

# SPECIAL REPORT

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## How Much Does President Obama's Budget Redistribute Income?

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### I. Introduction

Throughout last year's presidential campaign and continuing through President Obama's first two quarters in office, income redistribution has been a hot-button topic among policymakers, the media, and the general public. The issue was explicitly brought to the forefront of the campaign debate during the now infamous exchange between then-candidate Obama and

"Joe the Plumber," who asked why the candidate wanted to tax people like him who own a business that makes \$250,000. Obama replied, "... I think when you spread the wealth around, it's good for everybody."<sup>1</sup>

How much should the nation's tax and spending programs move money down the income scale? Unfortunately, the basic questions

#### Key Findings:

- Families' share of tax burdens is compared to their share of government benefits, by income class, yielding a comprehensive measure of income redistribution. Customarily, only tax burdens are analyzed by income class. We apply this framework to President Obama's Fiscal Year 2010 Budget released in May, as revised by the Mid-Session Review released in late August.
- In FY 2012, when President Obama's policies have taken effect, income redistribution from the top-earning 1 percent of families will rise by an average of \$109,000 per family. Families in the 95th-99th percentiles would pay slightly more, almost \$1,000 per family.
- On average, a family in the top 5 percent would have an additional 2.8 percent of its market income redistributed as a result of President Obama's policies (compared to baseline); for the top 1 percent only, that figure is nearly 6 percent.
- President Obama's policies would reduce the amount of income redistribution from families in the 70th-95th percentiles.
- President Obama's policies would increase the amount of income redistribution to families in the bottom 70 percent of the population, especially the bottom 30 percent.

<sup>1</sup> It was later discovered that Samuel Joseph Wurzelbacher did not earn close to \$250,000. Even if he had, neither the tax plan Sen. Obama campaigned on nor his current tax plan would spread much more of his wealth around, only a few hundred dollars.

needed to inform that debate have not been answered: “How much are we actually redistributing right now?” and “How would President Obama’s proposals change the amount of redistribution?”

Answering those questions is the purpose of the Tax Foundation’s fiscal incidence project, whose initial products are this *Special Report* and the accompanying working paper. Here we focus on 2012 because that is the first fiscal year (Oct. 1, 2011 – Sept. 30, 2012) during which the full Obama policy agenda is scheduled to be in effect, including his treatment of the expiring Bush tax cuts. That is also the first year in which Obama wants significant tax revenue deposited into his proposed health reform reserve fund. It is also when his climate revenues proposal kicks in. The projected budget deficit for FY 2012 is large, \$796 billion, but it is actually much smaller than what the administration’s budget predicts for fiscal years 2009 and 2010, both of which exceed \$1.5 trillion.

In the matter of income redistribution, we conclude that President Obama’s proposed budget lives up to his campaign promise to collect more tax revenue from high-income people and redistribute it down the income spectrum — what he would call a more even distribution of the economic pie.

On the paying end, we find that during FY 2012, if the new budget’s policies are enacted, the amount redistributed from the top-earning one percent of U.S. families will increase by \$109,000 per family up to a total of \$523,000 per family.<sup>2</sup> That is up from \$413,000 per family, the redistribution that would prevail in 2012 even if none of Obama’s major new initiatives were enacted. The upper-income families in the 95th through the 99th percentile of earners will lose only slightly more of their income. The large swath of so-called upper-middle-income families, those in the 70th through the 95th percentiles, will continue to have their

income redistributed to other families lower on the income spectrum, but Obama’s policies will actually decrease the amount they lose.

On the receiving end, Obama’s policies will redistribute more income to families in the bottom 70 percent of the income spectrum, with most going to the bottom 30 percent, over \$1,000 per family. Income redistribution to families in the 40th-70th percentiles would not change much.

## II. Highlights of President Obama’s Fiscal Year 2012 Budget

President Obama’s budget includes significant changes in tax policy, environmental and energy policy, defense policy, and health care policy, each of which has distributional effects. The major changes that drive the results presented in this paper include:

- Higher tax rates on upper-income wages, capital gains and dividends. On high wages and capital gains, he’ll allow the Bush tax cuts to expire on schedule, restoring the higher tax rates that prevailed before 2001; and on dividends, he’ll raise the tax from 15 to 20 percent.
- The revenue provisions in Obama’s health reform reserve fund, including the 28-percent cap on the value of itemized deductions as well as selected corporate and individual tax provisions aimed at tax “loopholes.”
- The health care spending that will take place from the revenue raised in the health reform reserve fund, which we assume is to target currently uninsured Americans, beginning in FY 2012.
- Obama’s proposed making-work-pay credit and his proposed expansion of education tax credits, which flow to all but the highest income groups.
- Obama’s proposed climate revenues designed to limit greenhouse gas emissions,

<sup>2</sup> The word “family” in this paper refers to family economic unit. See working paper for discussion.

which we assume are borne by energy consumers and consumers of all products.

- Significant cuts to defense spending, which are the principal reason Obama's budget can predict a budget deficit as "low" as \$796 billion in FY 2012.

To determine the change effected by Obama's budget policies, we compare the annual tax and spending patterns that would prevail under those policies for FY 2012 to the so-called baseline, that is, the annual tax and spending amounts that would prevail in 2012 without these new policies. The Obama administration's Office of Management and Budget has changed the definition of the baseline, altering substantially the way Obama's policy changes are measured and reported.

We label this new baseline the "Obama OMB Baseline," which differs from the one used by the Congressional Budget Office (CBO) and the one defined by the Budget Enforcement Act. These other baselines depend more on "current law," so if a congressman or president wants to extend an expiring tax cut, it is scored and reported as a new tax cut because it would raise less revenue than if current law took its course. The new Obama OMB baseline is based on "current policy" which treats most current provisions as permanent even if they are temporary in law, under the assumption that Congress could be expected to extend them in the normal course of business.

The scoring and reporting on two major taxes is affected by this change in the baseline. When President Obama decided that his budget would make permanent most of the Bush tax cuts, standard procedure would have been to count that as a huge tax cut. Similarly, when he decided that the temporarily high exemption from the alternative minimum tax (the AMT patch) should be made permanent, that also

would have been scored as a large tax cut. But the new Obama OMB baseline assumes that these would all have been extended by Congress, so Obama is not officially "cutting taxes" by extending the Bush tax cuts.<sup>3</sup>

### III. Measuring Income Redistribution

So how do we measure the extent to which government fiscal policies are redistributing income? Our method is quite simple. We ask what a family would be paying in taxes under a hypothetical, pure benefit principle system of taxation.

That is, we ask if a family's share of the tax burden is identical to its share of government benefits. If the tax burden is larger than the benefits, then the government is redistributing income from that family for the benefit of others. If the tax burden is comparatively small, then the government is redistributing income from someone else to that family. This all-inclusive metric permits citizens and policymakers to make informed judgments as to whether there is too little or too much redistribution in federal government fiscal policies.

Many redistribution studies have been published in the past, but no recent studies have included the effects of government spending. Standard distributional tables from CBO, the Joint Committee on Taxation (JCT), and the Urban-Brookings Tax Policy Center only look at the tax side of the federal budget. This is unsurprising because the tax side is easier to measure, but ignoring the spending side makes it impossible to answer the question of how much the federal government's fiscal policies are actually affecting the distribution of income.

To quantify the benefits of government spending to high- and low-earning families, we

<sup>3</sup> We also make assumptions regarding Obama's health reform reserve fund. While the "policy" figures in Obama's budget documents do not include the revenues or outlays on health reform, we do count the revenues in our analysis and make the assumption that the "spending" of Obama's health reform is in the form of a refundable tax credit for currently uninsured Americans that is both revenue-neutral and outlay-neutral. For a more detailed discussion, see *Tax Foundation Working Paper*, No. 7, "A Distributional Analysis of President Obama's Proposed Policies for Fiscal Years 2009-2019 as Outlined in His Fiscal Year 2010 Budget."

make some methodological assumptions. Some of the principal ones are:

- We assume that national defense, public health programs and most similar “public goods” benefit families in proportion to their cash income.
- By contrast with this proportional-to-income approach, we assume that income transfer programs entirely benefit the direct recipients of the transfers. Among the many transfer programs, some well known ones are:
  - ◆ food stamps;
  - ◆ Social Security;
  - ◆ parts of Medicare and Medicaid;<sup>4</sup>
  - ◆ the earned income tax credit (EITC); and
  - ◆ temporary assistance to needy families (TANF), commonly called welfare.

- We assume that the burden of the current year’s budget deficit is borne by today’s families in a combination of higher taxes and lower spending in the current year. This is why our calculations show net total redistribution for all families to be zero.

Finally, readers should note that our estimates are purely static; that is, although economists agree that many tax and spending increases affect private sector growth in the long run, affecting tax revenues and outlays, we do not account for these macroeconomic effects. Also, we have made no attempt to account for the so-called deadweight loss of taxes. Those are the inefficiencies that taxation foists on the economy, not counting the revenues collected. Nor do we account for any rents being earned by factors of production in government. For example, there may be government workers who do nothing all day but

*Table 1*  
*Distributional Impact on Average Families of Proposed Policies in President Obama’s Budget, Fiscal Year 2012*

Market Income Percentile	Average Market Income	Obama Policy			Change from Obama OMB Baseline		
		Average Tax	Average Spending	Average Income Redistribution	Average Tax	Average Spending	Average Income Redistribution
0–10%	\$ 5,296	\$ 1,941	\$ 20,751	\$ 18,810	\$ 296	\$ 1,348	\$ 1,052
10–20%	\$ 19,371	\$ 4,233	\$ 15,944	\$ 11,711	\$ 226	\$ 1,739	\$ 1,513
20–30%	\$ 32,870	\$ 6,731	\$ 16,656	\$ 9,925	– \$ 4	\$ 1,331	\$ 1,334
30–40%	\$ 46,573	\$ 9,883	\$ 16,823	\$ 6,941	– \$ 136	\$ 792	\$ 929
40–50%	\$ 62,802	\$ 13,128	\$ 18,880	\$ 5,753	– \$ 283	\$ 192	\$ 475
50–60%	\$ 82,666	\$ 17,678	\$ 21,284	\$ 3,606	– \$ 455	– \$ 61	\$ 394
60–70%	\$ 106,345	\$ 23,117	\$ 23,324	\$ 207	– \$ 686	– \$ 335	\$ 351
70–80%	\$ 135,085	\$ 29,954	\$ 26,600	– \$ 3,353	– \$ 1,091	– \$ 616	\$ 475
80–90%	\$ 180,138	\$ 41,487	\$ 31,852	– \$ 9,636	– \$ 1,939	– \$ 963	\$ 976
90–95%	\$ 252,044	\$ 57,263	\$ 42,356	– \$ 14,908	– \$ 3,372	– \$ 1,603	\$ 1,769
95–99%	\$ 438,211	\$ 113,116	\$ 63,420	– \$ 49,696	– \$ 2,466	– \$ 3,456	– \$ 990
99–100%	\$ 2,285,276	\$ 777,923	\$ 255,201	– \$ 522,722	\$ 83,525	– \$ 25,764	– \$ 109,290
ALL	\$ 98,455	\$ 24,429	\$ 24,428	\$ 0	\$ 134	\$ 135	\$ 0
Exhibit:							
Top 20%	\$ 356,323	\$ 97,060	\$ 52,097	– \$ 44,963	\$ 1,931	– \$ 2,878	– \$ 4,809
Top 10%	\$ 532,921	\$ 152,763	\$ 72,390	– \$ 80,374	\$ 5,811	– \$ 4,797	– \$ 10,608
Top 5%	\$ 811,927	\$ 247,626	\$ 102,223	– \$ 145,403	\$ 14,933	– \$ 7,970	– \$ 22,902
Top 1%	\$ 2,285,276	\$ 777,923	\$ 255,201	– \$ 522,722	\$ 83,525	– \$ 25,764	– \$ 109,290

Source: Prante and Fleenor, “A Distributional Analysis of President Obama’s Proposed Policies for Fiscal Years 2009-2019 as Outlined in His Fiscal Year 2010 Budget.”

<sup>4</sup> The fungible portions of Medicare and Medicaid benefits and 50 percent of the remainder are calculated to benefit only the direct participants in the program. The other 50 percent of the non-fungible portion is a public health component and is therefore counted as a public good allocated to families based on their cash income.

bring home hefty taxpayer-financed paychecks; similarly, there are defense contractors earning excessive profits that exceed a normal rate of return. For more information on these technical subjects and caveats, the parallel working paper has a detailed discussion of the economic incidence decisions made on both the tax and spending sides of the ledger.

### *Why Do We Redistribute Income?*

Economists typically offer two justifications for the federal tax system's requirement that high-income families pay more in taxes than lower-income families: (1) high-income families benefit more from government services; and (2) on the whole, high-income taxpayers benefit when low-income families can afford close to a middle-income lifestyle.

We find that the first is certainly true, and in this study we measure the substantial benefits of government spending to high-income

taxpayers. But the second justification — that redistribution is a public good in itself — is not easily quantifiable. If we attempted to quantify the value to high-income taxpayers of having their income redistributed to lower-income families, the entire process of estimating redistribution would be circular and thereby pointless.

The purpose of our study is to inform policymakers when they ask whether the nation is currently redistributing too little or too much income. The studies they currently consult to answer that question are inadequate because they look only at tax distribution tables. That does not allow us to isolate the redistributive component of the tax system. High-income families may pay more in taxes than low-income families, but how much of that difference is income redistribution, and how much is simply paying for the services that high-income people receive from government spending? This

Table 2

*Distributional Impact on Family Income Groups (Aggregate) of Proposed Policies in President Obama's Budget, Fiscal Year 2012*

Percentile	Market Income (Before Any Redistribution)		Income After Redistribution				Additional Income Redistributed by Obama's Budget in \$Millions
	Total in \$Millions	Share of Income	According to Obama OMB Baseline		According to Obama Budget Policies		
	Total in \$Millions	Share of Income	Total in \$Millions	Share of Income	Total in \$Millions	Share of Income	
0–10%	\$ 92,959	0.7%	\$ 404,642	2.8%	\$ 423,125	3.0%	\$ 18,483
10–20%	\$ 340,152	2.4%	\$ 519,245	3.6%	\$ 545,813	3.8%	\$ 26,568
20–30%	\$ 548,843	3.9%	\$ 692,273	4.9%	\$ 714,564	5.0%	\$ 22,291
30–40%	\$ 728,565	5.1%	\$ 822,614	5.8%	\$ 837,131	5.9%	\$ 14,517
40–50%	\$ 921,724	6.5%	\$ 999,187	7.0%	\$ 1,006,158	7.1%	\$ 6,971
50–60%	\$ 1,078,695	7.6%	\$ 1,120,608	7.9%	\$ 1,125,749	7.9%	\$ 5,141
60–70%	\$ 1,255,423	8.8%	\$ 1,253,735	8.8%	\$ 1,257,867	8.8%	\$ 4,132
70–80%	\$ 1,515,396	10.6%	\$ 1,472,454	10.3%	\$ 1,477,782	10.4%	\$ 5,329
80–90%	\$ 1,972,513	13.8%	\$ 1,856,312	13.0%	\$ 1,867,010	13.1%	\$ 10,698
90–95%	\$ 1,372,112	9.6%	\$ 1,281,323	9.0%	\$ 1,290,953	9.1%	\$ 9,630
95–99%	\$ 1,915,674	13.4%	\$ 1,702,752	11.9%	\$ 1,698,429	11.9%	– \$ 4,323
99–100%	\$ 2,534,040	17.8%	\$ 2,075,604	14.6%	\$ 1,954,417	13.7%	– \$ 121,187
ALL	\$ 14,250,686	100.0%	\$ 14,250,686	100.0%	\$ 14,250,686	100.0%	\$ 0
Exhibit:							
Top 20%	\$ 7,794,339	54.7%	\$ 6,915,991	48.5%	\$ 6,810,809	47.8%	– \$ 105,182
Top 10%	\$ 5,821,826	40.9%	\$ 5,059,679	35.5%	\$ 4,943,799	34.7%	– \$ 115,880
Top 5%	\$ 4,449,714	31.2%	\$ 3,778,356	26.5%	\$ 3,652,846	25.6%	– \$ 125,510
Top 1%	\$ 2,534,040	17.8%	\$ 2,075,604	14.6%	\$ 1,954,417	13.7%	– \$ 121,187

Source: Prante and Fleenor, "A Distributional Analysis of President Obama's Proposed Policies for Fiscal Years 2009-2019 as Outlined in His Fiscal Year 2010 Budget."

unique framework that we have developed allows us to analyze the income redistribution in the federal budget and how President Obama would change it.

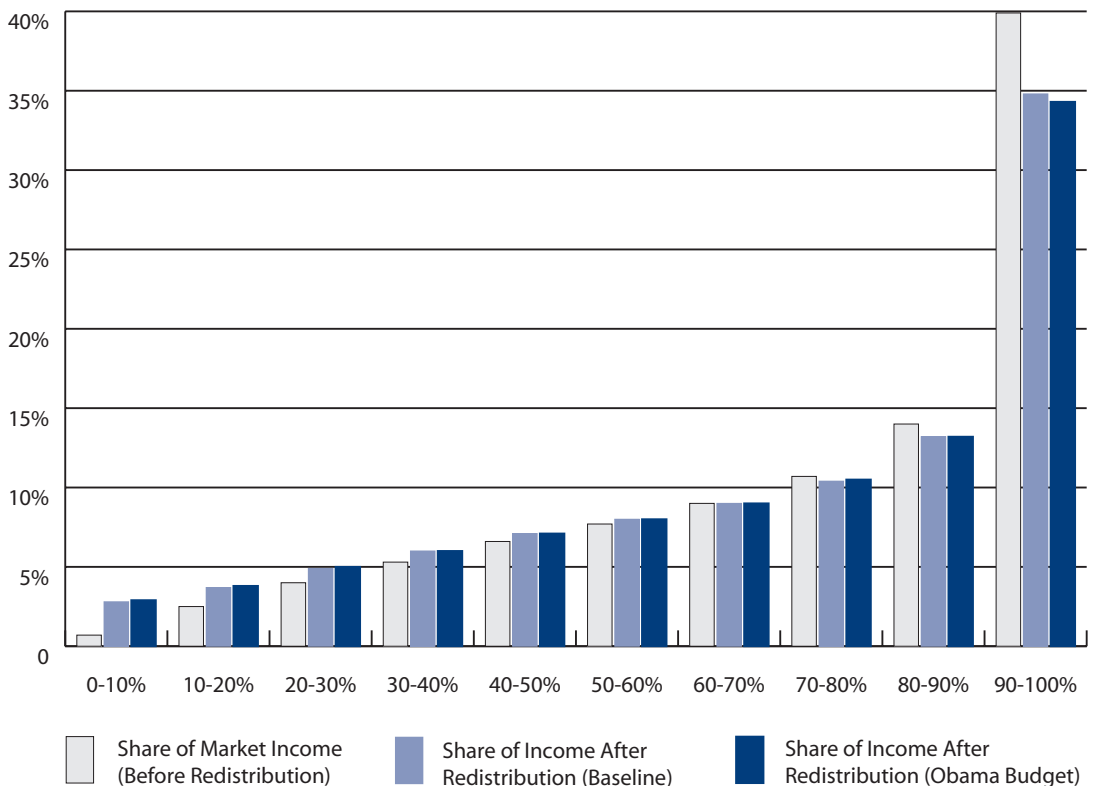
#### IV. Results for President Obama's Proposed Policies for Fiscal Year 2012

President Obama's proposed changes in fiscal policies for FY 2012 can correctly be labeled "progressive" or "redistributive" in the pro-poor sense of the word (see Table 1). That is largely because President Obama's policies would raise taxes on very high-income families while enacting new transfer spending and tax cuts for families at the bottom and middle of the income spectrum. We estimate that the typical

family in the bottom 10 percent of the income distribution would see its income, including all transfers and benefits of government spending, increase by around \$1,000 under Obama's budget. Meanwhile, the average family in the top one percent would see a nearly \$110,000 decrease in its income. The 95-99th percentile will pay less tax under Obama but will receive less in spending, and the net is a small drop in income; the bottom 95 percent (as a group) would see its income rise after redistribution.

In total, President Obama's policies would redistribute an additional \$125 billion from families in the top five percent of the income distribution to the remaining 95 percent of the population (see Table 2 and Figure 1). That's on top of the already \$671 billion in income

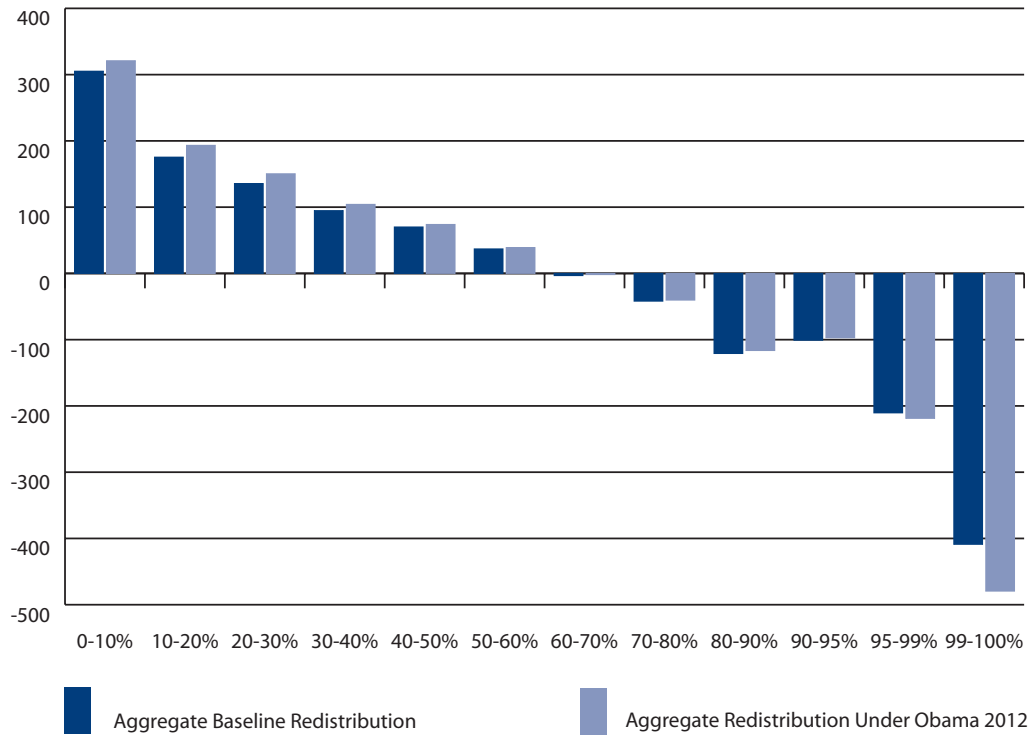
Figure 1  
Income Shares of Family Income Groups (Market Income, Post-Baseline Redistribution and Post-Obama Policy Redistribution)



Source: Prante and Fleenor, "A Distributional Analysis of President Obama's Proposed Policies for Fiscal Years 2009-2019 as Outlined in His Fiscal Year 2010 Budget."



Figure 2  
Change in Redistribution by Income Group Under Obama Policies in 2012 (\$Billions)



redistribution that was set to take place from those families in the top five percent, thereby creating a new total amount of redistribution from those approximately 5.4 million high-income families of \$796 billion, an average of about \$145,000 per family (see Table 2 and Figure 2).

To put this \$796 billion in perspective, those top five percent of families earn approximately \$4.45 trillion in market income (\$4,450 billion) collectively, meaning that the federal government, under Obama’s proposed policies for FY 2012 would redistribute approximately 17.9 percent of the group’s market income to other families. Under the Obama OMB baseline, that figure is lower, 15.1 percent of market income, meaning that Obama’s policies would redistribute an additional 2.8 percent of the top five percent’s income. For families in the

middle 20 percent of the income spectrum (as a group), redistribution boosts income by about 6-7 percent under both the baseline and policy scenarios.

At the bottom of the income spectrum, the amount of income redistribution flowing to the bottom 20 percent would increase under President Obama’s proposed policies. On average, we estimate that a family in the bottom 10 percent of the population would have its post-redistribution income increase by 4.6 percent as a result of Obama’s proposed policies (i.e. relative to the Obama OMB baseline). For the second decile, that figure is 5.1 percent, and for families in the second quintile (20th-40th percentiles), we estimate their post-redistribution incomes would grow somewhere between 2 and 3 percent in FY 2012 as a result of the president’s new policy proposals.

## V. Conclusion

President Obama campaigned on a promise that he would pursue policies that promote a more even distribution of the economic pie. As our study shows, the extent of income redistribution embedded in the policies he has outlined in his first budget as president do indeed intend to move the United States in that direction.

For fiscal year 2012, the first full fiscal year in which President Obama's full policy

agenda would be in effect, we estimate that his policies would increase the amount of redistribution from those in the top five percent of the income spectrum to those outside the top five percent by \$145 billion. The post-redistribution incomes of all other family income groups, including those in the top 20 percent yet outside the top five percent, would increase as a result of Obama's proposed policies. We estimate that the greatest dollar amount increase per family would flow to families in the bottom 30 percent of the income spectrum.<sup>5</sup>



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<sup>5</sup> Technically, President Bush proposed the budget for FY 2009, but significant changes have been made to it since Obama took office, most notably the enacted stimulus bill.