Taxation and the National Debt

ESSENTIAL DILEMMA

Is there a fair and efficient way to fund and maintain the public services we want?

INTRODUCTION

> In this world nothing can be said to be certain, except death and taxes.
>
> —Benjamin Franklin, 1789 (Martin, 2012)

> I, _____, pledge to the taxpayers of the ___ district of the state of _____, and to the American people that I will: ONE, oppose any and all efforts to increase the marginal income tax rates for individuals and/or businesses; and TWO, oppose any net reduction or elimination of deductions and credits, unless matched dollar for dollar by further reducing tax rates.
>
> —U.S. House Taxpayer Protection Pledge (Americans for Tax Reform, n.d.)

> Here's the truth: The only way America can reduce the long-term budget deficit, maintain vital services, protect Social Security and Medicare, invest more in education and infrastructure, and not raise taxes on the working middle class is by raising taxes on the super rich.
>
> —Former Secretary of Labor Robert Reich (2011)

Public services must be paid for with taxes. The pledge that the Americans for Tax Reform have asked all new members of Congress to sign since 1986 exacts an absolute promise not to vote to raise taxes of any kind, including the marginal tax rate. The marginal tax rate can be used to compel wealthy people to pay a higher proportion of their income than middle income or poor people pay. Robert Reich argues, in contrast, that firm caps on taxes, especially for the wealthy who are most able to pay, have significant opportunity costs in the form of reduced government services, increased taxes on the middle and working class, or increased deficits.

Some may wonder why we have deficits or debt at all if the government has nearly unlimited authority to tax residents—why don't we just tax our way out of debt? Others wonder, given the obvious costs and loss of economic freedom, if it wouldn't be preferable to simply eliminate most or all taxes, public goods, and services and allow people to spend money as they please.

In between these two extremes, there are challenging and nuanced questions that can be examined using the tools and evidence of economics.

- How can we generate the revenue we need to pay for public services without disrupting the economy by reducing the ability of people to pay for goods and services?
- Would we accept a tax system that generates enough revenue, but encourages undesirable behavior. Is such a system sustainable?
- How do we decide if taxes are "fair"? Should senior citizens have to pay for schools they will never use? Should pacifists be expected to pay taxes that go to support the military? Should the wealthy be asked to pay more because they are able, or is that punishing success?

This lesson explores these issues by examining the gas tax and the capital gains tax on investment income. Students will begin with the question of why we tax. Then, they will compare the cost of taxation to the costs of deficits and debt. Students will identify criteria for fairness and efficiency and use those criteria to judge the gas tax and the capital gains tax.

This lesson assumes some prior knowledge about what taxes are, and familiarity with some basic types of taxes, including income, property, and sales taxes. Students should also know how regressive, proportional, and progressive taxes work. "An Overview of Taxation" provides this background, and is included online among the Supporting Documents. Additional background, beyond what is provided here, also is available in the Glossary of Common Terms (available online) for students unfamiliar with the terms used in this lesson.

KEY TERMS

The following terms and concepts are used in this lesson and appear in the online glossary:

Budget, Budget deficit, Capital gains tax, Cost, Debt, Efficiency, Fairness, Incentive, Investment, Revenue, Taxation, User tax, Utility, Ways and Means committee

STUDENTS WILL UNDERSTAND

- In a budget that includes debt service, defense, and social welfare programs as major expenditures, balancing the budget through spending cuts or tax increases alone will be judged by many to be unwise, unfair, and/or untenable.
- Taxation has both direct and indirect costs, directly reducing income and some freedom to spend and indirectly affecting markets and distorting incentives.
- The "ideal" tax system is designed to balance the goals of efficiency and equity; an individual's ideal system will vary based on values and preferences.

STUDENTS WILL BE ABLE TO

- Ask good questions and make inferences.
- Analyze tables
- Support positions with evidence.

RELATED CURRICULUM STANDARDS

Common Core State Standards (CCSS) Initiative[1]

CCSS.ELA-Literacy.RI.11-12.7. Integrate and evaluate multiple sources of information presented in different media or formats (e.g., visually, quantitatively) as well as in words in order to address a question or solve a problem.

CCSS.ELA-Literacy.RH.9-10.7. Integrate quantitative or technical analysis (e.g., charts, research data) with qualitative analysis in print or digital text.

CCSS.ELA-Literacy.RH.11-12.8. Evaluate an author's premises, claims, and evidence by corroborating or challenging them with other information.

The College, Career, and Civic Life (C3) Framework for Social Studies State Standards[2]

D2.Eco.6.9-12. Generate possible explanations for a government role in markets when market inefficiencies exist.

D2.Eco.8.9-12. Describe the possible consequences, both intended and unintended, of government policies to improve market outcomes.

Council for Economic Education's Voluntary National Content Standards in Economics[3]

Content Standard 4: Incentives. People usually respond predictably to positive and negative incentives.

Content Standard 15: Economic Growth. Investment in factories, machinery, new technology, and in the health, education, and training of people stimulates economic growth and can raise future standards of living.

Content Standard 16: Role of Government and Market Failure. There is an economic role for government in a market economy whenever the benefits of a government policy outweigh its costs. Governments often provide for national defense, address environmental concerns, define and protect property rights, and attempt to make markets more competitive. Most government policies also have direct or indirect effects on people's incomes.

Content Standard 20: Fiscal and Monetary Policy. Federal government budgetary policy and the Federal Reserve System's monetary policy influence the overall levels of employment, output, and prices.

1. National Governors Association Center for Best Practices, Council of Chief State School Officers. *Common Core State Standards*. Washington, DC. Copyright 2010.
2. National Council for the Social Studies (NCSS). *The College, Career, and Civic Life (C3) Framework for Social Studies State Standards: Guidance for Enhancing the Rigor of K-12 Civics, Economics, Geography, and History*. Silver Spring, MD. Copyright 2013.
3. Council for Economic Education. *Voluntary National Content Standards in Economics*. New York, NY. Copyright 2010.

LIST OF LESSON RESOURCES

The following resources are used in this lesson and can be downloaded online:

1. Two Political Cartoons
2. Criteria for Evaluating Taxes
3. Perspectives and Evidence on the Gasoline Tax
4. Perspectives and Evidence on the Capital Gains Tax
5. Graphic Organizer: Criteria, Questions, and Evidence

DAY **1** of 2

ENTRY

Ask students to discuss what they already know about taxation using **Resource 1**, Two Political Cartoons, as a trigger to discussing arguments favoring taxation and arguments against too much taxation. Begin by dividing the class in half and distributing Resource 1 to students. One half should receive Cartoon A and the other half Cartoon B. Instruct students to analyze the cartoons. Students who receive Cartoon A should use it to trigger the discussion "Why does society need taxes?" Students who receive Cartoon B should use it to trigger the discussion "Can taxes be harmful to the individual or to the economy?" Tell students to consider what they think the cartoonist is trying to say and how that message fits with what they already know about taxation.

See Resource 1 online

Students should share their cartoons, interpretations, and responses to the trigger questions with one another. The objective is not to debate these questions, but rather to clarify what they know and think. Students should try to challenge, question, and cross-check one another to come to the best possible responses to the two framing questions as a group.

Invite groups to share responses to each of the two questions, encouraging students to cite specific examples and evidence where possible. Record responses on the board or chart paper using a two-column chart, with one column titled "Benefits of Taxation" and the other titled "Costs of Taxation."

- Why does society need taxes? (Cartoon A)

  [Student responses will vary, but may include the need to fund essential public goods and services, the desire to balance the budget and avoid deficits and debt, and, based on the cartoon, some desire for equity or fairness by closing loopholes for the wealthy rather than cutting social programs for people who need them.]

- Can taxes be harmful to the individual or to the economy? (Cartoon B)

  [Student responses will vary. In the cartoon, a Cinderella-like character is getting three wishes taxed. Students might infer that the cartoonist believes this is ridiculous and that "money" is simply being taken from her. Presumably, she will be able to keep only one of the three. If she wished for a fancy horse-drawn carriage, a beautiful dress, and a prince, she would only get one of the three. Emphasize that, with taxation, some costs are direct—the carriage, for example—whereas others are indirect; for example, without a carriage and dress, "Cinderella" won't get her prince. She'll indirectly lose "productivity." She loses the prince and (you might offer this leap), the economy loses whatever she and the prince might have created together—a new kingdom?]

LESSON STRATEGIES AND ACTIVITIES

Establishing Criteria

Inform students that they will now need to make decisions as voters on the design of the tax system. They will likely wish to support changes to the tax code that maximize benefits and revenue and minimize costs. To create a framework for making such judgments, students will engage in a simulation based on an idealized scenario in which they will select and prioritize criteria for evaluating the benefits and costs of any given tax. They will then "test-drive" and adjust their criteria based on two concrete examples.

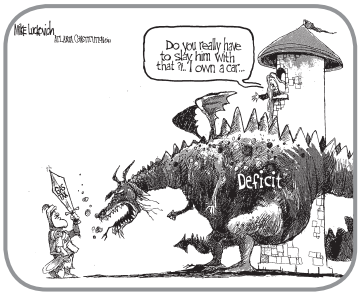
Distribute **Resource 2**, which describes the idealized scenario and offers suggested criteria from which students may select. Students should read the scenario, add any criteria of their own to the suggestions, and rank what they consider to be the top five most important criteria. Students should then reassemble in groups of four and compare responses, coming to consensus on the three most important criteria. Each group must also provide justification for the criteria it selects.

Once the groups have finalized their criteria, transition to the next activity by leading a discussion on which criteria relate to "fairness," which relate to "efficiency," and how students define those terms.

[Student responses and definitions will vary. Encourage diversity of opinions in that there are a multitude of definitions of fairness and differences of opinion on how to best achieve efficiency, which in this context means achieving the highest revenue at minimum cost. Fairness may mean that everyone is treated the same, or pays the same tax, or that those who use services the most pay the most. It could also mean that those who are most able pay the most, because they can afford to or to redistribute wealth. Efficiency might mean that taxes create the right incentives by, for example, putting higher taxes on undesirable things like smoking and lower taxes on desirable things like working. Students should also be encouraged to think about the extent to which these two goals—fairness and efficiency—are compatible, or if they are contradictory/mutually exclusive.]

Examining Evidence and Applying Criteria: Two Case Studies

The groups of four should now split into pairs. To prevent bias for or against each tax carried over from the cartoon activity, each pair should include one student who had Cartoon A and one student who had Cartoon B. Within each group, one pair will receive **Resource 3** and examine perspectives and evidence on the user tax on gasoline, and one pair will receive **Resource 4** and examine the capital gains tax.



See Resource 3 online

For the remainder of the period and for homework, students should individually read through all of the cartoons, text excerpts, quotations, tables, and graphs contained within the resources. As they read, they should highlight or note whenever there is evidence related to one of their top three criteria selected in the previous activity, and whether that evidence gives information on the fairness of the tax, the efficiency of the tax, or both.

DAY **2** of 2

Sharing Findings

Invite the members of each pair to take 10 minutes to share their findings with one another. Have pairs come to a consensus on what the tax is, and identify evidence they found related to the fairness and efficiency criteria. They should also prepare a quick, 2- to 3-minute summary describing and explaining the tax to the other partnership in their group, providing their initial assessment of whether the tax successfully meets the group's goals of an ideal tax along with justification for their assessment. After these preparations, the pairs should make brief presentations to each other. The group should then compare and synthesize what it has learned and concluded about the two taxes, using the following scaffolding questions to guide their discussion and ensure comprehension of the resources:

- What is the gas tax?

  [Students will note that the gas tax is a tax on gasoline paid by users (drivers) at the pump, the point of sale. Currently the federal gas tax is 18.4 cents a gallon, a figure that hasn't changed since 1993. When state taxes are added in, Americans pay an average of 43 cents per gallon in taxes.]

- What is the justification for the gas tax?

  [Students should understand that the gas tax supports the Highway Trust Fund. It accounts for 90% of the fund, and lately the Treasury Department has had to add an estimated $72 billion to cover expenses and deal with a backlog of repairs on bridges and roads. The tax also encourages consumers to buy fuel-efficient cars, which are better for the environment.]

- Why are some people opposed to the gas tax?

  [Opponents to the gas tax view it as money taken from the driver's pocket and not necessarily used in efficient ways. In particular, opponents might argue that it is particularly inappropriate during a recessionary period when consumers have less money to spend.]

- How does the gas tax in the United States compare to gas taxes in other countries?

  [Students will notice that the gas tax is about 50% less in the United States than it is in at least seven European countries.]

- What are capital gains?

  [Capital gains is money that is earned on investments and is often referred to as making money on money. These investments not only earn money for the investor, but also provide capital for projects and businesses, some of which are drivers of economic growth.]

- What does it mean that the tax system is progressive? What is the justification for that?

  [The tax system is progressive because people who earn more money are taxed at a higher rate than those who earn less. The formulation is based on money earned over a series of income brackets, and the

justification is two-fold. A progressive income tax takes more money from those who are most able to afford it, and it has a moderating effect on income disparity.]

- Why is the capital gains tax an exception to how progressive the tax system is? What is the reason for the exception?

  [Capital gains are taxed at a lower rate than regular income. Those in favor of this lower rate say that it is good for the economy because it enables the investment of capital in productive projects. An investor can pull money out of a company that is not successful and put it into one that is successful without the deterrence of a higher tax rate. They also argue that this money is already taxed because the income corporations earn is taxed. Those opposed to this lower tax rate argue that experience has shown that a higher rate of taxation on capital gains (as high as 30% between 1986 and 1997) does not discourage investment. They also argue that it deprives the country of needed revenue and contributes to income inequality because very wealthy people earn a large percentage of their money in this way. In addition, corporations have access to so many tax loopholes that, in practice, do not offset low capital gains tax.]

Revising Criteria, Asking Questions, and Seeking Evidence

Distribute **Resource 5**, which asks students to reassess their initial criteria. Groups should consider whether the priorities selected on day 1 have changed, and discuss why. Then, they should fill in the criteria, whether or not they have been revised. For each criterion and each tax, students should consider what questions they have and what additional economic evidence they would seek for better assessment. Inform students that this will serve as their final recommendation to Congress.

CLOSURE

Inform students that the current gas tax is 18.4 cents a gallon, and the current maximum capital gains tax is 15%. Without discussion, ask students to write on a piece of paper what their "gut feeling" on these taxes is—should they be raised, lowered, or kept about the same? In order to preserve the independence of their judgments, ask students to hide their answers, perhaps by folding their paper. Poll student responses and then ask for volunteers to defend their answers. Ask students who have not responded what more they would want to know to fully support their opinions. For homework, students should draft a letter to the Congressional Ways and Means committee summarizing their recommendations for how to further study these two important taxes. Tell students to account for the best of their classmates' reasoning in making their recommendations.

FURTHER ENGAGEMENT

Explore other types of taxation (carbon taxes, consumption vs. income tax, flat tax proposals, etc.). This can include critically evaluating tax reform proposals by 2016 presidential candidates.

Depending on where this lesson fits into an economics curriculum, there are several extension and application opportunities that more explicitly connect this material with microeconomic and macroeconomic theory. Examples include:

- If this lesson is used as part of a unit on the price elasticity of supply and demand, students can be encouraged to seek evidence on how production and consumption of gasoline vary by state and how they have changed over time as states have raised and lowered their gas taxes. This can help illustrate how elasticity determines the incidence of a tax.
- Students can be encouraged to draw graphs predicting what would happen if an excise tax, such as the gasoline tax, were raised or lowered, labeling supply curve, demand curve, producer surplus, consumer surplus, tax revenue, and deadweight loss.
- Students with some background in macroeconomics can be encouraged to think about taxation as a tool of fiscal policy. In particular, they should compare the effects of cutting taxes to those of increasing government spending, consider the tax and spending multipliers, and use this analysis to further explore the effects of capital gains taxes on investments and long-run growth.

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Resource 1 (1 of 2)

Two Political Cartoons

Cartoon A

by Khalil Bendib, otherwords.org

Resource 1 (2 of 2)

Two Political Cartoons

Cartoon B

"After federal, state, and local taxes, you get one-third of a wish."

by Randy Glasbergen, www.glasbergen.com

Resource 2

Criteria for Evaluating Taxes

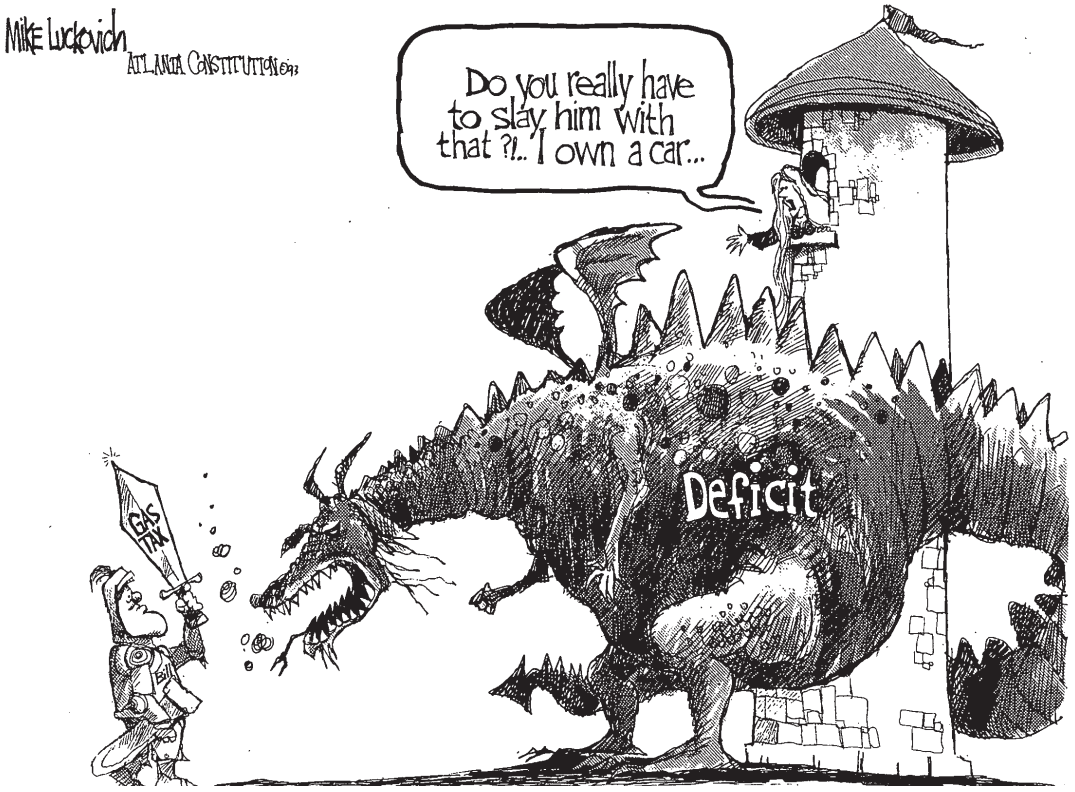
Congratulations! The U.S. Congress has decided to replace the tax code and start from scratch. The voters have already agreed that $3 trillion in revenue is needed to fund the services they desire. You have been hired as economic consultants to craft guiding principles to design the new tax system. You do not need to design the precise taxes and rates, but rather create priorities and objectives for the overall system. These will become the criteria by which the final proposals will be judged.

Based on significant prior research, Congress has already included a number of possible criteria for you to consider. It would also like your suggestions for additional criteria. Your job is to read over the following suggested list, add any criteria of your own, and rank them according to your own priorities. Share your top five choices with your colleagues and come to consensus on the *three most important* goals for a tax system, which will become the criteria by which a tax system will be judged.

Rank (#)	Criterion
	People are able to keep what they earn. They have a right to make choices as to what is best for them and their family, and no obligation to provide for other people. People know best what they want, and resources are allocated most efficiently when people have maximum freedom.
	Taxes should be simple, clear, and consistent; people shouldn't need to think too much about them or devote much time to figuring out how much they owe (or how they might avoid paying).
	People should pay taxes in proportion with their wealth. People who have more can more easily make sacrifices, and should pay more to support those in need.
	Taxes should be based on strict equity—just like anything else, everybody pays the same.
	Taxes should create the right incentives; they should encourage economically productive and socially desirable activities, like working, saving, and investing, and discourage undesirable behaviors like polluting the environment.
	Taxes should generate enough revenue to provide a "social safety net," including Social Security and Medicare, for everyone.

Resource 3 (1 of 5)

Perspectives and Evidence on the Gasoline Tax



by permission of Mike Luckovich and Creators Syndicate, Inc.

Look carefully at the words and images in the cartoon and think about what it is saying about the gas tax, specifically, and how taxes influence behavior, more generally. The "deficit" label on the dragon refers to the amount government spending exceeds revenues in any given year, which can be reduced by increasing taxes or lowering spending. Which of these interpretations of the cartoon comes closest to your own? Discuss what you find with a partner. If you do not agree on the best interpretation, try to convince one another of your position until you come to agreement.

Interpretation 1: The car can be used to defeat the dragon; this means the government can invest in transportation spending to help the economy grow. This will reduce the deficit.

Interpretation 2: The gas tax will not be enough to fight the deficit, because the dragon is so large. It might be easier to just escape the problem of a deficit with the car.

Interpretation 3: The government wishes to raise sufficient revenue with taxes to combat the deficit, but many taxes, including the gas tax represented by the sword in the cartoon, are politically unpopular. Voters essentially want government spending and do not want deficits, but believe that other people and other things should be taxed, besides the things they do.

Resource 3 (2 of 5)

Perspectives and Evidence on the Gasoline Tax

The Costs of Taxation

In economics, a *cost* is what you have to give up to get something. In general, then, a cost is something that is undesirable and that we seek to minimize.

Direct Cost

The direct cost of taxation is the loss of income by the taxpayer.

- Why is this a cost?
- Why would someone seek to avoid it?

Indirect Cost

The indirect cost is not observed. Instead, it is hypothetical—an estimation of what would have been if not for the tax. Taxes have two indirect costs:

- The government does not necessarily choose to spend things on what people want, or in a way that gives them as much satisfaction (in economics terms, *utility*) as if they got to spend the money exactly as they pleased.
- Taxes can reduce *incentives* to do positive things and increase incentives to do negative things. In economics, an incentive is something that makes us want to do something.

- Can you think of an example of a way that a tax might reduce the incentive to do something good?
- Can you think of an example of a way that a tax might produce an incentive to do something bad?

So, how do we minimize the costs?

The government tries to offset the direct cost by providing benefits, in the form of spending on public goods and services that provide people with utility.

- Can you think of an example of a benefit like this?

One way to reduce the indirect costs is by lowering taxes on things we wish people to do more and raising taxes on things we wish people to do less. An example of the first is that the government attempts to encourage giving to charity by reducing taxes for those who give a lot. An example of the latter is taxes on cigarettes, which the government uses to discourage smoking.

- Can you think of other examples?

Resource 3 (3 of 5)

Perspectives and Evidence on the Gasoline Tax

Average Retail Gasoline Prices, Including Taxes, in Selected Countries on for April–June 2015 (in $US/gallon)

$6.35	Belgium
$5.96	France
$7.08	Italy
$7.18	Netherlands
$7.71	Norway
$6.21	Sweden
$6.91	United Kingdom
$2.74	United States

Source: Randall, T. (2015, September 10). The real cost of filling up: Gasoline prices by country. Bloomberg. Retrieved from http://www.bloomberg.com/graphics/gas-prices/

Questions:

- What do you notice? Is there any obvious trend, or any obvious outlier?

- Based on television, movies, and news reports, have you noticed anything about cars or transportation in Europe in general that is different from in the United States?

- Do you think that difference may have any connection with the information in this table?

- Be cautious of making an inference of causality when you see a correlation, or two things happening at the same time; it may be that something else that you have not observed is actually causing both things. Do you have any alternate theories as to what might be causing what is happening in this table and what you observed in bullet number 2?

Resource 3 (4 of 5)

Perspectives and Evidence on the Gasoline Tax

Three Perspectives on the Gas Tax

Perspective 1

The federal taxes on fuel in the United States currently stand at 18.4 cents per gallon of gas and 24.4 cents per gallon of diesel. The average combined state and federal taxes across the country is 27.2 cents per gallon of gasoline. With gas prices above $3 per gallon in almost all areas of the country congress should immediately move to eliminate all federal gas taxes and eliminate federal funding for road projects.

Gas taxes were intended as a "user fee" in this country to fund the Federal Highway Trust Fund. The idea behind this tax is the more you drive the more you pay in taxes that fund road projects. Although the concept seems like a good idea in theory, in reality the funds are being wasted and raided for other projects. Just as the Social Security Trust fund is simply an old shoe box full of IOU's at this point, the Highway Trust Fund is also broke. In 2008 the fund required an $8 billion infusion of money from the government's General Fund. . . .

Like most "user fees," federal gas tax revenue depends on a variety of factors including how much we drive, how much fuel our cars burn, and the overall economy. The current recession has led to a sharp decrease in the number of miles driven, gasoline sold, and taxes collected compared to five or ten years ago. Although many road projects are planned years in advance the government has no solid method of predicted trust fund revenues in the future.

As much as we like to believe that cars and trucks are evil pollution generating devices, the fact is our economy requires driving in order to function. I don't care how "green" of a life you live, I guarantee those green products you are using were shipped by road and fuel-consuming trucks.

Source: DF. (2012, February 4). Eliminate federal gas taxes [Web log comment]. Retrieved from http://www.redstate.com/whatevrworks/2011/02/04/eliminate-federal-gas-taxes/

Perspective 2

. . . The demonization of smokers has been so successful that fewer and fewer people smoke. You'd think that was a good thing, but now fewer and fewer people are paying cigarette taxes, leading to less revenue in government coffers. Likewise, those nasty buyers of hybrid vehicles, with their care for the environment and desire for high fuel efficiency, are forcing lawmakers to consider taxing by the mile to offset the reduction in gasoline taxes. Faced with the success of their policies, now they want to go after alcohol, or I should say, further after alcohol, because it is typically already given its own excise and "sin" taxes.

But is this the right thing to do? Is it legitimate, in the spirit of America's founding, for the majority to decide that certain activities are "bad" or "good," and thus should be taxed at higher or different rates than others? Is it legitimate, in a country where we supposedly have "equal protection under the law," that some people and activities are just more "equal" than others?

Source: Warbiany, B. (2005, September 23). Taxes as behavior modification [Web log comment]. Retrieved from http://www.fairtaxblog.com/20050923/taxes-as-behavior-modification/

Resource 3 (5 of 5)

Perspectives and Evidence on the Gasoline Tax

Perspective 3

Harvard economist N. Gregory Mankiw argues in favor of targeted taxes, such as sin taxes on things like cigarettes and user taxes on things like gasoline. These taxes impose the costs of a behavior—increased healthcare costs in the case of smoking and increased road maintenance costs in the case of driving and using gasoline—directly on those doing the behavior. This lowers the concern about taxes distorting incentives, because the incentive created is to reduce the behavior that would otherwise create a cost for society. Furthermore, the revenue generated by the tax can be used to reduce other taxes, which do create disincentives for desirable behavior like working, saving, and investing. In Mankiw's words:

> There is, however, a simple way to remedy the market failure and restore the optimality properties from the fundamental welfare theorem: Individuals can be charged for the external costs they impose on others (and subsidized for the external benefits they give to others). The solution goes back to Arthur Pigou, the British economist from the early 20th century, who was sometimes friend and sometime nemesis to his more famous colleague John Maynard Keynes. In his honor, these corrective measures are called Pigovian taxes.
>
> For at least two reasons, Pigovian taxes are popular among economists. First, they are often the least invasive way to remedy a market failure. They can restore an efficient allocation of resources without requiring a heavy-handed government intervention into the specific decisions made by households and firms. Second, they raise revenue that the government can use to reduce other taxes, such as income taxes, which distort incentives and cause deadweight losses.

Source: Mankiw, N. G. (2009). Smart taxes: An open invitation to join the Pigou club. *Eastern Economic Journal, 35*, 14–23. Retrieved from http://scholar.harvard.edu/files/mankiw/files/smart_taxes.pdf

Resource 4 (1 of 3)

Perspectives and Evidence on the Capital Gains Tax

Fill in this table with the percentage of income *you* believe people should pay in federal taxes, based on how much total income they have. As a frame of reference, taken together and averaged, in 2014, the total share of income Americans paid in federal income taxes was 9.2%;[1] in contrast, in 2005 the total share was 20.5%.[2]

Income Quintile	What Percentage of Income Should They Pay?
Lowest 20% of Incomes	
Lower Middle: 20th–40th Percentiles	
Middle: 40th–60th Percentiles	
Upper Middle: 60th–80th Percentiles	
Top 20% of Incomes: 80th–100th Percentiles	

- Explain your decisions.

Resource 4 (2 of 3)

Perspectives and Evidence on the Capital Gains Tax

Now, look at the actual distribution of percentage of income paid in federal taxes, by income bracket, as of 2005[2]:

Income Level	Total Effective Federal Tax Rate
Lowest 20%	4.3
Lower Middle: 20th–40th percentiles	9.9
Middle: 40th–60th percentiles	14.2
Upper Middle: 60th–80th percentiles	17.4
Percentiles 81–90	20.3
Percentiles 91–95	22.4
Percentiles 96–99	25.7
Percentiles 99.1–99.5	29.7
Percentiles 99.51–99.9	31.2
Percentiles 99.91–99.99	32.1
Top 0.01%	31.5

For the most part, as people earn more income, they tend to owe more of their income in federal taxes. This is because the tax system is *progressive*, meaning that the wealthy are required to pay a larger share of their income in taxes.

- Do you think this is fair? Why or why not?

- Do you see an exception to this pattern?

Sources:

1. Saunders, L. (2015, April 10). Top 24% of earners pay 84% of income tax. *Wall Street Journal*. Retrieved from http://www.wsj.com/articles/top-20-of-earners-pay-84-of-income-tax-1428674384
2. Congressional Budget Office. (2008, December 23). Historical effective tax rates, 1979 to 2005: Supplement with additional data on sources of income and high-income households. Retrieved from http://www.cbo.gov/publication/20374

Resource 4 (3 of 3)

Perspectives and Evidence on the Capital Gains Tax

Two Perspectives on the Capital Gains Tax

Perspective 1

> Last year my federal tax bill—the income tax I paid, as well as payroll taxes paid by me and on my behalf—was $6,938,744. That sounds like a lot of money. But what I paid was only 17.4 percent of my taxable income—and that's actually a lower percentage than was paid by any of the other 20 people in our office. Their tax burdens ranged from 33 percent to 41 percent and averaged 36 percent.
>
> If you make money with money, as some of my super-rich friends do, your percentage may be a bit lower than mine. But if you earn money from a job, your percentage will surely exceed mine—most likely by a lot. . . .
>
> Back in the 1980s and 1990s, tax rates for the rich were far higher, and my percentage rate was in the middle of the pack. According to a theory I sometimes hear, I should have thrown a fit and refused to invest because of the elevated tax rates on capital gains and dividends.
>
> I didn't refuse, nor did others. I have worked with investors for 60 years and I have yet to see anyone—not even when capital gains rates were 39.9 percent in 1976–77—shy away from a sensible investment because of the tax rate on the potential gain. . . .
>
> **Source:** Buffet, W. (2011, August 14). Stop coddling the super-rich. *New York Times*. Retrieved from http://www.nytimes.com/2011/08/15/opinion/stop-coddling-the-super-rich.html?_r=1

Perspective 2

> Experts agree that capital gains tax cuts produce an especially large bang for the buck. They're a great way to boost the economy. That's because high capital gains [tax] rates cause what is called a "locked-in" effect. Investors hold off on selling assets to avoid the tax. But if capital gains taxes are cut, those same people sell—and invest. "Locked-in" wealth is released. Growth soars, along with a surge in tax receipts.

[In other words, Forbes and Ames believe investors will keep their money tied up in old investments if they know that selling them will result in high taxes on any profits they make. Without re-investment the economy won't grow. They also argue that lower taxes on capital gains will actually produce more money in taxes because when investors are freed up to sell, the lower rates will be offset by greater volume.]

Source: Forbes, S., & Ames, E. (2009). *How capitalism will save us*. New York: Crown, p. 170.

Resource 5

Graphic Organizer: Criteria, Questions, and Evidence

Capital Gains Tax	Evidence			
	Questions			
Gas Tax	Evidence			
	Questions			
Criteria				