



Notes: Clinton Tax Proposal

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Article citation:

Gaffney, Mason. "Notes: Clinton Tax Proposal." February 1993. Notes.

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Clinton Tax Proposals, 2/93
As Viewed after he spoke to Congress, 17 Feb

*Means change from the before notes

A. Items conspicuously omitted.

1. Payroll tax relief.

He did speak of "honoring work," but only w.r.t. a crumb thrown to lowest income tax bracket where he would raise earned income credit a little.

He said a jobless recovery is no recovery worth having. But that led to ITC, with no regard to substituting capital for labor. George Will (of all people) jumped on that.

*2. "Stimulus." Instead, he spoke of crowding-out. Commentators are wedded, still, to saying "stimulus" w.r.t. any spending program. They didn't get it.

3. Homeowners' deductions and exemptions. E.g., equity withdrawal

4. Angel of death provision. High revenue potential.

5. Death duties. (Nearest thing we have to a national wealth tax. Taking a small % of national wealth would pay off the national debt.)

6. Intergenerational equity. He proposed only taxing social security is double taxation. It would be more progressive to tax gains at death, estates, and property.

If granny-bashing is in, bash the rich grannies.

7. Significant restoration of corporate income tax. Proposed rise from 34% to 36% is a token.

10. How to cut soaring medical costs. This is a touchy one, because it involves challenging the overriding goal of prolonging life at all costs. The Governor of Colorado tried it once, and suffered for it.

On this, we are "waiting for Hillary." May she prove to be a genius.

11. Distinguishing earned and unearned income.

12. Plugging loopholes that serve no useful incentive effect.

Examples:

repeated write-off of old buildings.

depreciation of land

preferential treatment of gains from land value

increments

13. Imposing a surtax, earmarking proceeds for reducing debt.

14. The S&L bailout, bank bailout, etc. How to stop the bleeding. Recouping from beneficiaries.

B. Background

1. Tax rates on high incomes are historically low. From 1941-81 they were much higher, both corporate income and personal income. In addition, rate structures were much more progressive. During those high-tax years, jobs grew, real wage rates grew. It has not been demonstrated that lower tax rates, following 1981, have made jobs or raised wage rates. Neither has it been demonstrated that abandoning the previous progressive rate structure has stimulated productive incentives. The major forms of enterprise apparently stimulated were Mergers and Acquisitions, and land speculation.

2. 1981, "Revolt of the Haves," presaged by Prop. 13, 1978. It was also a revolt of the aged, a generation war.

a) It breached the social compact, relieved property of its traditional obligations.

b) It triggered off a bubble economy. Benefits were captured in soaring land and stock prices. Speculation and "frenzied finance" led to overpricing of land, followed by the present reaction and banking debacle.

3. The payroll tax is historically high. It has replaced the corporate income tax as #2 source of Fed. revenue.

The two income taxes were originally seen as taxes almost entirely on unearned income. Now they are mainly taxes on true earnings as opposed to takings.

4. Peace Dividend should make it possible to pay off national debt. Instead, the Federal Government declared a new Gilded Age (the original was 1868-73, except in former Confederate states), a "grand barbecue," cutting melons for the wealthiest among us. We went from "tax and spend" to "borrow and spend." Spending per se took few hits.

It is described by Kevin Phillips as a "capitalist blowout." However, it is not clear that capitalists proper - i.e. the owners of real capital - are the major beneficiaries, for the yield on new investing is not very high. Rather, it is the owners of old assets like land and common stocks who have gained by rising values.

5. Gasoline taxes are historically low, because they are per gallon rather than ad valorem.

6. Clinton promised not to raise taxes, except on "the rich." Now he is reneging. It is not unusual or unexpected for

candidates to promise more than they can deliver, and Clinton hedged his promises carefully. So the embarrassment, while real, is probably not fatal.

Depends on how extreme he gets. Raising taxes on everyone with \$30,000 or more income is too extreme. Makes it seem that candidate Clinton conned the voters.

(Bush's "read my lips" pledge had been much more firm and absolute, so reneging did get him into trouble, especially because he reneged not so much to gain revenue as to win a tax break on capital gains. Also, he depended on a different constituency, more vehemently anti-tax.)

C. Fudge words and concepts.

Failing to hit the nail on the head, these fudge words confuse issues.

1. "Stimulus." Actually, it is not clear that Federal borrowing and spending is a net "stimulus," if it just causes money to be spent one way instead of another.

In the short run, to the extent that taxes depress activity, anything that lowers taxes is a stimulus. However, as interest on the debt forces higher taxes, that quickly loses its conviction.

Anyway, that is not what those who say "stimulus" mostly have in mind. Rather, they are thinking in traditional Keynesian demand-side terms, where spending drives real activity. This thinking lost favor during the 1965-81 years of rapid, occasionally double-digit inflation, and therefore is approached only gingerly and indirectly today.

Therefore, the economics profession has no consensus on the relevant macro model. My own opinion is that borrowing tends to abort domestic private capital formation, and should be avoided. Our public debts, at all levels, are dangerously close to "treadmill" levels, where we borrow to pay interest on old debt.

2. "The Middle Class." This term means almost whatever any speaker wants.

3. Describing the personal income tax as a tax on "the rich," or "the wealthy." Wealth is not income; income is not wealth.

a) Wealth is a fund; income is a flow. Income and wealth are positively related, but far from identical. Their differences are important for tax policy.

b) Income derives from human effort, not just the yields from stocks. The human effort devoted by many physicians, for example, is very high; burnout and early retirement are common. To achieve the desired economy in Medicare, etc., we need to get

physicians to work for less. Taxing their effort will not foster that end.

c) Wealth accumulates over time

i) Over the life cycle, so older people are higher on wealth, younger people on wage and salary and entrepreneurial income

ii) Over generations, so people begin life with unequal endowments, and wealth is much more concentrated than income.

Exemplifying the point, the income/wealth ratio of blacks is much higher than the mean. That is not because of high income, but very low wealth.

d) Much wealth is consumer capital and land, yielding no taxed or measured income - indeed, used as a tax shelter.

4. Metaphors:

"Jump-start the economy" (This has replaced "pump-priming.")

"Overheating the economy"

"Earnings" used as synonym for income from whatever source.

E.g., proposed surtax on those "earning" > \$1m/year. Some incomes are "takings," without earning, e.g. rise in home prices.

D. An Energy Tax

1. We had one before, briefly, under Carter. He called it a Windfall Profits Tax (WPT), in response to the jump in energy prices. It was more of an excise tax, however, than a true profits tax.

As the name indicates, he advanced it on grounds of equity - striking back at unjust enrichment - more than on grounds of efficiency. This is in contrast to today's tendency to describe it as regressive.

2. It fills a vacuum. It offsets a number of subsidies, enumerated below. It would make more sense to withdraw the subsidies. The energy tax is quicker, but desubsidizing is a better long-run goal.

Energy production and consumption are subsidized in many ways. (For more, see NTA paper on interjurisdictional competition for tax revenues.)

Subsidies to energy production

a) Preferential income tax treatment of energy exploration and production.

b) Major avoidance of property tax by lands bearing hydrocarbons.

c) Exemption of nuclear plants from public liability.

d) Utilities allowed to go into energy exploration and production, and meld high costs into rate bases.

- e) Massive, premature sales of Federal OCS tracts, upon nomination by industry. Likewise, coal in Powder River Basin.
- f) Preferential freight rates on bulky raw materials like coal. "Value of service" rather than "cost of service" rule of rate-making.
- g) The nation pays for military umbrella over producing regions.

Subsidies to energy consumption

- a) City streets, county roads, paid for by others than drivers.
- b) Field price controls on oil and gas (until lifted)
- c) Two-price system, old and new gas. Consumer price held down by price controls on old gas, thus inflating demand. New gas allowed much higher field price, thus stimulating supply. Cost of new gas not passed through to consumers, but melded with cheap old gas.
- d) Failure to charge for pollution.
- e) Subsidized highway construction, operation, and maintenance.
 Highway Trust Fund, gas tax money earmarked for building new highways, for years. Other funds pay for repairing, replacing old highways. Bias toward extending the system, responding to land speculators in areas like old Rancho California (Temecula).
- f) Insurance cost is only weakly related to miles driven.

3. It should have more of the character of an effluent charge. However, in almost any form, it will combat pollution.

4. It should work toward conservation. To this end, it should be near the source, or upstream in the flow of production. Taxing energy downstream is a tax on refining, improving the product, storing it, converting it to more usable forms (electricity, gas under pressure), moving it to consumers, and other human work.

5. An exception to the above is a gasoline tax levied as a surrogate for highway use pricing, to alleviate congestion, and/or to finance mandatory insurance.

6. Energy taxes are probably not regressive. Almost any tax may be made to appear regressive by looking at it as a share of income of the lowest group of income receivers. That, however, is because this lowest "group" - which is different each year - consumes much more than its income. It is a technical statistical phenomenon, widely misinterpreted.

Regressivity is also shown by wrongly assuming the energy tax is all shifted to consumers.

Another error is to omit all but a few ways in which energy is consumed.

*7. BTU basis of energy tax seems arbitrary. It is certainly new, uncharted territory. It calls for new data and analysis. Nature of the tax is in the details, yet to be worked out.

\$1 worth of coal has more BTU than \$1 worth of gasoline, seems to be the idea. Gasoline is the more convenient fuel. Thus, the less convenient fuel pays more. Lignite and Peat fuel, if included, would pay even more per dollar; oil shale and tar sands, too. The dream of developing these sources would end.

Wood fuel, if taxed, would pay the most. It is commonly used in the northwest: hog fuel in lumber mills, sawdust to heat homes, etc.

Such fuels are more labor-intensive. It takes labor to overcome the inconvenience. Thus, maple syrup, for example, is the most energy-intensive product there is, in BTU per \$ of value. A BTU tax, applied consistently, would wipe out this industry.

How about hydro? Not clear how or whether that would be taxed. Some new kind of cross-measure, or rate of exchange, would have to be developed.

How about uranium? I surmise that \$1 worth of uranium has more BTU than other fuels.

How about imports?

A BTU tax has no locational element. Thus, oil from The Beaufort Sea, worth little at the source, would pay as much as oil from the Wilmington Basin.

Likewise, it has no cost of production deduction. Deepwell oil pays same as easy oil. Sweet pays same as sour.

8. Thus, a BTU tax will wipe out a lot of marginal production. That means it will be shifted forward to consumers: supply and demand. A tax based on value would spare marginal production, because it has no net value.

Another way to avoid forward shifting is to suppress demand, instead of supply.

9. Air travel is energy-using. Aluminum + jet fuel.

E. Miscellaneous

1. "There aren't enough rich people around to pay much."

It's not the number of people, it's how rich they are.

There are some 5.3% of families making over \$100,000/year (reported). But they make 27% of taxable income.

2.

F. Key proposals made

1. Raise tax on social security income for retired couples earning over 32,000/year. Now, 50% of soc. security is included in taxable income, as of last year. He would raise it to 85% inclusion.

That is triple taxation. Workers were originally taxed on income they never received, were told it was not a tax but a contribution for their old age. Now they are to be taxed again when they get the money back. Pretty raw.

Bad demonstration effect on current payors. They will now see clearly it is a tax.

Bad effect on incentives of elderly who want to continue working. A steep rise in taxes when you breach the trigger value.

"Lead ... or Leave," a political youth group, is behind this. They have their eye on the wrong ball.

To help youth, and other upwardly mobile people, need to tax wealth, not the already twiced-taxed social security payments.

2. Energy tax, BTU basis. Not thought through.

3. Mild return toward progressive rate structure.

4. Higher earned income credit at bottom.

5. Cut several porkbarrel programs.

6. Cut deficit. Pull the loans not made to govt. into private sector. Activate them by raising RRAT, and lowering i.r. (obviously he refers to long term rate).

7. "Targeting." He used it a lot. Presages dirigisme. Stiglitz likes it.

8. ITC, targeted on small business.

9. Lowering i.r., long-term.

Background. Long-term rates are now below levels of last 20 years, but are high cf. to s.r. rates.

This is more nominal than real: long-term rates reflect long-term inflationary expectations. With a huge nat. debt, many expect inflation.

10. Small business access to technology, credit. Community Development Banks. Enterprise Zones. P.w. Environmental cleanup (but Superfund is being cut).

11. Negotiated trade agreements, not unilateral free trade. Harder-nosed bargaining -- Laura Tyson.

12. Target growth industries, aid them: Japanese model.

13. Public health

14. College loans, repaid by community service.