Dave Dempsey

THE POVERTY OF THE STATE

BY THOMAS BODENHEIMER

State and local governments entered the 1970s in a state of deep crisis. All states made or considered welfare cuts in 1971. At least 20 state welfare departments began 1971 with deficits. Twenty-four state Medicaid programs were in the red, and many are denying health services to the poor. San Francisco county welfare recipients were cut back to $88 per month. Twenty-six city recreation halls in Cleveland were closed, and 85 percent of recreation department employees were removed from the payroll. Mayor Lindsay laid off thousands of New York City employees, crippling welfare, health, lead-poisoning, and rat-control programs. In California, Connecticut, and other states, freezes went into effect on state hiring. In California, state employees were denied cost-of-living wage increases.

What is happening? Widespread cutbacks in state and local public services. Decreases in numbers of public employees. Freezes in public employee wages. What is the reaction to these cutbacks and freezes? Los Angeles teachers struck for one month in 1970 to fight against inadequate school funding. New York City's Brownsville broke out into riots in 1971 to protest 10 percent welfare cuts. Welfare-rights groups sued the state

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The author is a physician who works with the Medical Committee for Human Rights. He wishes to acknowledge his debt to James O'Connor's article, "The Fiscal Crisis of the State" (*Socialist Revolution*, January and March 1970) from which the basic ideas for this piece were derived.

of California for cutting health services. Public employee strikes for higher wages swept the country in 1970-1971: city workers in Atlanta and San Francisco; police in Pittsburgh, New York, and Milwaukee; sanitation workers in Seattle; postal workers across the country; teachers in Woburn, Scranton, Stamford, Newark, Philadelphia, Muskogee, Chicago, Gary, Toledo, Butte, and many other cities and towns.

The number of work stoppages in the government sector has increased tenfold in four years. Public employees are demanding decent wages. Employees and users of public services are protesting cutbacks.

The answer of state and local governments to these protests and strikes? The Governor of Connecticut stated that his state is "wallowing in debt." The Governor of Pennsylvania pushed for new taxes to avert bankruptcy. California and Michigan faced large budget deficits. Massachusetts expects a $100 to $200 million deficit in its Medicaid program. In city after city, state after state, the same answer: there is no money.

How do taxpayers respond to this crisis of their governments? In Youngstown, Ohio, and in suburbs of St. Louis, schools were closed for weeks because voters refused to approve tax levies to operate them. In Cleveland, voters turned down a city income-tax increase. In California, a medical-school bond issue was defeated. A virtual tax revolt is upon us—people are refusing to pay. More than 2,300 well-organized tax protest groups exist around the country with two million members.

People's lives are increasingly dependent upon the state (the public sector). Eleven million public workers are now employed at federal, state, and local levels. In addition, tens of millions of people rely on the government for educational and social welfare services: students needing an education, welfare recipients, and users of public hospitals and health facilities. This group is expanding with rising public school and college enrollments, a 22.5 percent increase in welfare recipients in 1970, and a growing governmental share of health-care financing. Thus we have uncounted millions of public clients—people receiving services from the state.

The cutbacks and freezes show that governments have been less and less able to meet the needs of public workers and public clients. In order to maintain or improve services and to raise wages, taxes must be increased. Yet taxpayers are refusing to pay. These two trends—the rising demands of public workers and public clients, and the refusal of taxpayers to pay more—have placed the state in profound crisis. This crisis reflects a paradox of modern American society: in the richest country of the world the public-welfare sector is stricken by poverty.

To explain the poverty of the public-welfare sector, we must examine the relation between the government and the corporate rich. This relation is two-fold. First, the state collects relatively few taxes from the corporate rich, placing the major tax burden on working people and the poor; and these taxpayers are rightfully refusing to pay more. Secondly, the government provides huge subsidies to corporations, thereby using up a considerable portion of its budget in a way that does not benefit the general public. Public workers and clients are striking and protesting against the government's refusal to appropriate decent amounts for health, welfare, education, and recreation services.

Let us look at some details of this tax-and-subsidy system which impoverishes the public-welfare sector.

Taxation in America

Taxes can be classified as regressive, proportional, or progressive, according to how they are shared by different income groups. A regressive tax hits the poor harder than the rich; if families with income under $5,000 pay 10 percent of that income in a certain tax, whereas families over $15,000 pay 5 percent of their income in the same tax, then that tax is regressive. A tax is proportional if all are taxed the same percentage of their incomes, e.g., a 10 percent across-the-board tax. A progressive tax makes rich people pay, for example, 25 percent of their income while poor people might pay 10 percent.

Equitable taxation makes people pay according to their ability. Rich people normally save a sizable part of their incomes, and thus a 50 percent tax does not cut into the amount of necessities they can buy. Poor people spend all or most of their incomes on food, shelter, clothing, and transportation; and even a 5 percent tax becomes an enormous burden. Thus proportional taxation—such as a 10 percent tax for everyone—is not just; it hits the poor family very hard, yet is of little consequence to the rich. Only progressive taxation, with a substantial increase in tax rate as income rises, is truly equitable.

In fiscal year 1968-1969, federal, state, and local governments collected $312.6 billion. These revenues include $222.7 billion in taxes, $46.6 billion in social insurance payments (such as social security), and $42 billion in miscellaneous charges (such as state liquor sales, fines, etc.). The federal government collected $199.6 billion of the total revenues. State and local governments collected $59.8 billion and $53.2 billion respectively. State governments also received $17.8 billion in intergovernmental transfers from the federal government, and localities received $26.1 billion in transfers.[1] *

The *individual income tax* accounted for 36 percent of all tax revenues in 1968-1969.** The great bulk of income tax payments—$87 billion in that year—go to the federal government. People generally believe that this tax is truly progressive, with the rich paying significantly more than the poor. This belief is a myth. In fact, most people pay at approximately the same tax rate. And the super-rich frequently pay very little.

According to Brookings Institution economist Joseph Pechman, individuals or families earning between $4,000 and $5,000 pay an average of 5 percent of their incomes in federal income taxes.[2] Those making between $6,000 and $7,000 pay an average income tax of 7 percent; from $8,000 to $9,000 the average is 8 percent; the $12,000 to $13,000 bracket pays 10 percent; and the $15,000 to $20,000 category pays 12 percent. Pechman contends that rates rise from 23.5 percent on incomes between $50,000 and $75,000 to 34 percent on incomes over $1 million. However, he fails to take into account that a large portion of capital gains to the rich is never reported

* Numbered notes will be found at the end of the article.

** "Total tax revenues" will be taken to mean taxes plus social insurance payments. This total in 1968-1969 was $269.3 billion.

as income. Thus the actual average tax rate for earners over $50,000 is closer to 20 percent.[3]

Thus the federal income tax is progressive only to a very slight degree. And many wealthy people take advantage of enormous tax loopholes to pay little or no tax. In 1969, 56 people with incomes over $1 million paid no federal income tax at all. The total amount of revenue lost to the federal government through loopholes to the rich is estimated at a staggering $50 billion per year.[4] And the Tax Reform Act of 1969 did veiy little to correct these injustices.

The income tax is minimally progressive because it rests on the principle that some incomes are more taxable than others. Wages are taxed fully, income from stocks and other investments is taxed less, and income from municipal bonds is not taxed at all. Stern gives the following examples in *The Great Treasury Raid*: "Albert's $7,000 was earned over a year's time in a steel mill. Albert pays $1,282 in taxes. . . . Charles merely picked up the telephone, told his broker to sell some stock, and netted a $7,000 profit. Charles's tax: $526."[5] And Mrs. Horace Dodge, with $1.5 million in yearly income from municipal bonds, paid no taxes at all. Thus the income tax structure invariably hurts working people, who get most of their income from wages.

Social security payments amounted to $44 billion in 1968-1969, thus constituting 16 percent of total tax revenues. In describing social security, Pechman writes: "The payroll tax is the most burdensome tax levied by the federal government on the poor in the United States."[6] The following figures show why. A family with income of $3,000 to $4,000 pays an average of 11.3 percent of this income in social security payments. Families with incomes between $5,000 and $7,500 pay 6.8 percent in social security. Between $7,500 and $10,000, families pay 4.2 percent. From $10,000 to $15,000 the tax is only 2.1 percent. Over $15,000 the rate is less than 1 percent.

Why is social security so regressive? First, it taxes only wages. Low-income people earn money only from wages, all of which is subject to the payroll tax. People with higher incomes may have non-wage sources of money which are not taxed. Secondly, there is a cutoff point at $7,800; wages above

$7,800 are not taxed. A person earning $7,800 might pay $390 in social security payments, while someone making $15,600 also pays $390. The first person pays a 5 percent tax whereas the second pays only 2.5 percent.

Thirdly, the employer's portion of social security is actually paid by the employee. Social security deducts a certain percentage of the employee's income, and also collects money from the employer for each person on the payroll. However, the employer does not really pay his share. He generally shifts his portion of the payroll tax to the employee by keeping wages down. According to Pechman, most economists believe that "a major share of a payroll tax is borne by the wage earner, and some believe that all of it rests on him. . . . While they [employers] very likely are unable to reduce wages immediately after imposition of the tax, they can do so effectively over time by not increasing wages as much as they would have if the tax had not been introduced." The only exception might be a strongly unionized plant where "unions may succeed in inducing management to grant a larger wage increase after imposition (or increase) of the payroll tax. In such circumstances, part or all of the payroll tax may be shifted to the consumer." Thus the employer does not pay social-security taxes. Usually the worker is taxed by receiving lower wages, and occasionally the consumer bears the burden through higher prices.

The *corporate income tax* accounts for 14 percent of total tax revenue, most going to the federal government. The federal corporate tax revenue in 1968-1969 was $36.7 billion, with corporate profits before taxes totaling $136 billion. Thus the corporations appear to be taxed at a 27 percent rate. However, economists generally believe that corporate stockholders do not pay this entire tax themselves. As in the case of social security, corporations shift part of the tax to workers by keeping wages down, and part to consumers by raising prices.

How do corporations do this? Let us suppose that there were no corporate tax, and that corporate profits were $100 billion. Let us then suppose that the government imposes a corporate tax approximating $40 billion. The corporations manage to increase their pre-tax profits to $140 billion by raising prices and keeping wages down. In that case, after-tax corporate profits are still $100 billion. The corporations have paid no taxes but have shifted the burden to workers and consumers.

Suppose, however, that the corporations earn $120 billion in pre-tax profits, a $40 billion tax is imposed, and the corporations are able to raise their pre-tax profits only to $140 billion. Net profit, then, is $100 billion, and the corporations have lost $20 billion in taxes. In this case, the corporations managed to shift only 50 percent of their taxes and must pay the remainder themselves.

In reality, it is not known exactly what percent of corporate taxes are shifted, but the figure can be conservatively estimated to be 50 percent. Corporations, then, are actually taxed not at a 27 percent rate, but closer to 15 percent.

Some corporations find ways to successfully avoid the corporate tax. Oil companies are a good example. In 1967, Texaco was taxed at 1.9 percent of its income, Standard Oil of California at 1.2 percent, and Atlantic-Richfield paid no tax at all. Between 1960 and 1968, corporate profits increased 91 percent, whereas corporate taxes dropped by $5 billion.[7]

Sales and excise taxes brought in $39 billion to all levels of government in 1968-1969. For state governments, these taxes make up 48 percent of tax revenue. Sales taxes hit people in proportion to the percentage of their income spent on the taxed items. A sales tax on bread or milk is extremely regressive since everyone must buy basic foods, and for the poor, food is a high proportion of the family budget. A sales tax on caviar, French champagne, or diamond rings is not regressive since poor people are not interested in such items. Some state sales taxes are approximately proportional, since food, gas, and electricity are not taxed. (Any proportional tax, remember, is not equitable since the poor are less able to afford the payments.) Other states, however, place a sales tax on all items, resulting in very regressive taxation.

Most unjust of all is the *property tax*. This levy brings in $30 billion, making up 11 percent of all taxes. For local governments it becomes very important, accounting for 82 percent of tax revenues. (If one counts total local revenues, including transfer payments from federal and state governments, property taxes make up 38 percent.) Almost all property taxes are paid by tenants and homeowners. The property tax on business establishments is generally assessed on amounts far lower than the real value of the property, and can be shifted to consumers. In apartment buildings the property tax is totally shifted to tenants in the form of higher rents. The extraordinary regressivity of the property tax is shown by these figures from Rostvold's study of California financing: families earning $1,000 per year pay 13 percent of their income in property taxes; those making $4,000 to $5,000 pay 5 percent in property taxes; and families with incomes over $15,000 pay only 2 percent in property taxes.[8] The richer the family, the lower the percentage of taxation. It is no surprise that local governments, financed heavily by property taxes, are facing a tax revolt from millions of tax-exploited, lower-middle-income homeowners.

What is the overall effect of taxation in America? One authoritative estimate is shown in the table on page 15.

As the table shows, taxes hit the poor far harder than the rich. Up to $10,000 income, taxes are actually regressive. From $10,000 to $50,000 the rate is essentially proportional. Only the very rich appear to pay a substantially higher rate; however, the 45 percent figure may be far above the true figure because of already noted large amounts of unreported capital-gains income. In any case, the very rich pay at a lower rate than the very poor.

Government Subsidies to the Rich

A sizable portion of the federal budget is spent to help private corporations increase their profits. These corporate subsidies total well over $30 billion per year, according to a 1971 Associated Press survey.[10] The exact amount is hard to determine, since it depends on the definition of subsidy. The $30-billion figure refers only to payments giving special advantages to business; if one includes all money passing from the government to private industry, the figure is far higher. In addition, governmental laws and regulations assist the corporate rich through franchises, licensing, contracts, etc. Without question, federal aid to private enterprise is more than twice what the government spends for all its welfare programs.

Money Income Levels[9]	*Overall Percentage Tax Rate*
Under $2,000	50.0
$ 2,000—3,999	34.6
$ 4,000—5,999	31.0
$ 6,000—7,999	30.1
$ 8,000— 9,999	29.2
$10,000—14,999	29.8
$15,000—24,999	30.0
$25,000—49,999	32.8
Over $50,000	45.0

A significant portion of the $75-billion defense budget goes to private corporations. Some $20 billion is spent on procurement of supplies—buying bombs, tanks, and planes from private companies. Defense research and development cost $7 billion, which is also paid largely to private business.

Research and development in general is an important government subsidy; in 1969 the federal R&D expenditure topped $17 billion, one tenth of the entire budget. Corporations are reluctant to spend their money for R&D, which is an expensive and risky undertaking. Thus the government pays, yet the profits deriving from newly developed products belong to the companies.

Large subsidies go to certain sectors of the economy which are "in trouble." Agriculture is the best known: farmers received between $6 and $9 billion in 1970. Not surprisingly, a large part of this money was paid to big corporate farms which were never in trouble to start with. In 1970 two huge California growers alone received $4.4 million and $3.3 million in subsidies, and 400 farmers were each paid over $100,000. A recent limitation on subsidy payments is being successfully evaded by dividing large farms into smaller sections.

The purpose of the $3 to $4 billion foreign-aid program is not, as many Americans believe, to aid foreign countries; rather it serves to aid U.S. business to gain a foothold in those countries. The Agency for International Development (AID) lends money to underdeveloped countries, but that money is mostly used to buy American products. If AID finances a telephone network or potable water system in Peru, the telephone poles, wires, transformers, and water pipeline must be bought from American, not Peruvian, companies. Often U.S. construction firms actually build the projects. In these and other ways, foreign aid is a mechanism for transferring money from taxpayers to U.S. business.

Pollution control is another corporate subsidy. Government pays to mop up after industries have destroyed the environment and gives financial incentives to encourage industries to stop polluting. Again, the cost of controlling pollution rests on the taxpayer rather than on the corporate polluter. And numerous other subsidies benefit the corporate rich: half a billion dollars to the shipping industry, millions for airlines and railroads, government training programs for corporate employees, loan guarantees, construction contracts, and so on.

In these and countless other ways, governments help private corporations to lower their costs and maximize their profits. Higher profits result in increased stockholders' dividends. And these dividends do not go to average Americans. The richest 1 percent of families in the country own over 80 percent of the stock. So corporate subsidies almost exclusively benefit the very rich.

Corporate subsidies, then, compete with health, education, and welfare services and with public workers' salaries for the scarce tax dollars. Coupled with a tax system that favors the rich and lays its major burden on working, poor, and middle-class people, corporate subsidies become just another reason why the "impoverished" government cannot meet the needs of its workers and its clients.

The tax and subsidy system, then, tends to transfer money from the average taxpayer to a handful of wealthy corporate stockholders. It is precisely this system that helps to perpetuate a radically lopsided distribution of income in the United States. In 1967, the highest 10 percent of the population received 28 percent of total national income, whereas the lowest 10 percent received less than 2 percent.[11] This inequality has not changed since 1910.[12] The distribution of wealth (income, plus assets such as real estate, stocks, bonds, savings, etc.) is much more favorable for the rich. The top 10 percent of the population owns 60 percent of the country's wealth, with the super-rich 1.6 percent owning 32 percent of all assets.[13] One half of the population, on the other hand, owns virtually nothing.

As Kolko puts it in *Wealth and Power in America,* "We have not taxed the rich to give to the poor; we have taxed both the rich and the poor and . . . contributed only a small fraction of the proceeds to the welfare of the poor."[14]

Implications for Local Organizing

If all poor, working-class, and middle-class people were united and aware of the government's role in perpetuating the maldistribution of wealth in society, the inequality would not be allowed to continue. But these groups have defined themselves narrowly as workers, clients, or taxpayers and are frequently pitted against each other.

Competition is particularly evident on local issues. In municipal hospitals, for example, employees may strike for wage increases. The strike threatens patients, whose health care—a life-and-death matter—is temporarily halted. Likewise, taxpayers are angered, since higher wages mean higher taxes. Teachers' strikes create similar feelings in parents and taxpayers.

Disunity among workers, clients, and taxpayers also springs up when public clients demand improved services. Night and weekend clinics at a health center mean night and weekend work, which is not desired by most employees. Workers are afraid that client demands might mean speeded-up working conditions, since no new workers might be hired. Community control over hiring becomes a major threat to workers who fear the loss of their jobs. And taxpayers regard demands for increased services as equivalent to tax increases.

Again and again, the triad of public worker, public client, and taxpayer finds the members at odds with one another. However, this competition is not necessary. It is caused by the poverty of the state. Worker, client, and taxpayer fight over the few crumbs begrudgingly dropped into the public sector by the corporate giants, who greedily consume their multibillion dollar fare of subsidies and tax breaks. Were the exploited triad to combine and demand its share, there would be plenty of money and services to go around.

Groups engaged in local struggle must understand the potential conflicts and must develop demands that encourage unity. Every wage battle by public workers should include a demand for financing increased wages by progressive taxation. Every drive for increased services spearheaded by the community should include demands for more employees to carry out the services and a proposal for tax reform to pay for them. Workers' demands must include provisions for improved services. Clients' demands must speak for better wages and working conditions for workers. Demands must always include tax-reform proposals, especially at the local level where the regressive property tax finances many programs.

Unity among workers, clients, and taxpayers requires an understanding of why the public-welfare sector is so poor. The reason, of course, is the regressive character of the tax system and the payment of large corporate subsidies. With this understanding, the three groups can unite around programs that call for more and better services, improved wages and working conditions, paid for in a manner that more equitably taxes the rich and the corporations.

NOTES

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3. Gurley, J. G. "Federal Tax Policy," *National Tax Journal*, 20:319, September 1967.
4. House Ways and Means Committee, "Tax Reform, 1969" (Washington: Government Printing Office), pp. 1788 and 4199.
5. Stern, P. *The Great Treasury Raid* (New York: Random House, 1964).
6. Pechman, J. et al. *Social Security: Perspectives for Reform* (Washington: Brookings Institution, 1968).
7. House Ways and Means Committee, "Tax Reform, 1969," pp. 4194, 4315.
8. Rostvold, G., *Financing California Government* (Dickenson Publishing Co., 1967).
9. Herriot, R. and Miller, H., "The Taxes We Pay," *The Conference Board Record*, 8:31, May 1971.
10. *San Francisco Chronicle*, August 1, 1971.
11. Budd, E. C., "Postwar Changes in the Size Distribution of Income in the U.S.," *American Economic Review*, 60:247, May 1970.
12. Kolko, G. *Wealth and Power in America* (New York: Praeger, 1962).
13. Lundberg, F. *The Rich and the Super-Rich* (New York: Bantam Books, 1968).
14. Kolko, *Wealth and Power*.