Cost of Government Day® Report Calendar Year 2002

Tenth Edition

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Definition

Cost of Government Day is the date of the calendar year on which the average American worker has earned enough gross income to pay off his or her share of spending and regulatory burdens imposed by all levels of government, federal, state and local.

Methodology

Cost of Government Day is the total cost of government as a percentage of national income. The percentage is then multiplied by 365 days to determine the number of days worked to pay for the total cost of government.

Federal expenditures are derived from the latest Congressional Budget Office forecast. State and local expenditures are derived from the National Income and Product Accounts (NIPA) produced by the Bureau of Economic Affairs at the U.S. Department of Commerce.

For national income, we used the estimate of Net National Product (NNP) produced by the Bureau of Economic Affairs in NIPA. NNP is equal to Gross Domestic Product (GDP), plus the balance of international transfers, less depreciation. NNP is a widely accepted measure of income. We derived this estimate of national income from NIPA and from projections of federal budget trends produced by the Congressional Budget Office.

Estimates of federal, state and local regulatory burdens were derived from the best academic sources available. W. Mark Crain, Professor of Economics at George Mason University, and Thomas D. Hopkins, Dean of the College of Business at the Rochester Institute of Technology, produced a new comprehensive study on the cost of federal regulation in 2001.[1] The U.S. Small Business Administration commissioned the study. This study served as the foundation for our estimate of the cost of regulation.

[1] W. Mark Crain and Thomas D. Hopkins, The Impact of Regulatory Costs on Small Firms, a report for The Office of Advocacy, U.S. Small Business Administration, RFP No. SBAHQ-00-R-0027 (2001).

OVERVIEW OF RESULTS

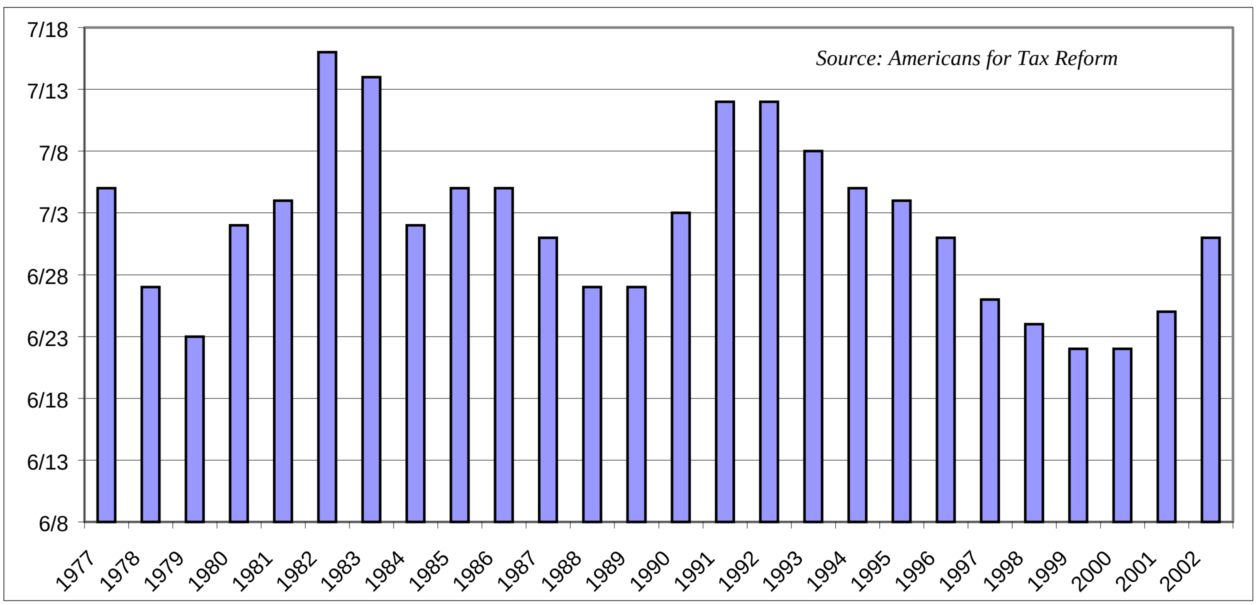
Cost of Government Day 2002

Cost of Government Day for 2002 is July 1. This is six days later than the 2001 Cost of Government Day of June 25. As a result, working people must toil on average 182 days out of the year just to meet all the costs imposed by government. In other words, the Cost of Government consumes more than 50% of national income.

Cost of Government: Trends and Components

Cost of Government Day is six days later in 2002 than it was last year and it is now at its highest level since 1996. This was primarily due to the recession (which slowed the growth of national income) while total government spending continues to increase in an unprecedented manner. Federal regulations also increased slightly for the first time in several years due to the War on Terrorism and the estimated cost of tax compliance increased by 50 percent.

Cost of Government Day 1977 – 2002



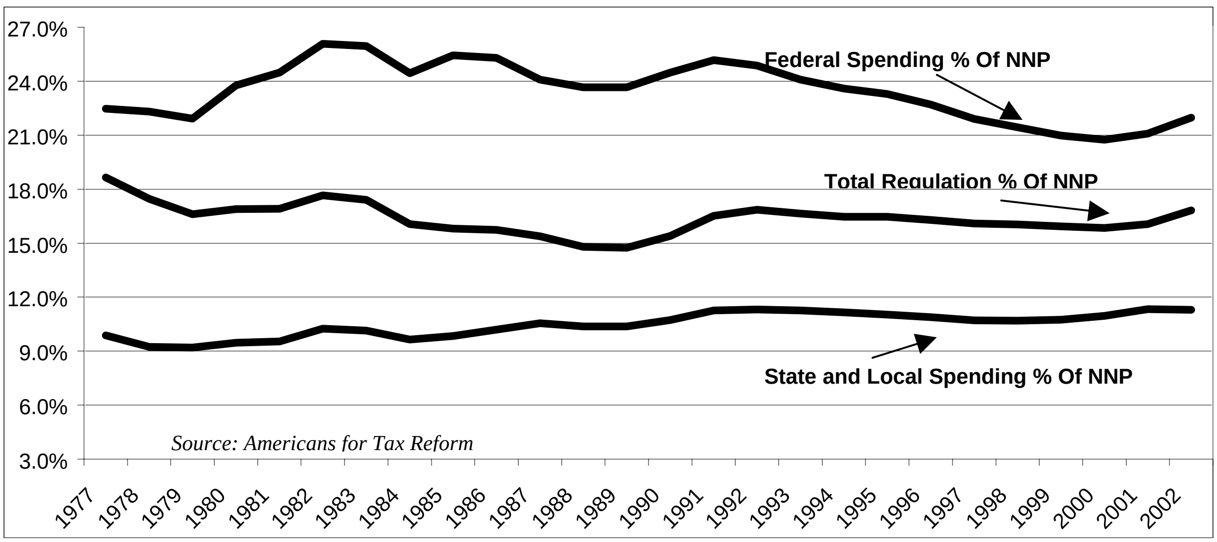
The increase can even be greater this year once the final numbers come in for spending on the War on Terrorism. While fighting the War on Terrorism is important, many members of Congress have also used this opportunity to load spending bills with unnecessary pork barrel spending guised as homeland security. Policymakers should be using the War on Terrorism to fund unnecessary programs and they absolutely must focus on reducing the cost of government substantially once that conflict is over. The data also shows the need to focus on tax reform to reduce the needlessly high cost of tax compliance.

Why is a lower Cost of Government desirable? First, because a lower Cost of Government means more of the money produced by workers, investors and entrepreneurs is left in their hands. That expands the economic freedom of everyone in the economy to choose how to consume, save and invest what they produce. It increases personal choice and control. Moreover, expanding the freedom and control of all Americans over what they produce follows sound notions of economic justice.[2]

Secondly, a lower Cost of Government increases the incentives for work, savings, investment and entrepreneurship. That is because with less taken in taxes and regulatory costs, the reward for all these economic activities increases. That in turn will mean more work, savings, investment and entrepreneurship. The end result would be expanded economic growth and opportunity, with more jobs, higher wages and increased personal income overall.

Restraining federal government spending as a percentage of national income fueled the downward trend in the Cost of Government Day over the past decade. Now, however, federal spending has been increasing much faster than the growth of national income and is projected to increase even more in the next year. Furthermore, regulatory costs have increased slightly while state and local governments also spent their accelerating tax revenue gains from the latter half of the last decade. These three variables have combined to increase the Cost of Government for the past two years.

Components of the Cost of Government 1977 –2001 (as percentage of NNP)



While federal spending tends to overwhelm regulatory and state and local spending, both state and local revenues, and the cost regulation, should not be considered insignificant. On the contrary, state/local taxes and regulation contribute approximately 56 percent to the Cost of Government. In fact, as the federal government restrained spending in the latter half of the last decade, state/local government spending and regulatory costs increased as a percentage of the Cost of Government.

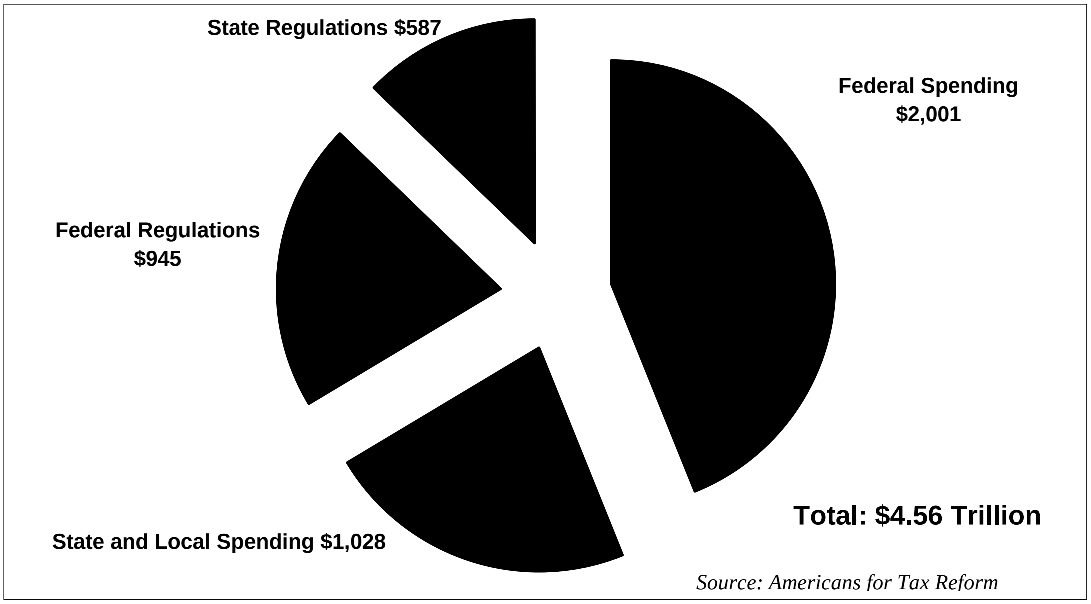
Throughout the past decade, state governments were flushed with tax revenues and spent those tax revenues on new programs. This spending outpaced growth of national income and clearly was excessive. When the economy cooled and revenues dipped, state governments were faced with budget shortfalls and spending commitments they could not afford. Yet, state governments have refused to make the tough decisions and cut this excess spending. Instead state policymakers have decided to raise taxes on working American families to bail out their mismanagement and maintain current levels of spending. Despite complaining about budget shortfalls this year, some states have

[2] Robert Nozick, *Anarchy, State and Utopia*, (New York: Basic Books, 1978).

even increased spending two to three times the rate of inflation, which will be funded with new tax increases. Approximately 40 states now have budget deficits and are expected to raise state taxes by a total of $10 billion in the next year. This will increase next year’s Cost of Government significantly, but will vary by state.

The largest component of the Cost of Government is federal spending, which accounts for 44 percent of the total. State and local spending accounts for 22.5 percent and federal regulations 20.7 percent. State and local regulation accounts for the remaining 12.9 percent.

2002 Cost of Government (in $ billions)



Federal, state and local spending combined account for 66.4 percent of the total Cost of Government. Federal and state regulations account for 33.6 percent of the total.

In total, federal government accounts for 64.5 percent of total costs, with state and local governments accounting for 35.5 percent.

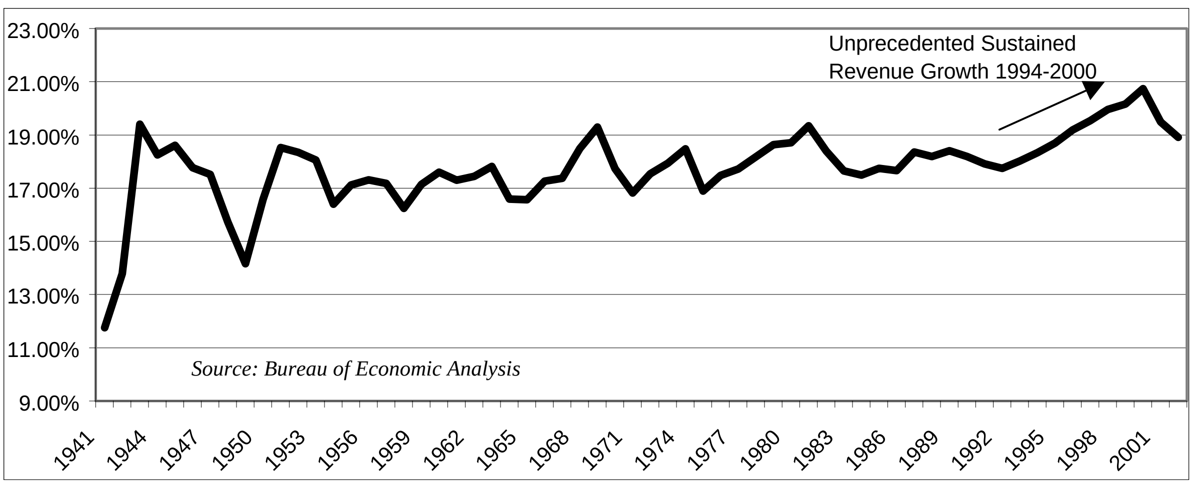
THE BURDEN OF GOVERNMENT SPENDING

Federal Taxation

Over the past decade, American taxpayers were saddled with the highest tax burden since World War II. For the past sixty years, federal revenues stayed in a stable range of 18% to 20% of Net National Product (NNP). But the huge tax increases adopted by President Clinton in 1993 raised taxes well outside this range. Taxes as a percentage of income climbed to 21.3% of national income by 1996 and an incredible 23.3% by 2000, higher than during World War II.[3]

Fortunately, the two tax cuts adopted under President Bush have stopped the increasing tax burden adopted under Clinton and brought that burden back towards its historical range relative to income. But even with the Bush tax cuts, federal taxes would still consume about 21.5% of national income, based on CBO projections, well above the historical range of 18% to 20%. Furthermore, if the Bush tax cuts are not made permanent, taxes as a percentage of income will again reach the historical levels experienced throughout the Clinton era.

Federal Revenues As A Percentage of Gross Domestic Product (GDP)



However, as the federal tax burden gradually lowers on the American taxpayer, federal spending is moving in the complete opposite direction. Reducing the federal tax burden back to the historical range of 18 – 20 percent requires Congress to stop spending. The strategy by opponents of tax cuts in the Congress has been to increase spending significantly, thus growing the size of the deficit and then to blame the Bush tax cuts for the deteriorating budget outlook. Accordingly, the assumption by opponents of tax cuts is that less revenue from tax cuts leads to budget deficits but new spending on government programs (that continually grow faster than actual revenue) has no impact on budget deficits. In reality, however, it appears that the exact opposite scenario is taking place.

According to the Congressional Budget Office, "over 70% of (FY2002 surplus reduction) results from the weak economy and related technical factors." Technical factors include CBO's overly optimistic forecast of capital gains revenue, which inflated the size of the budget surplus in the forecast. ATR is predicting that the capital gains revenue forecast is off by as much as $40 billion, and that the terrible forecasting of capital gains revenue will be anywhere from 20-40 percent of the

[3] Id.

2002 budget revision. Moreover, with fiscal year 2002 spending on pace to increase ten percent above last year, spending will be playing a much greater role for the worsening budget outlook then the tax cuts.

Regarding the tax cuts, the complete opposite has taken place then what the tax cut demagogues are screaming about. For example, in 2002, the President's tax cuts injected an additional $69 billion of tax relief into the hands of consumers and small businesses, which was used to bolster consumer spending, and in effect, helped businesses work off excessive inventories which will lead to future employment growth.

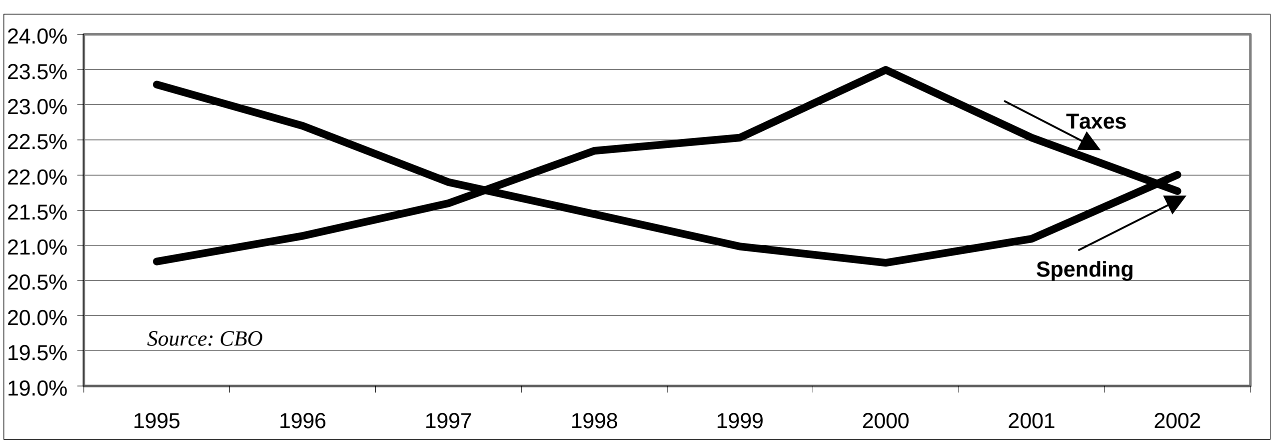
In fact, the strong 6.1 percent increase in Gross Domestic Product (GDP) during the first quarter of this year can be attributed to businesses working off excess inventories due to strong consumer spending. As such, the additional disposable income supplied by the tax cuts played an integral role in helping make this the shallowest recession on record, and actually helped keep revenues flowing into the government coffers.

Finally, there has been a more indirect effect from the President's tax cuts that opponents do not see: the reduction of enormous household debt burdens accumulated during the previous recession. From 1991 to 2001, household liabilities more than doubled, from $3.9 trillion to $7.9 trillion. The tax cuts boosted disposable income, which is clearly helping consumers pay off this enormous household debt.

In fact, consumer debt service burdens (as a percent of disposable income) fell to 14.05 percent in the first quarter of 2002 down from 14.32 percent in the fourth quarter of 2001. This is because disposable income is rising at a pace faster than debt service burdens for the first time in years. Thus, the tax cuts are setting the stage for continuous and more aggressive consumer spending in the future. This will only continue to further grow the economy, and hence, the budget scenario both in the short-term and the long-term.

However, while the President's tax cuts have been beneficial to the economic recovery and prevented tax revenues from precipitously declining during the recession, spending is moving in a completely opposite direction.

Collision Course: Taxes And Spending (% of NNP) Moving In Opposite Directions

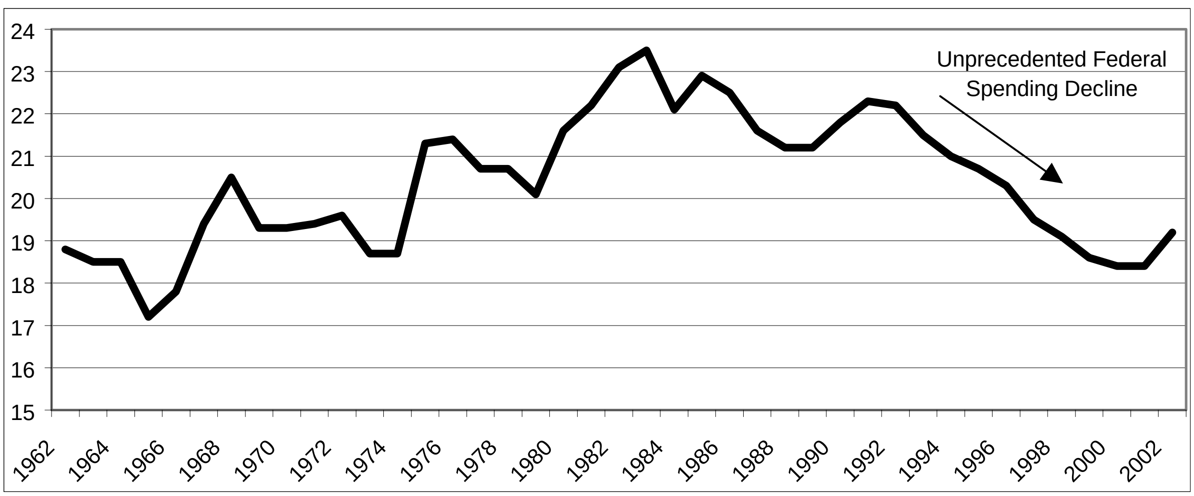


Federal Spending

Federal spending continues to be the single largest component of the total Cost of Government. Over the past decade, federal spending as a percentage of national income declined each year but now has risen two consecutive years. As such, federal spending is the main variable explaining the significant increase of the total Cost of Government over the last two years.

The rise in spending over the past two years is in direct contrast to the previous ten-year trend when that spending as a percentage of national income declined every year from 1991 until 2000. In fact, federal spending (as a percentage of income) declined for nine straight years, which reduced government spending from one out of every four dollars of national income to one out of every five dollars. By 2000, the average American worked 11 days less to pay off their entire spending and regulatory burden to government than in 1991.

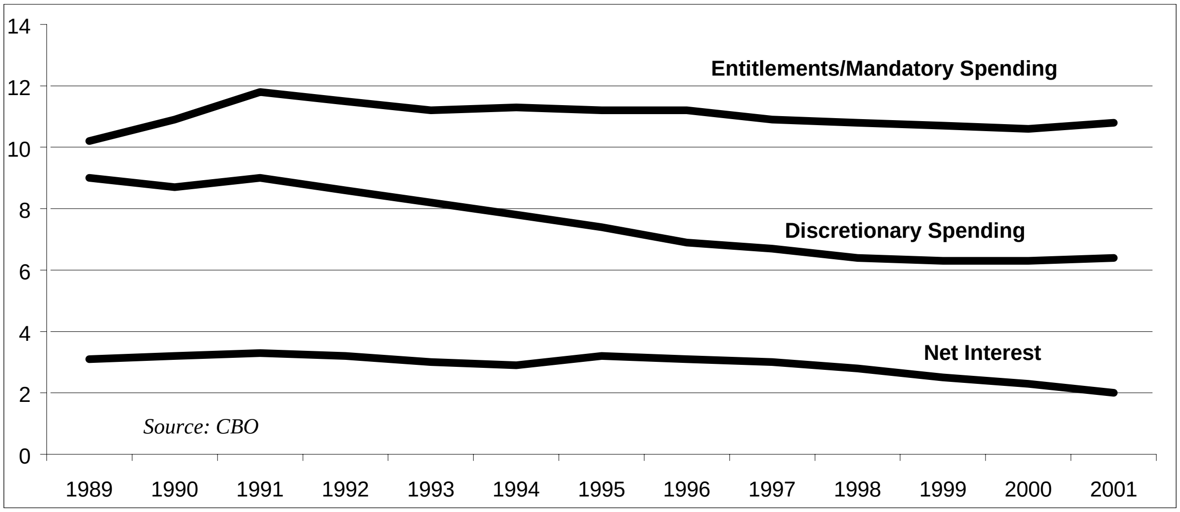
Federal Spending as a Percentage of Gross Domestic Product (GDP)



Over the past two years, however, federal spending has taken a dangerous course and now consumes 22 percent of national income. Essentially, the two-year rise in federal spending has wiped out all the reductions achieved from 1996 through 2000. Furthermore, the increase over the last two years is the largest since the 1989-91 period, when higher taxes fueled increasing spending. Even more remarkable is the fact that Congress is in the process of passing even more spending bills that will take effect next year, thus furthering the increase in the cost of government in the future.

The most significant factor in driving the unprecedented decline of federal spending were the limits placed on discretionary spending and restraint in creating new entitlements. In fact, according to the CBO, discretionary spending declined from 42.8 percent of federal spending in 1989 to 34.4 percent in 2000. Fiscal restraint by Congress, without question, limited the amount of revenue being spent. This, in turn, helped fuel surpluses, which was used to reduce debt and thus lowered the percentage of spending required for interest costs. Now, with increasing spending back on the horizon, new discretionary spending coupled with rising interest payments will lead to increasing higher costs of government for American families in the future.

Federal Spending by Source 1989 – 2001 (percent of Gross Domestic Product)



As mentioned earlier, federal spending is currently rising ten percent over last year's spending, which is more than three times faster than the expected increase for national income. There are a number of reasons for this upward surge, some short-term and some long-term. The War on Terrorism has increased defense spending by sixteen percent in the current fiscal year, as well as additional funding needed for transportation and other homeland security items.

However, the blatant fiscal irresponsibility of Senate must be noted here. The Senate version of the FY 02 Emergency Supplemental increases spending by approximately $4 billion above the amount President Bush requested. Moreover, the Senate removed $10 billion of the President's emergency items and replaced it with $14 billion of special interest pork, guised under the name "homeland security." Some of the ridiculous items in the bill include mapping coral reefs in Hawaii, protecting worms in alcohol at the Smithsonian, and studying bee populations. These are clearly not essential homeland security items, but have been guised as, and thus are also contributing to the rise in spending.

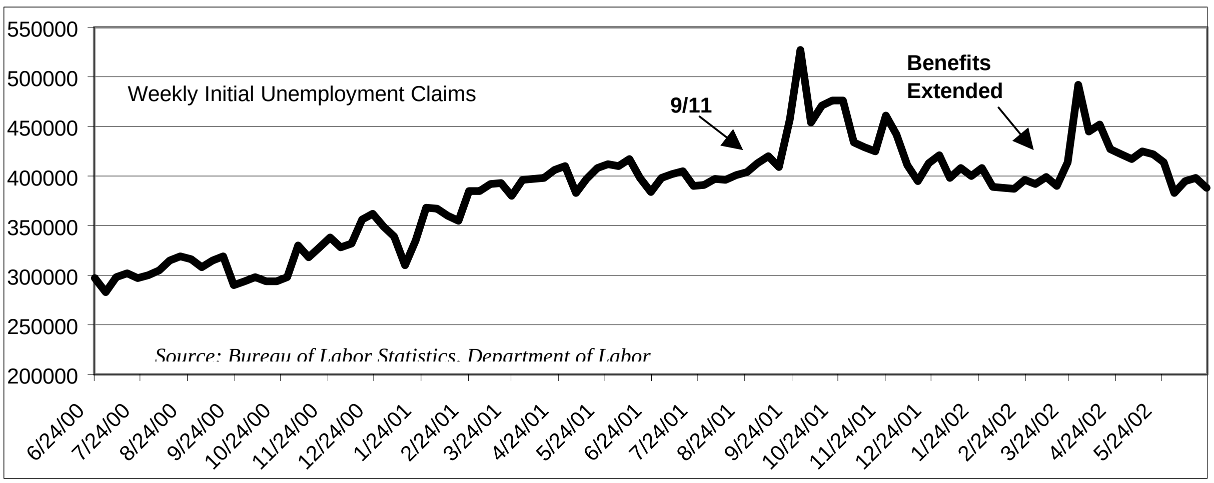
Given the recession and the war's effect on the federal budget, the Senate should not use the War on Terrorism as an excuse to first, increase spending, and second, to justify unnecessary pork spending. Instead, given the current fiscal climate, Senators should ensure that each dollar spent is used in the most efficient manner. This legislation clearly violates that principal at the expense of American taxpayers and working families.

Second, unemployment insurance funding has precipitously grown this year, increasing by more than 70 percent over the past fiscal year. Congress enacted a 13-week extended unemployment benefit as part of the economic stimulus package, which is expected to more than double outlays on unemployment insurance. However, while some people claim this was essential, the results of extending unemployment benefits have been dismal.

Prior to September 11th, initial claims for unemployment benefits were hovering around recessionary levels of 400,000 initial claims a week. Without question, the labor market was slumping and the attacks only further exacerbated the employment situation. In fact, initial claims reached its peak of 520,000 claims the week of September 29th and subsequently declined by more than 36 percent by mid-February.

Once the extended UI claims were enacted in March, however, claims spiked again up to 492,000, giving back nearly all the gains recovered over the previous five-month period. Furthermore, continuing claims reached its highest level since 1983 during this time. Now, after four months, the extended unemployment benefits are running out, the labor force is reabsorbing workers, and we are back at our pre-September 11th levels. It appears that extending unemployment benefits not only increased the Cost of Government Day, but also **increased** unemployment by providing an incentive for people to remain unemployed.

Extending Unemployment Benefits Increased Unemployment



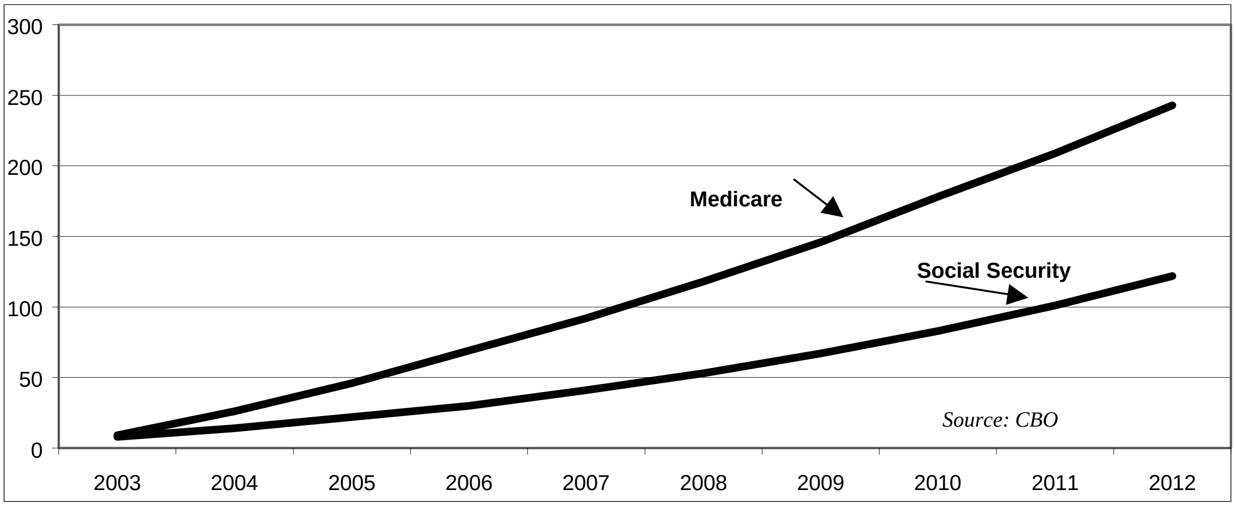
Finally, Medicaid and Medicare continue to increase in cost. Through the fiscal year 02, Medicare spending is up by more than ten percent and Medicaid spending is up by nearly 15 percent. As the nation's demographics shift to an aging population we can expect further upward pressures on Medicare spending. Accordingly, any new prescription drug benefit must be accompanied with Medicare reform to prevent the budget from bursting.

CBO expects discretionary spending to increase only half the rate of economic growth in the future, thus furthering this downward trend. However, the real problem on the horizon is the entitlement spending. Currently entitlement spending consumes half of the federal spending budget. Over the past fifty years entitlement spending has consistently increased, from 32 percent in 1969 to 59 percent in 2001. CBO further expects entitlement spending to reach 70 percent of all spending by 2012.

In total, mandatory spending is expected to increase by nearly $1 trillion over the next ten years. If this does occur, the entitlement spending will double from what we are paying currently. Therefore, the expected rise in entitlement spending will outstrip national income rising from 12.9 percent of national income in 2003 to 13.6 percent of national income in 2011.

Explaining this rise in entitlement spending is Social Security and Medicare, which consume 72 percent of all entitlements. Both programs face a looming crisis in the future, as America's population grows older and thus place greater demands on the system. Accordingly, both programs must be reformed to help keep the standard of living rising for American taxpayers. Clearly, without reform, taxes will be increased substantially just to pay the bill for increasing costs.

Expected Spending Increases Needed For Medicare and Social Security ($billions)



Although reform seems like common sense, Congress is getting set to debate a prescription drug benefit as part of Medicare. The House version is seeking more than $300 billion over ten years, while the Senate version will cost an astronomical $800 billion over ten years. Yet, neither version substantively addresses the reforms needed to restructure Medicare.

One idea to reform Medicare is to model a plan similar to the Federal Employee Health Insurance Plan, which covers 9 million civilian employees and their dependents. Under this model, Medicare's promise of defined benefits is matched with competition between private health plans and traditional Medicare plans. This will help keep costs down in the long-term while providing a reliable and flexible approach to providing healthcare services for those who need it.

Social Security is the largest component of entitlements. The growing insolvency of Social Security looms on the horizon for policymakers. Given the demographics, if social security is not reformed, benefits will have to be cut by 30 percent or payroll taxes increased by fifty percent. Allowing younger workers to voluntarily allocate a portion of their payroll taxes in market investments which significantly help ease the $17 trillion Social Security benefit shortfall expected in twenty years from now. Moreover, it is imperative that this reform begin immediately or the average American worker will be working until late July to pay for policymakers not having the leadership to transform Social Security for the next generation.

State and Local Spending

State and local spending has increased over the past few years. After the 1990 recession many states raised taxes to bail out their fiscal mismanagement. This, in turn, actually slowed the states' economic recoveries and tax revenues. It was not until 1997 when revenues began to pour into state coffers. The states used this new revenue to increase spending significantly. As such, state and local spending started to exceed growth of national income. Since 1999, state and local spending has increased from 10.7 percent to 11.3 percent in 2001. Despite all the noise about state budget deficits in the press, however, states have chosen to raise taxes rather than cut spending and this year are expected to increase spending roughly equivalent to growth in national income.

However, it appears state governments, as a whole, will experience a substantial increase in next year's COGD report. With 40 states facing budget deficits and balanced budgets required by their constitutions, many states have proposed raising taxes. Taxes will be raised an estimated $10 billion in the states next year, with nearly half coming from California's Gov. Gray Davis.

States are facing budget deficits because of massive overspending throughout the 1990s. In fact, according to the American Legislative Exchange Council (ALEC) state budgets increased 63 percent from 1990 through 2000. This represents an annual increase of 3.6 percent a year above the rate of inflation.[4] Moreover, in the latter half of the decade state budgets increased twice as fast as federal spending and nearly four times the rate of inflation.

A short-term goal should be to reduce state and local spending to the level of 10 percent of national income. This goal can be achieved by limiting state spending expenditures to the rate of inflation plus population growth and returning additional revenues back to the taxpayers.

An example is the State of Colorado's Taxpayer Bill of Rights (TABOR), which passed by citizen initiative in 1992 and has been enforced vigorously by Gov. Bill Owens. This program limits increases in per capita state expenditures to the inflation rate and mandates that surplus revenues be returned to taxpayers. According to Michael New of Stanford University, between 1997 and 2002 the state of Colorado has issued annual rebates totaling more than $3.2 billion to its residents.[5] And in 2002, Colorado residents will be the only state actually cutting taxes for its residents.[6]

[4] American Legislative Exchange Council, Crisis in State Spending, 2002.
[5] Michael New, Triggering Tax Rebates, Cato Institute April 2, 2002.
[6] Stephen Moore, Governors and Drunken Sailors, National Review June 3, 2002.

THE BURDEN OF REGULATION

As previously mentioned, we determined the cost of regulation based first on the new study of regulatory costs produced by Crain and Hopkins in 2001. That study estimated the total cost of federal regulation as $843 billion in 2000.[7]

Where Crain and Hopkins reported that the costs of subcategories of federal regulations were correlated with GDP, we increased the estimate of those costs to account for GDP growth since 2000.

Moreover, federal agencies are now required to provide cost-benefit analyses for proposed "major" regulations, defined as regulations estimated to result in annual regulatory costs of $100 million or more. There have been 86 such major new regulations since 2000.[8] We assumed very conservatively that each of these regulations imposed only $100 million in new costs, even though almost all of them substantially exceeded that level. For example, a nitrogen oxide rule issued by the Environmental Protection Agency (EPA) is estimated to add $1.7 billion in regulatory costs each year. We also didn't count any of the costs imposed by the myriad of smaller new federal regulations estimated to cost less than $100 million each year. Based on this methodology, we estimated that these 86 regulations added annual costs of $8.6 billion overall.

We then added the increase in the costs of tax compliance since 2000 estimated by the Tax Foundation. Crain and Hopkins included in their study the Tax Foundation's estimated annual cost of $129 billion for tax compliance in 2000. But the Tax Foundation's estimate for the cost of tax compliance soared to $194 billion in 2002. This increase is mostly due to improved methods of estimation, rather than a rapid real increase in compliance costs

With these adjustments, we estimated federal regulations to cost $945 billion in 2002. But apart from the estimated increase in federal tax compliance costs, federal regulatory costs have only increased about 2% per year since 2000. Consequently, the Bush administration seems to have been effective in slowing the growth of federal regulation.

Nevertheless, total regulatory costs, including state and local regulation, account for a hefty 16.8% of national income. Consequently, regulatory costs alone are consuming one out of every six dollars produced by the American people. This regulatory burden needs to be reduced to enhance economic prosperity and freedom.

Indeed, the ATR estimate of regulatory costs includes only the cost of complying with regulations. This includes the material resources and labor needed to carry out compliance with this regulatory requirement. For example, if a regulation requires new pollution control equipment for power plants, compliance costs include the costs of manufacturing, installing, operating and maintaining the equipment.

This leaves out all of the negative economic effects of the costs of regulatory requirements. These added costs slow the economy, as they introduce inefficiencies and distortions, and reduce the economic reward left over for productive activity. The new costs may prevent new firms from entering the market, or stop existing ones from expanding. They may even force some existing

[7] Crain and Hopkins (2001).
[8] General Accounting Office, SBREFA Rules Reports.

firms out. The end result is less overall output, fewer jobs, lower wages, and lower overall economic growth.

These costs may be as large as the direct compliance costs of regulation. Economists at Washington University in St. Louis, a leader in the study of regulation, have estimated these costs to be over $1.5 trillion per year in current dollars. The full, true burden of regulatory costs may consequently be twice as large as estimated above. This makes reform to reduce regulatory costs twice as urgent.

Consequently, the Bush administration, congressional leaders, and state and local leaders need to develop more aggressive long-term reform initiatives to reduce the cost of regulation.

STATE-BY-STATE BREAKDOWN

Below is the Cost of Government Day for each state based on the varying government burdens applying in each state. Federal tax burdens vary because relatively higher burdens are borne by states with relatively higher incomes. Of course, state and local tax burdens vary by state as well.[9]

The highest state Cost of Government Day by far is in Connecticut. The day there falls 17 days later than the rest of the country, coming on July 18. This is five days later than Cost of Government Day for the second highest state, Washington. The burden in Connecticut is so onerous both because it has very high relative incomes, getting a big hit from the federal income tax, and because it has high state and local taxes.

The third highest Cost of Government Day state is New York, followed by New Jersey, Wyoming and Wisconsin. Cost of Government Day in the remaining states is no more than two days later than the average for the entire country.

[9] State Cost of Government Days are calculated starting with the Tax Freedom Day for each state calculated by the Tax Foundation in its annual report for 2002. Moody and Hoffman, April 2002. The number of days spent working for regulatory costs and for the federal deficit is then added to each state's Tax Day. Since no credible estimates of state-by-state regulatory burdens exist, days worked due to regulatory and federal deficit costs were estimated to be the same in every state. This number is added to the Tax Freedom Day for each state to produce Cost of Government Day.

State	Tax Freedom Day	Cost of Government Day	Rank
Alaska	4/8	6/12	1
Oklahoma	4/15	6/19	2
West Virginia	4/16	6/20	3
Alabama	4/16	6/20	3
Tennessee	4/16	6/20	3
North Dakota	4/17	6/21	6
South Dakota	4/18	6/22	7
Mississippi	4/18	6/22	7
Montana	4/18	6/22	7
Louisiana	4/19	6/23	10
South Carolina	4/20	6/23	11
Kentucky	4/20	6/23	11
Missouri	4/20	6/23	11
Idaho	4/20	6/23	11
Texas	4/20	6/23	11
North Carolina	4/20	6/23	11
New Mexico	4/21	6/25	17
Oregon	4/21	6/25	17
Iowa	4/21	6/25	17
Indiana	4/22	6/26	20
Hawaii	4/22	6/26	20
Maryland	4/23	6/27	22
Pennsylvania	4/23	6/27	22
Utah	4/23	6/27	22
Arkansas	4/24	6/28	25
Virginia	4/24	6/28	25
Colorado	4/24	6/28	25
Kansas	4/24	6/28	25
Georgia	4/24	6/28	25
New Hampshire	4/25	6/29	30
Ohio	4/25	6/29	30
Nebraska	4/25	6/29	30
Arizona	4/25	6/29	30
Delaware	4/25	6/29	30
Vermont	4/27	7/1	35
Florida	4/27	7/1	35
Nevada	4/27	7/1	35
Rhode Island	4/28	7/2	38
Massachusetts	4/28	7/2	38
Maine	4/29	7/3	40
California	4/29	7/3	40
Illinois	4/29	7/3	40
Michigan	4/29	7/3	40
Minnesota	4/29	7/3	40
Wisconsin	5/1	7/5	45
Wyoming	5/4	7/5	46
New Jersey	5/5	7/9	47
New York	5/6	7/10	48
Washington	5/9	7/13	49
Connecticut	5/14	7/18	50
District of Columbia	5/17	7/21	-

RECENT DEVELOPMENTS

Taxes and Regulation

The biggest news on the tax front is the passage of the two Bush tax cuts, The Economic Growth and Tax Reform Reconciliation Act of 2001 (EGTRRA), passed in May 2001, and the Job Creation and Worker Assistance Act of 2002 (the economic stimulus package), passed in March 2002.

The first bill embodied the Bush tax cut promised in the 2000 campaign. It reduced taxes by $1,348 trillion from 2001 to 2010, the largest tax cut since the Reagan tax cuts of 1981. The major components of the Bush tax plan as enacted included:

- Income tax rates were reduced across the board. The 28% tax rate was reduced to 25%, the 31% rate was reduced 28%, the 36% rate was reduced to 33%, and the top 39.6% rate was reduced to 35%. These rate reductions were all phased in over 2001 to 2006.

- The 15% bracket was also reduced to 10% for the first $6,000 in income for singles (up to $7,000 in 2008), the first $10,000 for heads of household, and the first $12,000 for married couples filing jointly ($14,000 in 2008).

- Under the old tax code, the taxpayer's itemized deductions and personal exemptions were arbitrarily reduced and ultimately phased out as income rose. This effectively imposed a higher marginal tax rate on income. The Bush tax plan, however, eliminates these reductions and phase outs, allowing all taxpayers their full itemized deductions and personal exemptions. This is effectively another significant reduction in marginal tax rates.

- A slow phase out was adopted for the entire death tax (known in some circles as the estate tax), with complete elimination by 2010. The companion Generation Skipping transfer tax, which helps to enforce the estate tax, is also phased out on the same schedule.

- Relief from the marriage penalty, which imposes higher income tax burdens on married couples than on singles, was adopted by phasing in an increase in the standard deduction for married couples by 15% so that it is double the standard deduction for singles. The income threshold at which the taxpayer jumps from the 15% tax bracket to the next highest bracket was also increased about 11% for married couples so that it will be double the threshold for single people.

- The child tax credit was also increased in steps from $500 to $1,000 by 2010.

- The Bush tax bill also increased the maximum annual contribution limits for traditional and Roth IRAs. The maximum contribution limit will now be $3,000 per year for 2002 through 2004, $4,000 per year in 2005 through 2007, and $5,000 in 2008. This limit is also indexed to increase with inflation in future years.

- The annual contribution limits on Section 401(k) and Section 457 plans, which are supplemental, employer related, defined contribution, retirement plans, have also been increased to $11,000 in 2002, $12,000 in 2003, $13,000 in 2004, $14,000 in 2005, and $15,000 in 2006. These limits are now indexed as well to increase with inflation in future years. A new tax credit for contributions to these plans by lower and moderate income workers was also adopted, effectively providing a federal match to such contributions to encourage these lower-income workers to participate more.

- The annual contribution limit for education IRAs was also increased from $500 to $2,000. Moreover, the new law allows these funds to be used for elementary and secondary school expenses as well as higher education. This is very significant because the education IRA now effectively provides a limited federal tax deduction for private school tuition expenses. In addition, the Bush bill allows employers and tax-exempt organizations to contribute to education IRAs, making it a promising vehicle for providing resources for lower-income children to attend the school of their choice.

- The Bush tax bill also increased the Dependent Care Tax Credit, permanently extended the Adoption Tax Credit, adopted a tax credit for employer provided child care expenses, slowed the phase down of the Earned Income Tax Credit as income rises, extended the exclusion for employer provided education expenses to apply to graduate school education and made the exclusion permanent, and adopted a deduction for qualified higher education expenses.

This broad, highly beneficial tax bill will increase economic growth as well as allowing people to keep more of their money with the freedom to choose whether and how to spend or save it. But there is a problem. To satisfy procedural budget rules at the time of adoption, Congress included a clause in the tax cut bill providing that all these tax cuts automatically expire in 2011. Therefore, without change, a massive tax increase will occur in 2011 and undo all the good work done by the Bush tax cut.

As a result, President Bush and congressional Republicans have called for making the Bush tax cuts permanent. But congressional Democrats led by Senate Majority Leader Tom Daschle (D-S.D.) are bitterly opposed to that. They are supporting an effective repeal of the Bush tax cuts and an enormous consequent increase in taxes in 2011.

The economic stimulus package adopted in 2002 provides additional tax relief of $111 billion over 2002 to 2005. The bill provided for accelerated depreciation for investments made in the three-year period starting in September 2001. It extended the tax provisions for Medical Savings Accounts, as well as the welfare to work tax credit, the work opportunity tax credit, and tax incentives for investments on Indian reservations. It also adopted measures targeted to New York City to help it recover from the terrorist attack, such as a tax credit for damages, accelerated depreciation for investment, and tax-exempt bonds for rebuilding.

- According to the latest annual Tax Day Report of the Tax Foundation, Americans pay more in total taxes than they do for food, clothing and shelter combined. The Tax Foundation reports that in 2002, the average American will work 117 days out of the year just to earn the money needed to pay federal, state and local taxes. But the worker will only have to work 106 days to cover food, clothing and shelter.[10]

- Higher income workers actually pay a huge proportion of federal income taxes. The top 1% of income earners now pay an incredible 36% of all federal income taxes. The top

[10] Moody and Hoffman, The Tax Foundation, April 2002.

5% pay 55.5% of federal income taxes, while the top 10% pay 66.5%. The top 50% pay 94% of federal income taxes, while the bottom 50% pay just 6%.[11]

- The 2002 farm bill pending in Congress would impose total costs in terms of taxes and higher food prices that would be $462 billion over 10 years. This will amount to $4,337 for each household in America.

  The Heritage Foundation, www.heritage.org

- The cost of federal regulation in 2002 will amount to $9,151 for each household in the country. The cost of total regulation this year, counting the state and local regulatory burden, will amount to $14,837. Regulatory costs involve lost wages or increased prices costing this amount for each American family on average

- Small business bears a disproportionate share of regulatory costs. According to Crain and Hopkins, in 2000 firms employing fewer than 20 employees bore federal regulatory costs of $6,975 per employee, about 60% more than the per employee costs of federal regulation borne by firms employing over 500 workers.[12]

- Small manufacturing firms bear an even more disproportionate share of the regulatory burden. The estimated cost per employee of federal regulation for small firms with less than 20 workers is $16,920, 127% higher than for medium-sized firms, and 140% higher than for large firms.[13]

- Between 1970 and 2000 regulatory agency budgets grew by 203% in inflation-adjusted dollars. Total staffing in federal regulatory agencies in fiscal year 2000 equaled nearly 130,000 full-time equivalent employees, an increase of 86% since 1970.[14]

- "Beyond the ongoing Department of Justice crusade against the Microsoft Corporation, federal regulators have stepped up antitrust enforcement efforts within the field of high technology. Increasingly, federal bureaucrats to extort concessions or favors from industry in exchange for approval use the merger review process. Such regulatory blackmail results in confusing, contradictory regulatory standards and endless regulatory delays. A recent Heartland Institute study finds that regulatory merger delays in restructuring industries resulted in costs of more than $12 billion in 1996."

  The Heritage Foundation, Key Regulatory Facts and Figures, www.regulation.org

- A May 1999 review of economic deregulation initiatives in the United States by the Organization for Economic Cooperation and Development (OECD) concludes that

  > "The removal of most restrictions on pricing, entry and exit in network industries led directly to increased productivity and lower costs. ... More vigorous competition stimulated industry restructuring and innovation and benefited

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[11] These figures come from official IRS data. This data is thoroughly reported by the authoritative Tax Foundation in Washington, D.C. See David Hoffman, "Who Pays the Federal Individual Income Tax?", The Tax Foundation, Special Report, February 2002, No. 109.
[12] Crain and Hopkins, 2001
[13] Id., p. 34.
[14] Id., pp. 6-7.

consumers through better service and lower prices. ... An extraordinary surge in innovation and faster introduction of new technologies, services and business practices multiplied benefits for consumers and produced new high growth industries.... These effects allowed the U.S. economy to adapt more quickly to changes in technology and to external shocks, improved the trade-offs between inflation, growth, and unemployment, and boosted the U.S. lead in productivity."

Organization for Economic Cooperation and Development, *The OECD Review of Regulatory Reform in the United States*, preliminary edition, May 1999, p. 17, as quoted in The Heritage Foundation, Key Regulatory Facts and Figures, www.regulation.org

- A 1998 study by Brookings Institution Senior Fellow Clifford Winston reviews the deregulation of different U.S. industries. Winston notes that price declines ranged from 30 percent to 75 percent across a range of industries, including airlines, trucking, railroads, banking and natural gas.[49] He concludes that "Deregulation is a long-term process, from which society will continue to reap benefits as firms continue to adjust to free market competition and as more and more industries are more fully deregulated."

  Clifford Winston, "U.S. Industry Adjustment to Economic Deregulation," *Journal of Economic Perspectives*, Vol. 12, No. 3 (Summer 1998), Table 3, p. 101, as quoted in The Heritage Foundation, Key Regulatory Facts and Figures, www.regulation.org

- "In a 1997 study, *Economic Deregulation and Customer Choice: Lessons for the Electric Industry*, Robert Crandall of the Brookings Institution and Jerry Ellig of the Center for Market Processes at George Mason University documented the historical benefits of deregulation. After analyzing five major "network" industries--natural gas, telecommunications, airlines, trucking and railroads--that were deregulated and that share attributes with the electricity sector, they found that regulatory reform and customer choice generated very beneficial results.

  Specifically, Crandall and Ellig found that after deregulation:

  - Prices fall. "Within the first two years of deregulation, prices had fallen by 4-15 percent, and sometimes more for certain groups of customers. Within 10 years, prices were at least 25 percent lower, and sometimes close to 50 percent lower."

  - Service quality improves. "Deregulation and customer choice align service quality with customer desires. Crucial social goals like airline safety, reliability of gas service, and reliability of the telecommunications network were maintained or improved by deregulation and customer choice."

  - The rising tide lifts all boats. "Regulatory reform is not a zero sum game; it has generated genuine gains for consumers and society as a whole. It is possible to find narrowly defined groups of customers in special circumstances who paid somewhat higher prices after deregulation, but the gains to the vast majority of consumers far outweighed the effects on these small groups."

- More freedom equals more benefits. "Rates fell faster in parts of the market where regulators permitted greater customer choice. Choice for all customers for all competitive services will provide the most benefits."

The Heritage Foundation, Key Regulatory Facts and Figures, www.regulation.org

Regulatory Horror Stories

- The federal government imposed Corporate Average Fuel Efficiency (CAFÉ) standards in 1975 requiring automakers to produce cars, minivans, SUVs and light trucks that get better gas mileage. The National Academy of Sciences (NAS) recently released a study showing that since CAFE standards were imposed, an additional 2,000 deaths per year can be attributed to CAFE-required downsizing. That's a total of 52,000 deaths -- nearly as many Americans as were lost in Vietnam. The study also estimates that moving to smaller, lighter vehicles in the 1970s and early 1980s resulted in "an additional 13,000 to 26,000 incapacitating injures and 97,000 to 195,000 total injuries in 1993" alone.

  The Relief Report, National Center for Public Policy Research, Washington, D.C., Issue No. 105, Feb. 28, 2002

- The U.S. government's Energy Information Agency says that the global warming treaty would require the U.S. to cut back on its energy use by as much as 40 percent from current usage levels, which could throw between 1.5 and 3.2 million Americans out of work, raise electric utility bills by 86 percent and add an extra 66 cents per gallon to the price of gasoline. What's more, a report commissioned by the Black Chamber of Commerce, the U.S. Hispanic Chamber of Commerce and four other minority groups estimated that the Kyoto treaty would diminish the earnings of 25 million African-American and Hispanic workers by 10 percent and cost 864,000 African-Americans and 511,000 Hispanics their jobs.

  According to global warming theory, the lower atmosphere, known as the troposphere, was supposed to warm first. But careful measurements made on NASA balloons and satellites have shown no warming.

  The Relief Report, National Center for Public Policy Research, Washington, D.C., Issue No. 104, Feb. 19, 2002

- Indeed, the mammoth west Antarctic ice sheet, which contains enough water to lift the world's sea levels by 20 feet, isn't melting. Instead, its thickening and Antarctica is getting cooler. A new study by researchers from the California Institute of Technology's Jet Propulsion Laboratory and the University of California at Santa Cruz, published in the respected journal *Science*, found that the ice sheets of Antarctica are expanding by some 26.8 billion tons of ice a year. The scientists, Ian Joughlin, a geologist at CIT, and Slawek Tulaczyk, a professor of earth sciences at Santa Cruz, speculate the thickening ice streams are repeating a pattern that occurred from 1650-1850 when the Earth went through the Little Ice Age.

Another study, published in the current edition of the journal *Nature*, found that air temperatures measured in Antarctica's polar desert valleys actually declined by 0.7 degrees from 1986 to 1999.

The Relief Report, National Center for Public Policy Research, Washington, D.C., Issue No. 103, Jan. 31, 2002

- Federal regulators have reduced federal land available for oil and gas exploration in the western U.S. -- where 67 percent of the nation's onshore oil reserves and 40 percent of natural gas reserves are located -- by more than 60 percent since 1983. Oil exploration has essentially been banned from more than 300 million onshore acres of federal land.

  Congress also has prohibited exploration and production on more than 460 million offshore acres, including most of the best prospects for major new offshore discoveries outside the Western and Central Gulf of Mexico.

  The House of Representatives recently voted to permit environmentally responsible drilling on 2,000 acres of the oil-rich 19-million-acre Arctic National Wildlife Refuge (ANWR), most likely America's most valuable oil reserve. The Energy Information Administration estimates that ANWR contains between 5.7 and 16 billion barrels of oil. ANWR oil could replace Saudi oil imports for almost 30 years. Or, it could replace half of what we import from all of the Persian Gulf for 36 years. Yet, Senate Majority Leader Tom Daschle won't schedule a vote on the House bill because, he says, the Senate is too busy with other things.

  The federal government seems to be doing its best to ensure that we remain hostage to Middle East oil policies.

  The Relief Report, National Center for Public Policy Research, Washington, D.C., Issue No. 100, Nov. 1, 2001

- The EPA’s recently approved drinking water standard limits arsenic levels to no more than 10 parts per billion. According to the AEI-Brookings Joint Center for Regulatory Studies, this rule could cost $65 million per life saved. This amount of resources could provide an additional 984 border patrol agents to protect Americans.

  The Heritage Foundation, Issues: 2002, Regulation

POLICY RECOMMENDATIONS

Control Spending.

With the strong economy of the 1990s, and reasoned restraints on spending growth the nation actually made a great deal of progress in reducing federal spending relative to the economy during that decade.

But as this paper demonstrates we are losing control of spending and giving back our hard won gains. The key portion of the budget is discretionary spending, as entitlements and interest are bound by law and cannot be reduced without major reforms. The problem is that the federal government has lost control of **nondefense** discretionary spending in the last few years. We had tight control over this area of spending in the 1990s. In 1996, nondefense discretionary spending actually declined by 1.7%. In 1997, it grew by 3.3% and 1998 by 2.3%.

But in 1999, nondefense discretionary spending grew by 5.2%. Then in 2000, it grew by 7.9%. In 2001, President Bill Clinton's last budget, it grew by 8.9%. But in 2002, President George W. Bush's first budget, nondefense discretionary grew by an astounding 12.7%. That surely reflected emergency domestic spending in response to the September 2001 terrorist attack, which occurred just before the start of the 2002 fiscal year on September 30. But that only underscores the need to better control the rest of the domestic discretionary budget, and maybe avoiding unnecessary spending in response to 9/11.

The Bush administration is clearly trying to get on track with a proposed nondefense discretionary spending increase of 4.45% in 2003, followed by 2.75% in 2004, 1% in 2005 and 2006, and 2% in 2007. By that year, Bush projects total federal spending equal to 18.3% of GDP, the lowest since 1960.

That would be wonderful if it could be achieved. And ensuring that it is should be a chief focus of the taxpayer movement, and conservatives. Libertarians, Republicans and free market liberals. Congress and the Administration should be closely watched, and anyone who proposes to increase spending outside this framework should be ceaselessly challenged, in Washington and at home.

Nevertheless, there is good reason to fear that it will not be achieved. Exhibit A is the new farm bill now working its way through Congress. In 1996, Congress adopted historic farm program reforms with the Freedom to Farm Act. That act replaced price supports and other farm aid with federal subsidies set to decline over time.

But politics has led Washington to increase the promised subsidies in each of the last four years. The new bill would increase farm subsidies by an incredible 75% over the next decade, increasing federal farm aid spending to $174 billion over that time.

The entire federal farm aid framework should, in fact, be abolished, as there is no sound rationale for such public assistance to for profit businesses. Most farm products receive no government subsidies, and they all do better financially because they are not burdened with federal distortion of the marketplace. Federal farm aid just drives down the price of the favored commodity, leaving farmers on the edge financially for such crops and unable to survive without federal aid. With such federal interference abolished, farmers can respond to the market and grow the amount of each crop that market demand would support. Over the long run, they and the taxpayers would all be better off. Eliminating farm programs altogether would significantly reduce the Cost of Government.

Eliminating all other forms of federal corporate welfare would also significantly reduce the Cost of Government. ATR has identified 73 corporate welfare programs, which together spend over $60 billion per year. There is no rationale for these subsidies to Big Business or other for profit businesses.

An even larger reduction in the Cost of Government would result from extending welfare reform. The reforms already adopted apply primarily only to the old AFDC program. Those reforms block granted federal AFDC funds to the states, where they have adopted work-oriented programs. The result has been a reduction in the old AFDC rolls by over 50% across the country.

These same reforms should now be extended to the other major welfare programs – food stamps, Medicaid and housing assistance. This would substantially reduce state and local spending on these programs as well as federal spending.

Reform Social Security.

But the biggest reduction in the Cost of Government would result from Social Security reform allowing workers to choose a personal investment account to finance future benefits in place of some or all of their Social Security benefits. Social Security currently accounts for almost one-fourth of total federal spending (22.4%). To the extent that those benefits were shifted to private personal accounts, federal spending would be reduced.

Moreover, such reform would help to avoid a dramatic increase in the Cost of Government that will otherwise result when the baby boom retires. If no changes are made, then by 2030 Social Security, Medicare and Medicaid alone will push federal spending to 27% of GDP, assuming the rest of the budget grows no faster than the economy. That would increase the federal government by 50% compared to current Bush budget plans.

Such reform would also dramatically benefit working people. They would receive far higher benefits through the personal accounts than Social Security promises, let alone what it can pay. Through the accounts they would also avoid the benefit cuts and tax increases that would be inevitable under the current system.

These higher benefits would result as well for lower-income Americans, African-Americans, Hispanics, women and other minorities, who most need higher incomes in retirement. Indeed, the life expectancy of a black male born today is just under 65 years. But the normal Social Security retirement age is already slated to phase back to 67. That means the majority of black males will never receive any Social Security retirement benefits.

These black males and their families would especially benefit from another feature of personal accounts – when a worker dies he or she can leave the accumulated account funds to their children or other heirs. So a black male who dies before retirement will be able to leave his family with hundreds of thousands of dollars on average, instead of little or nothing through Social Security.

Workers would also enjoy direct personal ownership and control of the account funds, unlike Social Security, which provides workers with no ownership, property or contractual rights. Through personal accounts, the bottom half of the income distribution would be able to participate in the capital markets along with higher-income workers, for the first time. Ownership of wealth would consequently become far broader, as every worker would own a part of the nation's business and industry. This would promote social harmony and solidarity, as everyone would then have a direct stake in promoting the broadest economic prosperity.

Such Social Security reform is, indeed, the most progressive idea on the national agenda today.