Taxpayers and Tax Spenders

Does a Zero Tax Price Matter?

JODY W. LIPFORD AND BRUCE YANDLE

In January 2011, the U.S. Congressional Budget Office (CBO) issued its latest analysis of the U.S. budget and outlook. The report described a ballooning federal deficit that was the largest since World War II as a share of gross domestic product (GDP) in 2009 and 2010. The CBO summarized the situation as follows:

> For the federal government, the sharply lower revenues and elevated spending deriving from the financial turmoil and severe drop in economic activity—combined with the costs of various policies implemented in response to those conditions and an imbalance between revenues and spending that predated the recession—have caused budget deficits to surge in the past two years. The deficits of $1.4 trillion in 2009 and $1.3 trillion in 2010 are, when measured as a share of gross domestic product (GDP), the largest since 1945—representing 10.0 percent and 8.9 percent of the nation's output, respectively. (2011, 1)

As figure 1 shows, the looming deficit has a long pedigree that, notwithstanding the anomalous years 1998–2001, emerged systematically around 1970. The deficit problem clearly did not start with the Great Recession of 2007–2009.

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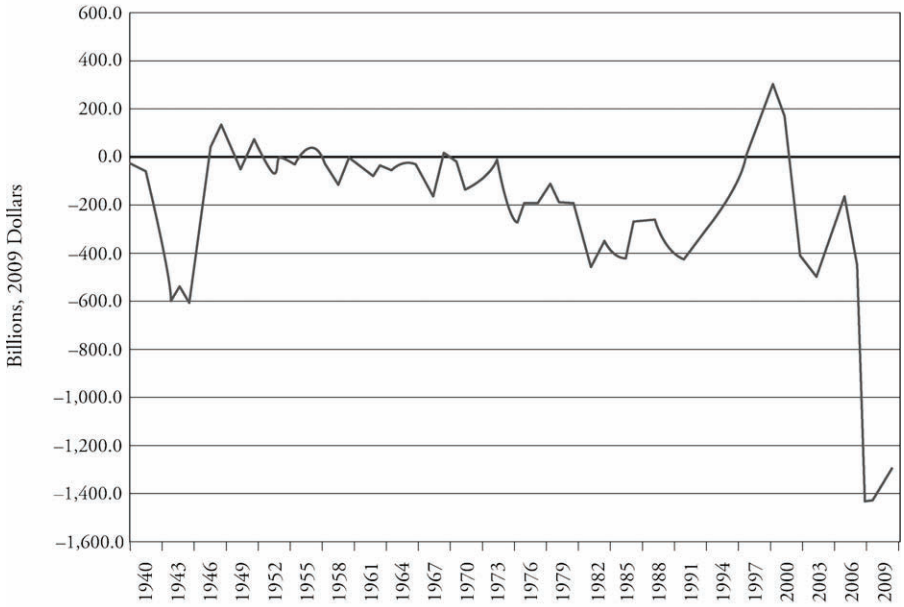
Figure 1
U.S. Federal Deficit, 1940–2010



Source: Data compiled from reports by the U.S. Office of Management and Budget, Congressional Budget Office, available at http://www.cbo.gov.

Shiploads of ink have been spilled on the U.S. deficit problem and its possible solutions, and we will not attempt to summarize this literature or enter the important debate about remedies (see Yandle 2010). Our purpose here is, instead, to examine a relationship between the share of citizens who pay taxes *(taxpayers)* and those who receive federally funded benefits *(tax spenders),* which we believe may explain part of the U.S. deficit explosion that has occurred in recent years. The relationship examined empirically is a simple one: When the tax price of federal benefits is zero, do people demand more of them, even if they are funded by deficits?

Of course, operating a deficit-financed public economy is not unique to the United States. As indicated in Carmen Reinhart and Kenneth Rogoff's (2009) excellent survey of experiences with government debt, deficits, and default over several centuries, high levels of debt and default have been common. These authors count twenty-six countries in Europe and Latin America that experienced default in the twentieth century up to 2008, with some countries defaulting multiple times (96). They also provide data on financial and banking crises for more than sixty-six countries for the years 1800–2008 (348–92). We focus here on the U.S. deficit experience, making no claim with regard to how our findings may apply to other countries.

In the first section, we discuss political and economic thought with regard to fiscal constraints and the relationship between those who pay taxes and those who

receive the benefits of taxation. Our discussion begins with John C. Calhoun and James Madison and extends through Milton Friedman's recommendation for a negative income tax. The relative strength of fiscal constraints is central to this discussion. Viewing the issue from a different perspective in the second section, we consider how to ration activity on the fiscal commons, the theme of an important strand of economic literature. This discussion focuses on literature that has examined the fiscal commons and the deficit commons that results. In both cases, an incentive exists either to get as much as one can or to avoid as much cost as possible. We then document what has happened on the fiscal commons as the share of citizens who pay no taxes has increased, deriving a series of refutable hypotheses. And in the third section, we look at trends and use regression analysis to test our hypotheses.

Taxpayers and Tax Spenders on the Commons

Among U.S. policy analysts, focused concern about the uneasy political relationship between those who pay taxes and those who receive benefits funded with tax revenues goes back at least to the early nineteenth century, when politicians and political theorists engaged in major debates about how to constrain the new government's spending. Writing in 1810 in *A Disquisition on Government,* American politician and political theorist John C. Calhoun warned of a problem that can develop when a community becomes divided into those who pay taxes and those who spend taxes. When one citizen group or region gains at the expense of another group, he reasoned,

> it must necessarily follow, that some one portion of the community must pay in taxes more than it receives back in disbursements; while another receives in disbursements more than it pays in taxes. . . . The necessary result, then, of the unequal fiscal action of the government is, to divide the community into two great classes; one consisting of those who, in reality, pay the taxes, and, of course, bear exclusively the burthen of supporting the government; and the other, of those who are the recipients of their proceeds, through disbursements, and who are, in fact, supported by the government; or, in fewer words, to divide it into tax-payers and tax-consumers. ([1810] 1992)

Calhoun's deeper concern was how to construct a constitution that would constrain political behavior and preclude the oppression of the minority who pay taxes by a majority consisting of those who receive benefits. In this context, he wrote:

> There is no difficulty in forming government. It is not even a matter of choice, whether there shall be one or not. Like breathing, it is not permitted to depend on our volition. Necessity will force it on all communities in some one form or another. Very different is the case as to [a] constitution. Instead

> of a matter of necessity, it is one of the most difficult tasks imposed on man to form a constitution worthy of the name; while, to form a *perfect* one—one that would completely counteract the tendency of government to oppression and abuse, and hold it strictly to the great ends for which it is ordained—has thus far exceeded human wisdom, and possibly ever will. ([1810] 1992)

Calhoun famously developed a theory of concurrent majorities, a constitutional order in which, for federal action to be accepted, a majority of the federated units must ratify the central government's action—a feature of the earlier Articles of Confederation.

Calhoun's older contemporary and Founding Father James Madison had similar worries as he struggled over the rights of suffrage. On the one hand, restricting the right to vote to those who own property risks oppression of the "rights of persons" and "violates the vital principle of free Govt. that those who are to be bound by laws, ought to have a voice in making them." On the other hand, granting the vote to those who do not own property risks oppression of a propertied minority by an unpropertied majority. Madison writes: "And whenever the Majority shall be without landed or other equivalent property and without the means or hope of acquiring it, what is to secure the rights of property agst. the danger from an equality & universality of suffrage, vesting compleat power over property in hands without a share in it: not to speak of a danger in the mean time from a dependence of an increasing number on the wealth of a few?" ([1821] 1987]). Madison thought through and proposed various voting strategies to try to balance these conflicting ideals, such as dividing the rights of suffrage between branches of government and differentiating the size of electoral districts and the length of legislators' terms.

When Calhoun and Madison were writing, the U.S. Constitution still contained Article 1, section 9, clause 4, the so-called Apportionment Clause, which required that "No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken." Though altered later, the Constitution of Calhoun's day required that the burden of total federal taxes collected from a particular state be proportional to that state's share of the nation's population. At the time, there were no income taxes. In 1913, however, ratification of the Sixteenth Amendment provided that "[t]he Congress shall have power to lay and collect taxes on income, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration." While granting the power to tax income, the Sixteenth Amendment eliminated the apportionment constraint and amplified the likelihood that a large number of citizens would become free riders in a grand redistribution game, which was one of Calhoun's basic concerns.

The Americans of Madison and Calhoun's era and those of today are obviously two very different nations and cultures. With a fast-forward focus on the country's political economy, we highlight the dramatic growth in the central government's redistribution of wealth that occurred during and after the Great Depression (1929–42) and then in conjunction with the Great Society programs that emerged in the

1960s. Spurred by the buildup of New Deal and Great Society programs, the share of the federal budget devoted to income security, labor services, health, and Social Security rose from 23.4 percent in 1962 to 61.4 percent in 2010.[1]

Seeking to add an element of recipient accountability to the great amount of welfare expenditures, Milton Friedman (1962) put forward his idea for a negative income tax. He argued that making transfers in cash rather than in kind would be more efficient. Funds the recipient might use to buy food would replace funds to subsidize food stamps. With a low-income threshold for triggering receipt of a check from the federal government, income-targeted individuals and families would be able to make their own decisions about how spending the money would satisfy them best. Friedman was well aware of Calhoun and Madison's concern, however.[2] After describing how his negative income tax program might work, he noted:

> The major disadvantage of the proposed negative income tax is its political implications. It establishes a system under which taxes are imposed on some to pay subsidies to others. And presumably, these others have a vote. There is always the danger that instead of being an arrangement under which the great majority tax themselves willingly to help an unfortunate minority, it will be converted into one under which a majority imposes taxes for its own benefit on an unwilling minority. Because this proposal makes the process so explicit, the danger is perhaps greater than with other measures. I see no solution to this problem except to rely on the self-restraint and good will of the electorate. (1962, 194)

Today, self-restraint on part of the U.S. electorate is hardly evident. The expansion of the welfare state and tax policies that exempt low-income earners and grant a host of credits and deductions to many others have resulted in a substantial share of the U.S. population's receiving government benefits and paying virtually no federal taxes (Murray 2010).

Data on the share of taxes paid by share of income are shown in table 1 for five-year intervals since 1980. As indicated, Friedman's concerns obviously were well

1. The specific budget components are health, income security, labor and social services, Medicare, and Social Security. The shares here are calculated from U.S. Office of Management and Budget data, available at http://www.whitehouse.gov/omb/budget/fy2011/assets/hist.pdf. For more on this matter, see Lipford and Slice 2007.

2. Friedman notes earlier recognition that those on welfare might form an interest group that would lobby successfully for expanded benefits: "Writing about a corresponding problem—[the] British old-age pension—in 1914, Dicey said: 'Surely a sensible and benevolent man may well ask himself whether England as a whole will gain by enacting that the receipt of poor relief, in the shape of a pension, shall be consistent with the pensioner's retaining the right to join in the election of a Member of Parliament.' The verdict of the experience in Britain on Dicey's question must as yet be regarded as mixed. England did move to universal suffrage without the disenfranchisement of either pensioners or other recipients of state aid. And there has been an enormous expansion of taxation of some for the benefit of others, which must surely be regarded as having retarded Britain's growth, and so may not even have benefited most those who regard themselves as on the receiving end" (1962, 194).

Table 1
Share of U.S. Federal Taxes Paid by Household Income, Selected Years

	Total Federal Taxes			Individual Income Taxes			Social-Insurance Taxes		
Year	Bottom 40%	Top 10%	Top 1%	Bottom 40%	Top 10%	Top 1%	Bottom 40%	Top 10%	Top 1%
1980	9.0	40.0	14.2	4.3	47.6	17.4	16.5	19.1	1.4
1985	9.5	39.5	14.8	4.2	50.5	21.2	15.2	21.6	1.9
1990	8.7	41.7	16.2	2.9	54.3	23.8	15.1	22.2	2.2
1995	7.1	46.6	20.1	–0.1	60.8	29.0	14.5	24.8	3.5
2000	5.9	52.2	25.5	–0.5	67.7	36.5	14.4	25.6	4.3
2005	5.0	54.8	27.7	–3.8	72.7	38.8	14.6	25.9	3.9

Source: Data compiled from U.S. Congressional Budget Office reports, various years, at http://www.cbo.gov.

placed. The share of total federal taxes paid by the bottom 40 percent of households has fallen from 9 percent in 1980 to 5 percent in 2005, and the share of the tax burden borne by the top 10 and 1 percent has risen steadily. The trends for the income tax are even more sharply divergent, with the bottom 40 percent receiving sufficient refunds so that their income tax liability is now negative, whereas the top 10 and 1 percent pay more than 70 percent and just less than 40 percent of total income taxes, respectively.[3] The trend for social-insurance taxes is similar, though significantly less pronounced.

The Problem of the Fiscal Commons

The concerns expressed by Calhoun, Madison, and Friedman were later described and analyzed as a problem of the fiscal commons (Wagner 1992, 2002; Raudla 2010). In the simplest possible way, the budgetary process is seen as a pasture that produces annually a certain amount of fiscal grass that can be harvested. Specialized politician-shepherds work on the pasture, but the commons has no fences other than those erected by the politicians who "graze" for their constituencies. Each politician, like each shepherd on a traditional commons, has an incentive to get as much grass as possible, even if doing so means borrowing from the future. Any rules that the grazing politicians may devise can be revised by future politicians. To ration fiscal activity requires constitutional change, and even the Constitution can be altered. In short, as Friedman surmised, the fiscal grazing problem has no apparent final solution.

3. The negative result for the bottom 40 percent is based on data reported in quintiles. The fourth and fifth quintiles show negative income tax payments in 2005, which suggests that the negative-payment status is widespread among persons in both quintiles.

The problem is compounded when each grazing unit, while seeking to obtain as much of the fiscal bounty as possible for a home district or state, also seeks to reduce contributions to the fiscal pasture. As James Buchanan and Richard Wagner point out, Knut Wicksell, wrestling with the problem of the fiscal commons as early as 1896, "suggested that the total costs of any proposed expenditure program should be apportioned among the individual members of the political community. These were among the institutional features that he thought necessary to make reasonably efficient fiscal decisions in a democracy" (1999). Barry Weingast, Kenneth Shepsle, and Christopher Johnsen (1981) examine the modern U.S. fiscal process and observe that because of the U.S. representative system, each representative seeks to earmark as much as possible for his unit, yielding concentrated benefits relative to the nation and dispersed costs across the nation. Says Earl Brubaker: "Overall, the process creates incentives to strive strenuously to avoid contributions to the common pool while striving equally strenuously to make withdrawals from it" (1997, 356).[4]

Moreover, efforts by political agents to maximize the net value of federally funded gains for their districts and states lead to a preference for district- or state-specific transfers. The politician has more to gain in reelection capital when he brings home a new dam, federal building, or reconstructed harbor than when he votes as one among many to pass a new welfare entitlement. Government-funded goods that simultaneously provide unrationed benefits to all citizens, of course, are public goods, broadly considered, but government action that funds a new harbor in a particular congressional district can lead to economic development, greater employment, and additional consumption of private goods by well-identified people. Political production of rents that accrue to electors at home are more valuable for reelection purposes than the production of public goods whose benefits cannot be packaged and appropriated.

Bumba Mukherjee (2003) examines 110 countries empirically and focuses on how the character of taxpayer-funded projects changes as the number of grazing units—specifically, in his case, the number of parties—increases. Expenditures on public goods (those goods and activities that provide unrationed benefits across all citizens) fall when there are more grazing units on the commons, but expenditures for targeted welfare and private benefits rise. Applied to the United States, Mukherjee's findings suggest that gains in district- or state-specific benefits yield greater reelection certainty.

At the same time, presidential politics, which are broader in scope, promote the expansion of benefits available to all citizens. Presidents were the champions of the New Deal, its landmark Social Security program, and the Great Society with its centerpieces Medicare and Medicaid. The expansion of Medicare to include prescription-drug benefits was also a presidential initiative. The result is a two-pronged expansion of

4. Barry Weingast and William Marshall (1988) describe additional complexities of life on the political commons. They note the high transactions costs associated with vote trading owing to the asynchronous nature of the contracts; one politician may vote with a vote-promising colleague in one period and later find his partner reneging on the deal or being no longer in office. They see the creation of committees and exercise of party leadership as attempts to constrain representatives so as to avoid over- and undergrazing.

government. Legislators graze the commons for the benefit of their specific constituents, and presidents graze for the benefit of all citizens.

We argue that the law of demand applies in both cases. If citizens in particular settings can gain taxpayer-funded benefits and avoid the burden of paying taxes themselves, then the demand for the political agents' services will rise even more. Similarly, the demand for broad-based benefits rises when presidents seek national electoral support and when broad-based interest groups that transcend legislative boundaries arise to secure and expand more of these benefits (e.g., the American Association of Retired Persons). When the finance of specific or broad benefits is uncertain, as is the case when the tax system becomes so complex that no ordinary mortal can identify who is paying for what, Wicksell's recommended constraint is no longer operational. This problem is compounded when the tax burden can shift to the future. The result can be fiscal illusion, where taxpayers think that they are getting services without paying for them (Wagner 1976), and as shown in table 1, there can be situations where a growing share of the population actually pays little or no taxes. Those suffering from fiscal illusion join forces with the nonpayers in lobbying for expanded government programs.

The expansion of government spending in the absence of awareness of who pays and of other constraints contributes to the rise of deficits. Examination of institutional constraints and policies that govern fiscal processes across countries reveals that constraints, such as balanced-budget rules and transparency, matter in limiting the growth of deficits (Alesina et al. 1999; Alesina and Perotti 1999). Other empirical research shows that once deficits become institutionalized, stabilization will not arrive until crises of sufficient magnitude force elected officials to come to grips with their spending habits (Alesina and Drazen 1991). Indeed, the U.S. experience with balanced-budget and pay-go rules is not at all encouraging.[5] To our knowledge, however, no empirical work on deficit growth has focused on the changing share of citizens who pay no taxes but receive large benefits.

In the next section, we examine data that enable us to test the following refutable hypotheses:

1. As the distribution of tax liability becomes more skewed so that a greater share of the population pays little or no taxes and a smaller share of the population bears more of the tax burden, the size of government will increase.
2. As the distribution of tax liability becomes more skewed so that a greater share of the population pays little or no taxes and a smaller share of the population bears more of the tax burden, the size of government debt will increase when taxpayers attempt to delay and even avoid payment of their tax obligations.

5. See Yandle 2010 for a discussion of Gramm-Rudman-Hollings constraints and other U.S. efforts to prevent spending from outdistancing revenue.

3. As the distribution of tax liability becomes more skewed so that a greater share of the population pays little or no tax and a smaller share of the population bears more of the tax burden, government expenditures for transfer payments will increase.

Our analysis considers trends in government spending, debt, and transfer payments in conjunction with changes in the distribution of the tax liability over time. We also present time-series regression estimates that employ these variables to determine the statistical significance of evident trends.

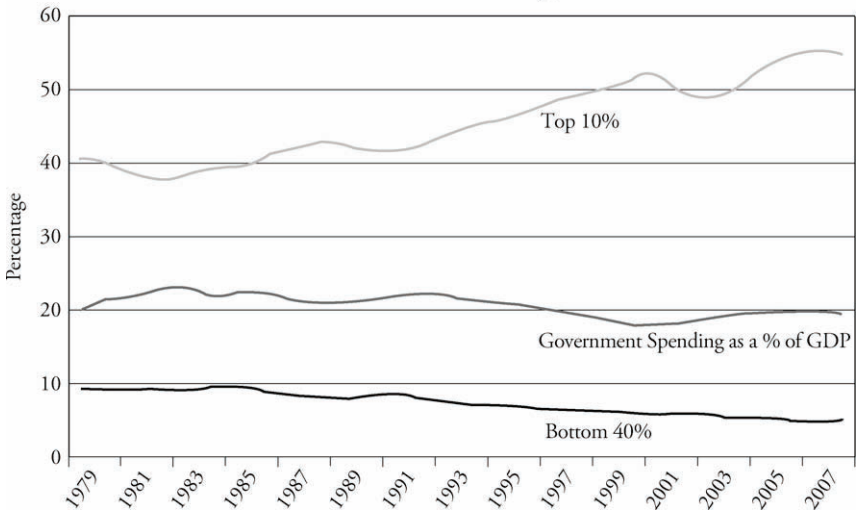
Assessing the Evidence

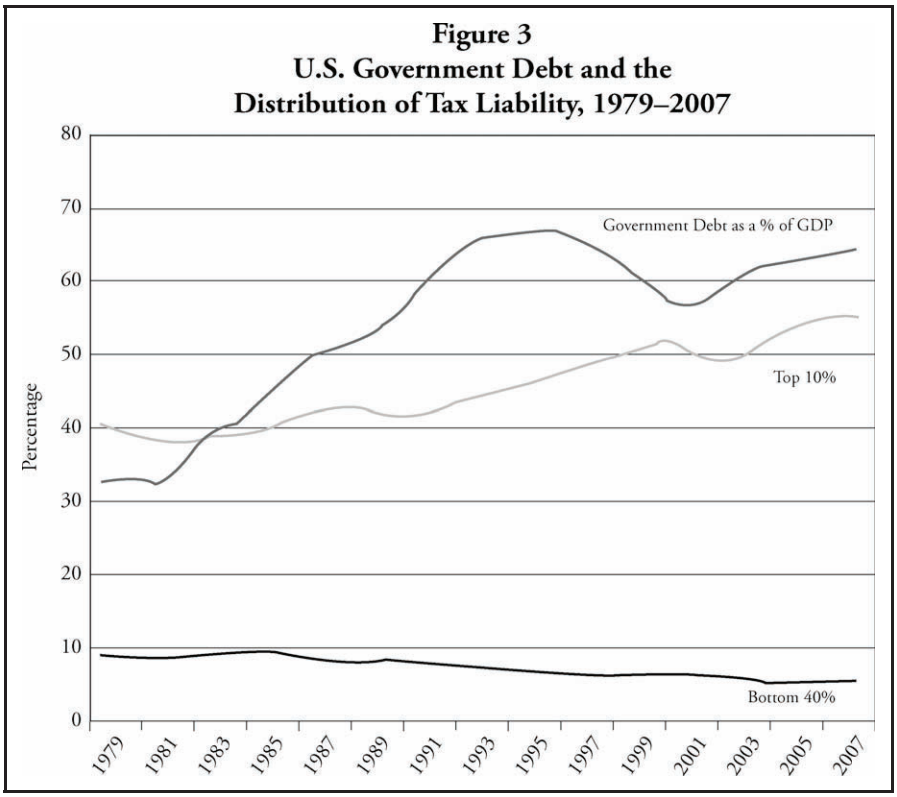
The CBO provides data on the distribution of federal tax liabilities by household income quintile from 1979 to 2007. The data are broken down into three categories relevant to our purposes: total federal taxes, individual income taxes, and social-insurance taxes. Because the data span only twenty-nine years, the trends and regression estimates as well as any inferences drawn from them must be interpreted cautiously.

Trends in Total Government Spending, Debt, and Entitlement Spending

Figure 2 shows the trend in total federal spending as a percentage of GDP from 1979 to 2007. Government spending as a share of GDP has, perhaps surprisingly,

Figure 2
U.S. Government Spending and the Distribution of Tax Liability, 1979–2007





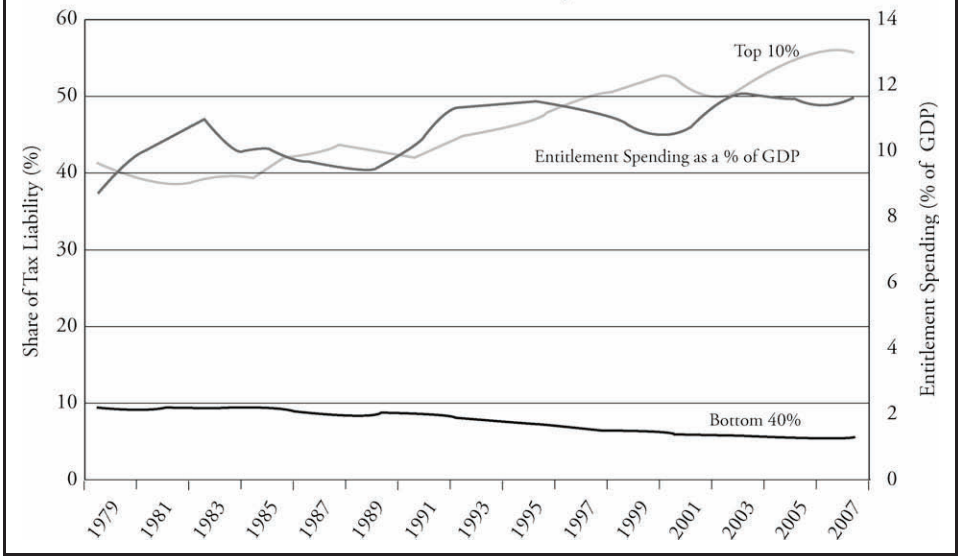
remained relatively constant, averaging just less than 21 percent over the years considered. The steadily rising share of total federal tax liabilities accounted for by the top 10 percent of taxpayers and the steadily falling share of federal tax liabilities accounted for by the bottom 40 percent of taxpayers show no correlation with total spending as a share of GDP—a trend counter to that implied by our analysis of the fiscal commons.

Turning to government debt, we see more evident trends. As shown in figure 3, the increase in the ratio of gross government debt to GDP has roughly corresponded to the rising share of federal taxes paid by the top 10 percent and the falling share of taxes paid by the bottom 40 percent.

Examination of entitlement spending, which we define as the sum of spending on Social Security, Medicare, health, and income security, reveals a tighter correlation with the distribution of tax liability. Entitlement spending as a share of GDP, which is measured by the right-hand-side vertical axis in figure 4, has risen more or less steadily as the share of federal taxes paid by the top 10 percent has risen and the share paid by the bottom 40 percent has fallen.

In sum, casual inspection of the data indicates that the shifting of U.S. tax liability from low-income earners to high-income earners has been associated with increases in gross debt and entitlement spending but has not been correlated with total government spending.

Figure 4
U.S. Entitlement Spending and the Distribution of Tax Liability, 1979–2007



Regression Estimates

Although the figures we have presented are instructive, we now investigate more carefully the relationship between the distribution of the tax liability and government spending and debt, using time-series regression analysis. The results we report must be interpreted cautiously, however, because of the small sample size. Nevertheless, they are instructive and support the evidence on trends already displayed in the figures.

We estimated regressions for five dependent variables: the ratio of government spending to GDP; the ratio of gross government debt to GDP; the ratio of social-insurance outlays (Social Security plus Medicare) to GDP; the ratio of health and income-security outlays to GDP; and the ratio of entitlement spending to GDP, where entitlement spending is measured as the sum of the two previous spending categories. For each dependent variable, we included the unemployment rate as a proxy for the status of the economy, the share of population age sixty-five and older as a proxy for demographic conditions that affect spending, and either the tax liability of the bottom 40 percent of households or the tax liability of the top 10 percent of households.[6] We refine the estimates further by using the liability of total federal taxes

6. Entering the tax liability of the bottom 40 percent of households and the tax liability of the top 10 percent of households in the same estimate is problematic because of the strong inverse correlation between the variables. The simple correlation coefficient between these variables is –0.982. In other estimates, using the tax liability of the top 5 percent or top 1 percent of household incomes, the results are essentially unchanged from those reported here.

for the estimates of the total spending, gross debt, and entitlement ratios, but we use the liability of social-insurance taxes for the estimates of the social-insurance ratio and the liability of individual income taxes for the estimates of the health plus income security ratio. To adjust for first-order serial correlation and preserve the first observation in the sample, we estimate with the Prais-Winsten technique. Results are shown in table 2, with t-statistics noted in parentheses.

As shown in the table, the findings are broadly consistent with our expectations and with the trends evident in the figures. For the spending ratio estimates, there is little of significance, except the unemployment rate, which indicates that total federal spending as a share of the economy rises when the economy slows down. The tax liability of the bottom 40 percent is positive and marginally significant, a finding inconsistent with our expectation that as the bottom two income quintiles pay more, total federal spending as a percentage of GDP rises.

The findings for the gross debt ratio are robust and match our expectations. In a dynamic world, as the bottom 40 percent of households pay more, the ratio of gross debt to GDP falls, and the top 10 percent of households are apparently able to avoid or delay their full tax liabilities, causing the ratio of gross debt to GDP to rise as the tax liability becomes more concentrated on top income earners. Moreover, the debt ratio rises sharply with the share of population that receives costly social-insurance benefits. However, the Durbin-Watson statistic for these estimates lies in the indeterminate range, so the findings must be interpreted cautiously.

Spending on Social Security and Medicare as a share of the economy rises during an economic slowdown and with an increasingly elderly population, but it is apparently unaffected by the distribution of the tax liability. Although this finding may seem curious, it is important to realize that the distribution of social-insurance taxes is not nearly as skewed as that of total federal and individual income taxes. Again, note that the Durbin-Watson statistics lie in the indeterminate range.

Estimates of the ratio of health and income-security spending to GDP and of total entitlement spending to GDP are quite strong. In both estimates, an economy in a recessionary state evidently raises spending as a share of GDP, and, at least for total entitlements, so too does an aging population. The tax-liability coefficients are revealing. If those in the bottom two quintiles of household income have to pay more, they will oppose greater spending on entitlements, but if the expenditures can be shifted to the top 10 percent of households, entitlement spending rises. In these regression equations, the Durbin-Watson statistics lie in the range where we may reject first-order serial correlation, giving us greater confidence in these estimates.

In sum, the data provide broad support for the ideas and concerns that Calhoun and Madison expressed in the early nineteenth century. U.S. tax policies have skewed the distribution of the tax liability so that a substantial portion of the population pays little or no federal taxes, and an increasingly small share of the population is liable for a greater share of the taxes. These trends do not appear to affect total spending as a share of GDP, but they are associated with higher ratios of government debt and

Table 2
Prais-Winsten Regression Estimates Using Variables Related to the Distribution of Tax Liability

	Dependent Variables									
Variable	Spending Ratio		Gross Debt Ratio		Social-Insurance Ratio		Health and Income-Security Ratio		Entitlement Ratio	
Constant	6.34/(0.81)	14.06/(2.03)	–170/(–6.23)	–205/(–9.67)	–5.92/(–1.82)	–3.70/(–1.46)	1.88/(0.75)	–1.12/(–0.39)	1.93/(0.48)	–9.16/(–2.82)
Unemployment rate	0.61/(6.28)	0.58/(5.15)	0.03/(0.08)	0.50/(1.21)	0.16/(5.06)	0.13/(4.17)	0.22/(5.40)	0.26/(5.25)	0.40/(6.63)	0.46/(6.48)
Population 65 and older	0.68/(1.17)	0.50/(0.78)	19.34/(9.65)	18.64/(9.39)	0.85/(3.84)	0.66/(2.57)	0.09/(0.45)	0.05/(0.19)	0.77/(2.61)	0.91/(3.00)
Bottom 40%	0.33/(1.78)		–1.65/(–2.54)		0.05/(0.83)		–0.16/(–4.82)		–0.44/(–4.62)	
Top 10%		–0.63/(–1.03)		0.62/(3.15)		0.05/(1.07)		0.05/(2.92)		0.12/(4.03)
F-statistic	149.33	127.55	36.26	32.09	53.67	64.27	27.27	22.06	61.55	54.27
Adj. R-square	0.95	0.93	0.79	0.77	0.85	0.87	0.74	0.69	0.87	0.85
N	29	29	29	29	29	29	29	29	29	29
Rho	0.79	0.85	0.70	0.76	0.93	0.90	0.65	0.76	0.68	0.68
Durbin-Watson statistic (trans.)	1.81	1.70	1.42	1.39	1.52	1.36	2.15	2.06	1.99	2.04

entitlement spending to GDP. These findings support the contention that if the U.S. government is to get its fiscal house in order, the tax laws will have to be changed to broaden the base.

Conclusions

Although the early American political theorists could not have anticipated the country's current fiscal problems, they were hardly ignorant of the possibility. Sovereigns have commonly defaulted throughout history. The key is to constrain government spending and deficits. One constraint is a broad tax base, a constraint that was largely applicable in the United States until the Sixteenth Amendment was added to the Constitution, permitting collection of income taxes without regard to the enumeration of the population. The stage was then set, as Calhoun had feared, for the population to divide into taxpayers and tax spenders. Although Madison was concerned about the rights of persons and the rights of property owners, his fear that those without property but with the right to vote would seek to violate the property rights of others seems to have been well founded.

The evidence we have presented must be interpreted with care. The time series we study here are too short for us to draw strong inferences from them. Nevertheless, trend lines and regression estimates point to the same conclusion: the decreasing share of tax liability borne by low-income households and the increasing share of tax liability borne by high-income households are clearly associated with greater government debt and entitlement spending. Although many factors may affect fiscal outcomes, we believe that a fundamental restructuring of the tax code is essential if the U.S. government is to bring down its debt and curb entitlement spending.

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