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THE "NEW" BUDGET AGREEMENT: PART III THE FAIRNESS ISSUE – TROJAN HORSE FOR TAXING THE MIDDLE CLASS

(Updating *Backgrounder Update* No. 147, "The 'New' Budget Agreement: Part II, Back to Carternomics," October 12, 1990, and *Executive Memorandum* No. 289, "The 'New' Budget Agreement: Part I, From Bad to Worse," October 9, 1990.)

An outcry from the American people led to the defeat in the House of Representatives several weeks ago of the President's budget summit package that would have raised taxes by $134 billion over five years. But rather than develop a new package that reduces the deficit by restraining the growth of federal spending, congressional leaders put together an even larger tax increase. They hope to pass this record tax hike by stirring up class hatred. Since almost no American wants to send more of his paycheck to Washington, and since very few people consider themselves wealthy, lawmakers assume that calls to "tax the rich" will appeal to most Americans.

This shrill rhetoric of class warfare masks the truth. With the new package, it is ordinary workers and consumers who will be the ultimate victims of higher taxes. The reason: as Famous Thief Willie Sutton responded when asked why he robbed banks, "that is where the money is." Most income in America is earned by the middle class and any tax increase designed to raise significant revenues inevitably must tax the middle class and add to the average family's tax burden. Advocates of higher taxes assert, incorrectly, that the 1980s saw the rich get richer and the poor get poorer. They also say, again incorrectly, that the deficit exists because revenues from higher taxes on lower- and middle-income workers were offset by huge tax breaks for the rich. In reality, economic growth in the 1980s produced significant income gains for all Americans. Moreover, wealthy Americans today are paying a greater percentage of the total tax burden than ever before. Indeed, the clamor to tax the rich is based on a series of myths, and these myths are used to justify what lawmakers really want – not fairness, but a return to the tax-and-spend policies of the 1970s.

Myth #1: The economic situation of most American families declined during the 1980s.

Fact: The well-being of the average American family, as measured by either family income or household income, illustrates that the 1980s were good years. After declining sharply from 1979 to 1982, median family income and median household income started growing and both now are at all-time highs. Table 1 shows the dramatic turnaround in income trends once the high-tax economic policies of the 1970s were replaced with pro-growth policies in the 1980s.

Table 1
Trends in Family and Household Income
(constant 1989 dollars)

Year	Family Income	Yearly Change	Household Income	Yearly Change
1976	31,225	955	26,483	447
1977	31,410	185	26,629	146
1978	32,405	995	27,673	1044
1979	32,821	416	27,583	-90
1980	31,675	-1146	26,683	-900
1981	31,811	-864	26,251	-432
1982	30,394	-417	26,163	-88
1983	30,719	325	26,167	4
1984	31,547	828	26,751	584
1985	31,962	415	27,218	467
1986	33,328	1366	28,168	950
1987	33,805	477	28,447	279
1988	33,742	-63	28,537	90
1989	34,213	471	28,906	369

Source: Census Bureau.
CPI-U-XI used for inflation adjustment.

Table 2
Percent Change in Income by Class
(constant 1989 dollars)

Years	Bottom Fifth	Second Fifth	Middle Fifth	Fourth Fifth	Highest Fifth
1973-1980	-5.1	-2.3	0.7	2.2	2
1979-1980	-5.3	-3.6	-3.3	-2.5	-3.7
1981-1989	5.9	9.3	10.6	13.4	24.5
1982-1989	11.9	11	12.6	14.2	22.1

Source: United States Senate Staff Report.

Myth #2: The rich have grown richer at the expense of the poor.

Fact: Confronted by the facts from Table 1, those who would raise taxes go on to argue that the numbers are distorted because large income gains for the wealthy mask the declining income levels among lower- and middle-income Americans. They are half right. The top 20 percent of income-earners did indeed see their inflation-adjusted incomes rise by more than 22 percent between 1982 and 1989. But the bottom 20 percent of income-earners also benefited from Reaganomics, with their inflation-adjusted incomes rising by 11.9 percent between 1982 and 1989. By contrast, between 1973 and 1980, the average incomes for the lowest 20 percent declined by 5.1 percent. Table 2 reveals the percentage change in inflation-adjusted incomes by each income quintile. The figures demonstrate conclusively that poor Americans suffered throughout the 1970s and all Americans suffered during the late 1970s, while all classes of Americans saw their incomes increase during the 1980s.

Myth #3: The budget deficit exists because the rich received huge tax cuts during the 1980s.

Fact: Tax revenues more than doubled during the 1980s, climbing from $517 billion in 1980 to an estimated $1.044 trillion in 1990. Federal taxes rose from an average of 18.3 percent of gross national product in the 1970s to more than 19 percent in the 1980s. The budget deficit exists because federal spending climbed by an even greater amount. If federal spending had "only" grown by the rate of inflation during the 1980s, the nation today would enjoy a budget surplus of more than $125 billion.

In any case, higher taxes on the rich would barely dent the budget deficit. Even if lawmakers confiscated every dollar of individual taxable income above $1 million, they could only run the government for a little more than twelve days.

Myth #4: The rich are not paying their fair share of taxes.

Fact: The share of the income tax burden paid by the top one percent of income-earners has climbed from 18 percent in 1981 to 25 percent in 1987, the latest year for which official figures are available. The Congressional Budget Office estimates that the wealthiest five percent have seen their share of the income tax burden climb from 36 percent in 1980 to 44 percent in 1990. The rise in income tax payments by the wealthy is, in part, a result of higher incomes and confirms the supply-side hypothesis that lower income tax rates encourage individuals to remove money from tax shelters and report it as taxable income.

Taxing the Poor

One element of the unfairness issue is true: higher Social Security taxes have disproportionately hurt poor and middle-income Americans. Social Security payroll taxes have risen considerably in the last ten years, largely thanks to legislation enacted in the 1970s. Many lower-income Americans pay no income taxes, mostly due to the 1986 Tax Reform Act. Payroll taxes, by contrast, are levied against the first dollar of income, so they fall particularly hard on those with lower incomes. The question of fairness thus requires reducing the excessive burden of payroll taxes on lower- and middle-income citizens. Senators Robert Kasten, the Wisconsin Republican, and Daniel Patrick Moynihan, the New York Democrat, have introduced legislation to reduce the payroll tax and prevent politicians from spending surplus Social Security tax revenues on other government programs. Lower payroll taxes would spur job creation and increase after-tax income for tens of millions of Americans. The alternative, raising taxes on middle- and upper- income taxpayers to "balance" high payroll taxes on lower income taxpayers, simply means all taxpayers lose.

The point that higher taxes ultimately hurt poor blacks, Hispanics, and other minorities was made this week by the U.S. Civil Rights Commission. The Commission noted that in bad economic times, black and Hispanic unemployment rates rise the fastest. In good times, a tight labor market encourages employers to cast a wider net when hiring, thus breaking barriers that have prevented minorities, women, and persons with disabilities from gaining better-paying jobs. Civil rights laws can do little to expand opportunities for members of historically disadvantaged groups when opportunities for all Americans shrink.

Commissioner Russell G. Redenbaugh warns that "It's becoming increasingly clear that the U.S. is now in an economic recession." Therefore he concludes that "To raise taxes when an economy is already weak and in a recession is like throwing a drowning man a rock." Redenbaugh adds that "A zero capital gains tax rate would be a magnet to draw and hold the wealth that is produced in" the inner cities. Commissioner Carl A. Anderson adds that "To me, this is quite a strong statement on implementation of civil rights policy and the need for a strong growth economy." These commissioners understand that a high-tax policy which transfers money from the productive sector of the economy to the government will stifle economic growth and thus harm minorities all Americans.

The 1970s and 1980s proved that low taxes trigger strong economic growth and thus higher income levels and living standards for all Americans. More than other citizens, it is the poor who most depend on a healthy economy. The high-tax decade of the 1970s culminated in prolonged economic stagnation. Inflation-adjusted gross national product was smaller in 1982 than it was in 1979, and it was the poor who suffered most during this period. Once the economic policy changes of the early 1980s took effect, however, Americans saw their incomes and living standards rise. The question policy makers face today is whether to retreat to the policy mistakes of the 1970s by raising taxes or to continue America's longest-ever period of peacetime economic growth by limiting the size of government.

A tax hike based on the politics of envy is little more than a Trojan Horse. Once the tax-increasers breach the taxpayers' defenses, economic policy will degenerate to the failed tax-and-spend policies of the 1970s. Today it is tax hike for the "rich": tomorrow it will be pink slips for the poor.

Daniel J. Mitchell
John M. Olin Fellow in Political Economy