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Generational Equity: Which Age Groups Pay More Tax, and Which Receive More Government Spending?

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I. Introduction

Do some age groups in America get a better deal from government than others? As America's growing number of retirees strains the nation's fiscal system, that question has become more important than ever. While many studies explore the fairness of taxes and government spending across income groups,[1] few studies explore the distribution of tax burdens and government spending across age groups in the United States.

A Lifetime of Taxes and Spending

As Americans move from youth to working age to retirement they experience dramatic life changes. Shifts in work habits, health, relationships, buying patterns, location and more directly affect household tax burdens as well as the amount that governments spend on them in return. Young and middle-aged households are targeted with the most spending on public schools, childcare services and welfare payments, while elderly Americans are disproportionately targeted with spending on old-age programs such as Social Security and Medicare. How do these amounts of government spending compare to the tax burdens each age group pays to finance them?

Just as it is important for lawmakers to understand the fairness of taxes across young,

Key Findings

- *As the Baby Boom generation prepares to retire, lawmakers should be aware of the distribution of taxes and government spending across age groups.*
- *America's youngest households aged 25 and under received $2.32 in government spending for each dollar of taxes paid in 2004. Middle-aged households aged 45 to 54 received $0.73 per tax dollar, and America's oldest households aged 75 and over received $4.93 per dollar of taxes paid;*
- *As a group, households aged 35 to 64 pay more in taxes than they receive in government spending, while households under age 35 and over age 64 receive more government spending than they pay in taxes. Overall between $376 billion and $872 billion per year is fiscally transferred from middle-aged groups to the youngest and oldest Americans each year through government taxes and spending;*
- *Over a lifetime, government spending follows a U-shaped pattern, with large education and welfare spending in youth and large Social Security and Medicare payments in old age. But even within each age group, there are large differences in taxes and government spending across households at different income levels.*

1 Andrew Chamberlain and Gerald Prante, "Who Pays Taxes and Who Receives Government Spending? An Analysis of Federal, State and Local Tax and Spending Distributions, 1991-2004." *Tax Foundation Working Paper,* No. 1 (2007). Available at www.taxfoundation.org/publications/show/2213.html.

middle-aged and elderly households, it is also important to understand whether dollars of government spending are being spent in ways that are viewed as appropriate by the voting public. Does the U.S. fiscal system treat different age groups fairly? Are lawmakers properly balancing the demands of the elderly with the needs of children and working-aged Americans? Does fiscal policy reward some age groups at the expense of others? These are the questions explored by this study.

The Coming Generational Turmoil

Because of important demographic changes on the horizon, it's more important than ever for Americans to have an understanding of the fairness of taxes and spending across age groups. As America's so-called "Baby Boom" generation nears retirement age, the single most pressing fiscal problem faced by Congress is the looming crisis of growing federal entitlement spending on the horizon.

Official projections from the Congressional Budget Office and others warn that federal spending for old-age entitlement programs is on an unsustainable long-term path due to the growing number of elderly Americans collecting federal transfer payments and the shrinking pool of American workers available to pay payroll taxes that finance those programs. As a result, Americans face hard choices in coming decades between sharply higher payroll taxes on young workers, steep cuts in Social Security and Medicare to the elderly, or some combination of the two.

Unfortunately, little information is available about the distribution of tax burdens and government spending across age groups to aid lawmakers as they approach this crisis. This information gap leaves Congress to face debates over entitlement reform with little knowledge about the fairness of U.S. fiscal policy toward age groups, risking that entitlement reform will be swayed by anecdotes and misperceptions rather than facts about U.S. tax and budget policy.

Between $376 billion and $872 billion per year is fiscally transferred from middle-age groups to the youngest and oldest Americans each year through government taxes and spending.

The goal of this report is to explain the current U.S. fiscal landscape and present the distribution of federal, state and local taxes and government spending across age groups for 2004. The results illuminate striking differences between the fiscal priorities of the federal government in Washington and those of state and local governments, and they provide lawmakers with a basic framework of facts to guide debates over entitlement reform.

All results presented in this report are drawn from a comprehensive 2007 Tax Foundation study of the distribution of America's total tax burden and distribution of government spending.[2] The complete study and the underlying methodology are available online at www.taxfoundation.org/publications/show/2282.html.

Table 1
Number of People in Each Age Group in America, and How Much Income They Earned in 2004

		Age of Household Head, Calendar Year 2004						
	U.S. Total	Under 25	25 to 34	35 to 44	45 to 54	55 to 64	65 to 74	75 +
Number of Households	113,475,724	6,645,895	19,426,353	23,193,207	23,299,131	17,730,862	11,524,832	11,655,444
Number of Individuals	291,166,198	16,604,603	55,962,111	74,713,804	64,727,518	38,705,146	22,045,387	18,407,630
Percentage of U.S. Population	100%	6%	19%	26%	22%	13%	8%	6%
Average Cash Money Income Per Household	$60,432	$35,409	$55,702	$72,532	$77,062	$67,180	$45,829	$29,435

Source: U.S. Census Bureau; Tax Foundation

2 Andrew Chamberlain and Gerald Prante, "Who Pays Taxes and Who Receives Government Spending? An Analysis of Federal, State and Local Tax and Spending Distributions, 1991-2004." *Tax Foundation Working Paper,* No. 1 (March 2007). Available at www.taxfoundation.org/publications/show/2282.html.

Summary of the Full Study's Methodology

- Time period: Calendar Year 2004.[3]
- Unit of analysis: Households
- Presentation of results: Seven age groups based on the age of the head of household.
- Data sources: Bureau of Economic Analysis, U.S. Census Bureau, U.S. Bureau of Labor Statistics, Office of Management and Budget, Centers for Medicare and Medicaid Services, and Tax Foundation.

Source: Andrew Chamberlain and Gerald Prante, "Who Pays Taxes and Who Receives Government Spending? An Analysis of Federal, State and Local Tax and Spending Distributions, 1991-2004." *Tax Foundation Working Paper,* No. 1 (March 2007). Available at www.taxfoundation.org/publications/show/2282.html.

II. The Graying of the American Population

America as a nation is getting older. In 1990, the median age of the American population was 32.8. By 2005 it had risen to 36.4. By all accounts that trend is expected to continue in coming decades.

America is aging for two basic reasons. First, young couples are having fewer children than in the past. According to the Centers for Disease Control and Prevention, the U.S. total fertility rate has fallen sharply from 3.7 births per woman in 1957 to around 2.1 children per woman today.[4] As fewer and fewer young Americans are born to replace those who enter old age, the nation is gradually aging.

A second reason is that the nation's largest demographic group — the "Baby Boom" generation born between 1946 and 1964 — is rapidly approaching retirement age. About 78 million Americans are part of the Baby Boom generation, or roughly 26 percent of the U.S. population. In 2011 the leading edge of the Baby Boomers will reach age 65, and by 2029 the entire group will have reached retirement age. This gradual aging of the nation's largest demographic group has led to a steady upward climb in the average age of the American population.

Table 1 shows the distribution of age groups throughout America in 2004. By far the largest age group was in the middle-age range of 35 to 54 that contains most of the Baby Boom generation. Together these two age groups accounted for roughly half the U.S. population. The smallest age groups in 2004 were the youngest age group — under 25 — and the oldest age group of 75 and over.

To give some perspective on the economic well-being of each age group, Table 1 also shows the average cash money income of households in each group.[5] As expected, most people's incomes follow a predictable path over a lifetime. Households generally begin with low incomes in youth which then rise throughout adulthood. Those incomes generally peak when workers reach the top of their careers in their late 50s and then decline steeply as households retire and spend down their life savings during old age.

As America's so-called "Baby Boom" generation nears retirement age, the single most pressing fiscal problem faced by Congress is the looming crisis of growing federal entitlement spending on the horizon.

Not surprisingly, the nation's highest household incomes are earned by those in their peak earning years of age 45-54. Conversely, the nation's lowest incomes are found in households aged 75 and over that contain the largest numbers of retirees. The nation's second-lowest incomes are found in the under-25 age group that contains workers at the beginning of their careers with the fewest skills, as well as many unemployed students living alone.

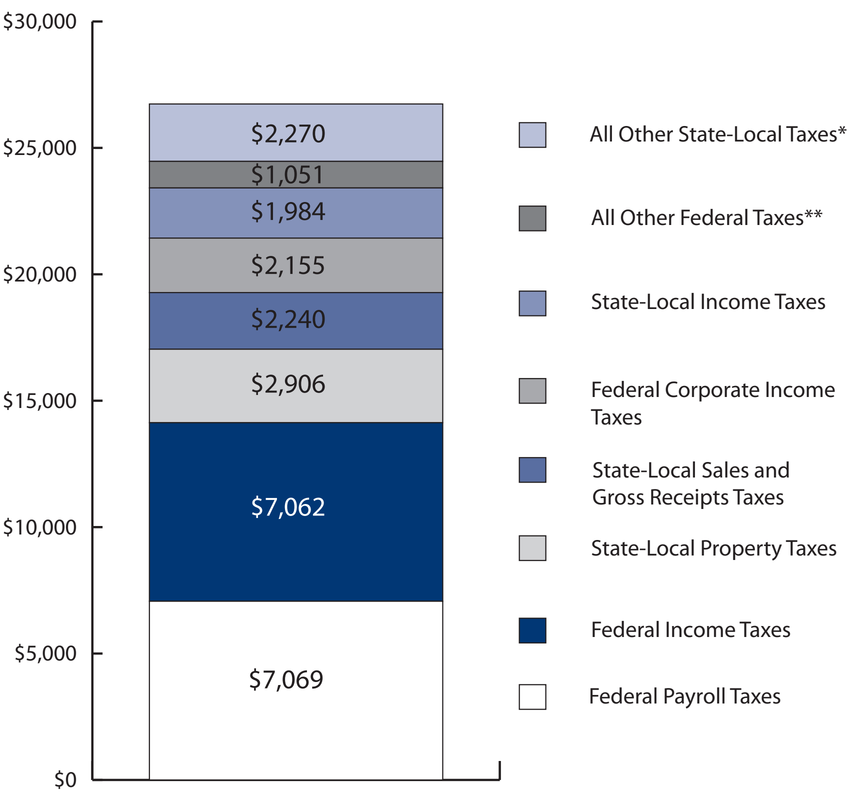
3 The complete study examines multiple years between 1991 and 2004, as well as differences in tax burdens and government spending received by different age groups. See Chamberlain and Prante (2007), *op. cit.*, pp. 24-25.

4 Joyce A. Martin et al. (September 29, 2006). "Births: Final Data for 2004," National Center for Health Statistics' *National Vital Statistics Reports* Volume 55, Number 1. Washington, D.C.: Centers for Disease Control and Prevention.

5 "Cash money income" is defined by the U.S. Census Bureau. It is broader than adjusted gross income (AGI) as defined by the IRS for income tax purposes. It consists of earned income such as wages and salaries, interest and rental income, as well as unearned income such as alimony, unemployment compensation, and Social Security payments. This definition of cash money income generally corresponds to most taxpayers' "common sense" definition of household income. For the complete definition of household cash money income, see "Income Measurement" at www.census.gov/population/www/cps/cpsdef.html.

In this sense, Table 1 serves as a reminder of the importance of age in debates about tax fairness and income inequality. Because age is an important driver of income, to some extent debates about tax fairness toward low-, middle- and high-income Americans are really debates about fairness toward different age groups. Similarly, while many economic and demographic factors contribute to income inequality, Table 1 reminds us that even in the absence of underlying changes in the U.S. economy the growing number of Baby Boomers moving through their peak earning years will have an important impact on measures of U.S. income disparities.

Figure 1
Total Taxes Paid by American Households
Average Dollars Per Household in 2004



* Note: "All Other State-Local Taxes" includes the following: Other business taxes, corporate income taxes, gasoline sales taxes, other selective sales taxes, public utilities taxes, insurance receipts taxes, personal motor vehicle licenses, tobacco excise taxes, business motor vehicle licenses, severance taxes, special assessments taxes, personal property taxes, estate and gift taxes, alcoholic beverages excise taxes, and other personal taxes.
** Note: "All Other Federal Taxes" includes the following: estate and gift taxes, gasoline excise taxes, customs duties, air transport excise taxes, other excise taxes, diesel fuel excise taxes, alcoholic beverages excise taxes, and tobacco excise taxes.
Source: Bureau of Economic Analysis; Tax Foundation

III. How Large Is the U.S. Tax Burden?

Now that we've explored the ages and incomes of the American population, let's explore the nation's tax system. While we often talk about the nation's "tax burden," Americans don't simply face one unified tax bill. Instead, they pay many different types of taxes to many different levels of government — federal income taxes, state cigarette taxes, local property taxes, and so on.

Because age is an important driver of income, to some extent debates about tax fairness toward low-, middle- and high-income Americans are really debates about fairness toward different age groups.

In this report, we count every tax in the United States, at all levels of government.[6] Figure 1 shows the total U.S. tax burden paid by Americans each year. It includes all taxes paid to the federal government in Washington and all taxes paid to state and local governments at home. To make the figures easier to understand, we've presented them on a per-household basis. That is, we've divided total tax collections by the roughly 113 million U.S. households in 2004. Those who prefer totals can simply multiply the numbers in Figure 1 by 113,476,000.

As is clear from Figure 1, the two biggest taxes Americans pay each year are to the federal government in Washington—federal individual income taxes, and the payroll taxes that are deducted from paychecks to fund Social Security and Medicare. In 2004, federal payroll

6 In practice, governments raise revenue both from taxes and non-tax revenue sources such as fees, proceeds from state-run lotteries, liquor store and utility revenues, and so on. As a result, there is considerable debate about which revenue sources should be counted as "taxes" and which should not. Because of the controversy surrounding the inclusion of non-tax revenues in tax burden estimates, this report does not include non-tax revenue sources in its tax burden totals. However, because non-tax revenues make up a relatively small part of overall government collections, the inclusion of these sources would not significantly affect the findings of this report. For a complete discussion of the relationship between taxes and non-tax revenue sources see Alicia Hansen, "Lotteries and State Fiscal Policy," *Tax Foundation Background Paper*, No. 46 (October 2004).

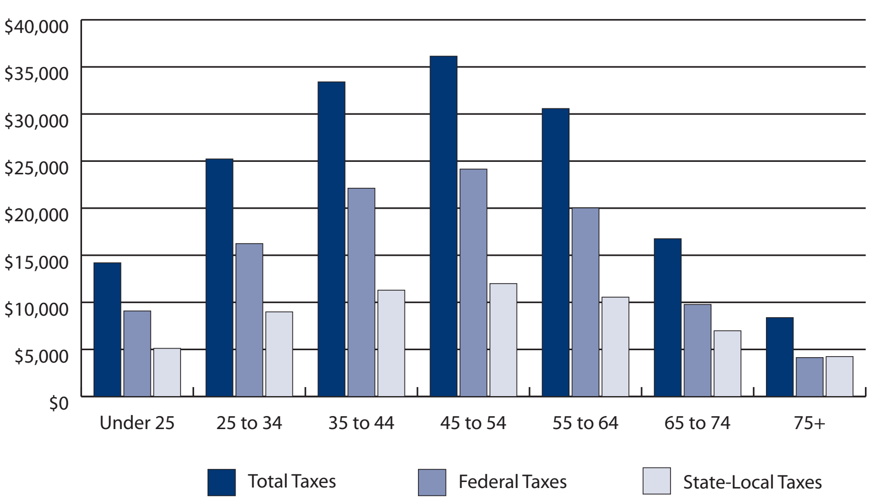
taxes averaged $7,069 per household, and federal income taxes were $7,062 per household.

State and local property taxes make up the third largest part of America's tax bill each year, averaging $2,906 per household. Those are followed by a mix of other smaller federal, state and local taxes such as corporate income taxes, sales taxes, cigarette and alcohol taxes, motor vehicle taxes, utilities and insurance taxes, severance taxes, estate and gift taxes and others.

When government spending is considered along with tax burdens, the overall picture of the impact of government policy across age groups is dramatically different from looking at only taxes or spending in isolation.

In total, the nation's tax burden in 2004 was $26,738 per household, or roughly $3 trillion in total. Of those taxes, about $2 trillion or $17,338 per household was paid to the federal government in Washington, and about $1 trillion or $9,400 per household was paid to state and local governments at home.

Figure 2
Average Dollars of Taxes Paid by Households in Each Age Group in 2004



Source: Tax Foundation

How big is $3 trillion in total tax collections? To get a sense of the size of that figure, imagine all 90,601 IRS employees sitting around a table manually counting the nation's tax bill. At a rate of $1 per person per second, working eight hours per day for 40 hours per week for 50 weeks per year, it would take the entire IRS workforce about 4.7 years to count out America's $3 trillion tax bill for 2004.

IV. The Tax Burden of Different Age Groups

Now that we've looked at the size of the U.S. tax burden, let's look at which age groups pay the most and least taxes.

As nearly everyone knows, those with higher incomes generally face higher tax bills than those with low incomes. The reason is simple: the largest federal, state and local taxes are all levied either on the income we earn or the things we buy in stores, both of which grow as we become more prosperous. However, because household incomes follow a predictable mound-shaped path over a lifetime, the U.S. tax burden follows a similar pattern across age groups.

Figure 2 shows the total tax burden per household faced by different age groups in 2004. Not surprisingly, households in their peak earning years who have the highest incomes also bear the nation's largest tax burdens. The heaviest tax burden falls on middle-aged Americans between 45 and 54. Households in that group pay an average of $36,140 per year, or $24,149 to the federal government in Washington and $11,991 to state and local governments.

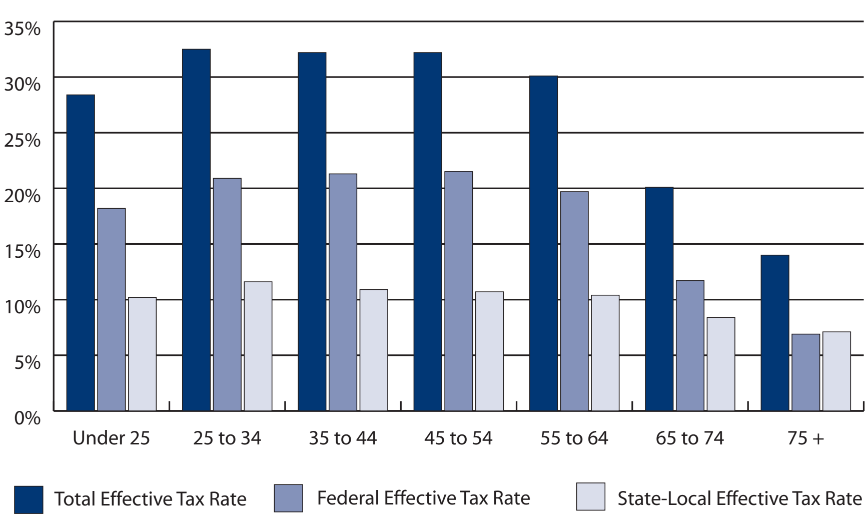
Because the nation's youngest and oldest also have the lowest incomes, they face the nation's lightest average tax bills. The nation's lowest tax bills are paid by those living in households headed by individuals 75 and older. These elderly households face an average annual tax bill of just $8,376, or $4,133 in federal taxes and $4,242 in state and local taxes. The nation's second-lowest tax burdens are faced by those in households under 25. These young households face an average annual tax bill of $14,196, or $9,085 in federal taxes and $5,111 in state and local taxes.

Households in their peak earning years who have the highest incomes also bear the nation's largest tax burdens. The heaviest tax burden falls on middle-aged Americans between 45 and 54.

Overall, households in their peak earning years of age 45 to 54 face an annual tax burden that is 4.3 times larger than that faced by those aged 75 and older, despite having average household incomes that are only about 2.6 times as large.

Across age groups, both federal and state-local taxes follow a similar mound-shaped distribution. However, because of the sharply progressive nature of the federal tax code, federal taxes vary widely across age groups. In contrast, because state and local taxes depend heavily on sales and property taxes, they are much more evenly spread across age groups.

Figure 3
Taxes as a Percentage of Household Income for Each Age Group in 2004



Source: Tax Foundation

Measuring Taxes as a Percentage of Income

While Figure 2 above shows how much each age group pays in dollars of taxes, it doesn't show how those tax burdens measure up to each age group's income. Another useful way to express tax burdens is as what economists call "effective tax rates." They're calculated by dividing each household's tax bill by their income.[7] The results show the percentage of a person's household income that is taken away by taxes. The higher the percentage, the higher the slice of income paid in taxes.

Figure 3 presents the average effective tax rates faced by Americans in different age groups. Overall, taxes make up a similar share of income for the vast majority of Americans between age 25 and 64. Americans in the youngest age group, those under 25, enjoy somewhat lower effective tax rates, while Americans in elderly households aged 65 and over pay a much smaller share of their income in taxes than any other age group.

The two biggest taxes Americans pay each year are to the federal government in Washington—federal individual income taxes, and the payroll taxes that are deducted from paychecks to fund Social Security and Medicare.

At the federal level, the highest effective tax rates are paid by those between 45 and 54. Their federal tax bill consumes 21.5 percent of their household income. The lowest effective federal tax rates are faced by those aged 75 and over, at 6.9 percent of income. At the state and local level, young adults aged 25 to 34 pay the highest effective tax rate of 11.6 percent of income, largely due to sales taxes that take a large share of the income of lower-income young people.

7 For a detailed explanation of the comprehensive household income concept used when expressing effective tax rates in this report, please see Appendix B (p. 100-108) in Andrew Chamberlain and Gerald Prante, "Who Pays Taxes and Who Receives Government Spending? An Analysis of Federal, State and Local Tax and Spending Distributions, 1991-2004," *Tax Foundation Working Paper,* No. 1 (March 2007). Available at www.taxfoundation.org/publications/show/2282.html.

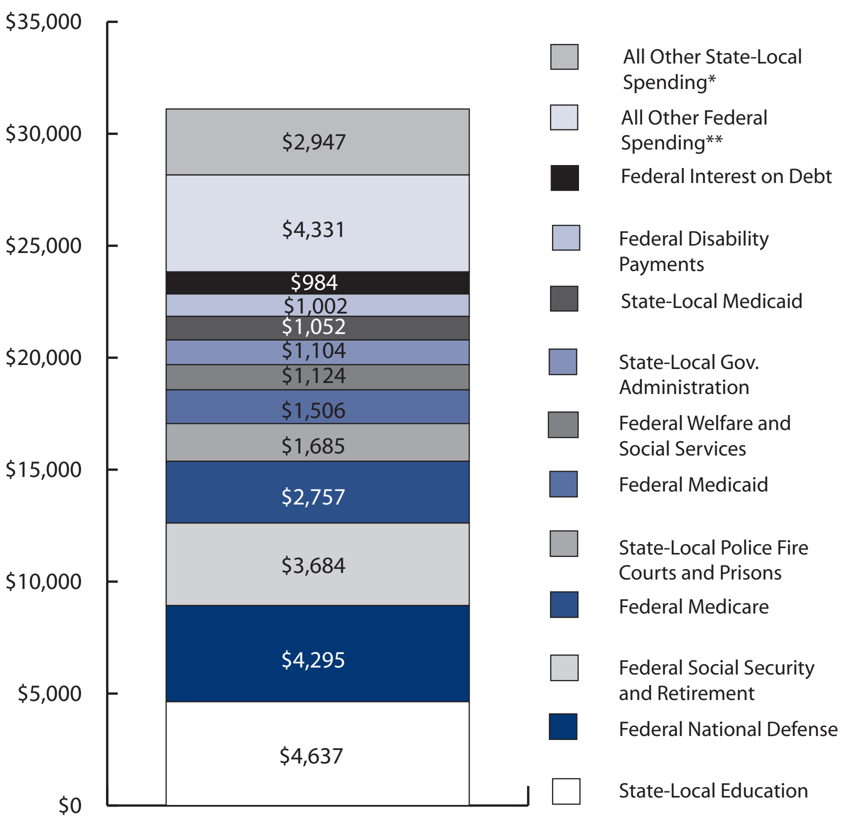
V. How Much Does Government Spend in America?

Now that we've looked at which age groups pay the most taxes to fund government programs in America, let's explore how government returns those tax dollars to different age groups in the form of spending.

While the nation's tax burden is easy to summarize, the vast array of federal, state and local government spending programs isn't. Total government spending is composed of tens of thousands of programs that affect nearly every facet of American life — public schools, police protection, medical subsidies, farm subsidies, roads, seaports, welfare payments, judicial courts, mass transportation, national defense, airports, college tuition aid, interest payments on debt, and so on. This makes it hard to explain in a simple way how government spends taxpayer dollars.

First let's look at the total amount of government spending. In 2004, governments at all levels spent about $3.5 trillion dollars, or roughly $31,108 for every household in the country. Of that amount, $2.2 trillion was spent by the federal government in Washington, and $1.3 trillion was spent by state and local lawmakers.

Figure 4
Total Government Spending on American Households
Average Dollars Per Household in 2004



* Note: "All Other State-Local Spending" includes the following state and local spending: interest payments on debt, highways and transit, welfare and social services, unemployment payments, agriculture, labor, energy, environment, recreation and culture, disability payments, other health, and housing and community services.
** Note: "All Other Federal Spending" includes the following federal spending: agriculture, labor, energy, environment, general government administration, education, veterans' health services, other income security, police, fire, courts and prisons, other health, highways, airports and transit, housing assistance, disaster relief, space, and recreation and culture.
Source: Bureau of Economic Analysis; Office of Management and Budget; Centers for Medicare and Medicaid Services; Tax Foundation.

Different Types of Government Spending

In this report we group government spending into what economists call "functional categories." That is, we group spending amounts by the purpose they're meant to serve — defending the borders, providing healthcare, fighting crime, and so on — rather than by the government agency that happens to spend them.

Figure 4 shows the amount that governments at all levels — federal, state and local — spent on programs supplied to U.S. households in 2004. To make the figures easy to understand, we've presented them on a per-household basis. That is, we've taken the roughly $3.5 trillion of government spending from 2004 and divided it by the roughly 113 million U.S. households.

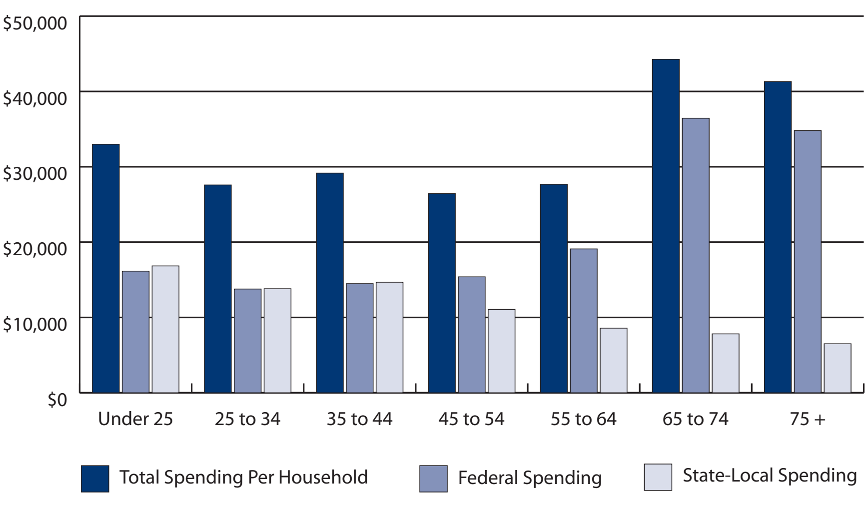
Households between age 35 and 64 pay more taxes on average than they receive in government spending, with households aged 45 to 54 facing the largest fiscal gap of $9,689 more in taxes than they receive in government spending.

As is clear from Figure 4, the single largest area of government spending in the nation is state and local public education. In 2004, that spending amounted to $4,637 per household. That includes all spending for the nation's public elementary and secondary schools, as well as state-local spending on public colleges and universities. Because the vast majority of this spending is funded by local property taxes, government spending on state and local public education represents a key driver of the nation's property tax burdens.[8]

The second largest spending category was national defense spending by the federal government, which amounted to $4,295 per household in 2004. Following defense, the next largest amounts of spending went for Social Security payments from the federal government to retired Americans ($3,684 per household), and Medicare payments from the federal government to provide health care to senior citizens ($2,757 per household). Because both Social Security and Medicare are funded by today's 15.3 percent federal tax on payrolls, these two spending categories largely drive the nation's payroll tax burden.

When all types of spending in Figure 4 are added up, they amount to total U.S. government spending of $31,108 per household in 2004.[9] Of that amount, $19,683 is spent by the federal government in Washington, and $11,424 is spent by state and local governments at home.

Figure 5
Average Dollars of Government Spending Received by Households in Each Age Group in 2004



Source: Tax Foundation

VI. Government Spending Received by Different Age Groups

Now that we've explored the total size of government spending, let's look at how much government spending is received by different age groups.

The first question to ask is, What do we mean when we say someone has "received" government spending? In this report, any time you use a government service, the amount of money it costs the government to provide that service to you is counted as part of the government spending you receive.

For example, if you use Medicare to pay for a hospital trip, you "receive" the amount that trip costs the federal government. Similarly, if you enroll your children in public schools, you "receive" the amount it costs the government to educate your child. If you have two children enrolled, you receive twice that amount. And so on. In this way, the amount of government spending received by a household can be interpreted as the cost to U.S. taxpayers of all the government services that household was supplied during one year.[10]

Federal spending is generally much more heavily tilted toward older households. In contrast, state and local spending is heavily tilted toward the youngest Americans.

Using official survey data from the U.S. Census Bureau and other federal government agencies, we're able to figure out which households in America are most likely to use the different government programs on the books—

8 Gerald Prante, "Property Tax Collections Surged with Housing Boom." *Tax Foundation Special Report*, No 146 (December 2006).

9 For a full list of types of government spending, please download the complete study at www.taxfoundation.org/publications/show/2213.html.

10 It is important to note that not all government spending "received" by households can be readily spent by them as income. Some government spending received by households such as cash welfare or unemployment compensation is perfectly fungible and can be spent just like regular income. However, government spending on in-kind goods such as medical care or food stamps is less fungible than cash, because it can't be traded away at its full value for other things. And in some cases, government spending received by households is completely non-fungible and can't be traded away at all, such as the value of national defense spent on a household's behalf. As a result, only some kinds of government spending received by households can be accurately described as cash income.

public housing, roads, schools, the Postal Service, unemployment compensation, Medicaid, college tuition subsidies, and so on. Once we've walked through every type of government spending and have allocated the costs to those who use them, the total received by each household is what we call "government spending received" in this report.

First we'll look at which age groups receive the most and least government spending. And then we'll compare those amounts to the taxes paid by each age group, showing which age groups receive more spending than they pay in taxes and which are net tax contributors to government treasuries.

Do Households Really "Receive" Government Spending?

When thinking about the figures in this report, it's important to keep in mind that these numbers tell you how much the government spends on different age groups. Or put another way, they tell you how much government spending aimed at each age group costs U.S. taxpayers each year. What they don't necessarily tell you is how much *you personally value* what government supplies to you.

For example, a child eating a government-supplied hot lunch at school may think it's only worth a few pennies. However if the meal cost the state $10 to provide, then that child's household "receives" that $10 of spending as measured in this report.

What does this mean? For one, it means that if you find yourself thinking you don't receive as much government spending as shown in Figures 4 and 5, you probably don't know about or don't value very highly the things that governments at all levels supply to you. For example, you may place a low value on the amount government spends to maintain the public parks in your neighborhood, but you still "receive" the amount of spending that it costs the government to provide it.

In fact, most Americans do not appear to have a good understanding of how much is spent on them by governments at all levels each year. In a 2007 nationwide survey conducted by Harris Interactive®, we asked the following question: "Thinking about all the government services you use during a year—national defense, roads, public schools, food stamps, Social Security, police protection and so on—how much would you say these are worth to you in dollars for one year? That is, how much would you be willing to pay for all the services provided to you by governments for one year?"

The average response was just $7,244, far below the $31,108 governments spent on each household in 2004 and below the $12,124 spent per person. As a result, it's no surprise that the comparatively large numbers in Figures 4 and 5 may come as a shock to many Americans.

* Source: Andrew Chamberlain, "What Does America Think About Taxes? The 2007 Annual Survey of U.S. Attitudes on Taxes and Wealth." *Tax Foundation Special Report*, No. 154 (April 2007). Available at http://www.taxfoundation.org/publications/show/22331.html.

Figure 5 shows the total amount that federal, state and local governments spent on different age groups in 2004. The numbers represent dollars of government spending received per household. For each age group, the blue bar on the far left represents total government spending, while the grey bar in the middle is federal spending only, and the white bar on the right is state-local spending only.

The first thing to notice about Figure 5 is that by a wide margin the largest total amounts of government spending are targeted toward the nation's most elderly households. Those aged 65 to 74 receive the largest amount of total spending, at $44,265 per household, and the second highest amount of spending is received by those aged 75 and over, at $41,315 per household.

Following the two most elderly age groups, the third highest amount of government spending is received by those living in households headed by the nation's youngest residents under age 25. These relatively young households receive an average of $32,989 per year in government spending per household.

These basic findings should not come as a surprise. Thinking back to Figure 4 which shows the largest areas of government spending, three of the four largest are education spending, which is targeted mostly at the young, and Social Security and Medicare, which are targeted at the elderly. As a result, Americans tend to receive the largest amounts of government spending at the beginning of their lives and in their twilight years of retirement.

Another important trend to note in Figure 5 is the vast differences between federal government spending and spending by state-local governments. Federal spending is generally much more heavily tilted toward older households. The reason is that the federal budget is dominated by old-age transfer programs such as Social Security and Medicare that are designed to target Americans in their retirement years.

11 For a full discussion of the issues surrounding the allocation of public goods to households, see Chamberlain and Prante (2007) *op. cit.*, pp. 42-44.

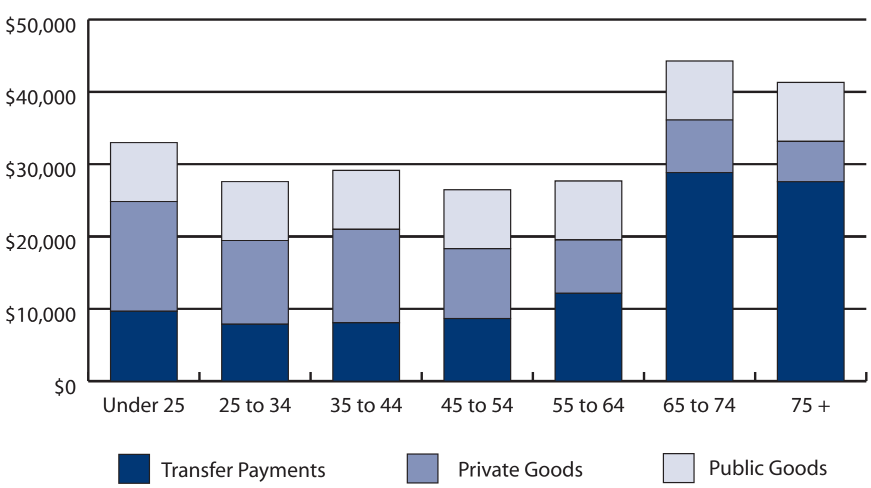
Even within each age group, there are large differences in taxes and government spending across households at different income levels.

In contrast, state and local spending follows an opposite pattern. It is heavily tilted toward the youngest Americans. The reason is that state and local spending is dominated by public K-12 and higher education spending, the vast majority of which is received by younger households.

A useful way to think about the large differences between the priorities of the federal government and state-local governments is to begin looking at Figure 5 on the far left where the early years of life are shown, and then move slowly to the right toward retirement years.

For about the first four decades of life, households receive similar amounts of federal and state-local government spending. However, by age 45 the two types of spending begin to diverge, and by age 65 the two amounts are radically different. While households under age 25 receive almost identical amounts of federal and state-local spending — $16,149 and $16,839 respectively — by age 65 households receive a staggering $36,446 in federal government spending compared to just $7,819 in state-local spending.

Figure 6
The Composition of Government Spending Varies Widely Between Age Groups



Source: Tax Foundation

A Closer Look at Spending Amounts

The spending amounts in Figures 5 include all federal, state and local government spending. However, when interpreting these figures it's important to note that there are significant differences between the types of government spending in those totals. In this report, we've grouped government spending into three broad categories — transfer payments, private goods, and what economists call "public goods."

Shifts in work habits, health, relationships, buying patterns, location and more directly affect household tax burdens as well as the amount that governments spend on them in return.

The first kind of spending is transfer payments. These are simply government spending that's designed to transfer money from one household to another. These include cash payments like welfare, farm payments, Social Security, unemployment and the refundable portion of the Earned Income Tax Credit (EITC), as well as in-kind spending that's very similar to cash such as Medicare, Medicaid and food stamps.

In 2004 government spending on transfer payments was about $13,000 per household, or 42 percent of all government spending.

The second kind of spending is what we call "private goods." In these cases, government is spending on things that aren't cash payments but are still supplied directly to identifiable households. These include spending on roads, airports, public schools, police and fire protection, parks, energy, the U.S. Postal Service, mass transportation and other government services.

Government spending on these private goods was about $9,960 per household in 2004, or about 32 percent of overall government spending.

Finally, some kinds of government spending are supplied to all households equally, and aren't targeted specifically at certain people. These include classic government functions such as national defense, environmental protection, criminal justice and so on. Economists call these things "public goods." They are supplied equally to all American households by lawmakers, and one person's use of them doesn't cost taxpayers additional dollars or reduce the amount left for others.[11]

In 2004, total spending on "public goods" like national defense and environmental protection was $8,150 per household, or about 26 percent of total government spending.

Figure 6 shows a more detailed composition of the government spending received by each age group in 2004. For each age group, the blue bar on the bottom represents government transfer payments received by that group, while the grey bar in the middle is spending on private goods and the white bar at the top represents spending on public goods.

As is clear from Figure 6, there are vast differences in the kinds of government spending received by different age groups.

Early in life, households receive large amounts of spending on private goods, primarily in the form of free and subsidized public education. Once households move beyond their school years, they receive on average less of all types of government spending. Finally, upon retirement households begin collecting large amounts of Social Security and Medicare benefits, which dramatically increases the amount of government spending they receive.

As a general rule, government spending on transfer payments primarily goes to senior citizens in the form of old-age insurance programs, and to the nation's youngest households that receive large amounts of income support and health care subsidies from government anti-poverty programs such as Temporary Assistance for Needy Families (TANF), the Earned Income Tax Credit (EITC), and Medicaid. Conversely, government spending on private goods — ranging from education to roads to utilities — primarily falls on younger households.

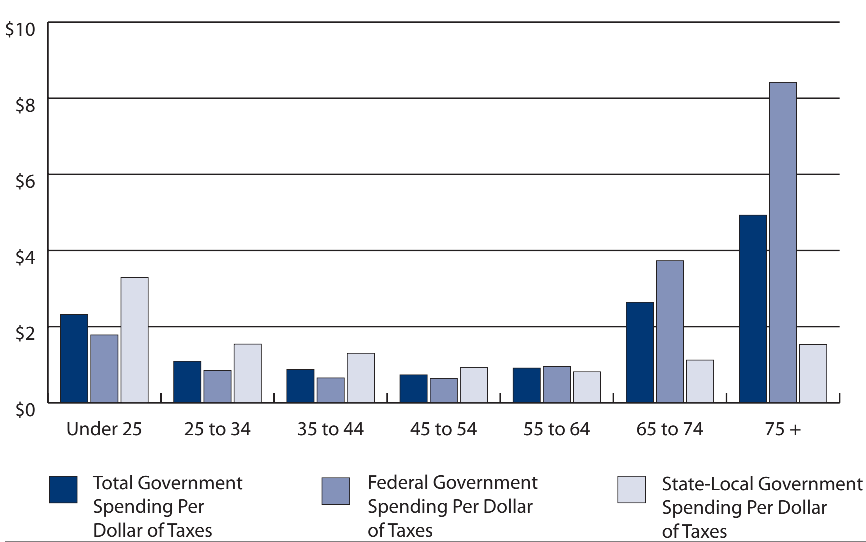
VII. Putting Taxes and Government Spending Together

Now that we've looked at both the tax burden of each age group and the amount of government spending they receive in return, let's put the two together. When we compare the taxes different age groups pay with the amount of government spending they receive, we end up with an annual measure of government's total fiscal impact on households.

Does the U.S. fiscal system treat different age groups fairly? Are lawmakers properly balancing the demands of the elderly with the needs of children and working-age Americans?

If a household pays more taxes than it receives in government spending, it is a net payer into the nation's fiscal system. If a household receives more government spending than it pays in taxes, it is a net fiscal receiver in that year, and the spending directed to that household is made up for by either government borrowing or taxes on other households.

Figure 7
Some Age Groups Receive More Dollars of Government Spending Per Dollar of Taxes Paid than Others



Source: Tax Foundation

Economists sometimes refer to this combined measure of both taxes and spending as "fiscal redistribution" or the "fiscal incidence" of government policy.

Figure 7 compares the tax burden of each U.S. age group to the amount of government spending it received in 2004. It answers the following question: "For every dollar of taxes paid, how much government spending is targeted at households in each age group in return?"

About 78 million Americans are part of the Baby Boom generation, or roughly 26 percent of the U.S. population. In 2011 the leading edge of the Baby Boomers will reach age 65, and by 2029 the entire group will have reached retirement age.

As is clear from the figure, when government spending is considered along with tax burdens, the overall picture of the impact of government policy across age groups is dramatically different from the picture that emerges from either taxes or spending in isolation.

The nation's fiscal system is clearly designed to benefit some age groups much more on a dollar-for-dollar basis than others. Overall, households under age 35 and over age 64 are net beneficiaries of government taxing and spending, as they receive more than one dollar of spending for every tax dollar contributed to the fiscal system.

The largest fiscal return on tax dollars was received by households aged 75 and over, which received $4.93 in government spending per tax dollar in 2004. The second highest return went to households between age 65 and 74, which received $2.64 of spending per tax dollar. The third highest spending-to-tax ratio was for the nation's youngest group, under age 25, which received $2.32 in government spending per dollar of taxes paid.

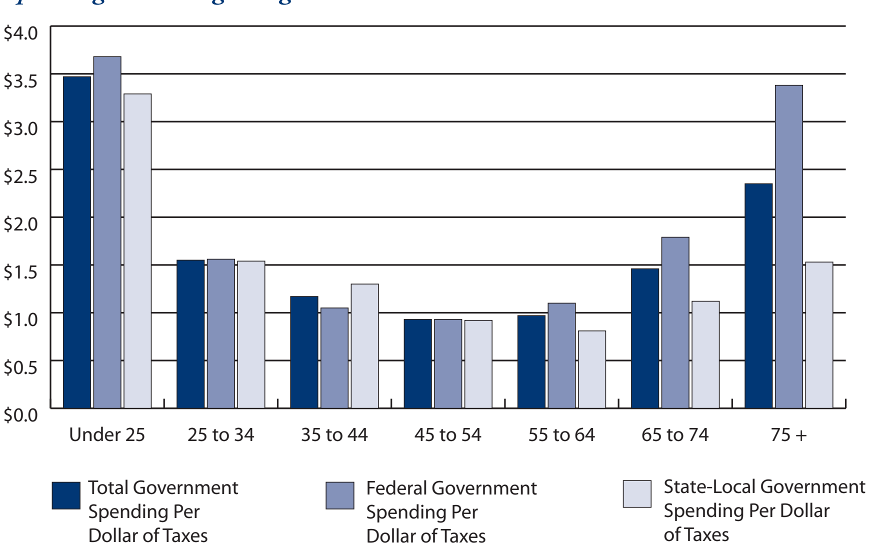
In contrast, households in their prime earning years, aged 35 to 64, each received less than one dollar of government spending for each tax dollar paid in 2004. The lowest fiscal return for any age group was for those in their peak earning years between the age of 45 and 54. They received just $0.73 in spending for every dollar of taxes paid—a result mostly driven by the high tax burdens paid by these high-earning households.

Clearly, the trends in Figure 7 are mostly driven by old-age insurance programs such as Social Security and Medicare. These programs make up a very large part of the federal government's budget, and they're specifically designed to transfer income to the elderly. For this reason, it's also helpful to show what Figure 7 would look like if we ignored Social Security and Medicare, and only looked at the rest of government spending and taxes.

Figure 8 shows the same data as Figure 7, but without spending on Social Security and Medicare, and without the federal payroll taxes that are designed to fund those old-age programs.

When we ignore the effects of Social Security, Medicare and the federal payroll taxes that fund them, the nation's youngest households, under age 25, receive the largest amount of government spending per dollar of taxes paid. When those old-age programs are excluded,

Figure 8
Government Spending Per Tax Dollar in 2004 Is More Bowl-Shaped When Spending on Old-Age Programs Is Excluded



Source: Tax Foundation.

the youngest households receive $3.47 in government spending per tax dollar.

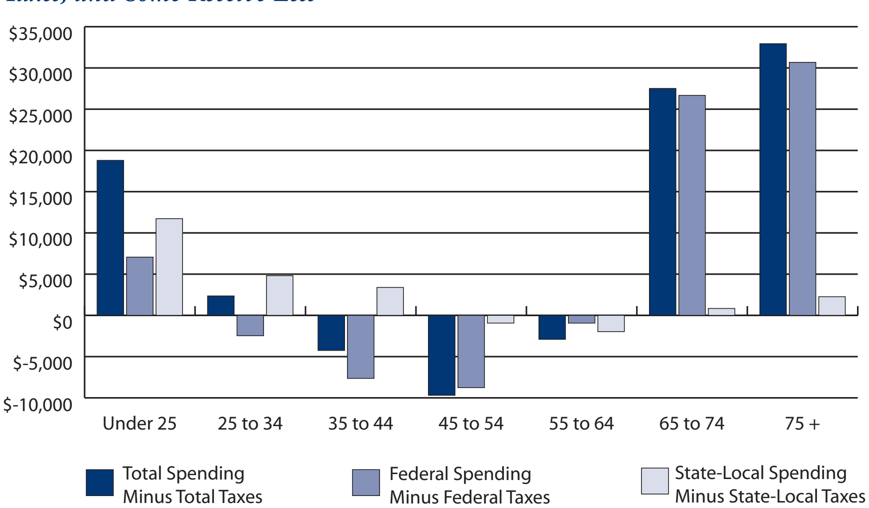
However, even when we ignore Social Security and Medicare spending, elderly households still receive substantial government spending compared to tax dollars each year. Those aged 75 and over receive $2.35 per tax dollar, while those between 65 and 74 receive $1.46 per tax dollar.

The explanation for this finding is simple. On the tax side, many elderly households face low income and payroll tax burdens due to their low retirement incomes, which pushes up their spending-to-tax ratio. Similarly, their spending-to-tax ratio is also increased on the spending side by income support payments received by many lower-income seniors, as well as the large amounts of interest payments received for government bonds held by these elderly households.

Government Spending Received Minus Taxes Paid

Another way to compare tax burdens and government spending is to add up all the spending each age group receives and subtract the taxes they pay. This gives a measure of that age group's "net fiscal burden," or the amount they pay or receive from government each year once all taxes and spending are counted.

Figure 9
Some Age Groups Receive More in Government Spending than They Pay in Taxes, and Some Receive Less



Source: Tax Foundation.

Figure 9 shows the total dollars of government spending households receive in each age group, minus the taxes they pay.

Households generally begin with low incomes in youth which then rise throughout adulthood. Those incomes generally peak when workers reach the top of their careers in their late 50s, and then decline steeply as households retire and spend down their life savings during old age.

Overall, the nation's youngest and oldest age groups — that is, those under age 35 and over age 64 — all received more government spending than they paid in taxes in 2004. The youngest age group of under 25 received $18,793 more in government spending than they paid in taxes, while those between 65 and 74 received an average of $27,513 more in spending than they paid in taxes. The nation's most elderly households of age 75 and over received a staggering $32,940 more in total government spending than they paid in taxes — a result largely driven by Social Security and Medicare benefits which under current law are partly determined by the amount of federal payroll taxes those households paid earlier in life.

In contrast, households between age 35 and 64 pay more taxes on average than they receive in government spending, with households aged 45 to 54 facing the largest fiscal gap of $9,689 more in taxes than they receive in government spending.

When the totals from Figure 9 are summed into an aggregate for the U.S. economy, households in the middle three age groups between 35 and 64 paid roughly $376 billion more in total taxes than they received in government spending. In contrast, the nation's bottom and top age groups, those under 35 and over 64, received about $872 billion more government spending than they paid in taxes. The difference between the two — approximately $496 billion — represents how much more government spent than it collected in taxes in 2004.

Depending on what assumption we make about who gets the benefits of this deficit spending — that is, whether we assume it goes to young, middle-aged or elderly households — governments at all levels fiscally redistributed somewhere between $376 billion and $872 billion from middle-aged households to the nation's youngest and oldest households through government taxes and spending in 2004.

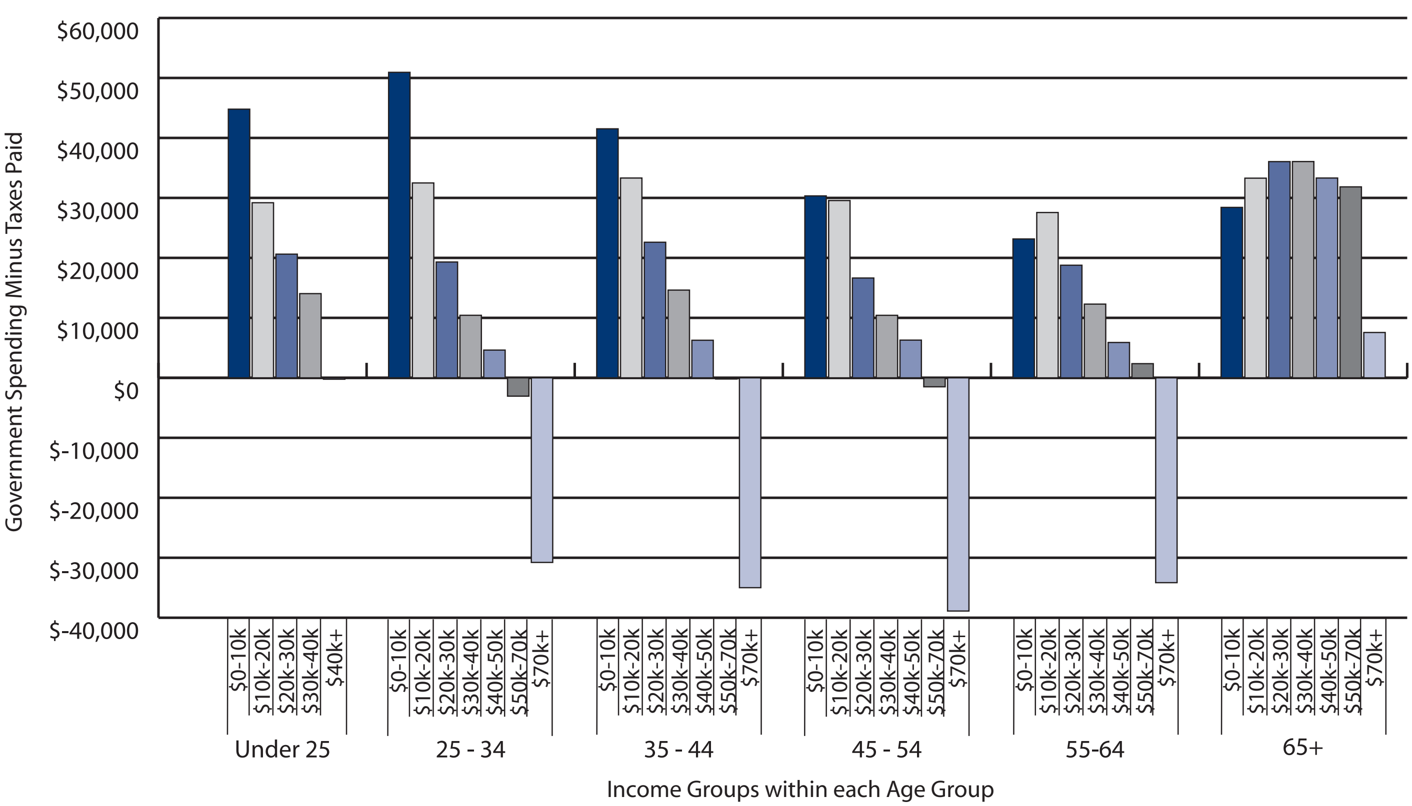
VIII. Tax Burdens and Government Spending Between Income Groups within Age Groups

In the figures presented above, we've looked at the average tax burdens and government spending received for everyone within each age group. However, within those age groups there are important differences between households who earn different incomes.

While young Americans under 25 generally earn lower incomes than middle-aged Americans between 45 and 54, within each of those age groups there are wide disparities in income between households. And because income has an important impact on a household's tax burden and the amount of government spending received, it's also useful to look within each age group to see how households with different incomes are affected by the nation's fiscal system.

Figure 10 shows the net impact of government taxes and spending on households who earn different levels of income within each of the age groups examined in this report. Within each age group, the bars represent the amount of government spending received by each income group minus the taxes they pay. If the

Figure 10
Even Within Each Age Group, the Net Fiscal Impact of Government Spending and Taxes Varied Widely Across Income Groups in 2004



Note: Under age 25, there are not enough households earning above $40K to break them out further.
Source: Tax Foundation.

bars are above zero, households in that income group are net fiscal recipients. If the bars are below zero, those households pay more in taxes than they receive in government spending.

In general, government spending on transfer payments primarily goes to senior citizens in the form of old-age insurance programs, and to the nation's youngest households that receive large amounts of income support and health care subsidies.

There are several interesting patterns to notice in Figure 10. First, in every age group across the entire lifecycle Americans living in households earning under $40,000 were supplied with more government spending than they paid in taxes in 2004. As a result, Americans who earn persistently low incomes over a lifetime bear a much lighter fiscal burden than is apparent from looking at age groups as a whole.

A second trend to note is that the nation's most elderly households receive substantially more government spending than they pay in taxes, regardless of their income level. Unlike any other age group, households at every income level in the 65 and over group received more government spending than they paid in taxes. The nation's youngest age group fared similarly. In that under-25 group, every income level except those earning over $40,000 received more government spending than they paid in taxes, and even those with the highest incomes paid on average just $230 more per household in taxes than they received in spending.

One final trend to note is that because of the generally progressive structure of the nation's tax system, only the highest-income households in each age group pay more taxes than they receive in government spending. Among all income groups in every age group, the only households that are net payers to government treasuries are those in the highest or second-highest income group. In Figure 10, these households are represented by the bars that reach below zero. This result is largely driven by the progressivity of state and federal income tax systems, which are designed to collect much heavier tax burdens from those with the highest incomes.

IX. Implications for Public Policy

As we've seen above, government taxes and spending fiscally redistribute between $376 billion and $872 billion between age groups in the United States each year. While the large size of this figure may come as a surprise to many, it should not come as a surprise that government taxes and spending do not fall evenly on households as they move through life from youth to old age.

For example, the nation's tax system is largely designed to tax most heavily those with the highest incomes. Because households with the highest incomes disproportionately are also in their peak earning years in the middle of their lives, it is inevitable that the nation's tax burden falls most heavily on those between the ages of 35 and 64.

Because some income groups fare better from government taxes and spending even within each age group, even on a lifetime basis some households are treated more favorably by current fiscal policy than others.

In contrast, many large government spending programs are specifically targeted at the nation's youngest and oldest households in the form of public education and Social Security and Medicare. As a result, it follows from these spending priorities established by lawmakers that the largest amounts of government spending fall on households early in life and late in life.

Because the nation's tax system follows a mound-shaped distribution across age groups while government spending follows a bowl-shaped distribution, it is inevitable that the combination of taxes and spending results in substantial fiscal redistribution among age groups through tax and spending policy in any given year. However, because some income groups fare better from government taxes and spending even within each age group, even on a lifetime basis some households are treated more favorably by current fiscal policy than others.

X. Conclusion

Examining the burden of government across age groups in the United States provides insights into the priorities of lawmakers crafting the nation's tax and spending policies. Just as some age groups are targeted with larger amounts of government spending, some age groups bear a much larger share of the nation's tax bill than others. Taken together, there are large disparities between the taxes paid and government spending received by different age groups in America.

As the roughly 78 million Americans in the Baby Boom generation move into retirement in the coming decades, the disparities between taxes and spending across age groups highlighted in this report are likely to grow. With a larger number of retirees drawing on old-age insurance programs largely financed by payroll taxes on young and middle-aged workers, the bowl-shaped distribution of net fiscal burdens across age groups is likely to become more pronounced in the coming decades.

As lawmakers prepare to address the coming crisis of growing federal entitlement spending, they should be aware of the equity of today's tax burdens and government spending across income groups, and how these distributions are likely to be affected by federal entitlement reform.

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