rising assessments. To keep *revenues* at a constant level, the tax rate will be cut. But since assessments on homes generally rise more quickly than assessments on businesses, the rate cut will have little real offsetting effect on taxes for homeowners—in fact, homeowners' taxes will continue to rise, in some cases as much as 7%—while the effect on *businesses* will be a real tax cut.

The long-range effect of this TRIM amendment, then, will be similar to the long-range effect that Californians are discovering their Proposition 13 will have: In California business used to bear 65% of the property tax burden and homeowners 35%. Eventually, because of Proposition 13, homeowners will carry 65%, and businesses 35%.

When the *same shift begins in Prince* George's County, residents there will find that it really was a "fever" they caught from California back in November, and that the effects are none too pleasant. □