The Tax Revenue Capacity of the U.S. Economy

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U.S. Taxation in Global Perspective.

- Historically and now, the United States has small government compared to other high-income (G-7) countries.
- This is reflected in, among other things, low total tax burdens. The large deficits of recent years reflect declining tax collections, but even prior to the crash, or prior to the 2000s, U.S. tax collections were low compared to those of other countries.
- Consider, for example, OECD statistics on total (federal plus subnational) tax revenues as a fraction of GDP, before and after the crash.

Total Tax Revenue as % of GDP.

Country	2006	2010
Canada	33.3	31.0
France	44.4	42.9
Germany	35.6	36.3
Italy	42.3	43.0
Japan	28.0	26.9
United Kingdom	36.4	35.0
United States	27.9	24.8

Where do the differences lie?

- The most obvious difference between the United States and other countries is that there is no U.S. value-added tax (VAT).
- A VAT can be thought of as a sophisticated form of a sales tax.
- Since 1966 more than 150 countries have introduced VATs; 33 out of 34 OECD countries use VATs.
- Many U.S. states have sales taxes (at rather low rates compared to VATs elsewhere), and there are state and federal excise taxes on specific goods, but overall U.S. taxes on goods and services are low compared to other countries.

Taxes on Goods and Services as % of GDP.

Country	2006	2010
Canada	8.1	7.5
France	11.1	10.7
Germany	10.1	10.7
Italy	11.1	11.1
Japan	5.2	5.1
United Kingdom	10.6	10.8
United States	4.8	4.5

The Role of Social Insurance Taxes.

- Other countries, particularly those in high-tax continental Europe, finance significant fractions of their expenditures with social insurance taxes.
- These taxes are typically imposed at flat rates, and only on labor-type income.
- As a result, these social insurance taxes appear to be much more regressive than income tax alternatives. (Of course, the expenditures they fund tend to be highly progressive.)
- Perhaps partly for that reason, the United States relies much less than do some other countries on social insurance taxes.

Social Security Taxes as % of GDP.

Country	2006	2010
Canada	4.9	4.8
France	16.4	16.6
Germany	13.7	14.2
Italy	12.5	13.6
Japan	10.2	11.0
United Kingdom	6.7	6.7
United States	6.6	6.5

What about personal and corporate income taxes?

- The United States relies relatively heavily on personal income taxes, and to a lesser extent corporate income taxes.
- As a result, U.S. tax collections from these sources look similar to those of other countries, despite the significantly smaller total size of the U.S. government.
- Personal – and particularly corporate – tax collections move over time with the business cycle, but in general the United States does not differ sharply from other G-7 countries in total tax collections as a fraction of GDP.

Individual Income Tax Revenue as % of GDP.

Country	2006	2010
Canada	11.9	10.8
France	7.8	7.3
Germany	8.6	8.9
Italy	10.7	11.7
Japan	5.2	5.2
United Kingdom	10.5	10.0
United States	10.1	8.0

Corporate Tax Revenue as % of GDP.

Country	2006	2010
Canada	3.8	3.3
France	3.0	2.1
Germany	2.2	1.5
Italy	3.4	2.8
Japan	4.7	2.8
United Kingdom	3.9	3.1
United States	3.4	2.7

What Do These Figures Suggest?

- It is always difficult to perform valid cross-country comparisons; and the U.S. economy differs from those of other countries in many meaningful ways that can influence tax collections.
- But that said, the United States certainly has significant untapped tax revenue capacity. Evidence from other countries indicates that the U.S. federal and state governments – if they want to – can collect significantly higher fractions of GDP in taxes.
- The United States currently has the lowest measured tax evasion rate in the world, with a shadow economy equal to between 9-16 percent of GDP. This, too, augurs well for potential future tax revenue collections (though the evasion rate presumably would rise with higher tax rates).
- It is one thing to have the ability to raise taxes, another to have the willingness. There are economic and political costs associated with higher taxes.
- Most deadweight loss estimates suggest that an additional $100 of federal tax collections is associated with efficiency costs of about $50.

How Is It Likely to Work?

- Higher tax revenues come at the expense of higher tax distortions, discouraging labor supply, saving, investment, business formation, and other desirable economic outcomes.
- Taxes differ in the extent to which they distort the economy. VATs and social insurance taxes are thought to have smaller efficiency costs than do personal income taxes, corporate income taxes, financial service taxes, and other taxes that discourage business activity.
- As a result, countries with large governments tend to rely less on business- and income-type taxes, and more on social insurance taxes and VATs.
- Globalization only makes this pattern stronger, as international mobility of capital and businesses increases the distortion associated with business- and income-type taxes.
- Small countries, which are the most exposed to globalization, rely the least on income and business taxes, and the most on VATs and excise taxes.
- Hence greater U.S. tax collections in the future will almost surely entail a tax system that is less progressive than is the current U.S. system.
- This reality generates considerable political anguish, which may be part of the reason why the country has for so long put off dealing with its fiscal realities.