Entitlement Reform

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TO: Bruce Reed, Counsel to the President

FROM: J. Larry Brown, Director Larry Brown

Based on our discussions last month I thought the enclosed materials, which have been circulated on the Hill, would be of interest to you. We share with you and others in the Administration concerns about the nature of current debate on welfare reform. Generally, discussion about the welfare system fails to note that federal government subsidies often accrue to the benefit of our wealthiest citizens. Moreover, these federal subsidies for the very rich may provide a useful vehicle to finance welfare reform for the poor. Analysis of preliminary research conducted by this Center suggests that reducing selected federal subsidies going to only the wealthiest 1% of taxpayers could yield billions of dollars per year for meaningful welfare reform.

Public debate over welfare reform is myopic. Virtually all Americans benefit from various welfare programs, yet discussions focus only on the poor. But analysis of major subsidies provided through the tax system shows that the poor receive fewer benefits than the wealthy, both on an aggregate and per capita basis. Many large federal subsidies are delivered through the tax system, typically in the form of write-offs which permit taxpaying units (individuals) to avoid paying taxes otherwise owed. The tables attached show the following outcomes on selected write-offs in the tax system for 1993:

** The richest 1% of taxpayers received $31.47 billion in government subsidies, compared to $15.29 billion received by the bottom 50% of the entire American population

** On a per capita basis, the richest 1% received $25,499, compared to $250 for the bottom 50%

** The U.S. government subsidized the richest 1% at a per capita level 100 times greater than the benefits provided to more than half the population

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These disparities are difficult to justify from a policy perspective. It must be asked whether it represents good public policy for the federal government to subsidize wealthy Americans at any time. The question is particularly poignant during a time of fiscal austerity, when government leaders are having a difficult time identifying revenue sources for meaningful reform.

To date nearly all welfare reform financing alternatives have focused either on reducing benefits for the poor, or on incremental reforms which include, for example, limited approaches to child care (a component necessary to enable the poor to enter the workforce). A broader discussion of financing alternatives, one that includes reducing subsidies for the wealthy, opens new avenues and new opportunities. The nation could then debate a welfare reform package which it can finance.

It has been suggested that a full reform package will cost in the vicinity of $15 billion over five years. If tax subsidies for the richest 1% of all taxpayers are put on the table, there would be no need to phase-in the reform. Reduction of any one major subsidy to this group alone could fully fund welfare reform at this suggested level (see Table 3). Elimination of two such subsidies for the wealthiest taxpayers could also help to fund health care reform. Further caps on subsidies to this group could save other American taxpayers billions of dollars.

Our research is on-going. It is necessary, for example, to try to determine potential unintended consequences of ending certain subsidies before advocating any one change. But an itemization of government subsidies by income category suggests that the richest 1% of all Americans are getting federal benefits more than one-and-a-half times as large as those provided to the poor under the AFDC program. On a per capita basis, the subsidy to this wealthiest group is more than sixty-five times as large as the average AFDC benefit to a family. This is highly significant.

To maintain the long-term viability of American social and fiscal institutions, the trend of increasing poverty must be reversed. This requires moving away from some of the old answers, and toward new solutions. It means improving programs that enable more of the poor to move into the labor force. Revenues for such initiatives must be found however; and this analysis suggests that they are available.

If discussion of welfare reform does not address the benefits provided to all Americans-- particularly the wealthiest-- proposed reforms may accomplish little. Precious federal dollars may be squandered for those who have little need for government help, while the opportunity to help the poor become self-sufficient may be lost.

Table 1: Federal Government Subsidies From Several Sources By Income Level of Recipients

(At 1993 Tax Rates and 1993 Income Levels)

	Top 1.0 % Of All Tax Returns By Income ($200,000+)	Top 5.0 % Of All Tax Returns By Income ($100,000+)	Bottom 52.0 % Of All Tax Returns By Income (Under $30,000)
	($Billions)	($Billions)	($Billions)
Mortgage Interest Deduction	4.44	15.84	0.97
Exclusion of Capital Gains at Death	7.04	9.58	0.47
Pension Contributions & Earnings	3.76	11.31	5.11
Real Estate Tax Deduction	1.86	5.04	0.27
State & Local Tax Deduction	7.46	13.51	0.19
Charitable Contributions Deduction	5.50	8.70	0.27
Medical Expense Deduction	0.17	0.53	0.75
Employer Health Insurance Contributions	1.24	7.14	7.27
Total ($Billions)	**$31.47**	**$71.65**	**$15.29**

Source: Based on data from the Congressional Budget Office, Joint Commmittee on Taxation, Congressional Research Service, Employee Benefit Research Institute, and the Association of Private Pension and Welfare Plans.

Table 2: Per Capita Federal Government Subsidies From Several Sources By Income Level of Recipients

(At 1993 Tax Rates and 1993 Income Levels)

	Per Return Subsidy To Top 1.0 % Of All Tax Returns By Income ($200,000+)	Per Return Subsidy To Top 5.0 % Of All Tax Returns By Income ($100,000+)	Per Return Subsidy To Bottom 52.0 % Of All Tax Returns By Income (Under $30,000)
	($ Per Return)	($ Per Return)	($ Per Return)
Mortgage Interest Deduction	$3,594.81	$2,711.40	$15.79
Exclusion of Capital Gains at Death	5,707.46	1,639.85	7.68
Pension Contributions & Earnings	3,047.00	1,935.98	83.54
Real Estate Tax Deduction	1,504.05	862.72	4.33
State & Local Tax Deduction	6,046.19	2,312.56	3.14
Charitable Contributions Deduction	4,457.05	1,489.22	4.35
Medical Expense Deduction	137.76	90.72	12.29
Employer Health Insurance Contributions	1,004.86	1,222.18	118.85
Total	$25,499.19	$12,264.64	$249.98

Source: Based on data from the Congressional Budget Office, Joint Commmittee on Taxation, Congressional Research Service, Employee Benefit Research Institute, and the Association of Private Pension and Welfare Plans.

Table 3: Federal Government Subsidies From Several Sources

By Income Level of Recipients

(At 1993 Tax Rates and 1993 Income Levels)

	Top 1.0 % Of All Tax Returns By Income ($200,000+)	Top 5.0 % Of All Tax Returns By Income ($100,000+)	Bottom 52.0 % Of All Tax Returns By Income (Under $30,000)
	($Billions)	($Billions)	($Billions)
Mortgage Interest Deduction	4.44	15.84	0.97
Exclusion of Capital Gains at Death	7.04	9.58	0.47
Pension Contributions & Earnings	3.76	11.31	5.11
Charitable Contributions Deduction	5.50	8.70	0.27
Medical Expense Deduction	0.17	0.53	0.75
Total ($Billions)	**$20.91**	**$45.95**	**$7.56**

Source: Based on data from the Congressional Budget Office, Joint Commmittee on Taxation, Congressional Research Service, Employee Benefit Research Institute, and the Association of Private Pension and Welfare Plans.