

SPECIAL REPORT

March 2007
No. 151

Who Pays America's Tax Burden, and Who Gets the Most Government Spending?

By

Andrew Chamberlain
Staff Economist
Tax Foundation

Gerald Prante
Staff Economist
Tax Foundation

Scott A. Hodge
President
Tax Foundation

I. Introduction

Are Americans getting a good deal for their tax dollars? While many studies answer the question of who pays taxes in America—and who doesn't pay enough taxes—the question of who gets the most government spending in return is almost always ignored.

Ultimately, Americans pay taxes in order to fund government spending programs created by lawmakers. And while Americans may be sharply divided over which government spending is useful and which is wasteful, one fact remains. In the long run, every dollar of government spending must be paid by taxes—either today or in the future—and those taxes ultimately come from the pocketbooks of American households.

Debates about taxes usually ignore government spending. But this leaves out an important part of the problem. Historically, the level of government spending has been an important driver of the U.S. tax burden, not the opposite. Many of the most important increases in the U.S. tax burden in the 20th century occurred during wartime and periods of high government spending. As former Director of the Congressional Budget Office Douglas Holtz-Eakin has argued,

"[The level of taxation] is always the second decision. The first one is how much are we going to spend ... if you spend this much money, you can't borrow it all."¹

In other words, government spending is often the horse that drives the tax cart—not the opposite. And so debates about whether taxes

Key Findings:

- *The question of who pays taxes is important, but so is the question of who receives government spending. Some Americans clearly receive more government spending in exchange for their tax dollars than others;*
- *America's lowest-earning one-fifth of households receives roughly \$8.21 in government spending for each dollar of taxes paid. Households with middle-incomes receive \$1.30 per tax dollar, and America's highest-earning households receive \$0.41 per tax dollar;*
- *Government spending targeted at the lowest-earning 60 percent of U.S. households is larger than what they paid in taxes in 2004. Overall between \$1.03 trillion and \$1.53 trillion was redistributed downward from the two highest income quintiles to the three lowest income quintiles through government taxes and spending;*
- *Looking at taxes alone doesn't tell us how much America's fiscal system is helping or hurting low-income households. To answer that, we must look at government spending as well. Lawmakers who ignore government spending may be making decisions based on an incorrect set of facts about the United States fiscal system.*

1. David T. Cook, "Douglas Holtz-Eakin." *The Christian Science Monitor* (December 2, 2005).

are too high or too low in America are really just debates about whether the level of government spending is too high or too low.

Once we realize that taxes and spending are fundamentally linked, we're led to an obvious question: who pays taxes in America, and who gets the dollars of government spending in return?

Just as taxes fall more heavily on some Americans, dollars of government spending don't flow to all Americans equally. Government transfer payments such as aid to needy families, veterans' benefits and Social Security payments benefit some Americans and not others. Similarly, government spending on public universities, airports and highways routinely benefit some Americans more than others.

Since both taxes and spending affect the well-being of Americans—taxes make people worse off, and government spending on useful things makes people better off—it's not enough to simply ask which Americans bear the nation's tax burden. We also need to know which Americans receive the most dollars of government spending.²

Spending Today Matters More than Ever

Two trends in recent years have made it more important than ever for Americans to look beyond tax burdens and focus on who's on the receiving end of government spending as well.

First is the rapid growth in what economists call "tax expenditures" and "targeted tax credits." These policies use the tax code to implement social and economic policy instead of traditional government spending. Lawmakers have come to prefer tax expenditures and credits in recent years because they are less transparent to taxpayers, face less budgetary scrutiny, and allow lawmakers to funnel taxpayer dollars from one group to another without facing criticism that they are big-spending politicians.

At the federal level there are myriad examples of this trend. The Earned Income Tax Credit (EITC) dispenses aid to low-income Americans through the tax code rather than direct welfare. Similarly, the Child Tax Credit gives generous subsidies to parents through the tax code rather than through direct welfare payments. And various targeted tax credits offer a wide range of tax bonuses to companies that produce alternative fuels, locate in politically favorable areas, or engage in other activities deemed worthy of subsidy by Members of Congress.

These special "tax expenditures" blur many traditional lines between taxes and spending, making it more important than ever to examine *all* public finances—both taxes and spending.

Another reason spending matters as well as taxes is the looming crisis of growing federal entitlement spending on the horizon. Currently, federal spending is on an unsustainable long-term path. In coming decades Americans face a stark choice between sharply higher taxes or dramatic cuts in Social Security, Medicare and Medicaid. On the tax side, there is plenty of information available to guide decisions about tax reforms. But on the spending side there is little information available on who gets the most from government spending programs and who gets little.

This information vacuum may lead Congress to make these difficult budget tradeoffs with no information about who gets government spending and how it compares to Americans' tax burdens. As a result, the coming debate over spending reform risks being swayed by anecdote and misperception rather than facts about the American fiscal system.

This report fills that information gap. We present the key findings of a comprehensive 2007 Tax Foundation study of the distribution of America's total tax burden and the distribution of government spending.³ The results

2. For example see Eugene C. Steuerle, "Can the Progressivity of Tax Changes be Measured in Isolation?" *Tax Notes* (September 1, 2003), p. 1187-8: "Unfortunately, these comparisons [of only the distribution of taxes] are incomplete. To know the effect of tax changes on the distribution of income, it is necessary to take into account what the government does with the money."

3. Andrew Chamberlain and Gerald Prante, "Who Pays Taxes and Who Receives Government Spending? An Analysis of Federal, State and Local Tax and Spending Distributions, 1991-2004." *Tax Foundation Working Paper*, No. 1 (2007). Available at www.taxfoundation.org/publications/show/2213.html.

show that looking at who pays taxes alone is a highly misleading guide to whether households are made better or worse off from government taxes and spending.

As will become clear below, once government spending is taken into account, some Americans pay far more to government than they receive in spending, while others receive large amounts of spending and pay little tax—what might be described as a nation of taxpayers and tax “consumers.”

The remainder of this report tells the story of the American fiscal system. First, we explain how to use this report to identify where you and your household lie on the income spectrum in the United States. Next, we present some facts about taxes in America, and who pays them. Then, we explain the size and scope of U.S. government spending, showing which Americans receive most from it. Finally, we explain why this story of combined taxes and spending matters for lawmakers, both in Washington, D.C. and in state and local governments across the country.

Summary of the Full Study’s Methodology

- Time period: Calendar Year 2004.⁴
- Unit of analysis: Households.
- Presentation of results: Quintiles of household cash money income containing equal number of individuals, and unequal numbers of households.
- Data sources: Bureau of Economic Analysis, U.S. Census Bureau, U.S. Bureau of Labor Statistics, Office of Management and Budget, Centers for Medicare and Medicaid Services, and Tax Foundation.

Source: Andrew Chamberlain and Gerald Prante, “Who Pays Taxes and Who Receives Government Spending? An Analysis of Federal, State and Local Tax and Spending Distributions, 1991-2004.” Tax Foundation Working Paper, No. 1 (2007). Available at www.taxfoundation.org/publications/show/2213.html.

II. Which Income Group Do You Belong To?

The first step in estimating U.S. tax burdens is to group Americans into categories, and estimate how much taxes are paid by each. In this report, we group the entire American population of 291 million people from 2004 into five groups. These groups are based on how much cash money income was earned by their household.⁵

Here is how we do that. First, we total up the income of every member of each person’s household. This is called a person’s “household income.” Next, everyone is arranged in a line from lowest to highest household income. This line is then cut into five equal sections, which

Table 1
Income Levels for the Five Groups of Taxpayers Used in This Report
Calendar Year 2004

	Total	Quintiles of Household Cash Money Income				
		Bottom 20 Percent	Second 20 Percent	Third 20 Percent	Fourth 20 Percent	Top 20 Percent
Total Household Cash Money Income for Each Group	na	Under \$23,700	\$23,700–\$42,304	\$42,305–\$65,000	\$65,001–\$99,502	Over \$99,502
Number of Individuals	291,166,198	58,217,357	58,246,236	58,414,918	58,058,486	58,229,201
Number of Households*	113,475,724	30,377,708	24,520,544	21,249,055	19,265,699	18,062,718

*Note: High-income groups generally have more married couples, and therefore they have fewer separate households than low-income groups. Because many single Americans reside in lower-income groups, those groups have the most households.

Source: Tax Foundation

4. This single-year analysis does not attempt to capture important distributional changes over time. However, the complete study examines multiple years between 1991 and 2004, as well as differences in tax burdens and government spending received by different age groups. See Chamberlain and Prante (2007), *op. cit.*, pp. 24-25.

5. “Cash money income” is defined by the U.S. Census Bureau. It is broader than adjusted gross income (AGI) as defined by the IRS for income tax purposes. It consists of earned income such as wages and salaries, as well as unearned income such as the value of various government transfer payments such as unemployment compensation and Social Security payments. This definition of cash money income generally corresponds to most taxpayers’ “common sense” definition of their household’s income.

Table 2
Taxes Paid to the Federal Government in Washington in 2004

Federal Taxes	Average Amount Per U.S. Household
Payroll Taxes (Soc. Security & Medicare)	\$7,069
Individual Income Taxes	\$7,062
Corporate Income Taxes	\$2,155
Estate and Gift Taxes	\$217
Gasoline Excise Taxes	\$213
Customs Duties, Etc.	\$205
Air Transport Excise Taxes	\$107
Telephone and Other Excise Taxes	\$92
Diesel Fuel Excise Taxes	\$81
Alcoholic Beverages Excise Taxes	\$74
Tobacco Excise Taxes	\$63
Total Federal Taxes	\$17,338

Source: Tax Foundation

Table 3
Taxes Paid to State and Local Governments in 2004

State and Local Taxes	Average Amount Per U.S. Household
Property Taxes	\$2,906
General Sales and Gross Receipts Taxes	\$2,240
Individual Income Taxes	\$1,984
Other Business Taxes	\$425
Corporate Income Taxes	\$380
Gasoline Sales Taxes	\$298
Other Selective Sales Taxes	\$258
Public Utilities Taxes	\$190
Insurance Receipts Taxes	\$129
Personal Motor Vehicle Licenses	\$120
Tobacco Excise Taxes	\$108
Business Motor Vehicle Licenses	\$67
Severance Taxes	\$61
Special Assessments Taxes	\$57
Personal Property Taxes	\$50
Estate and Gift Taxes	\$50
Alcoholic Beverages Excise Taxes	\$41
Other Personal Taxes	\$36
Total State and Local Taxes	\$9,400

Source: Tax Foundation

are called “quintiles.” Each quintile contains 20 percent of the American population—about 58 million Americans apiece.

To help readers identify which income quintile they belong to, Table 1 shows how we’ve divided up Americans into five equal groups. To find yourself in these groups, mentally total up the cash income of everyone who lives in your house—all wages, income from investments, government transfer payments, and so on. Then find which income group in Table 1 you belong to.

If your household’s cash money income was less than \$23,700 in 2004, you fall into the lowest income group. If it was \$99,502 or above, you belong to the highest-earning 20 percent of Americans. To qualify for membership in the often discussed middle 20 percent of incomes, your households had to have earned between \$42,305 and \$65,000 in total cash money income in 2004. Whichever group you find yourself in, there are roughly 58 million other American people with similar household incomes to yours who share that group with you.

III. How Much Is America’s Tax Burden?

Now that we’ve divided Americans into five income groups, let’s explore America’s tax system. While we often talk about the nation’s “tax burden,” Americans don’t simply face one unified tax bill. Instead, they pay many different types of taxes to many different levels of government—federal income taxes, state cigarette taxes, local property taxes, and so on.

In this report, we count every tax in the United States, at all levels of government. To show the differences between taxes paid to the federal government in Washington and taxes paid to state and local governments, we present federal taxes and state-local taxes separately.

The biggest federal taxes Americans pay are the income taxes they pay when they file their taxes each April 15th and the payroll taxes that are deducted from their paychecks at work to fund Social Security and Medicare. At the state

and local level, the biggest taxes Americans pay are local property taxes and retail sales taxes on the things they buy in stores.

Table 2 shows the full list of taxes Americans pay to the federal government in Washington each year, and Table 3 shows the taxes they pay to state and local governments at home. To make the figures easier to understand, we've presented them on a per-household basis—total collections divided by the roughly 113 million U.S. households in 2004. Those who prefer totals can simply multiply the figures by 113,476,000.

In 2004 Americans paid a total of \$3 trillion in total taxes—\$26,738 per U.S. household. Of those taxes, roughly \$2 trillion or \$17,338 per household is paid to the federal government, and roughly \$1 trillion or \$9,400 per household is paid to state and local governments. To give a sense of how large this total tax bill is, if one government agency manually collected all U.S. taxes like a bank teller accepting cash deposits, the agency would have to process \$96,211 per second—24 hours per day, seven days per week—for an entire year to collect \$3 trillion.

IV. Who Pays America's Total Tax Burden?

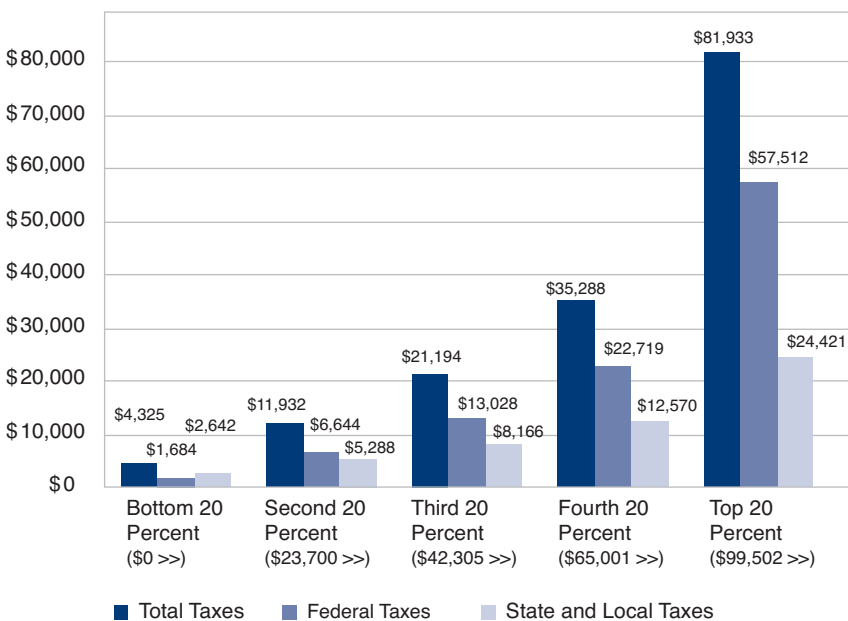
Now that we've looked at the size of the U.S. tax burden, let's look at which Americans pay those taxes.

As nearly everyone knows, some taxes fall heavily on upper-income Americans while others fall heavily on low-income Americans. For example, the federal income tax is heavily skewed toward those with the highest incomes, because it has six tax rates that rise from 10 percent to 35 percent as income rises. In contrast, cigarette taxes fall mostly on the lowest-earning Americans, because those with low incomes are more likely to smoke than those with high incomes.

However, when all taxes are considered together, America's highest-earning income groups clearly pay the largest amounts of taxes to finance government spending programs.

Figure 1 illustrates a familiar story about the U.S. tax burden. It shows how much in taxes households in each income group pay each year on average to federal, state and local governments. As is clear from the figure, America's tax burden varies widely across the U.S. income distribution.

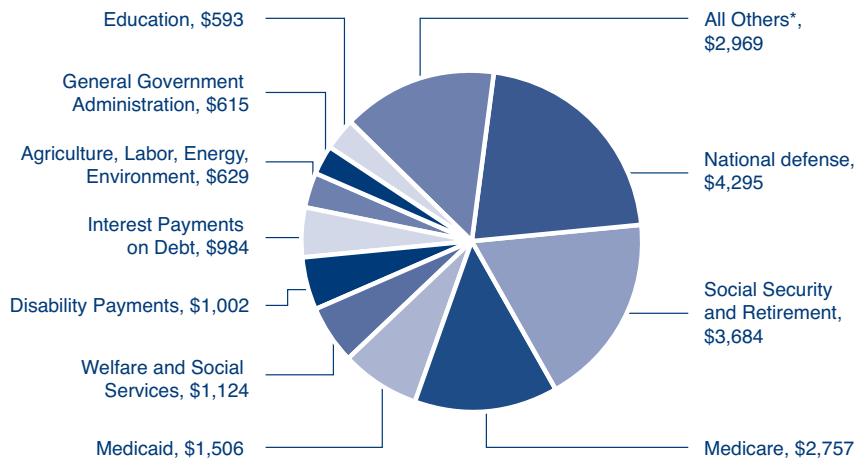
Figure 1
Average Dollars of Taxes Paid by Households in Each Income Group in 2004



In general, households that earn the most income pay the most dollars of taxes. This is no surprise, since income and payroll taxes make up a very large portion of the nation's tax bill. Overall, the most tax dollars were paid by households in the top income group. They paid an average of \$81,933 in taxes—\$57,512 to the federal government in Washington in 2004, and \$24,421 to state and local governments at home. Households in the middle income group—which some refer to as the “middle class”—paid an average of \$21,194 in taxes, or \$13,028 in federal taxes and \$8,166 in state and local taxes.

America's lowest-earning households—those earning less than \$23,700 in cash money income in 2004—face the nation's lowest tax burden. However, they still pay thousands of dollars per year to finance government spending at all levels. Households in the bottom income

Figure 2
Federal Government Spending Received by Americans in 2004

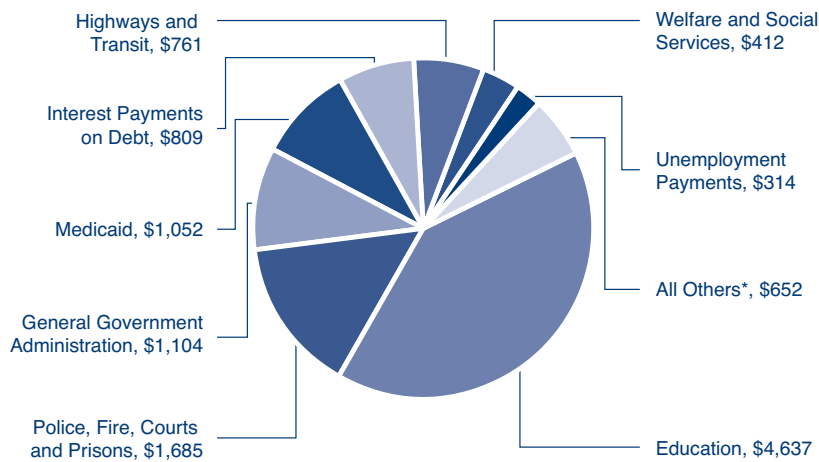


Total Federal Spending Per Household = \$19,683

* Note: "All Others" includes the following: Veteran's Health Services; Other Income Security; Police, Fire, Courts and Prisons; Other Health; Highways, Airports and Transit; Housing Assistance; Disaster Relief; Space; and Recreation and Culture.

Source: Bureau of Economic Analysis; Tax Foundation

Figure 3
State-Local Government Spending Received by Americans in 2004



Total State and Local Spending Per Household = \$11,424

* Note: "All Others" includes the following: Agriculture, Labor, Energy, and Environment; Recreation and Culture; Disability Payments; Other Health; and Housing and Community Services.

Source: Bureau of Economic Analysis; Tax Foundation

group paid an average of \$4,325 in taxes in 2004, or \$1,684 to the federal government and \$2,642 to state and local governments.

As is clear from Figure 1, federal taxes make up a much larger portion of the tax bill of upper-income households, while state and local taxes make up a bigger share of the tax bill for lower-income households. Sixty-one percent of the bottom income group's taxes are paid to state and local governments, while 39 percent are sent to Washington, D.C. In contrast, just 30 percent of the highest-income group's tax bill goes to state and local governments, leaving 70 percent for Uncle Sam.

V. How Big Is Government Spending in America?

Now that we've answered the question of who pays taxes in America, let's explore how governments return those tax dollars to households in the form of government spending.

While the nation's tax burden is easy to summarize, the vast array of federal, state and local government spending programs isn't. Total government spending is composed of tens of thousands of programs that affect nearly every facet of American life—farm subsidies, police protection, medical care, roads, seaports, welfare payments, judicial courts, mass transportation, national defense, public schools, airports, college tuition aid, interest payments on debt, and so on. This makes it hard to explain in a simple way how government spends taxpayer dollars.

First, let's look at the total amount of spending. In 2004, governments at all levels spent roughly \$3.5 trillion dollars on American households—or roughly \$31,108 for every household in the country. Of that amount, \$2.2 trillion was spent by the federal government in Washington, and \$1.3 trillion was spent by state and local lawmakers.

To give a sense of how large that is, \$3.5 trillion of total government spending is equal to about 30 percent of the U.S. economy in 2004. That's larger than the combined gross domestic product of Canada, Mexico, Austria, Belgium, Denmark, Finland, Greece, Hungary and New Zealand in 2004.⁶

Different Types of Government Spending

In this report we group government spending into what economists call “functional categories.” That is, we group spending amounts by the purpose they're meant to serve—defending the borders, providing health-care, fighting crime, and so on—rather than by the government agency that happens to spend them.

Figure 2 and Figure 3 show the amounts of money that federal, state and local governments spent on various items in 2004. To make the figures easy to understand, we've presented them on a per-household basis. That is, we've taken the total dollar amount of government spending in each category and divided it by the roughly 113 million U.S. households in 2004.

As is clear from the figures, defense, Social Security, Medicare, Medicaid and various other types of transfer payments dominate federal spending. At the state and local level, spending on public schools, police and fire protection, general government administration and the state portion of Medicaid dominates government spending.⁷

VI. Who Receives the Most Government Spending?

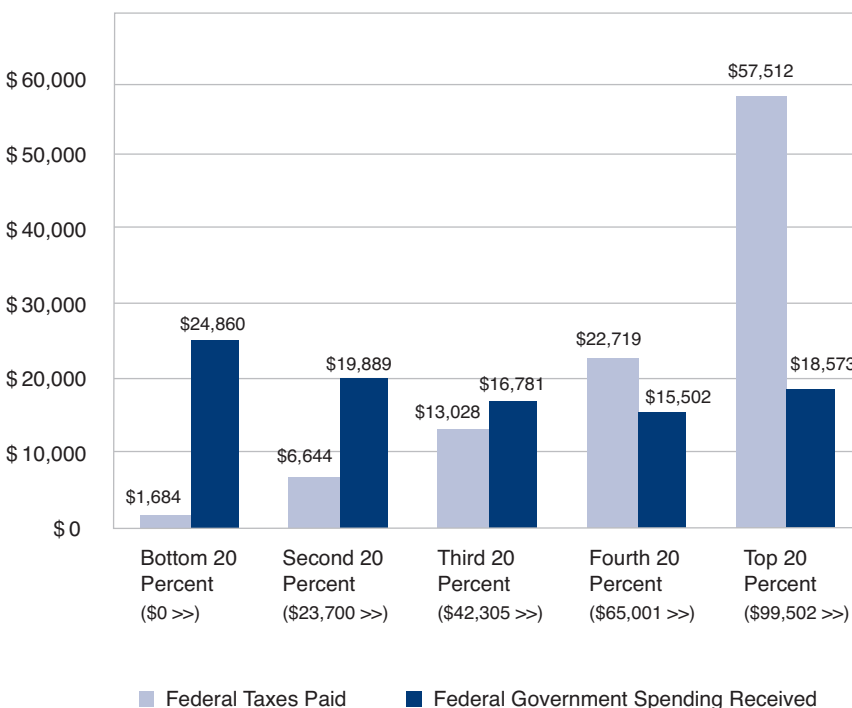
Now that we've explored both taxes and government spending in America, let's put the two together. How much government spending do people receive compared to the taxes they pay?

The first question to ask is, What do we mean when we say someone has “received” government spending? In this report, any time you use a government service, the amount of money it cost the government to provide that service to you is counted as part of the government spending you receive.

For example, if you use Medicare to pay for a hospital trip, you “receive” the amount that trip cost the federal government. Similarly, if you enroll your children in public schools, you “receive” the amount it cost the government to educate your child. If you have two children enrolled, you receive twice that amount. And so on.

Using official survey data from the federal government, we're able figure out which households in America are most likely to use all the different government programs on the

Figure 4
Some Households Received More Federal Government Spending Than They Paid in Federal Taxes, and Some Received Less
Calendar Year 2004



Source: Tax Foundation

6. Organisation for Economic Cooperation and Development, *OECD in Figures, 2005 Edition*, p. 12-13.

7. For a full list of types of government spending, please download the complete study at www.taxfoundation.org/publications/show/2213.html.

books—public housing, roads, schools, the Postal Service, unemployment compensation, Medicaid, college tuition subsidies, and so on. Once we’ve walked through every government program and have allocated the costs to those who use them, the total received by each household is what we call “government spending received” in this report.

Now that we know what counts as your government spending received, let’s look at who gets the most and who gets the least. First we’ll look at federal spending and taxes, and then we’ll explore state and local.

Figure 4 shows who pays federal taxes, and who receives federal government spending. For each income group, the left-hand bar shows the

average federal taxes paid per household. The right-hand bar shows the average dollar amount of federal government spending received in return. Clearly, some households get a much better deal from federal government taxing and spending than is apparent from looking only at federal tax burdens.

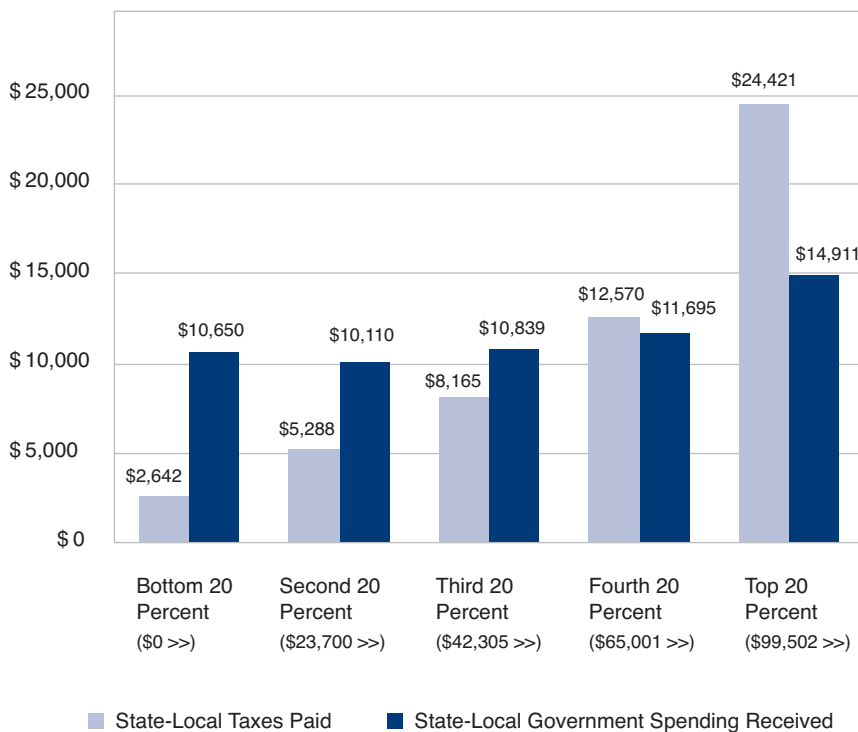
Overall, the bottom three quintiles of income—which contain the 60 percent of American households earning less than \$65,000—are targeted by lawmakers with more federal government spending than they paid in federal taxes. In contrast, the top two quintiles of income pay more in federal taxes than they receive in government spending.⁸

When thinking about these figures, it’s important to keep something in mind. Remember that these numbers tell you how much the government spends on you. They don’t necessarily tell you how much *you personally value* what government gave you. For example, a child eating a government hot lunch at school may think it’s only worth a few pennies. But if it cost the government \$10 to provide, then your household “receives” that \$10 of spending.

What does this mean? For one, it means that if you find yourself thinking you don’t receive as much government spending as shown in Figure 4, it probably means you don’t know about or don’t value very highly the things the federal government supplies to you. For example, you may place a low value on the public education received by your child, but you still receive the amount of spending that it cost the government to provide it.

Since 65 percent of Americans say they receive “poor” or “only fair” value for their federal tax dollars⁹—that is, they feel they get very little spending from the federal government—it’s no surprise that the numbers in Figure 4 come as a shock to many Americans.

Figure 5
Some Households Received More State-Local Government Spending Than They Paid in State-Local Taxes, and Some Received Less
Calendar Year 2004



Source: Tax Foundation

8. Due to budget deficits, surpluses and spending funded by non-tax revenue, taxes may not equal spending benefits in any single year. The overall ratio of spending to taxes for America as a whole was 1.16 in 2004.

9. Andrew Chamberlain and Scott A. Hodge, “2006 Annual Survey of U.S. Attitudes on Tax and Wealth,” *Tax Foundation Special Report* No. 141 (April 2006). Available online at <http://www.taxfoundation.org/publications/show/1408.html>.

Who Gets the Most State and Local Spending?

Now that we've looked at federal spending, let's move on to state and local government spending. Figure 5 presents state and local taxes paid per household, along with the amount of state and local government spending people receive in return.

The distribution of state and local taxes and spending is roughly similar to federal taxes and spending. Some households benefit more than others. However, state and local government spending generally tracks state and local tax burdens much more closely than federal taxes and spending. In other words, the more taxes people pay to state and local governments, the more spending they generally get back in return.

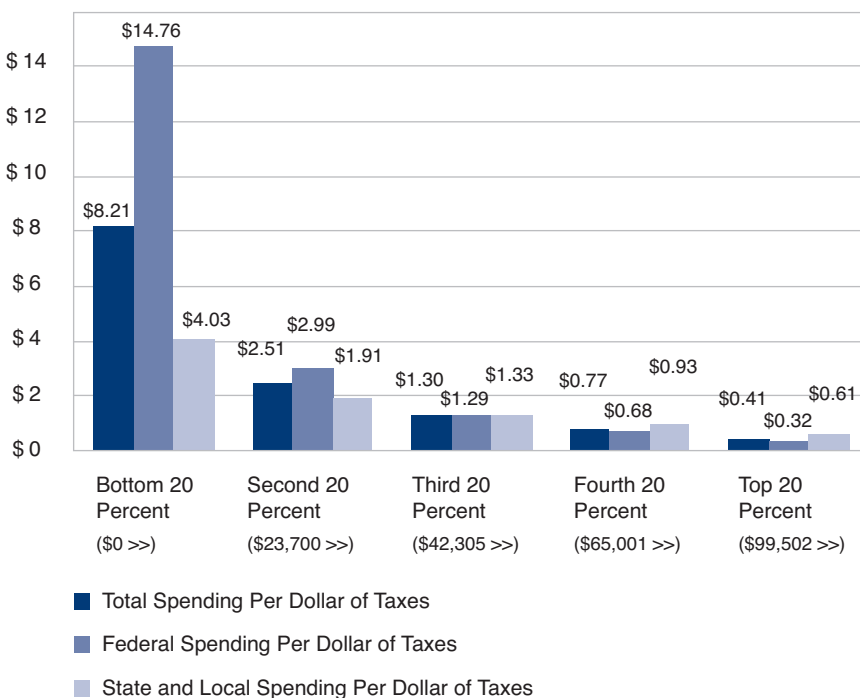
Nevertheless, some households still come out further ahead than others from state and local taxes and spending. Just as with federal taxes and government spending, the bottom three

quintiles were on the receiving end of more dollars of state and local government spending than they paid in taxes in 2004.

As a general pattern, the same three quintiles that receive more government spending than they pay in taxes also receive more state and local spending than they pay in state and local taxes. However, overall federal spending is more sharply tilted toward Americans with modest incomes. This happens because of the large size of federal transfer programs such as Medicare, Medicaid, Social Security and welfare, which are specifically designed to channel taxpayer dollars into the lowest income groups.

While state governments also channel large amounts of tax dollars to low-income households through Medicaid and other state welfare programs, state and local spending is generally less tilted toward lower-income households than federal spending. This is mostly because state and local governments spend large amounts on government programs that are disproportionately used by middle- and upper-income households. These include public education—upper-income groups generally have more school-age children—highways that are disproportionately used by upper-income households with the most cars, and interest payments on government debt that disproportionately go to upper-income households who hold government bonds.

Figure 6
Some Households Received More Dollars of Government Spending for Every Dollar of Taxes Paid
Calendar Year 2004



VII. Putting Tax Burdens and Government Spending Together: Net Tax Burdens

Now that we've looked at both the nation's tax burden and government spending, let's put them both together. When we do this, we end up with a measure of how much people pay into government, and how much government spends on to people in return. Economists sometimes refer to this as "fiscal redistribution" or the "fiscal incidence" of government policy.

Figure 6 compares household tax burdens to the amount of government spending received by Americans. It answers the following ques-

tion: “For every dollar of taxes paid, how much government spending is targeted at households in return?” As is clear from the figure, when government spending is considered along with tax burdens, the overall picture of the fairness of government policy is dramatically different from the usual picture of tax burdens alone.

Some households clearly benefit much more from current tax and spending policy on a dollar-for-dollar basis than others. Overall, households in the bottom three quintiles are net beneficiaries from tax and spending policies. They received more than one dollar of government spending for every dollar of taxes they paid in 2004. In contrast, households in the top two quintiles are net fiscal payers, receiving less than one dollar of government spending for every tax dollar paid to governments.

When all government spending is included, households in the lowest quintile received about \$8.21 in spending for every dollar of taxes paid. Households in the middle quintile received \$1.30, and households in the top quintile received \$0.41.

At the federal level, government spending and taxes are much more unevenly distributed than at the state and local level. America’s bottom income group received \$14.76 of federal

spending for every dollar of taxes they send to Washington, compared to \$1.29 for the middle quintile and just \$0.32 for America’s highest earners. State and local public finances also provide substantial benefits to lower-income households, but not to the same degree. The bottom income group received \$4.03 in state and local spending per dollar of state and local taxes, while households in middle quintile received \$1.33 and households in the top quintile received \$0.61.

The spending amounts in Figures 4, 5 and 6 include all federal, state and local government spending. However, some kinds of government spending really benefit all households equally, and aren’t targeted specifically at certain people. Economists call these things “public goods.” For example, spending on national defense, environmental protection and criminal justice are supplied to all American households equally by lawmakers. As a result, it’s sometimes useful to leave out those spending programs and see how the distribution of tax burdens and government spending changes.¹⁰

In 2004, total spending on “public goods” like national defense and environmental protection was about \$8,150 per household—\$6,059 in federal spending and \$2,090 in state and local spending. Table 4 shows what the numbers from Figure 6 look like when spending on “public

Table 4
Government Spending Received Per Dollar of Taxes Paid, With and Without National Defense, Environment and Other “Public Goods”
Calendar Year 2004

	Quintiles of Household Cash Money Income				
	Bottom 20 Percent (\$0 >>)	Second 20 Percent (\$23,700 >>)	Third 20 Percent (\$42,305 >>)	Fourth 20 Percent (\$65,001 >>)	Top 20 Percent (\$99,502 >>)
Total Spending and Taxes	\$8.21	\$2.51	\$1.30	\$0.77	\$0.41
Excluding Public Goods	\$6.33	\$1.83	\$0.92	\$0.54	\$0.31
Federal Spending and Taxes	\$14.76	\$2.99	\$1.29	\$0.68	\$0.32
Excluding Public Goods	\$11.17	\$2.08	\$0.82	\$0.42	\$0.22
State and Local Spending and Taxes	\$4.03	\$1.91	\$1.33	\$0.93	\$0.61
Excluding Public Goods	\$3.24	\$1.52	\$1.07	\$0.76	\$0.52

Source: Tax Foundation

10. For a full discussion of the issues surrounding the allocation of public goods to households, see Chamberlain and Prante (2007) *op. cit.*

goods” that benefit every household equally are left out. As is clear from the table, leaving out spending on public goods does not significantly change the overall pattern. Some taxpayers still come out further ahead than others.

Another way to compare tax burdens with government spending is to add up all the spending people receive, and subtract off the taxes they pay. This gives a measure of peoples’ “net tax burden,” or the amount they pay or receive from government once all taxes and spending are counted.

Figure 7 shows the total dollars of government spending households receive in each quintile, minus the taxes they pay. Overall, the bottom three income quintiles receive more dollars of government spending than they pay in taxes. Households in the lowest-earning

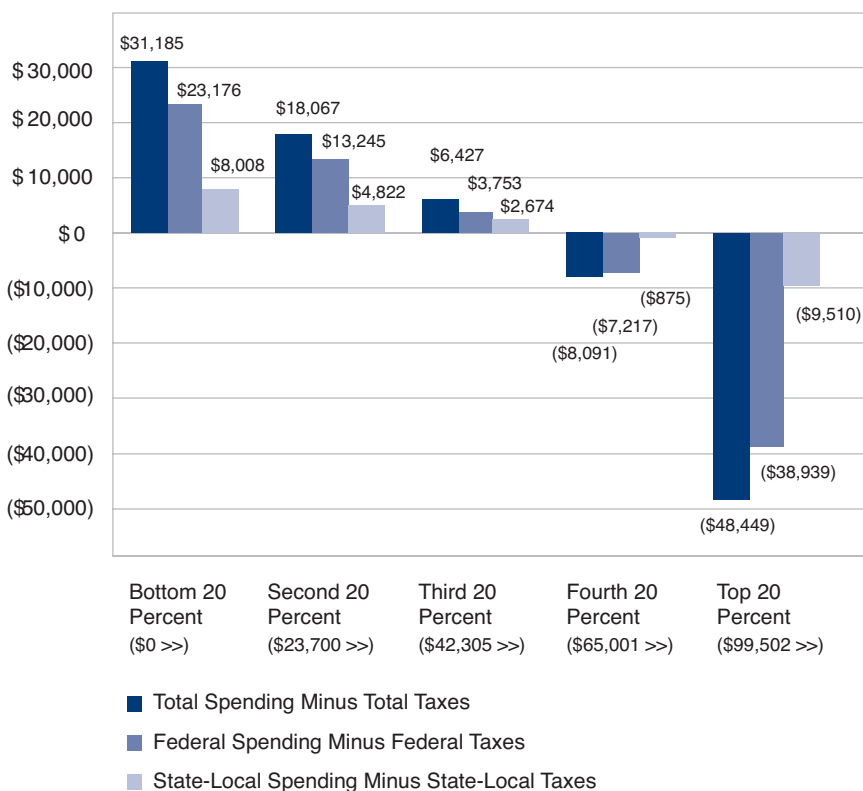
quintile receive about \$31,185 more in total spending than they pay in taxes, while households in the middle quintile receive \$6,424 more in spending than taxes.

In contrast, households in the fourth quintile pay \$8,091 more in taxes than they receive in government spending. Households in the top quintile receive the least spending compared to tax burdens, paying \$48,449 more in taxes on average than they get back in government spending.

When the totals from Figure 7 are summed into an aggregate for the U.S. economy, households in the top two quintiles paid roughly \$1.03 trillion more in total taxes than they received in government spending. In contrast, households in the bottom three quintiles received about \$1.53 trillion more in government spending than they paid in taxes. The difference between the two—approximately \$496 billion—represents how much more government spent than it collected in taxes in 2004.

Depending on what assumption we make about who gets the benefits of this deficit spending—that is, whether we assume it goes to those with upper-incomes, those with middle incomes, or those with low incomes—governments at all levels redistributed somewhere between \$1 trillion and \$1.5 trillion through government tax and spending policies in 2004.

Figure 7
Some Households Received More Dollars of Government Spending Than They Paid in Taxes



VIII. Implications for Public Policy

As we’ve seen above, government taxes and spending redistribute between \$1 trillion and \$1.5 trillion between the five quintiles of household income each year. This fact is not apparent by looking at the tax system alone. For this reason, it’s important for Americans to look beyond the distribution of only taxes and start counting government spending received as well. Only by counting both can we give an accurate judgment about what government policies are doing for different income groups in America.

A New Way Forward on Tax Reform

Once we realize taxes and spending are two sides of the same coin, new ways to achieve better tax policy for America become possible. By mixing together tax and spending policies, the classic trade-off between “efficiency” and “equity” disappears in many cases, allowing us to improve the economy by phasing-out inefficient taxes without taking away the advantages we’ve already conferred on America’s lowest-income households.

For example, many lawmakers favor sharply progressive taxes—that is, they favor taxes that fall more heavily on high earners than those with low incomes. These lawmakers usually oppose any tax reform plan that cuts the level of tax progressivity—such as a single-rate income tax or a retail sales tax—despite the economic benefits of those tax reforms.

But once we see that tax progressivity is only half the picture, and that progressivity can be achieved through either taxes *or* spending, these lawmakers’ opposition to economically efficient tax reforms no longer makes sense. Any amount of progressivity can be achieved by some mix of tax and spending changes. That means it’s possible to move toward a flatter, more economically neutral tax code, without reducing the progressivity in the fiscal system.

These types of win-win reforms are hidden from view in the current policy environment that’s fixated on tax progressivity. And this blindness toward government spending isn’t just a harmless omission. It often leads to poor tax policy.

For example, in 2005 the recommendations of the President’s Advisory Panel on Federal Tax Reform were sharply criticized for not proposing sufficiently bold tax reforms. However, the reason they made modest recommendations is that the panel was hamstrung by the Bush administration’s requirement that all tax plans be “distributionally neutral,” leaving the spread of tax burdens across income groups unchanged. This fixation on tax distributions—while ignoring government spending—makes little sense. A more appropriate criterion would

have been *fiscal distributional neutrality*, which would allow for a loss of tax progressivity so long as it’s offset on the spending side.

Conclusion

The burden of government on American households looks very different when we look at both taxes and government spending. Just as some households pay more taxes than others, some receive much more government spending. Taken together, governments at all levels redistribute a substantial amount of income between the nation’s income groups each year—a fact that’s not obvious by looking at taxes alone.

Unfortunately, lawmakers routinely ignore government spending when deciding whether taxes should fall more heavily on low- or high-income Americans. As we’ve seen above, ignoring spending gives a highly distorted picture of how the nation’s fiscal system treats Americans in different income groups. As a result, lawmakers often enact inferior tax policies and ignore ways to achieve both equity and efficiency by mixing together tax reforms and spending reforms.

Lawmakers should be wary of tax distributions alone. Instead, they should request that official agencies look at both government spending and taxes together. Such a shift would dramatically improve lawmakers’ knowledge of the fiscal system, and would open the door to many sensible tax and spending reforms that are currently hidden from view.



SPECIAL REPORT
(ISSN 1068-0306) is published
at least 6 times yearly by the Tax
Foundation, an independent
501(c)(3) organization chartered
in the District of Columbia.

4–20 pp.
Single copy: free
Multiple copies: \$5 each

The Tax Foundation, a nonprofit,
nonpartisan research and public
education organization, has moni-
tored tax and fiscal activities at all
levels of government since 1937.

©2007 Tax Foundation

Editor and Communications
Director, Bill Ahern

Tax Foundation
2001 L Street, NW, Suite 1050
Washington, DC 20036
(202) 464-6200
(202) 464-6201 fax
www.TaxFoundation.org
TF@TaxFoundation.org