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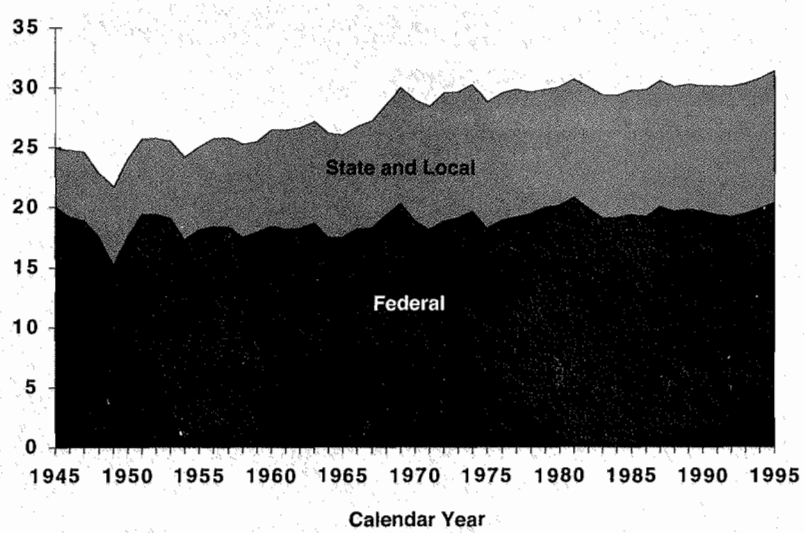
Fighting the Rising Tax Burden

Recently released data from the Department of Commerce reveal that federal, state and local taxes consumed a record 31.3 percent of gross domestic product last year — the highest level in U.S. history. As Figure I shows, even at the height of World War II in 1945 total taxes only consumed 25 percent of GDP. Taxes have risen by 1.3 percent of GDP under the Clinton administration.

Highest Tax Burden in History. Although, some of the increase in the total tax burden has occurred at the state and local government level, total state and local government taxes last year were only 0.1 percentage point higher than in 1992. Therefore, virtually all of the recent growth in the total tax burden is accounted for by the rise in federal receipts.

FIGURE I

Government Receipts as a Share of GDP



Source: Department of Commerce.

- Federal taxes reached 20.4 percent of GDP in 1995, the second highest level in history.
- The only year in which federal taxes took more was in 1981, before the Reagan tax cut took effect, when they reached 20.8 percent of GDP.
- In 1945, federal taxes amounted to 20.1 percent of GDP.

Historically, tax levels even close to these have triggered major tax cuts. State and local government receipts (now 10.9 percent of GDP) reached 10.6 percent in 1977. The following year Proposition 13 in California led a nationwide tax revolt at the state and local government level. Rising federal tax burdens in the 1970s resulting from bracket creep led to the Reagan tax cut.

Who Is Paying More. Figure II shows that the biggest percentage increase since 1992 has come from higher taxes on corporations — 55.5 percent. The next largest increase has come from personal taxes, which have risen 25.3 percent since 1992. Since GDP has only risen 16 percent since 1992, this means that personal taxes have risen 1.6 times faster than GDP and corporate taxes have risen 3.5 times faster.

- Had corporate taxes only increased as fast as GDP, they would have equaled $138 billion last year rather than the actual figure of $184 billion.
- Had individual income taxes risen at the same rate as GDP, they would have grown to $555 billion by 1995, or $43 billion less than the actual total of $598 billion.
- Federal taxes could have been cut $88 billion last year and the ratio of receipts to GDP would have been no lower than they were in George Bush's last year.

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Payroll taxes have risen at almost exactly the same rate as GDP. Indirect taxes, including federal excise taxes, have risen more slowly.

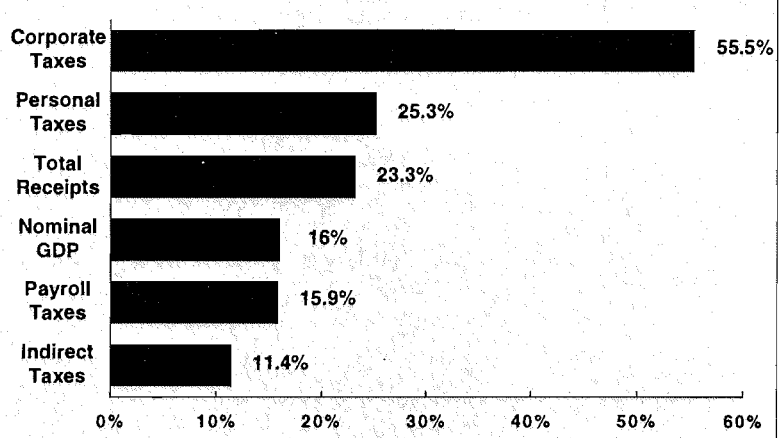
Why Taxes Rose. This vast increase in federal taxes is the result of two factors: the 1990 and 1993 tax rate increases and the effect of progressive tax rates. The latter may be more important. While tax rates are indexed to inflation, they are not adjusted for real growth in the economy. This means that even without legislated tax increases, taxes must be cut periodically just to keep the tax burden from rising.

According to the Senate Budget Committee, the median family had an effective federal tax rate of 12 to 13 percent in the early 1960s — income and payroll taxes combined. By last year, this rate had roughly doubled to about 25 percent, and was up two percentage points since 1987.

As workers manage to achieve some growth in their real incomes, they get pushed into higher tax brackets. A single worker with a taxable income of just $24,000, for example, will go from a federal income tax rate of 15 percent to 28 percent on the next dollar he or she earns. With Social Security taxes on top of that on all earnings up to $62,700, workers with incomes between $20,000 and $60,000 are among the most heavily taxed people in America.

FIGURE II

Percent Increases, 1992 - 1995



Source: Department of Commerce.

Taxpayer Relief Before Tax Reform. A 15 percent across-the-board cut in personal income taxes would reduce total federal receipts as a share of GDP to a level no lower than they were in 1992. Such a tax cut could take effect — and provide taxpayer relief — quickly. By contrast, it would take Congress a minimum of two years to reform the overall tax system, once the process was started — and the process has yet to begin.

While Republicans have talked about tax cuts for the last 18 months, they have continuously scaled back their proposals to where there is nothing left but the $500 child tax credit. However, the child tax credit does nothing for the economy, and it divides taxpayers into two groups. Those with children and modest incomes get a big tax cut, while everyone else gets nothing. But the tax burden has been rising for everyone, and an across-the-board tax cut would affect every taxpayer by an equal percentage.

A 15 percent cut would be good politics, but it would also be good for the economy because it would lower marginal tax rates — the tax on each additional dollar earned — which would stimulate work, saving and investment.

This Brief Analysis was prepared by NCPA Senior Fellow Bruce Bartlett.