Political Perspectives on Financing Social Benefits

Kimberly J. Morgan
Assistant Professor
The George Washington University
Social policy and taxation in the US today

- Political logjam on taxation
  - “No new taxes”
  - Opposition to payroll, consumption taxes

- Tax code as social policy
Tax policy as social policy…

- Child tax credits
- Earned Income Tax Credit
- Home Mortgage Interest Deduction
- Cutting tax rates
Tax Expenditures, 1980-2003
(percent of GDP)

Urban Institute, Updated by author.
Total Effective Federal Tax Rates by Quintile, 1979-2004

For households with children, includes payroll, excise, corporate income taxes
Source: CBO.
Role of taxes and transfers in reducing inequality

Social spending as a percent of GDP 2003

Source: OECD, social expenditure database.
American exceptionalism?

- Everywhere, people hate paying taxes
- People tend to think their taxes are too high, rich don’t pay enough
- Yet, people everywhere tend to like social programs
Taxes as a percent of GDP, 2004

Source: OECD, Revenue Statistics.
Financing social programs, 2003-04

## VAT rates in 2006

<table>
<thead>
<tr>
<th>Country</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>10%</td>
</tr>
<tr>
<td>New Zealand</td>
<td>12.5%</td>
</tr>
<tr>
<td>Germany</td>
<td>16%</td>
</tr>
<tr>
<td>UK</td>
<td>17.5%</td>
</tr>
<tr>
<td>France</td>
<td>19.6%</td>
</tr>
<tr>
<td>Sweden</td>
<td>25%</td>
</tr>
</tbody>
</table>

Source: OECD.
Why?

- Economic Reasons
  - Lindert’s “free lunch puzzle.”

- Political reasons
  - Less visible
  - More popular
  - Political compromise
Which tax is the least fair?
American responses in 2003

Sources: Gallup.
Why?

- Economic Reasons
  - Lindert’s “free lunch puzzle.”

- Political reasons
  - Less visible
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Some tax policy options

- Allow 2001-03 tax cuts to expire.
- Increase payroll tax/raise wage ceiling.
- Adopt national sales tax – tie to social spending.
- Increase gasoline tax/other excises.
Conclusions

- Renewing the social contract will require debate over taxation.

- Most countries rely heavily on payroll and/or consumption taxes to pay for social programs.

- Political factors help explain the reliance on less progressive forms of taxation.

- We should consider full range of taxes to pay for future social initiatives.