Economic Analysis of Tax Proposals

The flat 12% personal income tax scheme by itself will not generate nearly so much federal tax revenue as the prevailing federal tax system. The tax yield of the prevailing federal tax structure is shown below for the years 1981 and 1982, where all amounts are in billions of current dollars:

	1981	1982
Actual Personal Income Tax Collections	$282	$298
Actual Corporation Income Tax Collections	$ 61	$ 49
Total Actual Income Tax Collections	$343	$347

To compare the prevailing tax structure with the 12% flat tax rate, we examine the following:

	1981	1982
Aggregate Gross Personal Income	$2404	$2570
Government Transfers are given by	336	375
Subtracting The Transfers Yields	$2068	$2195
Aggregate Personal Exemptions at $1000 Each Totals to	209	212

	1981	1982
The Personal Income Tax Base Net of Both Transfers and Exemptions Equals	$1859	$1983
Assuming that Aggregate Personal Income is Unaffected by a Switch to the FLAT 12% Personal Income Tax Rate, The 12% Tax Yield Would Be	$ 223	$ 238
The Difference (Shortfall) of the Flat 12% Rate from the Total Current Income Tax (Personal Plus Corporate) is Roughly	$ 120	$ 109

Thus, the flat 12% personal tax rate being proposed (i.e., the tax base is personal income less both government transfers and $1000 personal exemptions) generates insufficient revenue to be equivalent to the present income tax structure.

To make up the revenue deficiency, a tax on aggregate less gov't purchases gross receipts (on final sales) ~~net of (1) capital expenditures on plant and equipment, (2) labor compensation, (3) the cost of materials, and (4) dividends (to stockholders)~~ could be levied. According to the calculations provided below, such a tax - ~~if it did not materially distort the pattern of dividends and wages~~ - could be levied in the range of ~~[illegible]~~ 4.8% As before, all figures are in billions of current dollars. Again, we concentrate on the years (calendar) 1981 and 1982:

	1981	1982
Gross receipts (final sales)	$2917	$3083
(1) Capital Expenditures (plant and equipment)	346	348
(2) Compensation Private Sector for Wages, Salaries and Benefits	$1485	$1555
(3) Dividends	$ 65	$ 70
(4) Cost of Materials	$ 299	$ 289
(5) Gross Receipts Net of (1), (2), (3) and (4):	$ 722	$ 781
The Tax Rates on Amounts (5) Required to Render the Tax Systems Equivalent (i.e. to make up the shortfall) are	16.6%	14.0%

These two percentages average out to a weighted 15.25% for the period. Clearly, any change in the amount of dividends paid out in the effort to escape (avoid) the above tax will result simply in a substitution of the 12% personal tax for the 15.25% rate. Thus, the net loss in top revenue is only $ .0325 per dollar of additional dividend.

An alternative to the 15.25% tax supplement presented above would be a tax on aggregate gross receipts (less government pruchases) to yield the necessary revenue to make up the shortfalls illustrated earlier ($120 in 1981 and $109 in 1982), a tax of roughly 4.8% would be needed. This is illustrated below.

	1981	1982
(A) Gross receipts (final sales)	$2917	$3083
(B) Gross receipts less all government purchases	$2320	$2436

The Tax Rate on (B) Needed to Make Tax Systems of Equal Yield Would Be	5.2%	4.6%

The weighted average of the two rates is 4.8%. Thus, the flat 12% personal income (as defined above) tax rate coupled with a 4.8% tax on gross receipts (net of government purchases) would yield the same federal tax revenue as the prevailing personal and corporate income tax structures. This conclusion, it should be noted, assumes that the flat 12% tax does not alter the value of personal income or government transfers and that the 4.8% tax has no net disincentive effects on production, investment, and consumption expenditures.

If revenue requirements decline by a net of, say, $30 (billion) due to reform in the food stamp program and elimination of farm price supports, then the revenue deficiencies of the flat 12% tax become:

$90 for 1981 and
$79 for 1982

Assuming such policies do not significantly affect aggregate personal income or aggregate personal income or aggregate gross receipts, the 12% flat personal income tax rate would then have to be accompanied by ~~(1) a corporate tax rate of only 11.5 - 11.75% on gross receipts less material costs, dividends, etc, or (2)~~ a gross receips tax (exclusive of government purchases) of only 3.6%.

~~Yet another alternative to the present income tax would be a tax on all final sales to consumers. To yield a federal revenue equivalent to the combined prevailing federal income taxes, if all commodities were taxed, would require an 18% rate. This is illustrated below:~~

	1981	1982
Final Sales to consumers		
Durables	$235	$243
Services	$874	$966
Nondurables	$735	$762
Total	$1843	$1971
The percentage tax needed to replace all income taxes and provide equal revenue yield is:	18.5%	17.6%

The weighted average of these two percentages is 18%. A budget decline of $30 would reduce this rate to 16%.

If food purchases ($391 in 1981 and $406 in 1982) are not taxed, the tax base becomes:

	1981	1982
	$1452	$1565

The percentage tax needed to provide equal yield to the combined prevailing income taxes would be

1981	1982
23.6%	22.2%

The weighted average of these percentages is 23%. A $30 decline in the budget would reduce this rate to 21%.

If the 12% flat personal income tax is to be supplemented by a broad based sales tax on all (food included) consumer sales, the latter rate would have to be 6.8%. A $30 budget cut would reduce this rate to 4.75%. If food is excluded from the consumer sales tax, the rate is 8.1%. If food is excluded from the tax base and $30 is cut from the budget, the rate becomes 6.1%.

Let us now focus on a new federal tax system, one consisting of (1) flat 12% personal income tax and (2) a 4.8% (or, if $30 (billion) is cut from the budget, a 3.6%) tax on final sales net of government purchases. The analysis below deals with the 5-year period from 1981 - 1985. Where actual figures were not used, forecasts have been made using standard econometric techniques. Naturally, the forecasts are only estimates.

First, the tax yields of the 12% flat tax are provided. Projected federal revenues are provided in the last column (in billions of current dollars):

Revenue Yields of Flat 12% Personal Income Tax

Year	Actual or Projected Avg. Personal Income	Less Transfer	Less $1000 Exemptions	Estimated Revenue Yield
1981	$2404	$2068	$1859	$223
1982	$2570	$2196	$1984	$238
1983	$2790	$2401	$2187	$262
1984	$2980	$2557	$2347	$282
1985	$3089	$2657	$2439	$293

The imposition of a 4.8% tax on final sales (net of government purchases) may act to make capital goods more expensive relative to labor. Let us assume that a 4.8% tax reduces private investment in new plant and equipment by 4.8%. Clearly, this is an arbitrary figure. Nonetheless, it serves to make the revenue projections provided below all the more conservative. The revenue yields of the 4.8% (or 3.6%) tax rates are shown in the last two columns. The sums of the yields of the 12% flat tax plus the 4.8% tax on final sales are roughly equivalent to the yield of the combined prevailing federal income taxes.

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BUDGET ANALYSIS AND REFORM:

	1981	1982
Housing		
Total Outlays, Federal: (excludes administrative costs)	$10.2 billion	$12.5 billion
Total Outlays, Federal+State+Local:	$14.8 billion	$16.9 billion
Number of Recipients:	15.5 million	15.7 million
Foods Stamps		
Federal Outlays(=Total): (excludes administration costs)	$11.1 billion	$12.3 billion
Number of Recipients:	21.2 million	21.5 million
Welfare(all other cash payments)		
Outlays(exclusive of administrative costs) Federal+State+Local:	$40.1 billion	$40.4 billion
Federal only:	$24.1 billion	$24.2 billion
Number of Recipients:	16.1 million	16.2 million
Estimated Administration costs:	$19.9 billion	$23.8 billion

If all benefits were standardized and consolidated, with the Federal government administering the welfare system through IRS computers and data, and with the Food Stamp program replaced by food-in-kind allocation by the CWF, the estimated aggregate savings to the government would have been:

1981	1982
$21.8 billion	$24.4 billion

Naturally, there is no way to estimate accurately the precise savings from repalcing bureaucrats with the CWF.

Sincerely,

Richard J. Cebula
Professor of Economics