

# TAX FEATURES

October 1993 Volume 37, Number 8

## Proposed "Sin" Tax to Hit Cigarette Smokers Hard *Average Smoker Could See \$363 to \$459 Increase in Annual Costs*

If Congress agrees to raise federal excise taxes on cigarettes by 75¢, a strong consideration under the Clinton administration's health care reform proposal, the government would raise \$16.5 billion in gross revenue annually, according to a recent Tax Foundation analysis. Raising the cigarette excise by \$1 would raise \$20.8 billion a year.

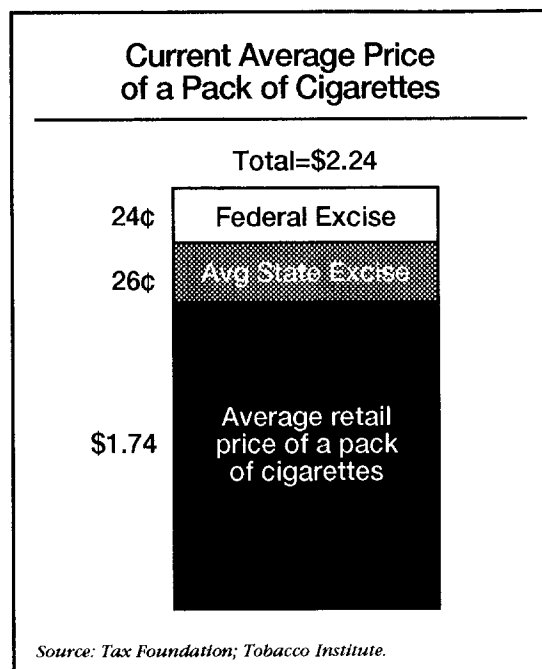
Although, as of early October, the administration had yet to make final health care financing decisions, Foundation Senior Economist Arthur Hall undertook an analysis of the additional annual tax burden an average smoker could expect in each state if a 75¢ or \$1 tax hike were enacted. Under such circumstances, smokers in Alaska would see the biggest increase on an annual basis (\$658 and \$837, for a 75¢ and \$1 increase), followed by smokers in Wyoming (\$481 and \$609), Texas (\$461 and \$584), South Dakota (\$458 and \$574), and Hawaii (\$424 and \$539). The average smoker nationwide could expect to pay \$363 more each year for a 75¢ increase, and \$459 for a \$1 increase.

Cost differences among the states are due to the fact that residents of some states consume more cigarettes per capita than those in other states. Also, state excises and the average price of a pack of cigarettes vary from state to state, affecting consumption patterns.

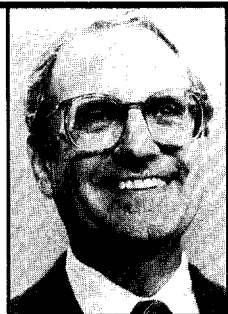
Raising the federal excise on a pack of cigarettes by 75¢ would reflect a 313 percent increase over the current tax of 24¢ per pack.

That, notes Dr. Hall, should by standard assumptions reduce cigarette consumption from 25.4 billion packs a year to approximately 22 billion, a 13 percent decrease. A \$1 tax hike would reflect a 417 percent increase in the tax, which should reduce consumption to 20.8 billion packs a year, an 18 percent decrease in consumption.

*Sin Tax continued on page 7*



### FRONT & CENTER



### The Need for Health Care Reform

**Senator George D. Mitchell**  
(D-ME)

## Top Tenth of Income Earners Still Paying Over Half of All Federal Income Taxes

According to recently released Internal Revenue Service data, the top 10 percent of income earners paid 55.3 percent of all federal individual income taxes in 1991. Chart 1 below shows that individuals at the upper end of the income scale continue to pay the bulk of federal income taxes.

Foundation Economist Chris Edwards suggests that 1991 returns reflect the slowdown in the American economy in 1991, as well as the impact of the 1991 tax increases on higher income individuals. Total adjusted gross income (AGI) reported on 1991 tax returns was only 1.5 percent higher than income reported in 1990, and total income tax paid was down slightly, 0.8 percent. In contrast, the AGI reported and income tax paid by high income individuals fell substantially in 1991.

While the top 10 percent of income earners paid 55.3 percent of all federal income taxes in 1991, the top 5 percent paid 43.4 percent and the top 1 percent paid 24.6 percent (see Chart 1 and the table on page 3). These tax shares paid by higher-income groups are down slightly from their peak in the late 1980s because of the recession, and possibly because higher tax rates on the wealthy passed in 1990 have created incentives to reduce reported incomes.

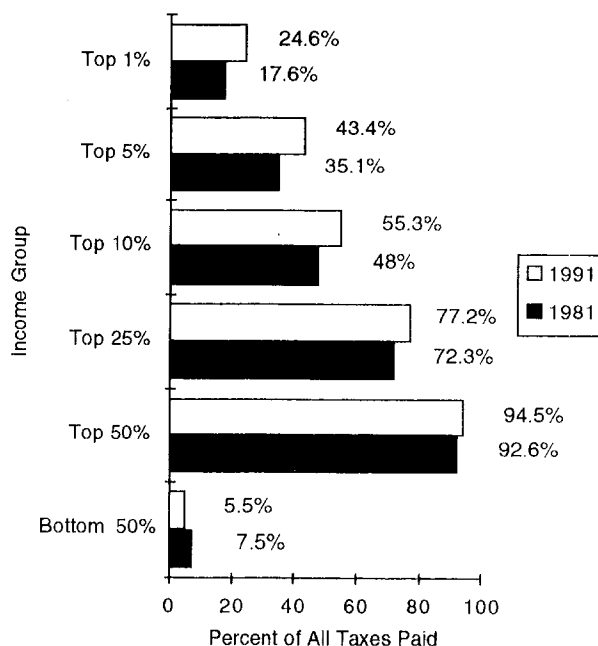
Chart 2 compares income shares (i.e., AGI) and tax shares for different income groups. While high-income earners claim a large share of all income, they pay an even greater share of federal income taxes. Chart 3 on the next page illustrates that higher-income earners pay a substantially higher average income tax rate

than do lower-income Americans. For example, the bottom 50 percent of earners (those earning less than \$20,108 in 1991) paid an average federal income tax rate of 4.6 percent. In contrast, those in the top 1 percent (earning greater than \$168,832 in 1991) paid a 24.1 percent average tax rate.

From 1981 to 1991 total federal income taxes paid increased 58 percent. However, total AGI for all federal taxpayers rose 96 percent, resulting in the average federal income tax rate falling from 15.8 percent in 1981 to 12.7 percent in 1991. (In contrast, federal social insurance payroll taxes rose faster than incomes over the same period, up 117 percent by 1991).

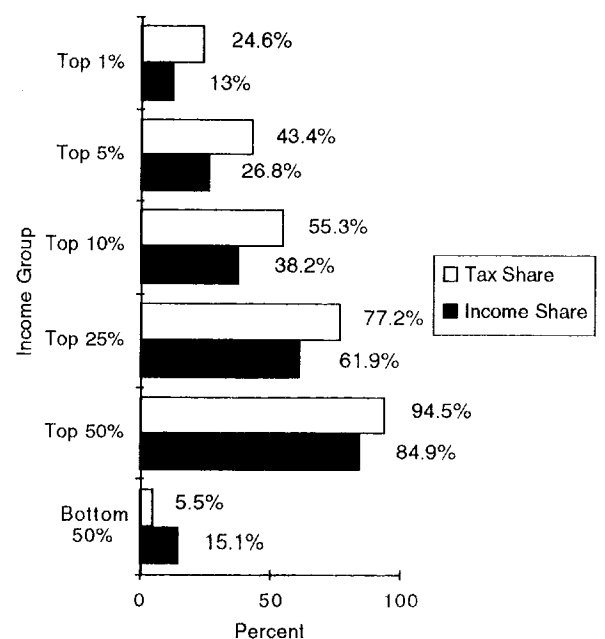
AGI of the top 10 percent of earners increased quickly over the 1981 to 1991 period, a total increase

**Chart 1**  
Percent of Federal Individual  
Income Taxes Paid by Income Group



Source: Internal Revenue Service.

**Chart 2**  
Income Share vs. Tax Share 1991

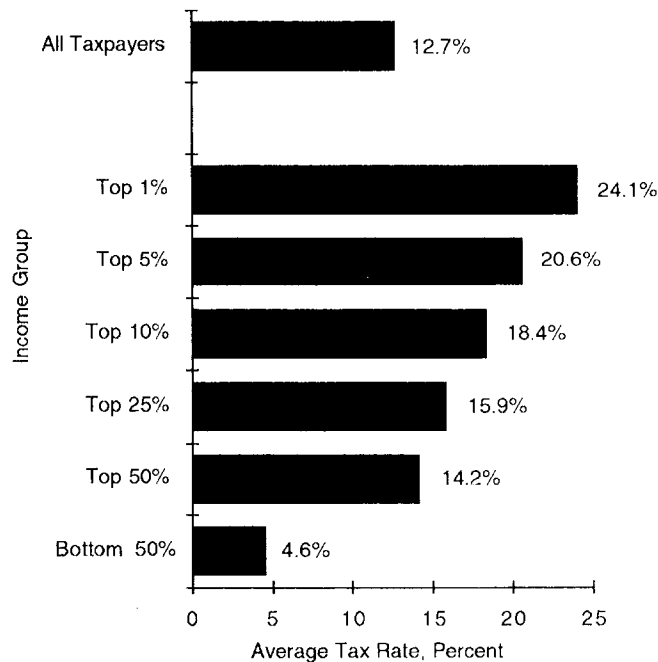


Source: Internal Revenue Service.

of 134 percent, helping to explain the increasing share of taxes paid by these high income earners. In 1991, the top 10 percent of earners are those individuals with incomes above

\$61,952. Whereas the top 10 percent of earners paid 48.0 percent of all federal income taxes in 1981, they paid 55.3 percent of the total federal income tax bill in 1991.

**Chart 3**  
**Average Federal Income Tax Rate**  
**By Income Group, 1991**



Source: Internal Revenue Service.

Chart 1 shows that the tax shares paid by the top 1, 5, 10, 25, and 50 percent of income earners increased over the decade, while the share paid by the bottom 50 percent of earners fell from 7.5 percent in 1981 to 5.5 percent in 1991.

Mr. Edwards notes that this increase in the share of taxes by top income earners is remarkable, given the reduction in tax rates on high income earners in the 1980s. The top federal individual rate fell from 70 percent in 1980 to 50 percent in 1982, to 38.5 percent in 1987, and finally to 28 percent in 1988.

This, says Mr. Edwards, supports the view that lowering excessively high tax rates on upper income earners may increase, not decrease, total tax revenue. For example, the dramatic drop in the top tax rate in the 1988 tax year coincided with an equally dramatic 25 percent increase in total income taxes paid by the top 1 percent of earners. (The top one percent of income earners in 1988 were those who earned more than \$157,136).

Lower income earners pay such a small portion of total federal income taxes that one has to wonder whether it costs more than it is worth to collect income taxes from them at all. It is noteworthy that the bottom 50 percent of federal income tax filers pay only 5.5 percent of all federal income taxes. The federal government collected just \$24.5 billion from the bottom 50 percent in 1991 yet had to process 56.9 million income tax returns to get it. ●

### 1991 Federal Individual Income Tax Data

	Number of Returns (000)	Adjusted Gross Income (AGI) (\$000,000)	Income Tax (\$000,000)	Percent of Total AGI	Percent of Total Taxes	Income Split Point	Average Tax Rate
Total	113,804	\$3,516,142	\$447,189	100%	100%		12.7%
Top 1%	1,138	456,348	109,784	13.0	24.5	above \$168,832	24.1
Top 5%	5,690	943,504	194,211	26.8	43.4	above \$81,601	20.6
Top 10%	11,380	1,342,999	247,485	38.2	55.3	above \$61,952	18.4
Top 25%	28,451	2,174,754	345,406	61.9	77.2	above \$38,917	15.9
Top 50%	56,902	2,984,002	422,660	84.9	94.5	above \$20,108	14.2
Bottom 50%	56,902	532,139	24,529	15.1	5.5	below \$20,108	4.6

Source: Internal Revenue Service

# Why We Need Health Care Reform

Senator George Mitchell (D-ME)

Members of the Senate Finance Committee have traditionally worked on a bipartisan basis on health care issues. Over many years, I've worked closely with Republicans on the Committee who are committed to providing access to quality health care for the poor, the elderly, the disabled, and others who are without access to health care.

We now face a legislative challenge that will take all the knowledge, experience, and cooperation that members of the Finance Committee have developed over many years. The need for affordable health care for all Americans is not a partisan issue.

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***Rising health costs represent the single greatest contributor to the future growth of the federal deficit—a deficit which drains needed savings and investment from the private sector.***

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Health care is a fundamental human need and, I believe, a fundamental right in a democratic society.

Our challenge is to provide access to affordable health care to every American. To achieve this goal, the attitudes, habits, and behavior of every health care provider and consumer must change. Rising health costs threaten the long term fiscal health of the nation. They represent the single greatest contributor to the future growth of the federal deficit—a deficit which drains needed savings and investment from the private sector.

Yet, despite the truly enormous national resources devoted to the health care system, it's a system that doesn't serve all the people. No American has security in the health care system today. A job loss, an unexpected illness or accident may result in the loss of health insurance even for those who are now covered.

Any plan for reform must meet the threshold test of providing health coverage for everyone and it must assure

that health care costs are controlled.

The president's plan meets that threshold test. It will assure access to health coverage for every American family. The plan also contains meaningful cost containment strategies to reduce the rate of increase of costs in the health care system.

The president's health care plan is the culmination of many months of work by many persons expert in the various disciplines. It builds on the work of many years by Members of Congress—including many members of the Finance Committee and many organizations dedicated to providing health care to every American.

It's not surprising that the president's determination to reform the system has found strong support in the business sector.

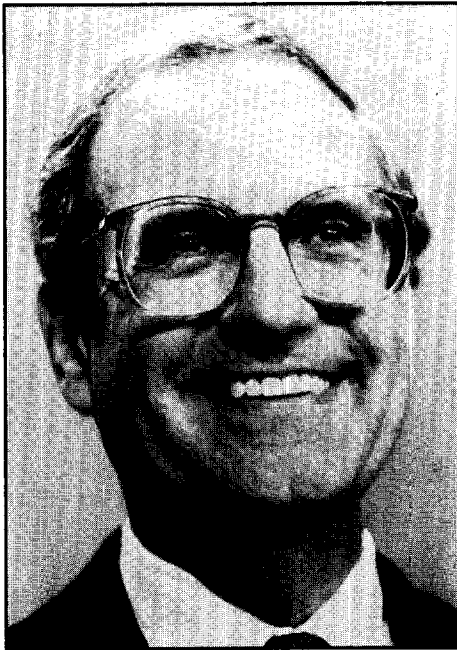
Those who pay the bills for health insurance know that they cannot continue to absorb these rising costs without seriously undermining their competitiveness in the free market.

Those who argue that health care reform will cost more are making the assumption that no one is paying those costs today. But they're wrong. The costs of care are being paid today, but not always by the people who receive the care.

There will be opposition to this proposal. There will be well-organized and well-financed lobbying efforts to defeat it. There will be claims that it will hurt business and cost jobs and produce no benefits, ignoring the fact that the current system hurts business and costs jobs and leaves many without benefits.

I do not assume that everyone on the Finance Committee will agree with every piece of the president's proposed program. All of us have the right, indeed, the obligation to work for those revisions we believe appropriate. The plan undoubtedly can be and will be improved by constructive input from many of the members of the Finance Committee.

I applaud the efforts of Senators John Chafee, Bob Dole, and other members of the Republican Health Care Task Force. The Chafee/Dole proposal contains many elements that are similar to the



president's plan. There is substantial common ground on which to build. There are also, not surprisingly, significant differences as well. I look forward to a vigorous and well-informed debate on those differences.

***Despite the truly enormous national resources devoted to the health care system, it's a system that doesn't serve all the people.***

Americans will be best served by a process in which all significant perspectives are debated fully with reason and civility. We will have a better plan at the end, and we will have built the consensus we must have if all participants know that their voices have been heard and their ideas thoroughly debated. ●

*The views expressed in Front & Center are not necessarily those of the Tax Foundation.*

## The Clinton Health Care Plan In Outline

### Health Alliances

- State-based regional health insurance alliances would be created to offer insurance to all individuals not otherwise provided with insurance. These alliances would act as intermediaries between insurers and consumers.
- Companies and multi-employer plans with over 5,000 employees would form "corporate alliances" and buy coverage directly from health plans.
- Each state would be responsible for ensuring that every eligible individual within its borders is enrolled in some alliance.

### Health Plans

- These plans would be networks of insurance companies and health care providers that would contract with alliances. All health plans would be subject to a limit on total spending each year. Health plans would have to accept every eligible person enrolled by an alliance; offer the standard federal benefit package; and set uniform premiums.

### Basic Benefit Package

- All citizens and legal residents would be guaranteed a standard benefit package as defined in statute.
- All employers would be required to pay for each employee at least 80 percent of the cost of the average-priced health plan with employees paying the balance of the cost.
- Federal spending would increase to fund the federal subsidy pool for low-income firms and workers and other benefits.

### National Health Care Budget

- A National Health Care Board would enforce a new National Health Care Budget which would serve to limit premium increases. The Budget is intended to bring inflation in health care costs down to the general level of inflation by the year 1999.
- Cost containment is to be achieved by promoting competition between health plans.
- In addition, the Clinton plan reforms workers comp, malpractice claims, and antitrust laws applying to health care providers, and provides a prescription drug benefit for Medicare beneficiaries and a subsidy for long-term care, and other administrative reforms.

**Tax Foundation's  
56th National Conference and Annual Dinner**

## **Tax Policy and the Continuing Deficit Debate: Is There a Consumption Tax in our Future?**

**Wednesday, November 17, 1993**

***The Waldorf-Astoria Hotel***

301 Park Avenue, New York, N.Y. 10022

• Registration	9:00 am	Jade Room
• Conference Sessions	10:00 am	Jade Room
• Lunch	12:30 pm	Astor Room
• Dinner Reception	6:00 pm	Hilton Room
• Annual Dinner	7:00 pm	Empire Room

- Professors and students can participate in the conference through the Foundation's College Classroom Program.
- Reservation deadline for the block of rooms reserved by the Tax Foundation is November 1, 1993. Call the Waldorf directly at (212) 872-4534.
- Conference and dinner reservations should be received by November 10, 1993. (Written cancellations for refunds accepted through this date only.)
- Questions about the conference and dinner should be directed to: Michelle Rubin, (202) 942-7690, Fax (202) 942-7675.

9:00 am	<b>Registration</b>		2:30 pm	<b>Session III</b>	<b><i>Alternative Consumption Taxes</i></b>
10:00 am	<b>Welcome</b>	<i>Dan Witt</i> , Executive Director, Tax Foundation		<b>Moderator</b>	<i>John Mills</i> , Vice President, Taxes, USX Corporation
10:15 am	<b>Session I</b>	<b><i>Fifteen Years of the Federal Budget, 1978-1993</i></b>		<b>Speaker</b>	<i>David Bradford</i> , Professor of Economics and Public Affairs, Princeton University
	<b>Moderator</b>	<i>Paul Zagortz</i> , Division Vice President of Taxes, Hallmark Cards, Inc.		<b>Commentators</b>	<i>Tom Neubig</i> , Director of Financial Sector Economics, Price Waterhouse <i>Mark Weinberger</i> , Tax Counsel, Office of Senator John Danforth
	<b>Speaker</b>	<i>John White*</i> , Director, Center for Business and Government, The Kennedy School, Harvard University			
	<b>Commentators</b>	<i>William G. Hoagland</i> , Minority Staff Director, Senate Budget Committee <i>John Fund</i> , Editorial Writer, <i>The Wall Street Journal</i>	3:30 pm	<b>Break</b>	
11:15 am	<b>Session II</b>	<b><i>Budget Policy in the Future</i></b>	3:40 pm	<b>Session IV</b>	<b><i>Advantages and Disadvantages of Consumption Taxes</i></b>
	<b>Moderator</b>	<i>Larry Kudlow</i> , Chief Economist, Bear Stearns		<b>Moderator</b>	<i>E. Noel Harwerth</i> , Vice President & Chief Tax Counsel, Citibank/Citicorp USA
	<b>Speakers</b>	<i>Robert D. Reischauer*</i> , Director, Congressional Budget Office		<b>Speaker</b>	<i>John Loffredo</i> , Chief Tax Counsel, Chrysler Corporation <i>Daniel J. Boyers</i> , Associate Tax Counsel, Sears Roebuck & Co.
	<b>Commentators</b>	<i>Stan Collender</i> , Director Federal Budget Policy, Price Waterhouse <i>James C. Miller III</i> , Former Director Office of Management & Budget Co-Chairman, Tax Foundation		<b>Commentator</b>	<i>Joseph J. Minarik*</i> , Associate Director for Economic Policy, Office of Mgt. & Budget
12:30 pm	<b>Luncheon</b>	<i>Senator Sam Nunn</i> (D-Ga.)*	4:40 pm	<b>Close</b>	<i>Dan Witt</i> , Executive Director, Tax Foundation <i>Bob Shapiro</i> , National Director, Tax Policy, Price Waterhouse
2:15 pm	<b>Introduction</b>	<i>Bob Shapiro</i> , National Director, Tax Policy Price Waterhouse	5:00 pm	<b>Adjournment</b>	<b><i>* Invited</i></b>

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**Conference Fee:**

Member/\$100, Non-Member/\$150  
Reception/Dinner: \$300

## Sin Tax

Continued from page 1

### Per Smoker Annual Tax Increase by State For 75¢ and \$1 Excise Increases

	75¢ Tax Hike	\$1 Tax Hike
Alabama	\$387	\$488
Alaska	658	837
Arizona	292	368
Arkansas	401	509
California	388	494
Colorado	393	498
Connecticut	346	440
Delaware	326	414
Florida	387	489
Georgia	351	445
Hawaii	424	539
Idaho	329	415
Illinois	345	436
Indiana	369	465
Iowa	357	452
Kansas	355	446
Kentucky	332	413
Louisiana	371	471
Maine	370	471
Maryland	335	422
Massachusetts	374	473
Michigan	400	509
Minnesota	315	400
Mississippi	358	449
Missouri	352	441
Montana	387	488
Nebraska	362	458
Nevada	370	470
New Hampshire	349	441
New Jersey	331	419
New Mexico	349	442
New York	350	443
North Carolina	349	438
North Dakota	359	453
Ohio	345	434
Oklahoma	302	382
Oregon	412	523
Pennsylvania	363	460
Rhode Island	336	424
South Carolina	344	432
South Dakota	458	574
Tennessee	299	379
Texas	461	584
Utah	376	473
Vermont	398	499
Virginia	319	403
Washington	367	466
West Virginia	354	447
Wisconsin	404	509
Wyoming	481	609
District of Columbia	365	464
United States	\$363	\$459

Source: Tax Foundation computations based on Tobacco Institute consumption and price data.

## FOUNDATION MESSAGE

### Gaining Insight on Health Care Reform

With President Clinton's speech to the nation on the need for health care reform, the debate took one giant step forward. The president described in some detail many of his goals for changing the way we provide and finance health care in the United States. Notably absent from his speech were the specifics on how this reform effort was to be financed, but these blanks will doubtlessly be filled-in in the weeks and months ahead.

Despite the generally high quality of health care available, the health care system in the U.S. suffers from a number of maladies on which there appears to be general agreement, including inadequate availability of health care for some Americans, escalating costs for most Americans, and the rising share of national output absorbed by health care.

In stark contrast to the widespread agreement on the problems to be solved, there are many major disagreements on the means of affecting solutions. One way to think of these alternative solutions is as a choice between greater government involvement, better government involvement, or a dramatic lessening of such involvement with a concomitantly greater reliance on market forces.



*J.D. Foster  
Chief Economist  
and Director*

To be sure, many advocates of reform would find such a presentation of the options to be simplistic. However, despite the enormous complexities that must be grasped and mastered in the reform process, the fact remains that health care services are delivered in a marketplace. The market for health care has been deeply distorted

by previous government policies which are directly responsible for many of its complexities and, given the strong feelings about the need for reform, must be judged as having, if not failed, at least succeeded at a high price.

Expanding the availability of affordable health care while simultaneously controlling inflation in the provision of health care services is a daunting task. The president's plan proceeds on the basis of establishing various collectives, called "alliances," which are to act as intermediaries between health care consumers (namely you and me) and health care insurers—who under the plan are themselves intermediaries between the doctors, nurses, and hospitals and the new alliances.

By acting as the policemen in the market for health care, these alliances are also supposed to be an instrument of cost containment by encouraging greater competition among insurers and by establishing fixed budgets on what may be spent in a given year. It is difficult to see at this early stage how the administration will resolve the conflict between guaranteeing minimum levels of health care and establishing fixed budgets which necessarily restrict health care availability.

As the debate proceeds, the Tax Foundation will strive to provide useful and credible information on health care reform to taxpayers, policy makers, and the media. The Foundation is pleased, therefore, to be able to include in this month's issue of Tax Features an article by the Majority Leader of the Senate, Senator George Mitchell, a recognized expert in health care issues. Senator Mitchell offers a widely held perspective on the direction in which the nation should go. Next month, Tax Features will include an article presenting an alternative approach to health care reform.

# Tax Foundation Announces Opening of N.I.S. Information & Training Center

## TAX FEATURES

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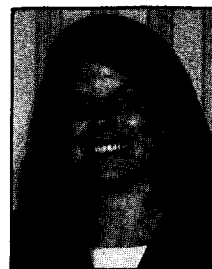
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After formal discussions with officials at the Russian State Tax Service and the Kazakhstani Ministry of Finance, the Tax Foundation has announced the creation of a New Independent States (N.I.S.) Information and Training Center in the former Soviet Union, with offices and programs in the capitals of Moscow and Almaty, as well as in Washington, D.C. By initiating such a program, the Foundation hopes to improve the exchange of information between Western corporate executives and Russian and Kazakhstani government officials, in an effort to improve the investment climates in both nations.

Because of the complexity of the project, the Tax Foundation board of directors recently voted to create a new, independent non-profit corporation to conduct the overseas programs. The Center, made possible by grants from over a dozen companies



Laurie Wood



Vladimir Samoylenko

(see sponsors box), will operate as a separate entity starting January 1, 1994.

The Center's programs are expected to provide American and European tax lawyers and business executives a critical link with government officials of the former Soviet Union, including unprecedented opportunities to advise these leaders.

Dan Witt will resign his current position as Executive Director of the Tax Foundation to assume the position of President of the Center. Laurie Wood will serve as Director of Programs in the Washington office. Ms. Wood has served as a consultant to the Foundation since January 1993, assisting with the development and implementation of the Foundation's overseas programs.

Vladimir Samoylenko will serve as Managing Director of the N.I.S. Center and will head the Moscow office. He is founder and has served as Chairman of the Business Relations Development Center in Russia's capital city.

Aisulu Naizagarina will manage the Almaty office.

Two members have thus far been named to sit on the Center's board of directors: the Honorable Shirley D. Peterson, former I.R.S. Commissioner and Assistant Attorney General, and the Honorable Bill Frenzel, Distinguished Fellow at the Foundation and former congressman from Minnesota. ●

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