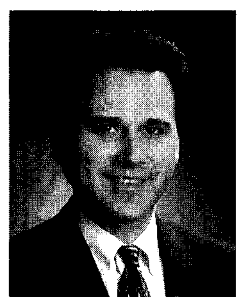
TAX FOUNDATION Since 1937

TAX FEATURES

www.taxfoundation.org August 2000 Volume 44, Number 7

Hodge Joins Tax Foundation as Executive Director; Fleenor Named Chief Economist

Scott Hodge has been named executive director of the Tax Foundation. Most recently he has worked as director of tax and budget policy at Citizens for a Sound Economy Foundation and is recognized as one of Washington's leading experts on the federal budget. He has been widely published on fiscal policy, notably in the pages of *The Wall Street Journal, The Washington Post, USA Today,* and *The Washington Times.*



Scott A. Hodge, new executive director of the Tax Foundation

His work as Senior Budget Analyst at the Heritage Foundation included the editing of three books on the federal budget. Mr. Hodge has been a commentator on nightly news shows such as NBC Nightly News and CBS Nightly News, and has been seen regularly on CNN, Fox Network, and C-SPAN. (See the Foundation Message on page 7 for more.)

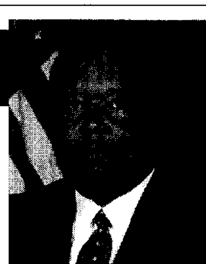
At the same time, Patrick Fleenor has been named the Foundation's chief economist. On staff at the Tax Foundation since 1993, Fleenor has improved the Foundation's core research projects, such as the models that calculate Tax Freedom Day® and the allocation of the federal tax burden by state. He has published extensive economic analyses of estate taxes, such as *A History and Overview of Estate Taxes in the United States* and *An Analysis of the Disincentive Effects of the Estate Tax on Entrepreneurship*. More recently, he has focused on the law enforcement and tax collection challenges caused along state borders when states impose significantly different excise tax rates on portable products like cigarettes and alcohol. Fleenor has a reputation among the media as a reliable source for tax data on myriad subjects.

Patrick Fleenor, now the Tax Foundation's chief economist

Hodge and Fleenor replace J.D. Foster, Ph.D., who held both titles from 1993 to June of this year, when he announced his departure for the staff of Rep. Phil Crane (R-IL). Foster will be legislative director and economic counsel to Rep. Crane, who is currently the second-ranking Republican on the House Ways and Means Committee, and chairman of its subcommittee on trade.

FRONT & CENTER

In this issue:



First Things First in Tax Policy: Help the Neediest

U.S. Representative Bennie Thompson (D-MS)

4-5

'Marriage Penalty' Tax Relief Passed by Congress, Vetoed by President, Debated by Bush and Gore

Created by Progressive Rate Structure and Popular Deductions, Marriage Penalty Is Something Both Candidates Decry

Looking for a way to avoid the marriage penalty? Here's a simple way: Just marry someone whose income is much higher or much lower than yours is. Do that and you may even receive a marriage bonus. That's the flip side of the "marriage penalty" — a side that many people are unaware of. Recent passage of H.R. 4810, the Marriage Tax Relief Reconciliation Act of 2000, by both houses of Congress has increased awareness of the marriage penalty and bonus by once again bringing this complex issue into the spotlight.

The bill was approved in July by the House (271 to 156) and Senate (60 to 34). On August 6, President Clinton vetoed the bill as he had promised he would, and on September 13 the House failed to override the veto. The vote was 270 in favor of the override, including 49 Democrats, against 158 votes to sustain the veto. Both presidential candidates have made marriage penalty relief part of their proposed tax plans (see Figure 1).

A marriage penalty occurs when the tax liability of a married couple filing jointly is greater than the sum of the filers' liabilities would be if they were single. This is not as simple as it sounds; it is not an actual additional tax levied on all married couples filing jointly. Rather, it is the result of the complex interactions of the more than sixty provisions of the tax code that vary with marital status, most of which have the potential to confer penalties or bonuses.

The two provisions most often responsible are the standard deduction and the differing widths of tax brackets for single and married filers, although many other provisions can have an effect, including the Earned Income Tax Credit (EITC), limitations on capital losses, home mortgage interest deductions, and education credits. The size of a penalty or bonus is determined by the couple's income, the way the income is split between the two, the number of dependents and the amount of itemized and standard deductions.

The Congressional Budget Office (CBO) estimates that in 1996, 42 percent of married couples incurred penalties, with the average penalty totaling $1,380, and 51 percent of couples received bonuses averaging $1,300 per couple. In 1999, 48 percent are estimated to have incurred penalties and 41 percent received bonuses. (See Figure 3 on page 6.)

Figure 1
How the Major-Party Candidates Plan to Redress the Marriage Penalty

	BUSH	GORE
Standard Deduction	NA	Raise the standard deduction for married couples by $1,400, to twice that of the standard deduction for a single filer.
Deduction for Lower-Earning Spouse's Income	Allow married couples filing jointly to deduct 10% of the lower-earning spouse's income, up to an earnings limit of $30,000.	NA
EITC	NA	Increase the amount of money a married couple can earn before beginning to lose their EITC: Married couples with incomes of up to about $29,000 would receive approximately an extra $500 in EITC dollars.
Child Credit	Raise the income cutoff on eligibility for per child credit from $110,000 to $200,000 for married couples.	NA

Sources: algore2000.com, georgewbush.com, issues2000.com

Paul and Lisa Meet the Marriage Penalty

Figure 2 illustrates a marriage penalty incurred by two people who each earn $40,000. There are two reasons for their $1,490 penalty.

- First, the standard deduction for joint filers is not twice that of a single filer. This means that two unmarried taxpayers together have a standard deduction larger than the one they would have as a couple. Now that Paul and Lisa are married, they lose $1,400 of the combined standard deductions they had as single filers. The result is an increase in their taxable income: As single filers they would have a combined taxable income of $65,900, while that amount more than doubles when they file jointly.
- Second, as a couple, Paul and Lisa have a larger percentage of their taxable income taxed at a higher rate. This is

because the breakpoint for moving from the 15 percent tax bracket to the 28 percent bracket is $25,750 for single filers and $43,050 for couples filing jointly. Since the joint filer tax brackets are not twice as wide as the brackets for singles, often the part of a couple's income that falls into the higher bracket is greater than the total that would fall into that bracket if both people filed singly. Sometimes part of a couple's income is pushed into a bracket that is higher than the bracket either person would fall into singly.

In this example, Paul and Lisa would each have 22 percent of their taxable income taxed at 28 percent; jointly, they have 36 percent of their taxable income taxed at 28 percent. Due to the combination of the joint filer standard deduction and joint filer brackets, they have over a quarter of their gross income taxed at 28 percent; if they filed separately, it would be only 18 percent.

Paul and Lisa can blame a woman named Vivien Kellerns for their marriage penalty. Kellerns was a single businesswoman who founded War Widows of America. Members were either widows or, like Kellerns, single women who claimed they had never married because WW II had created a shortage of single men.

In the 1960s Kellerns and her group protested what they considered to be a singles penalty: At the time, two single people often paid more then a married couple with the same income, sometimes as much as 40 percent more. The higher tax on singles resulted from Congress's 1948 joint-return provisions, which allowed married couples to file jointly and pay double the single-filer tax on one half of their combined taxable income. The joint-filer provisions negated the effect of some states' community property laws, which had been passed in an attempt to lower the federal tax burdens of those states' residents. The joint-filer provisions also ensured that all couples with the same income were taxed equally, regardless of whether one or both spouses had an income.

Figure 2
Examples of Marriage Penalty and Bonus
1999

	Paul	Lisa	Filing as Couple
Income	$40,000	$40,000	$80,000
Less Personal Exemptions	$2,750	$2,750	$5,500
Less Standard Deduction	$4,300	$4,300	$7,200
Equals Taxable Income	$32,950	$32,950	$67,300
Amt. Taxed at 15%	$25,750	$25,750	$43,050
Amt. Taxed at 28%	$7,200	$7,200	$24,250
Total Tax Liability	$5,879	$5,879	$13,248
Marriage Penalty			**$1,490**

	Bob	Mary	Filing as Couple
Income	$0	$80,000	$80,000
Less Personal Exemptions	$0	$2,750	$5,500
Less Standard Deduction	$0	$4,300	$7,200
Equals Taxable Income	$0	$72,950	$67,300
Amt. Taxed at 15%	$0	$25,750	$43,050
Amt. Taxed at 28%	$0	$36,700	$24,250
Amt. Taxed at 31%	$0	$10,500	NA
Total Tax Liability	$0	$17,394	$13,248
Marriage Bonus			**$4,146**

In 1969, after much media attention and many tea bags mailed to members of Congress (a reminder of the Boston Tea Party), Vivien Kellerns and her allies achieved victory: Congress passed legislation that resulted in a "marriage penalty" for some couples — mainly upper-middle-income couples at first — while creating a bonus for others. Subsequent legislation increased the number of couples who received a penalty.

Vacationing Single

For a real-life example of a marriage penalty, consider the case of a Maryland couple, David and Angela Boyter, who generated national publicity and media attention (as well as some negative attention from the IRS) in the 1970s by marrying and divorcing three times in order to avoid the marriage penalty. After each divorce they used the money they saved in taxes to pay for a Caribbean vacation. After the third divorce they announced plans to remain together but unmarried until the marriage penalty was eliminated.

Mary and Bob Get a Bonus

In our fictional example, Paul and Lisa are typical of a couple incurring a penalty in that they both earn the same amount. Couples in which one person earns much less than the other or has no income at all tend to receive bonuses, while couples where both people earn roughly the same amount tend to receive penalties. In general, an income split greater than 70/30 is likely to lead to a bonus.

In the second example (Figure 2) a couple with a large disparity in income level receives a bonus. Mary is a newly minted attorney earning $80,000 and her husband, Bob, is currently unemployed and has no income. Three factors are responsible for their $4,146 bonus.

- First, the standard deduction, which penalized the first couple, works in Bob and Mary's favor. By herself, Mary could claim a standard deduction of $4,300, while Bob could claim none since he has no income. Filing jointly, they can claim a deduction of $7,200—$2,900 greater than the deduction Mary

Continued on page 6

FRONT & CENTER

First Things First in Tax Policy: Help the Neediest

by U.S. Rep. Bennie Thompson (D-MS)

With regard to matters of economic consequence, including tax issues, I describe myself as a fiscal liberal. I subscribe to the general notion of helping those who need the most help.

Children die faster, teachers earn less and families are poorer in my district than anywhere else in the country.

My constituency is largely comprised of low-income families who have limited educational attainment. Children die faster, teachers earn less and families are poorer in my district than anywhere else in the country. Yet, my constituency has hope.

My district, which is 180 miles across at its widest point and 280 miles long, is trying to become more than cotton and catfish. Realizing the comparative advantage we have in the production of these goods, we are faced with the challenge of making sure that the new economy does not leave us behind.

The hope I speak of is evident in the great strides made in rural development — housing projects, empowerment zone and enterprise community designations, water systems, school construction and small business development. While these are examples of areas in which we are making progress, we are reminded by the sheer magnitude of the national and global economic boom that these gains pale in comparison to the goings-on of Silicon Valley and Wall Street.

So, how do you get businesses to become interested in the Mississippi Delta? The traditional method has been the use of tax breaks. These tax breaks have been given to large corporations, but not enough have been given to America's working families. With its 2001 budget proposal, the Clinton-Gore Administration seeks to provide working families with the leverage they need to successfully compete in the emerging economy and increase their own standard of living.

While many in the U.S. Congress are up-in-arms over the possibilities that come along with economic prosperity and budget surpluses, a few of us are determined to stay the course on helping America's working families. Rather than hasten to offer the wealthiest two percent further tax relief, why not offer low and middle income families greater access to quality health care and improved public schools? The Clinton-Gore 2001 budget addresses these and other pertinent issues.

After studying the proposed budget, several key points are evident. There is a commitment to:

- Debt elimination
- Medicare and Social Security solvency
- Prescription drug benefit improvements to Medicare
- Education and health care program support and
- Targeted tax relief

These are priorities that must be embraced if we are to act in the best interest of all Americans.

Debt Elimination

Simply put, the Clinton-Gore plan reduces the national debt by $2.9 trillion in ten years and eliminates it the subsequent two years. This is an attainable goal in large part because of the projected surplus of $211 billion — the largest ever. Even when the surpluses in Medicare and Social Security are excluded from the calculations, the surplus is $39 billion.

In communities all across the nation, Americans will be able to feel the burden being lifted as less of their tax dollars are spent on debt interest. For every $1 taxpayers send to Washington, 12 cents is allocated to paying the interest on the national debt. Once the debt is paid off, more federal dollars will be available for extending the life of Social Security, adding benefits like prescription drug coverage to Medicare and targeted tax relief for low and middle income families.

Medicare and Social Security

I am convinced that we can and should do a better job of managing our entitlement programs. By taking Medicare off-budget, the funds used to finance it would not be diverted to any other uses. This makes Medicare safer by extending its life. Any surpluses would be used to pay down the debt. By reducing the debt, that 12 percent of taxes will be freed for other uses.

With its 2001 budget proposal, the Clinton-Gore Administration seeks to provide working families the leverage they need to successfully compete in the emerging economy and increase their own standard of living.

It wasn't long ago that Medicare appeared to be doomed — and our seniors along with it. Over a seven-

---

Bennie Thompson is a member of the House Budget Committee.

year period, the Medicare surplus has increased by a staggering 500 percent. With $24 billion in surplus today, it is the perfect time to take advantage of a thriving economy by securing the future of Medicare and Social Security. Both programs would benefit from transfers aimed at making sure that Medicare lasts through 2030 and Social Security through 2057.

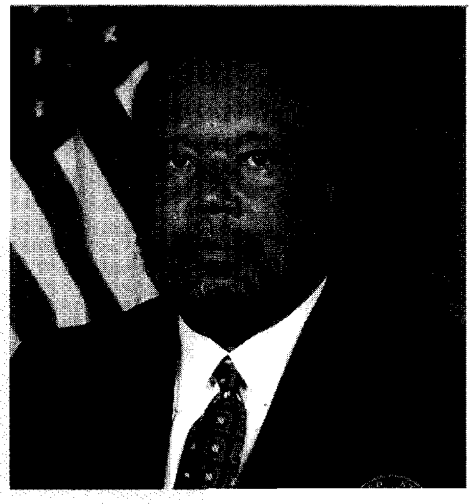
Prescription Drug Benefit

The President's proposal will place the maximum allowable payment by Medicare recipients at $4,000 per year. The ceiling would not move even with the improved benefit. In addition, seniors would be eligible for the program one year earlier and managed-care plans would receive immediate payments. While the President leaves the ceiling at $4,000, I believe it should be lowered to create an immediate impact on the pockets of seniors.

Education and Health Care

If any nation is to succeed, it will need to create some form of 'insurance' so that not all of its revenues are obligated — much like is done in a household. The Reserve for America's Future as proposed by the Administration will hold funds for education, retirement savings, research and health care. The use of these funds is contingent on the prosperity of the economy and the ability of the Congress to balance its budget.

Priorities like expanding health insurance coverage represent the growing concerns of many Americans. For example, in Panola County — the 5th richest county in my district — the biggest economic activity is the construction of a rural water system that



will potentially serve as many as 2,500 families.

President Clinton's proposal also includes allocations to fund the Qualified Zone Academy Bonds Program. It allows families to deduct up to $10,000 of college tuition through the College Opportunity Tax Cut. These are the types of efforts needed to ensure that we have a tax system that does not penalize families for seeking educational goals.

Targeted Tax Relief

When I go home, I never hear anyone say, "Congressman, what are we gonna do about this estate tax?" or "Bennie, this capital gains tax is really hurting me." My constituents are concerned about acquiring necessities that many others take for granted. As national leaders, we must be ever-mindful that the economic progress and prosperity of recent times has not touched all Americans in a positive way.

The President's Budget will make the maximum allowable payment by Medicare recipients $4,000 per year. The ceiling would not move up even with the many improved benefits that he proposes, but I believe we should go further and lower the ceiling to put money in the pockets of ailing seniors immediately.

President Clinton's proposal expands the Earned Income Tax Credit and helps families reduce the marriage penalty. These are reasonable tax relief measures that would improve the income tax code, but the poor often pay more in other kinds of taxes.

Also, numerous economic studies have proven that the burden of federal excise taxes is lopsided and falls mostly on the poor. According to Tax Foundation research, taxpayers with Adjusted Gross Incomes under $20,000 pay more than 25 percent of the telephone tax, in addition to paying more than 20 percent of alcohol taxes, gas taxes, and tobacco taxes. Amending these taxes, some of which do not bring in huge amounts to the Treasury, is another approach that could be taken to ease the tax burden of our poorest citizens.

Taxpayers with Adjusted Gross Incomes under $20,000 pay more than 25 percent of the telephone tax, in addition to paying more than 20 percent of alcohol taxes, gas taxes, and tobacco taxes.

As this legislative session comes to a close, we will be faced with the challenge of providing funds for programs vital to small and rural communities. By invoking a plan of targeted tax breaks and helping America's less fortunate, we all we will be better off and then a true measure of aggregate economic progression can be taken. ●

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

Marriage Penalty

from page 3

would receive alone. This deduction saves them $899 ($2,900 taxed at the 31 percent marginal rate that Mary would be subject to by herself).

• Bracket size also works in this couple's favor. Although not twice as large as those for single filers, joint filers' brackets are still large enough to create bonuses for some couples. As a single filer, Mary would have $10,500 of her income taxed at 31 percent; when she files jointly, the wider brackets keep all of her income at the 15 and 28 percent rates, thus saving the couple $2,395.

• Finally, if Bob were single he could not use his personal exemption, since he has no income. Filing jointly, he can use the exemption, which, when combined with Mary's, saves the couple $853 ($2,750 taxed at 31 percent).

A *Tax Foundation Special Report* published in 1998 about the marriage penalty explains that the three fundamental pillars of the current tax system affecting joint filers are contradictory, so that tinkering with the current code can never satisfy both single and married taxpayers. The three principles are a progressive rate structure, neutrality with regard to marriage (two single filers who together earn the same amount as a married couple should face the same tax liability as the married couple), and equal treatment of couples (two couples with the same income should pay the same amount of tax, regardless of each couple's income split). The current tax system satisfies only the first of these principles, and without fundamental tax reform, all three can never be satisfied.

If signed, H.R. 4810, the Marriage Tax Relief Reconciliation Act of 2000, would not have resolved the issue of marriage neutrality, although it would have brought joint filers $89.8 billion of tax relief over the next five years. Some Democrats have argued that it would not benefit those who need help the most because some of the tax relief would go to couples who already receive bonuses or have above-average income. This, some Democrats argue, not only does not solve the real problem, but is also the equivalent of a "singles penalty." The version of the bill on which the Senate and House compromised contained four major provisions:

• The standard deduction for married couples filing a joint return would be increased to twice the amount of the standard deduction for single filers.

• The 15 percent tax bracket would be widened for married couples so that it would include twice the income of the single filers' bracket. (The Senate version included a doubling of the 28 percent bracket as well.)

• The beginning and end points of EITC eligibility would be increased by $2,000 for married filers.

• The current provision that permits personal nonrefundable tax credits to count against both the regular and alternative minimum tax would be extended.

The CBO recognizes six major types of provisions that have been proposed as solutions to the marriage penalty: widening the tax brackets and raising the standard deduction for joint filers; exempting some of the lower-earning spouse's income form taxation; expanding the parameters of the EITC; allowing couples to choose the filing status that results in the lower tax burden; some sort of fundamental tax reform, such as a consumption tax or flat tax; and requiring spouses to file individual tax returns.

The only change that would necessarily eliminate all marriage penalties and bonuses is the last one; however, that solution would violate the principle of treating all couples equally. The only other way to do away with all penalties and bonuses is to alter or eliminate the more than sixty provisions of the tax code that affect joint and single filers differently. This would be no small task and would most likely require fundamental tax reform.

— Alicia Hansen

Figure 3
Distribution of Marriage Penalties and Bonuses by Size of Adjusted Gross Income

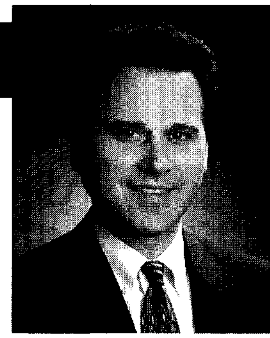
1999

Income Range ($thousands)	Number of Returns in Penalty (thousands)	Number of Returns in Bonus (thousands)	Neither Penalty Nor Bonus (thousands)	Total Married Returns (thousands)
Negative	25	18	439	482
0 – 15K	387	1,741	3,082	5,210
15K – 30K	3,397	4,177	868	8,442
All < 30K	3,809	5,936	4,389	14,134
	27%	42%	31%	100%
30K – 40K	2,846	2,478	94	5,418
40K – 50K	3,218	2,248	150	5,616
50K – 60K	2,560	2,324	361	5,245
All 30K – 60K	8,624	7,050	605	16,279
	53%	43%	4%	100%
60K – 75K	3,477	2,846	545	6,868
75K – 100K	4,325	2,292	49	6,666
100K – 200K	3,787	2,035	3	5,842
200 & Over	811	836	26	1,673
All > 60K	12,400	8,009	623	21,049
	59%	38%	3%	100%
Total	24,834	20,994	5,617	51,445
	48%	41%	11%	100%

Source: Treasury Department, Office of Tax Analysis

FOUNDATION MESSAGE

For Social Security, the Greatest Risk is the Status Quo



Scott A. Hodge, Executive Director Tax Foundation

I want to say first how delighted I am to be the new executive director at the Tax Foundation. Under my direction, the Tax Foundation will continue to monitor tax policy at all levels of government, disseminate relevant tax data and publish cogent, unbiased policy analyses. These are the activities that we engage in to advance a principled approach to tax policy.

When I say "principled approach to tax policy," I am referring to the Tax Foundation's principles of taxation. The first of those is that a good tax system requires informed taxpayers who understand what is being taxed. Several principles follow from this one: that the tax system should be as simple as possible, that it should be as stable as possible, and that changes should never be retroactive.

The purpose of the tax system is to raise needed revenue, not to micromanage the economy with subsidies and penalties. Therefore, taxes should be broadly based, and the rates should be moderate. We should aim for neutrality, favoring neither consumption nor investment.

The U.S. tax system must be competitive with those of other industrialized nations. Therefore, our tax system should not impede the free and fair flow of goods, services and capital by penalizing imports, exports, U.S. investment abroad or foreign investment here.

Since we have been pursuing this non-partisan, principled approach to tax policy for many decades, reporters have learned what a valuable resource we are. They call everyday, sometimes for interviews but often just to fact-check their stories or to get a basic understanding of a particular tax issue as background for a story. The appearance in a newspaper of the words "Source: Tax Foundation" underneath a chart or table has always been our most frequent citation in the press, and while we actively seek to play a greater role in providing policy analysis, we are always glad to simply provide objective data that we have culled from hundreds of governmental and private sources.

We often provide information and educational opportunities directly to lawmakers and their staffs. The next couple months will be exciting politically, and as the election nears, the Tax Foundation will produce a variety of economic analyses examining the major fiscal policy initiatives put forth by the presidential candidates.

I hope to use this space as my predecessor, J.D. Foster, did—to offer some insight on the issues of the day. In the space I have left, I'd like to touch briefly on the issue of Social Security reform.

In discussions of Social Security privatization, commentators often refer to future economic downturns as events that will wipe out the retirement savings of people who have invested in the stock market. While there is always risk in the stock market, these critics fail to mention how devastating economic downturns are to the current Social Security system—a system already heading toward bankruptcy.

As most Americans now know, Social Security will begin spending more on benefits than it collects in taxes in just fifteen years, and will continue to run cash deficits as far as the eye can see. According to Social Security actuaries, under moderate economic conditions, these cumulative cash deficits will total \$21.6 trillion by 2075—six times the current national debt.

If nothing is done to reduce liabilities, the government will have to raise payroll taxes by 36 percent (to 16.8 percent from 12.4 percent), or borrow more than \$11 trillion just to keep the system afloat until 2037, when the trust fund is expected to run out of IOUs. If politicians decide not to hike taxes or increase the national debt, they will have to cut Social Security benefits by at least 26 percent to make the system's costs match its revenues.

But that's the good news. The bad news is that an economic downturn would make these figures look rosy. Under what Social Security actuaries call the "High-Cost" scenario (where economic growth slows by 30 percent while inflation rises by one-third and unemployment rises 18 percent), the system will begin running cash deficits by 2010 and the trust fund will run out of IOUs by 2025. Through 2075, the system would face a total cash shortfall of \$29.5 trillion.

To cover these shortfalls, the government would eventually have to double the payroll tax or boost income taxes by nearly 30 percent. Otherwise, Social Security benefits would have to be cut in half.

While some may say the nation can "grow" its way out of the problem, Social Security's actuaries estimate that even under more robust economic assumptions, the system faces a total cash shortfall of \$7.6 trillion—twice today's national debt.

These sobering statistics are inescapably linked to Social Security's basic design: It is a defined benefit, pay-as-you-go program reliant on a shrinking pool of workers to pay for an expanding population of beneficiaries. The only way to reduce these unaffordable liabilities is to do what countries as diverse as Chile and the Czech Republic have done—gradually replace defined benefit social insurance systems with defined contribution systems. This allows workers to invest a portion of their payroll taxes in personal accounts that they own and control.

Ironically, the Reagan administration made identical reforms to the old Civil Service Retirement System, which faced financial collapse in the early 1980s. Federal employees can now invest in their version of a 401(k)—called the Thrift Savings Plan—whose stock fund has delivered an 18.18 percent compounded rate of return over the past ten years.

Allowing ordinary workers the similar option of investing a portion of their payroll taxes in Personal Retirement Accounts is not a quick fix for what ails the Social Security system. But given time, such reform will relieve the government and taxpayers of a tremendous financial burden.

TAX FEATURES©

Tax Features© (ISSN 1069-711X) is published 10 times a year by the Tax Foundation, an independent 501(c)(3) organization chartered in the District of Columbia. Annual subscriptions to the newsletter are $15.

Tax Foundation
(202) 783-2760
(202) 783-6868 Fax
www.TaxFoundation.org
TF@TaxFoundation.org

Seminar Hits on Inefficiency and Regressivity of Excise Taxes; Cook Previews November Elections

As part of its continuing program to study the economics of excise taxation, the Tax Foundation conducted a seminar July 13th and 14th at the Lansdowne Resort in Leesburg, Virginia.

The evening of the Thursday the 13th was devoted to informal discussions and a speech by nationally known political analyst Charlie Cook, who writes for the *National Journal* magazine and appears regularly on all the major network news shows. He gave a preview of the Gore-Bush race and handicapped the congressional races as well, predicting that several House races would be so close that control of the House might well be undecided for several days after Election Day.

The morning of the 14th began with a general primer on the economics of excise taxation by Tax Foundation Chief Economist Patrick Fleenor. He explained why excise taxes are particularly inefficient, hurting economic growth more per dollar collected than other taxes. He also commented that the consumption patterns of heavily taxed goods have resulted in a regressive excise regime that taxes the poor more heavily than any other income group.

Two other economists followed with discussions of particular excise taxes: Jane Gravelle, Ph.D., a senior specialist in economic policy at the Congressional Research Service, and Stephen Entin, executive director of the Institute for Research on the Economics of Taxation. Both have written papers on excise taxation for the Tax Foundation's *Background Paper* series.

Dr. Jane Gravelle has written extensively on the tobacco settlement, and she presented research showing that there was no credible evidence in public finance literature that cigarette smokers impose extra costs on government. According to Gravelle, the health care costs that federal and state governments incur due to smoking-related illnesses are more than made up by savings achieved at smokers' expense.

Stephen Entin followed Dr. Gravelle with an analysis of the telephone excise tax. He explained its legislative history and discussed its companion, the "universal service program." Both the tax and the subsidy violate basic economic principles and should be abolished, according to Entin, because they distort prices, reducing economic efficiency and consumer satisfaction. The welfare component should be converted to a line item in the Budget.

A panel of industry executives provided case studies about their products. The speakers were John Dunham, Senior U.S. Economist, the Philip Morris Management Corp.; Matthew Hein, Director of Statistical and Information Services, the Beer Institute; and David Ozgo, Vice President, Economic and Strategic Analysis, the Distilled Spirits Council of the U.S.

James C. Miller III, former Director of the Office of Management and Budget under President Ronald Reagan and a current member of the Tax Foundation Board of Directors, gave the seminar's concluding remarks. He commented on the corrupting influence of excise taxes, not only on consumers who unknowingly buy bootleg products or the bootleggers who profit from the tax differential across borders, but on law enforcement themselves.

TAX FOUNDATION
Since 1937

1250 H Street, NW Suite 750
Washington, DC 20005-3908

First Class
US Postage
PAID
Washington, DC
Permit No. 5229