BRIEFING

Is President Bush proposing too big a tax cut – especially for the rich? Here's how the US compares with its peers

Tax cuts as 'stimulus' – a global reality check

President Bush's stimulus plan

- Eliminate the tax on stock dividend earnings.
- Accelerate previously planned tax cuts, including: across-the-board cuts in income taxes, a rise in the child tax credit, a higher deduction for married couples, and expansion of the 10 percent bracket so more people are taxed at the lowest rate.
- Create "reemployment accounts," providing the unemployed up to $3,000 each to put toward finding a job.

By David R. Francis
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Looking at their pay slips, Americans may believe Uncle Sam takes too big a chunk. "Americans carry a heavy burden of taxes," President Bush declared in the speech outlining his tax cut package Tuesday.

By international standards, though, Americans are relatively lightly taxed.

When the revenues from all federal, state, and local taxes are added up, they amount to about 29.6 percent of gross domestic product (GDP), the nation's total output of goods and services.

Among 30 member nations of the Organization of Economic Cooperation and Development (OECD), a club of mostly rich countries based in Paris, only Japan, South Korea, and Mexico have a lower overall burden. The Bush tax cuts of 2001 and, perhaps, this year could reduce the overall US tax burden close to the level of Japan (27.1 percent of GDP) or South Korea (26.1 percent), but not to Mexico's 18.5 percent.

In a world of varying political philosophies and economic realities, there's no agreed-upon way of deciding the fairest way to collect taxes – or the way that will allow for the fastest economic growth.

But a comparison of the US tax system with its global peers can at least offer food for thought. Consider:

- Over the long term, economists have a hard time finding a connection between a nation's overall tax rate and its economic growth rate.
- Many nations have income taxes that, on their face, are less progressive than that of the US. Millions in America pay no income tax at all, though they do pay sizable Social Security taxes. The rich pay the highest rates, though many liberals say Bush's plan favors the wealthy.
- In most cases, other nations have more generous social-welfare systems than the US, effectively making those nations' tax-and-benefit systems more progressive.

Governments of rich countries that tax heavily may cover a universal, government-sponsored health plan, or a more generous social-security system, or even government-subsidized child care. Canadians, for instance, pay 35.2 percent of their income in taxes, but all get free healthcare. In the US, only the elderly and the poor get government-subsidized healthcare.

Taxing the paycheck, the house ... and the grocery bill

Most industrial nations apply a range of taxes, from sales taxes to levies pulled automatically from salaries to fund social security systems. In most areas, US taxes are relatively low, compared with other nations.

Revenue from different types of taxes, shown as a percentage of GDP

	Personal income	Corporate income	Social Security/ other payroll	Property	Goods & services
Britain	10.9%	3.7%	6.1%	4.4%	12.1%
Canada	13.2	4.0	5.9	3.4	8.7
Germany	9.6	1.8	14.8	0.9	10.7
Japan	5.8	3.7	9.9	2.3	5.1
Sweden	19.3	4.1	17.6	1.9	11.2
United States	12.6	2.5	6.9	3.0	4.7

Calculated using numbers from the Organization for Economic Cooperation and Development STAFF

Tax rates and growth rates

American conservatives, including the president, hold that small government boosts the pace of economic growth. The administration calls its 10-year, $670 billion tax-cut proposal a "growth package."

"Our first challenge is to allow Americans to keep more of their money so they can spend and save and invest," Mr. Bush said.

Most economists do hold that tax cuts usually have an immediate stimulative impact on an economy running below capacity. But over the long term, the evidence gets murky.

"Almost uniformly, economists have not found any growth effect from tax policy," says William Easterly, a former World Bank economist. Looking at studies of more than 100 nations, there is no empirical data to show that either tax rates or tax revenue levels influence long-run growth rates, he says.

"There is almost no relationship between the size of the government sector and the rate of economic growth," agrees Bernard Wasow, a Century Foundation economist.

But the president's Council of Economic Advisers (CEA) maintains the Bush plan would boost GDP growth between 2003 and 2007 by 0.2 percentage points a year on average. It would generate 2 million to 3 million jobs each year for three years.

A 1996 study by Federal Reserve economist Eric Engen and Dartmouth College's Jonathan Skinner did find that major tax cuts in the US have "modest effects" on growth – between 0.2 and 0.3 percentage points per year. That study, though, assumes cuts in the marginal tax rates (that on the last dollar earned) of 5 percentage points and a reduction in average tax revenues of 2.5 percentage points. Those changes are bigger than the Bush cuts.

Moreover, the Engen-Skinner study assumes a steady federal budget deficit. That won't happen with the Bush cuts. Even this week's CEA report sees an increase of $359 billion in the deficit between 2003 and 2007, a number that shrinks to only $166 billion if economic growth does step up, as assumed by the CEA, and thus boosts revenues.

Tax rates rising

In the past 25 years, overall tax rates have risen in most industrial nations, when measured as a percentage of the overall economy.

Total tax revenue as a percentage of GDP

	1975	2000
Britain	35.3%	37.4%
Canada	31.9	35.8
Germany	35.3	37.9
Japan	21.2	27.1
Sweden	42.3	54.2
United States	26.9	29.6

Source: OECD STAFF

The deficit problem

That change in the federal deficit presents some risk to the economy. Mr. Easterly, now with the Center for Global Development, says that cross-country studies show that huge budget deficits do damage growth. "The Bush administration is doing about the only thing it could do to lower growth, which is massively increase budget deficits," he charges.

Before the introduction of the US income tax in 1913 and after taxes grew rapidly, the long-term growth rate of the US has stayed stable around 2 percent a year per capita, says Easterly.

Economist William Gale of the Brookings Institution in Washington maintains that the Bush tax cuts would boost the federal deficit sufficiently that interest rates would rise, more than offsetting any tax-cut stimulus.

Tax cuts a global trend

Though there is little evidence that tax rates alter economic growth rates, many industrial countries have been lowering marginal tax rates in recent years.

"There has been a significant move away from highly progressive tax rates," says Jeffrey Owens, head of the department of fiscal affairs at the OECD. Many nations have trimmed high marginal tax rates on upper income families, though often broadening the "tax base" at the same times; that is, taxing more previously untaxed income of the rich.

'Robbing' from the rich?

The American tax system is less progressive than that of most European nations, says Herwig Immervoll, an economist at the University of Cambridge in Britain. That is, the US tax burden is lower in the well-to-do and higher on lower-income groups than is common in Europe.

Using one measure of progressivity which takes account of such government benefits as pensions and health insurance as well as taxes, he studied 14 European nations. The range of progressivity is great. The poorest 20 percent of Belgians, for example, pay nothing if benefits are subtracted from taxes paid, the richest 20 percent pay 34.1 percent. For Danes, the comparable range is 19 to 43.3 percent. For the British, the range is minus 47.6 to plus 24.5. The poor are greatly helped.

Mr. Immervoll hasn't analyzed the US tax-and-benefit system in the same way.

However, Bob McIntyre, director of Citizens for Tax Justice in Washington, has calculated the distribution across the income ladder for all federal taxes including Social Security and other taxes as well as the income tax. But he ignores benefits. He finds that those households in the lowest 20 percent (quintile) pay 7 percent of their income; the middle quintile 17 percent, and the top 5 percent pay 26 percent. A study by Timothy Smeeding at Syracuse University finds that the US has the worst poverty rate among children of 19 prosperous nations.

The US tax burden on different income groups

Currently, the highest-earning 20 percent of Americans account for 58 percent of all income and 68 percent of all taxes paid.

Income Group	Average pretax income	Share of America's pretax income	Share of total federal taxes	Effective tax rate
Lowest 20%	$9,400	3.3%	1.1%	7%
Second 20%	20,700	7.3	4.0	13
Middle 20%	34,300	12.1	9.1	17
Fourth 20%	56,100	19.7	17.9	21
Next 15%	96,200	25.4	26.5	24
Next 4%	204,000	14.3	16.1	26
Top 1%	1,028,000	18.1	25.1	26
ALL	56,500	100.0	100.0	22

SOURCE: Citizens for Tax Justice STAFF