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TAX·FEATURES

What Brackets Shoulder the U.S. Income Tax Burden? Top Half Pays Over 90 Percent; Top Ten Percent Pays Over Half

Washington's Largest Monument: $3.12 Trillion Debt Seen For FY'90

The present national debt ceiling of $2.8 trillion, set by Congress in 1987, will inevitably be breached before the current fiscal year ends September 30. Legislation increasing the debt limit must be enacted to insure the Treasury does not default on its maturing debt and payment obligations. To add insult to injury, hints of using this must-pass legislation to attach a significant tax increase are already surfacing.

Congressional Budget Office estimates now anticipate the FY1990 debt reaching a whopping $3.12 trillion. That represents well over $12,000 for every man, woman, and child in the United States; triple the amount of just ten years ago. Over the last decade, the upward climb in the Federal debt has been unremitting. Outstanding debt of the U.S. government passed $500 billion in 1975. By 1982, it had doubled, topping the $1 trillion level for the first time. In just four more years, it doubled again, exceeding $2 trillion in 1986. By 1990 debt will increase another trillion to over $3.12 trillion. How did we get into this mushrooming debt situation? Do deficits and the size of the debt really matter?

Budget Process Damaging

For many years now the White House and Congress have generally been locked in a budgetary stalemate which has impeded any significant deficit reductions. Little has been done to control the persistent escalating costs of entitlement programs. The FY1989 budget deficit is estimated at over $160 billion — no less than what it has averaged over the past eight years — each year's deficit fueling the larger accumulated debt total. The Gramm-Rudman-Hollings (GRH) process has helped some, but far less than promised. When GRH was first enacted during fiscal year 1986, the mandated deficit path reached balance in 1991. Two years later, the deficit was

(See DEBT CEILING on page 3)

The top earning half of the population continues to pay well over 90 percent of the Federal individual income tax bill, according to Tax Foundation analysis of preliminary IRS data for 1987 — the first comprehensive income tax data reflecting the effects of the Tax Reform Act of 1986 (TRA'86). Despite all the major tax legislation of the past decade, this group's share of the tax load has varied within a narrow 1.5 percent range — from a low of 92.6 percent in 1982 to a high of 94.1 percent for 1987.

The system remains progressive as the top ten percent of earners continue to shoulder a significantly larger share of the tax burden, up almost six percentage points, from 49.5 percent in 1979 to 55.4 percent in 1987. This growth in tax burden has occurred despite the alleged upper-income bias of the rate reductions and other tax cuts under the Economic Recovery Tax Act of 1981 (ERTA), and more recently the Tax Reform Act of 1986.

Growth in the income base itself has been increasing faster at the upper end of the income scale, resulting in increased income tax receipts from top earners. The 107 million returns filed for tax year 1987 reported an increase in adjusted gross income of about $300 billion, largely due to the fact that a number of income exclusions and adjustments were either repealed or limited by the new law. However, taxpayers reported receiving larger amounts of certain types of income, especially pension and annuity income. Over five million fewer returns showed itemized deductions. This was primarily due to the increase in the amount of the standard deduction all taxpayers can claim and a reduction in the deductions allowed, especially the elimination of the deduction for sales taxes.

Federal Income Taxes Paid by High and Low-Income Taxpayers 1979 and 1987[a]

Income Rank	Percent of Tax Paid 1979	1987[a]
Highest 5%	37.6	43.0
Highest 10%	49.5	55.4
Highest 25%	73.1	76.7
Highest 50%	93.2	94.1
Lowest 50%	6.8	5.9
Lowest 25%	0.5	0.7

[a] Data for 1987 are preliminary.

At the bottom line, 1987 total income tax receipts reached $371 billion, a modest one percent or $4 billion increase over 1986 collections. How-

(See TAX BURDEN on page 2)

(TAX BURDEN from page 1)

ever, the average amount of income tax paid per taxpayer declined from $4,374 to $4,280. Although 1987 total receipts increased by $4 billion, the income tax distribution reveals that those earning $50,000 or more paid $24 billion more in income tax in 1987 while the under $50,000 income groups experienced a tax reduction of $20 billion.

In 1987, the top five percent of earners paid an average tax of $29,820, up 71 percent from 1979. The top 10 percent paid $19,214, a 68 percent increase over what they paid in 1979.

While the top ten percent, or 10.7 million earners, paid well over half the total income tax in 1987, their adjusted gross income ranged down to $54,700, not exactly "fat cat" status. It still takes millions of basically middle and upper-middle income taxpayers to pay the bulk of the total income tax bill.

Federal Income Taxes Paid by High and Low-Income Taxpayers, 1979 and 1987[a]

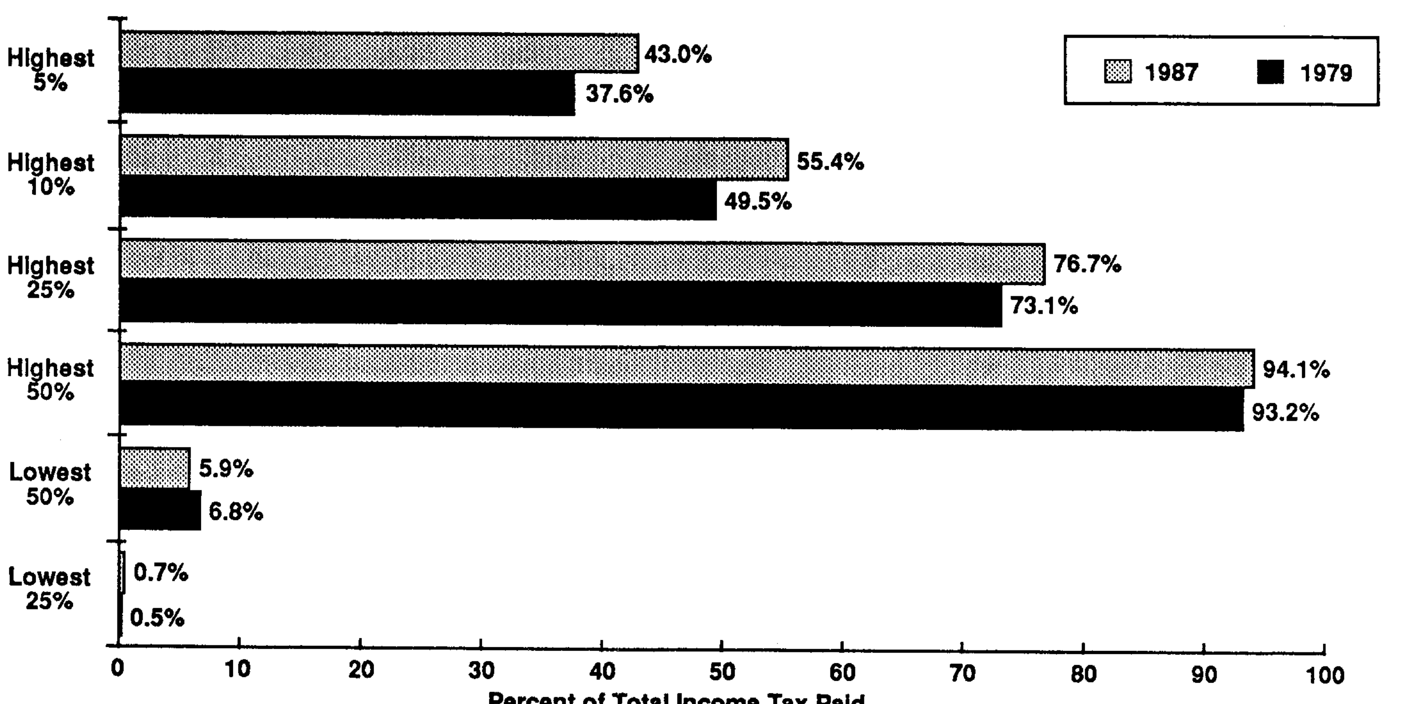
Adjusted Gross Income Class	Income Level 1979	Income Level 1987	Percent of Tax Paid 1979	Percent of Tax Paid 1987	Average Tax 1979	Average Tax 1987
Highest 5%	$ 39,000 or more	$ 71,125 or more	37.6%	43.0%	$ 17,407	$ 29,820
Highest 10%	32,710 or more	54,700 or more	49.5	55.4	11,456	19,214
Highest 25%	21,760 or more	34,260 or more	73.1	76.7	6,769	10,643
Highest 50%	11,870 or more	17,598 or more	93.2	94.1	4,315	6,526
Lowest 50%	11,869 or less	17,597 or less	6.8	5.9	313	410
Lowest 25%	5,565 or less	7,800 or less	0.5	0.7	46	90
Lowest 10%	2,212 or less	2,880 or less	[b]	[b]	9	25

1987 Income and Tax Data

Adjusted Gross Income Class	Total Individual Returns (thousands)	Total Adjusted Gross Income ($billions)	Percentage of Adjusted Gross Income	Average Tax Rate
Highest 5%	5,353	$ 713.4	25.6%	22.4%
Highest 10%	10,705	1,032.5	37.0	19.9
Highest 25%	26,763	1,705.4	61.2	16.7
Highest 50%	53,526	2,383.6	85.5	14.7
Lowest 50%	53,526	404.5	14.5	5.4
Lowest 25%	26,763	73.0	2.6	3.3
Lowest 10%	10,705	-13.1	—	—

[a] Data for 1987 are preliminary.
[b] Less than .07 percent.
Source: Tax Foundation computations based on Statistics of Income, Internal Revenue Service, U.S. Department of the Treasury.

Percent of Federal Income Taxes Paid by High and Low-Income Taxpayers, 1979 and 1987[a]



(DEBT CEILING from page 1)

far above the mandated path. Congress and the President simply revised the law so that balance would be reached in 1993. Both branches have since used accounting tricks to make the deficit appear lower than it actually is. Although annual deficits have decreased on paper over the last several years, the debt has been increasing by over $250 billion each year during the same period.

Debt Burden

Net interest payments (interest paid by the government less interest received on debt held by Federal accounts) is estimated to reach $170 billion in FY1990 — representing a record 15 percent of total outlays. Since 1980, interest costs have been the fastest growing segment of the Federal budget. In 1989 alone, interest payments will represent over $1,800 per U.S. household. More than one out of every seven dollars in the budget will be spent to pay interest on the public debt. Interest on the debt has generally risen much faster than the debt itself due to a strong upward trend in interest rates that must be paid on new borrowing and refunded debt.

Foreign residents are holding increasing amounts of the public debt, as we have had increasing difficulty financing the debt with our own savings — evident in the historically low U.S. savings rate.

Do Deficits and the Size of the Debt Really Matter?

More and more talk is being heard these days downplaying the impact the present Federal deficit and associated debt has on the overall economy. Whether this notion is correct depends on sorting fact from fiction.

FICTION: The deficit has grown ever larger compared to the economy.

FACT: The deficit has been declining as a percentage of GNP — from a recent peak of 6.3 percent in FY1983 to an estimated 1.8 percent by FY1990.

FICTION: With an expanding economy, deficit reduction is not vital.

FACT: The economy is in its seventh year of economic expansion, but it is a safe bet this expansion will come to an end. If the economy slows while the deficit is still large, government's recession-fighting options will be severely limited.

FICTION: The current debt burden is the largest ever.

FACT: As a percentage of GNP the Federal debt has been much higher, generally during wartime or recession. However, the current debt burden is much higher than during any peacetime period when unemployment was as low as it is now.

FICTION: The debt doesn't matter because we owe it to ourselves.

FACT: While approximately 84 percent of the public debt is currently held by U.S. interests, an increasing amount is being absorbed by foreign residents. Interest paid to foreign residents represents the transfer of wealth from the U.S. to other countries. Furthermore, the government has become increasingly dependent on the willingness of foreigners to lend us money, thus putting upward pressure on interest rates.

FICTION: We should eliminate the deficit as quickly as possible.

FACT: Cutting the deficit too quickly could do more harm than good. Eliminating the deficit through severe spending cuts and/or tax increases in a short period might cause more fiscal drag than the economy can stand.

The tables above and below provide further details.

Trends in Foreign Holdings of Federal Debt
Selected Fiscal Years 1965-1988
($Billions)

	Debt Held by the Public			Interest on Debt Held by the Public		
Year	Total	Foreign	Percent Foreign	Total	Foreign	Percent Foreign
1965	$260.8	$12.3	4.7%	$9.8	$0.5	5.1%
1970	283.2	14.0	4.9	15.6	0.8	5.1
1975	394.7	66.0	16.7	24.7	4.5	18.2
1980	709.3	121.7	17.2	60.4	12.0	19.9
1981	784.8	130.7	16.7	78.9	16.1	20.4
1982	919.2	140.6	15.3	97.7	17.9	18.3
1983	1,131.0	160.1	14.2	107.7	18.0	16.7
1984	1,300.0	175.5	13.5	129.0	19.0	14.7
1985	1,499.4	209.8	14.0	148.2	21.2	14.3
1986	1,736.2	253.4	14.6	155.4	22.3	14.4
1987	1,888.1	267.0	14.1	157.5	23.6	15.0
1988	2,050.2	334.3	16.3	169.8	27.3	16.1

Source: Treasury Department; Department of Commerce, Bureau of Economic Analysis; and Tax Foundation computations.

Trends in Federal Debt, Deficits, and Related Measures
Selected Fiscal Years 1940-1990
($Billions Except Per Capita)

	Debt Outstanding[a]			Net Interest				Deficit	
Year	Total	Per Capita	% of GNP	Total	Per Capita	% of Outlays	% of GNP	Total	% of GNP
1940	$50.7	$381	52.9%	$0.9	$7	9.5%	0.9%	-$2.9	-3.0%
1945	260.1	1,859	122.5	3.9	28	3.4	1.5	-47.6	-22.4
1950	256.9	1,687	96.3	4.8	32	11.3	1.8	-3.1	-1.2
1955	274.4	1,654	71.0	4.9	30	7.1	1.3	-3.0	-0.8
1960	290.5	1,608	57.3	6.9	38	7.5	1.4		
1965	322.3	1,659	47.9	8.6	44	7.3	1.3	-1.4	-0.2
1970	380.9	1,858	38.5	14.4	70	7.4	1.5	-2.8	-0.3
1975	541.9	2,509	35.6	23.2	107	7.0	1.5	-53.2	-3.5
1980	908.5	3,989	34.0	52.5	231	8.9	2.0	-73.8	-2.8
1981	994.3	4,320	33.3	68.7	299	10.1	2.3	-78.8	-2.6
1982	1,136.8	4,889	36.2	85.0	366	11.4	2.7	-127.9	-4.1
1983	1,371.2	5,840	41.3	89.8	382	11.1	2.7	-207.8	-6.3
1984	1,564.1	6,600	42.4	111.1	469	13.0	3.0	-185.3	-5.0
1985	1,817.0	7,594	46.0	129.4	541	13.7	3.3	-212.3	-5.4
1986	2,120.1	8,775	50.6	136.0	563	13.7	3.2	-221.2	-5.3
1987	2,345.6	9,616	52.9	138.6	568	13.8	3.1	-149.7	-3.4
1988	2,600.8	10,568	54.4	151.7	616	14.3	3.2	-155.1	-3.2
1989[b]	2,858.4	11,514	56.0	165.7	667	14.6	3.2	-161.5	-3.2
1990[b]	3,122.8	12,471	56.7	170.1	679	14.8	3.2	-99.7	-1.8

[a] End of fiscal year.
[b] Estimates based on projections from Office of Management and Budget; Congressional Budget Office; and House Budget Committee.

Source: Treasury Department; Office of Management and Budget; House Budget Committee; and Tax Foundation computations.

(See BUDGET WATCH on page 5)

Budget Watch By Allen Schick

Half a Trillion More . . . . And Still Not Enough

President Bush has called for a return to the old ways of preparing the Federal budget. Instead of beginning with baseline projections which adjust the future cost of current programs for inflation and mandatory workload changes, the President has urged that budgeting begin with an estimate of the additional revenue expected for the next year. The government would then decide how to spend this increment. It could allocate a portion to reducing the deficit and part to program needs. This approach, Bush has suggested, would enable the government to bring the budget back into balance while providing for new priorities.

"Federal receipts soared from $400 billion in 1978 to more than $900 billion in 1988 . . . Anyone who says that the government has not done a good job producing revenue just hasn't looked at the facts."

With this approach in mind, let us flash back to the late 1970s when the Federal budget was less than half its current size and examine how incremental revenue has been spent during the past decade. The most surprising trend is the truly prodigious rise in Federal revenue during the 1978-1988 period. Federal receipts soared from $400 billion in 1978 to more than $900 billion in 1988, the last complete fiscal year. Anyone who says that the government has not done a good job producing revenue just hasn't looked at the facts.

Now, let us see what all that money bought. Suppose that a decade ago, the government had known that it would have half a trillion dollars of additional money, and that it therefore decided to make liquidation of the deficit, then hovering around $60 billion, its number one budget objective. No one in his right mind could have envisioned that this steep increase in revenue would be accompanied by a huge run-up in the deficit. Of course, with the benefit of hindsight, we know that that was exactly what happened. During a decade in which receipts doubled, the budget deficit almost tripled.

How did the Federal government manage to overspend its $500 billion revenue dividend? A key part of the answer is that the money was not spent in one fell swoop. A portion was parcelled out each year, so that the budget never dealt with the issue of what half a trillion dollars might accomplish. Budgeting settled for a comfortable incrementalism in which the only thing that mattered was paying the next year's incremental claims.

The additional funds were distributed among a large number of Federal programs. A few programs were terminated during the decade, revenue sharing and urban development block grants (UD-AGS) being the most notable, but most spent more in 1988 than they did 10 years earlier. However, looking at the array of Federal programs leaves out a startling characteristic of the escalation in Federal spending. During the past decade, more than 95 percent of the incremental revenues were consumed by only four spending categories: national defense, Social Security, interest payments, and Medicare. The remainder was spread among other entitlement programs and nondefense discretionary outlays. Because the remainder was not enough to pay for everything else, the government spent an additional $100 billion that it didn't take in, thus producing bulging budget deficits in the 1980s.

"During a decade in which receipts doubled, the budget deficit almost tripled."

The following paragraphs review each of the major spending categories to see how we got into the budget mess and what might ensue in the years ahead.

Revenue and Outlay Increases
Fiscal Years 1978-1988
(dollars in billions)

	1978	1988	Difference	Outlay Increase as Percent of Revenue Increase
Total Revenue	$400	$909	$509	—
Total Outlays	459	1,064	605	—
National Defense	105	290	185	36%
Social Security	92	217	125	25%
Net Interest	35	152	117	23%
Medicare	25	86	61	12%
Other Mandatory Spending	101	198	97	19%
Nondefense Discretionary Outlays	124	176	72	14%
Budget Deficit	59	155	96	—

Source: Congressional Budget Office

National Defense

This is the most volatile portion of the budget; hence, the past is an uncertain guide to the future. We know that defense goes through cycles of buildup and attrition, but we do not know in advance how long and deep each leg of the cycle will be. In the late 1970s, the government decided to reverse the prolonged decline in defense spending that occurred after

TAX FOUNDATION
ONE THOMAS CIRCLE, N.W., SUITE 500

WASHINGTON, DC 20005
TELEPHONE 202-822-9050

FEDERAL TAX POLICY MEMO

Editor: Edward A. Sprague, Senior Vice President—Program Planning and Tax Policy

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Principles of Taxation

"In Light of Modern Developments"

In *The Wealth of Nations*, written in 1776, Adam Smith set down four principles which he felt should guide the making of tax policy. They bear repeating:

I The subjects of every State ought to contribute toward the support of the Government as nearly as possible in proportion to their respective abilities, i.e. in proportion to the revenue which they respectively enjoy under the protection of the State.

II The tax which each individual is bound to pay ought to be certain and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor and to every other person.

III Every tax ought to be so levied at the time or in the manner in which it is most likely to be convenient for the contributor to pay it.

IV Every tax ought to be so contrived as both to take out and keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of the State.

These maxims have proven remarkably resilient through the years as basic standards to uphold in public finance. New economic and social developments, of course, do condition the public policy response. The noted British economist, Sir Josiah Stamp, called Smith's principles "indisputable", but said they were "inadequate to the practical task of bringing under judgement the many different issues that confront us." Stamp attempted to recast and enlarge on Smith's standards in his own work, *The Fundamental Principles of Taxation in the Light of Modern Developments*. This was penned in 1920. Among other thins Stamp wanted to explain progressive taxation which Adam Smith's first principle appeared not to endorse.

Almost 70 years later we are still busy recasting and that is inevitable given the growth and diversity of market economies. But attention to basic principles is more important than ever because there are so many more opportunities to stray from them in a world of accelerating tax legislation and regulation.

In modern times Adam Smith's principles of taxation have been regrouped into three broad objectives:

(1) Equity
(2) Simplicity
(3) Efficiency

Equity among taxpayers was Smith's first point and remains cardinal. Simplicity combines the objectives of certainty and convenience — the administrability of tax matters for both the tax collector and taxpayer. Efficiency in collection of taxes — Smith's fourth point — has taken on a much larger meaning. Now, not only does this mean that taxation should not distort the workings of market economies but, to many observers, it is extended to mean that tax policy should actively promote economic growth.

There can be tension between these objectives. Overemphasis on one can diminish another. The best recent example of this in the U.S. was the Tax Reform Act of 1986 in which the pursuit of a more equitable income tax system ran roughshod over simplicity — and some would say over efficiency too. At the outset of the last round of tax reform, the objective of tax simplification was considered very important. The title of the 1984 Treasury Department report was *Tax Reform for Fairness, Simplicity and Economic Growth*. During subsequent consideration of the actual reform legislation, however, simplification dropped by the wayside. For many individual and corporate taxpayers the end result was a staggering increase in complexity and their tax administrative burden.

Furthermore, there is substantial disagreement among policy makers as to what actually makes for an equitable and efficient tax system. In the more than 200 years since the *Wealth of Nations*, the case for progressive taxation with graduated rates of tax or other means to impose a relatively heavier burden on upper income groups has become well ingrained. However, it has always been an uneasy case because of the lack of a truly objective standard — such as arithmetic proportion — and the doubtful application of progression to the universe of individual and business taxpayers. Therefore, in taxation, as in other aspects of public policy, fairness is often defined in the eye of the beholder. And as for efficiency, this is too often defined by whose econometric model is being used and by what interest group.

The Tax Foundation believes it is important to set forth an *explicit* and *consistent* set of principles to guide policy makers; principles that are instructive in terms of making actual policy choices "in the light of modern developments." The major concepts of equity, simplicity and efficiency are obviously evident throughout the list shown on page two.

The first five principles focus on tax certainty and taxpayers' ability to comply, which we believe need reemphasis in the wake of the 1980s' legislative onslaught. Principles six though nine relate to tax policy and economic efficiency, both domestic and international, and principle ten applies one through nine to the whole Federal system.

TAX FOUNDATION PRINCIPLES OF TAXATION

(1) A good tax system requires informed taxpayers. It should be clear to the taxpayer **who** and **what** is being taxed and how tax legislation is enacted.

(2) The tax system should be as simple as possible, easy to understand, and easy to comply with. Compliance expense is a cost to society, and complicated taxation undermines voluntary compliance.

(3) Stability is important. The tax law should not change continually. Regulations should be issued promptly after legislation is enacted but frequent change makes this impossible.

(4) Changes in the tax law should not be retroactive. Taxpayers should be able to rely with confidence on the law as it exists when they enter a transaction.

(5) Tax legislation should be based on sound legislative procedures and careful analysis. There should be open hearings with full opportunity to comment on legislative and regulatory proposals. Revenue estimates should be fully explained.

(6) The primary purpose of taxes is to raise needed revenue, not to micromanage the economy with subsidies and penalties. The tax system should aim for neutrality in economic decision making and minimize distortions of the free market. The tax system should not favor consumption over savings and investment (or vice versa).

(7) It makes a difference how large a share of GNP is taken by the government in taxes because the taxpaying private sector generates the wealth that determines our standard of living. It makes a difference how we define the tax base because we burden the activities included in the tax base.

(8) Taxes should be broadly based and rates of tax should be moderate at all points.

(9) As we live in a global marketplace, the U.S. tax system must be competitive with those of other industrialized nations. The U.S. tax system should not impede the free and fair flow of goods, services and capital. It should not penalize imports, exports, U.S. investment abroad, or foreign investment in the U.S.

(10) State taxes are an important factor in our Federal system. The same general policies that apply to Federal taxes should also apply to State taxes. Federal and State tax systems should be harmonized to the extent possible.

the Vietnam War. The buildup phase started while Carter was still President, accelerated when Reagan took office, peaked in the mid-1980s, and has ground to a halt since then. Defense outlays are continuing to rise gradually, principally because of obligations incurred during the buildup phase. Unless there is a severe deterioration in the international situation, defense will not be a leading source of spending increases in the 1990s. Its share of the Federal budget is likely to drop below the level it was when Reagan became President.

Social Security

There is nothing cyclical about the progressive rise in Social Security expenditures. They go up year after year, propelled by the growth in the elderly population (about half a million Americans are added to the Social Security rolls each year) and by the

> *"Unless there is a severe deterioration in the international situation, defense will not be a leading source of spending increase in the 1990s."*

automatic adjustment of benefits for inflation. Because Social Security receipts are going up faster than outlays, if is hard to get politicians to even consider cutbacks in this area. By the mid-1990s, the balance in the Social Security funds will be about $100 billion. The money is supposed to be saved to pay benefits in the next century when the postwar baby boom generation retires. In fact, it is being borrowed to finance other portions of the budget. Without Social Security, the budget deficit would be approximately $250 billion and rising.

Net Interest

The rise in interest payments illustrates how one year's deficit begets larger deficits in the future. The Federal government spent $117 billion more on these payments in 1988 than it did a decade earlier. In fact, the spiralling interest charges have accounted for the entire rise in the budget deficit during this period. To put the matter simply, if interest payments were no higher than they were in the late 1970s, today's deficit would be smaller than it was then. The future trend in interest charges depend on whether the government reins in the deficit. If it doesn't, a rising share of the budget will go for interest.

Medicare

The past decade offers a bleak outlook for the 1990s. During the 1980s, Medicare has been (a) the fastest growing Federal program, and (b) according to official statistics, the program that has suffered the most cutbacks. Medicare spending tripled during the past decade, a period during which $50 billion were allegedly lopped from this program. Some cuts have been made, but the official figures have been blown up by an assortment of gimmicks such as shifting the payments of funds from one year to the next. The steep rise in Medicare outlays has been driven by high inflation in health care, the aging of the population, the introduction of expensive technology, and increased utilization of services. CBO has projected that these factors will add another $100 billion in Medicare outlays by the 1994 fiscal year. If nothing is done to control costs, Medicare will consume a rising share of incremental revenue.

Other Mandatory Outlays

With the exception of defense, mandatory programs were the engine of spending growth in the 1978-88 period. In addition to the three big categories discussed above (Social Security, interest, and Medicare) the government operates dozens of other entitlements with an aggregate cost in excess of $200 billion a year. These include military and civilian retirement, Medicaid, food stamps, farm price supports, and veterans benefits. One should expect the spending growth in these programs to be at least as high in the next decade as in the previous one. Less than one-fifth of entitlement outlays are targeted to needy persons. One way of slowing the spiral in entitlements would be to narrow the eligibility rules, but this would likely be a politically difficult move.

Nondefense Discretionary Outlays

Discretionary spending increased during the past decade, but at a much slower rate than any other major category of expenditure. Although they now account for barely 15 percent of total outlays, discretionary programs

> *"For discretionary spending to accelerate, it will be necessary to take funds from defense or from taxpayers."*

still add up to more than $175 billion a year. Their share of future budgets might depend on how the "guns versus butter" competition for Federal dollars fares, as well as on the President's success in holding the line on tax increases. For discretionary spending to accelerate, it will be necessary to take funds from defense or from taxpayers. One should not be surprised if cutbacks in defense translate into higher domestic expenditure, not a lower deficit. Similarly, a tax increase might do more to ease pressure on domestic programs than to curtail the deficit.

There is a real possibility that the next decade will be a replay of the previous one, at least insofar as overspending incremental revenue is concerned. A decade from now, the Federal government will be taking in an extra one trillion dollars a year. Unless its spending habits change, Uncle Sam might find that one trillion dollars more is not enough. Like the overeaters in the Alka-Seltzer ads, the overspenders in the Federal budget commiserate, "We can't believe we spent the whole thing." They have, and more. Sooner or later, it will be necessary for the government to take the strong medicine of spending control. If it doesn't, one trillion dollars will disappear just as quickly as half a trillion did.

Major State Taxes and Rates

as of July 1, 1989

State	Income Taxes: Corporate	Income Taxes: Individual	General Sales and Use Tax	Gasoline Tax (per gallon)	Cigarette Tax (per pack of 20)	Property Tax
Alabama	5% (F)	2 to 5% (F)	4% (a)	11 cents	16.5 cents	X
Arizona	2.5 to 10.5 (F)	2 to 8 (F)	5 (a)	17	15	X
Arkansas	1 to 6	1 to 7	4 (a)	13.5	21	X
California	9.3 (q)	1 to 9.3 (q)	4.75 (a)	9	35	X
Colorado	5 to 5.4 (b)	5 (q)	3 (a)	12	20	X
Connecticut	11.5 (c, g)	1 to 14 (d)	8	20 (e)	40	X
Georgia	6	1 to 6	4 (a)	7.5 + 3% of retail	12	X
Hawaii	4.4 to 6.4	2 to 10	4	16 to 22.5	40% wholesale	
Idaho	8	2 to 8.2	5	18	18	X
Illinois	4 (p)	2.5	5 (a, e)	13	20	X
Indiana	3.4 (f)	3.4	5	15	15.5	X
Iowa	6 to 12 (F, h, q)	.4 to 9.98 (F, q)	4 (a)	20	31	
Kansas	4.5 (g)	3.65 to 8.75 (F, n)	4.25 (a)	15 (e)	24	X
Kentucky	3 to 7.25	2 to 6 (F)	5 (a)	15 (l)	3.001	X
Louisiana	4 to 8 (F)	2 to 6 (F)	4 (a)	16	16	
Maine	3.5 to 8.93 (q)	2 to 8	5	17	28	X
Maryland	7	2 to 5	5	18.5	13	X
Massachusetts	(j)	5 (k)	5	11 (l)	26	X
Michigan	2.35	4.6	4	15	25	X
Minnesota	9.5 (q)	6 to 8.5 (o, q)	6 (a)	20	38	X
Mississippi	3 to 5	3 to 5	6	18 (b)	18	
Missouri	5 (F, c)	1.5 to 6 (F)	4.225 (a, b)	11	13	X
Nebraska	4.75 to 6.65	3.1 to 4.8 (q)	4 (a)	22.3 (l)	27	
New Jersey	9 (g)	2 to 3.5	6	10.5	27	X
New Mexico	4.8 to 7.6	1.8 to 8.5	4.75 (a)	16.2	15	X
New York	9 (c, q)	4 to 7.875 (b, r)	4 (a)	8	33	
North Carolina	7	3 to 7	3 (a)	15.7 (l)	2	X
North Dakota	3 to 10.5 (F, q)	3.24 to 14.57 (F, h, m)	6	20	30 (b)	X
Ohio	5.1 to 8.9 (c)	.743 to 6.9	5 (a)	15.1 (l)	18	X
Oklahoma	5	.5 to 10 (F, n)	4 (a)	16	23	
Pennsylvania	8.5	2.1	6	12	18	X
Rhode Island	9	22.96% of Federal income tax	6	20 (l)	35	X
South Carolina	5	2.75 to 7	5	16	7	X
Tennessee	6	6 (d)	5.5 (a)	20	13	
Utah	5	2.6 to 7.35 (F, h)	5.094 (a, b)	19	23	X
Vermont	5.5 to 8.25	25% of Federal income tax	4	16 (b)	17	X
Virginia	6 (c)	2 to 5.75	3.5 (a)	17.5	2.5	X
West Virginia	9.45 (b)	3 to 6.5 (q)	6	15.5	17	
Wisconsin	7.9	4.9 to 6.93 (q)	5 (a)	20.8 (l)	30	X
Florida	5.5 (q)	These 7 states have no individual income tax	6 (a)	4	24	X
Nevada	These 5 states have no corporate income tax		5.75 (a)	16.25	15	X
South Dakota			4 (a)	18	23	
Texas			6 (a)	15	26	
Washington			6.5 (a)	18	34 (b)	X
Wyoming			3 (a)	9	12	X
Alaska	1 to 9.4 (q)		These 5 states have no general sales tax	8	16 (e)	X
Delaware	8.7	3.2 to 7.7		16	14	
Montana	6.75 (g, s)	2 to 11 (F)		20	16 (e)	X
New Hampshire	8	5 (d)		14	21	X
Oregon	6.6	5 to 9 (F, h)		16 (e)	27	X

(X) Indicates state levies a property tax.
(F) Allows Federal income tax as a deduction.

(a) Local taxes are additional.
(b) Future reduction scheduled under current law.
(c) Alternative methods of calculation may be required.
(d) In Connecticut, New Hampshire, and Tennessee, rates apply to income from interest and dividends only. Capital gains are taxed at 7% in Connecticut.
(e) Future increases scheduled under current law.
(f) A supplemental net income tax is imposed at 4.5%.
(g) Corporate surtax is imposed: Connecticut, 20%; Kansas, 2.25%; Montana, 4%; New Jersey's rate is .375% beginning July 31, 1989.
(h) Deductions limited.
(j) Excise tax is imposed equal to the greater of $400; or the sum of a tax on net worth or the value of tangible property not taxed locally, plus 9.5% of net income.
(k) Tax of 10% on income derived from intangibles, and 5% on all other income.
(l) Tax rate is periodically adjusted administratively.
(m) Optional tax of 17% of taxpayer's adjusted Federal income tax liability.
(n) In Kansas and Oklahoma the higher rates apply to taxpayers deducting Federal income tax.
(o) Additional tax is imposed on income over specified levels, varying with filing status.
(p) Additional 2.5% personal property replacement tax.
(q) Alternative minimum tax is imposed.
(r) Qualified taxpayers may elect to pay alternative taxes at varying rates.
(s) 7% rate for corporations using water's edge apportionment.

Source: Compiled by Tax Foundation from data reported by Commerce Clearing House through June 15, 1989.

Sales Taxes Garner Most Revenue for States

General sales taxes produced more revenue for the states than any other source, according to recent analysis by the Tax Foundation. Economists at the Washington-based tax watchdog organization say that in the 45 states which levy general sales taxes, $87 billion was brought into state treasuries in fiscal year 1988 — almost a third (32.9 percent) of the $264.1 billion total state tax collections for that year.

The personal income tax ranked a close second, bringing in $80.1 billion during fiscal 1988 for 30.3 percent of total tax receipts, a 5.4 percent increase over 1987's take. Corporate income taxes, the third largest single tax source, increased 4.8 percent, amounting to $21.7 billion or 8.2 percent of the total. Only five states (Nevada, South Dakota, Texas, Washington, and Wyoming) have neither a corporate nor a personal income tax, and only seven states (the previous five plus Alaska and Florida) have no individual income tax.

All states tax gasoline and motor fuels. A sizable 9.6 percent increase here netted $17.2 billion, 6.5 percent of states' total taxes in fiscal 1988.

Local property taxes are also levied in all 50 states, and 39 states have some form of property tax; 39 states have both general sales and income taxes; and 33 states have general sales, income, and property taxes, Tax Foundation economists say.

1989 Tax Rates

Sales Taxes

Connecticut leads the list of top rates with its 8 percent sales and use tax rate, followed by: Washington (6.5 percent); Florida, Minnesota, Mississippi, New Jersey, North Dakota, Pennsylvania, Rhode Island, Texas, West Virginia (6 percent); and Nevada (5.75 percent). No state general sales tax is levied in Alaska, Delaware, Montana, New Hampshire, or Oregon, although municipalities in Alaska do impose sales taxes.

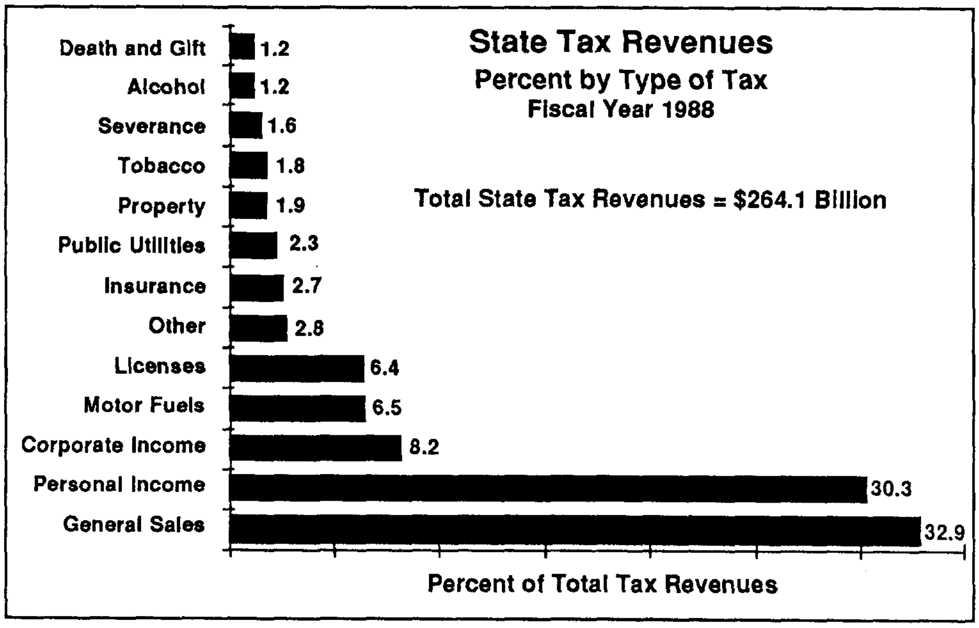
The state sales tax is lowest — 3 percent — in three states: Colorado, North Carolina, and Wyoming. Localities in 29 states levy sales taxes, generally in addition to those shown in the accompanying table.

Income Tax Rates

The tax rate schedules are progressive in all but six of the 43 states that levy a personal income tax. Colorado, Illinois, Indiana, Massachusetts, Michigan, and Pennsylvania apply a flat rate, regardless of income level. In two states, income taxes are levied as a percentage of Federal individual income tax obligations — Rhode Island and Vermont.

The maximum corporate income tax is highest in Iowa (12 percent), Connecticut (11.5 percent), and Arizona and North Dakota (10.5 percent).

(See STATE TAXES on page 8)



THE FRONT BURNER

By Robert C. Brown
President, Tax Foundation

A Parting Shot

This will be my last Front Burner as President of the Tax Foundation. Over the years this column has covered a wide variety of subjects, trying to provide some insight into basic, critical issues. I have been rewarded with a heartening flow of feedback — pro and con — from many of you, and I thank you.

Before handing the reins to my successor I want to make one last observation from this vantage point. We as a people who make up this American society have gone slightly "nuts" on the little-child cult of security guaranteed by government. In short, we are turning into a nation of parasites.

It is all based on the illusion that we can vote ourselves rich. We cannot. Citizens are only fooling themselves if they believe that "social security" rests on the promises of politicians rather than on the character, competence and courage of individual men, women, and families.

It will be one of the great frauds of history if we let ourselves be led to believe that the output of any society can be greater than the input of its individuals. Ask Mikhail Gorbachev about that.

It will be one of the ironies of history if we slip into the swamps of collectivism, just as the rest of the world is fighting, and dying, to climb back out.

(STATE TAXES from page 7)

Gasoline Tax

Taxes on motor fuels have increased faster than any category of state tax over the last year. Gasoline rates are currently highest in Nebraska (22.3 cents a gallon); Wisconsin (20.8 cents); and Hawaii (where combined state-local rates range from 16 to 22.5 cents per gallon). The lowest rate, 4 cents, is levied in Florida, where gasoline is also subject to the general sales tax. The next lowest rate — 8 cents — applies in Alaska and New York.

Cigarette Tax

Cigarette taxes also make a notable contribution to state tax revenues, Tax Foundation economists report. In fiscal 1988, the states collected $4.6 billion of their total taxes from tobacco product excises. Current rates range from a high of 40 cents a pack in Connecticut to a low of 2 cents in North Carolina.

The table on page six gives details, as of July 1, 1989 for major taxes and rates employed by the states.

State Government Tax Collections By Type

Fiscal Years 1987-1988

($Billions)

Type of Tax	1987	1988	Percent Change 1988	Percent of Total 1988
Total	$ 247.0	$ 264.1	6.9%	100.0%
General Sales	79.6	87.0	9.3	32.9
Personal Income	76.0	80.1	5.4	30.3
Corporate Income	20.7	21.7	4.8	8.2
Motor Fuels	15.7	17.2	9.6	6.5
Licenses	16.0	17.0	6.3	6.4
Other	7.3	7.4	1.4	2.8
Insurance	6.4	7.0	9.4	2.7
Public Utilities	6.0	6.2	3.3	2.3
Property	4.6	5.0	8.7	1.9
Tobacco	4.6	4.8	4.3	1.8
Severence	4.0	4.3	7.5	1.6
Alcohol	3.1	3.2	3.2	1.2
Death and Gift	3.0	3.2	6.7	1.2

Source: Department of Commerce, Bureau of the Census; and Tax Foundation.

Tax Features

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Tax Foundation
One Thomas Circle, N.W., Suite 500
Washington, D.C. 20005
202-822-9050

Tax Foundation
One Thomas Circle, N.W.
Washington, DC 20005
202-822-9050