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Tax Proposals and Charitable Giving

Recent proposals for tax reform could cause charitable giving to fall by roughly 20 percent, according to a study by NBER Faculty Research Fellow **Lawrence B. Lindsey**. Contributions from high-income donors would fall by more than 20 percent. Educational and cultural institutions, which are supported primarily by higher-income taxpayers, would be most severely affected.

In *NBER Working Paper No. 1592*, Lindsey analyzes Treasury I, the November 1984 plan that was shaped into the president's tax reform proposal. These plans affect charitable contributions in two ways. First, in calling for lower marginal tax rates, they raise the aftertax cost of giving. Using NBER's TAXSIM model, which simulates behavioral responses to changes in tax laws, Lindsey estimates that the proposed tax rates would raise the average price of giving by about 11 percent.

"A tax reform plan like the president's would... reduce charitable giving by about \$8 billion."

Second, these plans will drastically cut the number of taxpayers who itemize, mostly because the plans would eliminate the deduction for state and local taxes paid. Lindsey estimates that the number of taxpayers who itemize will be cut in half. For those who no longer itemize, the tax incentive for charitable giving will be removed.

According to Lindsey's calculations, the current average net-of-tax cost of a \$1 donation is 70¢ for one who itemizes. The proposed lower rates will raise that cost 8¢; the reduced number of taxpayers who itemize will raise the cost another 8¢. Under a tax reform like the president's, the total price of a \$1 donation would rise from about 70¢ to about 86¢. Lindsey estimates that the effect of these proposed changes would be to reduce charitable giving by about \$8 billion.

The Business Cycle's Effect on the Poor

Who is hit harder by the fight against inflation—the rich or the poor? Some claim that inflation, often dubbed "the cruelest tax," victimizes the poor more than other groups. Thus, they argue, an anti-inflation policy may benefit the poor. Others assert that the poor bear a disproportionate share of the burden when unemployment is used to wring inflation out of the system.

In *NBER Working Paper No. 1567 (Macroeconomics, Income Distribution, and Poverty)*, Research Associate **Alan S. Blinder** and **Rebecca M. Blank** conclude that it is the poor who suffer more. "The poor . . . have good reason to fear the recessions that lie ahead," they state. "When times are bad, less productive workers with lower skills are likely to be laid off first and to bear the brunt of unemployment," the authors note. "Unemployment, not inflation, has the strongest bearing on the well-being of the poor."

Blinder and Blank note that the official poverty rate falls in good times and rises in bad times. During the long expansion of the 1960s, for example, those in poverty fell from about 22 percent of the population in 1961 to about 12 percent in 1969. Poverty then increased during the mild recession in 1969-70 before dropping again in the expansion of 1971-73 to its historic low rate of just over 11 percent. The deep recession of 1973-75 pushed poverty back up again to over 12 percent. Recovery brought another drop; but back-to-back recessions in 1980 and 1981-82 raised poverty from under 12 percent in 1979 to 15 percent in 1982.

The poverty line was set by the government in 1965, based on a calculation of needs of various types of families. Since that time, it has been increased automatically each year by the percentage change in the Consumer Price Index. As real incomes grew in the late 1960s and early 1970s, the poverty line fell from 50 percent of mean family income for a family of four in 1959 to 33 percent in 1973. With the slowdown in economic growth in the last decade, that rate had been stalled around 34 percent ever since.

Blinder and Blank examine the effect of economic activity on income inequality: their research shows that the gap between rich and poor widens when the economy shrinks, and the gap narrows when the economy grows. The poor gain relative to the rich during cyclical upturns because they benefit from higher real wages, longer hours of work, and greater labor force participation.

The authors also find that high unemployment redistributes income away from the poorest two-fifths of families toward the richest one-fifth of families. Inflation, on the other hand, redistributes income away from the richer groups toward the lowest income group. Because unemployment hurts the poor more than the well-off, Blinder and Blank conclude that it is "the cruelest tax."

Blinder and Blank caution that "high unemployment is, presumably, a transitory phenomenon whereas the reduction of inflation that it 'buys' is presumably permanent. Hence the poor should balance the large, but temporary, losses from high unemployment against the small, but permanent, gains from lower inflation."

Among the poor, some groups fare better than others. Households headed by elderly people and by women seem to experience relatively less unemployment during recessions, for instance, since both

groups tend to drop out of the labor force when jobs become scarce.

By contrast, the teenage unemployment rate rises almost twice as fast during recessions as the unemployment rate of all workers. Nonwhite males are hardest hit: when the economy slows, their jobless rate rises three times as fast as the total unemployment rate.

"A healthy, growing economy may benefit all citizens, but it will help the poor the most, while an economic slump will hurt the poor most through increased unemployment."

A variety of government and private programs are explicitly designed to cushion the impact of unemployment on incomes, the authors note. The primary program is unemployment insurance, which covered 58 percent of all jobs in 1950 and 93 percent in 1980. However, many low-income workers are not eligible for unemployment insurance because benefits are restricted to people who worked several months before becoming unemployed. Further, private forms of unemployment protection, such as severance pay, are available to some 65 percent of unionized workers but tend not to help lower-wage workers who are less likely to be unionized.

Food stamps, welfare, and other such transfer payments help some low-income households, but not everyone is eligible. To receive food stamps, a household must have no more than \$1500 in assets (other than a house and car) and gross income no more than 130 percent of the poverty line. Moreover, welfare in half the states does not go to two-parent families.

Although these transfer programs benefit only a portion of the poor, they do ease the pain of recessions and unemployment somewhat. Moreover, food stamps and Social Security are fully indexed. Real Aid to Families with Dependent Children, by contrast, declined substantially between 1970 and 1983: the median state's maximum payment fell 27 percent in real terms as governments did not raise benefits in line with inflation. Blinder and Blank nevertheless conclude that inflation has not seriously lowered the relative income levels of the poor.

Turning to tax policy, Blinder and Blank find that the greatest blow to the poor has been the rapid and continuing growth of the Social Security payroll tax. Changes in personal income taxation have been minor for the very poor, because the earned income credit and the higher standard deduction have cancelled out the effects of a declining real personal exemption. But the state and local tax burden on the poor has increased. Overall, the tax burden on the poor has become greater in recent years.

Looking at the future, Blinder and Blank figure that tax hikes that boost corporate taxes and close loopholes that benefit mainly the rich will be mostly irrelevant to the poor. Indexing of the personal income tax, which began this year, will help the poor by halting the inflationary erosion of the personal exemption and the standard deduction. Scheduled increases in Social Security taxes will make the poor worse off.

In conclusion, the authors find that a healthy, growing economy may benefit all citizens, but it will help the poor the most, while an economic slump will hurt the poor most through increased unemployment.

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The International Competitiveness of U.S. Firms

Has the United States been losing its competitive edge in international markets? Perhaps so, but a new study by NBER Research Associates **Robert E. Lipsey** and **Irving B. Kravis** (*Working Paper No. 1557*) concludes that any such decline probably has not been the result of slipping managerial or technological performance by U.S. firms. In fact, between 1966 and 1977, U.S. multinationals increased their competitive position in international markets.

To measure competitiveness, Lipsey and Kravis look at countries' and firms' shares of world trade. They find that the U.S. share of total world exports of manufactured goods fell from 21 percent in 1957 to 16 percent in 1966 to 12 percent in 1977. In contrast, the share of world manufactured exports produced by U.S. multinationals in factories both in the United States and abroad rose slightly. In other words, although exports of manufactured goods produced in the United States grew more slowly than exports produced in other countries, those exports produced by U.S. multinationals grew more rapidly than exports of foreign firms.

Lipsey and Kravis also find that U.S. multinationals increased their share of manufactured exports both from developed and from developing countries. Multinationals' share of total manufactured exports from the United States rose from 63 percent in 1966 to 72 percent in 1977. In other developed countries it rose from 10 to 12 percent, while in developing countries it rose from 4 to 7 percent. Even in Far Eastern

countries other than Japan, where host country firms have been extremely successful in exporting, exports produced by U.S. multinationals rose from 4 percent of that region's manufactured exports in 1966 to 5 percent in 1977. U.S. firms thus held their own in highly competitive markets around the world.

"Any decline in competitiveness in U.S. manufacturing was not caused by lags in technology or by shortcomings in management."

According to Lipsey and Kravis, these figures suggest that any decline in competitiveness in U.S. manufacturing was not caused by lags in technology or by shortcomings in management, such as an undue focus on short-term profits or poor labor-management. If U.S. firms' technology and management skills in fact had declined relative to those of foreign firms, then U.S. firms' share of world exports also would have decreased. Since this did not happen, the authors conclude that the fall in the export share of U.S.-based manufacturing must have had other causes, such as domestic monetary and fiscal policy or trends in U.S. wages and productivity.

Why Is Productivity in the Construction Industry Declining?

Output per hour in the construction industry grew 2.2 percent per year between 1950 and 1968 but fell at about the same rate (2.4 percent) between 1968 and 1978, according to government statistics. NBER Research Economist **Steven G. Allen** estimates that the most important source of this decline in productivity between 1968 and 1978 was a shift in construction toward single family houses and away from industrial and educational buildings. Because it makes more intensive use of skilled labor, productivity in housing construction is lower than in industrial and school construction; therefore, overall labor productivity fell during this period.

In *NBER Working Paper No. 1555*, Allen further finds that a trend toward younger and less experienced construction workers tended to lower productivity. However, this trend was offset somewhat

by the fact that the workers were better educated than in the past; median years of schooling rose from 11.3 in 1968 to 12.3 in 1978. Another reason for the productivity decline, Allen estimates, was the decline in the percentage of construction workers who were unionized. Previous research by Allen has shown that productivity is higher in the union sector. The sources of this higher productivity include apprenticeship training and more professional management. Declines in the size of the average firm, which reduced economies of scale, and in the amount of capital per worker also contributed to the drop in labor productivity, he finds.

Allen cautions that government statistics may

“The most important source of this decline in productivity between 1968 and 1978 was a shift in construction toward single family houses.”

overestimate the decline in output per hour by overstating the amount of construction cost inflation that occurred between 1968 and 1978. In calculating output, the government divides nominal construction

output by a price index of construction costs. If the construction price index overstates the true increase in costs, the result will be an underestimate of real output.

Moreover, the index of construction costs used by the government to calculate output in the construction industry uses the prices of new single family homes, along with the rate of increase of labor and material prices, as a proxy for the prices of all buildings. Allen observes that between 1968 and 1978, in contrast to earlier periods, prices of single family homes increased considerably faster than prices of apartments and nonresidential structures.

To obtain a better measure of inflation, Allen estimates a separate index for these other structures based on square footage. He also adjusts the government's standard measure of highway construction costs to take account of a shift toward more difficult projects, especially in rural areas. Based on his alternative measures of inflation, Allen concludes that about half of the 1968-78 decline in labor productivity measured by the government was the result of overestimates of construction cost inflation. The actual decline in productivity in the construction industry between 1968 and 1978 was closer to 1.2 annually than to 2.4 percent, he calculates.

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