THE WALL STREET JOURNAL.

July 8, 1985

Return the Family to 1954

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President Reagan proudly describes his tax-reform proposal as "pro-family." And the substantial tax relief for families with dependent children that it would provide has gained wide support. But there is another "pro-family" element of his proposal: It would reduce the present tax benefit to mothers in middle-income families who decide to work. Advocates for working mothers have mounted a campaign against this aspect of the plan, and the administration is reconsidering it. The administration was on the right track in the first place; the plan need not be changed.

First, the noncontroversial part. By almost doubling the personal exemption from $1,080 to $2,000 and by raising the Zero Bracket Amount (the minimum standard deduction) for married parents from $3,670 to $4,000, the president's proposal lowers the tax rate for all families with children. Families at or below the poverty line, about $12,000, would pay no taxes. Under present law, a typical family of four at the poverty line pays about $450 in taxes.

Half of all of poor families are headed by single parents, whether widowed, divorced, or unwed. By raising the minimum standard deduction for heads of households from $2,480 to $3,600, the proposal also exempts these families from the income tax. When it comes to child care, the proposal makes no attempt to legislate morality.

The president's proposal would reverse an almost continuous postwar increase of the tax burden on middle-income families with children, caused by the failure to index the personal exemption and the standard deduction. At the end of the war, the $500 personal exemption was the equivalent of $3,000 in today's dollars. It was increased to $600 in 1947, then left unchanged for the next 20 years. By 1967, its value had eroded to about $2,000 in today's dollars. Over the next few years, it remained roughly constant, as Congress periodically raised it about enough to offset continuing inflation. But since 1973, its value has fallen steadily. The 1980 increase to $1,000 ($1,300 in today's dollars) did not offset the high inflation of the late '70s, and the 1981 tax cut did not increase the exemption, so that its real value declined still further. Right now, it is as low as it has ever been.

As a result, there has been a major shift of the tax burden onto families with children. According to an American Enterprise Institute study, over the last 30 years, the average effective tax rate on middle-income married couples with two children nearly tripled, while that for single people and married couples without children increased only by one-sixth.

Thus, the president's proposal would return families to the position they enjoyed until the ravages of inflation devalued the personal exemption. In 1954, typical married couples with two children paid about 4% of their income in taxes. By 1980, they paid 14%. Under the president's plan, assuming average deductions and both spouses taking full advantage of the IRA-deduction, their tax rate in 1986 would again be about 4%.

The redistributive effects of the tax plan have won support across the political spectrum. For example, Marian Wright Edelman, president of the Children's Defense Fund, described them as "a giant step toward providing poor working families with children desperately needed federal tax relief."

The proposed tax treatment of a working mother's earnings is another matter. By reducing overall tax rates and by raising the personal exemption, the president's proposal would lower the tax on the prime earner's income, usually the husband's, whether or not the other spouse works. On the other hand, by repealing the "marriage penalty" deduction (the 10% deduction for the second earner's income), by changing the child-care credit to a deduction, and by allowing a full IRA deduction for non-working spouses, the proposal in effect raises the tax on the wife's income.

In upper-income families, the overall reduction in tax rates is large enough to offset this effect, so that their tax rate declines. But for families with incomes between $20,000 and $35,000, with the wife earning from $5,000 and $10,000, the tax on her earnings would rise by between $100 and $500, and her take-home pay would decline by between 2% and 20%, depending on the deductions taken.

Consider one "typical" middle-income family: both spouses working, two children, a combined income of $27,500, with the husband earning 70% of the total and the wife the rest. Under current law, if this family takes full advantage of the IRA deduction and receives the maximum child-care credit, they pay no income tax on the wife's earnings. Her net income, after subtracting her Social Security tax and child-care expenses, is around $2,900 for the year. Under the president's proposal, there would be a $550 tax on her earnings, and her net income would be reduced to around $2,350.

These are extreme assumptions. But even if the family claims the average child-care credit and takes no spousal IRA at all, taxes on the wife's income would still go up, from about $950 to $1,025, and her take-home pay would fall from about $5,300 to $5,200. For many middle-income married mothers, then, the proposal reduces the financial rewards of working.

There are two ways to view this aspect of the president's tax proposal. Its opponents see it as a new penalty on working mothers, designed to encourage them to stay home and care for their children. As evidence, they point to the president's emphasis on "traditional family values" and the New Right's intensive lobbying in favor of this aspect of the plan.

The work-force participation of middle-income mothers would undoubtedly decline under the president's plan. Research has shown, not surprisingly, that wives' decisions about working are affected by the net wages they earn. Estimates of the wage elasticity vary. A reasonable estimate is that for every 1% reduction in after-tax earnings, they would reduce hours of work by the same percentage. Thus, the president's tax plan could reduce the amount of time a middle-income married mother works by up to 20%, depending on the deductions taken by the family. In some families, the effect would be enough to cause the mother to stay at home, rather than work at all.

It is more accurate, however, to view the proposal as remedial. Between 1975 and 1981, responding to widespread recognition that marginal tax rates on working wives were too high -- in 1975, a typical wife was in the 20% bracket -- their tax rates were progressively lowered. However, many would be surprised how far this much-needed reform was taken. Remember that in our hypothetical, extreme case, there was no income tax on the wife's earnings. The proposal would raise her tax rate from 0% to 7%. For the family claiming the average child-care credit and no spousal IRA, the wife's tax rate merely rises from 11% to 12%.

By fairly taxing a mother's earnings, the president's proposal more nearly neutralizes the tax code's impact on her decision about entering the work force. This is as it should be. A mother's working should be a personal choice, not affected by tax incentives.

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