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QUICK STUDY

Summary: *Government growth negatively correlates with economic success. By every conceivable measure, the U.S. government has grown larger than ever and almost certainly larger than necessary. A simple, transparent tax code would restrain the growth of government by allowing taxpayers to make rational cost-benefit decisions based on the price they are paying for government.*

THE ROAD MAP TO TAX REFORM™

The Most Expensive Government In World History

By Stephen Moore

Few Americans appreciate how enormous the United States government is today, let alone how much its size is due to growth in the past century—even in the past fifty years. The appropriations and expenditures of today's government do not even resemble the cost of government at the outset of the twentieth century. Government will spend more in the year 2001 than it spent from 1787 through 1900, even after adjusting for inflation. Government consumes four to five times more of America's national output than it did in 1900, and by one estimate, Americans spend half of their working lives either paying for government or complying with government rules, edicts, levies, paperwork and fees.

Government today has mushroomed far beyond what it was intended to be in America, and the projects, programs and price tag of the United States government are overwhelming in their expansion over the last hundred years. That kind of expansion, of course, has hindered economic expansion in the private sector. This paper outlines a few of the many ways that government has grown and discusses tax reform that can correct this trend.

Government consumption

Total taxes

As taxpayers, Americans have not insisted upon the same degree of excellence and frugality in government that we have, as consumers, demanded of every other industry. The inefficiency of public programs in recent decades is especially depressing when one considers how much money Americans spend on government today.

In 1957 the average two-earner family paid 28 percent of its income in taxes. Today, it pays 38 percent. During the Reagan years, the top marginal tax rate was reduced to 28 percent, but since then it has crept back up to 39.6 percent. The top estate tax rate, 55 percent, is the highest in the federal tax code and the highest estate tax of any country except Japan.

Income Tax: a relatively new taxation

Until the twentieth century, revenue for government was limited to tariffs and land sales. This changed fundamentally in 1913, when an income tax was instituted by a change to the Constitution (the Sixteenth Amendment). Never intended to grow much beyond its original maximum rate of 7 percent, the income tax soon ballooned to a maximum rate of 70 percent. State and local governments have become increasingly dependent upon a burdensome income tax code. By 1960, state and local governments raised 10 percent of revenues through income taxes. In 1992, income taxes made of 26 percent of state and local revenues.

The growth of the income tax can be physically measured by digesting the tax law. Originally 14 pages, it grew to almost 1,000 pages long before 1950. Today, it has expanded to 11,650 pages. One researcher has estimated that Americans spend 5.4 billion hours at an annual cost of $600 billion to the economy just completing the paperwork requirements of federal taxes.

Payroll Taxes: more costly than income taxes for many

Another major source of revenue tapped by government in the past century, the payroll tax, was established to pay for new programs that were never before intended to fall under a public umbrella. The first Social Security payroll tax rate, in place from 1937–1950, was 2 percent. By 1990, the rate increased to its current 15.3 percent.

The typical middle-income family now pays a greater share of its income in payroll taxes—including the portion hidden from view as the employer's share—than income taxes. Reducing payroll taxes may be the most effective way to reduce the tax burden on middle- and low-income working families.

Do we get what we pay for?

A $3 trillion dollar government

The real outlays of government—state, local and federal—have increased more than a hundredfold since 1900, from $33 billion to an astounding $3 trillion. While government spent $2,102 per household in 1900, today it spends $26,651.

The data in Figure 1 shows that this growth cannot be accounted for simply by the growth of either the population or the economy. Even adjusting for the fact that the economy is much larger today than 50 or 10 years ago, the government as a share of GDP has more than tripled.

Real Federal growth

Much of the enormous increase in the federal government has taken place within the last forty years. Real federal outlays have climbed from $100 million in 1800, to $155 million in 1850, to $10 billion in 1900, to $300 billion in 1950, and finally to $1800 billion today. Even adjusting for population growth and inflation, federal expenditures have mushroomed.

The greatest misfortune for the American economy is that federal spending is outpacing economic growth:

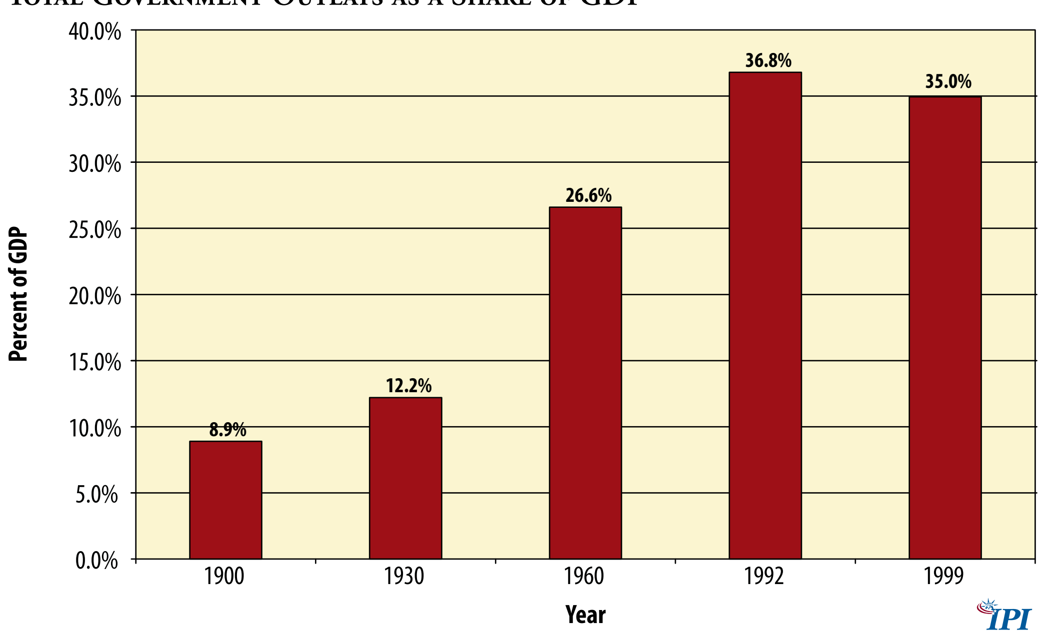
- In 1900 the federal government consumed less than 5 percent of total output.
- In 1950 the federal government consumed roughly 15 percent of total output.
- In 1999 the federal government consumed roughly 19 percent of total output.

The latest figures for federal spending as a portion of total output somewhat hide its rapid growth, as a technology-driven private sector expansion shrunk the relative size of government. In real terms, the government is quickening its pace of growth.

When Ronald Reagan entered the White House in 1980, his message to voters was plain and simple: big government is the problem, not the solution. However, in the 20 years since the Reagan Revolution began, the federal budget has almost quadrupled. Even adjusting for inflation, the federal enterprise is twice as large as it was in 1980. Over the next five years, the federal government is expected to spend more money than was spent on World Wars I and II, the Civil War, and the Revolutionary War—even after adjusting for inflation.

Figure 1

Total Government Outlays as a Share of GDP



The basic shift in Federal spending

The demise of military spending

The single most important activity of the federal government is to provide for the national defense. A free nation spends as much as necessary to protect its borders and its citizens. Is the modern-day growth of government on the federal level a result of the Cold War defense buildup? No way. Except for brief periods during wartime, national defense spending has continually shrunk from one-half of the total federal budget in 1800 to one-sixth today.

Records of government spending powerfully refute the common complaint by special interest groups that domestic programs were subject to draconian budget cuts in recent years. Although the Reagan years encouraged modest spending reductions in selected domestic programs, today's spending in every major domestic area except Defense is at an all-time high.

Welfare and Transfer Payments: a nation entitled

Virtually all United States transfer payment programs emerged in the twentieth century. Already, they have been canonized as a necessary part of American government—none can be eliminated or even reformed without howls of protest. It is noteworthy that in 1950 these transfer programs constituted roughly 12 percent of the federal budget. Today they consume almost 40 percent.

Since the 1997 enactment of welfare reform, which has shown some success, welfare rolls are down nationwide by more than 40 percent. Yet public assistance spending continues to soar as antipoverty programs grow, despite the fewer number of people on assistance. More welfare reform is needed to reduce the enormous costs of public assistance. After spending $5 trillion dollars on the war on poverty between 1965 and 1995, can we confidently say that the money was effectively used?

How big is Government? Employment and Regulations

Uncle Sam's Payroll

One of the biggest obstacles to government downsizing and reform is the growing number of its workforce—a "protected class." In the past 20 years private sector union membership has shrunk, while public sector unions how have record membership. The modern-day labor movement mostly consists of teachers and other government employees. Today, the AFL-CIO has more NEA members than Teamsters.

Figure 2 gives another disheartening image of how much government has grown. For the first time in its history, the United States had more civilian public sector employees in 1992 than manufacturing employees. Today, nearly 2 million more Americans work for the government than for manufacturers.

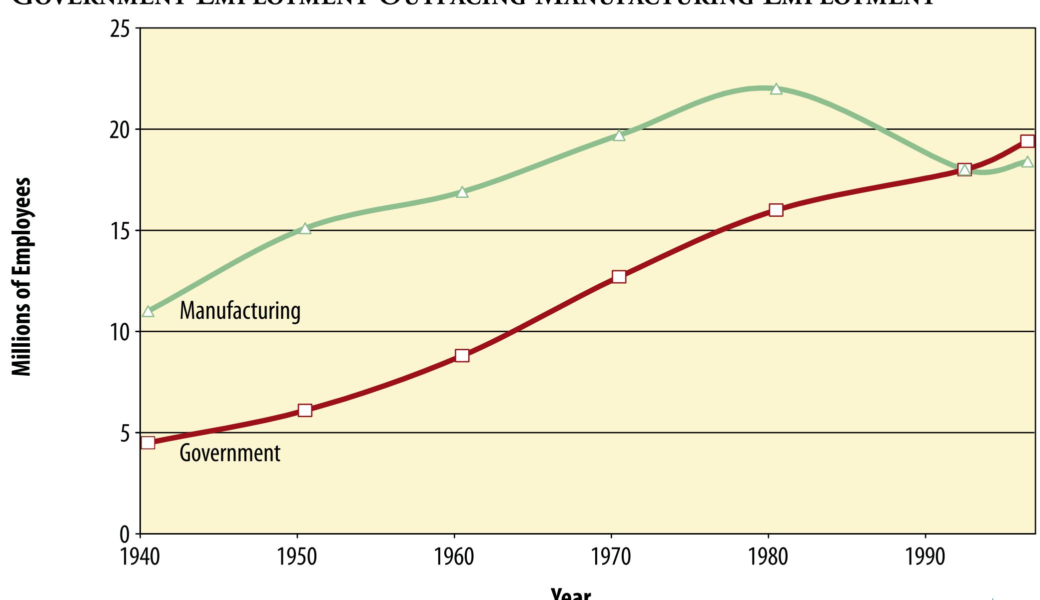
As the increase in public sector union membership suggests, the public workforce have secured special entitlements and privileges that do not exist in the competitive private sector. The average public sector bus driver earns 70 percent more than his private sector counterpart. Postal workers make one-third more in salaries and benefits than comparably skilled private sector workers. This kind of job security and compensation does not exist anywhere else in the economy, and it hurts a nation that competes internationally by draining its economy of funds and productivity.

Regulation's toll on the private economy

Government regulations and mandates have expanded beyond reason in the last 25 years, contributing some of the most negative effects of government on the economy. What is so pernicious about these regulations is that they have an invisible cost on productivity, wages and quality of life. The invisible cost for regulation may be as high as $4,000 per person. Certainly there is some call for safety measures and consumer

Figure 2

Government Employment Outpacing Manufacturing Employment



protection regulation, but studies show that the costs of regulations often far outweigh the benefits to consumers and workers. For instance, one study shows that the costs of the Clean Air Act Amendments of 1990 will outweigh their benefits by a ration between 2 to 1 and 4 to 1.

Environmental laws can provide benefits for human health and quality of life, but this is not always the case. In 1990, the Office of Management and Budget (OMB) estimated that business would have to spend $5.7 trillion to save one life under an EPA regulation on wood preservatives. That was equal to the entire U.S. GNP! As the United States continues to spend around $300 billion a year on environmental regulation, it costs a long-run reduction of 2.59 percent in the level of the U.S. GNP. In other words, environmental laws reduced GNP by about $180 billion in 1990 and contributed to the loss of 4 million jobs.

Beyond Measure

In this study we have documented government growth using a wide range of areas. When we combine all the costs of public sector activity—taxes, spending, borrowing, regulation, mandates, and litigation—we find that government now consumes almost 50 percent of our nation's total output. No single measure is sufficient to evaluate government today, and the ability for voters to make informed decisions is becoming harder and harder.

The question "How big is Government?" has recently occupied the minds of great scholars, and some have formulated different ways of accounting for the size and impact of government. Nobel laureate Milton Friedman proposes one alternative method of computing the real cost of government. Friedman suggests that the real cost is the ratio of government resources to private resources. The GDP, says Friedman, is a poor measure of real wealth producing output because it includes as one major component government spending. But government spending does not often add to national welfare and in many instances subtracts from it. Using Friedman's index, one finds that government swallows up 56 percent of all resources in American society today—four times what it took in 1929.

The Way to Trim Government and Stimulate Growth

A flat rate tax on consumption could swiftly and dramatically reverse the trend toward government growth. How? First, such a tax would stimulate investment, saving, and economic growth, reducing the need for the federal government to subsidize public services, which citizens can pay for directly. Second, a single uniform tax rate would mitigate the arguments that pit rich against poor, since all Americans would face the same rate on items they choose to buy. One likely outcome would be citizen solidarity against tax increases and for government spending reductions; another would be the disappearance of any motivation for politicians to seek support by pitting the financial interests of one group against those of another. Third, a flat consumption tax with minimal deductions and loopholes and with no tax withholding would be almost totally transparent. Americans would pay the tax either at the cash register or on a postcard tax return. The national consumption tax would also consolidate all taxes and allow Americans to reexamine levels of taxation. They would probably reconsider the ways tax monies are used. Finally, a consumption tax would radically reduce the compliance costs of the tax system. These compliance costs—estimated at $125 billion a year—are in and of themselves a "tax" on American workers.

Conclusion

Many Americans are realizing that government is too big for the well being of its people. There are signs that more and more are unwilling for government to expand any further. Yet we still face the tiresome prospect of continued government growth. It is not enough to prevent government's expansion. It is time for fundamental tax reform that trims government to levels prior to the programs and expenditures of Franklin Delano Roosevelt's administration.

The most effective and equitable way to trim government and increase private investment is through a tax based on consumption. The best result of fundamental tax reform would be a visible system of taxation, allowing people to size up the government. This, after all, is at the heart of the United States Constitution: knowing how much one is being taxed and having a say about how tax money is used. It is time to reinstate the authority of the Tenth Amendment, which reserves "to the states and the people" all powers not explicitly granted to the federal government.

This study is a summary of IPI Policy Report # 161, *The Most Expensive Government In World History* , by Stephen Moore, President, Club for Growth.

Want More Info?

Copies of the full study are available from our Internet Website (**www.ipi.org**), in HTML and Adobe® Acrobat® format. Point your browser to our website, and follow the dialogs to the Policy Reports section.

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