

those projects before, those projects still aren't worth \$10 million. We should just raise taxes less and not spend more."

To which everyone reluctantly agrees.

Now we erase that scene and substitute another breathless messenger.

"The President has just signed the tax credit plan," he shouts.

"So what?" replies the Governor. "We're no better off than we were before."

"But wait," says the budget director, "now we can raise \$10 million of income taxes and it costs our taxpayers only \$8 million. Those projects that weren't worthwhile before are a big bargain now."

To which everyone agrees. This little story illustrates what I consider the main point of a comparison among the plans. The bloc grant without an effort formula would result in less expenditure increase than the tax credit. I shall not go through the story again with a bloc grant with an effort formula, but presumably the intention and effect of the effort formula is to induce States to use more of the grant for increasing expenditures and less for reducing taxes.

Now I should like to comment briefly on the effects of the three plans on the pattern of total taxation—Federal, State, and local. My opinion that the income tax credit will result in more income taxes than the bloc grant plan may seem paradoxical. The income tax credit starts with a reduction of Federal income taxes, simply by virtue of the provision of a new credit. The bloc grant plans, even if, as I expect, they result mainly in a reduction of State and local taxes, would mainly result in reduction of sales and property taxes, since that is what the States and localities have. When I say reduction, of course, I mean reduction relative to the increase that would otherwise probably occur since we are undoubtedly in a trend of rising State and local taxes.

So it would appear obvious that the income tax credit plan would result in more reduction of income taxes and the bloc grant in more reduction of other taxes.

However, things are seldom what they seem. The main point is that the income tax credit creates a strong incentive for the States to impose and raise income taxes, both to finance increased expenditures and as a substitute for other taxes. As we have already noted, the credit reduces the cost of expenditures financed by State income taxes. It also makes the tax burden of a State lower, with a given amount of revenue, the larger the share that is raised from income taxes. If the income tax credit is 20 percent, the people of the State save \$2 million for every \$10 million shift from other taxes to income taxes. I think these incentives would result in an increase of State income taxes exceeding the reduction of Federal income taxes, or they could be made to do so by proper determination of the rate of credit.

The direction of the effects I would expect, although the amounts are uncertain, can be illustrated as follows. States now raise about \$4 billion of income taxes. Suppose that a 20-percent credit would cause a doubling of this, to \$8 billion, and that half of the additional State income tax revenue is used for additional expenditure and half is used for reducing other taxes. Then the reduction of Federal income tax revenue would be about \$2 billion—which is the 20-percent credit on the \$8 billion plus the Federal loss from the deductibility of an additional \$2 billion of total State taxes. Then we have a \$2 billion decline in Federal income taxes, a \$4 billion increase in State income taxes,