

## IN THIS ISSUE

- FCC Taxes Create Significant Efficiency Losses to the U.S. Economy
- Housing Projects not as Bad for Kids as Alternatives
- Supplemental Security Income Reduces Saving
- Recent Changes in Wages and Profits

## FCC Taxes Create Significant Efficiency Losses to the U.S. Economy

The nation's telecommunications network is regulated by a patchwork of subsidies and taxes overseen by the federal government through the Federal Communications Commission (FCC) and by the 51 state regulatory commissions (including the District of Columbia). To further complicate this picture, Congress has taken to raising taxes on specific sectors of the economy, including telecommunications, to pay for social programs. In **Taxation by Telecommunications Regulation** (NBER Working Paper No. 6260), NBER Research Associate **Jerry Hausman** calculates the efficiency cost to the economy from the imposition of one such tax increase—on interstate access charges for long distance calls—the revenue from which goes to subsidize school and library access to the Internet. Using the techniques of public finance analysis, he finds that the “cost to the economy is extraordinarily high compared to other taxes used by the Federal government.”

Specifically, he estimates that the program's cost runs around \$2.25 billion annually. Hausman calculates that the method chosen by the FCC to raise that money carries a cost to the economy of \$2.36 billion. In other words, the efficiency loss to the economy for every \$1 raised to fund the Internet access is an additional \$1.05 to \$1.25.

more efficient to generate the subsidy money by increasing general tax revenue. Although there is no one number that everyone rallies behind when it comes to estimating the value of the marginal efficiency loss to the economy from raising general taxes, the range of estimates in four major studies he cites is reasonably close. They all result in less than one-

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“The FCC chose the taxation method applied to interstate telephone service which likely maximizes the cost to the economy of raising the revenue to provide the Internet discounts.”

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Congress left to the FCC how best to fulfill its mandate that all users of interstate telephone service help pay for school and library Internet access. Unfortunately, “the FCC chose the taxation method applied to interstate telephone service which likely maximizes the cost to the economy of raising the revenue to provide the Internet discounts,” says Hausman.

He argues that it would be far

third the efficiency loss created by the FCC and its method of higher access rates on interstate long distance.

Of course, the political reality may be that raising general revenues is out of the question. So Hausman also devises several alternative ways the FCC could raise money for the Internet subsidy at a far lower cost to the economy. One is to hike the Subscriber Line Charge (SLC), a

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monthly fixed fee of \$3.00 for residential line and \$6.00 for business. That fee was established in 1984. The FCC would have to raise the SLC by about \$1.50 a month, but in real terms the increase would not quite bring the fee back to its 1984 value. The efficiency effect would be very small, too.

Alternatively, the FCC could use

some of the money it raises by auctioning spectrum. It could charge Internet users the marginal cost of the telephone network, although it is unclear how much revenue that would generate. The bottom line for Hausman is this: too many FCC decisions are made without adequately considering their economic effects, and the neglect is costing the econ-

omy billions of dollars—or even tens of billions—a year. “Telecommunications regulation at the federal level has always recognized the public interest standard as one of the main bases for regulation,” says Hausman. “The public interest standard should recognize economic efficiency as one of its primary goals.”

—Christopher Farrell

## Housing Projects not as Bad for Kids as Alternatives

**I**t has long been conventional wisdom that public housing projects are a disaster, particularly for children. But in many cities, families still fill waiting lists to live in public housing. In **Are Public Housing Projects Good for Kids?** (NBER

Department of Housing and Urban Development and the Census Bureau they find, unsurprisingly, that children living in housing projects are more likely to have been held back in school and to live in an overcrowded dwelling than children who don't live in projects. But when they control for demographic and other

In short, in terms of child outcomes, projects are usually better than the alternatives available.

Currie and Yelowitz speculate that part of the gap between perception and reality on housing projects stems from the disastrous failure of some huge urban projects, such as Chicago's infamous Robert Taylor Homes, which are in fact vastly different in terms of scale and quality from most of the country's housing projects. They also acknowledge that the data they rely on is of no use in determining whether children in housing projects are better off than children whose families receive government vouchers in order to help pay for better private housing. But they conclude that the data do suggest that “projects as a group have been unfairly vilified.”

—Justin Fox

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“...children in projects actually fare better in measures of educational attainment and housing quality than those of similar socioeconomic backgrounds who don't live in projects.”

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Working Paper No. 6305), NBER Research Associate **Janet Currie** and Faculty Research Fellow **Aaron Yelowitz** attempt to measure the effects of projects on children's living conditions and educational attainment.

Combining data from the U.S.

differences between project dwellers and the population at large, they find that children in projects actually fare better in measures of educational attainment and housing quality than those of similar socioeconomic backgrounds who don't live in projects.

## Supplemental Security Income Reduces Saving

**M**any low-income elderly plan ahead in order to qualify for a means-tested federal retirement program called Supplemental Security Income (SSI). According to NBER Research Associate **David Neumark** and co-author **Elizabeth Powers**, these older people spend enough extra money in the few years before retirement at 65 to qualify for strict

asset and income tests. In other words, they reduce their savings and wealth.

Although federal benefits are uniform across states, states may supplement federal SSI benefits. In 1985, for example, the maximum federal benefit was \$325 a month for an individual and \$488 for a couple. The highest state benefit was in California, and it resulted in a maximum combined benefit of \$504 for

an individual and \$916 for a couple.

In **The Effect of Means-Tested Income Support for the Elderly on Pre-Retirement Saving: Evidence from the SSI Program in the U.S.** (NBER Working Paper No. 6303), the authors use the variation in state supplemental SSI benefits to estimate the effects of SSI on saving. They find that relatively high SSI benefits reduce saving among households headed by individuals

approaching the age of SSI eligibility, and likely to end up participating in the program. This proves to be the case for both men and women. In states where the benefits are \$100 higher, for example, savings fall on average by \$163. Various other tests of the data confirm that aged, likely participants in the SSI program shrink their savings and other assets to assure their eligibility upon retirement.

Neumark and Powers find that the median wealth of likely participants in the present SSI program, aged 60 to 64, is equal to or very near zero. This implies that many of these likely

participants have little reason to dissave to qualify for SSI. But a sizable fraction of this group have some wealth that could be run down to satisfy asset tests. The nature of the

Disability Insurance. Financial resources also affect eligibility. For example, as of 1985, individuals with more than \$1,600 in countable assets, and couples with more than

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“...relatively high SSI benefits reduce saving among households headed by individuals approaching the age of SSI eligibility.”

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SSI program encourages this. The federal component of the program specifies maximum benefit levels for couples and individuals that are reduced by income from other sources, including Social Security benefits and

\$2,400 in countable assets, were ineligible for SSI. (Countable assets typically exclude a house and car.)

—David R. Francis

## Recent Changes in Wages and Profits

**T**he spectacular rise in the U.S. stock market and recent changes in the share of labor in U.S. national income have stimulated speculation about whether the U.S. economy has entered a “new era” of higher corporate profits funded by a decrease in the share of national income accruing to labor. In **The Rate of Return to Corporate Capital and Factor Shares: New Estimates Using Revised National Income Account and Capital Stock Data** (NBER Working Paper No. 6263), Research Associate **James Poterba** uses new Bureau of Economic Analysis estimates of physical assets to examine the behavior of rates of return and factor shares from 1959 through 1996.

Based on the historical evidence, he concludes that the recent decline in employee compensation, from 73 percent of national income in 1992 to 72.2 percent of national income in 1996, is not unusual. Neither is the unanticipated increase in the pretax return to nonfinancial corporations’

assets, from 7.4 percent in 1992 to 9.9 percent in 1996.

Since 1959, employee compensation and proprietors’ income, the broadest measure of labor’s share of national income used in the study, has ranged between a high of 83.1 percent (1973) and a low of 79 percent (1970). The 1996 value, 80.6 percent, is well within this range. The share of wages and salaries has shown a steady decline from 62.8 percent in 1959 to 58.9 percent in 1996, with a high of 65.6 percent (1970) and a low of 58.6 percent (1984). But this merely reflects the increasing importance of non-wage benefits like health insurance and retirement plans in employee compensation. Overall, the share of employee compensation rose from 67.9 percent in 1959 to 72.2 percent in 1996 with a high of 74.1 percent in 1982 and a low of 67.5 percent in 1965.

In a cautionary note, Poterba explains the dangers of looking at one or two years of data in isolation. In 1992, employee compensation was 73 percent of national income, the

highest fraction since 1983. Subsequent decline was therefore consistent with historical patterns. Furthermore, increases in the employee compensation share of national income have historically been associated with an increase in civilian unemployment. Given the fall in civilian unemployment from 7.5 percent in 1992 to 5.4 percent in 1996, it would not have been surprising if the decline in labor share had been larger than the observed 0.8 percent.

Similarly, Poterba finds nothing historically unusual in recent pretax returns on corporate capital. Though they jumped from 7.3 percent in 1991 to 9.9 percent in 1996, they remain below the 1960–9 average rate of return of 10.3 percent. Moreover, with the exception of Japan, since 1990 the rate of return on capital has risen in all of the G-7 nations and rates of return in the United Kingdom, Canada, and Italy have risen faster than those in the United States.

The study presents new estimates of the pretax and aftertax returns on corporate capital for 1959–96. The

pretax return averages 8.5 percent over this period. The aftertax return, which is net of corporate income and property tax payments, an estimate of investor-level taxes on corporate interest and dividend pay-

Poterba finds some evidence of a recent increase in the average after-tax return to investors. At 5 percent in the 1990s, it was 60 basis points more than the previous high of 4.4 percent in the 1960s. Poterba calcu-

vidual investors, and lower inflation rates.

The largest changes in corporate tax burdens occurred between 1970 and 1985, with the estimated average tax rate declining from 33.5 percent in the 1970s, to 23 percent in the 1980s. Relief for individual investors came later. With marginal tax rates on investment income reaching 70 percent in the 1970s, the investor tax-burden peaked at an estimated 25.2 percent of pretax earnings in 1980. By 1990 it was 13 percent. Falling inflation, declining marginal tax rates, and a growth of asset ownership in tax-deferred forms combined to produce an average tax burden of 10.8 percent for 1990-6.

—Linda Gorman

“...the recent decline in employee compensation, from 73 percent of national income in 1992 to 72.2 percent of national income in 1996, is not unusual.”

ments, and capital gains, averages 3.9 percent. This implies an average tax burden of 54 percent for 1959-96. This tax burden includes an average 30 percent for corporate income taxes, 10 percent for corporate payments of property taxes, and 14 percent for investor-level taxes.

lates that the total tax burden on corporate capital income, as a share of pretax returns, declined from an average of 64 percent in the 1970s to 42 percent in the 1990s. This change was attributable to various factors, including reductions in the statutory tax rates on corporations and indi-

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