

**What the Social Security Experience Tells Us
About Taxes Americans Can Embrace**

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What the Social Security Experience Tells Us About Taxes Americans Can Embrace

Abstract. The Great Recession has renewed calls for government to promote security and opportunity for the great majority of Americans. And yet the current administration seems immobilized by fiscal constraint and a well-entrenched anti-tax politics. Here I challenge the view of Americans as reflexively anti-tax and call for a program of investment in America's people and infrastructure supported by a sustainable source of revenues. I show how a VAT linked to such an investment program emulates politically attractive features of our most successful program, Social Security, with a tax that is easy to pay, spreads the burden widely, and confers to all participants a sense of stake in the benefits.

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In the face of the deepest recession in 70 years, many Americans are scared, wondering how to make ends meet now and genuinely frightened about the future. Many look to government to lead a recovery and to support important economic and human needs going forward. And yet in the face of this acute desire for security, President Obama, in his first State of the Union address, called for a hard freeze on domestic spending, a commission on the budget deficit, no new programs without corresponding cuts elsewhere (PAYGO budgeting), and a modest set of tax credits. This is a deeply disappointing agenda for a president elected on progressive hopes of investment and security, but who now seems cowed by three decades of anti-tax rhetoric from the political right. Those who want to make government work seem to assume that Americans hate taxes and won't pay them.

But is that accurate? Are Americans really unwilling to pay taxes? Or do they want security, opportunity, and economic growth, and are they willing to pay appropriately designed taxes to fund such investments?

The challenge is this: Americans do want protections from life's risks and investment in the future, and know they would have to help fund such programs. But they also are leery of a tax system that seems unfair, has eroded in its ability to meet their needs, and is so open to political attack. Thus we must create a program of investment in America's people and infrastructure that will provide security, opportunity, and greater productivity and that is supported by a sustainable source of revenue with recognizable benefits.

To do this, we can learn from the most successful social policy in American history, Social Security. Elites on both the left and right have critiqued Social Security, variously as a regressive tax, a threat to national savings, and a bad investment with a low rate of return. But the popular, moral understanding of Social Security is its common purpose in providing earned

security for all. The program benefits the majority, protects them in retirement from life's risks, and is funded by a tax that is easy to pay, creates a sense of stake in the system, and is politically successful because it is linked to a popular program. Indeed, the Social Security experience shows that Americans are not reflexively anti-tax, but rather embrace taxes with these attractive features.

The plan presented here builds on this example by funding an agenda of investment in education, health care, infrastructure, and other areas that fulfills the nation's potential by giving the broad majority of its citizens the means to achieve and the security they desire. It emulates Social Security's success in creating a sustainable source of funding that shares the payroll tax's attractive political features. The plan acknowledges that the progressive income tax must be retained, particularly in a nation with pronounced inequalities in incomes. But it also recognizes the political and economic shortcomings of the income tax and adds a value-added tax (VAT) as a robust supplement that can fund this broad security and investment agenda.

Not all progressives will agree with this plan. Many want to continue the federal government's near-singular reliance on the income tax and criticize a VAT as a regressive tax burdening the poor. But a well-designed VAT with a floor that blunts its regressivity, combined with a progressive set of programs that invest in the poor and middle class alike, can reimagine the Social Security model for a new era and bring security and prosperity to the broad swath of Americans who have been left behind over the last 30 years of conservative, free-market ascendancy.

Real Needs Amidst Anti-Tax Politics and Fiscal Challenges

Consider the sheer number of life's necessities that Americans have to provide themselves, needs that are costly and that tend to arrive in a lump sum, often at precisely the moment that individuals are least able to afford them: child care, preschool, college education, job training, family leave, health insurance. In many of these areas we've never had government programs (such as national health insurance or paid family leave). In others, a government program exists but benefits are meager and many are excluded from eligibility (such as unemployment benefits and federal college aid). In fact, in most areas government protections have receded over time, with fewer able to get help and smaller benefits for those who do.¹

And so Americans are on their own, having to buy health insurance, or get through a spell of unemployment or caregiving, or pay for college out of their own resources. And increasingly, they can't. Real wages have been falling for forty years. In response families at first sent wives into the work force (exacerbating the family time crunch and making certain needs like child care even more acute). With two earners in the workforce but still failing to make ends meet, they turned to credit, spending the equity in their homes and applying for more and more credit cards. The housing bust and credit crisis put an end to that. It's not clear what families will do now that these strategies are tapped out. And yet the yawning needs are still there. Between health care, the cost of housing in neighborhoods with good schools, car payments, and child care, two-income families have less left over than did one-income families in the 1970s.² Little wonder that Americans are scared and looking for help.

¹ Suzanne Mettler and Andrew Milstein, "American Political Development from Citizens' Perspective: Tracking Federal Government's Presence in Individual Lives over Time," *Studies in American Political Development* 21 (2007): 110-30.

² Elizabeth Warren and Amelia Warren Tyagi, *The Two-Income Trap* (New York: Basic, 2003).

Where will this help come from? Surely not employers, fewer of whom offer health insurance, more of whom employ contractors or part-time workers to whom they do not have to provide fringe benefits at all. In an era of global competition these trends are unlikely to change. Nor is private charity a realistic alternative. Voluntarism, charity, and philanthropy have long and admirable histories in the U.S., but the sheer magnitude of need for security far outstrips private capacities.

That leaves government, which in the past has responded at moments of great need, creating public pensions (Social Security), aid to the blind, deaf, and dependent children, unemployment insurance, and a number of jobs programs during the Great Depression, and Medicare, Medicaid, food stamps, and Head Start, among others, during the Great Society era.

But since then a virulent anti-tax politics has arisen, a right-wing populism fanned by conservative politicians who attack big government as bad and taxes as worse. Government is “is not the solution to our problem; government is the problem,” and taxes are “your money” which you can spend better than the government can, to quote two recent Republican presidents.³ Anti-tax messages dominate campaign discourse,⁴ and Americans seem to go along, supporting even tax cuts that go disproportionately to the wealthy.⁵ In the wake of a 40-year drumbeat of anti-tax sentiment, even Barack Obama felt compelled to pledge on the campaign trail that he would keep federal spending to 18.2 percent of GDP (when the post-war average is more like 20 percent, and Ronald Reagan was spending over 23 percent in his peak year).

³ Ronald Reagan first inaugural address, 20 January 1981; George W. Bush, Satellite Remarks From Genoa, Italy, to a Tax Relief Celebration in Kansas City, Missouri, 20 July 2001. Both accessed at the American Presidency Project, www.presidency.ucsb.edu.

⁴ Andrea Louise Campbell, *How Americans Think about Taxes* (Princeton University Press, forthcoming).

⁵ Larry M. Bartels, *Unequal Democracy* (Princeton: Princeton University Press, 2008).

And yet Obama also pledged to make major investments in health care, education, green energy and infrastructure as well as to shore up crucial existing programs like Social Security and Medicare, commitments that some observers say would require federal revenues of 25 to 28 percent of GDP, a third to half again as much as we're used to paying.⁶ Anti-tax Americans would seemingly reject such plans. But surveys show that Americans revere some government programs, such as Social Security and Medicare, and seem to want greater investment in yet others. In response to a 2007 poll, 87 percent of Americans (including 80 percent of Republicans) agreed "government should spend whatever is necessary to ensure that all children have really good public schools they can go to;" 70 percent (59% of Republicans) said "spending tax money to provide a college education for those who can't afford it is a good idea;" 67 percent (60 percent of Republicans) said "the government in Washington ought to see to it that everyone who wants to work can find a job;" and 78 percent (including 71 percent of Republicans) favored their own tax dollars being used to help pay for food stamps and other assistance to the poor."⁷

What are we to believe: that Americans are firmly in the grip of anti-tax conservatives and want low taxes at all costs? Or that Americans recognize that government can and does provide crucial services and benefits that bring security and opportunity for all, especially the middle class, which has not done so well by the market economy in recent decades and which could use a little help?

⁶ Alice M. Rivlin and Isabel Sawhill, *Restoring Fiscal Sanity 2005: Meeting the Long-Run Challenge* (Washington, DC: Brookings, 2005).

⁷ Benjamin I. Page and Lawrence R. Jacobs, *Class War? What Americans Really Think about Economic Inequality* (Chicago: University of Chicago Press, 2009).

Lessons from Successful Programs of the Past

Fortunately we have a model to follow. Arguably the most popular and politically durable tax in American history is the payroll tax for Social Security. It finances one of the most beloved programs, providing financial security in retirement for millions of older Americans, as well as benefits for the disabled and the spouses and children of deceased workers. It is also the most successful anti-poverty program in American history, transforming older Americans from the group with the highest poverty rate in society to the lowest.⁸ The program was established at the height of the Great Depression in 1935, with the payroll tax beginning in 1937 and the first benefits paid in 1940. It has been enormously popular from its earliest days, with approval rates over 80 and even 90 percent in the 1930s and 1940s,⁹ and remains popular today, with the non-elderly even more likely than the elderly to say that spending on Social Security should be increased.¹⁰

It's easy to see why Social Security benefits are popular. The program provides financial security for millions of Americans. Monthly Social Security checks account for the majority of income for the majority of senior citizens.¹¹ And Social Security is not just a retirement program but a policy that benefits entire families, one of the few examples of family policy we have in the United States. The program pays monthly benefits to the spouses and minor children of deceased workers, protecting families from financial disaster when a breadwinning husband or wife passes away. It gives financial assistance to those who are disabled and can no longer

⁸ <http://www.census.gov/hhes/www/poverty/poverty04/pov04fig04.pdf>

⁹ Michael E. Schiltz, *Public Attitudes toward Social Security, 1935-1965*. U.S. Department of Health, Education, and Welfare, Office of Research and Statistics, Research Report No. 33, p. 36.

¹⁰ Rockefeller Foundation/National Academy of Social Insurance, "Social Security Poll," July -14, 2009.

¹¹ Federal Interagency Forum on Aging-Related Statistics. 2008. *Older Americans 2008: Key Indicators of Well-Being*. Washington, D.C.: U.S. Government Printing Office.

work. And it provides financial freedom for adult children, the vast majority of whom do not have to support their elderly parents. In fact, in part because of the stability provided by Social Security (and Medicare), seniors are three times more likely to report having given financial support to their adult children than having received it.¹² Senior incomes are lower on average than those of working-aged people, but more steady and predictable, and they report many fewer financial concerns than younger Americans. In the face of the severe recession that began in 2007, polls show that seniors are far less likely than younger people to miss paying a bill, to borrow money from family or friends, to cut back on vacations or entertainment, or to avoid doctor visits due to cost. Older Americans have also been less susceptible to the more emotional impacts of the recession, less likely to feel depressed, to have trouble concentrating or sleeping, to get upset with a spouse or someone else for no apparent reason, or to use alcohol, cigarettes, or food for comfort.¹³ There are a number of media accounts of unemployed adults moving back in with their older parents who with their social insurance safety net can serve as their children's personal safety net. For all these reasons Social Security is one of the most revered programs in the United States.

Americans Love to Hate Taxes. Is There a Tax They Can Love?

But it's not just Social Security benefits that are popular – the payroll tax itself is well liked too. Back in the late 1930s, the Social Security tax was the most popular among levies

¹² Author calculations from Pew Research Center, "*Pew Social Trends: Family Bonds*," Poll #2005-SDT01, conducted October 5 - November 6, 2005. Accessed from the Roper Center at the University of Connecticut.

¹³ Author calculations from *Time Magazine*, "*Economic Downturn*," Poll #2009-4666, conducted on April 1-5, 2009. Accessed from the Roper Center at the University of Connecticut.

Americans faced, only 4 percent of survey respondents saying it was the tax they most disliked.¹⁴ Fast forward nearly 70 years, and Social Security remains the second most popular tax (after the state income tax; federal income and property taxes are the worst), with just one in ten respondents in a 2005 poll saying it is the worst tax, despite the fact that Social Security taxes per capita are much higher now than they were seven decades ago.¹⁵

Social Security taxes are more popular than others for several reasons:

Earmarked. A key reason for the payroll tax's popularity is that its proceeds are specifically dedicated to paying Social Security benefits. It's not just that the tax is linked to a popular program; it's that people don't mind being taxed – or mind less – if they know where the money is going. Moreover, Social Security's popularity is not due to people simply believing their own taxes go to fund their own benefits; the majority of Americans realize that Social Security is a pay-as-you-go program in which current payroll tax contributions pay current benefits (with the excess set aside in the Social Security trust fund to help pay for baby boomer retirement). Instead, the popular understanding is that government has a contractual obligation with its payroll tax-paying citizens to provide Social Security benefits to those who have contributed over their working lives. That the tax is dedicated to this program underscores that commitment.

Survey evidence shows that Americans feel very strongly about this program and support the taxes that fund it out of both self-interest and recognition of the program's societal role in

¹⁴ Author calculations from Gallup Poll USAIPO 1939-0157, May 1939. Accessed from the Roper Center at the University of Connecticut.

¹⁵ Richard L. Cole and John Kincaid, "Public Opinion on U.S. Federal and Intergovernmental Issues in 2006: Continuity and Change," *Publius* 36: 445-59; for a compilation of the "worst tax" polls, see Campbell, *How Americans Think about Taxes*. The state income tax is slightly more popular, with 7 percent saying it the worst tax. Ten percent and 17 percent of respondents said Social Security and state sales taxes are the worst tax, respectively. These taxes are typically far more popular than the federal income and property tax. During the 1990s, the federal income tax was the deemed the worst tax by 25 to 30 percent of respondents. With the Bush tax cuts, ire toward the federal income tax has fallen and anger over property taxes has increased, with 42 percent saying they were the worst tax in 2005.

providing security. In a July 2009 poll for the Rockefeller Foundation and National Academy of Social Insurance, 88 percent of adult respondents agreed, “I don’t know if I’m going to need Social Security money when I retire, but I want to know it is there just in case I do need it.” Eighty-seven percent agreed, “I don’t mind paying Social Security taxes because it provides security and stability to millions of retired Americans, the disabled, and the children and widowed spouses of deceased workers.” Responses to these questions are virtually identical across age groups, and vary little with income; even though the affluent are typically far less dependent on Social Security, four-fifths of those earning \$100,000 per year or more agreed with both statements. Hence the supposed anti-tax virulence of Americans virtually disappears when there is a clear linkage between funding and program.

Withheld. A second reason the payroll tax is popular is that it is easy to pay. Payroll taxes are withheld from paychecks by employers and sent directly to the Social Security Administration. The money is never in one’s hands; most workers never have to write a check or come up with a lump sum to satisfy their Social Security obligation. And the tax is taken out a bit at a time, making it possible for people living paycheck to paycheck to pay the tax.

Universal, spreading the burden widely and giving all regular contributors a stake in the benefits. A third reason the payroll tax is popular is that nearly all Americans have a stake in the system. With a handful of exceptions, all workers pay Social Security taxes. No one is off the hook. This universal participation confers legitimacy on the system. Not only does universal participation generate the economic logic of social insurance – those who die young help subsidize the long-lived who might otherwise run out of assets – but also it feeds Social Security’s political logic. Everyone feels entitled to Social Security benefits because they have contributed toward the program during their working lives or are related to a worker who has

made such contributions. It is an earned benefit in which everyone has skin in the game. Critics cannot out single out one group or another for escaping taxation, as happens with the much-reviled income tax. There it is easy to stir up middle class resentment of the poor, who don't pay because of the EITC, and the rich, who lower their obligations with creative tax planning and use of loopholes.¹⁶

Critics on the right allege that the Social Security payroll tax reduces private savings; on the left critics argue that it is a regressive tax unfairly burdening those who can barely make ends meet.¹⁷ But one response to the right is: forced savings is a good thing. Lower income people are unlikely to save on their own (and we know from patterns of private savings in voluntary vehicles like individual retirement accounts and 401(k)s that participation falls steeply at lower income levels).¹⁸ Payroll taxation for Social Security helps ensure these citizens will be able to survive their retirement years with dignity, not in destitution. Moreover, because low-income workers contribute to the system, they can't be criticized as "lucky duckies," to use the *Wall Street Journal's* term for those at the bottom of the earnings spectrum who escape income taxation.¹⁹ No, everyone pays the payroll tax, which secures legitimacy. And a response to the left is: the payroll tax is regressive, but the benefits schedule is progressive. The Social Security formula is designed so that lower income retirees get proportionally larger benefits, given their contributions, than higher income earners. The program redistributes in a hidden, non-

¹⁶ Of course the affluent do benefit from the Social Security "wage cap" – payroll taxes for this program are only exacted on the first \$106,800 of income in 2010 (adjusted annually with inflation). There is no cap for the Medicare payroll tax.

¹⁷ See Andrea Louise Campbell and Kimberly J. Morgan, "Financing the Welfare State: Elite Politics and the Decline of the Social Insurance Model in America," *Studies in American Political Development* 19 (2005): 173-95, for an account of this elite debate.

¹⁸ Alicia H. Munnell and Annika Sunden, *Coming Up Short: The Challenge of 401(k) Plan* (Washington, DC: Brookings, 2005).

¹⁹ *Wall Street Journal*, "The Non-Taxpaying Class," 20 November 2002, p. A20.

stigmatizing manner, pulling the vast majority of seniors out of poverty in a respectable, dignified manner.²⁰

Moreover, these criticisms of Social Security and its payroll tax funding are criticisms from political elites, whose understanding of the program diverged from that of ordinary Americans over time. As the Rockefeller/NASI poll attests, Social Security is popularly understood as an earned benefit and as a safety net that will be there no matter what else may have gone wrong in one's financial lifetime. Liberal critics concerned about regressivity – especially when such criticisms emerged in the late 1960s – may have had the well-being of low-income Americans in mind. But the truth is that Social Security has pulled far more Americans out of poverty than welfare or food stamps or other means-tested programs targeted at the poor ever have.²¹ And the contributory nature of the program gives even low-income people an uncontested right to those benefits, which is not the case for frequently criticized means-tested programs.

Conservative critics had an altogether different project in mind in their criticisms: undermining support for the program. They discovered the hard way that direct attacks on a popular program like Social Security don't work – the Reagan administration got burned in 1981 with a proposal to close the budget deficit in part by reducing benefits for the two-thirds of Americans who retire “early.” And so conservatives lit on a more indirect strategy. The first tack was to recast Social Security as an investment, and a poor one at that, with a “rate of return” far below that of the equity markets. The second was to offer private alternatives such as 401(k)s to wean people off public provision. Most recently, conservatives have tried to privatize Social

²⁰ Theda Skocpol, “Targeting within Universalism: Politically Viable Policies to Combat Poverty in the United States,” in *The Urban Underclass*, ed. Christopher Jencks and Paul E. Peterson (Washington, DC: Brookings, 1991).

²¹ One measure of Social Security's success: senior citizens, who once were the age group with the highest poverty rate, now have the lowest rate. See Federal Interagency Forum on Aging Related Statistics, “2008 Older Americans: Key Indicators of Well-Being,” p. 12.

Security, advocating that workers be allowed to invest a portion of their payroll tax contributions themselves in individual accounts. But the public wasn't buying. Indeed, even though George W. Bush made privatization the centerpiece of his second term domestic agenda, his proposal went nowhere.²²

Political elites can complain about the structure and goals of Social Security, but the public has its own firmly held conceptions. In the popular understanding, Social Security is a safety net program that helps those who can't save money for retirement on their own and that helps the rest of us with a sure benefit whose value isn't dependent on the ups and downs of the stock market. And it is an earned benefit that all recipients have helped pay for – even if some more modestly than others – with a tax that is not a burden to pay because it is withheld and paid over a lifetime and that is linked explicitly with the program. Not only is Social Security the most successful anti-poverty program in history, but also the payroll tax has proven one of the most politically sustainable levies, still popular with the public despite decades of elite attacks.

Taxes That Aren't Taxing

What can Social Security's remarkable political story tell us about the situation we face now? Which of its lessons is transferable? What strategies can those who wish to expand security and opportunity with a sustainable source of revenues adopt? The Social Security case provides some insights into tax options on the table today, and its central features – elevation of

²² Steve M. Teles and Martha Derthick, "Social Security from 1980 to the Present: From Third Rail to Presidential Commitment – and Back?" in *Conservatism and American Political Development*, ed. Brian J. Glenn and Steven M. Teles (New York: Oxford University Press, 2009).

popular programmatic goals, ease of payment, and creation of a stake in the system – can be emulated as we think about a tax system for a progressive agenda.

Highlight benefits and programs. One reason the payroll tax for Social Security is relatively popular is that it is linked to a revered program. How can this sense of linkage be carried over into other areas? Clearly we can't replicate Social Security exactly – we can't earmark a tax for each individual function of government. But we can do the next best thing: highlight the benefits and programs made possible by taxation. Play up what government does; prime on the programs. And explicitly link their existence to a revenue stream.

There are two reasons to highlight programs. First, programs tend to be popular. Americans may complain about government in the abstract, but most really like what government does: education, health care, unemployment insurance, assistance to the poor, Social Security.²³ Yes, on polls people say they would like lower taxes, when asked about taxes in isolation. But when asked about specific programs, the number one answer is generally to increase spending.²⁴ And in poll questions in which they directly confront a tradeoff between tax cuts and spending on various areas like Social Security, Medicare, education or the environment, the majority chooses spending over lower taxes.²⁵ Americans like protection from life's vagaries; they prefer to enjoy secure lives free from worry. And they recognize that government programs can provide such security. Thus highlighting programs and benefits, showing people what their tax dollars will be used for, is an enormously important and effective strategy.

²³ Page and Jacobs, *Class War?*

²⁴ As data from the American National Election Study and other surveys show.

²⁵ Jacob S. Hacker and Paul Pierson, "Abandoning the Middle: The Bush Tax Cuts and the Limits of Democratic Control," *Perspectives on Politics* 3 (2005): 33-53.

Why will this work politically? Because of the second reason we should highlight the benefits and programs made possible by taxation: Americans know and understand that taxes are necessary. They realize government isn't free.²⁶ In fact, politicians have sometimes gotten themselves into trouble trying to pass new programs without mentioning that new taxes would be necessary. Some argue that one reason the Clinton health care reform effort failed in 1993-94 is that the president made a fatal mistake in failing to mention financing in his unveiling speech (except for a brief mention of an increased cigarette tax). He did so out of fear that people would automatically reject reform as soon as taxes were mentioned. Ironically he instead bolstered skepticism about the plan: people couldn't figure out such a large reform could be paid for on such a narrow basis.²⁷ Above all, Americans are pragmatic – witness voter rejection of small government ballot initiatives during the Great Recession. As tempting as lower taxes might be when so many are facing hard times, voters in Massachusetts and North Dakota rejected ballot initiatives cutting taxes in 2008, and voters in Maine and Washington voted down limits on government spending in 2009.²⁸ Americans may ritualistically complain about taxes, but they know they are necessary. And highlighting desirable programs reinforces that underlying knowledge.

Benefits and programs should not only be emphasized and discussed first and foremost – they should also be explicitly linked to a revenue stream. I don't mean micro-level earmarking – it's not practical to earmark a tax for every program. What I do mean is that discussions of programs should mention how they are funded, which helps legitimate the revenue stream. If

²⁶ Susan Welch, "The 'More for Less' Paradox: Public Attitudes on Taxing and Spending," *Public Opinion Quarterly* 49 (1985): 310-16.

²⁷ Robert J. Blendon, Mollyann Brodie, and John Benson, "What Happened to Americans' Support for the Clinton Health Plan?" *Health Affairs* 14 (1995): 7-23.

²⁸ Federation of Tax Administrators, "Summary of Key Tax Issues on November 2008 State Ballots," *FTA Bulletin* (5 November 2008); E.J. Dionne Jr., "On Election Day, A Win for Government," *Washington Post*, 9 November 2009.

people know how the money is being used, they will feel better about the tax, especially when the tax is supporting programs they believe in. A couple of examples shows how advertising what government does can undermine anti-tax fervor. During the 1930s anti-tax citizen groups emerged that sponsored tax strikes in a number of cities in which people refused to pay their property taxes. A good government coalition quickly put these strikes to an end with an aggressive campaign of radio programs advertised the specific things government did and that would go undone if people failed to pay their taxes.²⁹ Similarly, the 2009 ballot measures limiting government spending in Maine and Washington were defeated in part because of effective advertising campaigns citing projected hits to school budgets and home nursing programs for the elderly.³⁰ These types of campaigns are rare, however, and typically people think government does nothing for them; no wonder they don't want to pay taxes. So talking about programs that people want, and showing how they are funded, will underscore for Americans both that government really does a lot for them, and that their taxes are necessary to support these valued functions.

Make taxes easy to pay. A second enormously important feature of sustainable revenue sources is that they are easy to pay. Americans feel better about taxes that they feel they can pay without undue burden. Easing payment not only helps public acceptance but also encourages compliance; if a tax is too difficult to pay, people will look for ways to avoid it, and it will raise less revenue than it should. Hence the mechanism by which taxes are collected is crucially important.

Perhaps the place to start is to discuss briefly how not to impose taxes: as a lump sum. We see this with the property tax, generally the main source of revenue for local governments.

²⁹ David T. Beito, *Taxpayers in Revolt: Tax Resistance during the Great Depression* (Chapel Hill: University of North Carolina Press).

³⁰ E.J. Dionne Jr., "On Election Day, A Win for Government," *Washington Post*, 9 November 2009.

People should like the property tax. Economists do: because the tax is a geographically defined one, falling on the same people who enjoy its benefits, there's no risk of "fiscal illusion" – no risk that people will demand more services than they are willing to pay for themselves. And there are reasons to believe the property tax might be popular among the public as well. It's an old tax, predating the Revolutionary War, and conventional wisdom among tax observers is that an old tax is a good tax.³¹ Moreover, local government is relatively popular in the American federal system, so we might think that the tax that supports it would be popular as well. But in fact, the property tax is loathed. In polls conducted since the early 1970s asking people what the "worst tax" is, it always shares the top spot with the federal income tax.³² Anger toward the property tax spurred the tax revolt of the late 1970s and helped usher in the Reagan era of conservative ascendance.³³ A chief reason the property tax is hated: it arrives in a lump sum. One has to take cash out of one's pocket and pay a large bill.³⁴ It is also invariant and unresponsive to one's financial circumstances. If one's income is reduced because of retirement or job loss, one's income taxes go down automatically, and one can reduce the sales taxes one pays by buying less. But one's property tax stays the same.

In contrast are two mechanisms that make taxes much easier to pay. The first is withholding. As we saw with Social Security, a tax is less burdensome if the money is never in one's hands to begin with. The federal income tax is withheld as well, and its unpopularity might seem to undermine this mechanism. However, while Americans love to hate the federal income tax, the problem is not the withholding. State income taxes are withheld too, and they

³¹ David Brunori, *Local Tax Policy: A Federalist Perspective* (Washington, DC: Urban Institute Press, 2003).

³² See data at note 15.

³³ Isaac William Martin, *The Permanent Tax Revolt: How the Property Tax Transformed American Politics* (Stanford: Stanford University Press, 2008).

³⁴ It is somewhat less of a burden to those who have the holder of their mortgage pay the tax. One reason the elderly in particular dislike the property tax is that most own their houses free and clear and must pay the lump sum bill. Brunori, *Local Tax Policy*.

are the most popular tax.³⁵ Indeed, withholding makes paying your income tax on April 15 easy – you’ve already paid it. What’s burdensome is filling out the tax return to make exactly sure the amount you already paid was correct. In fact, polls show that people don’t mind paying the federal income tax as long as they don’t have to pay extra upon submitting a tax return.³⁶ And in fact most people rig their withholding to get a refund, those expecting a refund outnumbering those who expect to owe by two or three to one in a given year.³⁷ Indeed, we know withholding works because conservatives detest it so much.³⁸ In his autobiography, conservative economist Milton Friedman lamented his role in establishing income tax withholding years earlier: “It never occurred to me at the time that I was helping to develop machinery that would make possible a government that I would come to criticize severely as too large, too intrusive, too destructive of freedom.”³⁹

The other mechanism that makes paying taxes easy is paying a little bit at a time. It’s hard to pay one’s property tax because it arrives as a big, lumpy bill. But if tax payments are spread out, it’s much easier for people living paycheck to paycheck to pay them. Withholding helps people pay taxes not only because the money is never in one’s hands but also because the income and payroll taxes that are withheld are spread out over time, reducing their burden.

Another category of taxes that are spread out are sales taxes. They are taken a small amount at a

³⁵ See data at note 15. It’s not entirely clear why the state income tax is the most popular. It could be that states are the most popular level of government in the federal system (37 percent of 1996 American National Election Study respondents said state government was the level of government in which they had the most faith, followed by local government (33 percent) and national government (30 percent). Just 18 percent said they had the least faith in state government, compared to 33 percent for local government and 47 percent for national government). Another factor could be the fiscal probity forced by the balanced budget requirements in place in 49 states.

³⁶ Susan B. Hansen, *The Politics of Taxation: Revenue without Representation* (New York: Praeger, 1983).

³⁷ See for example the Cambridge Consumer Credit Poll, March 2004, and the Associated Press, America Online and Ipsos-Public Affairs poll, April 2-April 4, 2007. Both accessed from the Roper Center at the University of Connecticut.

³⁸ e.g. Amity Shlaes, *The Greedy Hand: How Taxes Drive Americans Crazy and What To Do About It* (New York: Random House, 1999); and Charlotte Twight, “Evolution of Federal Income Tax Withholding: The Machinery of Institutional Change,” *Cato Journal* 14 (1995): 359-95.

³⁹ Milton Friedman and Rose D. Friedman, *Two Lucky People: Memoirs* (Chicago: University of Chicago Press, 1998), p. 123.

time, with each transaction. This makes sales taxes the most popular taxes next to state income taxes.⁴⁰ They are regressive, a greater burden on lower income people, who spend a larger portion of their money. But their regressivity can be blunted as with the exclusion for food and prescription drugs in many states.

Indeed, ease of payment is one of the chief arguments for implementing a consumption tax, such as a value added tax (VAT), as a new source of revenue for an enhanced agenda of security and opportunity programs. Such taxes are taken a bit at a time as with the sales tax. They also provide a steadier source of government revenue than income taxes, which tend to go up and down more with the state of the economy. Consumption taxes are regressive, which makes them the scourge of the left and popular with the right (at least as long as they are used as a replacement for the income tax and not as an add-on). But the regressivity of a VAT can be counterbalanced by a sliding scale of refunds to lower income people, and its revenue can be used for a progressive set of programs that provide security for lower- and middle-income people, such as Social Security has done. That is the path taken by many European countries. They typically have a progressive income tax, but one which takes in a far smaller proportion of total revenues than is the case the United States. Such countries rely more heavily on consumption taxes, such as value-added taxes (VATs) or goods and services taxes (GSTs), which are then used to finance a more expansive program of social provision than obtains currently in the United States.

Consumption taxes also have the political advantage of not inviting the ire of the affluent. One of the reasons anti-tax attitudes are so pronounced in the United States is because of the unusually high reliance on the income tax: we tax most heavily the most vocal and organized members of society. Not only do they continually complain about taxes, but they also lobby hard

⁴⁰ See data at note 15.

for tax breaks, which in turn makes everyone else angry about the income tax system. It would be difficult to imagine a system better engineered to create conflict.

Create stake in the system. A third component of sustainable funding is that everyone pays in. When everyone pays, the system is seen as more legitimate, and those who pay cannot grouse about those who do not. We see this with Social Security, where the universal nature of payroll taxation means that even the benefits of low-income people are earned; no one can criticize a recipient as undeserving, because that person paid in. Moreover, the universal deservingness of beneficiaries masks and, crucially, legitimates the redistributive aspects of the program, which in turn offsets the regressivity of the tax. In European countries with extensive social programs financed in part by consumption taxes, a similar dynamic operates. Everyone benefits from programs like universal health insurance and family allowances, but everyone has contributed as well, through their consumer spending. That consumption taxes fall more heavily on the poor is offset by the redistributive nature of the programs. And that the programs are universal – the affluent get health insurance too – keeps them on board politically.

Outside of Social Security and a few other programs, the United States tends not to have such a tied-together package of benefits and taxes. Government revenue relies heavily on the income tax system, which excludes the bottom 40 percent of Americans. On the spending side, outside of the major entitlement programs for senior citizens, we mostly have means-tested programs. Thus we have one segment of society that pays (income) taxes, and another which benefits (to exaggerate a bit). This makes for a problematic politics. If instead, everyone pays and everyone benefits, no group can be criticized for free-riding, and everyone has a stake in a popular set of benefits.

A Plan for Investing in America's Future

Building on the Social Security example, we can devise a program to invest in America's people and infrastructure, reinventing the Social Security example for the coming era with a set of programs that benefits the broad majority of Americans, supported by a revenue source that is durable, explicitly linked to those programs and easy to pay, and that generates a sense of a stake in the system.

Programs that Invest in America's People and Infrastructure

During the post-war boom, prosperity fed on itself as investments we made in the nation's human and physical capital paid for themselves many times over in increased productivity. We invested in the nation's people with education programs like the GI Bill, federal college aid, and strong support for elementary and secondary education. We built hospitals and passed programs to provide access to medical care. The interstate highway system and other transportation projects enhanced economic growth. Real incomes grew handsomely, and economic inequality shrank. But since then college aid programs have fallen behind tuition increases, K-12 funding is highly variable and inadequate to meet educational needs in a competitive world market, health care costs have soared and access has declined, and our physical infrastructure is literally falling apart. Incomes for most are stagnant and inequality soaring.

A new program of investment in America's people and infrastructure would rebuild the productivity capacity of the great majority of Americans and their environment. Such investments could include increased support for elementary and secondary education; more

generous federal college aid to reduce disparities in access; universal access to health insurance; enhanced job training; early childhood care and education; and support for infrastructure enhancements and green energy development. In short, these are inclusive programs that would benefit the broad swath of Americans, enhancing their individual capacities to make a good living and increasing the productivity of the economy overall.

Sustainable Revenues

These investments require new, robust sources of funding that build on what we know about how Americans think about taxes and their government. I advocate a two-pronged approach:

Keep the federal income tax and enhance its progressivity (to an extent). The above criticisms of the income tax notwithstanding, in a country with incomes as skewed as they are in the United States, one cannot in good conscience abolish the graduated income tax. Besides the fact that taxation according to ability to pay is a principal that dates back to Adam Smith, we need to utilize both the spending side and the taxing side of the equation to perform redistribution; the spending side alone would be insufficient. Moreover, we need the revenue; while consumption taxes are popular among conservatives who would use them to replace all or most of the income tax, that's not realistic. To shore up our existing social welfare programs and to make needed investments in people and infrastructure, revenue needs are great enough to necessitate both kinds of taxes.

Two of Obama's tax pledges mark a good place to begin. Increasing the rates on the top two income tax brackets to the levels that obtained under Bill Clinton and limiting the value of itemized deductions for the affluent will restore lost progressivity to the system and bring in

much needed revenue.⁴¹ Raising taxes on the wealthy is popular among the public⁴² and would help ease the impression that the income tax system is unfair.

But there are limits to how much revenue can realistically be raised by an income tax. Yes, peacetime top marginal income tax rates were once 35 points higher than they are now. But when rates are that high, the affluent seek out loopholes and other ways to reduce their taxes, resulting in actual taxation far lower than the statutory rates on the books. The effective rate of taxation of the top 1 percent of earners was about 20 percent in 2004, after the Bush tax cuts, a rate which most progressives would view as scandalously low. But it was only around 24 percent during the 1990s and was around 26 percent during the 1960s and 1970s, when the top marginal rate was 70 percent.⁴³ Such high rates encourage tax avoidance scheming among the affluent, which angers the great majority who cannot escape paying their own statutory rates and which undermines faith in the system, something conservative politicians have capitalized on to great effect. Or both economic and political reasons, the federal income tax cannot be the sole revenue source for a robust security and opportunity agenda.

Add a consumption tax, like a VAT. Thus at the same time, we should add a consumption tax such as a VAT. The income tax alone can't produce enough revenues for the kinds of investments we're talking about. And the VAT has the advantage of fewer compliance problems. But the real advantage of a VAT linked to a program of investment in America's

⁴¹ The top two brackets would rise from 33 and 35 percent to 36 and 39.6 percent.

⁴² Roper and Gallup surveys show that high income households are the group most likely to be perceived as paying too little in taxes or not their fair share. Karlyn Bowman, "Public Opinion on Taxes," AEI Studies in Public Opinion, www.aie.org/publicopinion6.

⁴³ W. Elliot Brownlee, "Historical Perspectives on U.S. Tax Policy toward the Rich," in *Does Atlas Shrug? The Economic Consequences of Taxing the Rich*, ed. Joel B. Slemrod (New York: Russell Sage Foundation, 2000); and Congressional Budget Office, "Effective Federal Tax Rates: 1979-2001" and "Historical Effective Federal Tax Rates: 1979 to 2003."

people and infrastructure lies in the many ways in which it squares with successful models of the past.⁴⁴

First, a VAT is easy to pay. Rather than confronting huge bills at inconvenient moments, individuals pay into the system gradually, a little at a time, and then get benefits in return when they need them. The ease of payment is akin to oft-heard personal financial advice: put aside a little at a time. Social Security makes retirement affordable because contributions are stretched out over a lifetime. The same would be true of the program of investments in people and infrastructure funded by a VAT.

Second, the universal nature of the benefits creates a sense of common purpose – everyone pays in and everyone can count on the program. But it also allows for redistribution in a nonstigmatizing manner. A sliding scale of refunds would blunt the regressivity of the VAT for low-income people. A program of investments in education, child care, job training, and so on, would benefit the middle class, providing political protection, but also significantly aid low-income groups who would not otherwise be able to afford such investments. Some progressives may object to this plan as forcing savings on the poor. But the Social Security example shows that creating a system by which people can spread out the costs of meeting their needs over time, in combination with the redistribution that a universal system makes possible, is a uniquely effective remedy for poverty.

⁴⁴ Proposals that link a VAT to health care, like that of Leonard E. Burman (see “Blueprint for Tax Reform and Health Reform,” statement before the Senate Committee on Finance, May 13, 2008), clearly seek to emulate the Social Security model. But we need investments in additional areas as well.

Conclusion: Robust Investments and Revenues for America's People

A new tax always seems scary. But periodically we have changed the way we fund government in the United States, with changes in the nature of the economy and the scope of government. Early on the federal government was funded almost solely by tariffs and excise taxes. Bonds were crucial to financing the Civil War and both World Wars. The federal income tax became a widespread tax during World War II. During the Great Depression, as states, in partnership with the federal government, began offering more protections from life's risks, the sales tax and state income tax were introduced, as was the payroll tax for Social Security.

Now we face a new era of needs. With real wages falling or stagnating, people have a tough time meeting life's vagaries on their own. Our lack of investment in education and infrastructure is undermining our ability to compete in a global economy. A new set of programs that enhance skills and provide security for the great majority of Americans, along with investments in infrastructure, all supported by a sustainable source of revenues, can increase our productivity and enhance the well-being not just of the very rich, who have fared so well in recent decades, but of the great majority of Americans.