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ARE AMERICANS OVERTAXED?

No. Taxes Are Down, Debt Is Up, and the Demand For Government Services Is Greater Than Ever.

By Robert Greenstein

No one likes paying taxes – least of all Americans. But, despite well-worn assertions to the contrary, Americans are not paying too much – at least not by historical standards, not compared to other developed countries, and most importantly, not in light of the revenues needed to maintain the size of government that Americans want.

Households in the middle of the income spectrum paid an average of 13.9 percent of their income in federal taxes in 2004 (the most recent year available), according to the Congressional Budget Office. That's the lowest share since CBO began collecting this data in 1979 (except for 2003, when it was 13.8 percent). These figures include all federal taxes, such as income, payroll, and excise taxes.

Federal taxes have declined mostly because federal income taxes have declined significantly. The median-income family of four paid only 5.8 percent of its income in federal income taxes in 2006. These "effective tax rates" are the lowest in at least half a century.

Moreover, both income taxes and overall federal taxes were at historically low levels even before the 2001 and 2003 tax cuts. In 2000, the median-income family of four paid a smaller share of its income in federal income taxes than in any year since 1966 (except for 1998-1999).

But because the purpose of taxes is to finance public programs, the fundamental tax question is whether we are collecting enough revenue to maintain the services we expect from government. As Federal Reserve Chairman Ben Bernanke told Congress, "Crucially, whatever size of government is chosen, tax rates must ultimately be set at a level sufficient to achieve an appropriate balance of spending and revenues in the long run."

Unfortunately, the United States faces a long-term imbalance between projected revenues and spending that's dangerously large. The national debt, now equal to 37 percent of the Gross Domestic Product, will soar to more than 200 percent of GDP by 2050 if current budget policies are continued — that is, if laws governing entitlement programs like Medicare do not change and the President's tax cuts are permanently extended.

Debt at this level would seriously damage the economy. It also would severely strain the federal budget. By 2050, more than half of federal revenues would go simply to pay interest on the national debt.

So, sooner or later, policymakers will have to put the nation's fiscal house in order.

The long-term budget gap is much too large to close solely by raising taxes. Even if all of the President's tax cuts were allowed to expire by 2010 as scheduled, the national debt still would climb to more than 100 percent of GDP in 2050 and keep rising thereafter.

But the budget gap is also too large to close solely by cutting spending. Medicare, Medicaid, and Social Security are projected to grow considerably in coming decades due to rising health-care costs throughout the economy and the impending retirement of baby boomers. By 2034, these three programs plus defense are projected to consume all federal revenues, leaving no revenues to pay for everything else the federal government provides — education, veterans' benefits, border security, assistance for the poor, environmental protection, and so on.

We simply can't continue to protect the nation, help the needy, provide health care coverage, educate our children, and do the other things we expect if we cut federal programs by the full amount needed to restore fiscal balance.

Therefore, serious deficit reduction must include both tax increases and spending cuts. Tough choices will have to be made on both sides of the ledger.

Some say that making the President's tax cuts permanent is vital for the health of the economy. But the tax cuts haven't produced an especially robust economic recovery. In terms of economic growth, investment, wages and salaries, and especially job creation, this recovery has been weaker than the average recovery since World War II — including that of the 1990s, when taxes were raised.

Nor have the tax cuts generated robust revenues. If this recovery were like the average recovery since World War II, revenues would be 10 percent higher (after adjusting for inflation and population growth) than when the current business cycle started in 2001. Instead, real per-capita revenues at the end of 2006 were still below their 2001 level.

Mainstream economists generally agree that large, permanent tax cuts will more likely hurt the economy than help it in the long run if they aren't fully paid for. That's because unpaid-for tax cuts make long-term deficits worse, and large, persistent deficits are a drag on the economy.

Even making the tax cuts permanent and paying for them would produce only a very modest improvement in long-term growth. Says who? Says the Administration's own Treasury Department.

Especially during tax-filing season, it's tempting for taxpayers to think they are over-taxed. The facts, however, simply don't support that belief.

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