Will Privileged Americans Pay to Invest in Our Future?

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With D.C. debating fiscal fixes, taxes are front and center. As SSN scholars explain, U.S. taxes are low by international standards and the privileged have benefitted from declining rates and burgeoning loopholes. Tax battles involve high stakes for equity and future prosperity.

HOW HIGH ARE U.S. TAXES – AND WHO PAYS?

Taxes were a central theme in the 2012 election, as President Barack Obama issued a clear call for high-income Americans to pay more as their contribution to sustaining federal government efforts on behalf of economic growth and social opportunity. Election exit polls and national surveys before and since the November elections show solid majority support for Obama's approach, but officials in Washington D.C. continue to debate whether tax rates should be increased and revenues captured by closing loopholes and reducing tax credits.

From often-misleading media coverage, people might get the impression that U.S. taxes are unusually high – and that businesses and wealthy Americans are weighed down by onerous tax burdens. Both notions are false, as SSN scholars show.

A timely SSN brief by Andrea Campbell of MIT summarizes the key facts about America's startlingly low taxes compared to dozens of other advanced democracies. She draws on her recent path-breaking article, "America the Undertaxed," which appeared in the October 2012 issue of *Foreign Affairs*. Campbell and Republican anti-tax crusader Grover Norquist debated the issues for *Foreign Affairs*' following November/December issue. As Campbell shows, U.S. revenues are low and volatile and U.S. taxes and social expenditures do relatively little to dampen rapidly rising economic inequalities. Privileged U.S. taxpayers have seen their effective tax rates drop in recent times, as the tax code has become increasingly complex and riddled with special-interest loopholes that undermine equity, economic efficiency, and citizen faith in the system.

Who actually pays the taxes needed by U.S. governments at all levels? The overall picture is pulled together by SSNers Alex Hertel-Fernandez and Vanessa Williamson of Harvard University. They bust the mythical claim that "half of all Americans pay no taxes," showing that this takes into account only the federal income tax and leaves out federal payroll taxes, which are just as important to national finances as the income tax. State and local sales and income taxes are also omitted. When all major taxes are considered together, poor and middle-income Americans often pay at higher rates than the very wealthy – a fact that Hertel-Fernandez and Williamson nicely dramatize by summarizing the types and levels of taxes paid by four typical families: the Lowes, the Middletons, the Highsmiths, and the Trulyriches. Their brief makes it easy for any reader to quickly learn who really pays taxes in the United States.

America's wealthiest people appear to have benefited from lower tax rates and more tax loopholes in recent decades. Many analysts argue that the rich should pay more to build a stronger national economy and a healthier society for all Americans. In an additional twist, economist Robert Frank explains why the wealthy themselves have an interest in paying higher taxes – not just so they can be part of a stronger nation, but also because added income at the very top just unleashes arms races in conspicuous consumption that do not leave the rich any better off.

CAN CLOSING "TAX LOOPHOLES" RAISE ENOUGH REVENUE?

Raising tax rates is one way to pay for federal programs and deficit reduction. Another approach – which gets a lot of visible support these days – is to close off tax credits, deductions, and loopholes built into the very complex U.S. tax code. Republicans and some self-styled "budget hawks" have suggested that limiting deductions for high-income tax payers could generate enough extra revenue to equal what higher income tax rates would bring in, and perhaps even to allow reductions in existing income tax rates. Proponents of this approach also believe that it would promote business efficiency and economic growth if the federal tax code was simplified and special deductions were limited.

Is this true that reducing tax exemptions alone could reverse the federal budget deficit? In a fascinating SSN brief, Leonard Burman of Syracuse University and Marvin Phaup of George Washington University explain in detail how eliminating major subsidies and exemptions in the tax code could, in principle, generate major new revenues while creating a fairer tax code. They argue that this approach could be made politically acceptable to both Democrats and Republicans.

Yet Burman and Phaup's brief also shows that eliminating credits and deductions would raise tax bills for more than just very high income earners, because some of the most expensive exemptions – for home mortgages, charitable giving, and employer-provided health insurance and pensions – affect middle-class as well as wealthy families. What is more, the subsidies and exemptions most important to the very wealthy affect business investments and taxes on capital gains – and Republicans seem completely unwilling to eliminate those tax breaks.

The incidence and politics of tax exemptions are illuminated by a number of SSN scholars. Most tax credits and subsidies tilt their benefits upward, but there is one major instance, the Earned Income Tax Credit, that helps to mitigate poverty, as Daniel Feder of Yale University spells out. A brief by Christopher Howard of the College of William and Mary provides a valuable overview of what the major tax expenditures are – and who benefits. And Suzanne Mettler of Cornell University tackles the knotty politics of these relatively invisible provisions buried in the tax code. Average citizens do not understand them, Mettler shows, and so they find it hard to hold politicians accountable for their cost and social consequences.

AMERICANS DO NOT ALWAYS OPPOSE TAXES

Right now, polls show that most Americans support tax increases on the wealthy as part of a "balanced" approach to funding government and reducing projected federal budget deficits. Some may say, well, yes, it is easy for majorities to support tax increases on the wealthy alone, but most Americans never want to tax themselves. But this is yet another myth that cries out to be busted, as several SSN scholars have learned in their research. Elizabeth Pearson of the University of California, Berkeley has tracked voter reactions to state-level tax increases between the 1940s and the 1970s. This was an era when many governors and other political actors were prepared to argue strongly in favor of public investments in education and other efforts to boost the economy and social wellbeing. Anti-tax groups often forced referenda on tax hikes, however, and Pearson has studied many such episodes. She finds that when voters could see concrete benefits from new public revenues they usually supported the new taxes.

Public support for taxes is not just a thing of the past. Andrea Campbell of MIT is doing comprehensive research on the long-term evolution of public opinion and finds that certain levies – such as the payroll tax dedicated to Social Security – garner strong support. The key is whether citizens believe that the tax revenues go to programs they value and which deliver benefits to many Americans. Taxes are also more acceptable if they are collected regularly in small amounts, rather than in big, visible, difficult-to-pay lump sums on April 15.

As the future of Social Security is debated today, overwhelming majorities of Americans support adding revenues to the system by "lifting the cap" on the payroll tax, as Fay Lomax Cook and Rachel Moskowitz of Northwestern University found in recent research on what Americans think about the future of Social Security.

Currently, high salary earners are not taxed for Social Security on earnings beyond a certain limit just over $100,000 a year. If this limit were to be raised or abolished, taxation for Social Security would become more equal for all income levels and the long-term finances of the system would be much improved. Senator Mark Begich of Alaska has introduced legislation along these lines to enhance funding for Social Security.

TAXES AND ECONOMIC PROSPERITY

Taxes are often presented as certain to dampen economic growth and make businesses less successful and profitable. High taxes collected the wrong way can certainly have such deleterious effects. But taxes inevitably influence economic decisions, and may be structured to encourage productive investments and savings, while making wasteful decisions less attractive for businesses and families. In addition, governments need revenues to support essential functions – including investments in transportation, communications, and other forms of infrastructure on which business depends, and expenditures on educational, health, and social programs that sustain a healthy workforce and enhance worker productivity now and in the future. SSN scholars have a lot to say about how taxes can foster economic growth and business success.

In the view of SSNer Dean Baker of the Center for Economic and Policy Research, a small new levy on speculative Wall Street transactions could not only raise revenue for important social needs, but also discourage purely speculative investments that create unnecessary "financial bloat" and risky vulnerabilities for the U.S. economy as a whole. Normal Wall Street transactions would not be affected much, but rapid "speculative churning" based on flipping investments with borrowed funds would become less attractive. Investments, argues Baker, would flow into more productive channels.

A number of SSN scholars make a strong case for boosting investments in infrastructure, research, and human capital to foster strong and equitable U.S. economic growth. When national tax rates are too low, productive investments become impossible. Andrea Campbell makes this point in her brief on U.S. taxes. Thomas Fisher of the University of Minnesota lays out a strong case for new investments to repair and enhance America's transportation infrastructure. Yale's Jacob Hacker and Nathaniel Lowentheil argue for tax-funded investments to create a prosperous economy for all Americans. Indeed, as Richard Lachmann of the State University of New York at Albany argues, the huge Bush tax cuts of the 2000s, accompanied by Bush era spending hikes on wars, defense, and domestic programs, put a fiscal squeeze on U.S. finances that threatens America's standing in the world. Enhanced federal tax revenues are now essential to make the investments we need to meet international competition.

Proposals to increase U.S. tax revenues to support new investments as well as deficit reduction run directly counter to current Republican calls for even lower taxes on business and higher income earners. GOP priorities are clearly laid out in budgets fashioned by Representative Paul Ryan of Wisconsin, Chair of the House Budget Committee, and endorsed by most Republicans currently in Congress. In August of 2012, more than a dozen SSN scholars teamed up to offer detailed analyses of the impact the Ryan budget would have on various social groups, states, and economic priorities. That collection of briefs remains pertinent to ongoing budget debates, and the Ryan Budget Spotlight can be accessed here.