TAX FOUNDATION'S VOL. 32, NO. 6 SEPTEMBER 1988

TAX·FEATURES

Bill Archer to Receive Distinguished Public Service Award at TF Annual Conference

"Soak the Rich" by Taxing the Highest Earners 100 Percent . . . And Run the Federal Government for 12 Days!

One of the continuing hopes of income redistributionists is that high income taxes on top earners could generate significant amounts of revenue, enough to close the budget deficit gap without resorting to other politically painful choices. Tax Foundation's ongoing research into tax collections at various income brackets continues to show this is not a viable case.

At the very top—those with a million dollars or more in annual income—there simply are not enough taxpayers in this group to make a significant difference. If the redistributionists are serious about shutting down the deficit, they would have to reach far down the income scale, a move that would undoubtedly raise stiff political opposition. Higher tax rates for just the top five percent of taxpayers, for example, would mean tax increases on returns starting at $67,000 (including joint returns), a level of income which certainly does not qualify as "fat cat" status.

One way to illustrate the point is to take the most extreme example of confiscating all taxable income of top earners. While taxing any category of earners at a 100 percent rate would have a drastic effect on work incentives, and no one of any stature has actually proposed this, it can serve as a relevant object lesson.

Starting with the Most Successful

Starting at the top, examination of 1986 individual income tax data (latest available) shows that those with adjusted gross income (AGI) of $1 million or over numbered 35,875 and represented just 0.03 percent of all taxpayers. Their adjusted gross incomes totaled $82.3 billion, their taxable

(Continued on page 2)

Bill Archer, Republican Congressman of Houston, Texas, will receive the Tax Foundation's 1988 Distinguished Public Service Award at the Foundation's annual conference and dinner on November 30 in New York City.

Hans W. Wanders, Vice Chairman of the Board of The Wachovia Corporation and Chairman of the Board of Trustees of the Tax Foundation, will present the award to Congressman Archer. A major policy addresss by the congressman will follow his acceptance.

Congressman Archer is the ranking Republican on the House Ways and Means Committee and the ranking House Republican on the Joint Committee on Taxation. Elected to the Congress from the seventh district in Texas in 1971, Bill Archer has served consecutive terms since that time, gaining each reelection with a higher winning percentage than any other Republican congressman.

THIS ISSUE:

Mark Your Calendars

To Attend

Tax Foundation's Annual Conference

on November 30, 1988

in New York City

(SOAK THE RICH, *from page 1*)
income $66.3 billion, and they paid $33.7 billion in income tax with an average effective tax rate of 41 percent on AGI. If the Federal government simply confiscated all this group's taxable income, Uncle Sam theoretically would have netted $32.6 billion in additional revenue—enough to run the government for 12 days at 1986 outlay levels. Had that revenue been applied against the deficit that year, it would have made only a small dent.

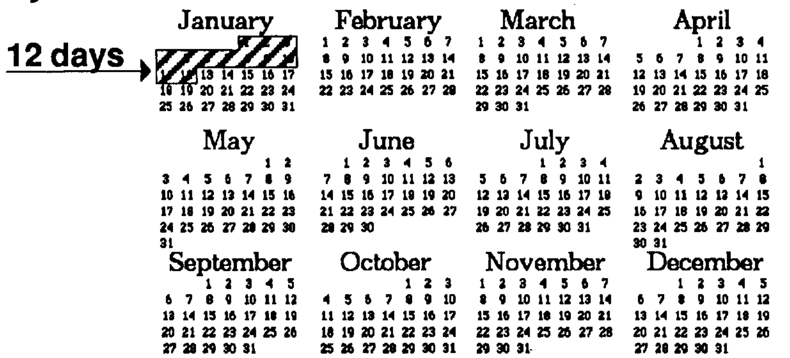
Reaching Down the Income Scale

Reaching deeper into the top brackets by confiscating 100 percent of taxable income from the $500,000-and-over group of 92,621, the Federal government could theoretically have extracted an additional $53.7 billion, sufficient revenue to pay its bills for 19.8 days or pay off about a quarter of the year's total deficit.

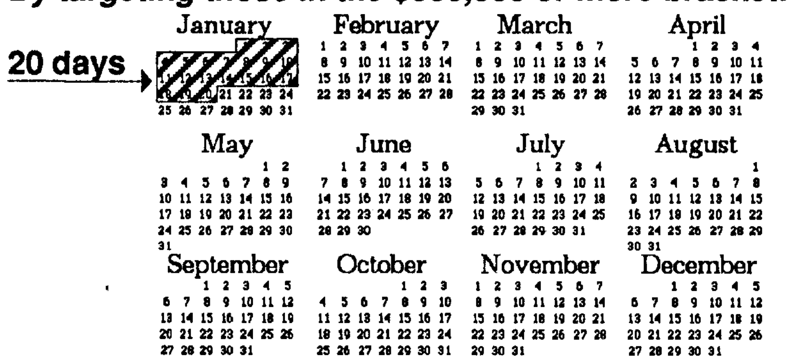
Taking it a step further, commandeering 100 percent of taxable income of the $200,000 and above earners hypothetically could have netted $88.4 billion from almost 400,000 taxpayers, enough to run the government a whole month. While this tactic is now generating some real money, it is also moving down from the rich to those who are merely very well off.

How Many Days Could the Federal Government Pay Its Bills By Simply Confiscating All the Taxable Income of Top Earners?

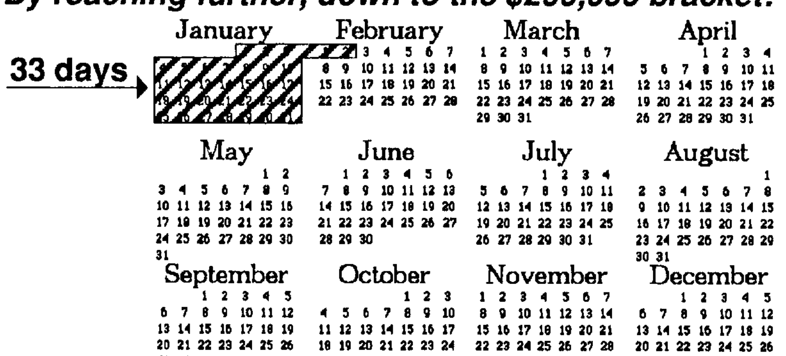
By 100% taxation of those with $1 million or more:



By targeting those in the $500,000 or more bracket:



By reaching further, down to the $200,000 bracket:



So even with 100% taxation, a "soak the rich" policy will run the Federal government for only a few weeks.

Confiscatory Rates a Daunting Prospect

Statistically, it is a long way from $200,000 to the median 1986 family income of $29,458. Emotionally, it's a lot closer. Imagine the impact on middle-income workers who, contemplating a successful career, had to look forward to confiscatory tax rates as the price of success. Realistically, these rates could never approach 100 percent on any block of income (though the marginal rate did reach 94 percent during World War II). But if it were, say, 75 percent on all income above $200,000 with much lower rates applying below that, the impact on incentives of middle- and upper-middle income workers still could be shattering.

The accompanying tables provide further details.

Additional Revenues and Number of Days the Federal Government Could Run By Taxing Top-Income Brackets at 100%

Tax Year 1986

Adjusted Gross Income Class	Number of Returns	Percent of All Returns	Adjusted Gross Income ($ Billions)	Taxable Income ($ Billions)	Income Tax Paid ($ Billions)	Average Tax	Effective Tax Rate (on AGI)	Net if Taxed at 100% ($ Billions)	Number of Days You Could Run Federal Government[a]
$ 1 Million or more	35,875	0.03%	$ 82.3	$ 66.3	$ 33.7	$ 939,202	41.0%	$ 32.6	12.0 Days
$ 500 Thousand or more	92,621	0.09%	$ 119.4	$ 96.8	$ 43.1	$ 465,588	36.1%	$ 53.7	19.8 Days
$ 200 Thousand or more	398,769	0.39%	$ 206.6	$ 165.2	$ 76.8	$ 192,635	37.2%	$ 88.4	32.6 Days

[a] 1986 total Federal outlays equaled $ 989.8 billion or $ 2.712 billion per day.

Source: Tax Foundation computations based on Statistics of Income, Internal Revenue Service, U.S. Department of the Treasury.

Budget Watch By Allen Schick

Will There Be a New Boom in Federal Spending?

As the Reagan presidency draws to a close, politicians and interest groups are preparing ambitious spending agendas for the next decade. The "in box" of ideas for new and expanded programs is fuller than at any time since Ronald Reagan took office in 1981. Despite the fact that the current Congress is not likely to act on most of these proposals, legislative activity is high as Members seek to build momentum for their favorite ideas. The first part of this article identifies some of the major items that might find their way into post-Reagan budgets; the second part discusses how the government might respond to emerging demand while it still faces high budget deficits.

The Emerging Budget Agenda

For the first time in many years, the phrase "pent-up demand" has crept into budgetary debate. The phrase tells us something about the waning budgetary influence of a lame duck President, but it also indicates that the country may be on the brink of a new expansion in Federal programs. Public opinion polls show substantial support, higher than at any time in the 1980s, for maintaining or expanding the Federal government's support of education, health care, and other functions. Cutbacks are hardly talked about these days, a far cry from the situation just eight years ago when candidate Reagan was promising to downsize the Federal government.

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The menu of ideas for new or expanded programs is unusually varied. Estimates of the cost of the various proposals are difficult to obtain, but the total is certain to run into the tens of billions of dollars. The following is a partial list of proposed initiatives.

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■ **The savings and loan and bank crises.** The Federal government insures deposits of savings and loan institutions (S&Ls) and banks. The crisis in the savings and loan industry has received a great deal of attention, but there are growing indications that the banking sector may also be in trouble. The estimated deficit facing the Federal Savings and Loan Insurance Corp. (FSLIC) ranges to $60 billion or higher. The bigger the shortfall turns out to be, the greater the likelihood that FSLIC will have to turn to the Treasury for direct financial aid. Commercial banking insurance is provided through the Federal Deposit Insurance Corporation (FDIC), but though it began this year with about $18 billion in reserves, these may be depleted by a few costly bailouts.

■ **Day care.** Both of the presidential candidates have endorsed major Federal support of day care. Their price tags are similar, about $2.5 billion each, but the approaches differ. The Democratic version would provide direct grants, the Republicans generally favor tax credits. Inasmuch as $2.5 billion would cover only a small portion of the families which might want day care, the final cost might be significantly higher.

■ **National defense.** The amount of new resources provided to the Pentagon has not kept up with inflation in some recent years. Several factors may make it difficult or risky to continue this downtrend. The arms limitation agreement signed by Reagan and Gorbachev, negotiations for a broader strategic arms limitation, and possible curtailment of the strategic defense initiative (SDI) might portend a shift from strategic to conventional forces. But because conventional forces may be even more costly to acquire and maintain, the United States might have to decide between spending more on defense and shrinking its military capabilities.

■ **Drug control.** Congress is convinced that money is the way to uproot this evil and it is moving to spend billions of dollars to eradicate illegal drugs. The issue has become so emotional and politicized, that it is hard to get serious debate as to whether providing vast amounts of money is the best way to deal with this problem.

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■ **Welfare reform.** The House and Senate have passed different versions, and they may not reach a compromise in the last days of the 100th Congress.

(Continued on page 4)

(BUDGET WATCH, *from page 3*)

Depending on the election and other factors, next year's legislation might be even more costly than this year's.

■ **Medical care for the elderly.** Earlier this year, Congress passed and President Reagan signed into law a major expansion of Medicare's protection against catastrophic illness. This could be the forerunner of legislation to subsidize the care of chronically ill in their own homes or in nursing facilities. The cost of changes in Medicare has been underestimated habitually in the past, and it should not be surprising if further expansion turns out to be much more expensive than its advocates concede.

■ **Housing programs.** Because subsidized housing has been sharply cut back in the 1980s, demands to rebuild the housing stock and to assist low-income families are escalating. To make matters worse, a substantial portion of the assisted-housing built in previous decades might be taken out of the low-income market in coming years as the contracts under which they were financed expire. It would cost billions of dollars to keep this housing available for low-income people.

This list of demands on the budget is far from complete. It does not include proposals for new Federal assistance for education and job training, nor does it include any initiatives to protect the environment or to rebuild the nation's physical infrastructure.

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Politicians, however, have ways of spending money without violating the deficit target.

Paying the Bills

Not all of these ideas will make it into law, but some probably will. If some are adopted, they will encounter a tight budget that has no room for program expansions. The latest budget projections indicate that even without new spending, it will be exceedingly difficult to meet next year's deficit target under the Gramm-Rudman-Hollings law.

Politicians, however, have ways of spending money without violating the deficit target. Here are some of the tricks they might pull out of the bag.

■ **Mandates.** They can shift the cost of programs to businesses or other governments by requiring them to provide services which the Federal government is unwilling to pay for. A number of bills have been introduced in Congress to require employers to provide health insurance to all workers. The cost of expanded health coverage would not appear in the Federal budget and it would not, therefore, add to spending or the deficit. The fact that it would add significantly to the cost of doing business would be someone else's problem.

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■ **Tax credits.** The 1986 Tax Reform Act reduced tax rates by terminating or narrowing numerous preferences. But Congress might reverse course and enact new preferences as a means of financing some initiatives. Tax credits have been proposed for child care, education, medical care of the elderly, and other programs. There is a danger that the resurgence of credits might generate pressure to raise tax rates.

■ **Budget tricks.** Just because the Federal government spends money does not mean that the outlay appears in the budget. Spending can be excluded by taking the program or agency off budget, by issuing guarantees in lieu of direct spending, or by establishing special corporations to handle the transactions. All of these devices have been proposed as means of dealing with the crisis in the savings and loan and banking industries. Some have already been applied in the farm credit sector.

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■ **Change the deficit target.** Because the deficit target might be out of reach next year, there is a high probability that it will be revised by Congress. In the course of postponing the promise of a balanced budget a few years, Congress might be tempted to make room in the target for some additional spending.

■ **Raise taxes or enhance revenues.** If all else doesn't suffice, there is always a tax increase to pay the piper. Because raising taxes is not popular, politicians might throw in some "sweeteners" in the form of additional spending to mobilize public support.

The Reagan years have been exciting times for budget makers and watchers. The budget is likely to be just as exciting in the next decade, but the results might be different.

Tax Features

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Social Welfare Outlays Dominate Government Expenditures

Governments in the United States paid out $727.9 billion for social welfare programs in fiscal year 1985 (latest officially reported) — showing a hefty $56.9 billion increase over the previous year. Social welfare spending accounted for nearly 52 percent of all Federal, state, and local expenditures climbing 8.5 percent over 1984 and amounting to 20.3 percent of GNP, according to economists at the Tax Foundation.

The $727.9 billion spent would be enough to give every man, woman, and child in the U.S. $3,049. The 8.5 percent increase in social welfare outlays reported for 1985 was modest when compared to spending increases in the recent past. During the 1960s, social welfare spending rose at an annual rate of nearly 11 percent; during the 1970s the rate jumped to almost 13 percent annually. Since 1980, annual growth has averaged just over eight percent.

Public welfare programs as defined by the Social Security Administration (SSA) include social security and public employee retirement, Medicare, Medicaid and cash payments under public assistance, unemployment compensation benefits, health, veterans' services, housing, education, and others.

Emerging Federal Role

The source of social welfare financing has gradually shifted from state and local governments to the Federal government. In 1960, the Federal government's share was 48 percent, less than the state/local contribution; but by 1985, Federal social welfare expenditures of $451.1 billion represented 62 percent of the total.

OASDHI—The Costliest And Still Growing

The largest and most expensive social welfare program, Old Age, Survivors, Disability, and Hospital Insurance (OASDHI), has grown more rapidly than any other. OASDHI payments of $260.5 billion in 1985 were seven times their 1970 size and now claim more than a third (35.8%) of all social welfare outlays, according to Tax Foundation economists. Federal budget figures for 1989 estimate that OASDHI expenditures will reach $317.8 billion — 22 percent higher than in 1985, the latest year covered in the SSA tabulations.

OASDI, the social security portion of OASDHI, has consumed an ever-increasing share of social welfare funds. In 1985 more than 15 percent of the civilian population received monthly social security benefits.

(Continued on page 6)

THE FRONT BURNER

By Robert C. Brown
President, Tax Foundation

"Learning to Ask the Right Questions"

Candidates for public office inevitably try to put the best construction on things. Prophets of doom seldom win elections.

This year's national races are no exception. On the stump, candidates are dodging the tough issues, putting the most favorable interpretation possible on every statistic and achievement that comes within range, and forecasting the best of all outcomes if they are elected.

The Tax Foundation is not in the forecasting business. We are, however, in the business of calling a spade a spade, of keeping the focus on the central issues, and of making sure all players are using the same set of numbers. The following questions suggest themselves for consideration — hopefully before the election, but most assuredly once the smoke has cleared and those who have won the right to govern must actually begin to do so.

• **Where's the fat?** We submit — as we have repeatedly said for years now — that there is still plenty of fat to be cut from virtually every publicly funded program in the Federal budget, and that a number of programs ought to be evaluated for sunsetting or swapping out so that some of the new issues can be addressed with new programs.

• **Do deficits matter?** In the face of a generation of deficit growth, a new breed of economists would answer that question, "Deficits don't matter." They would compute the shortfall as a percentage of gross national product, or find some other formula to justify the continued profligacy of the national government. Statist solutions to societal problems—simply throwing more money at them—have proven they don't work. The man or woman in the street already knows that deficits matter. They learned the answer the old-fashioned way by handling family budgets, managing credit cards, and balancing personal checking accounts. Deficits do matter. It's time we reminded the politicians that they do.

• **What taxes shall we raise?** One senses a tacit agreement in Washington that next year we'll have to raise taxes. We will hear calls for tax hikes disguised as user fees, revenue enhancements, co-insurance payments, mandated benefits or any other sheep's clothing the tax raising wolves can lay their hands on. America has yet to ask the *real* question: What percentage of the wage-earner's paycheck is government going to siphon off? Until we answer that, we cannot address the budget deficit, spending priorities, or revenue sources.

There are other questions. But these are a good start toward a national fiscal agenda from which we might expect some concrete results. I hope somebody remembers to ask them after the November election.

(SOCIAL SPENDING, *from page 5*)

When a program affects such a large proportion of the population, even relatively small programmatic changes have a large fiscal impact. For example, in 1985 the 3.5 percent cost-of-living benefit increase resulted in an $11.4 billion increase in outlays. The cost of care under the similarly large Health Insurance (Medicare) program increased 15.5 percent in 1985. Together, the Social Security and Medicare programs accounted for 37 percent of the total increase in social welfare spending in 1985.

Spending on Education a Distant Second

Until the 1970s the largest category of social welfare programs was public education. In 1976 education spending fell to second place, leaving OASDHI as the dominant social program. The $166.4 billion spent on education in 1985 represented 23 percent of all social welfare costs, down substantially from 35 percent in 1970. Education continues to be largely a state and local responsibility, while social insurance and veterans' benefits remain predominantly federally funded.

Additional details on social welfare spending, broken down by category, are provided in the accompanying table.

Social Welfare Expenditures under Public Programs by Source of Funds and Type

Selected Fiscal Years 1960-1985

Item[a]	1960	1970	1980	1985
		A. Amount ($Millions)		
Total expenditures	$ 52,293	$ 145,856	$ 492,797	$ 727,861
Social insurance	19,307	54,691	229,754	372,583
OASDHI	11,032	36,835	152,110	260,469
Public employee retirement	2,570	8,659	39,490	63,042
Unemployment insurance	2,830	3,820	18,326	18,344
Workmen's compensation	1,308	2,950	13,457	22,263
Public aid	4,101	16,488	71,799	95,965
Public assistance	4,042	14,434	44,888	66,080
Health and medical programs	4,464	9,907	27,919	39,955
Veterans' programs	5,479	9,078	21,466	27,171
Education	17,626	50,846	121,050	166,362
Elementary and secondary	15,109	38,632	87,150	120,742
Higher	2,191	9,907	26,176	35,445
Vocational and adult	298	2,144	7,375	9,891
Housing	177	701	7,210	11,879
Other social welfare[b]	1,139	4,145	13,599	13,947
From Federal funds, total	24,957	77,337	302,616	451,143
Social insurance	14,307	45,246	191,162	313,106
Public aid	2,117	9,649	48,667	61,174
Health and medical programs	1,737	4,775	12,688	18,403
Veterans' programs	5,367	8,952	21,254	26,833
Education	868	5,876	13,452	13,740
Housing	144	582	6,608	10,339
Other social welfare[b]	417	2,259	8,786	7,548
From state and local funds, total[a]	27,337	68,519	190,180	276,718
Social insurance	4,999	9,446	38,592	59,476
Public aid	1,984	6,839	23,133	34,792
Health and medical programs	2,727	5,132	15,231	21,552
Veterans' programs	112	127	212	338
Education	16,758	44,970	107,597	152,622
Housing	33	120	601	1,540
Other social welfare[b]	733	1,886	4,813	6,398
		B. Percentage Distribution		
Total social welfare expenditures	100.0%	100.0%	100.0%	100.0%
Federal	47.7	53.0	61.4	62.0
State-local	52.3	47.0	38.6	38.0
Exhibit: Total as a percent of GNP	10.3	14.7	18.5	20.3

[a] Subtotals include items not shown separately. Total financed from state and local funds includes minor amounts for veterans and housing programs.

[b] Includes institutional care, child nutrition and welfare, vocational rehabilitation, and other social welfare programs not elsewhere classified.

Source: Social Security Administration, Office of Research and Statistics; and Tax Foundation computations.

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