

# EXTRA POINT

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## Dynamics and Tax Fairness

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Having made the \$500 per child tax credit the centerpiece of their tax plan rather than economic growth, congressional Republicans never had much chance of avoiding being bludgeoned over the fairness of their tax cuts. Now they find themselves defending a do-little bill, and yet taking the same abuse from the forces of redistributionism as though they had tried for a major pro-growth tax cut.

One reason Republicans tend to stumble in these debates is that the expression "low-income taxpayer" is an oxymoron when it comes to the federal income tax. Few lower-income taxpayers pay federal income tax and a great many actually receive cash, on net, thanks mainly to the refundable Earned Income Tax Credit.

Of course, low-income taxpayers still pay taxes, particularly in the form of Social Security and federal excise taxes. The Social Security tax, however, raises a special problem for tax analysis. The tax itself is regressive, but Social Security benefits are highly progressive, and the system is progressive on balance. It's hard to argue, under the circumstances, that low-income workers should have some of their payroll tax burden offset by an income tax cut, assuming these workers can reasonably expect to receive the promised Social Security benefits.

Another reason Republicans have trouble with "fairness" is that many of their tax provisions are shown by the Joint Tax Committee and the Treasury to benefit mostly upper-income taxpayers. Take capital gains relief. After the initial surge in revenues due to accelerated realizations, capital gains relief as currently estimated begins to lose revenue. Capital gains tend to go to those with capital, so capital gains relief tends to go to the wealthy, at least as currently estimated.

The purpose of capital gains relief is to spur investment and real wage growth. Unfortunately, the JTC and Treasury maintain they don't know enough to estimate the additional econom-

ic growth that would result from reducing capital gains taxes. So they assume no additional economic activity. If they knew enough, however, at least to make a comfortable, conservative estimate, the consequences would be very interesting — and very helpful to pro-growth tax cutters.

One consequence is that, as we have learned repeatedly this year, when the economy grows faster, Treasury revenues grow faster. More jobs mean more personal income tax. Higher wages mean higher tax brackets. More profits mean more corporate income tax revenue. In fact, virtually every tax imposed yields more revenue when the economy does better. Thus, a capital gains tax cut would increase the revenue flow to the Treasury over and above that due to an acceleration of capital gains realizations. For tax distribution purposes, though, it's important to know who will pay these additional taxes.

The overall federal tax system is highly progressive. Left unchecked, this progressivity increases when real incomes grow. As incomes grow, taxpayers move from one tax bracket to a higher bracket. Then, as their incomes rise still further, more and more of their additional income is subjected to the higher tax bracket, raising their average tax rates every step of the way.

Estimated on the current, nearly static basis, a capital gains tax cut shows upper-income taxpayers benefitting disproportionately over the long run. But the economic growth from a capital gains cut would produce additional tax payments that would also fall disproportionately on upper-income taxpayers. This wouldn't make capital gains relief a net tax increase on the wealthy. But crediting capital gains relief, or any other pro-growth tax provision, with even a conservative estimate of the additional growth that might be expected would certainly make the tax distribution tables more accurate, and it might make a pro-growth tax policy a little easier to achieve the next time around. ●