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# TAX FEATURES

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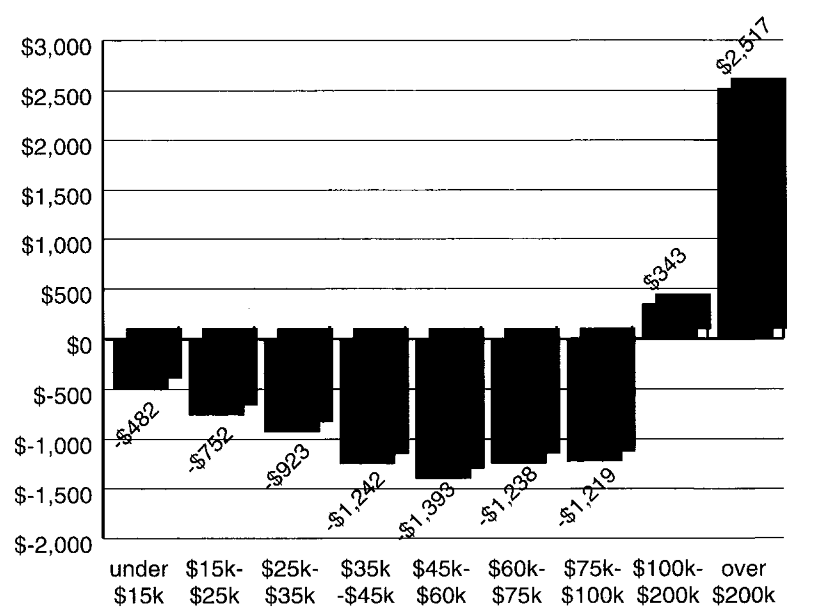
## Taxpayer Relief Act of 1997 Spreads the Wealth

### *But Less Affluent States with More Children Benefit Most*

After netting out the tax cuts and tax hikes, the tax bill enacted prior to Congress's August recess translates into a total of $764 for every individual income tax filer over the next five years, according to a new Tax Foundation analysis. When all provisions are considered, the new law will add an average of $452 to tax bills while subtracting an average of $1,216.

Chart 1: Per Filer Net Tax Cuts/Tax Hikes, FY 1997–2002




Source: Tax Foundation.

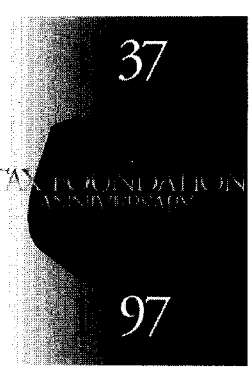
Roughly 80 percent of the average filer's tax cut — or $998 of the $1,216 — will come from the per-child tax credit and the educational tax incentives. Over 10 years the child credit — which grants parents a $400 tax credit in 1998 and a $500 credit in 1999 and beyond for every child under 17 in their household — accounts for 45.7 percent, or $183.4 billion, of the total revenue reduction. In that same time frame the educational incentives — which among other things provide a tax credit of up to $1,500 to help defray the cost of the first two years of post-secondary education — account for 18.9 percent, or $76.0 billion, of total revenue reductions.

But who really benefits most?

In his latest *Special Report*, titled "Bottom Line on the Taxpayer Relief Act of 1997," Tax Foundation staff economist Patrick Fleenor calculates the answer both by income group and by state, on a five-year and 10-year basis.

Starting with the retroactive provisions of the tax bill and looking forward until fiscal 2002, the vast majority of tax filers will see their taxes lowered (see Charts 1 and 2). Those earning between $35,000 and $100,000 will see the greatest tax relief. Only those earning over $100,000 will see a tax increase during this period. The reason: The tax incen-

**Tax Bill** *continued on page 2*




## FRONT & CENTER

### The Taxpayer Dividend Act: Stomping Pork, Safeguarding Prosperity

*Rep. John Boehner (R-Ohio)*

4-5

# Taxpayer Relief Act of 1997 Spreads the Wealth

## Tax Bill

*Continued from page 1*

tives for rearing children and for putting them through college are phased out at the upper income levels. Needless to say, the tax increases are not phased out: tax filers in top income brackets will feel the full effects, directly and indirectly, of the various tax hikes.

Mr. Fleenor's long-term projection for the impact of the tax law shows that tax filers in all income groups are in a position to see tax cuts (see Chart 2). Those earning between $35,000 and $100,000 could see decreases of more than $3,000, while due to the impact of estate tax and capital gains tax reforms, tax filers with incomes of $200,000 or more could see hefty tax cuts of $15,000 or more.

"The operative word here, of course, is 'could,'" observed Mr. Fleenor. "Projecting the impact of tax cuts and hikes 10 years from now is pushing the limits of economic forecasting."

As for the impact on states, the new bill — with its focus on families with children and its income-based caps on tax relief — creates a disproportionate distribution of tax cuts. Due to the income-based ceilings, less affluent states with greater populations of children will see a proportionately greater share of federal tax relief (see Chart 4, page 6).

As a result, while California, Texas, and New York — with the greatest populations — can claim the largest total tax relief, they will not see the most tax relief per filer. Utah can claim that honor. Mr. Fleenor projects that in the next five years the Beehive State will average $958 in tax cuts per filer, while Idaho filers will average $899 in relief, second highest in the nation.

On the other hand, residents of more affluent states are hit with the child-credit and education-credit phase-outs, and thus will not reap the same rewards as the less affluent, child-rich states. Alaska, for example, will only average $551 in tax cuts per filer, while Connecticut will average $634.

**Tax Bill** *continued on page 6*

### Chart 2: Per Filer Net Tax Cuts/Tax Hikes, 5-Year and 10-Year Projections

| | Net Effect | | Tax Cuts | | Tax Hikes | |
|---|---|---|---|---|---|---|
| Adjusted Gross Income | 5-Year | 10-Year | 5-Year | 10-Year | 5-Year | 10-Year |
| Per filer average | -$764 | -$2,136 | -$1,216 | -$3,114 | $452 | $978 |
| under $15,000 | -482 | -1,073 | -582 | -1,316 | 100 | 243 |
| $15,000 under $25,000 | -752 | -1,805 | -1,013 | -2,377 | 260 | 571 |
| $25,000 under $35,000 | -923 | -2,288 | -1,336 | -3,194 | 412 | 905 |
| $35,000 under $45,000 | -1,242 | -3,086 | -1,687 | -4,017 | 445 | 931 |
| $45,000 under $60,000 | -1,393 | -3,555 | -2,014 | -4,871 | 620 | 1,316 |
| $60,000 under $75,000 | -1,238 | -3,445 | -2,183 | -5,437 | 945 | 1,991 |
| $75,000 under $100,000 | -1,219 | -3,753 | -2,343 | -6,125 | 1,124 | 2,372 |
| $100,000 under $200,000 | 343 | -1,767 | -1,654 | -6,037 | 1,997 | 4,271 |
| $200,000 or more | 2,517 | -15,359 | -5,794 | -33,113 | 8,312 | 17,754 |

Source: Tax Foundation.

### Chart 3: Per Filer Effects of the Major Provisions of the 1997 Taxpayer Relief Act by Income Group (FY 1997 - 2002)

| | | Tax Cuts | | | | | | | Tax Increases | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Adjusted Gross Income | Net Effect | Total Cuts | Child Credit | Education Incentive | Estate Reform | Capital Gains | AMT | Other | Total Hikes | Airline | Cigarette | Other |
| Per filer average | -$764 | -$1,216 | -$682 | -$316 | -$51 | $1 | -$66 | -$103 | $452 | $266 | $41 | $145 |
| under $15,000 | -482 | -582 | -435 | -120 | -3 | 0 | -6 | -18 | 100 | 37 | 37 | 27 |
| $15,000 under $25,000 | -752 | -1,013 | -640 | -270 | -19 | 0 | -26 | -59 | 260 | 133 | 39 | 88 |
| $25,000 under $35,000 | -923 | -1,336 | -776 | -387 | -32 | 0 | -51 | -88 | 412 | 225 | 55 | 132 |
| $35,000 under $45,000 | -1,242 | -1,687 | -928 | -581 | -22 | 0 | -40 | -116 | 445 | 241 | 31 | 174 |
| $45,000 under $60,000 | -1,393 | -2,014 | -1,090 | -653 | -44 | 1 | -83 | -144 | 620 | 365 | 40 | 215 |
| $60,000 under $75,000 | -1,238 | -2,183 | -1,223 | -544 | -66 | 1 | -127 | -224 | 945 | 563 | 49 | 334 |
| $75,000 under $100,000 | -1,219 | -2,343 | -1,148 | -663 | -106 | 2 | -173 | -254 | 1,124 | 699 | 46 | 380 |
| $100,000 under $200,000 | 343 | -1,654 | -345 | -212 | -313 | 5 | -397 | -392 | 1,997 | 1,339 | 72 | 585 |
| $200,000 or more | 2,517 | -5,794 | 0 | 0 | -2,395 | 64 | -1,981 | -1,483 | 8,312 | 6,031 | 67 | 2,213 |

Source: Tax Foundation

# Making an 'Extra Point' about Tax Policy

## *Tax Foundation Launches New Commentary Series*

The Tax Foundation has introduced a new publication, to complement the organization's popular *Special Reports*, *Special Briefs*, and *Background Papers*. The new series, titled *Extra Point*, will feature commentary by Foundation economists and adjunct scholars on tax policy.

Following are excerpts from three *Extra Points* released in recent weeks:

### Income and the Art of Tax Distribution Analysis

*By J.D. Foster, Executive Director, Tax Foundation*

Defining income properly is enormously important for an income tax, so economists, lawyers, and accountants have debated the matter for years....

The Joint Tax Committee...uses Adjusted Gross Income (AGI) as its definition for tax distribution analysis. AGI is relatively well understood, relatively simple, and derives from the income tax itself. But AGI is itself a consequence of tax policy and therefore could be an unsteady basis for measuring changes in tax policy.

The Treasury Department, on the other hand, uses Family Economic Income (FEI). In using FEI, Treasury seeks to develop a more comprehensive measure of income than AGI. FEI, for example, includes items of income excluded from AGI because otherwise the tax code would become too complex (e.g., imputed rent from owner-occupied housing), or for other policy reasons (e.g., the child care credit).

The disadvantage of using FEI is that it is a highly complex measure of income dependent on many critical assumptions, each of which open the calculation to criticism and possible manipulation....

Given its difficulties and possible disadvantages, why choose FEI over AGI in running distribution tables? Primarily because FEI is useful when "ability-to-pay" guides tax policy....

Ability-to-pay is at the heart of the belief that taxes should be used to redistribute income from the rich to the poor. But if you do not believe in redistributionism, you must conclude that ability-to-pay is not a proper guide to tax policy....

...Most observers once took (tax distribution) tables at face value, assuming they reflected a dispassionate calculation about which we could all pretty much agree. What this year's debate has revealed, however, is that there are a great many assumptions built into these tables about which there may be little or no agreement at all.

### Where Economics and Politics Meet

*By J.D. Foster, Executive Director, Tax Foundation*

According to the Joint Tax Committee, 75 percent of the value of the tax cuts in the tax bills before the Congress would go to households earning less than $75,000 annually. According to the Treasury Department, under these tax bills the top 1 percent of taxpayers get the same amount of tax relief as the bottom 60 percent of taxpayers. Can both statements be true? Actually, yes....

The main culprit in the debate, not surprisingly, is capital gains relief. According to the JTC, capital gains relief raises receipts in the first two years, reduces receipts in the next two, raises receipts again in the fifth, and loses money thereafter. [T]his curious result is due to the well-established principle that taxpayers will accelerate their realizations in the face of capital gains relief, but that there is a limited pool of capital gains taxpayers have accrued over the years and will want to realize once the tax rate is lower....

Another dimension to the capital gains conundrum is the treatment of the accelerated capital gains taxes paid. Remember, the capital gains cut raises revenue in the first two and fifth years because some individuals with accrued capital gains realize those gains, and pay tax, sooner rather than later. The JTC takes the common-sense approach that a tax is a tax is a tax. If more taxes are paid, it's a tax increase....

The Treasury argues that the taxpayer had accrued a capital gain and that he or she would have sold the asset and realized at some point anyway. At that time, the capital gains would have faced a higher rate but for the (new tax law)....

Analytically, the Treasury has a point, but only up to a point. Perhaps the gain would not have been realized in the future without an offsetting capital loss from the sale of some other asset. In this case, no tax would have been paid, so the fact that the asset was sold earlier actually means the capital gains tax paid may represent a tax increase. Or perhaps the gain would never have been realized because the asset would have carried over to the owner's estate and therefore qualified for a step-up in basis. Again, this would mean the tax paid today is a clear tax increase.

### U.S. Tax Obstacles in a Global Marketplace

*By E. Barry Asmus, Senior Policy Advisor, National Center for Policy Analysis (from remarks made at a Tax Foundation conference held in January 1997)*

This force called demographics, this force called globalization will change the way we do business. Now your competition comes from around the world, not just next door. You have two choices: Continuous improvement and/or re-engineering. General Motors looked at its operation. It went from 51 percent market share to 45 percent, to 40 percent, to 35 percent, to 31 percent. Folks, how smart do you have to be before you bring the Board together and say, "Hey, this isn't working; this continuous improvement is wrong. We've got to re-engineer this completely." And so they stopped producing cars off 17 platforms. They moved to start producing cars off 5 platforms. And they began to re-engineer....

Business today realizes that it's all about service, service, service, service. Service is not a competitive edge. Ser-

**Extra Points** *continued on page 8*

# The Taxpayer Dividend Act: Stomping Pork, Safeguarding Prosperity

***By Rep. John Boehner (R-Ohio)***

Have you ever been to a department store and purchased an item at full price, only to discover a day or two later that the same item has been marked down? At most stores, you're entitled to a refund of the difference, or at the very least a credit toward your next purchase. The trick is, you've usually got to catch the price change yourself — and insist on getting your money back.

Taxpayers this year face kind of the same situation. The surprisingly robust economy is almost certain to result in unexpected revenue for the government in 1997 — a "growth dividend" of extra tax revenue flowing into federal coffers not anticipated when this year's balanced budget was drawn up and passed into law. The Congressional Budget Office (CBO)'s September review recently confirmed this, projecting implementation of the balanced budget will generate as much as $137 billion more tax revenue than needed to reach balance by 2002.

> ***These [extra tax] revenues are not manna from heaven; nor are they free cash for the free spenders. The money belongs to the American people. Washington has no claim to the extra revenue — and thus has no business spending it, either.***

If CBO is right, then the federal government is overcharging Americans to the tune of $137 billion en route to a balanced federal budget in 2002. That's what any smart shopper — or in this case, smart taxpayer — would call a major rip-off. They're entitled to a refund.

After all, fair is fair. But Washington hasn't always played fair with taxpayers' money. Diminished in size but still a political force even today are traditional tax-and-spend liberals, who all but openly drool over the prospect of a multi-billion dollar social shopping spree of new programs, pork projects and other irresponsible Washington ventures. They're eager to take the extra revenue and do with it exactly what they've always done: spend it.

That's precisely what should not happen. After all, the growth dividend is entirely a product of our energized economy — which in turn is the sum total of the initiative of the average tax-paying, hard-working American citizen.

These revenues are not manna from heaven; nor are they free cash for the free spenders. The money belongs to the American people. Washington has no claim to the extra revenue — and thus has no business spending it, either.

U.S. Sen. Spencer Abraham (R-Mich.) and I have drafted new legislation — known in the House as the Taxpayer Dividend Act (TDA) — that prohibits any unanticipated revenue from being used for new federal spending. TDA establishes a fund for all revenues in the next five years that exceed projections set forth in the Balanced Budget Act. The assets of that fund, while still available for deficit reduction and/or debt repayment, could be used by Congress to provide further tax cuts to the American people, but would be strictly off-limits for new spending.

TDA isn't a late-inning effort to make this year's tax cuts more meaningful, though it certainly could have that pleasant effect. Under TDA, Washington can use that additional revenue to further protect taxpayers and continue to address responsibly our nation's fiscal problems as we enter the next century.

TDA blocks Washington from using growth dividends for new spending, but leaves Congress with plenty of more responsible options to choose from. Let's consider a few of the possibilities.

One possible scenario is that the entire fund could be used for deficit reduction or to help pay down the national debt. While the budget is on track to reach balance by 2002 or sooner, it's unlikely yet still possible a severe recession could throw us off course. The TDA fund could provide an emergency reserve to make up for

the revenue shortfall.

Another option: use the entire fund for additional tax cuts. Long-term, sustained economic growth is America's ultimate debt-retirement tool. We can't have that while retaining a tax code that taxes too much, punishes growth and discourages initiative. The TDA fund could be used to provide meaningful tax relief that goes far beyond the baby steps taken in this year's budget. The present tax relief package totals $93 billion over the next five years, while the projected dividend is substantially larger, at $137 billion — offering the possibility of more than doubling the size of the tax cuts already passed into law.

Along those same lines is a third option: use the assets of the fund to help with tax reform. We must replace the current tax code with a fairer, flatter, and simpler one. And one of the principle arguments against doing that is that moving toward a flatter, simpler structure might cause revenue to plunge in the transition period. If that proves to be the case, the Taxpayer Dividend Act would help smooth the path for reform by offset any decrease in revenue until the transition was complete.

We should consider using the people's money to give them a tax system they find fair, flat, and simple, one that will generate the economic growth and opportunities they deserve and our country needs.

A fourth option: some hybrid of all of the above.

There's really only one thing Washington is expressly forbidden to do with unanticipated revenue under TDA: spend it. The Era of Big Government is over — even according to President Clinton. We've been there, done that, and for Washington to squander yet another opportunity to do the right thing for America's future would be the height of foolishness.

Implementation of the TDA and its pork-punishing provisions would be a powerful gesture of newfound accountability on the part of the federal government. After all, the effort to restore fiscal responsibility to Washington doesn't end with balancing the budget. Besides helping to further restore sanity and discipline to the budget process, adoption of TDA would be another step toward restoring lost trust between taxpaying Americans and their government and restoring lost freedom to families and communities. That's a step worth taking.

For years the biggest myth in Washington has been that we can't balance the budget and provide tax relief at the same time. This summer, our leaders shattered that notion by doing just that. Now, the new myth is that we can't balance the budget and cut taxes further.

The truth is, we can. And we must. •

***Another option: use the entire fund for additional tax cuts. Long-term, sustained economic growth is America's ultimate debt-retirement tool. We can't have that while retaining a tax code that taxes too much, punishes growth and discourages initiative. The Taxpayer Dividend Act fund could be used to provide meaningful tax relief that goes far beyond the baby steps taken in this year's budget.***

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*The Tax Foundation invites a national leader to provide a "Front and Center" column each month in* Tax Features. *The views expressed in these columns are not necessarily those of the Tax Foundation.*

# New Tax Bill Benefits Some State Tax Filers More than Others

*Continued from page 2*

## Chart 4: Effects of the 1997 Taxpayer Relief Act by Income Group (FY 1997 - 2002)

| | | Tax Cuts | | | | | | | Tax Increases | | | | | Memo: Percentage of Eligible Dependents: | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Net Effect | Total | Child Credit | Education Incentives | Estate Tax Reforms | Capital Gains | AMT | Other | Total | Airline | Cigarette | Other | Total Net Effect ($Millions) | Child Credit | Education Credit |
| Total | -$764 | -$1,216 | -$682 | -$316 | -$51 | $1 | -$66 | -$103 | $452 | $266 | $41 | $145 | -$95,276 | 95.6% | 94.4% |
| Alabama | -797 | -1,187 | -706 | -315 | -33 | 1 | -49 | -84 | 390 | 215 | 50 | 125 | -1,535 | 97.1 | 96.2 |
| Alaska | -551 | -924 | -509 | -251 | -32 | 1 | -48 | -86 | 372 | 213 | 31 | 128 | -211 | 94.0 | 92.8 |
| Arizona | -827 | -1,235 | -717 | -324 | -48 | 1 | -59 | -88 | 408 | 240 | 37 | 132 | -1,544 | 96.5 | 95.4 |
| Arkansas | -815 | -1,185 | -715 | -315 | -33 | 1 | -46 | -77 | 370 | 198 | 56 | 115 | -888 | 97.6 | 96.8 |
| California | -797 | -1,270 | -710 | -322 | -61 | 1 | -76 | -102 | 473 | 293 | 28 | 152 | -11,526 | 94.9 | 93.4 |
| Colorado | -731 | -1,168 | -658 | -311 | -44 | 1 | -58 | -99 | 438 | 253 | 37 | 148 | -1,350 | 95.2 | 94.0 |
| Connecticut | -634 | -1,252 | -626 | -307 | -85 | 2 | -104 | -130 | 618 | 389 | 34 | 195 | -1,078 | 91.5 | 90.0 |
| Delaware | -723 | -1,211 | -670 | -318 | -52 | 1 | -68 | -103 | 488 | 279 | 55 | 154 | -262 | 95.2 | 94.1 |
| District of Columbia | -2,764 | -3,257 | -579 | -257 | -68 | 2 | -83 | -2,272 | 494 | 312 | 23 | 158 | -875 | 93.8 | 92.0 |
| Florida | -753 | -1,197 | -674 | -301 | -63 | 2 | -68 | -92 | 444 | 263 | 43 | 138 | -5,178 | 95.8 | 94.6 |
| Georgia | -748 | -1,178 | -678 | -310 | -40 | 1 | -57 | -94 | 430 | 243 | 47 | 140 | -2,474 | 95.7 | 94.6 |
| Hawaii | -754 | -1,182 | -659 | -316 | -47 | 1 | -61 | -100 | 428 | 260 | 20 | 149 | -459 | 95.6 | 94.6 |
| Idaho | -899 | -1,269 | -757 | -351 | -33 | 1 | -44 | -85 | 369 | 205 | 38 | 127 | -461 | 97.1 | 96.4 |
| Illinois | -751 | -1,238 | -681 | -321 | -58 | 1 | -73 | -105 | 487 | 292 | 38 | 157 | -4,360 | 94.8 | 93.6 |
| Indiana | -770 | -1,211 | -695 | -328 | -39 | 1 | -57 | -92 | 441 | 241 | 62 | 138 | -2,149 | 96.7 | 95.9 |
| Iowa | -823 | -1,219 | -705 | -333 | -42 | 1 | -54 | -85 | 395 | 226 | 42 | 127 | -1,132 | 97.2 | 96.6 |
| Kansas | -819 | -1,253 | -713 | -337 | -49 | 1 | -62 | -93 | 434 | 253 | 42 | 139 | -994 | 96.3 | 95.5 |
| Kentucky | -748 | -1,175 | -693 | -314 | -35 | 1 | -50 | -83 | 427 | 215 | 87 | 124 | -1,268 | 97.1 | 96.3 |
| Louisiana | -824 | -1,213 | -726 | -321 | -34 | 1 | -50 | -82 | 389 | 212 | 54 | 122 | -1,532 | 97.0 | 96.0 |
| Maine | -769 | -1,169 | -673 | -313 | -43 | 1 | -58 | -83 | 400 | 230 | 47 | 123 | -462 | 97.3 | 96.6 |
| Maryland | -713 | -1,220 | -659 | -318 | -56 | 1 | -76 | -112 | 508 | 306 | 34 | 167 | -1,799 | 93.7 | 92.3 |
| Massachusetts | -668 | -1,186 | -626 | -301 | -66 | 1 | -84 | -110 | 518 | 321 | 34 | 164 | -2,034 | 93.8 | 92.5 |
| Michigan | -756 | -1,214 | -678 | -322 | -49 | 1 | -67 | -99 | 459 | 272 | 39 | 148 | -3,425 | 95.7 | 94.7 |
| Minnesota | -758 | -1,210 | -674 | -326 | -47 | 1 | -63 | -100 | 452 | 265 | 38 | 150 | -1,709 | 95.5 | 94.6 |
| Mississippi | -820 | -1,163 | -717 | -308 | -26 | 1 | -40 | -72 | 342 | 180 | 55 | 108 | -949 | 97.9 | 97.1 |
| Missouri | -766 | -1,204 | -689 | -318 | -47 | 1 | -61 | -90 | 439 | 247 | 58 | 134 | -1,913 | 96.5 | 95.6 |
| Montana | -827 | -1,178 | -701 | -319 | -37 | 1 | -46 | -76 | 352 | 197 | 41 | 114 | -340 | 97.5 | 96.8 |
| Nebraska | -816 | -1,206 | -699 | -328 | -41 | 1 | -53 | -85 | 390 | 224 | 39 | 127 | -662 | 97.0 | 96.2 |
| Nevada | -732 | -1,183 | -669 | -311 | -46 | 2 | -56 | -103 | 451 | 254 | 42 | 154 | -548 | 96.1 | 95.2 |
| New Hampshire | -707 | -1,226 | -663 | -321 | -62 | 1 | -79 | -102 | 519 | 299 | 68 | 152 | -415 | 95.4 | 94.5 |
| New Jersey | -680 | -1,248 | -649 | -312 | -74 | 1 | -93 | -121 | 568 | 353 | 35 | 180 | -2,798 | 92.2 | 90.6 |
| New Mexico | -834 | -1,183 | -712 | -315 | -33 | 1 | -46 | -79 | 349 | 200 | 32 | 117 | -638 | 97.3 | 96.4 |
| New York | -698 | -1,225 | -652 | -305 | -71 | 1 | -86 | -112 | 527 | 327 | 33 | 167 | -5,992 | 94.1 | 92.8 |
| North Carolina | -738 | -1,150 | -670 | -306 | -36 | 1 | -52 | -88 | 412 | 225 | 56 | 131 | -2,558 | 96.6 | 95.7 |
| North Dakota | -840 | -1,201 | -708 | -330 | -37 | 1 | -47 | -80 | 362 | 205 | 37 | 120 | -261 | 97.3 | 96.6 |
| Ohio | -716 | -1,141 | -648 | -303 | -42 | 1 | -59 | -90 | 425 | 242 | 49 | 134 | -3,996 | 96.6 | 95.7 |
| Oklahoma | -817 | -1,208 | -716 | -322 | -38 | 1 | -52 | -81 | 391 | 216 | 54 | 121 | -1,188 | 97.4 | 96.6 |
| Oregon | -790 | -1,205 | -697 | -323 | -41 | 1 | -53 | -92 | 414 | 233 | 43 | 138 | -1,174 | 96.3 | 95.4 |
| Pennsylvania | -746 | -1,193 | -669 | -315 | -49 | 1 | -65 | -95 | 447 | 261 | 44 | 142 | -4,389 | 95.9 | 94.9 |
| Rhode Island | -713 | -1,174 | -646 | -306 | -55 | 1 | -71 | -96 | 461 | 276 | 42 | 143 | -348 | 95.8 | 94.8 |
| South Carolina | -766 | -1,150 | -682 | -307 | -31 | 1 | -48 | -82 | 383 | 209 | 51 | 123 | -1,326 | 97.2 | 96.3 |
| South Dakota | -822 | -1,184 | -703 | -323 | -36 | 1 | -44 | -80 | 362 | 198 | 45 | 119 | -288 | 97.4 | 96.7 |
| Tennessee | -745 | -1,160 | -676 | -307 | -37 | 1 | -53 | -87 | 415 | 227 | 58 | 130 | -1,838 | 96.6 | 95.6 |
| Texas | -815 | -1,228 | -715 | -320 | -45 | 1 | -59 | -90 | 413 | 242 | 36 | 135 | -6,877 | 96.0 | 94.7 |
| Utah | -958 | -1,337 | -788 | -381 | -31 | 1 | -47 | -90 | 379 | 218 | 26 | 134 | -784 | 96.3 | 95.6 |
| Vermont | -741 | -1,168 | -661 | -310 | -49 | 1 | -62 | -86 | 426 | 243 | 55 | 129 | -214 | 96.7 | 95.9 |
| Virginia | -713 | -1,194 | -660 | -314 | -50 | 1 | -67 | -104 | 482 | 278 | 48 | 155 | -2,294 | 94.5 | 93.2 |
| Washington | -779 | -1,222 | -687 | -329 | -45 | 1 | -59 | -103 | 442 | 259 | 30 | 153 | -2,047 | 95.7 | 94.7 |
| West Virginia | -804 | -1,195 | -711 | -321 | -34 | 0 | -50 | -80 | 391 | 210 | 61 | 119 | -612 | 97.7 | 97.1 |
| Wisconsin | -770 | -1,201 | -679 | -326 | -44 | 1 | -59 | -94 | 431 | 248 | 42 | 141 | -1,934 | 96.5 | 95.7 |
| Wyoming | -816 | -1,240 | -714 | -337 | -45 | 2 | -57 | -91 | 425 | 239 | 51 | 135 | -191 | 97.1 | 96.4 |

Source: Tax Foundation.

## FOUNDATION MESSAGE

# Looking for Direction

*J.D. Foster*
*Executive Director*
*& Chief Economist*

Both political parties are having a little trouble seeing what they should do next. At times like this, it can be useful to review the bidding, as a professor of mine used to say.

The Democrats are in the minority and their President is acting mighty Republican. Their top issue, campaign finance reform, is a yawner, and their top tactic — stopping Republicans — hardly inspires.

Republicans are faring no better. Much of what they wanted to do, they've already done, and they've gotten little credit for their efforts. Welfare reform — enacted. Line-item veto — enacted. Balanced budget — coming soon, likely to be followed by budget surpluses as matters currently stand. And let's not mention the calamitous coup attempt in the House.

Republicans said they wanted a tax cut and they got one, albeit a very small one. Many congressmen would love additional tax reductions. Despite the recent tax bill, the tax load continues to grow. And 1998 is an election year. So the when and why of the next tax cut effort are settled, but the how and what are still up in the air.

To the surprise of almost all economists, the Federal Reserve has tamed the beast inflation, this great and terrible Grendel of the economy. Consequently, the foreign exchange markets are as stable as one can expect.

The economic expansion, now in its fifth year, shows no sign of bottlenecks or over-heating. While real growth is modest, it has pulled unemployment down to a level that only a few years ago would have been thought impossible without risking greater inflation. Put all these factors together and it's no wonder the stock market has boomed.

On the foreign front, there is one superpower, and we're it. Fortunately, the U.S. has zero enthusiasm for anything but small-scale military adventurism. The reduction in foreign threats should translate into continued reformation of our military, and could well result in a further reduction in defense spending. The U.S. currently spends more on defense than does the rest of NATO and Russia, combined. This level of expenditure is difficult to justify and seems unlikely to continue.

The end of the Cold War should translate into a smaller, more focused foreign affairs budget. It is no longer quite so necessary to bribe countries to be our friends, or at least, not to be our enemies' friends. This should produce some more savings to the taxpayer.

On the debit side of the national ledger, income inequality between the rich and poor in America continues to grow, despite a myriad of government programs to shift income from the rich to the poor. Obviously, this approach doesn't and can't be made to work without destroying the economy. The recent budget deal bought Medicare a few years grace, but it's still projected to drown in red ink before long. And Social Security won't be far behind.

In summary, we face a rare opportunity when all the right stars are in alignment to launch a golden age of stable growth that, in turn, can spawn solutions to the problems on the debit side. And it all started the day President Clinton signed the budget bill. Not because the bill solved our problems, but because it cleared away stumbling blocks to solutions. For example, we can now table talk of deficit reduction, always a sterile alternative to fiscal policy. And the bill included two tax cut proposals that would otherwise dog all future tax policy discussions: the per child tax credit and capital gains relief.

Beginning with the enactment of the budget bill, fiscal policy can again focus on spending reform and tax cuts. As long as spending remains in check, a growing economy will produce enormous amounts of new revenues over and above what is necessary to fund spending. Some, like Rep. Mark Neumann (R-Wis.), would use surplus revenues to buy back the national debt. This would be like buying a bank CD just as the stock market booms — not a terrible idea, but not a good idea, either.

A much better idea would be to use the budget surpluses created by economic growth and by spending cuts to cut taxes. Tax cuts should be simple, broad-based, and specifically directed towards reducing the tax bias against work, saving, and investment. Such tax cuts would further strengthen the economy. The resulting additional jobs and higher wages would ease the pending crises in Medicare and Social Security, and reduce the effective burden of the federal debt. And it would do so by improving the economy's ability to provide goods and services, so it would not re-ignite inflation. Finally, the growth would further increase federal receipts, thereby sowing the seeds of future, additional, tax reductions.

Through perseverence and a little luck the U.S. has a rare opportunity to usher in a new age of prosperity. Problems remain, but they can be addressed effectively without threatening or diminishing the economy's strength. Indeed, of the big three problems remaining — Medicare and Social Security insolvency and the growing income gap — workable solutions will probably further reinforce the economy.

At such a time, let's not blow it with timid proposals, like a government debt buy-back program, or by squandering the additional tax revenues on a growth spurt for big government, or even by tax cuts that can't help the economy. This is a time for calculated boldness. This is a time for political leadership. Though often maligned and misused, this is a time for what was once called "the vision thing." Whichever group first adopts and can defend its bold vision for the future is likely to be the group that leads in the future. ●

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## Extra Points

*Continued from page 3*

vice is the competitive edge. When it comes to service, there is no finish line. You can never stop thinking about it. Good enough never is.

Quality is part of service. Pricing is part of service. It's not just price, it's not just quality, it's not just service, it's a value revolution. It's all three. And you listen. And you customize. You listen and you customize.

There's the world that we're going into. Every product, almost customized to the customer. Business is going to have to learn you've got to make a customer for life, and the way you make a customer for life is you know everything about them and you meet their whims and their needs in just the way they want it. That's the way it's all going. And the information/technological/digital age is allowing us to do that very thing. It's all a value revolution.

Quality, service, improvement, demographics, globalization, the devolving of government, the return to the market, the whole world understanding freedom. What a time! Just one caveat: Everybody has got to wake up. In a globalized world, Japan and Germany have capital gains taxes that are almost non-existent and we tax capital gains at 28 percent. What are we thinking? In a world where we're taxing income at the point of production, point of output, point of supply, point of employment — what are we thinking?...

...[T]o compete, we've all got to be similar to the guy who walked into a trophy shop for the very first time. He'd never been in a trophy shop before. He looks around and says, "Gosh, this guy is good."

High expectations produce high results. ●




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