INSIDE: Fairy Tales About Kid's Health Care

IPI Insights

The Newsletter of the Institute for Policy Innovation June-August 1997

The House Tax Package: A Good Deal?

By Gary and Aldona Robbins, *Senior Research Fellows*

The budget agreement recently negotiated between the White House and Congress calls for a small tax cut. The House of Representatives has approved a tax bill that meets the broad outlines stipulated in the budget agreement. It attempts to balance the political considerations in the budget agreement and economic growth. Here's how it breaks down.

The Tax Cuts

The House tax bill would cut taxes by $135 billion over the next five years. Tax cuts dealing with the child credit, education incentives, savings and investment, alternative minimum taxes and estate taxes account for over 95 percent of the revenue effects.

Child Credit

The largest tax cut is a nonrefundable credit for families with children. Nonrefundable means that those who pay no income taxes will not receive the credit. In 1997, 1998 and 1999, taxpayers would get to reduce their federal income tax bill by $400 for each qualifying child under the age of 17. After 2000, the credit would increase to $500. The child credit accounts for 41.7 percent of the total proposed tax cuts. (See chart on top of page 2)

Education Tax Incentives

The House tax bill contains tax incentives aimed at education. A tax credit for tuition and fees associated with the first two years of post-secondary education, along the lines of previous proposals by President Clinton, accounts for 13.8 percent of the tax cuts.

The House bill also contains incentives to save for education. It would allow penalty-free withdrawals from IRAs before age 59½ for post-secondary education expenses, and taxpayers also could deduct up to $10,000 in amounts going to state-sponsored ►

In This Issue . . .

education programs or education investment accounts that are to be used to pay tuition expenses. These account for 7.2 percent of the tax cuts.

Incentives to Save and Invest

Incentives to save and invest come as a tax cut for capital gains and creation of American Dream Savings Accounts. The House bill would reduce the maximum tax rate paid by individuals on capital gains:

- From 15% to 10% for taxpayers in the 15% bracket (single returns with income less than $24,650, joints with less than $41,200);
- From 28% to 20% for taxpayers in higher brackets; and
- Index capital gains for inflation on assets purchased after 2000.

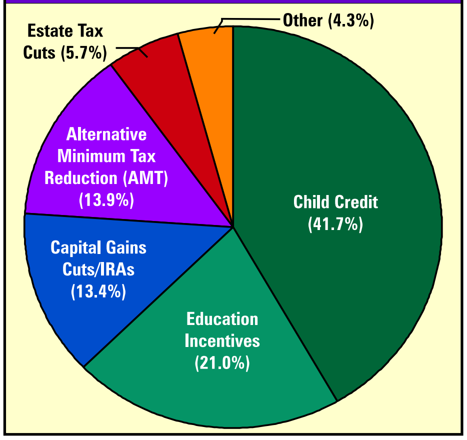
The tax rate on capital gains paid by corporations would be lowered from 35% to 30% on assets held more than 5 years. Because the lower tax rate is expected to unlock some of the $6 to $7 trillion in unrealized capital gains, the capital gains tax relief would raise $2.7 billion for the first five years but cost $37.6 billion over ten, accounting for 9.7 percent of total tax cuts.

The House bill also proposes to expand IRAs. American Dream IRAs (AD IRAs) would comprise 3.6 percent of the total tax cut.

Alternative Minimum Tax

The Tax Reform Act of 1986 greatly complicated the tax code through the alternative minimum tax (AMT).

Share of Static Revenue Cost by Tax Provision



Once triggered, the AMT increases the taxable income of affected taxpayers by denying deductions they could otherwise take. The Joint Committee on Taxation estimates that even modest inflation could ensnare millions of middle income Americans in the AMT over the next few years. The House bill would adjust the parameters that define the AMT to avoid this unintended expansion.

The AMT for corporations is even more complicated. The House bill would repeal the AMT for small business beginning in 1998 and for other corporations beginning in 2007.

AMT provisions in the House bill make up 13.9 percent of the tax cut.

Estate Taxes

Current estate tax rules exclude the first $600,000 of gross estate from tax, supposedly to remove the estates of lower and middle-income taxpayers from the tax rolls.

However, inflation along with rising income and asset values make the estates of more middle-income taxpayers taxable today than in 1987.

The House bill would gradually increase the exemption from $600,000 to $1 million by 2007. The cost of estate tax relief would be 5.7 percent of the total tax cuts.

The Tax Increases

Yes, the House bill would raise taxes by $50 billion over five years, eventually offsetting about 30 percent of the tax cuts. Almost 80 percent of the tax increase would come through higher excise taxes, mainly on airline travel. The remainder of the tax increases would come from provisions affecting corporations, financial products and tax-exempt organizations.

Effect on the Economy

As a whole, the House tax bill would increase output, growth, jobs and capital formation faster than what is anticipated. By the year 2007, the economy would have produced $1,243 billion more in GDP than otherwise, and annual GDP would be $249 billion above the baseline. There would be 448,000 more jobs and over $1 trillion more in capital formation than otherwise.

Effect on the Budget

Higher growth would lead to more income, payroll, excise and other tax revenue for federal, state and local governments. *Because of the added growth it would generate, the House tax bill would pay for itself over the next ten years.*

Some critics of the tax bill argue that it would be a "budget buster," particularly in the later years. But, even without new revenue from economic growth, it is difficult to argue that the tax bill will break the federal budget. To put things in better perspective, the House net tax cut amounts to a 1.3 percent reduction in revenues between now and 2007. If revenue forecasting errors of up to 5 percent are considered acceptable by the Washington community (and often occur), we should not lose too much sleep over a possible error on a tax cut roughly one-fourth that large.

Which Tax Cuts Provide The Most "Bang For The Buck?"

Provision	Distribution of: Static Revenue Loss[1]	Distribution of: Economic Growth[2]	Bang for the Buck[3]	Revenue Returned by Tax Cuts[4]
Child & Dependent Care Tax Credits	41.7%	0.0%	$ 0.00	$ 0.00
Education Tax Incentives	21.0%	2.7%	$ 0.44	$ 0.09
Capital Gains	9.7%	58.5%	$20.80	$ 4.11
American Dream IRAs	3.6%	5.7%	$ 5.46	$ 1.08
Alternative Minimum Tax	13.9%	17.7%	$ 4.40	$ 0.87
Estate & Gift Tax	5.7%	12.7%	$ 7.70	$ 1.52
Other tax cuts	4.3%	2.7%	$ 2.19	$ 0.43
TOTAL	**100.0%**	**100.0%**	**$ 3.46**	**$ 0.68**

[1] Distribution of revenue loss in chairman's mark, Ways and Means bill from 1997 to 2007.
[2] Based on simulations using the Fiscal Associates Model.
[3] Share of total increase in GDP between 1997 and 2007 ($1,243 billion) divided by the share of total static revenue loss ($358.8 billion) of each provision.
[4] Share of total dynamic revenue increase between 1997 and 2007 ($245.7 billion) divided by the share of total static revenue loss ($358.8 billion) of each provision.

How Does it Pay for Itself?

Not all tax cuts are equal as far as growth is concerned. Specifically, the capital gains tax cut provides 58.5 percent of the economic growth. Over the period 1997 to 2007, the capital gains cut generates $20.80 in added GDP and $4.11 in additional federal revenue for every dollar of static revenue loss. The House tax cuts as a whole provide $3.46 in added GDP and $0.68 in additional federal revenue for every dollar of static revenue loss. (See table at bottom of page 2.)

Who Benefits Most?

Most of the tax cuts contained in the House tax bill would go to lower and middle income taxpayers. Ignoring gains from economic growth, over 75 percent of the individual tax cuts would to to taxpayers with less than %75,000 in adjusted gross income. Because taxpayers with less than $75,000 pay 38 percent of federal individual income taxes while those with $200,000 or more income pay 33.4 percent, the tax bill should be considered as progressive. (See chart above.)

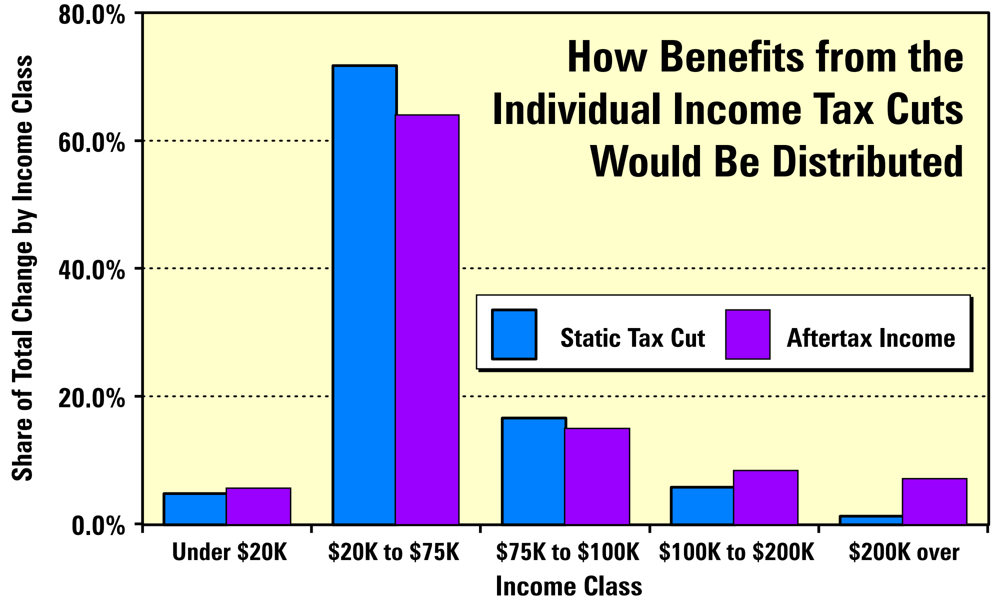
Put another way, for every $100 of tax paid:

- Taxpayers with less than $20,000 in income would receive $8.51 in tax cuts;
- Taxpayers with between $20,000 and $75,000 in income would receive $5.64 in tax cuts; while
- Taxpayers with over $200,000 in income would receive $0.10 in tax cuts.

Even more important is the distribution of the growth dividend generated by the tax cuts. On this basis, lower and middle income taxpayers would find a greater percentage increase in aftertax incomes as well.

Put another way, for every $100 of income:

- Taxpayers with less than $20,000 in incomes would see their aftertax income increase by $1.53;
- Taxpayers with between $20,000 and $75,000 in income would see their aftertax incomes increase by $1.42; while
- Taxpayers with over $200,000 in income would see their aftertax incomes increase by $1.07.



Does It Move Us Toward Tax Reform?

Because major tax reform remains on the policy agenda, at least for the longer run, tax proposals should be assessed within this context. Major aims of broad-based tax reform are: (1) to lower marginal tax rates on work, saving and investing; (2) to reduce the double taxation of saving and investment; and (3) to simplify the tax code.

To assess the House tax bill, we evaluated the major tax cut provisions in light of this. We found that the child and education credits, which make up the lion's share of the tax package, would move the package in the exact opposite direction from tax reform.

Conclusion

The tax bill passed by the House would provide a positive stimulus for economic growth. Over the next ten years, it would add an extra 0.2 percentage points to the real growth rate.

Because of this extra growth, the tax bill would pay for itself over the long run, and will not be the culprit if the federal budget does not attain balance as called for in the budget agreement.

Most of the benefits of the tax bill and its resulting additional growth would go to taxpayers with incomes below $100,000, because most of the tax cut is directed at the middle class.

Moreover, pressure to do something about the AMT and estate taxes is building anyway because they are affecting more and more middle-class taxpayers due to inflation.

Although the House bill achieves a delicate balance between growth and political considerations, it does not score well in terms of tax reform aims. The addition of special tax breaks will be difficult to eliminate in the future. □

IPI Insights

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Fairy Tales:

Fact and Fiction About Kid's Health Care

By Dr. Robert M. Goldberg

Children's Health Crisis: A Political Fairy Tale

Like so many stories told by "children's advocates," the story of the children's health care crisis is full of little legends and a lot of myths. While some of their stories are full of facts, as Mark Twain once noted, "get your facts first, then you can distort them as you please." And when you distort the facts you get distorted priorities and misspent tax dollars. Supporters of a new federal health care entitlement for children claim that kids without health care coverage are more likely to get sick and die than are those who have insurance. In making the case for this new program, the Children's Defense Fund cites a General Accounting Office study showing that 10 million children lack insurance. This estimate follows Twain's advice about distortion to the letter.

The 10 million uninsured children figure—actually 9.8 million—is faulty for a number of reasons. The Census Bureau derives this "estimate" from the Current Population Survey (CPS), which is designed to collect data on employment and demographics, not health coverage. In March of every year, the CPS asks respondents to think back 15 months and recall whether they had health coverage in January of the previous year. Such a long recall period will cause many respondents to forget they had coverage, thus inflating the number of uninsured.

The CPS also counts millions of children who have coverage available to them at no cost as "uninsured." The General Accounting Office (GAO), Congress' watchdog agency, estimates that Medicaid already covers 2.9 million of these 9.8 million "uninsured" children.

Most importantly, the CPS estimate is faulty because it is a static figure and cannot describe a dynamic market. Many of the 9.8 million "uninsured" children are only temporarily uninsured and will regain coverage within months. Children who are counted as "uninsured" today may be insured again tomorrow. By ignoring normal market turnover, the CPS paints an inaccurate picture of 9.8 million children permanently locked out of the system.

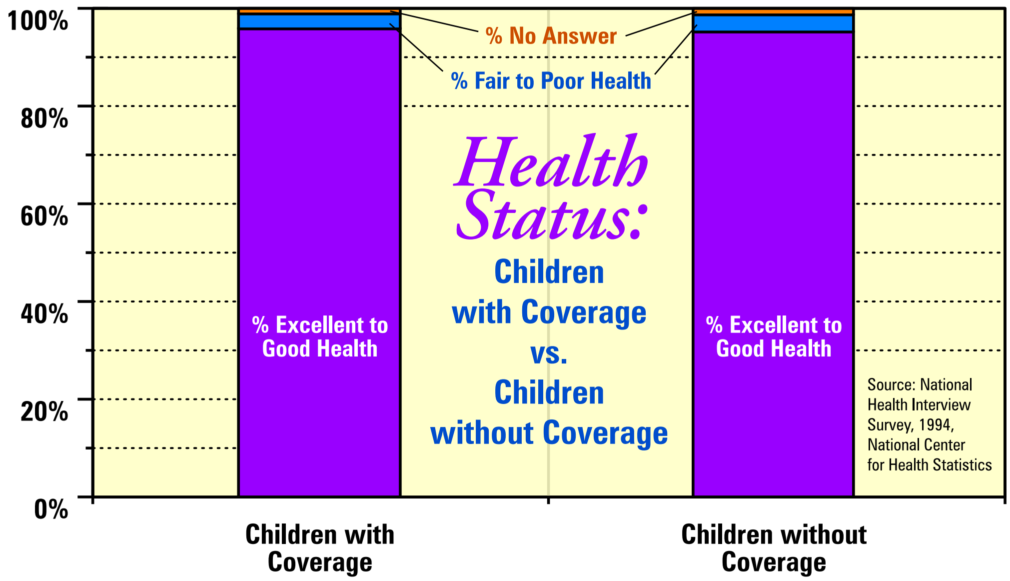
Un-Distorting the Facts: A Better Measure

Fortunately, there is a better tool for measuring the number of children without coverage. The Census Bureau's Survey of Income and Program Participation (SIPP) tracks the same children over a two-year period to determine who does and who does not have coverage and for how long. This makes for a more accurate measure of uninsurance because it captures much of the turnover in the market. Unlike the CPS, the SIPP is actually designed to measure health coverage and only asks respondents to recall their health coverage status for the previous four months.

The most recent SIPP (conducted from 1992-1994) reveals that of 68 million children in the U.S., 47.7 million (70 percent) have health coverage without interruption. Another 17.6 million (30 percent) experience some interruption in coverage, with over half of these children regaining coverage within four months. Much of this interruption is due to families who, thanks to ambiguous government regulations, jump on and off Medicaid. And according to a study by the Congressional Research Service, 30 percent of all uninsured kids, including those who regain coverage within four months, have parents who make $35,000 a year or more.

Gaps in coverage are problematic. But they do not comprise a crisis. Nor, as we shall see later, does it harm the health of children. What of the 8.8 million children who go without health insurance for more than four months? Does their lack of coverage reflect America's neglect or the immense burden of paying for health care? Again, the CRS analysis suggests otherwise: 1.5 million children ages 0-18 (15 percent of all uninsured children) live with parents who have their own coverage, but do not choose to cover their children. Another 2.9 million of all uninsured children are eligible for Medicaid but are not enrolled. 1.4 million chronically uninsured children live with parents making $50,000 or more a year

Thus 3 million children, not 10 million, are chronically uninsured who are also not eligible for Medicaid.



Crowding Out:
The Roots of the Child Health Insurance "Problem"

Why are 3 million children without health care coverage in America? There are two likely reasons. First, many American families have made a conscious choice to go without health care coverage because of financial considerations. The National Health Interview Survey conducted by the National Center for Health Statistics shows that of 34 percent of children lacked insurance because of the cost. Another ten percent were not covered even though the cost of insurance was not mentioned as a reason.

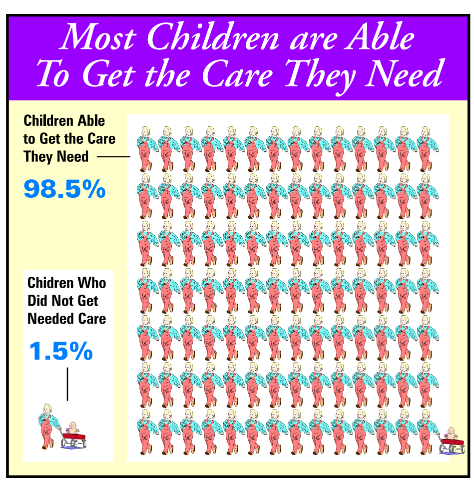
Second, parents may be unable to obtain insurance because employers dropped family coverage in the wake of the expansion of Medicaid. Between 1988 and 1995 the percentage of children covered by private insurance fell from 72 percent to 64 percent. At the same time the percentage of children covered by Medicaid climbed from 15.5 percent to 23.1 percent. Studies have shown at least 77 percent of the shift is the result of people and employers dropping private coverage. Indeed, research shows that reduction in private coverage largely came from workers deciding to drop their own insurance coverage, and particularly coverage of dependents.

In addition, Medicaid policy may affect private insurance coverage by changing employers' behavior. Employers may increase workers' cost sharing when they know that the public sector is more generous for uninsured workers. In the process, it is likely that some parents simply did not re-enroll in Medicaid and instead just kept coverage for themselves. Indeed, as noted earlier, over 1.4 million children seem to be in this category.

Hence, the displacement of private insurance by Medicaid—the creation of an entitlement and an expectation that health care should be provided by government—may explain why many parents managed to insure themselves but not their children. Expanding Medicaid to include more families or children would increase government health care coverage while causing many parents and employers to drop private coverage for their children.

Health Insurance, Access and Well-Being:
Fairy Tale and Facts

The Children's Defense Fund argues that kids with health insurance are healthier than those who do not have health insurance. But this appears to be another misreading of available data. The claim that lack of health insurance causes poor health cannot be sustained any more than the failure of children to get timely and good care is the result of lack of insurance. An analysis of the 1994 National Health Interview Survey—the largest national survey ever conducted regarding access to health care—presents the most recent data available. The NHIS is an in-person survey conducted by the National Center for Health Statistics. In 1994, the NCHS collected information about access to health care for a sample of 32,460 children, which is approximately double the sample size ever surveyed previously on access to care.



Health Care Coverage, Cost and Health Status

The chart above shows that, contrary to the claims of many supporting a new entitlement for kids, children without health coverage are just as likely to be in excellent to good health as are children with health coverage.

Further, as the table below shows, 98.5 percent of all children were able to get the care they needed. Of the 1.5 percent that did not, about one percent cited cost or lack of insurance. This is less than one million children. In general, children who did not have health insurance because it was too expensive had largely the same health status as children who had health insurance.

In general then, the level of children's health is unrelated to the cost of care and/or whether they have health insurance. Does this mean that cost and lack of coverage is not a problem? Of course not. But it also means that the assertion that health insurance is crucial to children's health cannot be supported by the facts. Thus, the proposed new entitlement of health care for children is based on a fake crisis and on a distortion of data. □

This article was taken from an upcoming IPI Issue Brief by Dr. Robert M. Goldberg, A Senior Reserch Fellow with the Center for Neuroscience, Medical Progress and Society at George Washington University.

Americans Work More Than Half the Year for Government

Perhaps you didn't realize it, but as a typical American, you worked from January 1 to July 3, or more than half the year, solely to pay for government spending. After breaking for Independence Day you can begin earning the portion of your annual income that represents true independence.

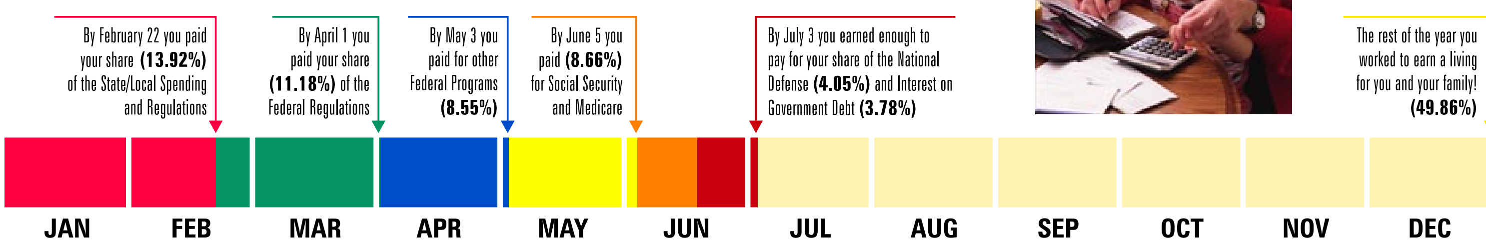
Yes, for this year, the day before Independence Day, was Cost of Government Day (COGD). COGD is the date of the calendar year, counting from January 1, on which the average American worker has earned enough in cumulative gross income to pay for his or her share of government spending (total federal, state and local) plus the cost of regulation.

Last year, 10 states issued proclamations to make COGD official, and the U.S. House of Representatives passed House Concurrent Resolution #102, recognizing COGD for this year.

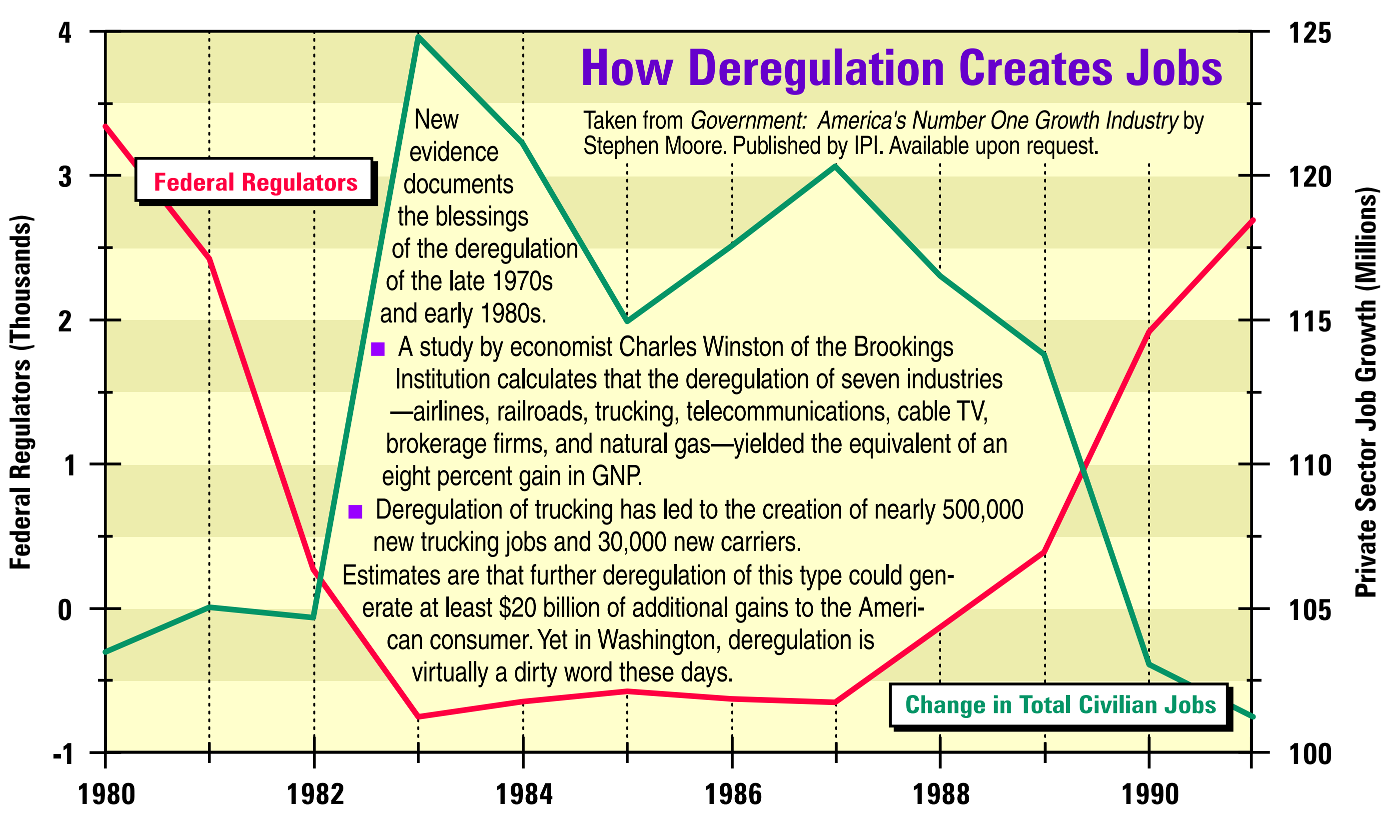
The fact that COGD is July 3 this year means that Americans spend more than half the calendar year (50.1 percent) working for the government. The total cost of government in 1997 is estimated at $3.519 trillion, up from $3.375 trillion in 1996. That's $13,500 for every man, woman, and child in America.

The federal government plans to spend $1.757 trillion in 1997, while state and local governments combined nationwide will spend $1.002 trillion. Federal regulation will claim $785 billion from taxpayers, and another $196 billion will be required by state worker's compensation and tort costs.

Looking to the future, COGD may be pushed even further into the year if the Clinton administration's 1997-98 regulatory agenda prevails. According to the 1996 year-end version of the government's twice-yearly compilation of proposed new regulations, Unified Agenda of Federal Regulations, there were thousands of new regulations in the pipeline for 1997, imposing at least $12.2 billion in new regulatory costs. □



Facts on the Growth of Government



Notes From

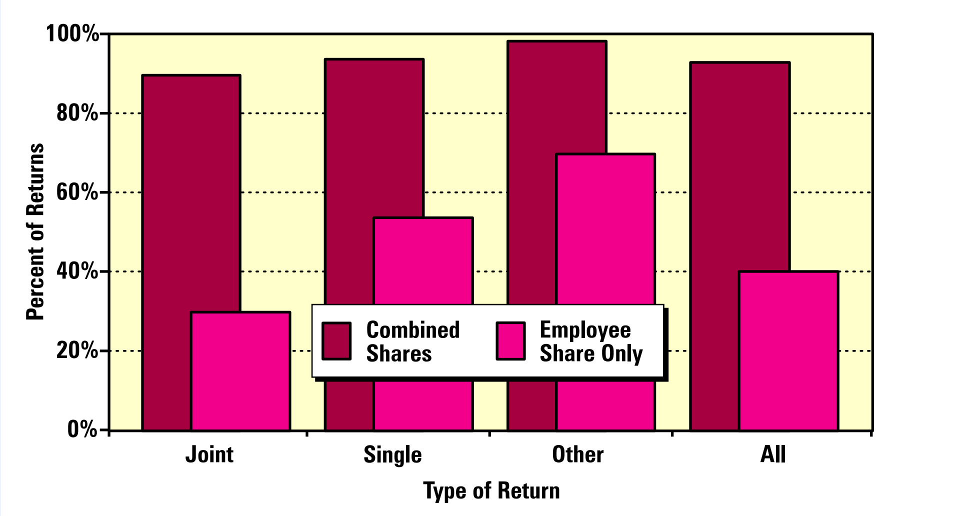
TaxAction Analysis

A Tax Deduction For Payroll Taxes

by Gary and Aldona Robbins,
Senior Research Fellows

Payroll taxes are not small potatoes: Today, over 90 percent of all workers pay more in payroll taxes than in income taxes, correctly counting the employer's share. (See chart at right.)

Most Workers Pay More in Payroll than in Income Taxes



Payroll Tax Burden on American Workers

Under current law, payroll taxes paid by the employee are subject to the income tax while those attributed to the employer are not. Payroll taxes withheld from workers' paychecks are counted as taxable wages. For example, if a worker earns $30,000 in wages, the employer pays a payroll tax of $2,295, and another $2,295 is withheld from the employee's paychecks. The $2,295 paid by the employer does not appear on the employee's W-2 form and is not included as part of taxable wages. However, because the $2,295 withheld from the worker's paychecks counts as part of the $30,000 in taxable wages, the worker also must pay income taxes on his or her share of payroll taxes. **Many consider the fact that workers must pay income taxes on their payroll taxes a tax on a tax.**

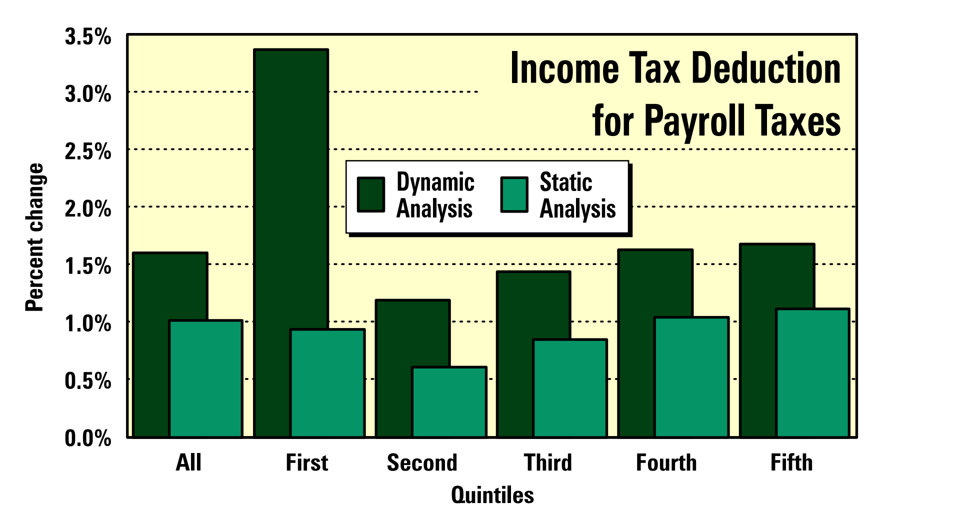
> ***[By] making the payroll tax deductible, income taxes would be calculated on the basis of working families' real net incomes.***
>
> —Kemp Commission Report

The Ashcroft Proposal: An Income Tax Deduction for Payroll Taxes

A proposal by Senator John Ashcroft (R-MO) would eliminate this double taxation by allowing workers an income tax deduction for the payroll taxes they pay. Specifically, workers would take an "above-the-line" deduction for their share of payroll taxes that finance Social Security. Above-the-line means that the deduction would be available to taxpayers whether they itemize or take the standard deduction.

After five years, on average, taxpayers in the middle of the income distribution would experience roughly a 1.5 percent increase in aftertax income from the payroll tax deduction. Those in the top fifth would see their aftertax income increase by 1.7 percent. Taxpayers in the bottom fifth would experience the largest increase in aftertax income, 3.4 percent, because they pay little or no income tax and, therefore, get to keep more of their gains from growth. (See chart at left.)

Change in Average Aftertax Income, 2002:



Conclusions

Payroll taxes are for most Americans more burdensome than income taxes. Allowing workers to deduct the payroll taxes that they pay directly from their wages would offer some relief, particularly for those with lower and middle incomes. A payroll tax deduction also would provide a modest boost to the economy and, unlike the child or tuition tax credits, move in the same direction as broader based tax reform. □

TaxAction Analysis is the tax policy arm of the Institute for Policy Innovation. TaxAction Analysis publishes **Economic Scorecard**, a quarterly newsletter, as well as additional commentary on tax policy. If you are not receiving **Economic Scorecard** and other TaxAction Analysis publications, call or write for more information.

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Parting Shots

Things taken for granted by most Americans come as revelations to some welfare recipients. Paul Kortman, human resource manager at C.D. Baird & Co., a Milwaukee firm that creates point-of-purchase advertising displays, recalls talking to a trainer who suggested an alarm clock to a constantly tardy student and heard this reply: "What's an alarm clock?"

Training

Capitalism is a moral system if only because it is based on trust. When we turn on a light, we assume that there will be electricity. When we drive into a service station, we assume that there will be fuel. When we walk into a restaurant, we assume that there will be food. If we were to make a list of all the basic things that capitalism provides—things that we take for granted—it would fill an encyclopedia.

Steve Forbes in *Imprimis*

Does the death penalty keep people from murdering? Ask the state that actually carries it out. Texas has been executing killers at a record pace, and murders are down sharply in its biggest cities. Of the ten largest U.S. cities, the three in Texas ranked at the top with the biggest drops in murders in 1996. First was Dallas with a murder decline of 21.4 percent. Second was San Antonio with a reduction of 17.6 percent, while Houston was third with a drop of 17.4 percent. Is it merely coincidental that these 1996 reductions happened after Texas led the nation with 19 executions in 1995?

Investor's Business Daily

IPI News

Have Dinner with Steve Forbes on September 10

Mark your calendars! IPI is celebrating its tenth anniversary this year. In recognition of this milestone, we're hosting an anniversary banquet to celebrate. The event will be held in the Dallas area on Wednesday, September 10, 1997 at the Harvey Hotel on SH 114 in Irving, Texas. **Steve Forbes**, Editor-in-Chief of *Forbes* magazine and 1996 Presidential candidate, will be our keynote speaker. Other noted conservatives will also be on hand to make remarks during the program. This is sure to be a fantastic event that you won't want to miss. If you are able to be in Dallas during the second week of September, please plan to join us for a very special evening with your friends at IPI. □

For more information, please contact: Lisa Polster at 972/219-0811

The only thing worse than a German shepherd lunging at your leg is an armed German shepherd lunging at your leg. Soon, police dogs could be equipped with muzzles containing remotely activated "stun guns" so that they can zap perpetrators rather than bite them. This immobilizes suspects for a few seconds so that police can catch up and cuff them. The inventors conceived the idea to help solve the liability problems of sicking dogs on litigious suspects.

Newsweek

A number of big credit-card issuers are quietly exploring imposing new types of fees on their least-profitable customers, such as those who don't use their cards much and those who payoff or close their accounts. Soon, credit card companies could be charging fees like $15 for each six month period the card is not used, or a $25 fee for paying off the outstanding balance or closing the account.

Wall Street Journal

The Depression-era Davis-Bacon Act sets "prevailing wages" for more than 84,000 construction jobs across the country, requiring government contractors to pay specified wages and benefits to workers on federally funded projects. Its effects on disaster-stricken regions are particularly acute. The reconstruction of Grand Forks and other flood-ridden areas of the Plains will have to wait while the Labor Department conducts surveys and updates thousands of Davis-Bacon level wages.

Washington Times