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LOWER TAX RATES LEAD TO HIGHER TAX REVENUES

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Whenever the public discourse turns to the question as to who is to pay for new or expanded federal spending programs, one side of the debate resorts at times to the argument that the rich are getting richer because they have had their taxes lowered substantially since the Reagan Revolution and lowered still further over the last eight years. Thus it is only fair and reasonable, those advocates argue, that the rich should have their taxes hiked to cover the enormous increases in government expenditures since Obama was inaugurated and the Democrats took control of Congress. A review of IRS data for 1986-2007 (the most recent year available) will help to confirm or dismiss that argument.

While the average rate of taxation for the top one percent of all individual income taxpayers dropped from 33.1 percent in 1986 to 22.4 percent in 2007, according to the IRS, those filers paid a total of \$450.9 billion in 2007 compared to \$94.5 billion in 1986. Their share of the total taxes paid rose from 25.8 percent in 1986 to 40.4 percent in 2007. Over the same period, the top five percent had their tax rate decreased from 25.7 percent to 20.5 percent but saw their taxes increased from \$156.2 billion to \$676.3 billion. Their share of the total taxes paid climbed from 42.6 percent to 60.6 percent.

Federal Income Tax Return Information

	<u>1986</u>	<u>2000</u>	<u>2007</u>
Average federal income tax rate (percent)			
Top one percent	33.1	27.5	22.4
Top five percent	25.7	24.4	20.5
Bottom fifty percent	5.6	4.6	3.0
<i>All taxpayers</i>	<i>14.5</i>	<i>15.3</i>	<i>12.7</i>
Federal income tax paid (billions)			
Top one percent	\$94.5	\$366.9	\$450.9
Top five percent	156.2	553.7	676.3
Bottom fifty percent	23.7	38.3	32.3
Total federal income tax share (percent)			
Top one percent	25.8	37.4	40.4
Top five percent	42.6	56.5	60.6
Bottom fifty percent	6.5	3.9	2.9

The bottom fifty percent of filers paid \$8.6 billion more in taxes in 2007 than 21 years earlier, but had their average tax rate cut from 5.6 percent to 3.0 percent, and saw their share of the total taxes paid drop from 6.5 percent to 2.9 percent. IRS data for taxpayers at the bottom one percent of the income distribution are not readily available.

The federal income taxes actually paid by the top 1 percent in 1990 represented 37.5 percent of the \$299.3 billion spent on national defense. In 2007, the super-rich alone were paying the equivalent of 74.2 percent of national defense expenditures of \$607.3 billion.

And, though this is not central to the main issue addressed here, federal income taxes paid over the 1986-2007 period averaged 13-15 percent of taxable income suggesting the reasonableness of adopting a flat-tax which would be applied to all taxpayers with the possible exception of persons and families with incomes below the poverty level.

The IRS evidence tends to dismiss the class-warfare argument that the rich are getting richer because their taxes are being cut. Everyone, on average, has seen their federal income tax rates cut since 1986 and at the same time has been paying more in taxes. However, the overall tax share paid by the super-rich has been rising while for those in the lower half of the income distribution the share paid has been falling.

Supply-side economists argue that the IRS data proves their proposition that cutting tax rates stimulates economic growth and adds to national income by incentivizing producers to work harder and smarter knowing that their heightened efforts will be handsomely rewarded. Further, by boosting national income, cutting tax rates actually increases federal income tax revenues. To some extent Keynesian economists tend to agree with supply-siders in that the Keynesians argue that tax rates should be cut in an economic slowdown to stimulate the economy on the demand side. Thus, if they were not already known as Keynesians, they might be called demand-siders.

Critics of supply-side economics, which in the past they referred to mockingly as “voodoo economics,” point to enormous increases in yearly federal budget deficits and the public debt as compelling reasons to reverse the downward trend in the taxes rates applied to the rich in order to raise the revenues needed to pay for the additional federal spending in areas such as health care. Left-leaning anti-war activists argue that the rich have gotten richer through huge increases in military spending over the years, have created greater income inequality especially through unearned income from interest, dividends, and capital gains, and higher tax rates on the rich are necessary to reduce that inequality. However, the historical record on the tax revenue side since the mid 1980s, not to mention the huge increases in nonmilitary spending notably for the social safety net which have added substantially to deficits and the overall debt and the recent financial meltdown which has underscored the risks involved in stocks, bonds and other financial instruments, lend little support to their argument.

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