

MEMORANDUM

July 7, 1989

To: Susan Stuntz  
From: Martin Gleason <sup>HG</sup>  
Subject: Earmarking Book Proposal

Attached is a proposal from economists Richard Wagner and Robert Tollison for a book on "user fees" and earmarked taxes. The book, "Charging Beneficiaries for Public Services: User Charges and Earmarked Taxes in Principle and Practice," will show that fiscal policies permitting cigarette tax revenues to be dedicated for funding various programs -- i.e., education, catastrophic health care, etc. -- violate the classical public finance analysis of earmarking. This analysis holds that earmarking is fair when there is a direct relationship between those being taxed and those who benefit from the services provided by the dedicated revenues.

Wagner and Tollison propose that the book contain 12 chapters individually authored by themselves and five other members of the economist network. While these economists are all credible and respected academicians, the treatise will almost certainly be enhanced by contributions from Henri LePage and Nobel laureate James Buchanan.

The book, which builds upon the eight social cost research papers commissioned in 1988 and 1989 -- as well as Smoking and the State -- will carry over discussion of this issue into the public finance arena. Our social cost resources have been used, to date, to educate the general public and support like-thinking economists and academicians. The earmarking book will expand that audience to include staff of tax-writing committee members in both federal and state legislatures, and other policy-makers.

The book can be completed within nine to twelve months from the date the project is approved. We intend to commission and seek publication of book reviews by the economist network. As several of the book's chapters will stand on their own, we will encourage the authors to submit them separately to independent tax-policy and economic journals for publication. The book will also be a great "hook" upon which to schedule state-specific media tours, particularly when tax legislation is pending.

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Copies of the proposal have been forwarded to Covington and Burling, Federal Relations and State Activities. C&B has cleared the project. FRD has raised no objections and SAD sees some use for a "lay" version of the book. This project also has been mentioned in industry briefings and in presentations to the Communications and Executive Committees.

Several years ago, we identified a need to establish a foundation of support on social costs. A key building block in that foundation was Smoking and the State. We feel the proposal now under consideration will establish a similar broad base of support on earmarking and "user charges." We recommend that The Institute authorize funding for the earmarking book, which is included and budgeted in our 1989 social cost plan. We would like to tell Wagner and Tollison as soon as possible to move forward.

Please let me know if you have questions.

Attachment

CFR 100

CHARGING BENEFICIARIES FOR PUBLIC SERVICES:  
USER CHARGES AND EARMARKED TAXES IN PRINCIPLE AND PRACTICE

edited by

Richard E. Wagner

Center for Study of Public Choice

George Mason University

There is a long-standing principle in public finance scholarship which says that in many cases it is a good idea to try to place the costs of public services upon those who use them. It should perhaps be noted that this "benefit principle" is not generally presumed to be applicable to cases where the redistribution of income is thought to be a significant element of the service being publicly provided, as with various welfare services. But it is thought to be generally applicable to cases where efficiency and not redistribution is thought to be the primary object of the public program. This covers a vast terrain, including highways, airports, retirement insurance, health insurance, higher education, and recreation--to mention but a few of myriad possible illustrations.

This idea of charging beneficiaries is called the "benefit principle of public finance." While this principle is thought to be generally applicable to the financing of all public programs where income redistribution is not thought to be a primary component of the program, it is also thought that its practical applicability is limited by the ability readily to identify beneficiaries and to charge them directly for their use of public services. This leads to the suggestion for user charges, where beneficiaries are charged directly for their use of public services, and to tax earmarking, which is regarded as an indirect form of user charging, which operates by taxing something closely related to the public service being supplied and earmarking the

revenues collected for support of the public service.

With the development of public choice scholarship, scholars are coming increasingly to recognize that actual political or fiscal practice may diverge, and sometimes sharply, from the justifications or principles advanced in support of particular measures. This book will examine user charges and tax earmarking from such a perspective. The justifications for user charges and tax earmarking run, as noted above, in terms of their ability to promote economic efficiency through imposing the cost of public services upon those who benefit from their provision. But the theory of public choice suggests that actual governmental choices concerning user charges and tax earmarking will emphasize not so much the promotion of economic efficiency as the promotion of political success. Actual policies concerning user charges and tax earmarking will tend to promote the political interests of dominant interest groups pertaining to the issue at hand, and the resulting consequences of these policies will often be economic efficiency.

The essays in this book will explore from several angles the disjunction between normative principles and fiscal politics with respect to user charging and tax earmarking. A tentative outline of authors and topics is given below. The essays should generally run in the 20-30 page range, so the book should run in the range of 250 to 300 manuscript pages. (It should be noted that three of these chapters have been presented in embryonic form in professional meetings: Chapters 3 and 4 at the Atlantic Economic Society in Philadelphia, October 1988, and Chapter 7 at the Western Economic Association in Los Angeles, July 1988. However, the chapters in the book will represent substantial developments and emendations upon those initial efforts.)

CHARGING BENEFICIARIES FOR PUBLIC SERVICES:

USER CHARGES AND EARMARKED TAXES IN PRINCIPLE AND PRACTICE

1. "The Benefit Principle of Public Finance:  
A Disjunction between Principle and Practice?" by Richard E. Wagner

This essay will survey the benefit principle of public finance and describe how user charges and tax earmarking are viewed as helping to promote economic efficiency within the context of this principle. It will subsequently set forth in a general way the public choice perspective and explain how actual fiscal practice may diverge from the normative principles used to justify earmarking and user charges.

2. "The Fiscal Significance of User  
Charges and Earmarked Taxes: A Survey" by Gary Anderson

This paper will describe the relative importance of user charges and earmarked taxes, both at the federal and at state and local levels of government.

3. "User Charges, Rent Seeking,  
and Public Choice" by Bruce Yandle

This paper will place user charges in the context of the theories of rent seeking and public choice. It will explain and illustrate how much of the support for user charges would evaporate if economists were to incorporate more realistic approaches to political processes into their models.

4. "User Charges, Political Incentives,  
and the Theory of Bureaucracy" by Dwight R. Lee

This paper will examine in particular how insights from the economic theory of bureaucracy lead to a superior understanding of the actual use of user charges. In doing so, it will build upon the more general treatment of user charges presented in Yandle's essay.

5. "Subjective Cost, Property Rights,  
and Public Enterprise Pricing"

by Richard E. Wagner

This paper will further extend the preceding two essays by explaining how the economic principles of subjective cost and property rights show why it is impossible for public enterprises to institute economically efficient prices, even if the problems of political incentive were set aside.

6. "Public Utility Pricing in France:  
The Triumph of Myth Over Reality

by Henri Lepage

Public utility pricing in France is generally regarded by economists throughout the world as illustrating how efficient user charges can be put into practice. This essay, by a leading French scholar who is conducting a major research project into the mythology of utility pricing in France, will complement the preceding three essays in injecting a strong dose of realism into the literature of user charges.

7. "The Political Economy of  
Tax Earmarking"

by Dwight R. Lee and  
Richard E. Wagner

This paper will first describe the normative theory of tax earmarking, and then show how the support that this theory gives for tax earmarking is turned upside down when earmarking is examined in terms of a model of realistic--as against idealistic--politics.

8. "Rent Seeking and  
Tax Earmarking"

by Dwight R. Lee and  
Robert D. Tollison

Tax earmarking creates a link between those who are being taxed and those who benefit from the services provided by the earmarked revenues. This essay will explore the implications of this link from within a model of realistic politics.

9. "Earmarked Taxes, Lobbying,  
and Budgetary Choice"

by Mwangi S. Kimenyi  
Dwight R. Lee, and  
Robert D. Tollison

Earmarking injects very different incentives into the budgetary process, as compared with general fund financing. With general fund financing interest groups have strong incentive to compete for larger shares of the budget, but only weak incentive to lobby for tax increases. Earmarking creates a strong incentive for interest groups to lobby for tax increases, and this paper will explore the consequences and implications of this difference in incentive.

10. "Tax Earmarking, Rent Seeking, and  
the Political Economy of Leviathan"

by James M. Buchanan

Professor Buchanan is, of course, one of the primary founders of the theory of public choice. In this essay he will examine tax earmarking from the perspective of his recent scholarship on tax reform, scholarship that is characterized as a political economy for leviathan government.

11. "Taxes, Charges, and Political Extortion"

by Fred S. McChesney

Professor McChesney has been developing a substantial research project on bring a public choice perspective to bear on tax legislation. In this paper he will explore his insight that the legislature will often threaten to tax as a means of extorting favors from private producers, and will consider earmarked taxes and user charges from this perspective.

12. "User Charges, Earmarked Taxes,  
and Budgetary Process: A  
Constitutional Perspective"

by Robert D. Tollison and  
Richard E. Wagner

The preceding essays will have shown how the reality of user charges and earmarked taxes is strikingly different from the normative justifications that seem them as means of enhancing economic efficiency. This final essay will address how it might be possible to reform the budgetary process so that any user charges or earmarked taxes that might be imposed would conform more closely to standards of economic efficiency.

PROPOSED BUDGET

The budget proposed for this project is \$145,000, as outlined below. Eleven of the 12 essays in the book will carry a total fee of \$75,000, while the fee for the Buchanan essay will be \$20,000.

Outline of Budget

|  |               |
|--|---------------|
| Buchanan essay   | \$20,000      |
| 11 essays (chs. 1-9, 11-12)  | 75,000        |
| Organizing, Editorial, and Management Fees (including finding and working with publisher). |               |
| Dick Wagner  | 25,000        |
| Bob Tollison   | <u>25,000</u> |
| TOTAL AMOUNT   | \$145,000     |

As for a method of payment, for the individual essays one-half of the amount due would be paid upon submission of draft essays and the remainder would be paid upon submission of the final version. For the editorial work, one-half would be paid when all chapters have been submitted in draft form and the remainder would be paid when the final manuscript has been assembled for delivery to a publisher.