How the Government Evades Taxes*

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The "tax revolt" of the 1970s, the election of President Reagan whose commitment to lower taxes and spending at the federal level of government struck a responsive chord, and public opinion polls all reveal that American taxpayers are disillusioned with paying more in taxes and receiving less in services from the public sector. In the tradition of the nation's founders, Americans have turned to constitutional and statutory constraints on governmental powers to limit both the size and scope of government at all levels. Since 1970, some thirty-two states have imposed legal limitations on local government taxing, spending, and borrowing powers; similar restrictions exist for a number of state governments. In an effort to restrain the fiscal operations at the federal level, thirty state legislatures have voted for a convention to adopt a balanced budget amendment to the Constitution.

Evidently, there is considerable faith in the ability of balanced budgets and tax/expenditure limitations to induce government to become more efficient and responsive. Unfortunately, the historical evidence on such restrictions at the state and local levels of government reveals that this faith is based on fantasy rather than fact. For nearly a century, non-federal politicians have easily evaded fiscal restraints—both constitutional and statutory—by the simple expedient of redefining the budget. Expenditures and debt controls that apply to the public sector can be ignored by "off-budget enterprises" created in great numbers by politicians. At the federal level of government off-budget operations have grown at an astounding rate in the past several years and, as pressures for a balanced budget mount, can be expected to play a major role in circumventing the taxpayer's desires for a fiscally responsible federal sector.[1]

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1. There are other ways of evading balanced budget or spending limitation rules which are discussed below.

The Continuing Saga

Tax revolts are not new; indeed, the issue of taxation played a role in precipitating the Revolutionary War. Beginning with the federal Constitution, American political history is a record of attempts, constitutional and otherwise, to control the politicians' propensity to spend and borrow. Restrictions on borrowing at the state level of government can be traced back to the early nineteenth century when the financial panic of 1837 produced embarrassment, financial difficulties, and even default for states with inordinate debt burdens. To avoid future excesses and, more importantly, to restore investor confidence in their bonds, constitutional limits were imposed at the state level. As new states were formed, debt limits were also incorporated in the constitutions so that the bond offerings of these new entities would not be at a competitive disadvantage in the capital markets. State restrictions on local borrowing came somewhat later. In the mid-nineteenth century, a railroad-building boom developed and municipalities were quick to recognize that rail service could determine whether a community thrived or merely survived. To entice the railroads to provide service, municipalities would either guarantee the railroad's bonds to aid the company in raising capital or would employ the proceeds of a municipal bond issue to purchase railroad stock. Again, financial panic burst the borrowing bubble—this time in 1873. Local governments were heavily overextended and, to prevent future defaults, state restrictions on local debt became commonplace. In addition, state governments over the past half century have imposed restrictions on local government taxes and spending. As shown in Table I, there were thirty-two state measures which placed constraints on the fiscal operations of local governments prior to 1970.

The most recent chapter of this continuing saga consists of the well-publicized "tax revolt of the 1970s." Since 1970, thirty-two states have imposed fifty-four different limitations on local government taxing and spending powers.[2] Eighteen initiatives were passed in eleven states during the period 1970–73, followed by only three in 1974 and 1975. But in 1975, the tax revolt began to ferment. Taxpayers approved only 29 percent of the total amount of

2. The types of limits listed in Table I are self-explanatory except for "full disclosure," which requires local officials to warn taxpayers of property tax increases by advertising them, and voting on them at public hearings.

TABLE I

State Restrictions on Local Government Taxing and Spending

	Property Tax Rate Limit	Property Tax Levy Limit	General Revenue Limit	General Expenditure Limit	Limit on Assessment Increases	Full Disclosure	Total
Before 1970	29	3	0	0	0	0	32
1971	1	2	0	2	0	1	6
1972	3	1	0	0	0	0	4
1973	3	4	0	1	0	0	8
1974	1	0	0	0	0	1	2
1975	0	0	0	0	0	1	1
1976	1	3	0	1	0	1	6
1977	0	1	0	0	2	1	4
1978	2	3	0	0	1	0	6
1979	1	2	2	2	1	2	10
1980	3	2	0	1	1	0	7

Source: Calculated from Advisory Commission on Intergovernmental Relations, *State Imposed Restrictions on Local Government Tax and Expenditure Powers* (Washington, D.C.: ACIR, 1981).

state and local government bond referenda in that year compared to 62 percent in 1974. The tax revolt then became much more pronounced in 1976. From 1976 to 1980, thirty-three tax or spending limitation initiatives were implemented, including the infamous Proposition 13 in California in June of 1978. Thus, the taxpayer revolt of the 1970s appears to have begun in earnest in 1976, the two-hundredth anniversary of the beginning of the most famous taxpayer revolt of all, the American Revolution. Several states have also placed limits on state taxing and spending, and thirty state legislatures have voted to hold a convention to add a balanced budget and/or spending limitation amendment to the federal Constitution.

It is hardly surprising that the tax revolt accelerated during the 1970s. The combination of inflation-induced bracket creep and increasing tax rates, particularly for social security, left the median income earner worse off in 1980 than in 1970. According to the Tax Foundation, median family income after adjustment for inflation and direct federal taxes was $7,976 in 1980, fully $436 less than in 1970. In addition, per capita state and local taxes increased by approximately 25 percent in constant dollars during the same time period.[3]

Taxpayer Discontent

Taxpayers are frustrated not only with the steadily declining levels of after-tax income, but also with the fact that they seem to be receiving so little for their tax dollars. At the federal level, billions of dollars have been spent on housing and urban renewal, energy programs, poverty, and so on; and yet slums abound in the nation's cities, the Department of Energy admits to having had no positive effect on energy problems, and millions remain in poverty. Economist Walter Williams calculated that if all the money spent by federal, state, and local governments on "poverty programs" were actually given to the poor, each family of four which is at or below the poverty level of income would receive approximately $40,000 this year!

At the state and local levels of government, where per capita government expenditures increased by 335 percent between 1960

3. Advisory Commission on Intergovernmental Relations, *Significant Features of Fiscal Federalism: 1980-81* (Washington, D.C.: 1981).

and 1978, things are not much different.[4] Crime rates continue to soar, streets and highways are full of potholes, and educational achievement through high school continues to decline. For example, average scores on student achievement tests fell steadily between 1962 and 1978, despite the fact that educational spending per student had tripled during that period.[5]

Growing taxpayer frustration and disillusionment with government has been clearly revealed in a series of national surveys conducted between 1964 and 1976 by the Center for Political Studies at the University of Michigan. These show a steady erosion in the public's trust in government.[6] In 1976, 62 percent of Americans believed that government could be trusted "to do what is right" for them *only some* rather than most of the time; in 1964 the figure was 22 percent. More and more Americans are viewing government as being too powerful and extremely wasteful. In 1976, 50 percent of the public believed that government had grown too powerful, compared to 31 percent in 1964. The proportion of people believing that government wastes "a lot" of their tax money increased from 46 percent in 1964 to 74 percent in 1976. These attitudes are widespread in all sectors of society and there is remarkably little variation in the skeptical view of government among the young, middle-aged, and elderly, between the poor and those who are well-off, liberals and conservatives, and whites and nonwhites.

The message is clear: Taxpayers believe that they are paying too much and getting too little from government and, in order to force politicians to be more responsible and cost-conscious, are trying to impose constitutional and statutory limitations on taxes, spending, and borrowing. So deep is the discontent among citizens that the tax revolt has taken a physical form. Disgruntled taxpayers have begun to vent their anger by bodily attacking local government employees. As a result, some local civil servants are demanding "combat pay" for work "in the front lines of the municipal infantry," and union contracts in New York City now provide for eighteen months of leave with full pay after an assault.[7]

4. U.S. Bureau of the Census, *Statistical Abstract of the U.S.* (Washington, D.C.: U.S. Government Printing Office, 1981).
5. Tax Foundation, *Facts and Figures on Government Finance* (Washington, D.C.: Tax Foundation, 1979), pp. 255, 257.
6. Jacob Citrin, "The Alienated Voter," *Taxing and Spending* (October/November 1978), pp. 7–11.
7. Jeffrey Sheler, "The New Incivility Toward Civil Servants," *U.S. News & World Report* (July 27, 1981), pp. 56–57.

Has the tax revolt been effective? A *New York Times* editorial has asserted that the tide is finally turning; state and local government spending since 1978 is actually expected to decline.[8] A statistical study of the effects of tax and spending limitations imposed on local governments conducted by the Advisory Commission on Intergovernmental Relations concluded that they have indeed been successful.[9] Many social scientists now routinely assume that tax and spending limitations put money into the taxpayers' pockets and promote efficiency and responsiveness in government.[10] In addition, there are many who place great faith in the ability of a balanced budget amendment to the Constitution to produce a greater degree of economic stability and to constrain inflation.[11] The Reagan administration is firmly committed to both a balanced budget and spending limitations at the federal level.

One would think that, from the more than two centuries of experience with constitutional and statutory restrictions on governmental powers, the optimism over the prospective effects of the recent "taxpayer revolts" is well founded and thoroughly tested. However, it appears that no one has even examined the historical record on the success or failure of taxing, spending, and borrowing limitations. For over three-quarters of a century, state and local governments have routinely evaded all restrictions on their financial independence by the simple expedient of moving large segments of the public sector off-budget. Off-budget spending at the federal level is also gaining momentum.

Government Goes Off-Budget

Taxpayer preferences are routinely evaded at both the state and local levels of government by conducting many public sector activities through off-budget enterprises (OBEs) which are beyond the control and scrutiny of taxpayers. OBEs are corporations created and owned by one or more political jurisdictions and are often referred to as authorities, districts, commissions, agencies,

8. Rudolph Penner, "Why Local Spending Is Finally Slowing," *New York Times* (Dec. 7, 1980), p. D-2.
9. Advisory Commission on Intergovernmental Relations, *State Limitations on Local Taxes and Expenditures* (Washington, D.C.: ACIR, 1977).
10. For example, *see* M. Menchilk, "Fiscal Limitation Fever: Who Gets Hurt?" *Journal of Contemporary Studies* (Winter 1981), pp. 67-80.
11. For example, *see* Phillip N. Truluck, *Balancing the Budget: Should The Constitution Be Amended?* (Washington, D.C.: The Heritage Foundation, 1979).

and boards. OBEs are formed by a public statute that defines their powers. In over two-thirds of the states, local politicians establish OBEs by ordinances of various types, within the terms of general enabling legislation adopted by the state legislature. In most states, all that is required is the filing of a corporate charter, but in a few states, such as New York, OBEs must be chartered by special acts of the legislature. There are thousands of OBEs at the local level of government in the U.S., including over 2,500 in Pennsylvania alone.[12] OBEs have no taxing power, by definition. Rather, their activities, which include the entire spectrum of local governmental activity from airports to waste water treatment, are financed by issuing nonguaranteed (and not voted on) revenue bonds. Since revenue bonds are not subject to voter approval, they are not backed by the taxing powers of any governmental unit but, theoretically, by user fees from the OBE's activity. Because OBEs typically do not receive appropriations their spending and debt do not appear on government budgets. OBEs are thus in theory "financially independent," but in reality are heavily subsidized by other units of government. The managers of OBEs are typically patronage appointees who enjoy far greater discretion than do managers of regular local governmental departments or of private industry. In most cases OBEs are exempt from compliance with civil service restrictions, pay no taxes or license fees, are not regulated by public utility commissions, are exempt from compliance with many state and federal regulations, and have powers of eminent domain that extend beyond the boundaries of the political entity which created the OBE.[13] Moreover, the expenditures, borrowing, and employment of OBEs are not included in the reported statistics of the political jurisdiction(s) that form(s) them.

The major difference between regular governmental departments and OBEs is that OBEs can raise and spend money without reference to the immediate wishes of the electorate, whereas a government can raise and spend money only in the amounts and manner specified by the electorate under the constitution and statutes of the state. In fact, the principal reason for the establish-

12. Donald Schlosser, *Municipal Authorities in Pennsylvania* (Harrisburg, PA: Dept. of Community Affairs, 1977).
13. Annmarie Walsh, *The Public's Business: The Politics and Practices of Government Corporations* (Cambridge: MIT Press, 1979).

ment of OBEs in the U.S. has been to subvert the wishes of the electorate whenever the voters express a demand for fiscal restraint by local political decision-makers, as can be illustrated by consideration of OBEs in Pennsylvania.[14]

During the late nineteenth and early twentieth centuries, profligate borrowing practices by local governments led to frequent financial crises and defaults on debt payments. As lenders and taxpayers became more suspicious of public borrowing, the state legislature was induced to impose severe restrictions on municipal borrowing by limiting it to 7 percent of assessed property valuation. Pennsylvania voters hoped that their constitution could be used to constrain the irresponsible borrowing practices of local politicians, but in 1935 the state legislature passed the Municipal Authorities Act which exempted "government-owned corporations" from municipal debt restrictions. Numerous OBEs were soon created to finance school buildings, airports, parking lots, recreation centers, and various other activities. Local governments no longer had to be concerned with either the immediate wishes of the voters or with the intent of the state constitution.

In the late 1940s, Pennsylvania voters began pressuring their state representatives for limits on local property taxes, much in the spirit of the "tax revolt of the 1970s." As a result, in 1949 statutory property tax rate limits were enacted that applied to cities, boroughs, townships, and school districts. The immediate response of local politicians and bureaucrats was to intensify the use of the off-budget mechanisms. The number of "municipal corporations" created tripled in 1950, and the amount of nonguaranteed bonds issued increased by 465 percent, from $11.5 million to $65 million in just one year. Thirty-four "school building authorities" alone were formed in 1950 compared to a total of fourteen in the preceding fifteen years. The amount of nonguaranteed debt issued by school building authorities increased by 583 percent in that year, from $2 million to $11.8 million.

By 1975 the number of OBEs in Pennsylvania had risen to 2,456 with $4.8 billion in debt outstanding compared to $2 billion in voter-approved "full faith and credit" local debt outstanding. As of 1975, 71 percent of total local debt outstanding in Pennsylvania was therefore not approved by and was beyond the control and scrutiny of taxpayers.

14. Schlosser, *op. cit.*

There are two types of OBEs in Pennsylvania (and elsewhere)—the "lease-back authority" and the general operating authority. Most are lease-back authorities that do not operate public facilities; they issue revenue bonds and invest the proceeds in various projects that are then leased to local governments for specified rental payments that are paid from local tax revenues. This organizational structure provides local political decision-makers with an even greater degree of independence from the wishes of the electorate. For example, the state legislature has not yet granted municipalities the right to create lease-back electric utility authorities. Not to be constrained by either voters or their elected state representatives, local politicians have evaded this restriction by creating lease-back *water* authorities, selling their existing water systems to them, and using the proceeds of the sale to expand municipally-owned electric power systems. Furthermore, many municipalities sell existing facilities to specially created OBEs and then lease them back simply to place them off-budget and beyond the view of the voters.

Pennsylvania does not constitute a special case. In 1980, of the total long-term municipal security sales in the U.S. of approximately $48.4 billion, fully $34.3 billion or 71 percent were nonguaranteed revenue bonds. This compares to 48 percent in 1975 and 34 percent in 1970.[15] In addition, as of 1975 the nonguaranteed debt of "public authorities and special districts" is the largest single source of new state and local government security sales, comprising $23.4 billion in 1979; in contrast, guaranteed (and voter-approved) debt in that year totaled $4.4 billion for state governments and $15.6 billion for municipalities, counties, and townships combined.[16] As a percentage of total state and local government security sales, special districts and public authorities were responsible for 54 percent in 1979 compared to 31 percent nine years earlier. Off-budget enterprises undertake a massive amount of investment activity which is beyond the control of the voters, is in excess of that of regular units of government, and has been increasing rapidly as a result of state-imposed local government tax and expenditure limitations.

15. Public Securities Association, *Statistical Yearbook of Municipal Finance* (New York: Public Securities Association, 1981), p. 124.
16. U.S. Bureau of the Census, *op. cit.*, p. 300.

OBEs and State Government

Off-budget enterprises are prevalent at the state level of government as well. There are thousands of OBEs at the state level nationwide, and there are more in New York than elsewhere. Consequently, voters in New York state cannot effectively control government spending by either constitutional means or by referendum requirements. New York's state constitution does have a referendum requirement for all proposed general obligation borrowing of the state which is backed by the "full faith and credit" of the state government. However, bond referenda in New York have placed no constraints whatsoever on government borrowing.[17]

In 1956 voters rejected a $100 million housing bond issue for the third time; Governor Rockefeller created the Housing Finance Authority which issued massive amounts of nonguaranteed debt, at one point in excess of the entire guaranteed debt of New York state. In 1961 voters rejected a $500 million higher education bond issue for the fourth time; the Governor created the off-budget State University Construction Authority. In 1965 the voters rejected, for the fifth time, a housing bond issue; the Governor created the Urban Development Corporation. By 1975, 81 percent of the total debt outstanding of New York state was the nonguaranteed debt of OBEs. In the areas of health and higher education, voter-approved debt stood at $283 million compared to approximately $5.8 billion in nonguaranteed debt outstanding for these functions. From 1964 to 1974 the state's own debt for construction programs increased by $2 billion, while the nonguaranteed debt of OBEs increased by $8 billion. Although the state's OBEs are theoretically "financially independent," they are heavily subsidized by the state and federal governments. In 1980 accumulated *state* subsidies in the coffers of OBEs amounted to about $2 billion, approximately $113 per capita.[18] It is clear that referendum requirements place no constraints on government borrowing in New York state since billions of dollars of debt are placed off-budget to finance a myriad of often extravagant projects, including horse breeding farms and "space development." As mentioned above, OBE activity in New York state is not atypical.

17. The following is based on New York State Moreland Act Commission, *Restoring Credit and Confidence: A Reform Program for New York State and Its Public Authorities* (Albany: State Printing Office, 1976).

18. Office of the Governor, *New York State Budget for 1980–81* (Albany: State Printing Office, 1980).

Federal sponsorship of OBEs at the state and local level has been widely felt and has been nonpartisan. In 1955, President Eisenhower actively advocated federal legislation to encourage local governments to create off-budget school building authorities that could ignore restrictive debt limits in order to build schools. The following quotation seems decidedly out of character for a president who condemned the Tennessee Valley Authority, a federal off-budget enterprise and pet project of Franklin Roosevelt, as "creeping socialism."

> Many school districts cannot borrow to build schools because of restrictive debt limits. They need some other form of financing. Therefore, [this] proposal is designed to facilitate immediate construction of schools without local borrowing by the school district.
>
> To expand school construction, several States have already created special statewide school building agencies. These can borrow advantageously, since they represent the combined credit of many communities. After building schools, the agency rents them to school districts. The local community under its lease gets a new school without borrowing.
>
> I now propose the wider adoption of this tested method of accelerating school construction. Under this proposal the Federal Government would share with the States in establishing and maintaining for State school-building agencies an initial reserve fund equal to 1 year's payment on principal and interest.
>
> The State School-building agency, working in cooperation with the State educational officials, would issue its bonds through the customary investment channels, then build schools for lease to local school districts. Rentals would be sufficient to cover the payments on principal and interest of the bonds outstanding...In time, the payments...would permit repayment of the initial Federal and State advances. When all its financial obligations to the agency are met, the local school district takes title to its building.[19]

Even this brief survey of tax revolt history has ominous implications for the taxpayers: constitutional or statutory restrictions on

19. Message from the President of the United States, H. R. Doc. No. 84 84th Cong., 1st Sess. 3(1955) as quoted in C. Robert Morris, "Evading Debt Limitations With Public Building Authorities: The Costly Subversion of State Constitutions," 68 *Yale Law Journal* (December 1958), pp. 240-41.

state and local government taxing, spending, and borrowing have never been effective; politicians have been able to ignore all fiscal constraints by the simple expedient of moving large segments of the public sector off-budget. There is much cause for concern that similar actions will be taken by the federal government.

Off-Budget Federal Outlays

The Congressional Budget and Impoundment Control Act of 1974 has been praised by *U.S. News & World Report* as "a revolutionary budget reform intended to give Congress a tighter grip on the nation's purse strings."[20] The Budget Reform Act emerged from a recognition that existing budgetary procedures generated a bias toward overspending and budget deficits. Prior to 1974 the total amount of federal spending was the product of many individual appropriations decisions; no decision was ever made regarding the total amount of public expenditure. The Budget Reform Act created a Budget Committee for each House responsible for setting overall targets for revenues, expenditures, and the resultant deficit or surplus. The Congressional Budget Office was created to assist in this process.

The main impact of the Budget Act is to make taxing, spending, and deficit levels explicit; the Act itself does nothing to curb spending. In keeping with traditions established at the state and local levels of governments, the "up-front" requirements of the Budget Act have elicited a good deal of "back door spending" at the federal level. In the wake of the Budget Act, numerous federal agencies have been and continue to be placed off-budget and immune from any appropriations process. Off-budget federal outlays, by agency, are shown in Table II. Although the projected $23.2 billion in off-budget outlays is only about 4 percent of the federal budget, this amount has increased by an astounding 23,100 percent since 1973. Most recently, the Synthetic Fuels Corporation, scheduled to begin operations in 1981, was also placed off-budget. Congress had previously authorized $20 billion for the development of this "industry." The penchant for back-door federal spending is obviously nonpartisan. Both the Democratic-controlled House and the Republican-controlled Senate, at

20. As quoted in James M. Buchanan and Richard E. Wagner, *Democracy in Deficit: The Political Legacy of Lord Keynes* (New York: Academic Press, 1977), p. 156.

TABLE II
Off-Budget Outlays By Agency
(Billions of Dollars)

	1973	1974	1975	1976	TQ	1977	1978	1979	1980	1981[e]
Federal Financing Bank (1974)	—	.1	6.4	5.9	2.6	8.2	10.6	13.2	14.5	23.1
Rural Electrification and Telephone Revolving Fund (1973)	.1	.5	.5	.2	.1	.4	.1	–*	–*	—
Rural Telephone Bank (1973)	*	.1	.1	.1	*	.1	.1	.1	.2	.2
Pension Benefit Guaranty Corporation (1974)	—	—	–*	–*	*	–*	–*	–*	—	—
United States Postal Service Fund (1974)	—	.8	1.1	1.1	–.7	–.2	–.5	.9	.4	.2
United States Railway Association (1973)	—	*	*	.1	*	.2	.1	.1	*	–.3
Total Off-Budget Outlays	0.1	1..4	8.1	7.3		8.7	10.3	12.4	14.3	23.2

[e]estimate—Office of Management and Budget estimate in fiscal 1982 budget document.
*less than $50 million.
Source: *Budget of the United States Government*, Office of Management and Budget, 1981.

the insistence of the Reagan administration, recently voted to place the Strategic Petroleum Reserve "off the books."

As seen in Table II the Federal Financing Bank (FFB) is by far the most active off-budget agency.[21] The FFB, a part of the Treasury Department, does business with both on- and off-budget federal agencies. The major activity of the FFB is the purchase of agency debt from funds obtained by borrowing directly from the Treasury. FFB borrowing is not, however, included as part of the Treasury's budget outlays; interest payments from the FFB to the Treasury are, nevertheless, counted as deductions from Treasury outlays. Consequently, FFB borrowing activity actually results in a reduction in outlays reported by the Treasury Department! In essence, the FFB serves as an intermediary which permits the spending of federal agencies to be placed off-budget.

A second type of FFB activity is the purchase of agency loans and loan assets. When a federal agency sells a loan to a private entity, the loan is considered repaid for budgetary purposes. Loan sales are afforded the same treatment when the FFB is the purchaser. Proceeds from the sale are counted as loan repayments rather than as a means of financing, and thus are an offset to the agency's gross expenditures. An agency's on-budget loan can therefore be converted to an off-budget loan by selling it to the FFB. In 1981 about 90 percent of all federal agency loan and loan asset sales will be sold to the FFB resulting in off-budget financing.

Rather than selling actual loans, an agency can sometimes pool its loans and issue securities backed by the pooled loans. These securities, known as "Certificates of Beneficial Ownership," can be sold to the FFB which places them off-budget.

The final activity of the FFB is its purchase of guaranteed loans. Typically, a loan guarantee occurs when a federal agency sanctions a loan between a private lender and a private borrower. The result is an interest subsidy to the borrower at no explicit cost to the Treasury, unless the borrower defaults. Frequently, however, an agency will ask the FFB to act as the private lender and purchase the borrower's note. In this case the loan guarantee becomes, in effect, a direct loan from the government, which is not reflected in the budget. In 1981 FFB purchases of loan guarantees are estimated to be $10.1 billion.

21. For a detailed discussion of the Federal Financing Bank's activities *see* Congressional Budget Office, *Loan Guarantees: Current Concerns and Alternatives for Control* (Washington, D.C.: CBO, January 23, 1979).

Circumventing Budget Restrictions

Off-budget activities are by no means the only way in which balanced budget or tax/expenditure limitation requirements have been evaded by politicians. Politicians can subsidize a particular group without resorting to the appropriations process by enacting various forms of "sweetheart legislation." For example, import quotas on automobiles (or any other product) would restrict the supply of automobiles, increasing the prices paid by consumers and the profits of the owners of the auto industry. The effect is the same as a tax-financed subsidy—a special-interest benefit at the expense of the general public. Government regulation provides myriad ways to conduct "business as usual" regardless of budgetary restrictions.

A second type of regulation which is used to achieve the ends of politicians and entails significant non-budgeted costs is the direct regulation of industry by various agencies such as the Interstate Commerce Commission (ICC), the Federal Trade Commission (FTC), the Federal Communications Commission (FCC), and so on. Politically influential groups such as the trucking industry, the airline industry, and labor unions have used these agencies to restrict competition and increase profits and wages. For example, with the sanction of the ICC, trucking firms have been able to act as a cartel in setting their rates. Representatives of the regulated firms meet periodically to set freight rates. These "rate bureaus" have been specifically exempted from the anti-trust laws regarding price fixing. The Teamsters union has also benefitted from the ICC's policies of entry restriction, because such restrictions prevent nonunion firms from entering the industry and competing for traffic carried by unionized firms. Consequently, the Teamsters have been able to raise the wages of their drivers to a level about 50 percent higher than those in the unregulated sector.[22] Regulation of this sort, which is quite pervasive, imposes great burdens on taxpayers and consumers even though there are no budgetary entries to reflect such costs. In addition, special interest groups spend millions of dollars each year lobbying for preferential treatment; such expenses are an additional cost to society

22. Rayburn M. Williams, *Inflation: Money, Jobs, and Politicians* (Arlington Heights, Ill.: AHM Publishers, 1980), p. 105.

since the resources could have been used to produce additional goods and services, rather than merely redistributing income.[23]

A third way in which government conducts its business without explicitly taxing or spending is by regulating the day-to-day activities of businesses regarding working conditions, finances, consumer safety, the environment, hiring practices, and so on. Although these regulatory activities may or may not result in diminished competition in various industries, they surely impose enormous costs on taxpayers in return for sometimes questionable benefits. Economist Murray Weidenbaum conservatively estimated that the direct, measurable cost of federal regulation of business was $102.7 billion in 1979, of which only $4.8 billion or approximately 5 percent was budgeted as administrative costs; the remaining $97.9 billion was the cost of compliance which was largely paid by consumers.[24]

Regulation and Labor

Government regulation has major allocative and distributive effects not only on product markets, but also on labor markets.[25] Occupational licensing requirements, for example, are a means of subsidizing special interest groups without resorting to explicit taxation. One well-known example of the effects of licensing is the regulation of the taxicab business. In New York City a license costing $65,000 must be purchased to own and operate a cab. Consequently, the supply of taxi services is severely restricted, increasing cab fares to the benefit of existing drivers at the expense of potential drivers and customers. Similar outcomes exist in other industries as a result of more than 3,000 statutory provisions requiring occupational licenses for various practices from fortune-telling to funeral directing and the practice of medicine.[26]

23. These lobbying activities have been termed "rent-seeking" by Gordon Tullock and are described in detail in James Buchanan, Robert Tollison and Gordon Tullock, editors, *Toward A Theory of the Rent-Seeking Society* (College Station: Texas A&M Press, 1980).

24. Murray Weidenbaum, *The Future of Business Regulation* (New York: American Management Association, 1979).

25. For a discussion of labor market regulation *see* James T. Bennett, Dan C. Heldman, and Manuel H. Johnson, *Deregulating Labor Relations* (Dallas: The Fisher Institute, 1981).

26. Walter E. Williams, "Government Sanctioned Restraints That Reduce Economic Opportunities for Minorities," *Policy Review* (Fall 1977), pp. 1–29.

A second way in which government regulation of labor markets redistributes wealth is through enforcement of the minimum wage law. It is a well established empirical fact that, regardless of good intentions, the effect of the minimum wage law is to hurt precisely the group that the law is supposed to help—those with the least skills, seniority, and income.[27] If an unskilled worker, for example, can contribute $2.50 per hour to a firm's profits, and the law mandates a $3.50 per hour minimum wage, it will be more profitable for the firm not to hire the unskilled worker. Thus, increases in the minimum wage are accompanied by increased unemployment of unskilled workers, predominantly teenagers. The major beneficiaries of the minimum wage law are politicians who can convince people they are doing something positive about unemployment and poverty, relatively skilled workers who retain their jobs at the higher (minimum) wage, and members of labor unions who, being relatively skilled, compete with unskilled, nonunion labor. It is difficult to believe that labor unions in California, for example, advocate the enforcement of minimum wage laws to nonunion migrant workers because of altruism rather than a desire to price migrant workers out of the market.

"Equal employment opportunity" regulation is another way in which the government can affect the allocation of labor resources without explicit taxing or spending. One example is the "equal pay for equal work" rule, which most likely *increases* employment discrimination. If an employer discriminates by paying male workers $10 an hour and equally qualified female workers $5 an hour, in a competitive labor market the firm's female workers will be bid away at wages greater than $5 an hour. Eventually, all of the firm's female labor will be bid away, leaving the firm at a competitive disadvantage, reducing its profits. Thus in an unregulated labor market discrimination is costly to employers. Equal pay for equal work rules lower the costs of discrimination in employment since an employer's profits are no longer lowered by passing over equally qualified women to hire men. Therefore, enforcement of such laws will more likely lead to more, not less discrimination. American labor unions comprised mostly of white males are among the most vocal advocates of equal pay for equal work laws, and it is hard to believe that this concern is based on altruism. Labor unions in South Africa have similarly lobbied in-

27. Bennett, *et. al.*, pp. 86-98.

tensely for such laws, and openly admitted that the reason for doing so is because government programs "no longer protected the white worker."[28]

Finally, government also influences labor market outcomes by enhancing the market power of labor unions via actions of the National Labor Relations Board (NLRB). A recent study has shown that the NLRB's regulation of collective bargaining has greatly enhanced the power of labor unions at the expense of those who are barred from employment by unions as well as consumers who pay the price of reduced economic efficiency and higher inflation.[29] The social cost of NLRB regulation was estimated to be at least $22 billion in 1979. Overall, the total social cost of labor market regulation was estimated to have been $170.3 billion in 1979.

In summary, it is important to recognize that *in addition* to off-budget activities, existing regulatory mechanisms permit politicians to affect the allocation of hundreds of billions of dollars of resources without taxing or spending. The predominant activity of government, the redistribution of wealth from the general public to special interest groups, is conducted through extensive regulation of product and labor markets which requires administrative expenses that are trivial when compared to the social cost of regulation.

Restricting OBEs

The American taxpayer has for decades attempted to reduce the burden of government by limiting taxes, spending, and borrowing and to make the public sector more cost conscious and responsive, particularly at the state and local levels. State politicians, in order to placate voters and pacify lenders, have enacted both constitutional and statutory constraints on taxing, spending, and borrowing at both the state and local level. The record shows, however, that such limitations have not in any way impeded the expansion of public sector activities, for off-budget enterprises not subject to voter control have been established on an enormous scale nationwide.[30] These entities are not subject to legal debt re-

28. Walter E. Williams, *op. cit.*, p. 11.
29. Bennett, *et. al.*, pp. 112-19.
30. Off-budget enterprises are not unique to the United States, but also exist in Australia, Israel, France, Italy, Japan and in Great Britain where such entities are known as "QUANGOS," an acronym for quasi-autonomous nongovernmental organizations.

strictions and permit politicians to spend vast sums on projects that voters may find questionable. Because the spending, debt, and employment of off-budget enterprises are not included in the budgets or statistics for the political entities that form them, the reported size of the state and local public sector is grossly understated: the role of the public sector in the nation's economy is much larger than generally believed.

At the federal level, pressures have been building for a balanced budget as shown by the action of thirty state legislatures in calling for a constitutional convention to adopt a balanced budget amendment. In responding to such sentiments, President Reagan attempted to balance the budget in 1984, a difficult undertaking at best. Although the off-budget activity of the federal government has, in the past, been small in absolute terms, it is growing very rapidly. Even the Reagan administration advocated (and Congress approved) placing expenditures for the Strategic Petroleum Reserve off-budget. The lesson is straightforward: the balanced budget amendment is likely to be a totally ineffective constraint on federal spending as long as the government practices the budgetary magic of off-budget spending. In addition to off-budget activities, government regulation of product and labor markets permits government to exert a profound influence over the allocation of resources without explicitly taxing or spending. Regulation entails an implicit tax of hundreds of billions of dollars which is not likely to be reduced by a balanced budget amendment. The taxpayer who relies on a constitutional amendment to control politicians is, as the evidence clearly shows, leaning on a very weak reed.

Reagan versus Thatcher

DAVID HALE

This is a confusing period for anyone in the United States trying to understand what is happening in the British economy. Both supporters and critics of the Reagan economic program have been trying to pin the label of Thatcherism on those with whom they disagree. Critics of the Reagan program, such as Dr. Leonard Silk of *The New York Times*, contend that the severe recession which has occurred in Britain since Margaret Thatcher became Prime Minister in May 1979 is the inevitable by-product of an economic policy which combines dogmatic monetarism with supply-side economics. The U.S., he argues, is headed down the same road because of a Reagan program which includes loose fiscal policy and tight monetary policy.[1]

Reaganites counter by attacking Mrs. Thatcher for failing to implement a proper supply-side strategy. Both *The Wall Street Journal* and Dr. Arthur Laffer blame the current British recession on Mrs. Thatcher's failure to cut taxes, reduce public expenditures, and effectively manage the growth of the money supply.[2]

Who is correct? Each side has evidence in its favor, but neither is really telling the whole story of the recent British experience. There are at least four major problems with many of the recent American comparisons between Thatcherism and Reaganism. First, however similar President Reagan and Mrs. Thatcher may appear to be in ideological terms, their economic programs differ significantly in both composition and priorities. Second, they were introduced in radically dissimilar economic environments. Third, they face substantially different structural obstacles to success. Finally, it is blandly assumed by almost everyone writing on the subject that Mrs. Thatcher has failed. While the performance of the U.K. economy since 1979 has been poor by any traditional yardstick, it is too soon to write off the Thatcher experiment totally.

1. Leonard Silk, "Lessons From Britain," *The New York Times*, (July 10, 1981).
2. Arthur Laffer, "Margaret Thatcher's Tax Increase," H. C. Wainwright, (August 6, 1979).