STATEMENT OF ALBERT SHANKER, PRESIDENT
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TO THE SENATE COMMITTEE ON FINANCE
ON TAX SIMPLIFICATION LEGISLATION
July 28, 1985

Mr. Chairman, Members of the Committee:

Thank you on behalf of the 610,000 members of the American Federation of Teachers for this opportunity to testify. I will use this occasion to call the Committee's attention to some of the implications President Reagan's tax plan has for public education.

In the opinion of the AFT, the President's tax plan as presented to the Congress will do more harm than good. As we view the elements of the new proposed tax structure, we find President Reagan seeks a continuation of most of the tax preferences enacted in 1981. In addition, the 1985 tax plan would have the effect of severely hamstringing education reform efforts by eliminating the deductibility of taxes paid to state and local governments.

President Reagan's tax plan seems to set the traditional relationship between government and the private voluntary sector on it's head. Mr. Reagan proposes to continue tax deductions for donations for private charitable purposes while eliminating tax deductions for publicly levied taxes that are the base of support for public services. Such a proposal makes little sense from a public policy point of view. State and local taxes are levied through democratic political procedures in order to support the core services of eduction, sanitation, health, transportation, nutrition and other public concerns. Charitable giving is usually a supplement through which private organizations provide additional support for many of these same services. No one would argue that private, non-profit charitable institutions are capable of performing the primary role in the provision of these vital services, yet, the proposed tax bill seeks to make contributions for private supplementary services deductible while eliminating the same deduction for public compulsory support of these same services. As I stated earlier, this change in policy makes no sense, and if enacted, will work to the detriment of public services and those citizens who depend on them.

The AFT does not oppose the allowances in the President's bill for charitable giving, just as we did not oppose allowing non-itemizers to claim a charitable deduction in the 1981 tax bill. We only wish to point out that if deductibility of state and local taxes is lost, a massive inequity will be created as support for private giving stays tax deductible while support for public giving through taxation becomes taxable.

President Reagan's tax bill does not really seek to end tax preferences in our tax code. The tax bill as proposed continues the process of picking winners and losers through tax preferences.

Federal support for all public education through deductibility amounts to approximately $16.5 billion according to a survey done by the AFT. If this federal support is lost, state and local taxpayers will be required to increase their tax liability by an amount greater than the budget for the U.S. Department of Education as proposed by the President for FY'86. As education loses tax support, loopholes for the oil industry and for the corporate sector go unchallenged. Ironically, private sector education will benefit from charitable giving, while public schools may have to endure a 20% decline in property tax support. This is the unexamined impact of the President's tax plan.

It is important to note that education reform and improvement is now a national issue. This has happened in part because of the efforts President Reagan made in 1983 to call attention to our nation's educational shortcomings. Some of us who had been attempting to focus the nation's attention on the need to improve education welcomed the President's leadership. The AFT invited President Reagan to present his view on education reform to our 1983 convention. The President made a compelling case for education reform as a national issue. Mr. Reagan, however, does not believe that the federal government should pay any of the costs for educational improvement.

By and large, states and localities have borne the burden of financing school improvements. Federal cutbacks have been enacted across the board for federal programs that aid state and local governments, yet support for education has increased. The taxpayers have been willing to shoulder the cost of increased education spending in return for improvements in education policies. We, in the AFT fear that if federal deductibility of state and local taxes is lost the efforts now underway to improve education will be stymied. Loss of deductibility could cause a serious erosion in educations' tax base.

Most of the testimony that this Committee will receive will be based upon projections of conditions that may result from one change or another in tax policy. For state and local governments we must rely upon the so called "tax price" method of calculating the effects that loss of deductibility would have on the ability of state and local government to finance education.

Since 1956, when Mr. Charles Tiebout published an article entitled, "A Pure Theory of Local Expenditures" in *The Journal of Political Economy,* "tax price" has been a key concept in public finance literature. The Tiebout model envisions taxpayers "voting with their feet" to find the package of services and taxes that suit their desires. This model has been challenged over the years but no one doubts that government services carry an identifiable price. High officials in the Treasury Department have been known to talk about voters/taxpayers "voting with their feet" to avoid paying high state and local taxes.

The method of calculating the true price of services goes relatively unchallenged: The national average marginal rate under current law is about 28%. Nationwide, under current law, the average itemizing taxpayer pays the following "tax price" for state and local services.

$$T.P. = \$1\ (1\ \text{marginal tax rate})$$
$$T.P. = \$1\ (1-\ .28)$$
$$T.P. = \$0.72$$

The average itemizing taxpayer is paying \$.72 for every dollar received in state and local services. Loss of federal deductibility would mean that itemizing taxpayers would be paying full price for the same services. The loss of deductibility would therefore cause a perception of a sharp increase in the tax price of services such as education. Other favorable developments such as lower rates would not offset the perception that state and local taxes would be sharply higher. The following result would occur:

Current law "tax price" State and Local Services	$.72
Treasury Tax Plan: New Tax Price for S&L Services:	$1.00
Perceived Increase "tax price"	.28
Percentage Increase in "tax price":	.28/.72 = 39%

Some generally accepted guidelines exist for calculating the effect of a 39% increase in the real property tax price. Although there are variations, the Congressional Research Service maintains that "price elasticity" for state and local services is about -0.5. This means that over time voters are likely to respond to a 39% increase in a tax price by demanding that it be cut in half.

If this expectation is accurate we can anticipate a 20% cut in local revenue for education. A revenue cut of that magnitude would certainly result in a similar spending cut.

Because education is still heavily financed by the property tax the "tax price" theory is easily applied. Other public services which depend on state income or sales taxes might not be so subject to "tax price" sensitivity and it is possible that base broadening in the Reagan plan could offset losses. We do know that increasing the tax price will result in a reduction of spending at all levels of government. The Advisory Committee on

Intergovernmental Relations states that local property taxes pay for about half of the state and local cost of elementary and secondary education. The federal government pays about 7%.

The President and Treasury Department have made elimination of deductibility for state and local taxes their number one priority. Presidential Assistant Patrick Buchannan has stated that the elimination of deductibility is aimed at the "neo-socialist" states of the Northeast. The President's plan however, is loaded with tax references for politically powerful elements in the private sector. President Reagan would have us believe that "reform" now depends on more sacrifices from the public sector. This is Mr. Reagan's preference, not a true statement of fact. This current opportunity for tax simplification should not become a contest between public and private needs. It is necessary, however, to point out that the President's philosophy seems to be that economic growth and prosperity must come at the expense of the public sector. The AFT believes that quality education, good mass transit, health care and transportation are indispensable to national economic growth and prosperity. Loss of deductibility will impact negatively on all elements of the public sector. It has become clear over the last few years that the availability of public services, especially education, is an important consideration in decisions made by business leaders. A healthy public sector is just as important as a healthy private sector in the equations of economic growth. The Reagan Administration has stated that rate reduction is impossible without the $38 billion in revenue taken from the public sector through the elimination of deductibility for state and local taxes. We believe that it is very possible to have a tax reform bill and maintain deductions for state and local taxes.

AFL-CIO President Lane Kirkland has presented testimony to this Committee that outlines where revenues can be found to fund tax rate reductions. The AFT endorses the AFL-CIO proposals as the best way to not only reduce tax rates, but restore a measure of equity to the federal tax code.

Like the AFL-CIO, the AFT believes that other elements of the Reagan tax plan must be revised by the Congress. The proposed new taxes on life support benefits such as health insurance, workers compensation, black lung and death benefits are totally wrong and should be rejected by the Committee. The AFT also opposes the Administration's plan to further tax unemployment compensation.

The Administration proposals in the retirement plan area are of serious concern to the AFT and its members. Many of these highly technical proposals would severely discourage teachers from participating in retirement programs, and would greatly reduce the opportunities for them to accumulate necessary levels of retirement income. For example, we are concerned that the proposed changes in the taxation of contributory pension plans will have a particularly harsh impact on teachers and other public employees who commonly participate in these plans. We also are concerned that the proposed restrictions on the payment of benefits under tax-deferred annuity programs (sec. 403(b)), and the proposed 20 percent penalty tax on so-called "preretirement distributions", will severely discourage teachers and other employees with moderate incomes from maintaining or supplementing their retirement security. This is because many persons of modest means will be afraid to set aside amounts of retirement if those funds will be unavailable to meet unforeseen emergencies. Accordingly, the proposed distribution rules would, in practice, significantly decrease, rather than increase, the retirement savings of low and middle income persons. As another example, the proposed repeal of the special "catch-up" limits for tax-deferred annuity programs would have a dramatic effect on the retirement saving opportunities available to our members, and would substantially disrupt established patterns of retirement savings.

In short, these proposed retirement plan changes will only complicate, rather than simplify, the tax law in this area. More importantly, the relatively small amount of revenue which these proposals might raise will bear the costly price tag of lower levels of retirement income for our members and many other working Americans. We strongly recommend that these proposals be rejected.

As I stated earlier, the Administration's plan is not a step forward for most American citizens. Reduction of the maximum rate from 50 - 35% is not a step that helps many citizens. It is especially wrong to use revenues gained from taxing life support benefits to reduce the tax burden on the very rich.

The AFT urges the Congress to pass a fair tax bill. Passage of such a bill will depend upon the determination of the Congress to confront the real special interests in the tax code.

State and local tax deductions are not a special interest, rather they are a key to improving education and many other public sector contributions to our nation's economic growth. Retaining federal deductibility preserves the principle that we should not be required to pay taxes on taxes legally levied by other levels of government.

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