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THE BRACKET RACKET: HOUSE TAX BILL LOWERS TOP TAX THRESHOLDS WITH INFLATION

A review of the fine print in the House-passed tax proposals reveals that it would let inflation lower the real income thresholds at which the proposed 36% bracket and the 10% surtax kick in.

> ***The proposed delay in implementing indexing... proves once again just how eager Washington is to pull a fast one on the taxpayers, and how important a safeguard for taxpayers indexing is.***

Ostensibly, the 36% bracket would begin at $140,000 for married taxpayers and $115,000 for a single taxpayer in 1993. The (formerly) millionaires' 10% surtax would begin at $250,000 in 1993. The other tax brackets, the personal exemptions, and standard deductions are adjusted (indexed) for inflation. These new thresholds would be indexed too, but only after a year's delay, that is, for tax years beginning after December 31, 1994.

In other words, assuming 4% inflation between 1993 and 1994, the 36% bracket thresholds for 1994 and beyond would be allowed to slip to $134,615 in real 1993 dollars for married taxpayers and to $110,577 for single taxpayers. The 1994 surtax threshold would slip to $240,385 in real 1993 dollars, and remain at this depressed real level forever after.

The result of the slippage in the bracket thresholds will be to subject more of the nation's most productive people to punitive tax rates, disproportionately discouraging output and saving. Punishing the nation's major savers and investors is strange behavior for Members of Congress who publicly fret over the inadequacy of national saving and investment.

The tinkering with indexing may be part of a broader strategy to suck an increasing share of everyone's income into the Treasury: add more tax brackets, repeal indexing, and inflate away! The effect on the economy would be devastating.

President Carter tried using inflation and bracket creep to balance the budget. The result was higher labor costs and reduced employment growth as workers were forced to demand pay increases in excess of the cost of living to maintain the same real after-tax income after bracket creep. U.S. competitiveness collapsed. At its peak, the bracket creep due to the inflation of the late 1970s was absorbing 100% of the productivity-related gains in gross national product. Not a penny of the gains went to labor or capital, and after-tax incomes fell. Carter did Marx one better: From each according to his ability, to the government.

Workers and businesses did not sit still for this, of course. Strikes against mandatory overtime became common; no one wanted time-and-a-half in cash with wages spilling over into higher tax brackets. The flight to shorter hours and non-taxable fringe benefits took off (including ever-more generous health fringes that added fuel to the medical cost fire that consumes the federal budget today). Production moved offshore. Higher tax rates depressed private saving and investment. The tax element of interest rates zoomed, raising capital

Institute for Research on the Economics of Taxation

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costs for businesses and lifting the interest expense on the federal debt. Ultimately, the bracket creep resulted in stagflation, recession, and the Reagan revolution. Come to think of it, maybe that's what the economy needs, if this time around we could make it stick!

Tax increases should be enacted in a forthright, above-board manner. The government should not steal money away like a thief in the night. Letting inflation sneak a tax increase past the public without a vote being taken in the Congress is despicable. It is exactly this sort of slick policy trick that tax indexing is meant to correct. The proposed delay in implementing indexing for the new brackets proves once again just how eager Washington is to profit from inflation at taxpayer expense, and how important a safeguard for taxpayers indexing is.

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Note: Nothing written here is to be construed as necessarily reflecting the views of IRET or as an attempt to aid or hinder the passage of any bill before Congress.