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VIEWPOINT

Price Of Not Extending Bush Cuts: Return To Historically High Taxes

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Despite liberal condemnation of the Bush tax cuts, virtually no one embraces a complete return to their pre-cut level — including the Democratic majority in Congress and both pending presidential nominees. There is good reason.

Implicit in this rejection is the admission that they were too high to return to. While the media won't say it now, and certainly wouldn't then, those supposedly halcyon days of fiscal policy rested on historically high tax levels.

Taxes got there by increasing retroactively in 1993, adding a 36% income-tax bracket and effectively another of 39.6% through a surcharge on incomes above a certain level. That hike also raised the corporate rate to 35%, increased estate taxes and the gas tax, taxed certain Social Security benefits and upped AMT rates to 26% and 28%.

In short, most everyone making more than $20,000 paid more in taxes.

Eight years later, those hikes were reversed. The 2001 tax cut created a low 10% rate bracket and lowered all the rest — the top 39.6% rate to 35%, 36% to 33%, 31% to 28%, and the 28% bracket to 25%.

It also increased the child credit, eased the marriage penalty, incentivized pension contribution and decreased estate taxes.

In short, most everyone paying income taxes paid less in taxes. The difference is reflected in individuals' effective tax rates — the rate of taxes actually paid.

The Congressional Budget Office studied effective rates from 1979 to 2005. It showed the 1993-2000 average for all quintiles at 22.6% — higher than any other *single* year outside 1993-2000. The 2001 tax cut decreased these effective rates across the board, as the accompanying chart shows.

A comparison of the distribution of the federal income tax burden is similarly illuminating.

Using 2008 Internal Revenue Service statistics, the 2001 cuts shifted the income tax burden *up* the economic ladder.

In 2000, the top 1% paid 37.4% of all income taxes vs. 39.4% in 2005. The top 2% went from 56.5% to 60%, the top 10% from 67.3% to 70.3%, the top 25% from 84% to 86%, and the top 50% from 96% to 97%.

In addition to its impact on taxpayers, the 1993-2000 years also had a historically high federal tax burden on the economy. Over the last 60 years, the federal tax burden has averaged 17.9% of GDP; the 1993-2000 period averaged 19.2%.

While that 1.3% difference may seem slight, it is greater than the 1% level deemed necessary earlier this year to stimulate the slowing economy.

In contrast, the 2001-07 period averaged 17.9% of GDP — equaling the 60-year average despite the 2000 economic slowdown that tipped into a recession following 9/11.

The 1993-2000 burden magnitude is demonstrated by the fact that its 19.2% *average* was surpassed by only three *single* years — 1981 (19.6%), 1969 (19.7%) and 1945 (20.4%) — outside the period.

The period's highest year, 2000's 20.9%, is unsurpassed and only equaled by 1944's wartime level.

All told, the period was the highest of any eight years recorded in the Historical Tables of the President's Budget.

Comparing the federal income tax burden to the economy is even more dramatic. The average of the last 60 years is 8% of GDP. The 1993-2000 period average was 8.8%; 2001-07's 8.1%.

Again, the 1993-2000 period was the highest of any eight-year period, and its 2000 peak of 10.3% of GDP was higher than any on record.

We need not simply look backward to understand what will happen going forward.

The CBO projects that, even with the removal of the Alternative Minimum Tax's impact, federal taxes will immediately return to 19.8% of GDP in 2012 — easily exceeding the 1993-2000 average — just two years after the 2001 tax cuts expire.

The effect on income taxes is even greater, tying the all-time record of 10.3% of GDP by 2016 and breaking it at 10.4% a year later.

The current fixation on the 2001 tax cuts masks the real, bigger tax story. By myriad measures — marginal rates, effective rates, distribution of the tax burden or as percentage of the economy — taxes were not just high before the 2001 tax cuts; they were also historically high.

It's no wonder that such tax levels are being rejected — at least in part — across the political spectrum this election year. But they will return in 2011.

They will not increase gradually, but immediately return to high levels. They will come regardless of the state of the economy. And they will come regardless of what politicians promise this year . . . unless they act by Congress passing and the president signing legislation.

Talk is cheap, particularly in an election year. But rest assured, the taxes of 2011 will not be.

Young served in the Treasury Department and the Office of Management and Budget from 2001 to 2004 and as a congressional staff member from 1987 to 2000.

Effective Tax Rates Under Clinton And Bush

The cuts that President Bush pushed through reduced the tax burden for almost everyone making more than $20,000. Failing to extend the cuts would return taxes to levels that were among the highest on record