



## How Crazy is our Fiscal System?

The U.S. fiscal system comprises over 1,000 spending programs. There are 51 distinct versions of Medicaid, SNAP (food stamps), Section-8 housing support, Affordable Care Act subsidies, and many other in-kind and in-cash benefit programs. Each program has its own, often draconian, eligibility rules and tax/benefit schedules that depend on a host of demographic and economic factors.

On the tax side there is the federal income tax, the FICA tax, child tax credits, 42 state income taxes, 46 state sales taxes, federal and state corporate income taxes, federal and state childcare credits, federal and state estate taxes, etc.

Because all of our tax and entitlement programs interact in very complicated ways, it is impossible to say how any particular welfare or tax reform will affect different people at different income levels in different locations. Until now.

Using new software, never before available, Boston University economics professor Laurence Kotlikoff and his colleagues are able to [cut the Gordian Knot of fiscal complexity](#). This will be an invaluable tool for policy makers at the federal level and in every state capitol.

For example, the economists are able to calculate life-time net marginal tax rates. This is important because choices made early in life affect Social Security and Medicare benefits and other entitlements during the years of retirement.

Take the case of an Idaho couple, both age 37 and both high-school educated, with three children ages six, six, and ten. The couple's

limited resources place them in the bottom resource quintile. Their lifetime marginal net tax rate is 652.9 percent! Earning an extra \$1,000 leaves them worse off by \$5,529 in present value, because of a loss of entitlement benefits.

The economists are also able to do something else that has never been done before. They are able to calculate what a utility-maximizing individual would do in the face of a very complex set of fiscal incentives.

Consider a worker earning \$30,000 a year. If this individual drops back to part-time work and earns \$15,000, he qualifies for \$10,000 in means-tested welfare benefits. Compared with a non-distorting, lump-sum tax, his annual labor supply is 51 percent lower and his wealth at retirement will be 42 percent lower as a result of this decision. Plus, the government (i.e., taxpayers) is worse off by about \$6,500 a year.



*John Goodman with Congresswoman Beth Van Dyne, a member of the House Committee on Ways and Means*

## We Offer the Democrat Party a Platform

Instead of tax and spend, all kinds of Democrats' goals could be achieved with deregulation. Here are some examples.

### Free the housing market.

One of the main reasons for homelessness in America is that low-income families have been priced out of the housing market. Economists from across the political spectrum agree that a major reason for that is [excessive regulation](#) – including laws that make it [difficult to convert](#) vacant office buildings into residences. This should change.

### Let seniors go back to work.

Most people begin collecting Social Security benefits before they reach the full retirement age. Yet if they decide to return to the labor market, even at a part-time job, they can only earn \$22,320 a year without penalty. Beyond that sum, for every \$2 they earn they lose \$1 of Social Security benefits. That's a 50 percent tax on top of income and payroll taxes, as well as the Social Security benefit tax. Indeed, average-income seniors can end up in a [90 percent tax bracket](#)! Abolishing the earnings penalty should be a no-brainer.

### Encourage independent contracting.

The idea that people will work 40 hours a week at an employer's place of business dominates an enormous amount of labor law. But millions of people have decided that's not the way they want to work. [Public policy](#) should accommodate their preferences.

### Let every school become a magnet school.

It's hard to find a Democratic politician these days who supports school choice. That's because teachers' unions hate the idea and they are large backers of Democratic candidates. But I am not



*Goodman discusses The Enlightenment with author Steven Pinker at Freedom Fest*

aware of any teacher union complaint about the oldest and largest system of school choice we have: our [magnet schools](#).

### Liberate Medicaid.

Why not let low-income families buy medical care the way they buy food? At the supermarket, they combine food stamps with out-of-pocket money and pay the same market prices everyone else pays. If they do that today with medical care, it's a criminal act. Under a reformed Medicaid, they could still go to the emergency room and lose a day's pay. Or they could save time and money at a MinuteClinic.

We should also give low-income families access to 24/7 primary care. [Direct primary care](#) (DPC) doctors give patients their cell phone numbers so that they can get medical advice at nights and on weekends instead of immediately going to the ER. At [AtlasMD](#) in Wichita, the cost is \$50 a month for a mother and \$10 for a child for all primary care.

Medicaid should deposit funds for primary care into Health Savings Accounts for low-income families, allowing them to purchase care directly or pay a monthly fee to a DPC doctor of their choice.



## A Better Way of Taxing Social Security Benefits

Writing in [The Hill](#), John Goodman and Stephen Moore say that maybe Donald Trump is on to something when he questions why the federal government taxes Social Security benefits.

Technically, this isn't even a tax on benefits. We impose a tax on additional income that Social Security beneficiaries earn while they collect Social Security checks. If Social Security is the only source of income, individuals don't pay any tax on it.

As a result of this tax and other penalties, seniors who continue to work often pay the country's highest tax rates – much higher than the rates young people with the same income pay. That's unfair and a punishment for those who work while they collect Social Security benefits.

Under current law, if one-half of Social Security payments plus other income exceeds \$25,000, the individuals must pay income taxes on 50 cents of Social Security benefits for each additional dollar they earn. Since they also must pay regular income taxes on that dollar, they have to effectively pay taxes on \$1.50 for each \$1.00 of earnings. That means that the tax rate on an additional dollar of earnings is 50 percent higher than it would be for a young person with the very same income!

It gets worse.

Once the combined income threshold reaches \$34,000, the tax on Social Security benefits rises to 85 percent for each additional dollar they earn. The tax liability is 85 percent higher than it would be for a young person with the very same earnings.

For someone in the [15 percent bracket for ordinary income](#):

- The Social Security benefits tax potentially

increases the tax rate on pension income and 401(k) and IRA withdrawals from 15 percent to 27.75 percent.

- It can raise the tax on capital gains and dividend income from zero to 12.75 percent.
- Even tax-exempt income can be taxed at a rate of 12.75 percent.

When income and payroll taxes are added in, senior workers can face a marginal tax rate that exceeds 80 percent – i.e., for every additional dollar they earn, they take home 20 cents!

Note that these high marginal tax rates only apply to middle-income seniors. Low-income seniors don't earn enough. And for high-income seniors, the marginal tax rates go away when benefits have been completely liquidated by the earnings penalty or when they have been “fully taxed” by the benefits tax.

We could eliminate those very high marginal tax rates by treating a portion of the benefits as ordinary (taxable) income instead of the Rube

Goldberg arrangement we have today. No longer would seniors be paying rates that are effectively 50 percent or 85 percent higher than what other workers pay.

This would also eliminate the stealth inflation tax imposed on seniors because tax rates on ordinary income (unlike the current Social Security benefit tax) are already inflation-indexed.

Seniors who want to continue to work, invest and contribute to the economy shouldn't be so heavily penalized for doing so. And the government should never benefit from the inflation it causes at the expense of the elderly and the disabled.

*Some seniors face a marginal tax rate greater than 80 percent.*

## Outreach

Dr. Goodman represented the Goodman Institute this quarter at the Freedom Fest conference in Las Vegas, the State Policy Network conference in Phoenix, the Heartland Institute annual dinner in Chicago and the Mont Pelerin Society conference in New Delhi.

He also testified before the Texas Senate Committee on Health and Human Services in Austin on the need to deregulate medical practice restrictions for clinicians.

## Testimony in Austin

Should people in various aspects of medicine be able to practice to the top of their training? Common sense would say yes. Dr. Goodman told a legislative committee in Austin that scholarly research backs the common sense.

Texas is one of 11 states that do not allow nurses to perform any medical act without a doctor's supervision. For example, Dallas nurses must pay a doctor-supervisor \$50,000 a year in order to set up an independent practice.

The need for a doctor-supervisor almost guarantees that nurse practitioners have to locate where doctors are located – and that tends to be in large cities. Goodman said that at a minimum we should allow nurses who relocate to under-doctored areas to pocket the \$50,000 they were giving to their supervisor.

The American Association of Nurse Practitioners publishes a list of studies that



*John Goodman with Nigel Farage at the Heartland institute annual dinner*

support the quality of nurse-practitioner care. A majority of states allow nurses to practice independently – without doctor supervision. Even the American Medical Association admits that nurses can provide services within their level of training comparable to the care that physicians provide.

Another reason for reform is to provide better care for low-income patients. New enrollees in Medicaid increased their use of the emergency room by 40 percent.<sup>1</sup> This is a wasteful way to deliver care that in most cases does not require a hospital setting.

<sup>1</sup> [Shannon Firth](#), “Study: ER Visits Increase 40 Percent With Expanded Medicaid,” US News, Jan. 4, 2014.



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