"America the Undertaxed"

By Editor Test *Wed, Sep 5, 2012*

Compared with 33 other industrialized nations, total tax revenues in the U.S. were the third lowest as a percent of GDP in 2009. But MIT's Andrea Campbell doesn't necessarily think that's something to brag about.

At a little past midnight in the old-fashioned clubroom of an Ivy League university a few months ago, two men settled deeper into leather chairs and swirled the ice in their last cocktails of the night. The topic of U.S. tax policy came up.

It's not healthy, one said, when as many as half of all Americans pay virtually no federal income taxes, leaving the rest with a huge burden. If the poorer people paid more, they might better appreciate the true cost of what society gives them and relinquish their sense of entitlement.

Personally, I *would* prefer to owe more taxes. That's not because I think it could make me a better citizen, but because I've noticed that bigger tax bills tend to correlate with higher standards of living. In any case, I'm not sure whether I'm taxed fairly or unfairly, relative to the services and benefits I get.

In the home stretch of a presidential race where the tax question is front and center, an MIT political science professor makes the counter-intuitive claim in the latest issue of *Foreign Affairs* that the U.S. is a low-tax haven compared with other advanced countries.

In an article called "America the Undertaxed," Andrea L. Campbell claims that the overall tax burden has been shrinking in the U.S. for decades, on both rich and poor, and that the decline has led not to general prosperity but merely to a concentration of wealth in fewer hands.

Campbell gathered a wide range of data that enable her to make comparisons between the U.S. of several decades ago and today and also between the U.S. and some 30 other countries in the Organization for Economic Cooperation and Development, or OECD.

In terms of historical data, she claims that the effective federal income tax rate for a family of four with a median income was was just 5.6% in 2011, down from 12% in 1980. Overall, the individual income tax was equal to 10.4% of Gross Domestic Product in 1980 but had fallen to 8.8% in 2005.

Wealthy families have evidently gotten about as much relief as the median family. "The top one percent of taxpayers paid an average federal income tax rate of 23% in 2008, about one-third less than they paid in 1980, despite the fact that their incomes are now much higher in both real and relative terms," Campbell writes.

Taxes on US corporations, as a percent of all federal revenues, have fallen to 10% today from 30% in the 1950s, her data shows. And while the U.S. has a statutory corporate tax rate of 39%, tax credits made the effective corporate tax rate between 2000 and 2005 only 13%, according to a Treasury Department report cited by Campbell.

Compared with 33 other industrialized nations, total tax revenues in the U.S. were the third lowest as a percent of GDP in 2009, the article said. The highest percentage was 48.1% in Denmark. The percentages in the U.K. and Canada were 34.3% and 32.0%, respectively, and the percentage in the U.S. was 24.1%. Only Chile and Mexico, at 18.4% and 17.4%, respectively, ranked lower than the U.S. on that scale.

Looking only at personal income taxes at all levels of government as a percentage of GDP, the U.S. doesn't differ much from other countries, on average. Our personal income taxes equal about 9.2% of our GDP, while the OECD average is 10.1%. But European countries have a value-added tax or VAT, which accounts for their higher total tax revenues, as a percent of GDP.

The VAT is a tax on the value added to goods and services at every stage in the production of a given product. On average, other OECD countries get the equivalent of 6.7% of GDP from VAT every year. The VAT is a regressive tax, meaning that it eats up a larger percentage of the income of the poor than of the rich, but the VAT is generally used to finance universal social services, which tend to have relatively more value to the poor than the rich.

Since taxes in the U.S. are already low, according to Campbell's analysis, she sees little point in proposals by Rep. Paul Ryan (R-Wis.), the Republican vice presidential nominee, to reduce the tax burden by cutting federal spending to 16% of GDP by 2050 from 24% of GDP today. "Ryan's plan would give those with incomes over $1 million a tax cut of $265,000" on top of the Bush tax cuts already in place, while raising taxes on low-income households by cutting the Earned Income Tax Credit, she writes.

But, as one of the two men in the clubroom argued, wouldn't cutting entitlements and raising taxes on low- or moderate income households give that demographic a stronger sense of responsibility? Doesn't social insurance spoil people and encourage moral hazard?

That idea does have a certain self-serving appeal, but it's difficult to see how someone with even an average income could afford higher taxes. A person with a gross income of $42,000, for instance, currently takes home about $2,500 a month after withholding for income and payroll taxes and deductions for health insurance and a modest 401(k) deferral. That doesn't leave much room for higher taxes.

If our taxes have in fact been shrinking for decades, then why do we feel so hounded by the taxman? I don't know. Maybe it's because there are so many different taxes and fees, or because the tax code is so complex. Maybe we fail to factor in the value of the available tax credits and deductions, or don't acknowledge the value of what our taxes buy. Perhaps higher tax rates are just an inevitable (though nonetheless unwelcome) covariant of success.

Or it may be that declines in tax revenues, such as we've seen as a result of the financial crisis, can't help but translate into higher levies on those who are still able to pay. For them, it must feel like persecution.