WebMemo
Published by The Heritage Foundation
No. 1973
June 26, 2008

European Levels of Taxation: Barack Obama's Tax Plan

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Note: Representatives of the Obama campaign have informed the authors that the campaign is not committed to the full 12.4 hike in the payroll tax. An increase in the payroll tax is merely one of many different tax increases that are being considered for those making over $250,000. The Obama campaign implies that the tax increase on those earning over $250,000 may not be limited to earnings but also cover different types of income. Despite questioning, the campaign has not provided any more details.

Presidential hopeful Senator Barack Obama (D–Ill.) has unveiled his economic plan of raising taxes on the successful. His plan would boost the top marginal rate to well over 55 percent—before the inclusion of state and local taxes—resulting in many individuals seeing their marginal tax rate double. The consequences of this policy would be a return to the bad old days of tax avoidance, with taxpayers disguising personal income as business income or capital gains and the migration of capital from the United States to abroad.

Among the more prominent elements of his tax proposal, Senator Obama would end the Bush tax cuts and allow the top two tax rates to return to 36 and 39.6 percent. He also would allow personal exemptions and deductions to be phased out for those with income over **$250,000**. The real kicker, though, is that Senator Obama would end the Social Security payroll tax cap for those over $250,000 in earnings. (The cap is currently set at **$102,000**.) These individuals will then face a tax rate of 15.65 percent from payroll taxes and the top income tax rate of 39.6 percent for a combined top rate of over 56 percent on each additional dollar earned.

High-income individuals will be forced to pay even more if they live in cities or states with high taxes such as New York City, California, or Maryland. These unlucky people would pay over two-thirds of each new dollar in earnings to the federal government.

How the Obama Tax Plan Compares to Other Countries. Senator Obama's new tax rate would give the United States one of the highest tax rates among developed countries. Currently only six of the top 30 industrial nations have a tax rate for all levels of government combined of over 55 percent. Under this tax plan, the United States would join this group and have a higher top rate than such high-tax nations as Sweden and Denmark. The top marginal rate would exceed 60 percent with the inclusion of state and local taxes, which means that only Hungary would exceed Senator Obama's new proposed top tax rate.

The costs in economic terms of such high taxes are real. For example, of the six countries with higher tax rates than 55 percent, the average unemployment rate is 7.35 percent (see Chart 1). This figure includes Denmark, which appears to have a very low unemployment rate of 3.9 percent. However, Denmark spends over 5 percent of its GDP on

This paper, in its entirety, can be found at:
www.heritage.org/Research/Taxes/wm1973.cfm

Produced by the Center for Data Analysis

Published by The Heritage Foundation
214 Massachusetts Avenue, NE
Washington, DC 20002–4999
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unemployment programs and benefits, thereby increasing its unemployment rate.[1]

A Return to the Bad Old Days. Historically, Senator Obama's tax rate would be the highest individual tax rate since the Jimmy Carter days. Tax shelters and tax avoidance strategies were common when the top marginal rate was 70 percent or higher. This new top tax rate will again encourage these gimmicks, reducing investment and economic growth as resources are squandered in an attempt to avoid punitive taxation.

Many individuals will attempt to transfer their compensation from wages to capital gains, since capital gains would only be taxed at 25 percent, or less than half of the top rate on wages. This would put a great deal of pressure on a company to do anything it could to make its stock quickly increase in value. Other individuals would try to incorporate so they could pay business taxes instead of having to pay taxes on their wages. Again, these resources would be diverted away from more productive uses and slow the economy.

High tax rates also encourage capital and income flight to lower-taxed areas. There is ample evidence in the United States of individuals and businesses moving to states such as Florida or Delaware to take advantage of their tax-friendly laws. A higher federal tax rate would encourage individuals to move assets abroad to take advantage of lower tax rates in countries such as Canada, France, and Great Britain.

These high tax rates could also have a large impact on the labor force. Many workers could choose to reduce their hours or simply retire in the face of such high taxation. Economists usually argue a great deal about what effect minor changes in the tax code will have on incentives to work. However, the Obama plan calls for a tax increase so large that economists will be focusing on the harm to the overall economy rather than just the isolated effects on labor and on capital.

Obama Tax Proposal Threatens U.S. Jobs

Presidential candidate Barack Obama's tax proposal would increase the U.S. top marginal income tax rate from 42.7% to 56%. Most other nations with high top rates also have high unemployment.

Nation	Top Marginal Personal Income Tax Rate	Unemployment Rate in 2006
Hungary	73.3%	7.5%
Denmark	63.0	3.9
Belgium	60.7	8.2
Germany	57.3	9.8
Sweden	56.6	7.0
U.S. Under Obama Plan	56.0	–
Finland	55.7	7.7
United States	42.7	4.6

Source: Organization for Economic Co-operation and Development, OECD Tax Database, at *http://www.oecd.org/document/60/0,3343,en_2649_201185_1942460_1_1_1_1,00.html#table_I4* (June 23, 2008), and Organization for Economic Co-operation and Development, OECD Standardized Unemployment Rates (SURs) - Updated: May 2008, at *http://www.oecd.org/document/3/0,3343,en_2649_201185_40591875_1_1_1_1,00.html* (June 23, 2008).

Chart 1 • WM 1973 heritage.org

A Finite Source of Revenue. Perhaps a larger worry than the damage to the economy is thelong-run budget problem of the United States. While Senator Obama raises taxes a great deal on upper income individuals, the overall tax plan increases the national deficit. As a result, the country will be even less prepared to pay for current and future Social Security and Medicare obligations. When money is needed to pay for those programs, it will be hard to tax the rich even more, given that the top rate will already be so high. Instead, in order to pay the government's spending and entitlement shortfalls, taxes would fall most heavily on middle-income Americans. After all, even successful taxpayers are not an infinite source of revenue.

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1. Denmark.dk, The Official Website of Denmark, "Flexicurity Model Turning Heads, Denmark's 'flexicurity' employment model has been bantered about the EU and is now riding the wave over to the US" (February 14, 2007), at *http://www.denmark.dk/en/servicemenu/News/FocusOn/Archives2007/FlexicurityModelTurningHeads.htm* (June 24, 2008).

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