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HOW TO STRENGTHEN AMERICA'S CRUMBLING FAMILIES

INTRODUCTION

America's families are under siege. Middle-income as well as blue-collar families are finding it hard to buy a first home or pay for their children's college tuition, partly because a steady rise in the burden of taxation means they have less money in their pockets. Working families also suffer because slow productivity growth in the United States economy in recent decades means real wages have stagnated. Poor families have been especially hard hit. Those who fall below the poverty line enter a dispiriting welfare system of perverse incentives that undermine work, personal responsibility, and family stability. What is worse, the incentives of the welfare system mean fathers become a financial liability if they stay with their family. This encourages fathers to abandon their responsibilities.

Growing Tax Burden. The growing tax burden has undermined the finances of millions of families. When state and local taxes are included, government now takes over one-third of the income of the average two-parent family. During the past four decades, the federal income tax burden on a family of four has increased by over 300 percent as a share of family income. Single Americans and married couples with no children have escaped most of this tax increase. Measured by average after-tax per capita income, families with children now are the lowest income group in America. Their average after-tax income is below that of elderly households, single persons, and couples without children.

Families with children face a disproportionate tax burden because the federal tax code has become increasingly biased against these families. The main reason for this has been the steady decline in the value of the personal exemption applying to children, which is the tax allowance for the cost of raising children.

Fortunately, lawmakers in Washington seem at last to have come to understand that the American family is overtaxed. To cut this tax burden, lawmakers from both parties have submitted legislation in Congress. On the Republican side, bills cutting taxes on families have been introduced in the House by Representatives Frank Wolf of Virginia (H.R. 1277) and Vin Weber of Minnesota (H.R. 3744), and in the Senate by Indiana Senators Dan Coats (S. 710) and Bob Kasten (S. 1920). On the Democrat side, bills have been introduced in the Senate by Senators Albert Gore of Tennessee (S. 995), Lloyd Bentsen of Texas (S. 1921), and Bill Bradley of New Jersey (S. 1846), and in the House by Representative Tom Downey of New York (H.R. 2242). In addition, President George Bush as well as Governor Bill Clinton have proposed family tax relief in their campaigns for the White House.

Wage Stagnation. These measures represent a welcome, if belated, recognition that action is needed to reverse a tax trend that is wounding American families. But because mushrooming taxation is only one factor in the financial problems facing the average American family, easing the tax burden is not the complete solution. The other cause for concern is the slowdown in the growth of real wages and salaries for working parents. Since 1970, wages and salaries, adjusted for inflation, have grown much less rapidly than in the 1950s and 1960s.[1] For the first 25 years following World War II, the average family could expect a continuing improvement in income, based on the steady real growth of one breadwinner's earnings. But since about 1970, a growing number of families have found it necessary for both parents to enter the work force for there to be even modest growth in real family income, both before and after taxes. And even though the Reagan tax cuts enacted in the 1980s did help, this tax relief was not sufficient to offset the policy mistakes of the 1970s. Caught between this slowdown in wage growth and the rise in taxation, most parents today thus find they must work more and more to achieve even a modest annual improvement in family income.

Family Disintegration. The third major problem facing families and children is the decline of marriage. Studies indicate that many of the social problems of young Americans—which often continue into later life—are linked to their upbringing in single-parent households. The erosion of the institution of marriage has affected all segments of American society, but its consequences have been most devastating in low-income communities. In the black community the decline of marriage is now a crisis. In 1965, when the War on Poverty began, roughly one out of four black children were born out of wedlock. The rate today is 65 percent, and if current trends continue the rate will rise to 75 percent by the year 2000.

Much of the increase in single parenthood among the poor is caused by an expanding welfare state which has transformed low-income fathers from necessary breadwinners to financial burdens for their families. The current welfare system actively rewards households in which a father avoids his obligations, and it penalizes marriage. A new system is needed which promotes the formation of self-sufficient, two-parent families.

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1 All income figures in this paper are adjusted for inflation using the U.S. Bureau of Labor Statistics Consumer Price Index, model CPI-U-X1. This deflator more accurately depicts changes in consumer prices in the 1970s and early 1980s, and is more accurate for historical comparisons. If the alternative CPI-U were used, the data would show the same rates of income growth as those presented in this chapter for the 1950s, 1960s, and 1980s, but slightly lower income growth in the 1970s. All figures in the text depicting taxes as a percentage of income and income lost to increased taxes are unaffected by the inflation measure chosen. For a discussion of the CPI-U-X1 and CPI-U, see U.S. Bureau of the Census, *Money Income of Households, Families, and Persons in the United States: 1990*, Current Population Reports, Series P-60, No.174 (Washington, D.C.: U.S. Government Printing Office, 1991), pp. 8-9.

A comprehensive policy to strengthen American families must include four key elements:

Element #1: Family Tax Cuts. There must be tax cuts to relieve the burden on overtaxed families with children. Federal taxes on working families with children should be cut at least $1,000 for each dependent child.

Element #2: Increased Productivity. Policies are needed to stimulate productivity growth in the economy and thereby raise the real wages and salaries of American parents as well as other workers. These policies require tax cuts on savings and investment. Among the necessary steps: a reduction in the capital gains tax, expanded individual retirement accounts (IRAs), and tax fairness for investment by allowing business to deduct the full value of new investments in plants and equipment as a business expense.

Element #3: Spending Cuts. Increasing taxes on other Americans to finance tax relief for families with children might help those families in the short run, but it would do so only by reducing long-term economic growth and thus adding to the wage stagnation problem. Tax cuts which would cause further increases in the federal deficit also would be folly. Thus family tax relief should be paid for by capping the growth of non-defense federal spending. Holding the spending growth at roughly five percent per annum would allow a reasonable level of tax relief. In this way, each dollar of family tax relief would be matched by one dollar in reduced domestic spending.

Element #4: Welfare Reform. The current welfare system discourages work, marriage, and family responsibility, and encourages welfare dependency. To rebuild America's shattered poor families, the welfare system must be overhauled to promote responsible behavior, marriage, and self-sufficiency.

In welfare, you get what you pay for. Since the 1960s the government has been paying for single parenthood and non-working households and it has been getting dramatic increases in both. The welfare incentive system must be revised to promote rather than penalize marriage and self-sufficiency. This can be accomplished by increasing support to low-income two-parent and single-parent families who are prepared to work. Conversely, the high welfare benefits that go to non-working single mothers on welfare must be reduced, and some welfare mothers should be required to work in exchange for the benefits they receive.

The family is the core of American society. It is the principal mechanism through which values, knowledge, discipline, and motivation are passed from one generation to the next. The family almost alone molds the character of future generations, and thus it serves as the foundation of civilized life. If the family is weakened, government programs cannot repair the damage. But rather than bolstering families, many government policies actually undermine them. These anti-family government policies must be reversed if American society is to regain its health and vitality.

HOW WASHINGTON HAS HIKED TAXES ON CHILDREN

Federal taxation of families with children has increased dramatically over the past four decades. In 1948, a family of four at the median family income level paid just two percent of its income to the federal government in taxes.[2] In 1989 the equivalent family paid nearly 24 percent of its income to the federal government.[3] When state and local taxes are included, the tax burden on that family exceeds one-third of its income.[4]

As Table 1 shows, the rise in federal income taxes on families with children in the last four decades has been much faster than for other groups of Americans. From 1954 to 1989, the average federal income tax rates for single persons and married couples with no children did not increase.[5] But for a married couple with two children, the average income tax rate more than doubled. And for a family with four children, the average income tax rate rose from zero in 1954 to 2.6 percent in 1960, and to 6.3 percent in 1989.

The root cause of this growing anti-family bias in the federal income tax code has been the eroding value of the personal exemption. The personal exemption for children was intended to offset part of the annual costs of raising a child by allowing families to deduct an amount of money from their taxable income. In 1948, the personal exemption was $600. This was equal to roughly 20 percent of the median income of two-parent families, then $3,272.[6] For a family of four, the $600 personal exemption shielded nearly 80 percent of family income from federal income tax. Families could reduce their tax bill further by itemizing deductions or taking the standard deduction, and this protected most of the remaining 20 percent of income from income tax. The result: in the late 1940s and early 1950s the average family with children paid little or no income tax.

In the past four decades, however, increases in the personal exemption have lagged far behind the rise in incomes and inflation. Although the Tax Reform Act of 1986 raised the value of the personal exemption from $1,000 to $2,000, this only partially offset the erosion in the value of the exemption since the 1940s. Chart 1 shows the declining value of personal exemptions relative to the median income of two-parent fami-

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2 The value of the personal exemption also declined between the imposition of the federal income tax in 1913 and Word War II. But 1948 is chosen as a benchmark because it is neither a depression year nor a war year, and because it marks the beginning of a long period of high inflation and rising taxes.

3 These figures represent the tax rates for a family of four at the median family income level for two-parent families.

4 Estimate based on data supplied by U.S. Bureau of the Census.

5 The average or effective income tax rate is a measure of total taxes compared with income. By contrast, the marginal tax rate, or "tax bracket," is a measure only of the tax paid on the last dollar earned. Thus many families have experienced a cut in their marginal tax rates, yet their average tax rates have climbed.

6 Mary F. Henson, *Trends in Income, by Selected Characteristics: 1947 to 1988*, U.S. Bureau of the Census, Current Population Reports, Series P-60, No. 167 (Washington, D.C.: U.S. Government Printing Office, 1990), p. 19.

Table 1

Federal Income Tax for Median Income Family by Family Size and Type, 1948-1989

		Single		Joint					
				No Children		2 Children		4 Children	
Year	Median Family Income	Tax	% of Income	Tax	% of Income	Tax	% of Income	Tax	% of Income
1948	$3,187	$300	9.4%	$208	6.5%	$9	0.3%	$0	0.0%
1954	4,167	534	12.8	402	9.6	162	3.9	0	0.0
1960	5,620	780	13.9	625	11.1	385	6.9	145	2.6
1966	7,532	962	12.8	741	9.8	524	7.0	328	4.4
1972	11,116	1,544	13.9	1,201	10.8	916	8.2	631	5.7
1978	17,640	2,602	14.7	2,101	11.9	1,768	10.0	1,408	8.0
1980	21,023	3,348	15.9	2,643	12.6	2,176	10.4	1,756	8.4
1982	23,433	3,543	15.1	2,767	11.8	2,327	9.9	1,904	8.1
1984	26,433	3,641	13.8	2,844	10.8	2,421	9.2	2,061	7.8
1986	29,458	4,107	13.9	3,217	10.9	2,744	9.3	2,348	8.0
1987	30,853	3,869	12.5	2,876	9.3	2,306	7.5	1,736	5.6
1989	34,213	4,404	12.8	3,352	9.8	2,751	8.0	2,151	6.3

Note: Median Income is the level at which half of all families have income below that level, and half above. Examples assume itemizable expenses equal to 23 percent of Adjusted Gross Income in all years. No deductions are made for two-income families.

Sources: Figures for 1948-1978 from Eugene Steurle, "The Tax Treatment of Families of Different Sizes," *Taxing the Family*, (Washington, D.C.: American Enterprise Institute, 1983), p. 76. Figures for 1978-1989 from Thomas M. Humbert, "Ending the Tax Code's Anti-Family Bias by Increasing the Personal Exemption to $6,300," Heritage Foundation Backgrounder No. 687, January 30, 1989. Income data based on *Money Income of Households, Families and Persons in the U.S.*, U.S. Bureau of the Census, various years.