

How the Current Tax System Works

Foundations for Tax Reform

by Gary and Aldona Robbins Senior Research Fellows

POLICY REPORT 154

SEPTEMBER 2001

Executive Summary

If meaningful tax reform is ever to be successful, there has to be a better understanding of how taxes interact with our economy. It is crucial to recognize that without the workers, investors and entrepreneurs who produce the economy's goods and services, there would be nothing to tax.

Some taxes, like "employer" payroll or corporate income taxes, are collected at the business level. Others, like the employee portion of social security or the personal income tax, are collected from individuals. But the reality is that, whether called an income tax, a payroll tax, a sales tax, a business tax or a property tax, all taxes are paid out of the income people earn *with their labor and capital*.

Proceeding from this fact, we have developed a set of National Tax Accounts that links output, taxes and the income earned by labor and capital. Some key findings are:

- Output, or gross domestic product, is equal to the sum of income earned by the factors of production, capital and labor. In 1999, GDP totaled almost \$9.3 trillion.
- Taxes, which amounted to \$2.7 trillion in 1999, come out of the income earned by capital and labor. With almost two out of every three dollars of income in the economy arising from labor services, 61 percent of the taxes collected by all levels of government fall on labor income and 39 percent on capital income.
- Federal taxes account for two-thirds of the total, mostly from income and payroll taxes. Almost 70 percent of revenues raised by states and localities come from sales, excise and property taxes.
- Almost \$1.3 trillion, or about half, were taxes paid at the business level, like employer payroll taxes, corporate income taxes, sales taxes, and property taxes. These taxes shaved 9.9 percent off labor income before it got to workers and 19.1 percent off capital income before it got to investors, savers and entrepreneurs.
- Individuals paid the rest. These taxes, which include the individual income tax, employee payroll taxes and estate taxes, reduced personal income by 18.7 percent.
- Private businesses account for three-fourths of the economy and pay almost 90 percent of federal, state and local taxes. On average, a third of the labor income (33.2%) and almost half of the capital income (47.5%) arising in the private sector goes to taxes. Taxes on the next dollar of income are even higher by a third for labor (44.4%) and a fourth for capital (60.6%). Marginal rates are especially important because production costs and prices depend on the last unit employed, not the first or the average.
- Labor in the rest of the economy government, government enterprises, domiciles and institutions faces somewhat lower tax rates. Capital is essentially untaxed because these sectors do not operate as for-profit entities and generate no capital income as measured by market transactions.

American workers and American capital pay a lot in taxes. Setting aside the issue of whether government is too big, is there a better way to raise revenue? While tax collections depend on average rates, economic expansion depends on marginal rates. The current tax system needlessly hamstrings growth because marginal rates exceed the averages. Taxing capital more heavily than labor only make matters worse through an inefficient resource mix.

These are the problems tax reform needs to address. The method of accounting presented here offers a starting point to assess how well proposals measure up to the current system and to each other. "Whether called an income tax, a payroll tax, a sales tax, a business tax or a property tax, all taxes are paid out the income people earn with their labor and capital."

"The current tax system needlessly hamstrings growth because marginal rates exceed the averages."

Table of	Part I: How the Economy Works: The Circular Flow
Contents	Government Enters the Picture
	Part II. Measuring Economic Activity
	GDP as Expenditures.GDP by ProductionGDP as Factor CompensationSources and Uses of Private Business FundsSources and Uses of Other Producer FundsSources and Uses of Personal Income1
	Part III: Tax Rates under the Current System
	Identifying Taxes on Labor and Capital 1 Tax Rates on Labor and Capital 1 Marginal Tax Rates Are Even Higher 1 Economic Implications of Current Tax Rates 1
	Conclusions
	Endnotes
	Appendix
Charts, Tables & Figures	Chart 1 Simple Circular Flow: Businesses and Households 1 Chart 2 Circular Flow in a Market Economy with Money 1 Chart 3 Adding Government to the Circular Flow 1
	Table 1Thild Sales of What Was FroducedTable 2Who Produces the Goods and ServicesTable 3aSources & Uses of Private Business Funds, 1998 & 1999Table 3bDistribution of Income from Private Business Output, 1998 & 1999Table 4aSources & Uses of Government Enterprise Funds, 1998 & 1999Table 5bDistribution of Income from Government Enterprises, 1998 & 1999Table 6aSources & Uses of Funds for Domiciles, 1998 & 1999Table 6aSources & Uses of Funds for Institutions, 1998 & 1999Table 6bDistribution of Income from Institutions, 1998 & 1999Table 7aSources & Uses of General Government Funds, 1998 & 1999Table 7bDistribution of Income from General Government, 1998 & 1999Table 7bDistribution of Income from General Government, 1998 & 1999Table 7bDistribution of Income from General Government, 1998 & 1999Table 7bDistribution of Income from General Government, 1998 & 1999Table 7bDistribution of Income from General Government, 1998 & 1999Table 9bReconciling Personal Income, 1998 & 1999Table 9bReconciling Personal Income, 1998 & 1999Table 91Taxes on Labor and CapitalTable 11Ranking of Taxes on Labor (L) and Capital (K) as Revenue Sources by Producer and Level of Government, 1999Table 13Marginal Tax Rates on Capital and Labor Income by Major Producer, 1998 & 1999Table 14Taxes on Labor and Capital by Major Production Sector, 1998 & 1999Table 15Share of GDP and Taxes by ProducerFigure 1Share of GDP and Taxes by Producer

Acknowledgments

We would like to thank Ernie Christian, Steve Entin, JD Foster, Tom Giovanetti, Bill Helming, and Barry Rogstad for their comments, suggestions and general encouragement on this project. Any errors of omission or commision contained in this report are, of course, those of the authors.

How the Current Tax System Works

by Gary and Aldona Robbins Senior Research Fellows

Growing dissatisfaction over record tax burdens and the complexity of the present code, coupled with worries that Americans are not saving enough, should make tax reform a high priority for the administration and Congress. But if policymakers and the public do not understand how taxes affect the economy, efforts to reform the tax system could easily fail.

This study is the first in a series that will provide a foundation for tax reform. To begin the journey, we will lay out where we are. In future reports, we will focus on our destination and the best way to get there.

Our look at the present tax system — where we are — begins by examining how goods and services are produced and sold in the economy. The first section relies on a device used in introductory economic courses — the circular flow — to describe how an economy works. Systematically tracing the flow of physical goods and services, along with the dollars spent to acquire them, reduces the chance that something will be overlooked or double-counted. Next, we look at different ways to measure total economic activity using a set of National Tax Accounts developed for this series. Greatest focus is put on the factor-income method because all taxes ultimately are paid out of the compensation earned by labor or capital. The last section measures the burden of the current tax system using average and marginal tax rates on labor and capital.

Anyone who has taken a beginning economics course probably has gone through an accounting exercise called the *circular flow of income and output*. The circular flow describes the workings of a market economy in which people both produce and consume goods and services. *Businesses* produce goods and services. *Households* provide labor and capital to businesses as well as consume the goods and services produced by businesses. And the same people who make up the households own and operate the businesses. Labels merely distinguish among their economic activities. In the simplest form, as shown in Chart 1, businesses and households barter with one another. Businesses trade goods and services to acquire the services of labor and capital from households. Households exchange their labor and capital services for goods and



Introduction

Part I: How the Economy Works: The Circular Flow



services produced by businesses. Here it is important to note that the two flows -(1) the real goods and services that businesses produce and (2) the labor and capital services that households provide – are exactly equal in value. In other words, these two flows are different ways to measure the same thing: total economic activity.

Introducing money into a market economy makes it easier for households and businesses to conduct transactions. It also doubles the number of flows. As shown in Chart 2, total economic activity can now be expressed as either:



- (1) the real flow of goods and services produced by businesses and consumed by households;
- (2) the money households spend to purchase those goods and services from businesses;
- (3) the real flow of factor services from households to businesses; or
- (4) the compensation businesses pay to households for their labor and capital inputs.

Each of the four flows depicted in Chart 2 describes what is happening in the economy at any one point in time. But whether from the perspective of what is produced, what is bought, what inputs are used in production, or what inputs receive in compensation, the total value of activity going in one direction mirrors the total value of activity flowing in the other. Let us emphasize this extremely important point:

- A dollar's worth of goods produced (real flow) is the same as a dollar spent to buy those goods (money flow). From the standpoint of total economic activity, it counts as only one dollar, not two.
- Similarly, a dollar's worth of factor services (real flow) is the same as a dollar spent to compensate labor and capital for those services (money flow). Again, from the standpoint of total economic activity, it counts as only one unit of economic activity, not two or four.

Our economy so far has been made up of two main players: (1) households, which supply factor inputs and buy goods and services, and (2) businesses, which hire factor inputs and produce goods and services. Of course there is another key player — government — which imposes taxes, purchases goods and services, and provides transfers and subsidies.

The addition of government makes the circular flow analysis much more complex. For simplicity, we will focus only on the money flows.

Chart 2 **Circular Flow in a Market Economy with Money**

Note: "R" indicates a real flow and "\$" indicates a money flow.

"A dollar's worth of goods produced is the same as a dollar spent to buy those goods. From the standpoint of total economic activity, it counts as only one dollar. not two."

Government Enters the Picture



Chart 3 Adding Government to the Circular Flow

Chart 3 shows government sitting inside the circular flow. As we have seen, businesses earn income by selling goods and services while households earn income by providing labor and capital services. Government, by contrast, gets its revenue by taxing the income that flows between households and businesses. For example, sales taxes divert income from expenditures flowing from households to businesses. Payroll taxes divert income from labor compensation flowing from businesses to households. Taxes levied on business, like the corporate income tax, reduce the factor compensation that would otherwise go to households. Taxes levied directly on households, like the personal income tax, also reduce the compensation for labor and capital services.

Government can use its tax revenues in one of three ways. It can purchase goods and services, which enter into the expenditure flow going to businesses. It can hire labor services, which enter into the compensation flow going to households. Or it can make transfers to businesses and households in the form of welfare payments or subsidies.

The central fact is that government interacts with businesses or households at numerous points in the circular flow. In doing so, it siphons off income that otherwise would go to those who produce the economy's output.

With the major players introduced, let us now turn from graphs to numbers. The basic economic data we use come from the Commerce Department's *National Income and Product Accounts (NIPA)*, a comprehensive set of accounts that measure economic activity.¹ Total economic activity is typically summarized as gross domestic product (GDP), which is the value of all the goods and services produced within the U.S. Because our interest is taxes, we have to rearrange the NIPA accounts to better reflect how taxes affect economic activity. To that end, we have developed a set of National Tax Accounts that link taxes with the expenditure and factor compensation flows in Chart 3.

Using the NIPA and National Tax Accounts, we now will show three ways to measure total economic activity: (1) as what is spent on goods and services; (2) as what is produced by major sectors and (3) as what is paid to the factors of production, labor and capital. When all is said and done, all three will add up to the same thing, GDP.

Measuring economic activity in terms of what is sold (the "Expenditure" flow in Chart 3) is straightforward. Commerce routinely reports GDP as the final sales on four broad categories of goods and services: consumption, investment, government, and net exports. "Government interacts with businesses or households at numerous points in the circular flow."

Part II. Measuring Economic Activity

GDP as Expenditures In 1999, the total amount spent on U.S. goods and services was \$9.3 trillion. Two-thirds were purchases by households for personal consumption. Private businesses bought another 17.5 percent for investment in plant and equipment. Government purchases of goods (like roads) and services (like park rangers) claimed another 17.6 percent. Because GDP measures what is produced within the nation's boundaries, we need to subtract the goods and services sold in the U.S. supplied by foreign producers (13.5%) and add back what U.S. producers exported (10.8%). [See Table 1 for GDP by major expenditure category.]

Final Sales of Wha Gross Domestic Product by Type	t Was Pro of Expenditu	duced re, 1998 & 199	99	
	\$bil	%T	%Total	
	1998	1999	1998	1999
Gross domestic product	8,759.9	9,256.1		
Personal consumption expenditures	5,848.6	6,257.3	66.8%	67.6%
Gross domestic private business investment	1,531.2	1,622.7	17.5%	17.5%
Net exports	(149.6)	(253.9)	-1.7%	-2.7%
Exports	966.3	998.3	11.0%	10.8%
Imports	1,115.9	1,252.2	12.7%	13.5%
Government consumption & investment expenditures	1,529.7	1,629.8	17.5%	17.6%

Table 1 **Final Sales of What V** Produced **Gross Domestic Produc** Type of Expenditure, 19 1999

U.S. Department of Comme National Income and Prod Accounts, Table 1.1, April

GDP by Production

Commerce also reports GDP by the amount of goods and services produced in three broad sectors: businesses, households and institutions, and general government. To capture different tax treatments, we have made several refinements. First, we have split businesses into private businesses and government enterprises. Second, we have combined the imputed value of owner-occupied housing from the business sector with Commerce's "household" sector (comprising the services of domestics) and re-named the sector "domiciles."²

In 1999, the total amount produced in the U.S. economy was \$9.3 trillion — the same as the amount sold. Businesses produced 77.7 percent of GDP - 75.8 percent by the private sector and 1.9 percent by government enterprises like the Postal Service. Next were domiciles and institutions (defined generally as nonprofits) with 11.3 percent. Last was general government at the federal, state and local levels with 11 percent. [See Table 2 for GDP by legal form of ownership.]

Table 2 Who Produces the Goods	Who Produces the Goods and Services Gross Domestic Product by Sector, 1998 & 1999						
and Services		\$bil	lions	%1	Total		
Gross Domestic Product by		1998	1999	1998	1999		
Sector, 1998 & 1999	Gross domestic product	8,759.9	9,256.2				
U.S. Department of Commerce.	Businesses	6,804.8	7,194.1	77.7%	77.7%		
National Income and Product	Private businesses	6,640.2	7,018.5	75.8%	75.8%		
Accounts, Tables 1.1 & 1.7,	Government Enterprises	164.6	175.6	1.9%	1.9%		
April 2000	Domiciles and institutions	982.8	1,043.1	11.2%	11.3%		
Domiciles	Domiciles	557.8	594.3	6.4%	6.4%		
	Institutions	425.0	448.8	4.9%	4.8%		
	General government	972.3	1,019.0	11.1%	11.0%		

GDP as Factor **Compensation**

> A third way to measure GDP is in terms of what was paid for the services of the labor and capital used in production. From our circular flow analysis, we know that:

Expenditures (the value of goods and services sold)

Factor Compensation (the value of labor and capital services).

In other words, all the money received from selling the goods and services goes to cover the costs of hiring the labor and capital used in production. To show this relationship, we have developed a set of *T*-accounts listing the sources and uses of funds for the five producer sectors: private business, government enterprises, domiciles, institutions and general government. The discussion below centers around a table for

each sector that has two parts. Part "a" is the sources and uses of funds which show how much each sector received in revenue and how it was disbursed. Part "b" of the table rearranges information on the uses of funds to show how much labor and capital received after the taxes collected at the business level.³

Private businesses, which produce three-fourths of GDP, receive more than 99 percent of their funds from sales of the goods and services they produce. The rest comes from government subsidies to business. [See Table 3a for sources and uses of private business funds.]

Sources & Uses of Private Business Funds, 1998 & 1999							
	\$bill	lions	As ^c Private Bu	% of: siness GDP ¹			
Sources	1998	1999	1998	1999			
Total sources of private business funds	6,675.8	7,062.3	100.5%	100.6%			
Private business GDP	6,640.2	7,018.5	100.0%	100.0%			
Taxable private business GDP	6,630.1	7,007.9	99.8%	99.8%			
Untaxable, in kind compensation	10.1	10.6	0.2%	0.2%			
Subsidies	35.6	43.8	0.5%	0.6%			
Uses							
Total uses of private business funds	6,675.7	7,062.3	100.5%	100.6%			
Gross labor income	3,935.5	4,195.2	59.3 %	59.8 %			
Compensation of employees	3,719.8	3,967.2	56.0%	56.5%			
Untaxable employee payments in kind	9.9	10.4	0.1%	0.1%			
Compensation of private business employees	3,709.9	3,956.8	55.9%	56.4%			
Wages and salaries	3,161.2	3,386.5	47.6%	48.3%			
Employer contributions for social insurance	263.8	279.9	4.0%	4.0%			
Other labor income	285.0	290.4	4.3%	4.1%			
Indirect business taxes on labor	215.7	228.0	3.2%	3.2%			
Gross capital income	2,740.2	2,867.1	41.3%	40.9%			
Corporate profits with IVA and CCA	723.6	763.3	10.9%	10.9%			
Profits tax liability	213.6	225.3	3.2%	3.2%			
Dividends	314.6	331.6	4.7%	4.7%			
Undistributed profits	128.8	162.1	1.9%	2.3%			
Inventory valuation adjustment (IVA)	20.9	(13.0)	0.3%	-0.2%			
Capital consumption adjustment (CCA)	45.6	57.2	0.7%	0.8%			
Net corporate interest paid	130.6	140.8	2.0%	2.0%			
Proprietors' income with IVA and CCA	595.1	646.7	9.0%	9.2%			
Untaxable in kind proprietors' income	0.2	0.2	0.0%	0.0%			
Proprietors' net interest paid	85.1	93.8	1.3%	1.3%			
Other proprietors' income with IVA and CCA	3.4	3.7	0.1%	0.1%			
Rental income of persons with CCA	58.9	62.4	0.9%	0.9%			
Other private business net interest paid	42.5	57.7	0.6%	0.8%			
Consumption of fixed business capital	743.4	796.4	11.2%	11.3%			
Business transfer payments	38.1	39.4	0.6%	0.6%			
Payments to persons							
Payments to rest of world							
Indirect business taxes and fees on capital	366.8	387.8	5.5%	5.5%			
Statistical discrepancy	-47.6	-125.1	-0.7%	-1.8%			

Sources and Uses of Private Business Funds

Table 3a Sources & Uses of Private Business Funds, 1998 & 1999

U.S. Department of Commerce, National Income and Product Accounts, Tables 1.9, 1.15, 1.16 & 8.19, April 2000. Italicized line items are untaxable and would likely never enter into a tax base.

¹ May add to more than 100% because of subsidies.

In 1999, almost 60 percent of the \$7,018.5 billion in sales of private business output went to compensate the labor used in production. Almost 90 percent of the \$4,195.2 billion in *gross labor income* went to workers directly as wages and salaries (\$3,386.5 billion), *other labor income*, or fringe benefits,(\$290.4 billion), or payments in kind (\$10.4 billion).

Businesses sent \$279.9 billion of gross labor income to government for the "employer portion" of social insurance taxes. Here it is important to note that, whatever the label, payroll taxes for social security, medicare, and unemployment insurance are not really paid by employers or business. Rather, taxes on compensation are a cost of hiring labor and, as such, come out of funds which represent the value of labor's participation in production.

The rest of gross labor income went to pay labor's share of *indirect business taxes* (\$228 billion). Indirect business taxes levied on output, like sales taxes or excise taxes on telephone services, alcohol, and tobacco, must come out of the proceeds that would otherwise go to compensate labor and capital. We have apportioned indirect business taxes on output based on the how much each factor contributes to the production process, roughly two-thirds for labor and one-third for capital economy-wide.

While 60 percent of private business output was used to pay labor, the remaining 40 percent (\$2,867.1 billion) compensated capital for its services. About two-thirds of capital services come from corporations. The rest come from people who own unin-corporated businesses such as partnerships, proprietorships and farms.

Corporate profits (\$763.3 billion) represent the return on corporate capital financed through equity while net corporate interest paid (\$140.8 billion) is the return on debt-financed capital. Together they account for 31.5 percent of gross capital income and 12.9 percent of private business output.

Equity shareholders received 43 percent of corporate profits in dividends (\$331.6 billion), government got 30 percent in corporate income taxes (\$225.3 billion), and corporations retained a fifth (\$162.1 billion) for reinvestment. But it is important to remember that, just as employers do not really pay payroll taxes, corporations do not pay income taxes. Rather, taxes on corporate profits reduce the funds that would otherwise go to shareholders, either as dividends or higher stock prices in the future.

The last two categories under corporate profits are capital consumption adjustment (CCA) and inventory valuation adjustment (IVA). CCA is the difference between depreciation based on tax return data and the consumption of fixed capital, or economic depreciation, as estimated by Commerce. IVA represents the paper gains or losses that businesses holding inventories experience as prices change. Corporate profits less CCA and IVA are roughly equivalent to the corporate tax base under the current system.

Remuneration for noncorporate capital amounted to 30 percent of gross capital income and 12.3 percent of private business output in 1999. Returns to equity capital show up under the categories of proprietors' income with IVA and CCA (\$646.7 billion), other proprietors' income with IVA and CCA (\$3.7 billion), and rental income of persons with CCA (\$62.4 billion). Debt-financed capital falls under the categories of proprietors' net interest paid (\$93.8 billion) and other private business net interest paid (\$57.7 billion).

The remaining categories under gross capital income in Table 3a combine corporate and noncorporate capital. The consumption of fixed business capital (\$796.4 billion) accounted for 27.8 percent of gross capital income and 11.3 percent of private business output. Also known as depreciation, it is Commerce's estimate of what it would cost to replace existing capital that had worn out or become obsolete in 1999.

Indirect business taxes paid by capital amounted to \$387.8 billion. As with labor, they include capital's share of the indirect business taxes levied on output. They also include those indirect business taxes, like property taxes, levied specifically on capital.

"Payroll taxes for social security, medicare, and unemployment insurance are not really paid by employers or business."

"Just as employers do not really pay payroll taxes, corporations do not pay income taxes." Business transfer payments (\$39.4 billion) include insurance payments, donations and income taxes that U.S. businesses pay to foreign governments. The statistical discrepancy, which is the difference between the sources and uses of funds, appears under capital income because we believe most of it stems from mismeasuring noncorporate, business income.

Last, we want to draw attention to the italicized line items in Table 3a, a convention we have used to identify categories as untaxable. Because these categories do not go through a market, they would likely never enter into a tax base. *Untaxable, in-kind proprietors' income* is Commerce's imputed value of the food farmers grow for themselves and *untaxable employee payments-in-kind* is the food, lodging and clothing furnished to employees on location. Together they show up under sources of funds as *untaxable, in-kind compensation.*

To summarize, proceeds from the sale of goods and services produced by private businesses are paid to labor and capital as compensation for the services they provided. For the sector as a whole this works out to be roughly 60 percent for labor and 40 percent for capital. But not all of the income reaches the households that supplied the labor and capital services. As Table 3b shows, government drains more than 12 percent of gross labor income and 21 percent of gross capital income through employer payroll taxes, corporate income taxes, and indirect business taxes.

Distribution of Income from Private Business Output, 1998 & 1999								
	\$billion		% of Priv Bus GDP		% Inc	come		
	1998	1999	1998	1999	1998	1999		
Private Business GDP	6,640.2	7,018.5	100.0%	100.0%				
Private Business GDP + Subsidies	6,675.8	7,062.3	100.5%	100.6%				
Gross Labor Income	3,935.5	4,195.2	59.3%	59.8 %	100.0%	100.0%		
less Subsidies	(23.5)	(28.9)	-0.4%	-0.4%	-0.6%	-0.7%		
less Employer payroll taxes	(263.8)	(279.9)	4.0%	4.0%	-6.7%	-6.7%		
less Indirect business taxes	(215.7)	(228.0)	3.2%	3.2%	-5.5%	-5.4%		
equals Labor Income after Business Taxes	3,432.5	3,658.4	51.7%	52 .1%	87.2%	87.2%		
Gross Capital Income	2,740.2	2,867.1	41.3%	40.9%	100.0%	100.0%		
less Subsidies	(12.1)	(14.9)	-0.2%	-0.2%	-0.4%	-0.5%		
less Corporate income taxes	(213.6)	(225.3)	3.2%	3.2%	-7.8%	-7.9%		
less Indirect business taxes	(366.8)	(387.8)	5.5%	5.5%	-13.4%	-13.5%		
equals Capital Income after Business Taxes	2,147.6	2,239.1	32.3%	31.9%	78.4%	78.1 %		
Government Business Taxes	1,059.9	1,121.0	16.0%	16.0%				

"Government drains more than 12 percent of gross labor income and 21 percent of gross capital income through employer payroll taxes, corporate income taxes, and indirect business taxes."

Table 3b Distribution of Income from Private Business Output, 1998 & 1999

Households pay other tolls directly to government. But before we get to them, let us look at the sources and uses of funds for the remaining producer sectors.

While private business is far and away the biggest producer, the other sectors — government enterprises, domiciles, institutions, and general government — make up almost a fourth of the economy. Because all of them hire labor services through the market, the labor income items in the sources-and-uses tables that follow are similar to those for private business.

Where they differ is with regard to capital services. Capital income in private business is, in essence, profit. Because none of the other producer sectors operate as for-profit entities, they generate no capital income as measured by market transactions. To figure out what these other sectors contribute to GDP, Commerce must impute capital income, based largely on the physical assets each owns. What is more, because this imputed capital income does not go through a market, there are no direct income taxes on it.

Sources and Uses of Other Producer Funds

Government Enterprises

Table 4a Sources & Uses of Government Enterprise Funds, 1998 & 1999

U.S. Department of Commerce, National Income and Product Accounts, Tables 1.9, 1.15, 1.16 & 8.19, April 2000. Italicized line items are untaxable and would likely never enter into a tax base. Government enterprises generally consist of government-operated businesses that provide commercial services. Funds received by government enterprises represent the value of the goods and services sold by entities such as the Postal Service, Tennessee Valley Authority and state-controlled liquor stores, less the cost of intermediate goods. [See Table 4a for sources and uses of government enterprise funds.]

Sources & Uses of Government Enterprise Funds, 1998 & 1999							
	\$billions		% Government Enterpris GDP				
Sources	1998	1999	1998	1999			
Total sources of government enterprise funds	164.6	175.6	100.0%	100.0%			
Gross domestic product, government enterprises	164.6	175.6	100.0%	100.0%			
Uses							
Total uses of government enterprise funds	164.6	175.6	100.0%	100.0%			
Gross labor income	97.3	102.7	59.1%	58.5 %			
Compensation of employees	97.3	102.7	59.1%	58.5 %			
Wages and salaries	71.4	74.9	43.4%	42.6%			
Employer contributions for social insurance	1.8	2.0	1.1%	1.1%			
Other labor income	24.1	25.9	14.6%	14.7%			
Gross capital income	67.3	72.9	40.9%	41.5%			
Current surplus of government enterprises	41.4	51.4	25 .1%	29.3 %			
Consumption of government enterprise fixed capital	27.8	29.5	16.9%	16.8%			
Federal reserve bank profits after tax	(1.8)	(8.0)	-1.1%	-4.6 %			

About 60 percent of government enterprise funds are used to compensate the workers they hire. In 1999, employees received 98 percent of gross labor income directly in wages and salaries (\$74.9 billion) and fringe benefits (\$25.9 billion). The remaining 2 percent went to government for the employer share of payroll taxes (\$2.0 billion).⁴ Because the output of government enterprises is not taxed, there are no indirect business taxes to allocate to labor. [See Table 4b for the distribution of income from government enterprises.]

Distribution of Income from Government Enterprises, 1998 & 1999							
	\$billions		% of Government Enterprise GDP		% In	come	
	1998	1999	1998	1999	1998	1999	
Government enterprises GDP	164.6	175.6	100.0%	100.0%			
Gross Labor Income	97.3	102.7	59.1%	58.5 %	100.0%	100.0%	
less Subsidies	0.0	0.0	0.0%	0.0%	0.0%	0.0%	
less Employer payroll taxes	(1.8)	(2.0)	1.1%	1.1%	1.9%	1.9%	
less Indirect business taxes	0.0	0.0	0.0%	0.0%	0.0%	0.0%	
equals Labor Income after Business Taxes	95.5	100.8	58.0%	57.4%	98.1 %	98.1 %	
Gross Capital Income	67.3	72.9	40.9%	41.5%	100.0%	100.0%	
less Subsidies	0.0	0.0	0.0%	0.0%	0.0%	0.0%	
less Corporate income taxes	0.0	0.0	0.0%	0.0%	0.0%	0.0%	
less Indirect business taxes	0.0	0.0	0.0%	0.0%	0.0%	0.0%	
equals Capital Income after Business Taxes	67.3	72.9	40.9%	41.5%	100.0%	100.0%	
Government Business Taxes	1.8	2.0	1.1%	1.1%			

The capital income that Commerce imputes to government enterprises consists of any funds over and above operating expenses (\$51.4 billion) plus depreciation (\$29.5 billion) less the interest income that the Federal Reserve retains for its operations (\$8 billion).⁵ There are no direct or indirect taxes on the capital income of government enterprises.

Domicile output consists of the labor services supplied by domestics, such as housekeepers, cooks and baby sitters, plus the value of capital services received by people who own their homes. Commerce imputes this value as the sum of mortgage interest, property taxes, depreciation and an assumed rate of return on the stock of housing occupied by owners.

Table 4b Distribution of Income from Government Enterprises, 1998 & 1999

Domiciles

The items under "gross labor income" are similar to those for government enterprises and private businesses. Only 0.1 percent of the \$15.9 billion in gross labor income in 1999 went for the employer's share of payroll taxes. The reason is that individuals who hire domestics tend not to withhold taxes or provide fringe benefits. [See Tables 5a and 5b for sources, uses, and distribution of domicile funds.]

Sources & Uses of Funds for Domiciles, 1998 & 1999								
	\$bil	lions	% Domi	cile GDP				
Sources	1998	1999	1998	1999				
Total sources of domicile funds	557.8	594.3	100.00%	100.00%				
Domicile GDP	557.8	594.3	100.00%	100.00%				
Subsidies to owner-occupied nonfarm housing	0.0	0.0	0.00%	0.00%				
Uses								
Total uses of domicile funds	557.8	594.3	100.00%	100.00%				
Gross labor income	14.0	15.9	2.5%	2.7%				
Compensation of employees	14.0	15.9	2.5%	2.7%				
Wages and salaries	13.6	14.6	2.4%	2.5%				
Employer contributions for social insurance	0.3	1.3	0.1%	0.2%				
Other labor income	0.0	0.0	0.0%	0.0%				
Gross capital income	543.8	578.4	97.5 %	97.3 %				
Income from owner-occupied housing	<i>543.8</i>	578.4	97.5 %	97.3 %				
Proprietors' and rental income	85.9	91.4	15.4%	15.4%				
Net interest paid	266.7	283.7	47.8%	47.7%				
Consumption of fixed capital	101.0	107.4	18.1%	18.1%				
Indirect business tax and nontax liability	90.2	95.9	16.2%	16.1%				

Table 5a Sources & Uses of Funds for Domiciles, 1998 & 1999

U.S. Department of Commerce, National Income and Product Accounts, Tables 1.7, 6.3 & 8.19, April 2000. Italicized line items are untaxable and would likely never enter into a tax base

Distribution of Income from Domiciles, 1998 & 1999							
	\$billions		% of Dom	nicile GDP	% Income		
	1998	1999	1998	1999	1998	1999	
Domicile GDP	557.8	594.3	100.0%	100.0%			
Gross Labor Income	14.0	15.9	2.5%	2.7%	100.0%	100.0%	
less Subsidies	0.0	0.0	0.0%	0.0%	0.0%	0.0%	
less Employer payroll taxes	(0.3)	(1.3)	0.1%	0.2%	2.4%	8.0%	
less Indirect business taxes	0.0	0.0	0.0%	0.0%	0.0%	0.0%	
equals Labor Income after Business Taxes	13.7	14.6	2.4%	2.5%	97.6 %	92.0 %	
Gross Capital Income	543.8	578.4	97.5 %	97.3 %	100.0%	100.0%	
less Subsidies	0.0	0.0	0.0%	0.0%	0.0%	0.0%	
less Corporate income taxes	0.0	0.0	0.0%	0.0%	0.0%	0.0%	
less Indirect business taxes	(90.2)	(95.9)	16.2%	16.1%	16.6%	16.6%	
equals Capital Income after Business Taxes	453.6	482.5	97.5 %	97.3 %	83.4%	83.4%	
Government Taxes	90.5	97.2	16.2%	16.4%			

Table 5b Distribution of Income from Domiciles, 1998 & 1999

Institutions

Domicile capital, which accounts for almost 98 percent of domicile GDP, is the value of services that homeowners receive from their homes as imputed by Commerce. Because this income does not go through a market, it is not, and likely never will be, taxed directly. Homes, however, are subject to indirect taxation through property taxes levied on asset values.

In 1999, of the \$578.4 billion imputed to owner-occupied capital income, about half went for mortgage interest (\$283.7 billion). After depreciation (\$107.4 billion) and property taxes (\$95.9 billion), homeowners received a net income, albeit imputed, of \$91.4 billion.

Labor services accounted for 87 percent of the \$448.9 billion in output produced by institutions, such as hospitals, schools, and churches. In 1999, of the \$392.4 billion in gross labor income, 93 percent went for wages and salaries (\$339.1 billion) and fringe benefits (\$27.1 billion). The rest went to government for the employer share of payroll taxes (\$26.2 billion). Because nonprofit institutions either do not charge for their goods and services or have tax-exempt status, there are no indirect business taxes on output and therefore none on labor.⁶

For the same reason, Commerce must impute capital income to the nonprofit sector based on the physical assets it owns. Almost two-thirds of the \$56.5 billion in gross capital income estimated for 1999 was for depreciation (\$35.7 billion). Net interest on nonprofit capital amounted to \$16.3 billion and property taxes to \$4.5 billion. [See Tables 6a and 6b for sources, uses, and distribution of institution funds.]

Table 6a Sources & Uses of Funds for Institutions, 1998 & 1999

U.S. Department of Commerce, National Income and Product Accounts, Tables 1.7& 8.19, March 2000. Italicized line items are untaxable and would likely never enter into a tax base.

Table 6b Distribution of Income from Institutions, 1998 & 1999

Sources & Uses of Funds for Institutions, 1998 & 1999								
	\$bil	lions	% Institu	tion GDP				
Sources	1998	1999	1998	1999				
Total sources of institution funds	425.0	448.8	100.0%	100.0%				
Institution GDP	425.0	448.8	100.0%	100.0%				
Uses								
Total uses of institution funds	425.1	448.9	100.0%	100.0%				
Gross labor income	371.6	392.4	87.4%	87.4%				
Compensation of employees	371.6	392.4	87.4%	87.4%				
Wages and salaries	316.6	339.1	74.5%	75.6%				
Employer contributions for social insurance	26.5	26.2	6.2%	5.8%				
Other labor income	28.6	27.1	6.7%	6.0%				
Gross capital income	53.5	56.5	12.6%	12.6%				
Consumption of nonprofit fixed capital	33.8	35.7	8.0 %	8.0%				
Indirect business taxes on nonprofit capital	4.3	4.5	1.0%	1.0%				
Net interest on nonprofit capital	15.4	16.3	3.6%	3.6%				

Distribution of Income from Institutions, 1998 & 1999								
	\$billions		% of Institution GDP		% Income			
	1998	1999	1998	1999	1998	1999		
Institution GDP	425.0	448.8	100.0%	100.0%				
Gross Labor Income	371.6	392.4	87.4%	87.4%	100.0%	100.0%		
less Subsidies	0.0	0.0	0.0%	0.0%	0.0%	0.0%		
less Employer payroll taxes	(26.5)	(26.2)	6.2%	5.8%	7.1%	6.7%		
less Indirect business taxes	0.0	0.0	0.0%	0.0%	0.0%	0.0%		
equals Labor Income after Business Taxes	345.1	366.2	81.2 %	81.6%	92.9%	93.3%		
Gross Capital Income	53.5	56.5	12.6%	12.6%	100.0%	100.0%		
less Subsidies	0.0	0.0	0.0%	0.0%	0.0%	0.0%		
less Corporate income taxes	0.0	0.0	0.0%	0.0%	0.0%	0.0%		
less Indirect business taxes	(4.3)	(4.5)	1.0%	1.0%	8.0%	8.0%		
equals Capital Income after Business Taxes	49.2	52.0	12.6%	12.6%	92.0%	92.0%		
Government Taxes	30.8	30.7	7.2%	6.8%				

General Government

General government consists of the functions normally associated with government — defense, police, education, welfare, etc. Government's ability to tax other sectors, however, complicates the sources-and-uses analysis followed so far.

Taxes, which amounted to \$2,822.5 billion in 1999, account for 99 percent of the funds received by government. But government's contribution to economic activity amounts to little more than a third of its income. Commerce measures government GDP as the value of labor services hired (\$852.3 billion) plus the imputed depreciation on the physical assets owned by government (\$166.8 billion). [See Table 7a for sources and uses of general government funds.]

Transfer payments for social security, medicare, and other welfare programs (\$999.2 billion) amount to almost as much as government GDP. About 11 percent of general government funds go to purchase goods and services from the private sector such as consultants, contractors, or vaccines distributed through

Sources & Uses of General Government Funds, 1998 & 1999							
	\$bil	lions	% Government GDP				
Sources	1998	1999	1998	1999			
Total sources of general government funds	2,659.5	2,840.1	273.5%	278.7 %			
Receipts	2,644.4	2,822.5	272.0%	277.0%			
Personal tax and nontax receipts	1,105.2	1,188.6	113.7%	116.6%			
Corporate profits tax accruals	240.2	259.4	24.7%	25.5%			
Indirect business tax and nontax accruals	677.0	716.3	69.6%	70.3%			
Contributions for social insurance	621.9	658.2	64.0%	64.6%			
Dividends received by government	0.3	0.3	0.0%	0.0%			
Current surplus of government enterprises	14.8	17.3	1.5%	1.7%			
Uses		% Government Ince					
Total uses of general government funds	2,659.5	2,840.2	100.0%	100.0%			
Consumption expenditures	1,261.0	1,332.2	47.4%	46.9 %			
General government GDP	972.3	1,019.0	36.6%	35.9%			
Compensation of employees	813.8	852.3	30.6%	30.0%			
Wages and salaries	622.3	652.6	23.4%	23.0%			
Employer contributions for social insurance	13.6	14.3	0.5%	0.5%			
Other labor income	177.9	185.5	6.7%	6.5%			
Consumption of general government fixed capital	158.6	166.8	6.0%	5.9%			
Other consumption of goods and services	288.7	313.2	10.9%	11.0%			
Transfer payments (net)	965.2	999.2	36.3%	35.2%			
To persons							
To rest of world (net)							
Net interest paid	276.4	262.1	10.4%	9.2%			
Subsidies	35.6	43.8	1.3%	1.5%			
Current surplus or deficit (-), NIPA	121.3	202.9	4.6%	7.1%			

Table 7a Sources & Uses of General Government Funds, 1998 & 1999

U.S. Department of Commerce, National Income and Product Accounts, Tables 1.7, 1.9, 1.15 & 3.1, April 2000. Italicized line items are untaxable and would likely never enter into a tax base.

public health agencies. Another 10 percent pays interest on publicly held debt and a little more than 1 percent goes for subsidies.⁷ The difference between what general government takes in and what it spends is the current surplus or deficit. In 1999, federal, state and local governments ran a combined surplus of \$202.9 billion, or 7.1 percent of total funds received. [See Table 7b for the distribution of income from general government.]

Distribution of Income from General Government, 1998 & 1999									
	\$billions		% of Go G	vernment DP	% In	come			
	1998	1999	1998	1999	1998	1999			
General government GDP	972.3	1,019.0	100.0%	100.0%					
Gross Labor Income	813.8	852.3	83.7%	83.6%	100.0%	100.0%			
less Subsidies	0.0	0.0	0.0%	0.0%	0.0%	0.0%			
less Employer payroll taxes	(13.6)	(14.3)	-1.4%	-1.4%	-1.7%	-1.7%			
less Indirect business taxes	0.0	0.0	0.0%	0.0%	0.0%	0.0%			
equals Labor Income after Business Taxes	800.2	838.0	82.3%	82.2%	98.3 %	98.3 %			
Gross Capital Income	158.5	166.7	16.3%	16.4%	100.0%	100.0%			
less Subsidies	0.0	0.0	0.0%	0.0%	0.0%	0.0%			
less Corporate income taxes	0.0	0.0	0.0%	0.0%	0.0%	0.0%			
less Indirect business taxes	0.0	0.0	0.0%	0.0%	0.0%	0.0%			
equals Capital Income after Business Taxes	158.5	166.7	16.3%	16.4%	100.0%	100.0%			
Government Taxes	13.6	14.3	1.4%	1.4%					

Table 7b Distribution of Income from General Government, 1998 & 1999 The only tax paid by general government is the employer share of the payroll tax, which amounted to \$14.3 billion in 1999.⁸ As with all producers except private businesses, there are no direct taxes on capital income. As with government enterprises, there are no indirect taxes on labor or capital.

Total Economy

Capital income, labor income, and taxes at the business level for the U.S. economy are simply the sums of those categories for the five producer sectors we have just looked at individually. In 1999, 60 percent of total economic activity (\$9,256.2 billion in GDP) went to pay labor for its services and 40 percent went to compensate capital. [See Table 8, which restates the 1999 dollar amounts from the "Distribution of Income" tables for each sector.]

Table 8
Summary: Distribution of
Income from GDP, 1999

"Government siphoned off almost \$1.3 trillion, or 13.7 percent of GDP, through taxes paid at the business level."

Summary: Distribution of Income from GDP, 1999									
	Tota	al U.S. Econ	omy	Amounts in \$billions from Tables 3b, 4b, 5b, 6b an					
	\$billions	% of GDP	%Income	Private Business	Government Enterprises	Domiciles	Institutions	General Government	
GDP	9,256.2	100.0%		7,018.5	175.6	594.3	448.8	1,019.0	
Gross Labor Income	5,558.5	60.1 %	100.0%	4,195.2	102.7	15.9	392.4	852.3	
less Subsidies	(28.9)	-0.3%	-0.5%	(28.9)	0.0	0.0	0.0	0.0	
less Employer payroll taxes	(323.6)	-3.5%	-5.8%	(279.9)	(2.0)	(1.3)	(26.2)	(14.3)	
less Indirect business taxes	(228.0)	-2.5%	-4.1%	(228.0)	0.0	0.0	0.0	0.0	
equals Labor Income after Business Taxes	4,978.0	53.8 %	89.6 %	3,658.4	100.8	14.6	366.2	838.0	
Gross Capital Income	3,741.6	40.4%	100.0%	2,867.1	72.9	578.4	56.5	166.7	
less Subsidies	(14.9)	-0.2%	-0.3%	(14.9)	0.0	0.0	0.0	0.0	
less Corporate income taxes	(225.3)	-2.4%	-6.0%	(225.3)	0.0	0.0	0.0	0.0	
less Indirect business taxes	(488.3)	-5.3%	-13.1%	(387.8)	0.0	(95.9)	(4.5)	0.0	
equals Capital Income after Business Taxes	3,013.1	32.6%	80.5%	2,239.1	72.9	482.5	52.0	166.7	
Government Business Taxes	1,265.2	13.7%		1,121.0	2.0	97.2	30.7	14.3	

But not all of that compensation made it back to the households which provided labor and capital services. Regardless of the label, all taxes were paid out of income earned by the factors of production, labor and capital. In 1999, payroll taxes collected from employers and indirect business taxes on labor reduced the amount of labor income available for distribution to workers by 9.9 percent. Corporate income taxes and indirect business taxes on capital lowered the amount of capital income available for distribution to investors, savers and entrepreneurs by 19.1 percent. All in all, government siphoned off almost \$1.3 trillion, or 13.7 percent of GDP, through taxes paid at the business level.

Sources and Uses of Personal Income

We have just seen how the funds producers receive from selling output are dispersed to the factors that produced it and to government for taxes collected at the business level. To complete the analysis, we now turn to households to look at what happens to the income, referred to as *personal income*, they receive.

In 1999, U.S. personal income totaled \$8,126.3 billion. Compensation for labor services accounted for about 61.6 percent and capital compensation 25.8 percent. [See Table 9a for sources and uses of personal income.]

Transfer payments make up the remaining 12.5 percent of personal income. Almost all come from government programs like social security, medicare, and welfare paid for through taxes imposed on capital and labor income.⁹

Before going further, we should reconcile personal income with the labor and capital income paid out by U.S. producers shown in Table 8. As Table 9b shows, there is a minor difference between labor income after business taxes (\$4,978 billion) and the component of personal income derived from labor services (\$5,008.1 billion). The latter subtracts labor income that U.S. businesses paid to foreigners and adds labor income that U.S. households received from foreign producers.

Personal saving	197.1	119.8	2
Personal transfer payments to the r.o.w. (net)	22.3	24.3	0
Reconciling Personal In	come and	Factor Inco	me, '
Gross Labor Income (Table 8, line 2)			
less Subsidies			
less Employer payroll taxes			
less Indirect business taxes			
equals Labor Income after Business Taxes			
plus Other adjustments*			
equals Compensation for Labor Services (Table 9a	a, line 2)		
Gross Capital Income (Table 8, line 7)			
less Subsidies			
less Corporate income taxes			
less Indirect business taxes			
equals Capital Income after Business Taxes			
less Consumption of fixed capital			
less Government surpluses			
plus Other adjustments*			
equals Compensation for Capital Services (Table	9a, line 5)		

Sources & Uses of Personal Income, 1998 & 1999

999

\$billions

5,558.5

(28.9)

(323.6)

(228.0)

4,978.0 30.1 5,008.1 3,741.6 (14.9) (225.3) (488.3) 3,013.1 (1,135.8) (246.3) 469.0 2,100.0

	\$DI	llions	% Person	al income
Sources	1998	1999	1998	1999
Total sources of personal income	7,674.9	8,126.3	100.0%	100.0%
Compensation for Labor Services	4,701.7	5,008.1	61.3%	61.6%
Wage and salary disbursements	4,186.0	4,472.3	54.5%	55.0%
Other labor income	515.7	535.8	6.7%	6.6%
Compensation for Capital Services	1,989.6	2,100.0	25.9%	25.8%
Proprietors' income with IVA and CCA	606.1	658.5	7.9%	8.1%
Rental income of persons with CCA	137.4	145.9	1.8%	1.8%
Personal dividend income	348.3	364.3	4.5%	4.5%
Personal interest income	897.8	931.3	11.7%	11.5%
Transfer payments to persons	983.6	1,018.2	12.8%	12.5%
Uses				
Total uses of personal income	7,674.8	8,126.3	100.0%	100.0%
Personal consumption expenditures	5,848.6	6,257.3	76.2 %	77.0%
Taxes Paid by Individuals	1,421.1	1,523.2	18.5 %	18.7%
Personal contributions for social insurance	315.9	334.6	4.1%	4.1%
Personal tax and nontax payments	1,105.2	1,188.6	14.4%	14.6%
Interest paid by persons	185.7	201.7	2.4%	2.5%
Personal saving	197.1	119.8	2.6%	1.5%
Personal transfer payments to the r.o.w. (net)	22.3	24.3	0.3%	0.3%

Table 9a Sources & Uses of Personal Income, 1998 & 1999

Table 9b Reconciling Personal Income and Factor Income, 1999

Several adjustments reconcile the bigger gap between capital income after business taxes (\$3,013.1 billion) and personal income derived from capital services (\$2,100 billion). The largest single item is the consumption of fixed capital (\$1,135.8 billion), which represents how much is needed to replace existing plant and equipment that has worn out or become obsolete. Also removed are government surpluses (\$246.3 billion). Added back are adjustments of \$469 billion, which largely represent tax payments to foreign governments.

We have already accounted for taxes collected at the business level. Now let us see what households pay by returning to the uses of personal income in Table 9a. Individuals spent over three-fourths of personal income on the purchase of goods and services. Taxes claimed another 18.7 percent. In 1999, the employee portion of payroll taxes reduced labor income by \$334.6 billion. Personal tax and nontax payments, like the individual income tax and estate taxes, totaled \$1,188.6 billion and were split roughly 70-30 between labor and capital.¹⁰ After consumption and taxes, people were able to save only 1.5 percent of their income.

U.S. Department of Commerce, National Income and Product Accounts, Table 2.1, April 2000.

^{*} Includes income earned abroad and foreign taxes paid.

Part III: Tax Rates under the Current System

Identifying Taxes on Labor and Capital

Table 10 Taxes on Labor and Capital

"While people talk about taxing 'consumption' or 'wealth,' the simple fact is that taxes can be paid only out of income." Federal, state, and local governments impose taxes at a number of points in the economy. Businesses write checks for corporate income taxes, excise and other indirect business taxes, and the employer portion of social insurance taxes. Individuals write checks for personal income taxes and the employee share of payroll taxes. Yet, as we have seen, those taxes ultimately must be paid out of the income earned by the factors — capital and labor — that produced the real goods and services sold in the marketplace.

While people talk about taxing "consumption" or "wealth," the simple fact is that taxes can be paid only out of income. When government taxes the purchase of clothing, it does not accept a shirt or pair of socks as payment. Rather, part of the total purchase price that would otherwise go to the producer, and ultimately to labor and capital, goes to government. In other words, taxes raise the cost of producing goods and services and reduce the take-home pay of workers and the return to owners of capital. Because factor payments — wages, dividends, interest, profits, etc. — are the only tax bases that government can draw upon, all taxes are paid out of the income going to capital and labor.

In 1999, government at all levels collected taxes from the income of labor and capital amounting to \$2.7 trillion.¹¹ Because almost two out of every three dollars of income generated in the economy arises from labor services, 61 percent of these taxes fell on income earned from labor and 39 percent on income earned from capital. [See Table 10 for a listing of taxes on labor and capital and Appendix Table A for taxes on labor

	Taxes on Labor and Capital
Туре	Description
Labor Taxes	
Personal taxes	Individual income tax on wages and salaries
Payroll taxes	Social security and Hospital Insurance; unemployment insurance; worker's compensation; railroad retirement
Indirect business taxes on output	Labor's share (about 2/3) of sales and excise taxes
Capital Taxes	
Personal taxes	Individual income tax on interest, dividends, capital gains, rent, royalties, unincorporated business income; estate and gift taxes
Corporate income	Corporate income tax; franchise taxes; gross receipts taxes
Indirect business taxes on capital	Taxes on business property including severance taxes, Outer Continental Shelf royalties and deposit insurance premiums; property taxes on homeowner housing
Indirect business taxes on output	Capital's share (about 1/3) of sales and excise taxes

and capital by producer.]

Federal taxes (\$1,832.1 billion) accounted for two-thirds of the total. Personal taxes, which consist of income taxes and estate taxes that individuals pay, were the most important revenue source, accounting for 49.5 percent (34.4% on labor and 15.1% on capital) of all federal taxes.¹² Next came payroll taxes which amounted to 34.2 percent. Corporate income taxes raised 10.8 percent of all federal revenue while excise taxes raised 5.5 percent. Because of the sizable payroll tax needed to fund social security and medicare, 71.4 percent of federal taxes were paid out of labor income. [See Table 11 for a ranking of taxes by type and by producer.]

State and local governments collected \$885 billion in 1999. Indirect business taxes accounted for 69.5 percent of revenues. Thanks to the heavy reliance on property taxes, almost half were on capital. Labor's share of indirect business taxes on output amounted to 21 percent. Personal taxes accounted for a fourth of the revenues

Ranking of Taxes on Labor (L) and Capital (K) as Revenue Sources by Producer and Level of Government, 1999

All Government		Federal		State and Local	
		All Producers			
Personal taxes L	28.8%	Personal taxes L	34.4%	Indirect business taxes K	48.5%
Payroll taxes L	23.4%	Payroll taxes L	34.2%	Indirect business taxes L	21.0%
Indirect business taxes K	17.6%	Personal taxes K	15.1%	Personal taxes L	17.1%
Personal taxes K	12.8%	Corporate income K	10.8%	Personal taxes K	8.0%
Indirect business taxes L	8.7%	Indirect business taxes L	2.8%	Corporate income K	4.2%
Corporate income K	8.6%	Indirect business taxes K	2.7%	Payroll taxes L	1.3%
All Taxes	100.0%	All Federal Taxes	100.0%	All State & Local Taxes	100.0%
		Private Business			
Personal taxes L	21.9%	Payroll taxes L	30.4%	Indirect business taxes K	37.2%
Payroll taxes L	20.8%	Personal taxes L	26.1%	Indirect business taxes L	21.0%
Personal taxes K	14.9%	Personal taxes K	17.6%	Personal taxes L	13.3%
Indirect business taxes K	13.9%	Corporate income K	10.8%	Personal taxes K	9.2%
Indirect business taxes L	8.7%	Indirect business taxes L	2.8%	Corporate income K	4.2%
Corporate income K	8.6%	Indirect business taxes K	2.7%	Payroll taxes L	0.9%
All Taxes	88.9%	All Federal Taxes	90.5%	All State & Local Taxes	85.6%
		General Government			
Personal taxes L	4.1%	Personal taxes L	5.0%	Personal taxes L	2.3%
Payroll taxes L	0.7%	Payroll taxes L	0.8%	Payroll taxes L	0.3%
Indirect business taxes L	0.0%	Indirect business taxes L	0.0%	Indirect business taxes L	0.0%
Personal taxes K	0.0%	Personal taxes K	0.0%	Personal taxes K	0.0%
Corporate income K	0.0%	Corporate income K	0.0%	Corporate income K	0.0%
Indirect business taxes K	0.0%	Indirect business taxes K	0.0%	Indirect business taxes K	0.0%
All Taxes	4.8%	All Federal Taxes	5.9%	All State & Local Taxes	2.6%
		Institutions			
Personal taxes L	2.2%	Payroll taxes L	2.7%	Personal taxes L	1.2%
Payroll taxes L	1.8%	Personal taxes L	2.6%	Indirect business taxes K	0.5%
Indirect business taxes K	0.2%	Personal taxes K	0.0%	Payroll taxes L	0.1%
Personal taxes K	0.0%	Corporate income L	0.0%	Personal taxes K	0.0%
Corporate income K	0.0%	Corporate income K	0.0%	Corporate income K	0.0%
Indirect business taxes L	0.0%	Indirect business taxes K	0.0%	Indirect business taxes L	0.0%
All Taxes	4.2%	All Federal Taxes	5.3%	All State & Local Taxes	1.8%
		Government Enterprises			
Personal taxes L	0.5%	Personal taxes L	0.6%	Personal taxes L	0.3%
Payroll taxes L	0.1%	Payroll taxes L	0.1%	Payroll taxes L	0.0%
Indirect business taxes L	0.0%	Indirect business taxes L	0.0%	Indirect business taxes L	0.0%
Personal taxes K	0.0%	Personal taxes K	0.0%	Personal taxes K	0.0%
Corporate income K	0.0%	Corporate income K	0.0%	Corporate income K	0.0%
Indirect business taxes K	0.0%	Indirect business taxes K	0.0%	Indirect business taxes K	0.0%
All Taxes	0.6%	All Federal Taxes	0.7%	All State & Local Taxes	0.3%
		Domicilies			
Indirect business taxes K	3.5%	Payroll taxes L	0.1%	Indirect business taxes K	10.8%
Personal taxes L	0.1%	Personal taxes L	0.1%	Personal taxes L	0.1%
Payroll taxes L	0.1%	Indirect business taxes L	0.0%	Payroll taxes L	0.0%
Corporate income K	0.0%	Corporate income K	0.0%	Corporate income K	0.0%
Indirect business taxes L	0.0%	Indirect business taxes K	0.0%	Indirect business taxes L	0.0%
Personal taxes K	-2.1%	Personal taxes K	-2.6%	Personal taxes K	-1.2%
All Taxes	1.6%	All Federal Taxes	-2.4%	All State & Local Taxes	9.7%

Table 11

Ranking of Taxes on Labor (L) and Capital (K) as Revenue Sources by Producer and Level of Government, 1999

- Calculations based on data in Appendix Table A.
- L indicates tax comes out of labor compensation; K indicates tax comes out of capital compensation.

The subsidies (negative taxes) that show up under domicile capital result from income tax deductions allowed for mortgage and other costs of owner-occupied housing. (17.1% on capital and 8% on labor). Corporate income (4.2%) and payroll taxes (1.3%) made up the remaining 5.5 percent.

Labor and capital in private business, which accounts for three-fourths of the economy, paid 90.5 percent of the federal tax tab. Private businesses made up a little less (85.6%) of state and local taxes because of property taxes paid by homeowners. An interesting note is that the mortgage and other deductions afforded homeowners at



Figure 1 Share of GDP and Taxes by Producer

the federal level fall far short of the property taxes they pay to states and localities.¹³ [See Figure 1 for taxes by producer.]

Tax Rates on Labor and Capital

The facts and figures presented so far were a necessary prelude to what follows. While there are several ways to measure total economic activity, we have focused on factor income because all taxes ultimately must be paid out of income earned by labor or capital. Previous sections have: (1) defined GDP in terms of the income going to capital and labor and (2) identified the various federal, state and local taxes each factor currently pays. Using this information, we have produced measures of the tax burden imposed by the current system.

Table 12 shows average tax rates on labor and capital income for the five producer sectors.¹⁴ On average, taxes reduce the income that would otherwise go to workers in private businesses by a third. Domestic workers and those in

Average Tax Ra	ates on	Capita	al and I	Labor l	ncome	by Ma	jor Pro	ducer,	1998	f 1999
	Private I	Private Business		Domiciles		Institutions		Government Enterprises		eral nment
	1998	1999	1998	1999	1998	1999	1998	1999	1998	1999
Capital	47.5%	49.1 %	8.1%	8.0%	26.2 %	26.4 %	na	na	na	na
Federal	26.3%	27.6%	-10.1%	-10.2%	3.6%	3.7%	na	na	na	na
State and local	21.2%	21.6%	18.2%	18.2%	22.6%	22.7%	na	na	na	na
Labor	33.2%	33.3%	22.4%	22.7%	28.1%	27.6 %	14.8%	14.9%	15.2%	15.3%
Federal	25.8%	25.9%	19.3%	19.6%	25.2%	24.8%	12.2%	12.3%	12.5%	12.6%
State and local	7.3%	7.4%	3.1%	3.1%	2.9%	2.9%	2.6%	2.6%	2.7%	2.7%
Total Factor Income	38.0%	38.5%	8.5%	8.5%	28.0%	27.6 %	na	na	na	na
Federal	26.0%	26.5%	-9.2%	-9.2%	24.1%	23.7%	na	na	na	na
State and local	12.0%	12.1%	17.7%	17.7%	3.9%	3.9%	na	na	na	na

Table 12Average Tax Rates onCapital and Labor Incomeby Major Producer, 1998& 1999

Appendix Table A contains the tax amounts. Labor and capital income are from Tables 3a, 4a, 5a, 6a and 7a. Labor income is gross labor income while capital income is gross capital income less consumption of fixed capital.



Figure 2 Average Tax Rates on Labor by Producer

"Prices depend on the cost of producing the last, not the average, unit of output."

nonprofit institutions face average tax rates of around 25 percent. Government and government enterprise workers are taxed around 15 percent. [See Figure 2 for average tax rates on labor by producer.]

Taxes claim almost half the income that would otherwise go to the savers, investors, and entrepreneurs who provide capital services to the private sector. More than a fourth of the capital income imputed to nonprofits goes to taxes, primarily property taxes. Homeowners pay almost 9 percent of the imputed income from their homes, with federal subsidies offsetting more than half of state and local property taxes. Neither capital in government enterprises nor capital in general government pays any tax. [See Figure 3 for average tax rates on capital by producer.]

For the private sector as a whole, taxes amount to 38.5 percent of total factor income. Put another way, government claims in taxes almost 39 cents out of every dollar of goods and services produced, with two-thirds of that going to the federal government.



Figure 3 Average Tax Rates on Capital by Producer

Note: Government enterprises and general government have no capital income to tax. The negative federal tax rate on domiciles is due to the income tax deduction for mortgage interest and property taxes.

Marginal Tax Rates Are Even Higher

While these average tax rates are high, marginal rates — that is, the tax on the *next* dollar of income produced by working or running a machine another hour — are even higher. Marginal tax rates are especially important because prices depend on the cost of producing the *last*, not the average, unit of output.

Marginal tax rates on labor are roughly a third higher than the average rates. In 1999, workers in the private sector had to give back 44.4 percent in taxes out of their next dollar of labor income. Those employed as domestics faced a marginal rate of 35.3 percent, while those employed by nonprofit institutions paid 39.5 percent. Because many state and local government employees do not pay social security taxes, government workers face much lower marginal rates of roughly 25 percent. [See Table 13, Figure 4 and Figure 5 for marginal tax rates by major producer.]

Marginal Tax Bates on Capital and Labor Income by Major Producer

1998 & 1999										
	Private	Private Business		ess Domiciles		Institutions		nment prises	General Government	
	1998	1999	1998	1999	1998	1999	1998	1999	1998	1999
Capital Income	58.5%	60.6%	-1.4%	-1.9%	28.7%	29.0%	na	na	na	na
Federal	35.8%	37.6%	-18.4%	-18.8%	5.8%	6.0%	na	na	na	na
State and local	22.6%	23.0%	17.0%	16.9%	23.0%	23.0%	na	na	na	na
Labor Income	43.9%	44.4%	35.5 %	35.3%	39.6 %	39.5 %	24.7%	24.9%	25.5%	25.8 %
Federal	35.2%	35.6%	30.7%	30.6%	35.2%	35.1%	20.8%	21.0%	21.5%	21.8%
State and local	8.7%	8.8%	4.8%	4.7%	4.4%	4.4%	3.9%	3.9%	4.0%	4.0%
Total Factor Income	48.8%	49.8 %	-0.3%	-0.3%	39.0%	39.0 %	na	na	na	na
Federal	35.4%	36.2%	-16.9%	-17.2%	33.7%	33.6%	na	na	na	na
State and local	13.4%	13.5%	16.6%	16.5%	5.3%	5.3%	na	na	na	na

Marginal tax rates on capital income are about a fourth higher than the average rates. Out of an extra dollar earned by private capital, 60.6 cents went to cover taxes versus 49.1 cents out of the average dollar. What is more, marginal tax rates on capital are about a third higher than those on labor.

Combining the marginal rates of both factors, taxes claim 50 cents out of every dollar in additional economic activity. Put another way, taxes make up half the costs of producing an extra unit of U.S. output.



Table 13Marginal Tax Rates onCapital and Labor Incomeby Major Producer,1998 & 1999

Appendix Table A, Tables 3a, 4a, 5a, 6a and 7a. Measures of marginal rates on types of income are from the Fiscal Associates Tax Model.

Figure 4 Marginal Tax Rates on Labor by Producer



Figure 5 Marginal Tax Rates on Capital by Producer

Note: Government enterprises and general government have no capital income to tax. The negative federal tax rate on domiciles is due to the income tax deduction for mortgage interest and property taxes.

The current systems of federal, state, and local taxes adversely affect the economy in at least two ways. First, both capital and labor pay higher rates on the next dollar of income than on the average dollar. Average tax rates decide the government's tax take, but marginal tax rates influence decisions to work, produce, and invest. The more marginal tax rates exceed the averages, the less the economy will use labor and capital, and the less output will be produced. A smaller economy means lower incomes and tax revenues. Conversely, economic disincentives decrease as marginal tax rates come closer to the averages, meaning more output and higher incomes and tax revenues.

Another inefficiency occurs if one factor is taxed more heavily than another. As we have seen, capital is presently taxed more heavily than labor. As a result, producers use less capital than they would if marginal rates on capital and labor were the same, leading to a less efficient mix of resources and lower output.



Economic Implications of Current Tax Rates



Conclusions

"Marginal tax rates that exceed average rates deter growth without bringing any additional revenue." Federal, state, and local governments impose taxes at many different points in the economy. Some taxes are levied on business, others on workers or owners of capital, and still others on purchases. Whatever the label, all taxes ultimately reduce the income that would otherwise go to labor and capital for producing goods and services.

Currently, on average, taxes take more than a third of what the U.S. economy produces. But, largely due to graduated income tax schedules, marginal rates claim almost half of the increases in output. While average rates determine what government will collect, economic expansion depends on the cost of producing the last unit. In other words, marginal tax rates that exceed average rates deter growth without bringing any additional revenue.

While American workers pay a lot in taxes, American capital pays even more. Ideally, technology and input costs, not taxes, should decide how much labor and capital is used. With taxes on capital about 40 percent higher than those on labor, our economy is not using the best mix of inputs. Simply taxing labor and capital at the same rate would lower production costs, improve economic efficiency, and increase output.

But, even if capital and labor are taxed at the same, uniform rate, there could still be problems. The critical issue of *what* is being taxed, that is, what is in the tax base, will be the topic of the next report in the series.

Endnotes

1

- See U.S. Department of Commerce, *Survey of Current Business*, December 1999 for the National Income and Product Accounts and a discussion of major revisions that included definition changes and a rebasing of the price deflator from 1992 to 1996.
- 2 NIPA includes the imputed value for income received from owner-occupied housing, which amounted to \$578.4 billion in 1999, as part of business output.
- 3 Table footnotes reference the NIPA data used in the creation of the sector T-accounts.
- 4 There are several reasons why this share is smaller than that of private business. First, many government workers are not covered by social security and do not pay FICA taxes. Second, before its 1999 NIPA revision, Commerce treated federal employee retirement plans like social security. Contributions along with interest and dividends counted as government receipts, and benefits were considered transfer payments to individuals. As long as the federal retirement program was solely pay-as-you-go, this treatment made some sense, though it did ignore the saving aspect of federal employee retirement. Federal employees hired after 1984 have a new retirement program that operates like a 401(k) or Individual Retirement Account (IRA), and many state and local governments have their own retirement systems.

NIPA now treats the old and new federal retirement programs the same as private pension plans. Contributions, interest, dividends and benefits paid are deleted from the government accounts and added to labor compensation. Doing so, reduces government savings and increases both personal income and personal savings.

- 5 Current surpluses of government enterprises are turned over to general government.
- 6 An unrelated business income tax (UBIT) is applied to the activities of nonprofits that directly compete with for-profit organizations.
- 7 The largest two categories of subsidies are agriculture and housing.
- 8 See footnote 6 for changes in how NIPA treats employer contributions to social insurance for government workers.
- 9 A small part comes from business as insurance payments, donations to nonprofits and losses suffered due to fraud and theft.
- 10 In the latest NIPA revision, Commerce has reclassified estate taxes as a transfer of capital from individuals to government instead of a tax. The effect is to lower the tax burden and raise savings. Because estate taxes, like any other tax, must be paid out of income, we add them back into personal taxes as Commerce used to do.
- 11 This amount is a little less than the \$2.8 trillion in Table 7a. The latter includes receipts such as fines, donations, personal license fees and unclaimed bank deposits which are difficult to assign to either labor or capital.
- 12 We attribute personal income taxes to labor and capital based on their respective shares of adjusted gross income from individual tax returns. Estate taxes fall on private business and domicile capital.
- 13 Property taxes on homes in 1999 amounted to \$95.9 billion, compared to income tax deductions worth \$47.9 billion at the federal government and \$10.2 billion at the state and local levels. See Appendix Table A.
- 14 The average rate on labor is labor taxes at the appropriate level of government divided by the gross labor income of each sector shown in Tables 3a, 4a, 5a, 6a and 7a. Similarly, the average rate on capital is capital taxes at the appropriate level of government divided by the gross capital income of each sector. Average rates on total factor income are weighted averages of labor and capital.

Table A

Appendix

Taxes on Labor and Capital by Major Production Sector, 1998 & 1999 (in \$billions)												
			All Pro	ducers					Private	Business		
	la	hor	Car	nital	То	tal	la	hor	Car	nital	To	tal
Type of Tax	1998	1999	1998	1999	1998	1999	1998	1999	1998	1999	1998	1999
Personal tax and nontax receipts	730.0	782.1	318.5	346.9	1,048.4	1,129.0	554.1	595.7	372.1	404.1	926.2	999.7
Federal	587.6	631.0	252.5	275.9	840.1	907.0	443.8	478.3	296.6	323.1	740.4	801.4
State and local	142.4	151.1	66.0	71.0	208.4	222.0	110.3	117.3	75.5	81.0	185.8	198.3
Corporate profits tax accruals	0.0	0.0	213.7	234.7	213.7	234.7	0.0	0.0	213.7	234.7	213.7	234.7
Federal	0.0	0.0	179.9	197.7	179.9	197.7	0.0	0.0	179.9	197.7	179.9	197.7
State and local	0.0	0.0	33.8	37.0	33.8	37.0	0.0	0.0	33.8	37.0	33.8	37.0
Indirect business tax and nontax accruals	218.8	237.2	458.1	479.2	676.9	716.4	218.8	237.2	363.6	378.7	582.4	615.9
Federal	48.7	51.8	48.6	49.7	97.3	101.5	48.7	51.8	48.6	49.7	97.3	101.5
State and local	170.2	185.4	409.4	429.5	579.6	614.9	170.2	185.4	314.9	329.0	485.1	514.4
Contributions for social insurance	601.9	637.0	0.0	0.0	601.9	637.0	532.0	564.7	0.0	0.0	532.0	564.7
Federal	591.1	625.9	0.0	0.0	591.1	625.9	524.4	556.9	0.0	0.0	524.4	556.9
State and local	10.8	11.1	0.0	0.0	10.8	11.1	7.5	7.8	0.0	0.0	7.5	7.8
Total	1,550.7	1,656.4	990.2	1,060.7	2,540.9	2,717.1	1,304.9	1,397.6	949.3	1,017.5	2,254.3	2,415.0
Federal	1,227.4	1,308.7	481.0	523.3	1,708.4	1,832.1	1,016.9	1,087.0	525.1	570.5	1,542.0	1,657.5
State and local	323.4	347.6	509.2	537.4	832.6	885.0	288.0	310.6	424.2	447.0	712.2	757.5
			Dom	iciles					Instit	utions		
	La	bor	Cap	oital	To	tal	La	bor	Caj	oital	To	tal
Type of Tax	1998	1999	1998	1999	1998	1999	1998	1999	1998	1999	1998	1999
Personal tax and nontax receipts	2.3	2.5	(54.5)	(58.1)	(52.1)	(55.6)	54.4	58.5	0.9	0.9	55.2	59.4
Federal	1.9	2.1	(44.8)	(47.9)	(42.9)	(45.9)	44.4	47.9	0.7	0.8	45.2	48.7
State and local	0.4	0.5	(9.7)	(10.2)	(9.3)	(9.8)	9.9	10.6	0.2	0.2	10.1	10.7
Corporate profits tax accruals	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Federal	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
State and local	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Indirect business tax and nontax accruals	0.0	0.0	90.2	95.9	90.2	95.9	0.0	0.0	4.3	4.5	4.3	4.5
Federal	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
State and local	0.0	0.0	90.2	95.9	90.2	95.9	0.0	0.0	4.3	4.5	4.3	4.5
Contributions for social insurance	0.8	1.1	0.0	0.0	0.8	2.4	50.1	50.0	0.0	0.0	50.1	50.0
Federal	0.8	1.1	0.0	0.0	0.8	2.4	49.3	49.2	0.0	0.0	49.3	49.2
State and local	0.0	0.0	0.0	0.0	0.0	0.0	0.8	0.7	0.0	0.0	0.8	0.7
Total	3.1	3.6	35.7	37.8	38.9	42.7	104.5	108.4	5.2	5.5	109.6	113.9
Federal	2.7	3.1	(44.8)	(47.9)	(42.1)	(43.5)	93.8	97.1	0.7	0.8	94.5	97.9
State and local	0.4	0.5	80.5	85.7	80.9	86.2	10.7	11.3	4.5	4.7	15.1	16.0
		Gov	ernment	Enterpr	ises			Ge	eneral G	overnme	nt	
			La	bor					La	bor		
Type of Tax		1998			1999			1998			1999	
Personal tax and nontax receipts		12.3			12.9			106.9			112.5	
Federal		10.0			10.6			87.4			92.2	
State and local		2.2			2.3			19.5			20.4	
Corporate profits tax accruals		0.0			0.0			0.0			0.0	
Federal		0.0			0.0			0.0			0.0	
State and local		0.0			0.0			0.0			0.0	
Indirect business tax and nontax accruals		0.0			0.0		<u> </u>	0.0			0.0	
Federal		0.0			0.0			0.0			0.0	
State and local		0.0			0.0		<u> </u>	0.0			0.0	
Contributions for social insurance		2.2			2.3		<u> </u>	16.9			1/.7	
Federal	ļ	1.9			2.0		<u> </u>	14.7			15.4	
State and local		0.3			0.3			2.2			2.3	
I OTAI		14.4			15.3			123./			130.2	
reaeral State and least		11.9			12.0		<u> </u>	102.0			107.6	
State and local		Z.5			Z.b			Z1./			22.b	

About the Authors	Gary Robbins is President of Fiscal Associates, an Arlington, VA economic consulting firm, and Senior Research Fellow of IPI. Mr. Robbins has developed a general equilibrium model of the U.S. economy that specifically incorporates the effects of taxes and government spending. He recently participated in a Modeler's Conference, sponsored by the Joint Committee on Taxation, to analyze the economic and revenue effects of broad-based tax reform. Mr. Robbins' sixteen years experience at the U.S. Department of Treasury includes serving as Chief of the Applied Econometrics Staff (1982-85), assistant to the Under Secretary for Tax and Economic Affairs (1981-82), and Assistant to the Director of the Office of Tax Analysis (1975-81). Recent IPI publications include <i>The Case for Burying the Estate Tax, An Analysis of "The Taxpayer Refund and Relief Act of 1999"</i> and <i>Complicating the Federal Tax Code: A Look at the Alternative Minimum Tax (AMT)</i> . Mr. Robbins' articles and analysis frequently appear in the financial press. He received his master's degree in Economics from Southern Methodist University.
	Aldona Robbins, Vice President of Fiscal Associates and Senior Research Fellow of IPI, has analyzed a wide range of issues including how taxes affect the economy, the long-run financial problems facing retirement programs and how government forecasting methods could be improved. Dr. Robbins coauthors the <i>Economic Scorecard</i> , a quarterly publication of IPI, that tracks the economy and federal budget. As senior economist in the Office of Economic Policy, U.S. Department of the Treasury from 1979 to 1985, she performed staff work for the Secretary in his capacity as Managing Trustee of the Social Security trust funds. Recent IPI publications include <i>Retiring the Social Security Earnings Test, The Case for Burying the Estate Tax</i> and <i>Adjusting the Consumer Price Index</i> . Dr. Robbins frequently writes on the economy, taxes and Social Security for the financial press. She received a doctorate in Economics from the University of Pittsburgh.
About IPI	The Institute for Policy Innovation (IPI) is a non-profit, non-partisan educa- tional organization founded in 1987. IPI's purposes are to conduct research, aid development, and widely promote innovative and non-partisan solutions to to- day's public policy problems. IPI is a public foundation, and is supported wholly by contributions from individuals, businesses, and foundations. IPI neither solic- its nor accepts contributions from any government agency.
	IPI's focus is on developing new approaches to governing that harness the strengths of individual choice, limited government, and free markets. IPI emphasizes getting its studies into the hands of the press and policy makers so that the ideas they contain can be applied to the challenges facing us today.
	Copyright ©2001 Institute for Policy Innovation
	Nothing from this document may be reproduced or transmitted in any form or by any means, electronic or mechanical, including photocopying, recording, or by any information storage and retrieval system, without permission in writing from the publisher, <i>unless such reproduction is properly attributed clearly and legibly on every page, screen or file.</i>
	The views expressed in this publication do not necessarily reflect the views of the Institute for Policy

The views expressed in this publication do not necessarily reflect the views of the Institute for Policy Innovation, or of its directors, nor is anything written here an attempt to aid or hinder the passage of any legislation before Congress.

Direct all inquiries to: Institute for Policy Innovation 250 South Stemmons, Suite 215 Lewisville, TX 75067

(972) 874-5139 [voice] (972) 874-5144 [fax]

Email: ipi@ipi.org Website: www.ipi.org