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The Design of the Tax System



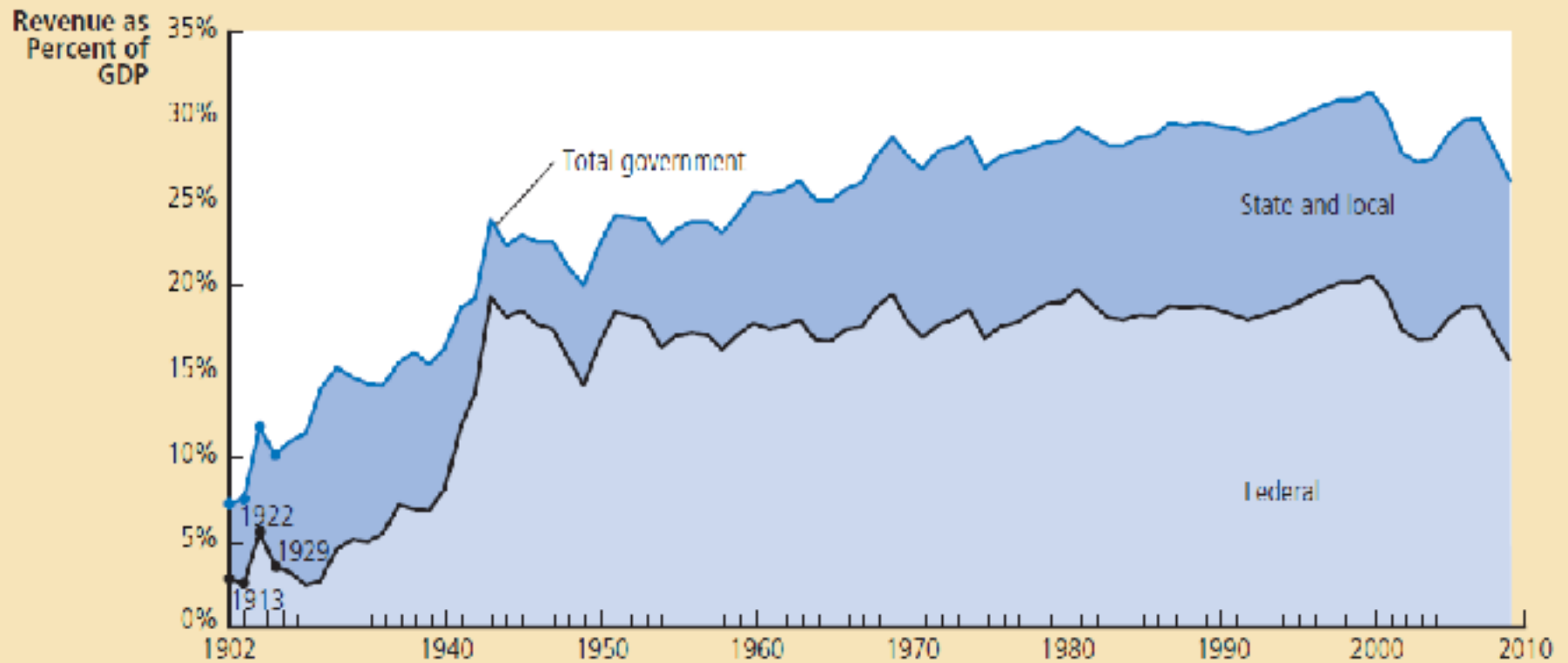
Financial Overview of Government

- **Government revenue - increased**
 - As percentage of total income
 - As economy's income has grown
 - Government's revenue from taxation has grown even more
- **As a nation gets richer**
 - Government - takes a larger share of income in taxes



Figure 1

Government Revenue as a Percentage of GDP



This figure shows revenue of the federal government and of state and local governments as a percentage of gross domestic product (GDP), which measures total income in the economy. It shows that the government plays a large role in the U.S. economy and that its role has grown over time.

Table 1

Total Government Tax Revenue as a Percentage of GDP

Sweden	49%	United States	28%
France	44	Japan	28
United Kingdom	37	Mexico	21
Germany	36	Chile	20
Canada	33	China	15
Russia	32	India	14
Brazil	30		



The Federal Government

- **The federal government's receipts**
 - Individual income tax
 - Based on total income (marginal tax rate)
 - Payroll taxes - tax on wages
 - “Social insurance taxes” – pay for Social Security and Medicare
 - Corporate income tax - based on profit
 - Other:
 - Excise tax, estate tax, custom duties



Receipts of the Federal Government: 2009

Tax	Amount (billions)	Amount per Person	Percent of Receipts
Individual income taxes	\$ 915	\$2,978	43%
Social insurance taxes	891	2,899	42
Corporate income taxes	138	449	7
Other	161	524	8
Total	<u>\$2,105</u>	<u>\$6,846</u>	<u>100%</u>

Table 3

The Federal Income Tax Rates: 2010

On Taxable Income . . .	The Tax Rate Is . . .
Up to \$8,375	10%
From \$8,375 to \$34,000	15%
From \$34,000 to \$82,400	25%
From \$82,400 to \$171,850	28%
From \$171,850 to \$373,650	33%
Over \$373,650	35%

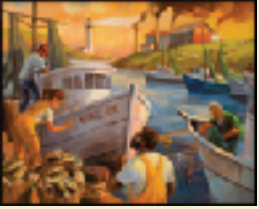
This table shows the marginal tax rates for an unmarried taxpayer. The taxes owed by a taxpayer depend on all the marginal tax rates up to his or her income level. For example, a taxpayer with income of \$25,000 pays 10 percent of the first \$8,375 of income, and then 15 percent of the rest.



The Federal Government

- **The federal government's spending**
 - Social Security, 19%
 - Transfer payments to the elderly
 - National defense, 19%
 - Income security, 15%
 - Transfer payments to poor families
 - Temporary Assistance for Needy Families (TANF)
 - Food Stamps
 - Unemployed compensation





The Federal Government

- **The federal government's spending**
 - Medicare
 - Health plan for the elderly
 - Other health spending
 - Medicaid - health program for the poor
 - Spending on medical research
 - Net interest





The Federal Government

- **The federal government's spending**
 - Other spending
 - Federal court system
 - Space program
 - Farm-support programs
 - Housing credit program
 - Salaries of members of Congress and the president



Table 4

Spending of the Federal Government: 2009

Category	Amount (billions)	Amount per Person	Percent of Spending
Social Security	\$ 683	\$ 2,221	19%
National defense	661	2,150	19
Income security	533	1,733	15
Medicare	430	1,398	12
Health	334	1,086	9
Net interest	187	608	5
Other	690	2,244	20
Total	<u><u>\$3,518</u></u>	<u><u>\$11,441</u></u>	<u><u>100%</u></u>



The Federal Government

- **Budget deficit**
 - Government spending $>$ government receipts
 - Financed - borrowing from the public
- **Budget surplus**
 - Government receipts $>$ government spending
 - Uses the excess receipts to reduce its outstanding debts





State and Local Government

Table 5

Receipts of State and Local Governments: 2007

Tax	Amount (billions)	Amount per Person	Percent of Receipts
Sales taxes	\$ 439	\$1,426	19%
Property taxes	383	1,246	16
Individual income taxes	289	941	12
Corporate income taxes	61	197	3
From federal government	468	1,521	20
Other	690	2,244	30
Total	<u>\$2,329</u>	<u>\$7,574</u>	<u>100%</u>





State and Local Government

- **Spending**
 - Education
 - Public schools: kindergarten to high school
 - Public universities
 - Public welfare
 - Transfer payments to the poor
 - Highways
 - Building and maintenance of roads





State and Local Government

Table 6

Spending of State and Local Governments: 2007

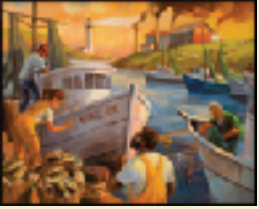
Category	Amount (billions)	Amount per Person	Percent of Spending
Education	\$ 777	\$2,526	34%
Public welfare	389	1,266	17
Highways	145	471	6
Other	955	3,105	42
Total	<u>\$2,265</u>	<u>\$7,367</u>	<u>100%</u>



Taxes and Efficiency

- **Administrative burden**
 - Time spent to fill out forms
 - Time spent keeping records for tax purposes
 - Resources the government use to enforce the tax laws
 - Tax lawyers and accountants
 - Resources for complying with tax laws
 - Can be reduced by simplifying the tax laws
 - Politically difficult





Taxes and Equity

- **The benefits principle**
 - People should pay taxes based on the benefits they receive from government services (e.g., toll roads, vehicle registration, property tax)
- **The ability-to-pay principle**
 - Taxes should be levied on a person according to how well that person can shoulder the burden



Table 8

The Burden of Federal Taxes

Quintile	Average Income	Taxes as a Percentage of Income	Percentage of All Income	Percentage of All Taxes
Lowest	\$ 17,200	4.3%	3.9%	0.8%
Second	39,400	10.2	8.4	4.1
Middle	60,700	14.2	13.2	9.1
Fourth	89,500	17.6	19.5	16.5
Highest	248,400	25.8	55.7	69.3
Top 1%	1,743,700	31.2	18.8	28.3

The fiscal challenge ahead

- 2009 - budget deficit = \$1,413 billion
 - Eightfold increase over the deficit in 2007
 - Cause: deep recession of the economy
- Long-term projections
 - Government - spend vastly more than it will receive in tax revenue
 - As a percentage of GDP
 - Taxes – constant
 - Government spending – rise gradually and substantially

- Rise in government spending
 - Social Security and Medicare
 - Significant benefits for the elderly
 - The elderly - growing percentage of overall population
 - Medical advances and lifestyle improvements
 - » Increased life expectancy
 - Fewer children, smaller families
 - Labor force - growing more slowly
 - Fewer workers paying taxes to support the government benefits that each elderly person receives

- Rise in government spending
 - Rising cost of healthcare
 - Medicare – healthcare to the elderly
 - Medicaid – healthcare to the poor
 - Medical advances
 - New, better, and expensive ways to extend and improve our lives

- Handle spending increases
 - Raise taxes - as a percentage of GDP
 - Reduce the promises now being made to the elderly of the future
 - People - encouraged to take a greater role caring for themselves as they age
 - Raising the normal retirement age
 - People - more incentive to save during their working years