Are U.S. Taxes Too High Or Too Low? Choose Your Chart

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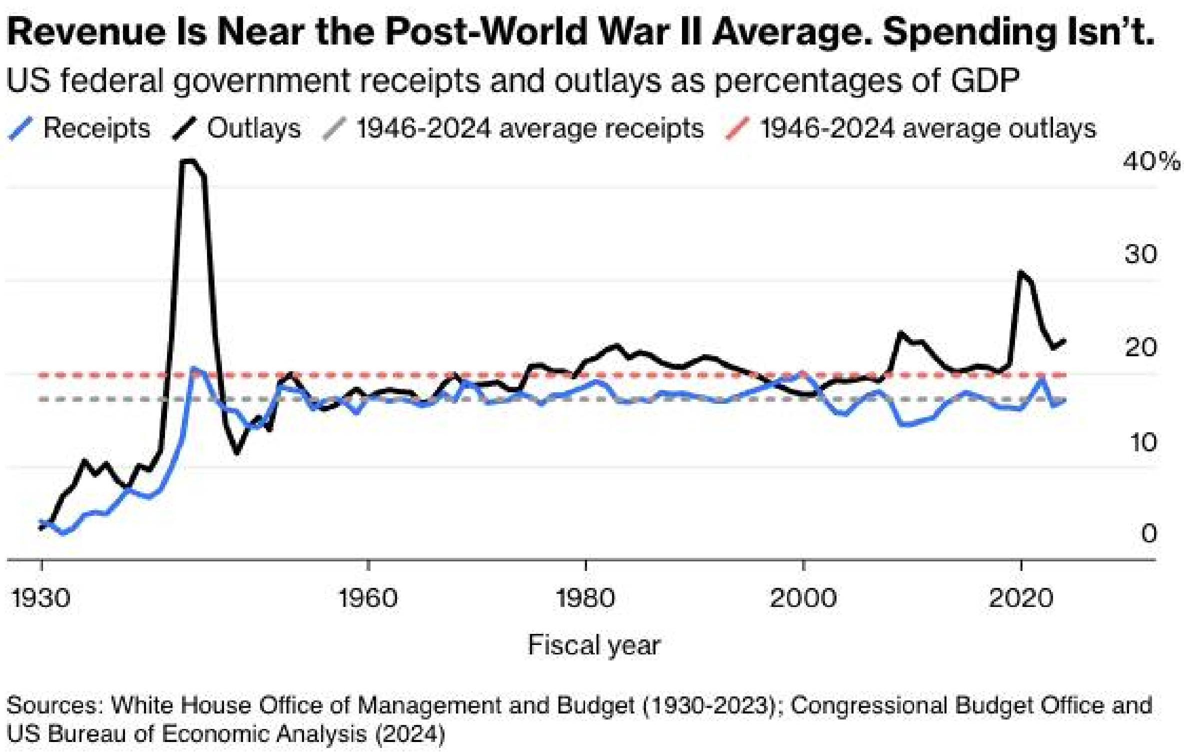
The gap between U.S. federal spending and tax revenue is currently bigger, as a share of gross domestic product, than it's ever been outside of major war or other crisis. Is that because spending is too high or tax revenue too low?

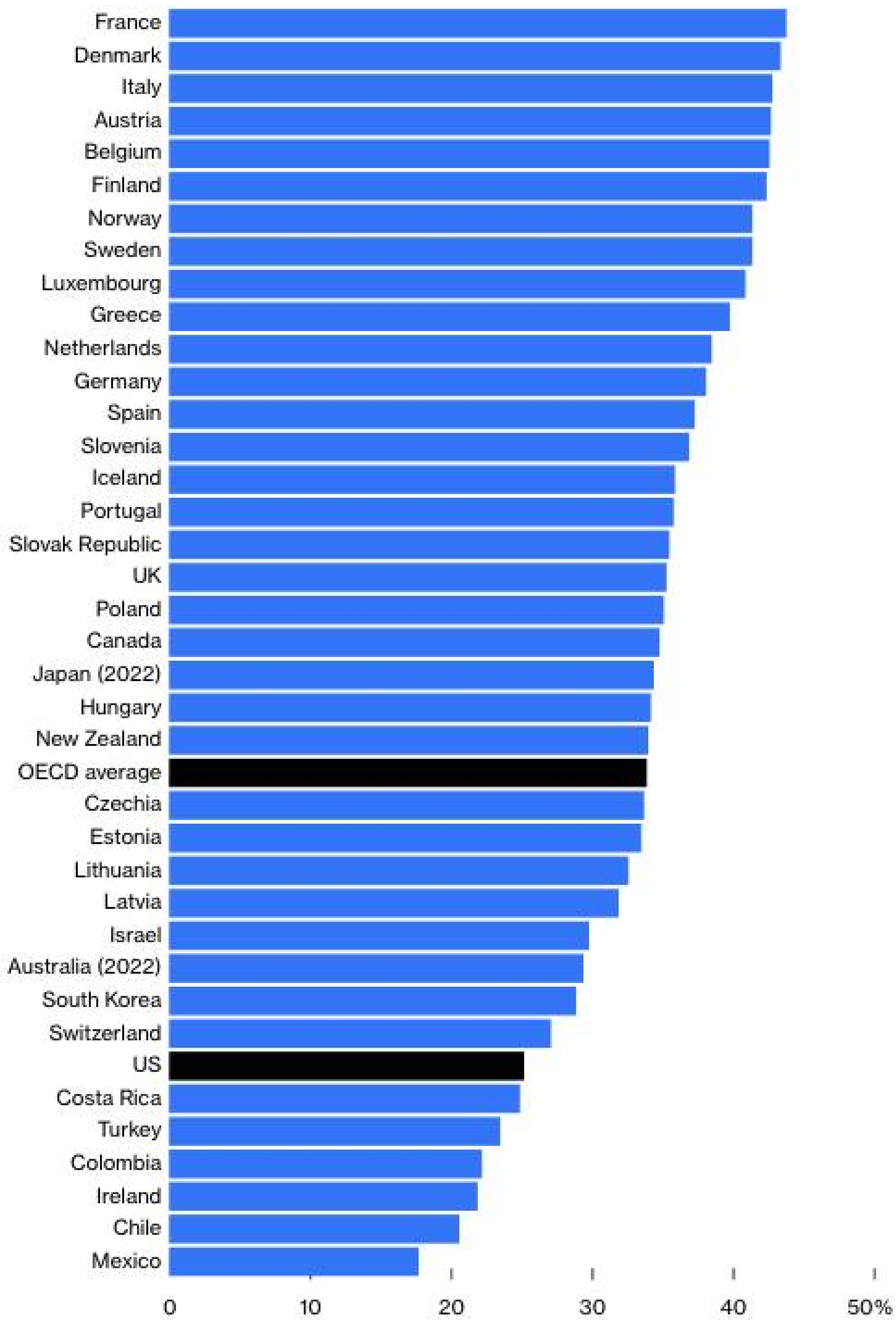
"The federal government has a significant spending problem," was Treasury Secretary nominee Scott Bessent's answer at his confirmation hearing last week. The historical data would seem to back him up: Federal revenue, at 17.1% of GDP during the last fiscal year, was at just about the post-World War II average of 17.2%, but spending was 23.4% compared with an average of 19.8%.



A chart like this (which I originally made last month for a column on U.S. spending) is useful context in the debate over taxing and spending in the U.S.. But it's not the only useful context. Consider the revenue statistics released in November by the Organization for Economic Cooperation and Development, the club of the world's affluent democracies. Of the OECD's 38 members, the U.S. had the seventh-lowest government revenue relative to gross domestic product in 2023—at 25.2% of GDP compared with an OECD average of 33.9%.

For an Affluent Country, the US Has Pretty Low Taxes

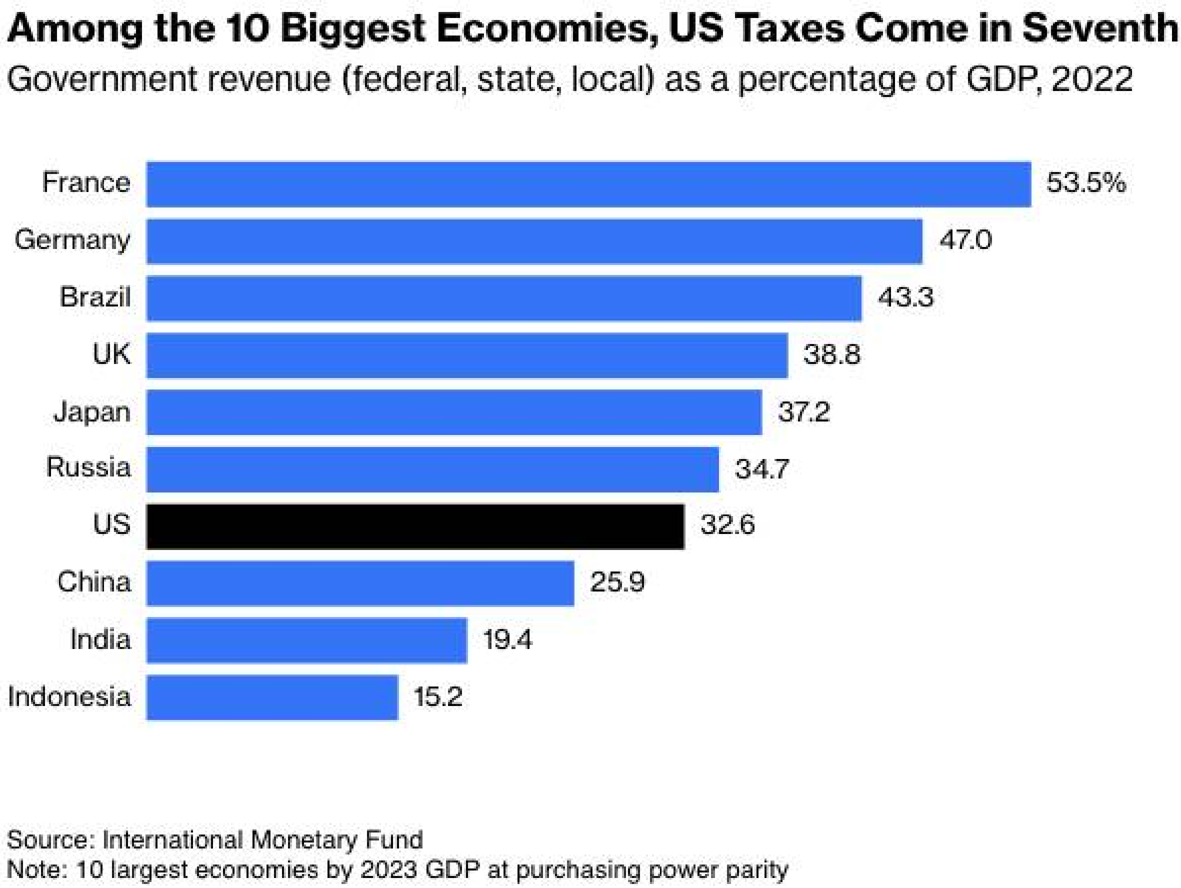
Government revenue (federal, state, local) as a percentage of GDP, 2023



Source: Organization for Cooperation and Economic Development

This includes state and local as well as federal taxes, tariffs and other income sources, because without combining the different levels of government it's impossible to make meaningful comparisons across countries with more or less centralized governance. Judgment calls remain about what to count and what to exclude, with the International Monetary Fund estimating 2023 U.S. government revenue at a markedly higher 29.9% of

GDP. That's still on the low side among affluent countries, although there are some large world economies with lower taxes than the U.S. (this chart shows 2022 data because 2023 numbers aren't available for some of the countries).



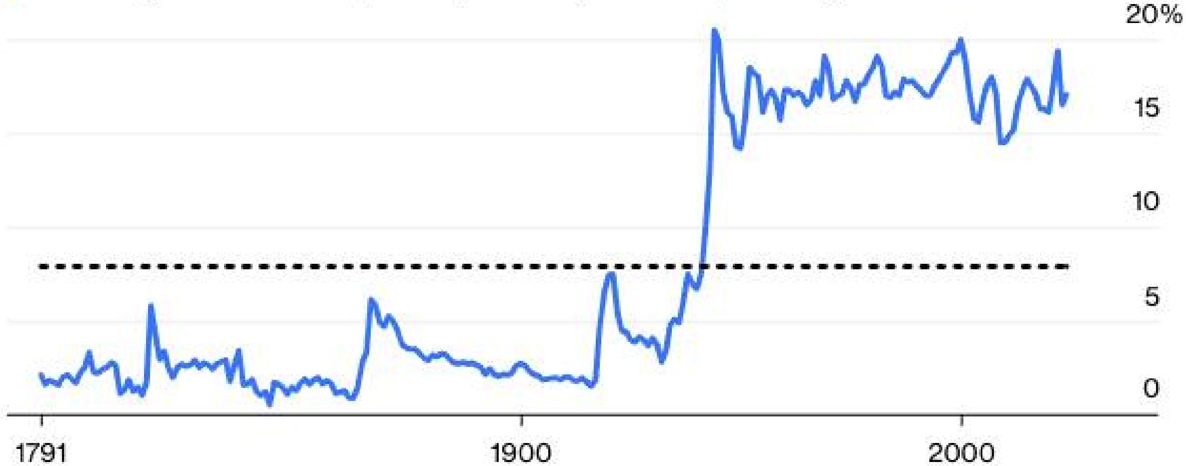
So federal taxes are at about the historical norm, and taxes overall are lower in the U.S. than in most peer countries. My takeaway from the above charts is that, with broadly popular programs to provide income and health care to the elderly (Social Security and Medicare) getting more expensive as the U.S. population ages, federal taxes should be a bit higher. But I'm not quite done with the charts yet.

President Donald Trump has repeatedly invoked the William McKinley administration as the high point of U.S. economic success, so it's worth noting that current federal revenue is actually well above the historical norm if you start measuring in the 1790s.

Taking the Long, Long View

Before World War II, US federal taxes were much lower

Federal government receipts as a percentage of GDP / Average 1791-2022

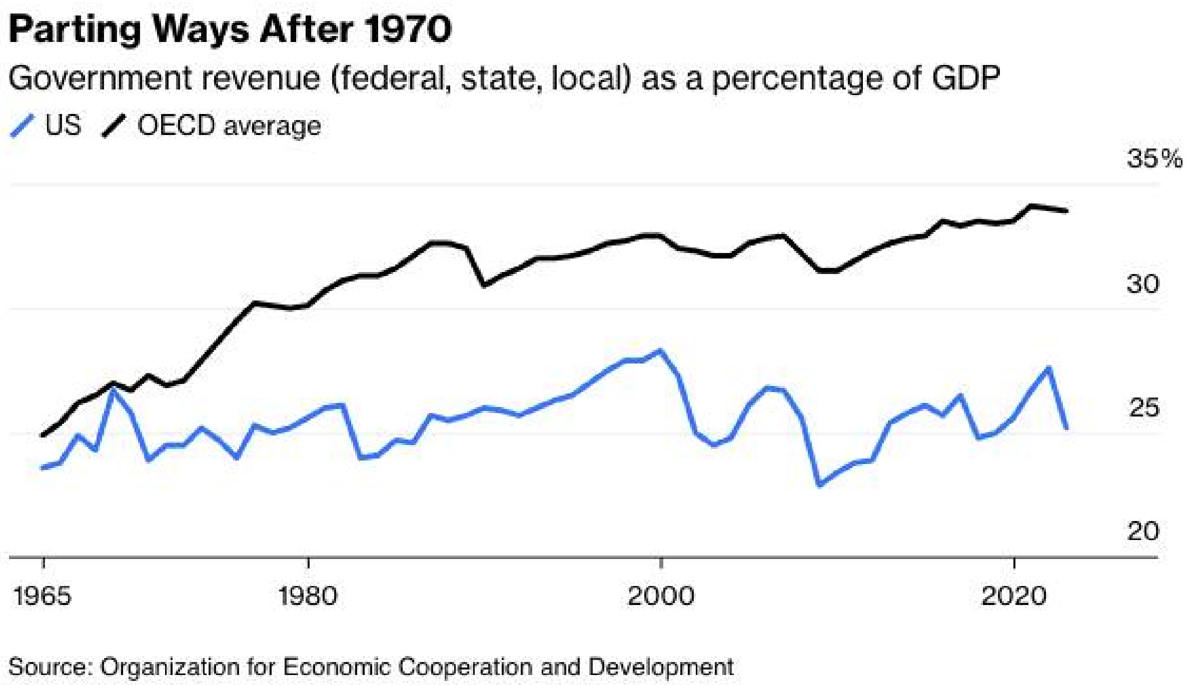


Sources: Historical Statistics of the United States, Colonial Times to 1970, and MeasuringWorth (1791-1929); White House Office of Management and Budget (1930-2023); Congressional Budget Office and US Bureau of Economic Analysis (2024)

Note: Receipts measured by fiscal year, which coincided with the calendar year through 1842 and did not after that. From 1843-1929, fiscal-year spending is divided by calendar-year GDP. After that both receipts and GDP are by fiscal year.

Nostalgia for pre-World War II or even pre-World War I fiscal-policy norms has been part of the Republican agenda since Warren Harding's "return to normalcy" campaign in 1920. Harding and successor Calvin Coolidge did succeed in rolling back taxes, but not to anywhere near prewar levels. There was even less of a rollback after World War II. A big rollback now, absent epic spending cuts that seem unlikely under a president who has pledged not to touch Social Security and Medicare and boosted federal expenditures during his first term in office, might spark a fiscal crisis.

Since the big jump during World War II, sustainably increasing revenue has also proved difficult for the U.S.. This hasn't been the case in most other OECD countries, which went from having government revenue relative to GDP similar to that of the U.S. in the 1960s to much higher by the late 1970s. U.S. tax revenue has also been much more volatile since then.

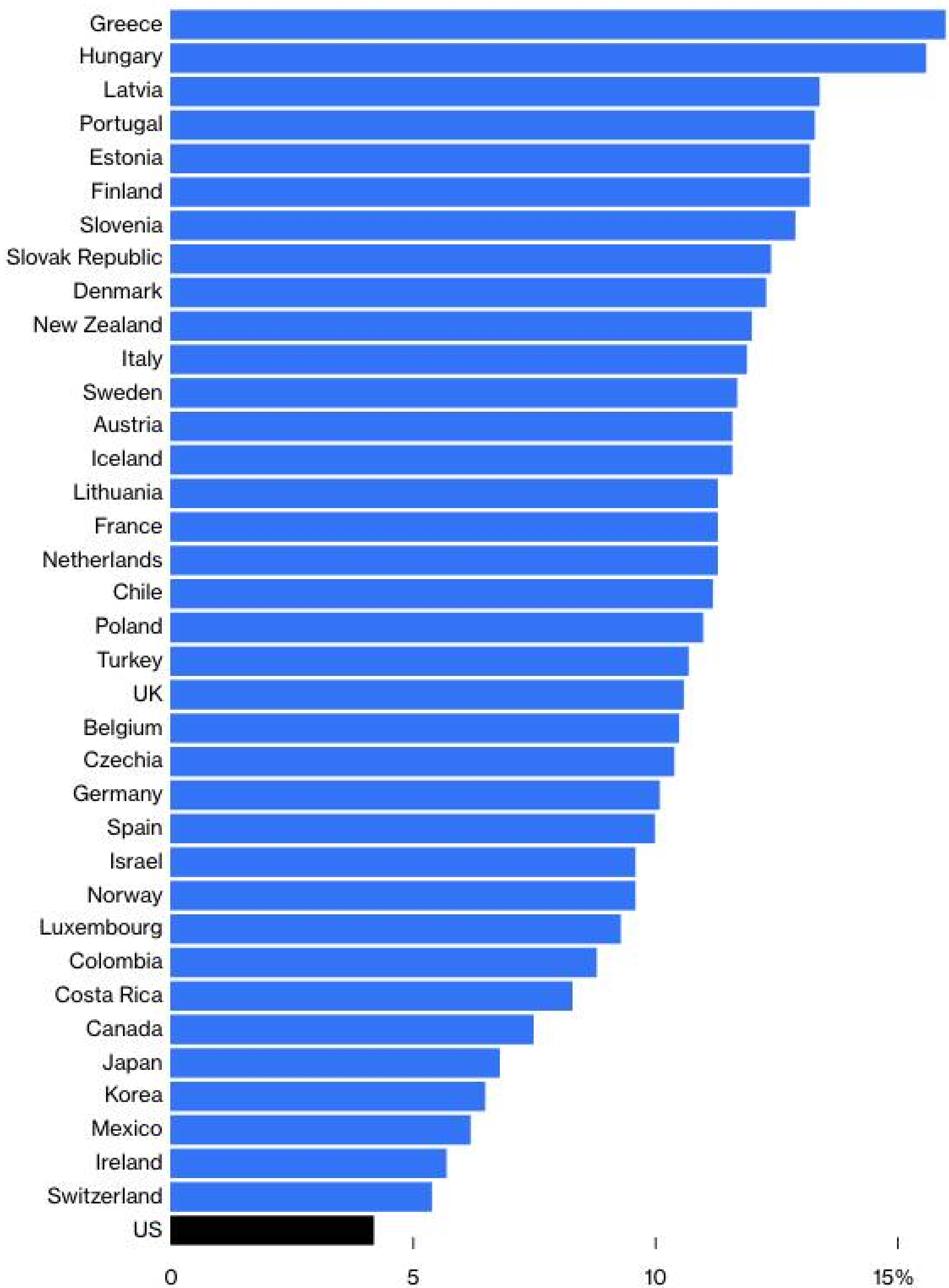


A simple explanation for both these phenomena is that the U.S. has remained more dependent on personal income taxes than other OECD countries. The individual income tax has brought in about half of federal revenue in recent years; add in Social Security and Medicare taxes, and it's more than 85%. U.S. personal income tax revenue is above the OECD average as a percentage of GDP, and the U.S. income tax system more progressive than those of most other OECD countries—that is, it's more dependent on revenue from high-income taxpayers.

Such a system generates much more revenue in some years than others, and there are limits to how much more money can be squeezed out of it over the long haul, limits that almost every other nation on earth has addressed by turning to the value-added taxes pioneered by France in the 1950s. The VAT is a consumption tax that is assessed at each stage of the production of a good or service, with credit for taxes paid at previous stages. It's easy to enforce and widely believed to be more economically efficient than income taxes. The U.S. has never adopted a VAT, its revenue from consumption taxes is the lowest in the OECD, and most of that comes from state and local sales taxes.

The US Is Dead Last in Consumption Taxation

Taxes on goods and services as a percentage of GDP, 2023



Source: Organization for Economic Cooperation and Development

Federal consumption tax revenue was just 0.6% of GDP in the U.S. in 2023. Tariffs accounted for about half of that, and President Trump of course wants to increase tariff revenue. But it's hard to raise a lot of money that way, partly because imports make up a small share of U.S. economic activity to begin with and partly because higher tariffs will change behavior in the U.S. and abroad in ways that will probably reduce revenue. Ernie Tedeschi of the Budget Lab at Yale suggested in a Bloomberg Opinion column in November that a better alternative would be the destination-based cash flow tax floated by House Speaker Paul Ryan in 2016, a tax on business income that favors imports over exports and is similar to a VAT in its economic effects. Or maybe the time is coming when the fiscally strapped U.S. finally gives in and embraces the VAT itself.

Justin Fox is a Bloomberg Opinion columnist covering business, economics and other topics involving charts. A former editorial director of the Harvard Business Review, he is author of The Myth of the Rational Market.

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