

WebMemo



Published by The Heritage Foundation

No. 1313
January 16, 2007

Congress Should Reject New Taxes and Curb Exploding Entitlements

Stuart M. Butler, Ph.D., and Alison Acosta Fraser

With entitlement spending set to surge when the Baby Boomers start to retire, recent talk on Capitol Hill of fiscal discipline is welcome. But to some lawmakers, that means raising taxes rather than tackling the core problem of entitlement spending. Raising taxes would be folly. Any tax increase would be a real and unacceptable threat to America's prosperity.

The nation's fiscal problems are not the result of inadequate taxation. Federal tax revenues are surging into the Treasury, and the tax burden is already scheduled to increase under current law. With no changes to current tax policies, the tax burden on the American people will reach a record high in 2026 and continue to rise thereafter. Rather than add new taxes, Congress should focus on curbing the projected growth of taxes and crafting a serious strategy to reform and constrain entitlements.

For now, Congress should:

- Reject tax rate increases and impose no new taxes;
- Reject any increase of the Social Security wage cap;
- Make the Bush tax cuts permanent; and
- Fix and then repeal the Alternative Minimum Tax (AMT).

The Current-Law Crisis. America faces an entitlement spending tsunami. According to the Congressional Budget Office (CBO), spending on the big three entitlements—Medicare, Medicaid, and Social Security—is projected to rise from just over

8 percent of GDP today to almost 19 percent in 2050, when today's college graduates are nearing retirement.

Meanwhile, federal taxes as a proportion of GDP are also scheduled to rise sharply under current law—from today's 18.4 percent, which is just above the post-World War II average, to almost 24 percent by 2050—well above the highest levels the nation has ever experienced. (See Chart 1.) Contrary to liberal rhetoric, even making the Bush tax cuts permanent would ease this surging tax burden only marginally—by less than 1 percentage point. This effect would likely be even smaller if dynamic scoring were used to calculate the impact these higher taxes would have on the economy, rather than just their bookkeeping “cost.”

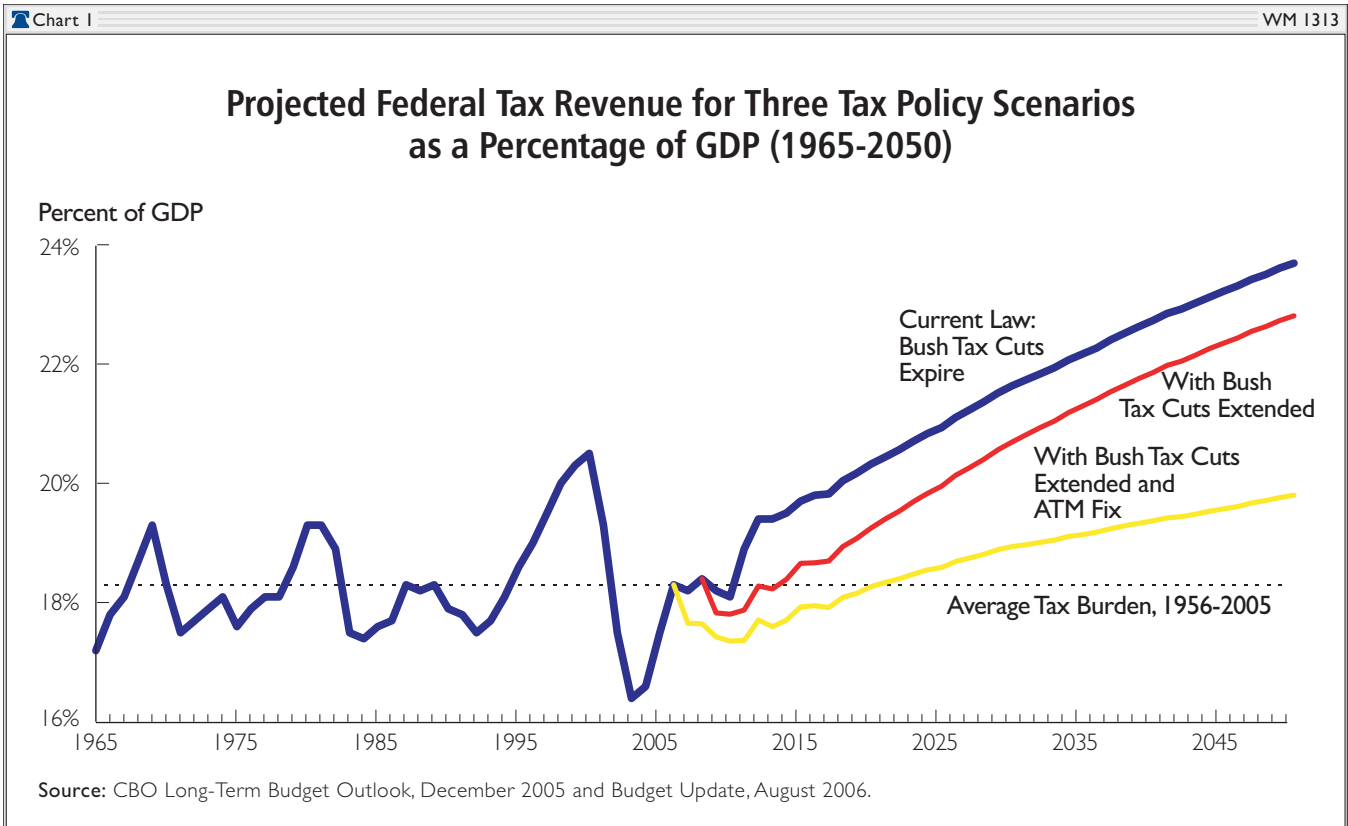
Reject New Taxes. Any tax increase on top of this rising burden would put America well on the way to European-level taxes, causing European-style economic stagnation, slow income growth, and unemployment. Even France has begun to recognize how damaging such levels are, and French President Jacques Chirac has proposed to cut France's corporate income tax rate from 33 percent to 20 percent. Congress must ensure that the U.S. does not take even one step down the road to higher

This paper, in its entirety, can be found at:
www.heritage.org/research/taxes/wm1313.qfm

Produced by the Domestic Policy Studies Department

Published by The Heritage Foundation
214 Massachusetts Avenue, NE
Washington, DC 20002-4999
(202) 546-4400 • heritage.org

Nothing written here is to be construed as necessarily reflecting the views of The Heritage Foundation or as an attempt to aid or hinder the passage of any bill before Congress.



taxes and a slower economy. Instead, it should face up to the challenge of entitlement spending.

Reject Raising the Social Security Wage Cap.

Congressional Democrats, unfortunately, have offered a rash of schemes to respond to the entitlement explosion by raising taxes even faster than they are scheduled to grow. One is to increase the Social Security wage cap, which limits the amount of an individual's income that is subject to the Social Security payroll tax. This change would not address Social Security's financial imbalance; it would only postpone huge operating deficits by a few years. More worrisome, this step would impose a large marginal tax rate increase on 3 million entrepreneurs and small business owners. This will cost jobs, decrease personal savings, and undermine American competitiveness. Raising taxes is an unacceptable solution to a spending problem.

Make the Bush Tax Cuts Permanent. The Bush tax cuts, especially the 2003 tax rate reductions, have been a critical part of the recent economic expansion. Letting them expire would constitute a huge increase in marginal tax rates and would dramatically boost

the double taxation of saving and investment. This risky step also would speed the increase in the tax burden that is built into existing law.

Letting the cuts expire would be counterproductive. Washington is now awash in tax revenues. Federal tax revenues have surged to record levels in recent years, thanks in large part to the growth in capital gains and dividends receipts after the tax rate reductions were implemented. Job growth has also boosted revenues, underscoring the fact that lower tax rates help economic growth.

Under current law, these beneficial rate reductions will sunset over the next four years, leading to rate increases and putting America on an accelerated path to record tax burdens. That must not happen. As a first installment, the tax rate changes must be made permanent. Congress should then begin to reform the tax code to reduce rates and the total tax burden. Such steps toward fundamental tax reform would lead to faster economic growth.

End the AMT. The AMT was originally intended to ensure that a tiny number of millionaires could

not escape taxation by sheltering their income through credits, exemptions, and deductions. But subsequent expansions of the law, combined with the lack of indexing of the AMT, have resulted in millions of Americans—especially those with children, heavy state and local taxes, or small businesses—being snared into the AMT's higher tax rates. The number of tax filers facing the AMT will rise from 3.5 million in 2006 to as many as 23.4 million in 2007. Indeed, the AMT is the main culprit behind the aggregate tax burden's projected to climb to 24 percent of GDP.

Congress needs to take two steps to address this pernicious tax. First, it should immediately index the tax's thresholds to prevent any more Americans from being sucked into the AMT. Second, Congress should enact legislation to repeal the AMT—without offsetting the repeal with new taxes elsewhere and so retaining the escalation in total tax burden.

Conclusion. America has prospered in part because Americans enjoy low taxes and low spending. But under current law, spending and taxes are both set to increase to record and unsustainable levels, threatening America's prosperity and the freedom of American families to control the uses of their income. Congress's spending agenda should be to craft serious reforms to get entitlements under control. And the tax agenda for the new Congress should be the same as it would be for any Congress: no new taxes and decisive steps to reverse the increase in the overall tax burden that is already scheduled to occur.

—*Stuart M. Butler, Ph.D., is Vice President for Domestic and Economic Policy Studies, and Alison Acosta Fraser is Director of the Thomas A. Roe Institute for Economic Policy Studies, at The Heritage Foundation.*