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Big Government Requires High Taxes on the Middle Class

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KEY TAKEAWAYS

In European welfare states, middle-class workers—not just the wealthy—shoulder a massive tax burden and get a highly intrusive government for their money.

A lower-income European earning $40,000 pays $6,000 more in taxes than a similar American. On the current fiscal course, Americans will face European-style taxes.

Lawmakers should reject the Left's fiscal and social agenda, which guarantees crippling taxes on every American.

The United States is a low-tax country compared to its European allies, especially for lower-income and middle-income workers. Keeping taxes low should be a primary goal of lawmakers. However, low taxes are not sustainable if America continues to move toward a European-style social welfare system.

Paying for the currently projected government spending will require large tax increases on all Americans. Paying for new entitlement programs, such as Medicare for All, free college, a national job guarantee, or paid family and medical leave, will require yet higher taxes.

It is mathematically impossible to pay for large new spending programs with tax increases only on high-income Americans.[1] Under an expanded government welfare system, middle-class Americans should expect their taxes to increase dramatically. In Europe, single workers making $40,000 are left with $22,467 of personal income after taxes. In the United States, the same worker would have almost $6,000 more, or $28,352, in useable income after taxes. Europe provides an illustrative example of how countries pay for big government in practice.

Taxing Like the Europeans

On average, about 37 percent of all economic activity is taxed by the governments of the 23 countries that are members of the European Union as well as of the Organization for Economic Co-operation and Development (EU–OECD).[2] In the U.S., taxes consume 27 percent of economic output (gross domestic product (GDP)). Taxes on wages (individual income and payroll taxes) make up the largest share of revenue in every EU–OECD country and the United States.

Value added taxes (VATs) comprise the second-largest portion of most countries' tax revenue.[3] The United States is the only country in the OECD that does not use a VAT to raise a majority of consumption tax revenue. Instead, most consumption-tax revenue in the U.S. is collected by state governments through a sales tax at the point of sale. The average EU–OECD standard VAT rate was 21.8 percent in 2016.[4] The average state and local sales tax rate across the U.S. states and the District of Columbia was 6.4 percent in the same year.[5]

Expansive government services and government-run health care exist in most European countries. If Congress is unwilling to reduce the growth rate of spending, and American voters continue to demand European-style government services, American taxpayers should be ready to pay European-style taxes. European welfare states do not rely on overly progressive tax systems.[6] Instead, they use broad-based taxes like the VAT, high payroll taxes, and relatively flat income taxes, which fall heavily on taxpayers in the middle of the income distribution.

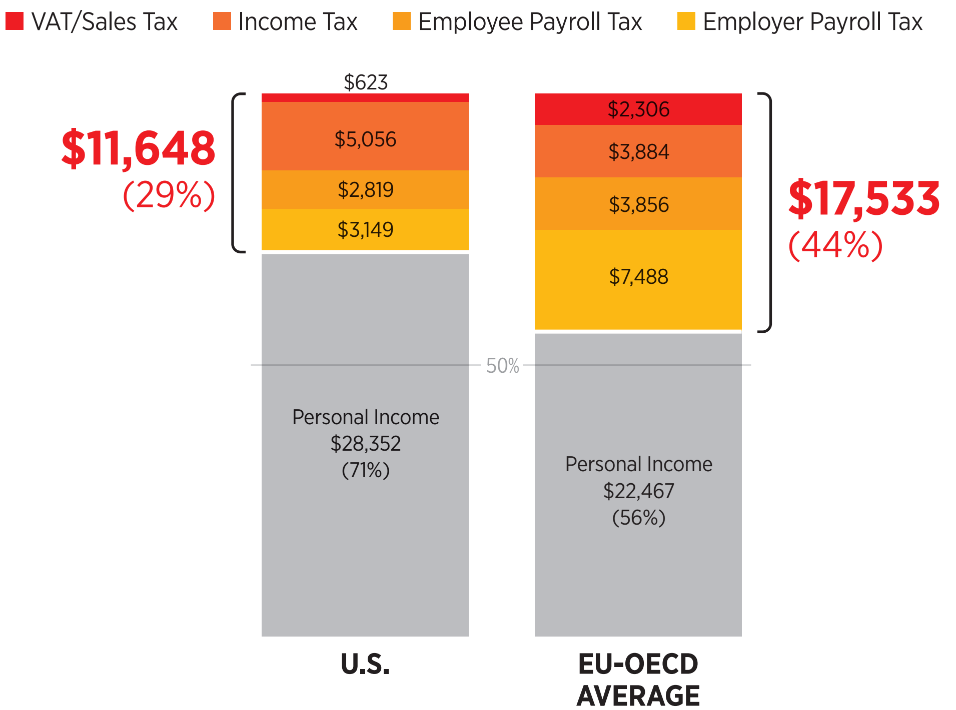
High Taxes on Low-Wage Workers

Single workers with no children in EU–OECD countries earning two-thirds (67 percent) of the average wage face average tax rates of 43.8 percent. The same worker in the U.S. pays an average effective tax rate of 28.5 percent.

The tax burden is made up of four main components: (1) income taxes, (2) employee payroll taxes, (3) employer payroll taxes, and (4) VATs/sales taxes.[7] Income taxes and employee payroll taxes are paid directly out of workers' wages. The employer payroll tax is legally paid by the business,

CHART 1

In Europe, Lower-Income Workers Earning $40,000 Pay $6,000 More in Taxes than in the U.S.



NOTES: The $40,000 income figure is approximately 67 percent of the average pre-tax income. Pre-tax income is measured as the employer's pre-tax labor costs.

SOURCES: Author's calculations using data from OECD, "Taxing Wages 2019," April 11, 2019, https://www.oecd.org/ctp/tax-policy/taxing-wages-20725124.htm (accessed August 30, 2019); OECD, "Consumption Tax Trends 2018: VAT/GST and Excise Rates, Trends and Policy Issues," 2018, https://doi.org/10.1787/ctt-2018-en (accessed August 30, 2019); and Nicole Kaeding, "Sales Tax Base Broadening: Right-Sizing a State Sales Tax," Tax Foundation, October 24, 2017, https://taxfoundation.org/sales-tax-base-broadening/ (accessed August 30, 2019).

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but the economic cost of the tax is paid by the worker in the form of lower wages. Similarly, the VAT is paid by businesses, but the long-run cost falls on workers through lower wages and higher prices.[8]

In the U.S., a single worker earning two-thirds the average wage would be paid about $40,000 in the absence of any taxes in 2018.[9] That worker pays $5,056 in income taxes, $5,968 in payroll taxes, and $623 in sales taxes, leaving her with $28,352 of personal income—71.5 percent of her total earnings. A similar worker in the EU–OECD pays $3,884 in income taxes, $11,344 in payroll taxes, and $2,306 in VAT, leaving her with $22,467—56.2 percent of her total earnings. (See Chart 1.)

In Belgium and Germany, low-wage workers pay average tax rates of 50.6 percent and 50.2 percent, respectively. More than half of every dollar earned by someone making around $40,000 in these high-tax countries is taxed away.

Across the EU–OECD, marginal taxes on low-wage workers are even higher, representing how much tax a worker must pay on the next dollar of income earned. High marginal taxes reduce the incentive to take a side job or work as hard to get a raise or promotion. In the United States, a single person earning two-thirds the average wage faced a marginal tax of 32 percent in 2018, lower than in any EU–OECD country. In eight countries, marginal taxes are above 50 percent for the same low-wage worker. In France and Belgium, marginal rates on below-average incomes are 70 percent and 68 percent, respectively.

High Taxes on Upper-Middle-Class Workers

Single workers with no children in EU–OECD countries earning 167 percent of the average wage face an average effective tax rate of 51.7 percent. The same workers in the U.S. pay an average effective tax rate of 34.1 percent.

In the U.S., a single worker earning 167 percent of the average wage would be paid about $100,000 in the absence of any taxes in 2018.[10] That worker pays $19,579 in income taxes, $14,498 in payroll taxes, and $1,418 in sales tax, leaving her with $64,504 of personal income, 65.9 percent of her total earnings. A similar worker in the EU–OECD pays $18,797 in income taxes, $27,955 in payroll taxes, and $4,956 in VATs, leaving her with $48,292, 48.3 percent of her total earnings. (See Chart 2.)

In Belgium and Germany, upper-middle-class workers pay average tax rates of 62.4 percent and 55.6 percent, respectively. Well more than half of every dollar earned by someone making $100,000 a year in these high-tax countries is taxed away.

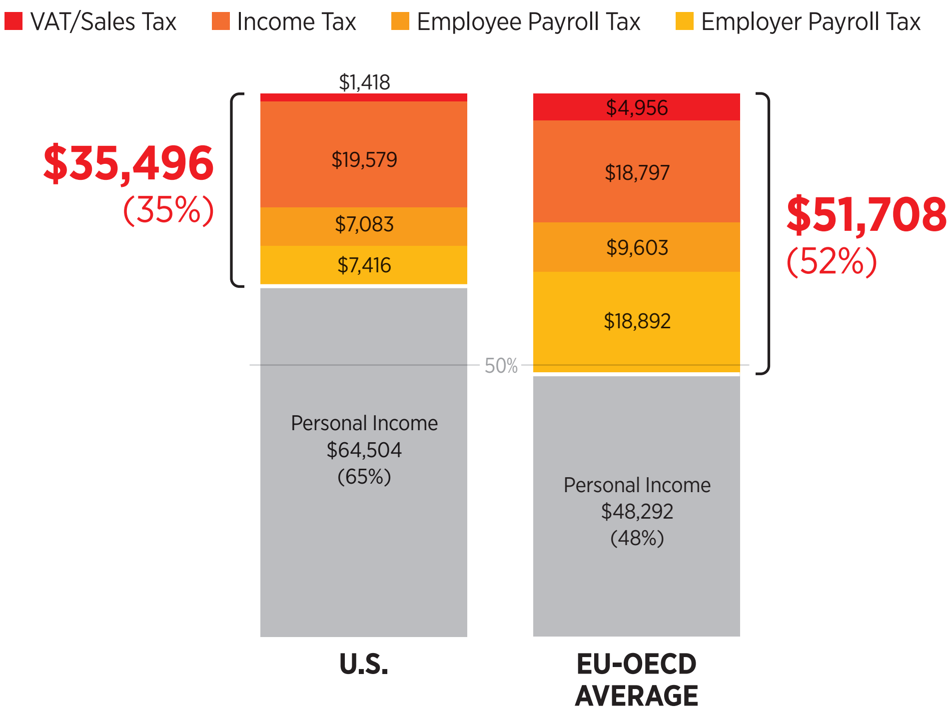
Workers earning above the average wage pay even higher marginal taxes, topping 50 percent in 13 of the 23 EU–OECD countries. The United States had the second-lowest marginal wage tax of 41 percent, behind Poland (37 percent) in 2018. Three countries have marginal taxes above 60 percent, and Sweden's top rate is just shy of 70 percent for workers earning 167 percent of the average wage.

Recommendations

As is clear when looking at the European fiscal model, large welfare states cannot be sustained by primarily taxing any narrow segment of the population. Everyone must pay for big government. The cost of high taxes

CHART 2

In Europe, Higher-Income Workers Earning $100,000 Pay $16,000 More in Taxes than in the U.S.



NOTES: The $100,000 income figure is approximately 167 percent of the average pre-tax income. Pre-tax income is measured as the employer's pre-tax labor costs.
SOURCES: Author's calculations using data from OECD, "Taxing Wages 2019," April 11, 2019, https://www.oecd.org/ctp/tax-policy/taxing-wages-20725124.htm (accessed August 30, 2019); OECD, "Consumption Tax Trends 2018: VAT/GST and Excise Rates, Trends and Policy Issues," 2018, https://doi.org/10.1787/ctt-2018-en (accessed August 30, 2019); and Nicole Kaeding, "Sales Tax Base Broadening: Right-Sizing a State Sales Tax," Tax Foundation, October 24, 2017, https://taxfoundation.org/sales-tax-base-broadening/ (accessed August 30, 2019).

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is more than the direct costs; all taxes have economic costs, even if they are turned into widely available benefit programs. Across Europe, for example, workers work fewer hours, spend more time on vacation, and are less entrepreneurial. Even those people who want to work or earn more are discouraged because high average and marginal taxes directly undercut any personal benefit from more effort.[11]

The European welfare state, financed by high taxes, is not inevitable in the United States. Americans still have a choice. To secure a future where taxes can stay relatively low, Congress must:

- **Reform the largest drivers of future deficits**—Medicare, Medicaid, Obamacare, and Social Security. The Heritage Foundation's 2020 *Blueprint for Balance* presents one road map to balancing the budget without raising taxes by 2029.[12]

- **Adopt a firm budget for the U.S. government** to prohibit sustained deficit spending.

- **Reject the $100 trillion progressive tax-and-spend agenda**, including Medicare for All, taxpayer-funded college, a national job guarantee, paid family and medical leave, and the Green New Deal.[13]

Big government is costly, and those costs are largely shouldered by the middle class through higher taxes and fewer economic opportunities. The progressive agenda cannot be funded without raising taxes on typical Americans.

If an American worker earning $40,000 were to move to Europe, her taxes would increase by 15 percentage points, or almost $6,000. Someone making $100,000 a year would pay more than $16,000 if they were taxed in Europe. If current U.S. spending growth is not slowed down, European level taxes are inevitable. There are no other sustainable options. Not adding any new spending and reforming existing programs is the only way to avoid significantly higher taxes on all Americans.

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Endnotes

1. David R. Burton, "It Is Arithmetically Impossible to Fund the Progressive Agenda by Taxing the Rich," Heritage Foundation *Backgrounder* No. 3430, August 14, 2019, https://www.heritage.org/taxes/report/it-arithmetically-impossible-fund-the-progressive-agenda-taxing-the-rich.
2. Those 23 countries are: Austria, Belgium, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, the Netherlands, Poland, Portugal, the Slovak Republic, Slovenia, Spain, Sweden, and the United Kingdom.
3. The VAT is a type of national sales tax that is collected by businesses at each stage of production, rather than at the cash register.
4. Organization for Economic Co-operation and Development, "Consumption Tax Trends 2018: VAT/GST and Excise Rates, Trends and Policy Issues, 2018," OECD iLibrary, https://doi.org/10.1787/ctt-2018-en (accessed March 29, 2019).
5. Author's calculations from Scott Drenkard and Nicole Kaeding, "State and Local Sales Tax Rates in 2016," Tax Foundation, March 9, 2016, https://taxfoundation.org/state-and-local-sales-tax-rates-2016/ (accessed April 10, 2019).
6. Adam N. Michel, "A Progressive Road Map for Soaking the Middle Class," Heritage Foundation *Backgrounder* No. 3414, June 6, 2019, https://www.heritage.org/taxes/report/progressive-road-map-soaking-the-middle-class.
7. Corporate income taxes, excise taxes, and tariffs also tend to have an incidence that falls on workers, but are excluded from this analysis for simplicity.
8. In this *Issue Brief*, VATs and sales taxes are distributed using the methodology described by Robert Bellafiore, "The U.S. Tax Burden on Labor, 2019," Tax Foundation *Fiscal Fact* No. 656, May 23, 2019, https://taxfoundation.org/publications/the-u-s-tax-burden-on-labor/ (accessed August 9, 2019). The VAT rates and base (calculated as the revenue ratio) are from Organization for Economic Co-operation and Development, "Consumption Tax Trends 2018: VAT/GST and Excise Rates, Trends and Policy Issues, 2018." U.S. sales tax base is a simple average from Nicole Kaeding, "Sales Tax Base Broadening: Right-Sizing a State Sales Tax," Tax Foundation *Fiscal Fact* No. 563, October 24, 2017, https://taxfoundation.org/sales-tax-base-broadening/ (accessed August 12, 2019).
9. Total gross labor cost before taxes in U.S. dollars for a single person at 67 percent of average earnings with no child was $39,964 in 2018. The U.S. dollar purchase-power-parity exchange-rate-adjusted 67 percent labor cost varies by country. The EU–OECD average 67 percent labor cost is $36,817. For purposes of illustration, this *Issue Brief* uses $40,000 as the base gross labor costs for the examples.
10. Total gross labor cost before taxes in U.S. dollars for a single person at 167 percent of average earnings with no child was $99,119 in 2018. The EU–OECD average 167 percent labor cost is $91,897. For purposes of illustration, this *Issue Brief* uses $100,000 as the base gross labor costs for the examples.
11. While the direction of causation is not necessarily certain, Edward Prescott finds that "virtually all the differences between U.S. labor supply and those of Germany and France are due to differences in tax systems." Edward Prescott, "Why Do Americans Work So Much More than Europeans?" Federal Reserve Bank of Minneapolis *Quarterly Review*, Vol. 28, No. 1 (July 2004), pp. 2–13, https://www.minneapolisfed.org/research/qr/qr2811.pdf (accessed August 12, 2019).
12. *Blueprint for Balance: A Federal Budget for Fiscal year 2020* (Washington, DC: The Heritage Foundation, 2019), https://www.heritage.org/blueprint-balance.
13. Burton, "It Is Arithmetically Impossible to Fund the Progressive Agenda by Taxing the Rich."