Highest taxed nation on Earth? Not really

- If an economy doesn't produce, taxes are going to be high no matter what.
- According to the OECD and as of 2014, U.S. "implied" corporate taxes represented 2.19 percent of GDP, ranking it 25th lowest of 35 countries.

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President Donald Trump gives a speech on tax reform at the Heritage Foundation's President's Club Meeting at a hotel in Washington, DC, on October 17, 2017.

The late Sen. Daniel Patrick Moynihan once said: "Everyone is entitled to his own opinion, but not his own facts." Unfortunately, the senator did not get to encounter the Trump administration's world of "alternative facts."

As he has done many times before, the president last week repeated the claim that the U.S. is "the highest taxed nation in the world."

If we simply limited the definition of "taxes" to "corporate taxes," and further limited that to the "statutory" rate, otherwise known as what the tax rate is according to the books and not what companies actually pay, then the president is absolutely correct.

But critics of the president point to the "implied" tax rate that companies pay, which is what actually comes out of their bottom-lines, as being a more accurate statistic to use for comparison. That calculation shows the U.S. is nowhere near being the top-taxed nation on Earth.

The implied tax rate shares a fault with the statutory rate: Both look at companies as mutually exclusive entities. A full understanding of the tax burden on an economy is incomplete without taking into account the overall "value-added" that is created in the economy and the taxes collected as a result. This requires an understanding of the degree of interaction between companies, not an assumption they stand alone.

Economics 101 tells us that the value chain leading to the creation and sale of total finished goods and services (i.e. the GDP of a country) employs three primary resources: natural, human and capital. All three, by the way, are constrained in their availability. An optimal tax rate is one that takes into account this important limitation and prevents one category from being overtaxed relative to the other, so that the overall growth profile of the value-added is not negatively affected.

If an economy does not produce sufficient value-added from the interactions, then taxes collected relative to overall activity will be high even if the actual statutory or implied rates are low. If on the other hand, a complex economy exists where the value chain is deep and the value-added high, then the tax burden will be low even if on a one-by-one basis the statutory or implied tax rates on all resources are high relative to elsewhere.

According to the OECD and as of 2014, U.S. implied corporate taxes represented 2.19 percent of GDP, ranking it 25th lowest of 35 countries. Japanese corporate taxes, by contrast, represented 4.14 percent of GDP. Of the G-7 countries only Germany ranked lower than the U.S., at 1.74 percent of GDP.

The U.S. rate also compares favorably with the rates at or near the previous two economic cycle peaks (3.07 percent in 2006 and 2.23 percent in 2000).

At the personal level, the U.S. collected the equivalent of 10.17 percent of its GDP in taxes during 2014 putting it in ninth place (out of the same 35 countries). Canada and Italy in the G-7 ranked higher, while Germany was slightly lower at 9.63 percent, and Japan at 6.06 percent.

When including all taxes such as Social Security, property, payroll and sales taxes to all governmental entities, the U.S. collected approximately 25.88 percent of its GDP in taxes during 2014, which ranked it as the 32nd lowest-taxed country of the 35. (The U.S. beat out Mexico, Chile, and South Korea.)

None of these *per se* is an argument for taxes not be even lower, mind you. But when assessing the environment and the suitability of lower (or higher taxes for that matter), the key consideration should always be what the present tax-burden is relative to what those taxes are producing in overall value-added, where we want it to be and what each contributing category's share should be given the size of the other side of the equation, spending.

In and of itself, spending is an entirely different animal and one that no one wants to touch now or in the foreseeable future.

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