

TAX FACTS

Throughout the 2008 presidential campaign and often since, Barack Obama has said the income tax program adopted under President G.W. Bush rewarded the wealthy at the expense of others and that it is a major cause of the much higher federal deficits since he took office. He now says, or at least implies, that restoring the previous tax rates for those in the top income brackets will do much to reduce the high deficits projected for the next decade, and says doing that is only “fair.” Because of their relevance to the current debate about how to reduce the ballooning debt, we have examined governmental records to determine whether his prior criticisms and recent comments are valid. We conclude they are not.

We started by comparing what happened between 2000, the year before Bush took office, and 2007, after the nation had recovered from the recession that started in 2000 and the effects of 9/11 and before the economic collapse that started in late 2007 had much effect. Summarizing, we found the following:

- In 2007, the income taxes owed by the top 1% and 5% of those who filed tax returns were about 22% higher than in 2000.
- On the other hand, while the reported incomes of the bottom 50% of tax filers were 29% higher in 2007 than in 2000, their reported tax liability was 16% lower.
- In 2007, the percentages of the total income taxes paid by those in the top 1%, 5%, and 50% brackets were the highest since 1980 and probably the highest ever. Correspondingly, the percentage of the total tax owed by the bottom 50% was the lowest ever, having decreased 30% since the Bush program took effect.
- Total income tax collections in 2007 were 14% higher than in 2000--the highest ever. At least 90% of that increase was paid by the top 5%, and the payments of the bottom 50% decreased at least 20%--even more if the so called “refundable tax credits” received by many with low incomes are taken into account.

These facts show that the Bush’s tax program made the income tax structure more “progressive”—i.e., it shifted more of the tax toward high incomes—not less.

Because it increased tax allowances and credits for those in the bottom half of the income distribution, that group as a whole now receives more payments from the government than their total reported income tax liability. That makes the actual tax structure even more progressive than indicated by the numbers shown above.

Altogether, these facts demonstrate that the claim by Obama and many Democrats that the Bush's tax program benefitted the wealthy at the expense of others—a claim that continues to be perpetuated by much of the media—is clearly false. Although it is true that both the pre-tax and after-tax incomes of those in the top brackets increased much more between 2000 and 2007 than did those with lower incomes, that trend in the income distributions has been going on for decades and was actually much higher under Clinton. The real complaint of liberals, though they seldom state it, is that Bush's program didn't do more to change the distribution of incomes—not income taxes—to favor those with low incomes. We submit that is not the proper purpose of the income tax structure.

Next, we examined Obama's frequent claim that the Bush tax program was a *major* cause of the very higher annual deficits that have occurred since he took office. As explained below, we find that claim is also contrary to the facts.

By 2000, the last year of Clinton's administration, individual income tax collections had increased to 10.2% of the Gross Domestic Product (GDP, the highest percentage ever. Although Bush's tax program reduced that percentage to 8.4% in 2007, it was still 0.8% higher than when Clinton was elected and about equal to the average of the previous twenty years. Therefore, contrary to the claim of some liberals, Bush did not reduce income tax collections to an all-time low relative to the GDP.

Between 2000 and 2002, the recession Bush had inherited and the effects of 9/11 had caused the total incomes of all tax filers to decrease 5%. Nevertheless, by 2007, their incomes had increased 2.7 trillion dollars, a remarkable 37%! Although liberals still dispute it, at least part of that increase was undoubtedly due to Bush's tax program, which didn't take full effect until after 2003.

Between 2000 and 2007, the Bush program reduced the *average* income tax rate for all tax filers from 15.26% to 12.68%, a decrease of 2.58% in absolute terms. Even so, the total individual income tax liability increased by \$135 billion, 14%.

Nevertheless, President Obama claims tax revenues would have been much higher if the Bush program had not been enacted. To test that claim, assume that, contrary to all past experience when tax *rates* were reduced, total incomes would still have increased as they did without Bush's program but the average tax rate would have been 2.58% higher. Multiplying the total gross income of \$8.799 trillion in 2007 by 0.0258, we calculate that total income tax revenue would have increased by \$227 billion. Assuming that spending didn't increase—also unlikely—that would have reduced the 2007 deficit by about two-thirds. However, almost half of the additional tax would have been paid by the bottom 95% of all taxpayers, and Obama doesn't propose to increase their taxes. Similar arithmetic shows that restoring the rate for only the top 1% would have generated at most \$100 billion, only 29% of that year's deficit, if there were no adverse effect on the economy.

By 2008, the economic collapse that started in late 2007 had hit hard, decreasing the total reported incomes of all taxpayers. Because the incomes of those in the top brackets decreased much more, percentagewise, than those with lower incomes, raising their tax rates would have raised much less additional revenue in 2008-10 than in 2007. Moreover, because the deficits soared in 2009 and 2010, any additional revenue that might have been collected would have reduced those deficits very little, percentagewise.

For example, in 2008, restoring the rates on the top 1%, those making over \$380,000 a year, would have generated at most \$70 billion, only 11% of that year's deficit of \$642 billion. Not having data on the income tax distributions after 2008, we can only approximate how much more revenue might have been raised since then. However, the reported *total* individual income tax collections in 2009 and 2010 were about 21% lower than in 2008. Assuming that the \$70 billion increase we estimated for raising the rates on the top 1% in 2008 would have decreased 25% to \$53 billion per year, and given that the deficits had ballooned to over \$1.4 trillion in both 2009 and 2010, the percentage deficit reductions would have been only about 3.5%!

This analysis clearly demonstrates that restoring the income tax rates of those with high incomes to the pre-Bush level would have done very little to decrease the huge deficits that have developed since Obama became President. Instead, those deficits resulted from two very large changes: 1) the large drop in individual and

corporate income tax revenues caused by the drop in incomes due to the depressed economy and the resultant very high unemployment, and 2) much higher governmental spending.

Consider the following facts: Between 2007 and 2009, the total of all “on budget” annual federal receipts decreased \$482 billion and “on budget” federal spending increased \$726 billion, a combined change of \$1,208 billion. The decrease in receipts was due almost entirely due to decreases in individual and corporate income taxes. In terms of percentages of GDP, total receipts decreased from 13.9% to 10.3%, the lowest percentage since 1942, and spending increased from 16.4% to 21.3%, the highest level since 1946! The combined 8.5% net increase in spending minus receipts directly accounts for the \$1.2 trillion increase in the “on budget” deficit between 2007 and 2009.

The “on budget” numbers we cite here exclude over \$500 billion per year of “off budget” items, mostly related to Social Security, so the percentages of the GDP would be about 4.6% and 3.5% higher if the “off budget” items were included. We use the “on budget” numbers because, due to the nature of federal accounting, they give a truer measure of the actual deficits than do the so-called “total” numbers. The reported “totals” reduce the reported deficit by the amount of the annual Social Security “surplus” and the growing interest on the Social Security trust fund balance, even though that fund contains only governmental IOU’s because all the money has already been spent.

Returning to our main point, the huge increases in the annual deficits since Obama took office were not due mainly to the income tax *rate* structure, which hadn’t changed, and they could not have been changed significantly, if at all, by raising the tax rates on a few, or even on all. In 2009 the income taxes of *all* taxpayers would have had to be more than doubled to eliminate the entire deficit!

Nevertheless, in his April 13 speech at George Washington University, and in others since, Obama says that increasing the income tax rates on high-income people is an important part of his “new” approach to reducing the nation’s ballooning debt. However, using the same governmental records we’ve used, an April 17 article in the Wall Street Journal reached much the same conclusion as we

have regarding how relatively little could be gained by increasing income taxes on those with high incomes.

In further support of our conclusion, we find that even though the budget for fiscal 2012 Obama issued in February assumed the tax rates on families with incomes above \$250,000 per year would be restored to the 2000 level after 2012, it still predicted the annual deficit would *average* \$939 billion per year for the next ten years! No more evidence should be needed to demonstrate that raising the tax rates on the top earners can do little if anything to reduce the deficits and the national debt will soar if Obama's spending policies continue.

Over 90% of the projected \$9.4 trillion debt that was forecast in Obama's ten-year budget projection resulted from the difference between expenditures and receipts for Medicare, Medicaid, and Social Security, mostly due to Medicare and Medicaid. But as big as that is, it is less than one tenth of the current value of the unfunded future obligations of those entitlement programs, which is over 100 *trillion* dollars—mostly due to Medicare.

In his April 13 speech the President announced a “new budget plan”—titled a “Framework for Shared Prosperity and Shared Fiscal Responsibility”—that he said would reduce the federal deficits by \$4 trillion by 2023--a 12 year period versus the 10 year projection in his February budget. However, his speech and the fact sheet released by the White House didn't make clear whether that \$4 trillion would be a net reduction in the current debt or only a reduction from the \$9.4 trillion increase by 2021 predicted in the February budget. Numerous other aspects of the new plan aren't made clear, so it hasn't been “scored” by the Congressional Budget Office, and an analysis by National Review Online concluded it is largely the same as the February budget. Much of the confusion is due to expressing the results in terms of deficit reductions, yearly changes from an unstated baseline, instead of debt reduction, a cumulative change from a known starting point.

If Obama meant a \$4 trillion reduction from the \$9.4 trillion debt increase predicted in his February budget, the debt would still increase from \$14 trillion now to an unacceptable \$20 trillion by 2023. That would mean an average annual debt increase (deficit) of \$500 billion for the next 12 years--about half that projected in the February budget. But if he meant a \$4 trillion reduction from the

current debt of \$14 trillion, it would imply an average *surplus* of \$300 billion per year for 12 years, an unbelievable turnaround from the recent deficits of about \$1.5 trillion per year and all past experience. Either way, we find it inconceivable that in only two months the Administration was able to find credible ways to change its projection of the debt so drastically. Moreover, there is no indication the measures he mentioned would significantly reduce the huge unfunded obligations of the current entitlement programs.

It is also inconceivable to us that Obama and most Congressional Democrats don't understand the true magnitude of the problem the nation faces in the longer term, including the monstrous unfunded liability of the current entitlement programs. So we conclude their refusal to propose a budget that greatly reduces spending and agree to substantial entitlement reforms results from their uncompromising ideological beliefs and their assessment of what favors their short term political interests.

The President's repeated rhetoric about "shared sacrifice," "without cutting into the social compact", and "fairness" evades the real issues, especially the sheer unsustainability of the nation's current fiscal path. Instead of talking about how it would be fair for the rich to pay more taxes, he and Congressional Democrats should address how to greatly reduce governmental spending. Of course, those with very high incomes can afford to pay more taxes, but, raising their taxes, no matter how high, or raising the taxes on *all* who pay income taxes, cannot generate enough revenue to reduce the ballooning national debt significantly without crippling the economy.

Because of all the above, we agree with those who believe the only remedy for the nation's fiscal problems is a massive reduction of federal spending, especially entitlements, coupled with intelligent reform of the federal tax structure. It is way past time for the American people and our elected officials to face up to the severity of the situation the nation faces. The refusal of the President and most Democrats to address the need for major spending cuts, especially Medicare reform, proves their unwillingness to do what is needed. Almost as alarming, some polls indicate many Americans support increasing taxes on the wealthy and oppose changing Medicare in any way. But we believe that is because many of

those people don't pay income taxes, and they don't understand the facts we have presented here. That is exactly why we wrote this article.

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