THE 2024 JOINT ECONOMIC REPORT

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OF THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

ON THE

2024 ECONOMIC REPORT
OF THE PRESIDENT

CHAPTER 3 OF THE
REPUBLICAN RESPONSE

Tax Increases Harm Growth

JUNE 17, 2024

Joint Economic Committee Republicans
Vice Chairman David Schweikert

CHAPTER 3: TAX INCREASES HARM GROWTH

The United States is on an unsustainable fiscal path.[1] Persistent budget deficits are ballooning the national debt at an alarming rate. As of May 2024, the debt held by the public is over $27 trillion (99 percent of Gross Domestic Product), and the total government debt is almost $35 trillion (124 percent of GDP). According to the Congressional Budget Office (CBO), it is estimated that by 2050, these components will reach 155 and 169 percent of the size of the economy, respectively.[2] These could be underestimations. Figure 3-1 shows that debt projections have been consistently below the realized values in the past two decades.

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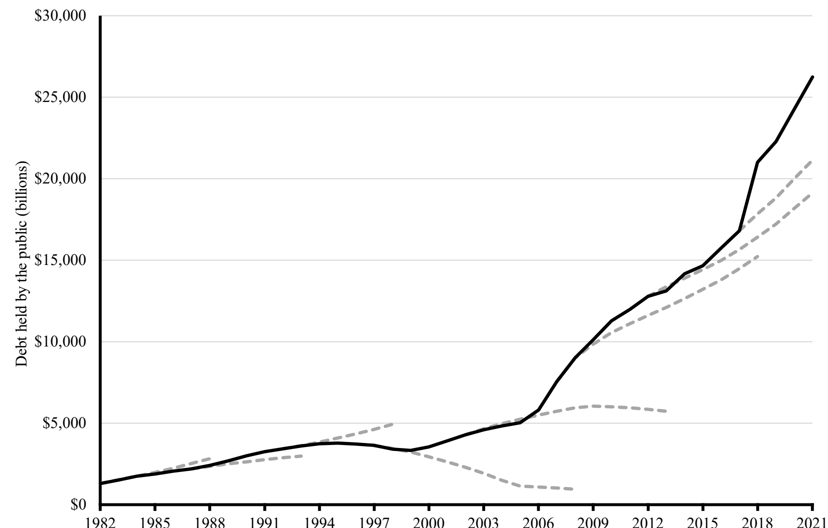
[1] Taylor Giorno, "Powell: 'The US is on an unsustainable fiscal path,'" *The Hill*, February 4, 2024, https://thehill.com/homenews/4447860-powell-the-us-is-on-an-unsustainable-fiscal-path/.

[2] Congressional Budget Office (CBO), *The Long-Term Budget Outlook: 2024 to 2054* (March 2024): Table 1, https://www.cbo.gov/system/files/2024-03/51119-2024-03-LTBO-budget.xlsx.

Figure 3-1: Debt Held by the Public Compared to CBO Projections



Source: Congressional Budget Office (CBO), baseline projections (1985, 1990, 1995, 2000, 2005, 2010, 2015, 2020)
Note: CBO baseline projections prior to 1996 are 5-year projections

While large jumps in the debt-to-GDP ratio typically coincide with recessions, the primary driver of deficits is mandatory spending which only continues to increase. Most of the growth in mandatory spending is due to demographics, specifically the aging of the population. Figure 3-2 shows that while Social Security and Medicare were less than 19 percent of total outlays in 1970, by the 2040s they will represent almost one of every two dollars spent by the government.[3] This means that over 60 percent of all primary spending will be transfers to the population aged 65 and over. Moreover, as the size of the debt continues to grow, so does net interest on the debt. Spending on debt service will likely increase

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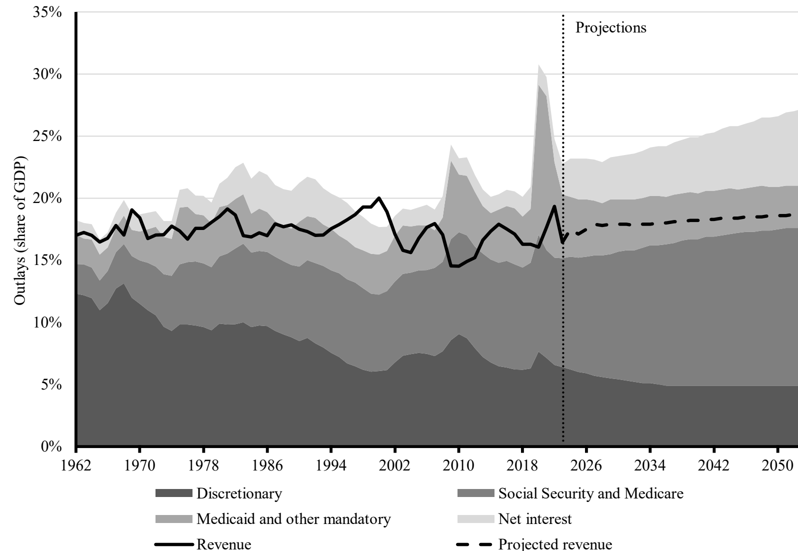
[3] CBO, *The Budget and Economic Outlook: 2024 to 2034* (February 2024): Table 1-4, https://www.cbo.gov/system/files/2024-02/51118-2024-02-Budget-Projections.xlsx; CBO, *The Long-Term Budget Outlook: 2024 to 2054*, Table 1; CBO, Historical Budget Data, February 2024, https://www.cbo.gov/system/files/2024-02/51134-2024-02-Historical-Budget-Data.xlsx

due to interest normalization and debt maturities.[4] According to CBO, by 2052, the combination of Social Security, Medicare and net interest will be higher than total revenue.

Figure 3-2: Federal Expenditures as a Share of GDP



Source: Congressional Budget Office (CBO)

Deficits are projected to be greater than 8 percent of GDP in the next three decades, portending ever-higher debt levels. A growing public debt crowds out private capital investment, reducing growth.[5] As discussed in Chapter 1, the economic literature agrees that large government debts have severely negative effects on

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[4] Low interest rates in the past two decades led many economists to dismiss the debt problem. However, for most skeptics, the rise in the rates to values above the GDP growth after the pandemic was an awakening on the true problem of the public debt.

[5] CBO, Historical Budget Data; Kent Smetters and Marcos Dinerstein, "Explainer: Capital Crowd Out Effects of Government Debt," Penn Wharton Budget Model blog, June 28, 2021, https://budgetmodel.wharton.upenn.edu/issues/2021/6/28/explainer-capital-crowd-out-effects-of-government-debt.

GDP growth.[6] Moreover, a perceived inability by policymakers to address imprudent fiscal policy will erode the confidence of investors, who may see rising probabilities of large tax increases or even a default. Either scenario would be catastrophic, leading to economic instability and making it more difficult for the government to sell treasury securities to fund further deficit spending. These frictions in debt management would make it difficult to raise spending in response to a future global crisis, which has national security implications.[7] Moreover, the status of the dollar as the world's reserve currency gives the United States the privilege of a higher debt threshold. However, a future multipolar globe and the possibility of the erosion of the relative status of the dollar due to fiscal inflation might move the point of financial reckoning closer than anticipated.[8] The failure of the

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[6] Jack Salmon, "The Impact of Public Debt on Economic Growth," *Cato Journal* 41, no. 3 (2021): 487-509, https://www.cato.org/sites/cato.org/files/2021-10/cj-41n3-2.pdf.

[7] Romina Boccia and Dominik Lett, "National Security Implications of Unsustainable Spending and Debt," Cato Institute blog, July 27, 2023, https://www.cato.org/blog/national-security-implications-unsustainable-spending-debt; Government Accountability Office (GAO), "A Warning About the Nation's Fiscal Health," WatchBlog, February 16, 2024, https://www.gao.gov/blog/warning-about-nations-fiscal-health.

[8] Losing such privilege is not without precedent, as the U.K. was in a similar position in the 19th Century and first decades of the 20th Century. On fiscal inflation, see Barro and Bianchi and Dorn; on the privileged position of the U.S. on debt sustainability, see Choi et al. According to the Penn Wharton Budget Model, the United States has about 20 years until reaching the point that no fiscal policy would be able to avoid a default. Robert Barro, Francesco Bianchi, "Fiscal Influences on Inflation in OECD Countries, 2020-2022," NBER Working Paper no. 31838 (November 2023), https://doi.org/10.3386/w31838; James A. Dorn, "The Menace of Fiscal Inflation," Cato Institute blog, June 16, 2022, https://www.cato.org/blog/menace-fiscal-inflation; Jason Choi, Duong Q. Dang, Rishabh Kirpalani, and Diego J. Perez, "On Exorbitant Privilege and the Sustainability of US Public Debt," NBER Working Paper no. 32129 (February 2024), https://doi.org/10.3386/w32129; Jagadeesh Gokhale, Kent Smetters

118th Congress to implement a debt commission only lends credence to the sentiment that policymakers are unwilling to address the politically difficult fiscal problems.

Stabilizing the debt-to-GDP ratio is likely the most important policy goal the Federal government must address over the next decade. While reducing the deficit is the required course of action (reducing the growth of the numerator), these policies should not hamper economic growth (the denominator). Deficit reduction that disregards economic growth is a recipe for failure. The Biden Administration, more interested in putting the economy at the service of the state, has taken the stance that debt can be fixed by "taxing the rich" and making them pay their "fair share."[9] This is misleading; high-income individuals already pay for the vast majority of government spending; increasing taxes on this group would not raise sufficient revenue (as low as 19 percent of deficits), and the White House is overly optimistic of the effects of such policies on the economy.[10]

This Chapter explores the limits of the "taxing the rich" approach to balancing the fiscal situation by first looking at the issue across each type of tax, then determining that these shortcomings are

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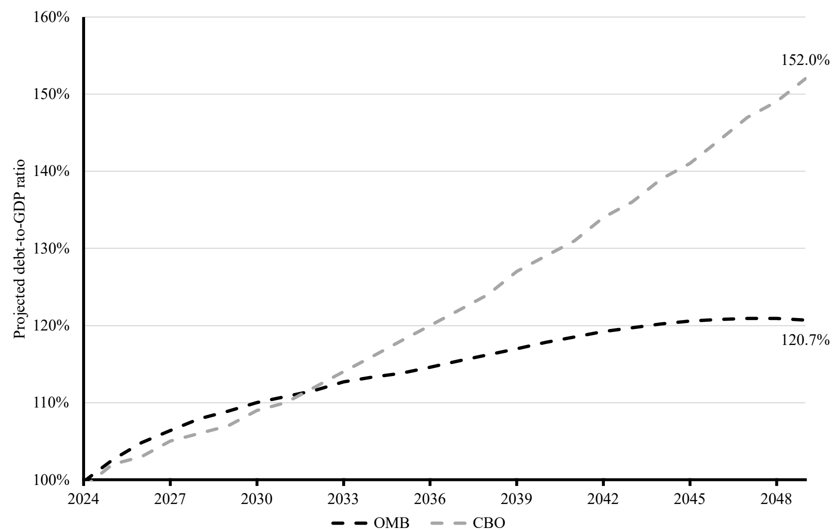
and Mariko Paulson, "When does federal debt reach unsustainable levels?", Penn Wharton Budget Model brief, October 6, 2023. https://budgetmodel.wharton.upenn.edu/issues/2023/10/6/when-does-federal-debt-reach-unsustainable-levels.

[9] Office of Management and Budget (OMB), *Budget of the U.S. Government Fiscal Year 2025*, (The White House, 2024): 8, 15, 19, 20, 45, 46, 47, 78, 133, 138, 139, 145, 149, https://www.whitehouse.gov/wp-content/uploads/2024/03/budget_fy2025.pdf.

[10] Calculation based on Brian Riedl's lower bound estimation of 1.1 percent reduction in deficit, divided by the 5.7 percent of GDP deficit estimation by CBO. Brian Riedl, "The Limits of Taxing the Rich," Manhattan Institute report (September 2023), https://manhattan.institute/article/the-limits-of-taxing-the-rich; CBO, *The Budget and Economic Outlook: 2024 to 2034*.

more evident when examined at a macro level. Finally, we briefly discuss the advantages of instead taking prudent approaches to fiscal consolidation.

Figure 3-3: Differences between OMB and CBO Debt-to-GDP Projections



Source: Congressional Budget Office (CBO); Office of Management and Budget (OMB)

The Limits of Taxing the Rich

As the public and their elected representatives have become more cognizant of the deteriorating fiscal situation, there has been an increased interest in policy solutions, with ubiquitous cries among the left to "tax the rich." Given the allure of having someone else pay to solve the nation's fiscal concerns, perhaps it is unsurprising the Biden Administration targets successful businesses and higher income individuals in its proposals to raise revenue. With the magnitude and path of deficits, merely taxing the rich will be insufficient to fully address the country's fiscal concerns. "Tax the rich" is inflammatory political rhetoric, not rational economic policy. Economic theory supports the idea that there are limits to the revenue raised from higher tax rates, and estimates of the

revenue raised as a percentage of GDP from taxing the rich are low. These limits differ by country and change over time, and, while they could improve the country's finances, they come at a great cost for private businesses and households. Furthermore, their estimations could vary widely, depending on the assumptions of the public's reaction to changes in tax rates.

Laffer Curve

One well-examined theory illustrating the relationship between tax rates and revenue raised is the Laffer curve. Developed by economist Arthur Laffer, the concept begins with the premise that both at a tax rate of 0 and at a rate of 100 percent, there will be no revenue raised. This is because the taxed market activity would be unprofitable and thus cease to continue. Tax rates between these two points would generate varying levels of revenue. Increases in tax rates would generate more revenue only up to a certain level, beyond which any increase in rates would result in less in revenue because economic activity would decline.[11] Its shape further suggests that each additional tax dollar results in a larger loss for the economy. The shape of the Laffer curve is a function of taxable income elasticity (or the sensitivity to a change in tax rates). As discussed later in the Chapter, there are diverging opinions on this elasticity, which lead to different estimations of the optimum tax rate. The revenue-maximizing tax rate depends on economic conditions, the rates of other taxes, the possibility for an amount of tax avoidance, and other factors, but—contrary to some policymakers' beliefs—evidence supports the premise that taxes can only be raised so high to maximize revenue.[12]

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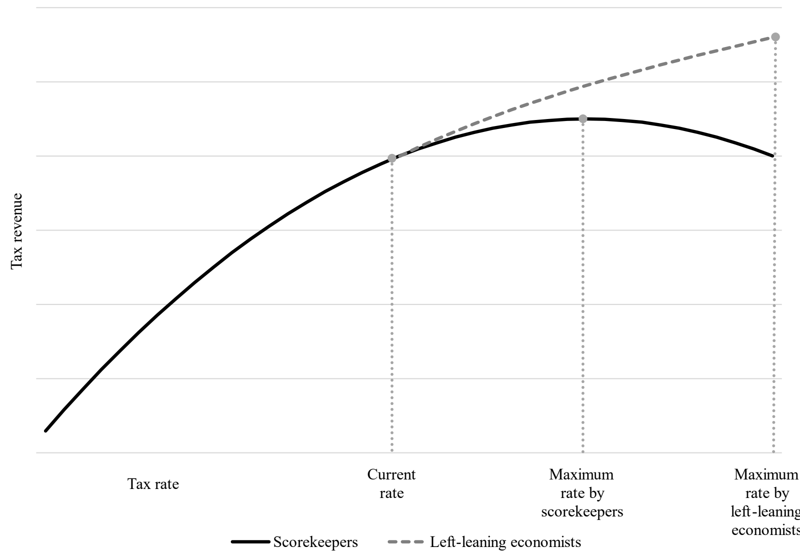
[11] Art Laffer, "Laffer Curve Napkin," National Museum of American History, September 14, 1974, https://americanhistory.si.edu/collections/nmah_1439217.

[12] The JEC Republicans avoid using the term 'optimal rate,' as included in part of the literature, because a tax rate maximizing the size of the government cannot be considered optimal.

Figure 3-4: Diverging Views on the Laffer Curve



The U.S. Tax System is Highly Progressive

While a key justification for targeting businesses and high-income individuals with higher effective tax rates is the need to raise revenue, the idea of equity buttresses the policy. Specifically, there is a perception that high-income individuals pay less than their "fair share."[13] In 2019, the top 1 percent paid over 20 percent of all Federal taxes and almost 40 percent of all income tax.[14] Notably, the Tax Cuts and Jobs Act of 2017 (TCJA) made the U.S. tax code more progressive. The same data from CBO show that the ratios of Federal tax liabilities paid by the upper percentiles was higher in every year after the passage of the law in 2017.

[13] The meaning of what is "fair" is uncertain. This term is repeated throughout every economic document released by The White House; see, for example: OMB, *Budget of the U.S. Government Fiscal Year 2025*, 8, 15, 19, 20, 45, 46, 47, 78, 133, 138, 139, 145, 149.

[14] CBO, *The Distribution of Household Income in 2020,* November 2023. https://www.cbo.gov/publication/59509

Moreover, the Congressional Budget Office estimates that, while the top quintile earns almost 60 percent of all income, after taxes and transfers that percentage drops under 50 percent, while every quintile in the bottom 80 percent sees an increase in their shares (see Figure 3-6).[15] While the concept of decreasing marginal utility of income—that a rich person would value less an additional dollar than someone poorer—supports taxing the wealthy to reduce the budget deficit, the U.S. already maintains one of the most progressive tax systems among developed nations.[16] Given the degree of progressivity, it is critical to question whether further steepening would generate the purported revenue, or, alternatively, what level of income would be classified as "rich" and therefore subject to higher taxation, to close the chasm between projected receipts and expenditures.

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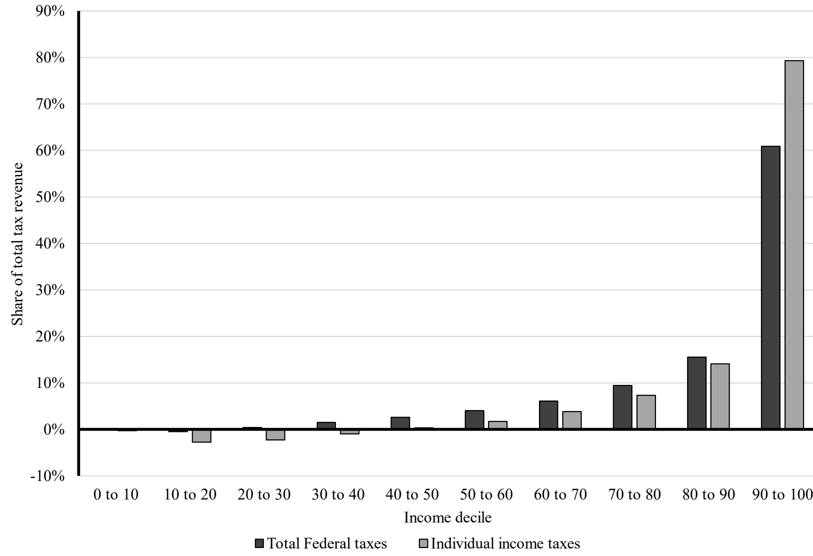
[15] CBO, *The Distribution of Household Income in 2020*

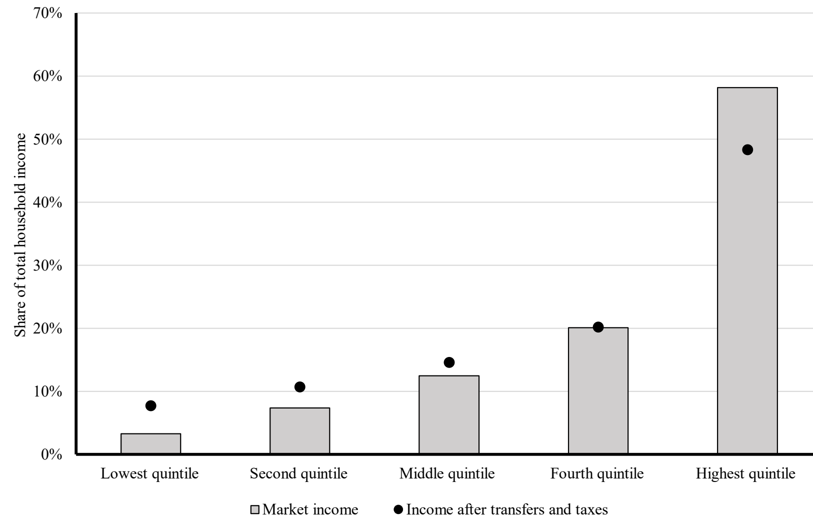
[16] Joint Economic Committee (JEC) Republicans, *Republican Response to the Economic Report of the President* (U.S. Congress, 2023), https://sen.gov/LVQYY; Thomas Blanchet, Lucas Chancel, and Amory Gethin, "Why Is Europe More Equal than the United States?" *American Economic Journal: Applied Economics* 14, no. 4 (2022): 480-518, https://doi.org/10.1257/app.20200703.

Figure 3-5: Share of Tax Liability by Income Decile, 2024



Source: U.S. Department of the Treasury, Office of Tax Analysis

Figure 3-6: Comparing the Distribution of Household Income before and after Transfers and Taxes, 2019



Source: Congressional Budget Office (CBO) "The Distribution of Household Income in 2020"

Box 3-1: The Importance of State and Local Taxes in the Analysis

Most discussions on taxes focus on the Federal level. An analysis including all levels for each type of tax would include multiple rates, in some cases, one for each municipality in the country. The Federal government lacks authority over state and local taxes but including state and local taxes is important when discussing average households' tax burden and distributional aspects.

There is an abundant heterogeneity of tax codes between states and localities. For example, while approximately 11.2 percent of household income is paid in taxes by state and local governments, this range varies from 7.4 percent in Wyoming to 15.9 percent in New York.[17] The heterogeneity is not only in rates but also in composition. States like Nevada and Washington rely heavily on sales taxes, while others like Montana do not tax consumption, relying on revenue from property and income.[18] This heterogeneity also opens the possibility for individuals to avoid heavier tax burdens by moving across state lines.[19]

State and local taxes represent over 30 percent of all U.S. tax revenue, placing it in the top five for this metric among developed

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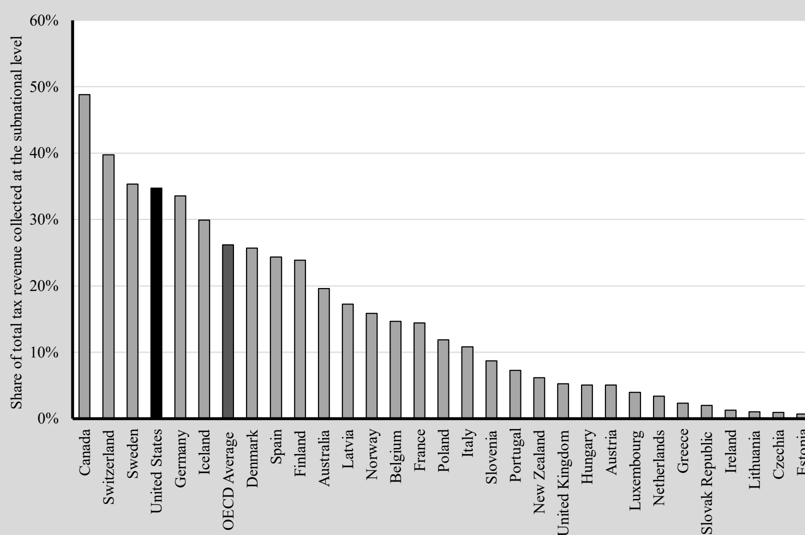
[17] Note that Alaska has a lower rate (4.9 percent) but the state receives high rate of federal subsidies, not making it useful for comparison. Tax Foundation, *Facts & Figures 2024: How Does Your State Compare?* (April 2024): Table 2, https://taxfoundation.org/wp-content/uploads/2024/04/Facts-and-Figures-How-Does-Your-State-Compare-Tax-Foundation-2.pdf.

[18] Tax Foundation, *Facts & Figures 2024*, Table 7.

[19] Jorge Barro, "Domestic Migration and State Tax Policy," Rice University's Baker Institute for Public Policy Center for Public Finance issue brief (August 12, 2022), https://www.bakerinstitute.org/research/domestic-migration-and-state-tax-policy-0.

countries.[20] Moreover, while the U.S. is often criticized for collecting a relatively small share of taxes on income compared to peer countries, after accounting for state and local taxes it shifts to the middle of the distribution.[21]

Figure 3-7: Share of Total Tax Revenue Collected at State and Local Levels



Source: OECD Revenue Statistics 2023

[20] Organisation for Economic Co-operation and Development (OECD), "Effective Tax Rates," OECD.Stat, accessed May 8, 2024, https://stats.oecd.org/index.aspx?DataSetCode=CTS_ETR.

[21] Excluding the collection of regressive taxes and considering only those based on income and property.

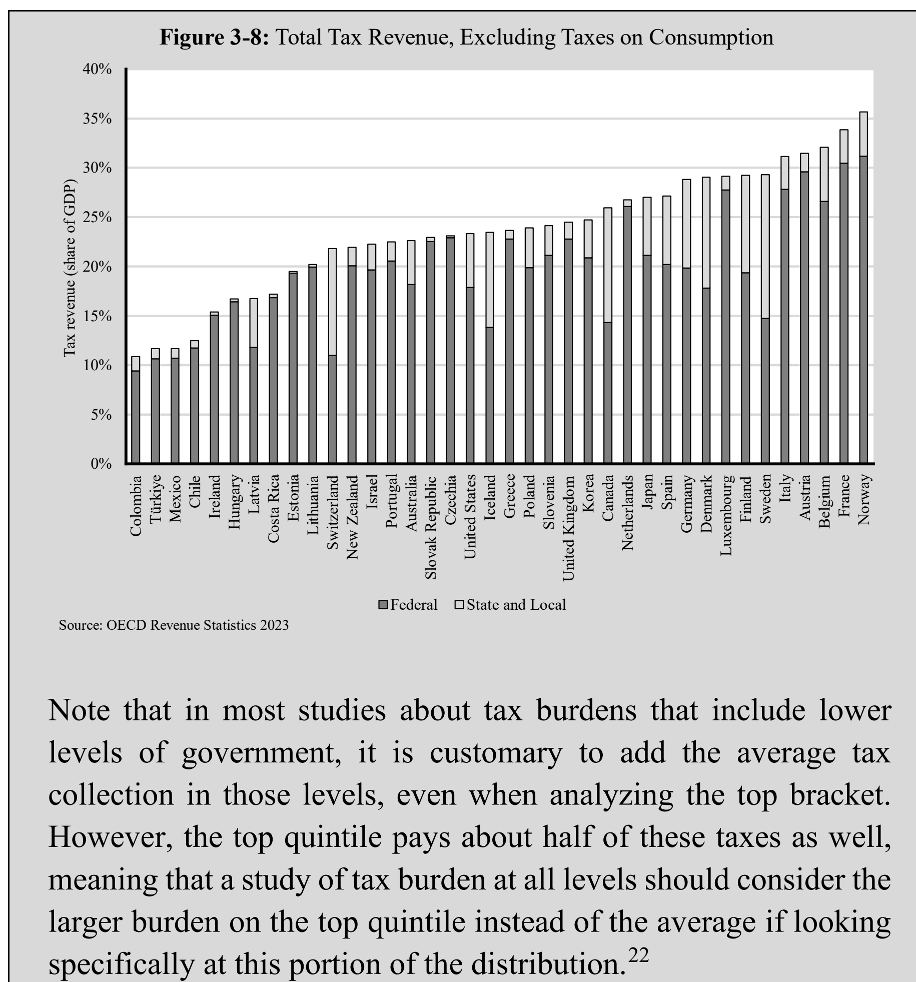


Figure 3-8: Total Tax Revenue, Excluding Taxes on Consumption

Source: OECD Revenue Statistics 2023

Note that in most studies about tax burdens that include lower levels of government, it is customary to add the average tax collection in those levels, even when analyzing the top bracket. However, the top quintile pays about half of these taxes as well, meaning that a study of tax burden at all levels should consider the larger burden on the top quintile instead of the average if looking specifically at this portion of the distribution.[22]

[22] Nevertheless, the same study shows that while the tax burden is higher for the top quintiles, state and local taxes are easier to transfer to consumers and wages, transforming its distribution into a flat one when looking at its incidence. Timothy Vermeer, Alex Durante, Erica York, and Jared Walczak, "America's Progressive Tax and Transfer System: Federal, State, and Local Tax and Transfer Distributions," Tax Foundation, March 30, 2023, https://taxfoundation.org/research/all/federal/who-pays-taxes-federal-state-local-tax-burden-transfers/.

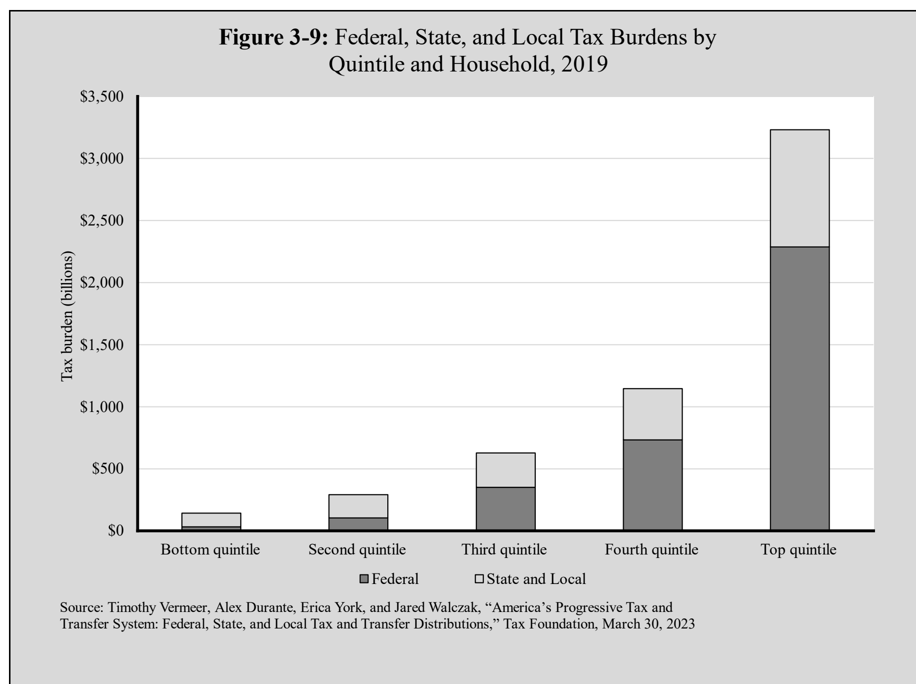


Figure 3-9: Federal, State, and Local Tax Burdens by Quintile and Household, 2019

Source: Timothy Vermeer, Alex Durante, Erica York, and Jared Walczak, "America's Progressive Tax and Transfer System: Federal, State, and Local Tax and Transfer Distributions," Tax Foundation, March 30, 2023

Biden Administration Tax Proposals

In March 2024, the White House released the Biden Administration's FY2025 Budget.[23] Its purported objective of stabilizing the debt-to-GDP ratio is laudable, however, the Administration's proposals warrant critique. First, as discussed above, tying tax increases to making successful businesses and affluent individuals "pay their fair share" reinforces misconceptions about the true distribution of the tax burden, especially when using misleading statistics to distort reality.[24]

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[23] OMB, *Budget of the U.S. Government Fiscal Year 2025*.

[24] Note, however, that OMB projects that the baseline debt-to-GDP would stabilize organically by 2048, which is very different than the nonstop growth projected by CBO. OMB, *Budget of the U.S. Government Fiscal Year 2025*, Table S-1; OMB, *Analytical Perspectives Budget of the U.S. Government Fiscal Year 2025* (The White House, 2024): 20, https://www.whitehouse.gov/wp-

Second, there is uncertainty about the size of the revenues that the proposed tax increases would generate. Taken together with the Administration's record of implementing spending that costs more than estimated at enactment, there is a reasonable risk that its policies will exacerbate rather than relieve fiscal pressures.[25] Third, large tax increases severely harm economic growth and could be counterproductive to stabilizing debt ratios and supporting investments that may make disruptive discoveries that could drastically improve Americans' quality of life.

The tax policy proposed in the FY2025 Budget would make the U.S. one of the most heavily taxed countries in the developed world. Presently, the country's statutory top marginal corporate tax rate is approximately 25.8 percent (including the average state corporate tax), which, in comparison to European countries, would make it the seventh-highest country out of 52.[26] If corporate income tax rates rose to 28 percent, as proposed in the President's

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content/uploads/2024/03/spec_fy2025.pdf; Glenn Kessler, "Biden keeps saying billionaires pay 8 percent in taxes. Not really," *The Washington Post*, January 23, 2024, https://www.washingtonpost.com/politics/2024/01/23/biden-keeps-saying-billionaires-pay-8-percent-taxes-not-really/.

[25] Estimates that extending all provisions from TCJA would cost more than 3.4 trillion through 2033. Additionally, the original costs related to the Inflation Reduction Act were underestimated. Note also that recent increases in the interest rates have (unanticipatedly) contributed significantly to the level spending. CBO, "Budgetary Outcomes Under Alternative Assumptions About Spending and Revenues," CBO report (May 2023), https://www.cbo.gov/publication/59154#data; Travis Fisher, "The Inflation Reduction Act's Energy Subsidies Are More Expensive Than You Think," Cato Institute blog, September 2023, https://www.cato.org/blog/iras-energy-subsidies-are-more-expensive-you-think.

[26] Cristina Enache, "Corporate Tax Rates around the World, 2023," Tax Foundation (December 12, 2023), https://taxfoundation.org/data/all/global/corporate-tax-rates-by-country-2023/.

Budget, the combined Federal and state rate would be 32.8 percent. This would bring the U.S. to the second-highest rate when compared to European countries. Moreover, the FY2025 Budget proposes raising long-term capital gains taxes to 44.6 percent, which is higher than Denmark, the highest rate in Europe at 42 percent. [27]

In addition to the high tax rates, the Budget also relies on unrealistic assumptions to generate rosy results.[28] First, the Budget projects no changes in revenue and spending on Social Security, unemployment insurance, and customs duties despite the vast increase in taxes and social spending.[29] The projections fail to reflect the repercussions on retirement, employment, and life expectancy.[30]

Second, the White House projects no significant effect from the proposed tax policies on growth. Meanwhile, outside analyses

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[27] U.S. Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2025 Revenue Proposals* (March 11, 2024), https://home.treasury.gov/system/files/131/General-Explanations-FY2025.pdf; Alex Mengden, "Capital Gains Tax Rates in Europe, 2024," Tax Foundation Europe (March 12, 2024), https://taxfoundation.org/data/all/eu/capital-gains-tax-rates-in-europe-2024/.

[28] James C. Capretta, "The Biden Administration's 2025 Budget," American Enterprise Institute AEIdeas, March 12, 2024, https://www.aei.org/health-care/the-biden-administrations-2025-budget/.

[29] Compare Tables S-3 and S-4. OMB, *Budget of the U.S. Government Fiscal Year 2025*.

[30] There are many other aspects worth analyzing but they are unrelated to taxation. For example, under current law, spending on defense is scheduled to decrease as a share of GDP to a record low of 2.4 percent, which might not be the most likely scenario as global tensions continue to mount. Additionally, a more qualitative criticism could be made to the proposed transfer of several programs from discretionary to mandatory spending, curtailing the power of the purse given to Congress by the Constitution.

predict a drop in the long-run GDP of more than two percent due in large part to notable declines in capital, employment, and wages.[31] A slower economy means households are relatively poorer, implying a smaller tax base. According to the Tax Foundation, the proposals in the Budget would only reduce the deficit by $1.4 trillion over the next 11 years, which is less than half of what the White House Office of Management and Budget (OMB) estimates.[32] The lack of pro-growth policy measures will only widen this gap further in the long run.

It is concerning that the Administration's proposals ignore that changes to taxation distort economic behavior and can ultimately slow growth. Most taxes are not neutral and change the relative cost of labor and consumption, impacting individual decision-making. This can have large-scale effects on investment and labor participation when aggregated to the scale of the macroeconomy. These omissions in their analysis are particularly important when the policies proposed include significant new taxes whose effects are not independent. Additionally, the burden of tax incidence trickles down to consumers and workers.

This criticism is not unique to the White House's economic team. Most of the academic research by left-leaning economists related to increasing tax revenue share similar flaws in their analysis. Many greatly underestimate the response from the private sector with regards to the decrease in earnings and omit the interactions

[31] Garrett Watson, Erica York, William McBride, Alex Muresianu, Huaqun Li, and Alex Durante, "Details and Analysis of President Biden's Fiscal Year 2025 Budget Proposal," Tax Foundation (March 22, 2024), https://taxfoundation.org/research/all/federal/biden-budget-2025-tax-proposals/.

[32] Watson, York, McBride, Muresianu, Li, and Durante, "Details and Analysis."

of different proposals when aggregating their effects.[33] Furthermore, despite their optimism, none of these studies find that when incorporating economic effects of higher taxes, there will be enough revenues collected to stabilize the debt-to-GDP ratio in the long term. JEC Republicans estimate that, to keep that ratio at 100 percent, the primary deficit (revenue minus non-interest spending) needs to decrease between 1 percent of GDP in

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[33] Most of these papers share many of the provisions that President Biden proposed since his time as a candidate, and the proposals are a response to TCJA. In general, they raise taxes on corporations in similar ways as in the President's Budget without measures to mitigate GDP growth slowdown. In particular, Batchelder and Kamin also add a surtax to high incomes and propose expanding the estate tax while eliminating the step-up basis, and therefore double taxing part of the inherited wealth. Sarin and Summers propose similar changes and add an additional $400 billion in revenue by investing $20 billion in the IRS. However, those proposals only raise 1.1 percent of GDP. Notice that when these papers were written, the budget deficit had been at an average slightly over 3.1 percent in the previous five years. Clausing and Sarin proposed a tax reform that include a subset of those FY 2025 reforms and add a Financial Transactions tax and Corporate Carbon Fees (and also revenue neutral changes to TCJA and expansion of tax credits) that would raise almost $5 trillion dollars ($3.5 trillion net of additional spending, or 1.1 percent of GDP). While they propose restoring expensing for research and experimentation, this is not enough to prevent a slowdown in the economy. For reasons explained below, this *Response* leaves out of consideration proposals that include taxes on wealth or on unrealized gains that are almost impossible to implement and have the potential of seriously harming the economy. Lily Batchelder and David Kamin, "Taxing the Rich: Issues and Options" (September 2019), https://doi.org/10.2139/ssrn.3452274; Natasha Sarin and Lawrence Summers, "A broader tax base that closes loopholes would raise more money than the plans by Ocasio-Cortez and Warren," *The Boston Globe*, March 28, 2019, https://www.hks.harvard.edu/sites/default/files/centers/mrcbg/files/Broader%20tax%20base%2C%20Summers.pdf; Kimberly A. Clausing and Natasha Sarin, "The coming fiscal cliff: A blueprint for tax reform in 2025," The Hamilton Project paper (September 2023), https://www.hamiltonproject.org/wp-content/uploads/2023/09/20230927_THP_SarinClausing_FullPaper_Tax.pdf.

2025 to 2.5 percent in 2054.[34] Notably, this is a low estimate that assumes spending continues as projected under current law. A more likely scenario would incorporate at least some incremental spending from new programs, the renewal of expiring ones, and other additional costs to current policies.[35] An underestimation of future deficits will require larger reductions to stabilize it. Furthermore, any delay in fiscal consolidation would stabilize the debt at a higher level, increasing the cost of net interest payments which would require a larger reduction of the deficit.

Calls to Increase Corporate Income Taxes

The President's FY2025 revenue proposals include a variety of reforms to business taxation.[36] About half of the $2.7 trillion in additional taxes on businesses is expected to come from an increase in the corporate income tax rate from 21 to 28 percent.[37] The 2023 *Response* discusses the shortcomings of the corporate tax proposals in the President's FY2024 Budget.[38] As the corporate tax proposals in the President's FY2025 Budget are

[34] JEC Republicans calculations are based on CBO's long-term budget projections. These calculations account for the reduction in the deficit after certain provisions from TCJA phase out. CBO, *The Long-Term Budget Outlook: 2024 to 2054*.

[35] Estimates that extend all provisions from TCJA would cost more than 3.4 trillion through 2033. Additionally, the original costs related to the Inflation Reduction Act were underestimated. Note also that recent increases in the interest rates have contributed significantly to the level spending. CBO, "Budgetary Outcomes Under Alternative Assumptions;" Fisher, "The Inflation Reduction Act's Energy Subsidies Are More Expensive Than You Think."

[36] U.S. Treasury, *General Explanations FY2025*.

[37] OMB, *Budget of the U.S. Government Fiscal Year 2025*, 45.

[38] Note that most of the largest provisions in FY2025 are the same as FY2024, so the analysis done applies to this year as well. JEC Republicans, *Response*, 62-92.

almost identical to the previous year's, the sentiments presented in last year's *Response* are also applicable.[39]

The policies:

- reduce incentives to invest, hampering growth and delaying technological advances;
- distort the types of business that are viable;
- incentivize profit shifting and relocation overseas;
- have a substantial incidence on wages of all quintiles, reducing employment;
- tax the same income twice; and
- reduce the volume of long-term investments as investors anticipate a probable tax hike. That is, GDP growth may slow even if the tax hike never materializes.

Corporate income taxes are levied on the earnings of businesses structured as corporations and are distinct from the taxes applicable to businesses structured as pass-through entities. The Administration cites administrative simplicity of a corporate tax increase and increasing progressivity of the tax code as primary reasons for their revenue proposal.[40] The statement on the simplicity of the tax to raise revenue is at odds with the Administration proposing over 25 additional measures to prevent tax avoidance, including an increase in the corporate alternative minimum tax rate.[41] On top of this, empirical research show that

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[39] OMB, *Budget of the U.S. Government Fiscal Year 2025*, Tables S-1 and S-9; JEC Republicans, *Response*

[40] U.S. Treasury, *General Explanations FY2025*.

[41] Business practices are complex and can lead to different tax rates, depending on the type of corporation (C-type or pass through), origin of the profits, type of financing, type of costs, etc. Increasing the complexity of the tax code makes it easier to find paths for tax avoidance.

labor bears a significant amount of the corporate tax burden, between 20 and 70 percent.[42]

The Tax Foundation finds that raising the corporate tax rate to 28 percent would reduce long-run GDP by 0.9 percent, the capital stock by 1.7 percent, wages by 0.8 percent, and full-time equivalent jobs by 192,000.[43] The additional measures in the Budget would exacerbate this effect. Some of these changes would apply only to domestic firms and not to foreign, creating incentives for U.S. corporations to move their headquarters overseas, merge with foreign corporations, and sell their assets to foreign investors, resulting in a reduction of the domestic stock of capital, which is an essential component of economic growth.[44] Moreover, while profit shifting (that is, the practice of moving intangible capital to low-tax countries) is often seen as negative, there is evidence that, in its absence, new taxes could have a much

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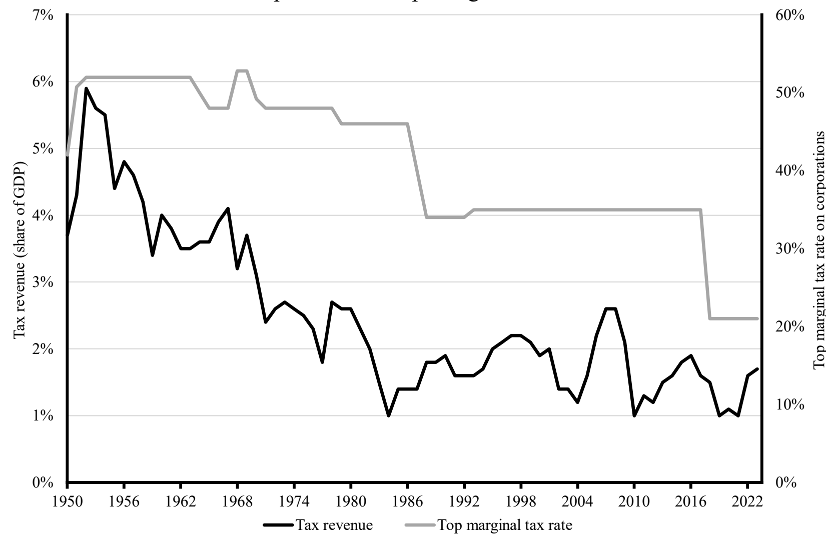
[42] Stephen J. Entin, "Labor Bears Much of the Cost of the Corporate Tax," Tax Foundation Special Report no. 238 (October 2017), https://files.taxfoundation.org/20181107145034/Tax-Foundation-SR2382.pdf; James R. Nunns, "How TPC Distributes the Corporate Income Tax," Tax Policy Center (September 13, 2012), https://taxpolicycenter.org/publications/how-tpc-distributes-corporate-income-tax.

[43] Watson, York, McBride, Muresianu, Li, and Durante, "Details and Analysis."

[44] Kyle Pomerleau, "Biden's Reforms to the Tax Treatment of US Multinational Corporations: The Knowns and Unknowns," American Enterprise Institute Economic Perspectives (July 20, 2021), https://www.aei.org/research-products/report/bidens-reforms-to-the-tax-treatment-of-us-multinational-corporations-the-knowns-and-unknowns/; Cody Kallen, "Effects of Proposed International tax Changes on U.S. Multinationals," Tax Foundation Fiscal Fact, no. 761 (April 2021), https://files.taxfoundation.org/20210427161012/Effects-of-Proposed-International-Tax-Changes-on-U.S.-Multinationals.pdf; Pomerleau, "Biden's Reforms to the Tax Treatment of US Multinational Corporations."

larger negative impact on employment, wages and investment.[45] Expecting no reaction from the business sector to a large reduction in their returns to investment is contrary to one of the most fundamental concepts in economics.

Figure 3-10: Corporate Income Tax Revenue as a Share of GDP Compared to the Top Marginal Tax Rate



Source: Office of Management and Budget (OMB); U.S. Department of the Treasury, Office of Tax Analysis

Furthermore, historical data shows that increases in corporate tax rates do not meaningfully increase receipts (see Figure 3-10).[46]

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[45] In this paper, the author warns that preventing multinationals from using tax shelters might have serious impact on investment and employment, that is not prevalent when this option is available.; Juan Carlos Suárez Serrato, "Unintended Consequences of Eliminating Tax Havens," NBER Working Paper no. 24850 (July 2018), https://doi.org/10.3386/w24850.

[46] Note that the corporate tax rate is not the only determinant of the tax revenue. Changes in legislation other than the rate (tax credits and exemptions, for example) affect revenue. However, according to Auerbach and Poterba, the main determinant behind the drop in revenue in the three decades before the 1980s was a drop in the corporations' margin of profits.; Alan J. Auerbach and James M. Poterba, "Why Have Corporate Tax Revenues Declined?" *Tax Policy*

Advocates for raising the corporate tax rate often make the argument that revenue from this form of tax as a share of GDP is significantly lower than in other developed economies.[47] While this may be the case, the U.S. has relatively more pass-through companies and relatively fewer corporations than peer countries.[48] Kyle Pomerleau and Donald Schneider estimate that if the rest of the OECD had the same corporate composition as the U.S., the U.S. would fall near the median. Notably, by international standards, the U.S. does not have a low corporate tax rate and raising it would make the country notably less competitive than its peers.[49]

Given the swath of evidence of the limited positive and broad negative effects, proposals to raise such a large amount of taxes from corporations are ill-advised. They would only encourage relocation of companies, reduce capital formation, growth and

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and the Economy 1 (1987): 1-28, https://doi.org/10.1086/tpe.1.20061761.

[47] Jason Furman, "How to increase growth while raising revenue: Reforming the corporate tax code," The Hamilton Project, (January 28, 2020), https://www.hamiltonproject.org/wp-content/uploads/2023/01/Furman_LO_FINAL.pdf.

[48] While in 1980 about three-quarters of business income was originated in C-corporations, by the 2010s this was under one-half, with most of the remainder split between partnerships and S-corporations. Note that many of the new pass-through businesses are just individuals who formed a business to manage their personal investments at a lower tax rate. The authors also find that some of the partnerships taxed at a lower rate are part of clusters of partnerships partially owned by each other, such that it is difficult to identify the true ownership of these companies.; Kyle Pomerleau and Donald Schneider, "The Biden Administration's Corporate Tax Statistic Is Misleading," *Bloomberg Tax*, April 16, 2021, https://news.bloombergtax.com/daily-tax-report/the-biden-administrations-corporate-tax-statistic-is-misleading; Michael Cooper et al., "Business in the United States: Who Owns It, and How Much Tax Do They Pay?" *Tax Policy and the Economy* 30, no. 1 (2016): 91-128, https://doi.org/10.1086/685594.

[49] Enache, "Corporate Tax Rates around the World, 2023."

employment, all while having a negligible impact on deficit reduction, reversing many of the achievements of the TCJA.

Increase in Personal Income Taxes

The Biden Administration proposes raising over $1.8 trillion in additional personal income taxes.[50] Part of this increase comes from restoring the top marginal rate to 39.6 percent, a reform of the capital gains tax, and an expansion of the net investment income tax.[51] Notably, it also plans to impose a minimum tax of 25 percent (inclusive of unrealized capital gains) on taxpayers with a net worth of $100 million or more. As with the proposed corporate tax increases, the Biden Administration reinforces the misconception that many Americans do not "pay their fair share," citing progressivity and redistribution as motives for their proposals.

The expectation of increasing tax collections by returning to pre-Reagan Administration-era tax rates is based on misguided academic research that estimates a maximum rate of up to 70 percent, but such research is based on unrealistic assumptions.[52]

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[50] Note that when adding the changes in estate tax and additional collections from the expansion of the IRS, this value would be closer to 2.2 trillion. These proposals are also a repeat from previous Budgets. U.S. Treasury, *General Explanations FY2025*.

[51] The two main changes regarding capital gains are taxing high-income earners at ordinary rates and realizing the capital income at death or donation.

[52] Vanessa Williams, "Alexandria Ocasio-Cortez's 70 percent tax on the rich isn't about revenue, it's about decreasing inequality," *NBC News Think*, January 26, 2019, https://www.nbcnews.com/think/opinion/alexandria-ocasio-cortez-s-70-percent-tax-rich-isn-t-ncna963146; Alan Cole and Scott Greenberg, "Details and Analysis of Senator Bernie Sanders's Tax Plan," Tax Foundation (January 28, 2016), https://taxfoundation.org/research/all/federal/senator-bernie-sanders-tax-plan-2016/; Peter Diamond and Emmanuel Saez, "The Case for a Progressive Tax: From Basic Research to Policy Recommendations,"

Raising the top statutory marginal tax rate is a suboptimal policy response to the burgeoning Federal debt for various reasons.[53]

The relatively modest revenue projected to be raised is consistent with the effects of past tax rate changes. While income tax rates have generally declined over the past 45 years, tax revenue as a share of the economy has remained relatively stable (see Figure 3-11). This may result from a greater incentive for skilled tax planning, with higher rates raising the incentive for tax avoidance, increasing the deadweight loss from this form of tax.[54] This problem is particularly pertinent for states with high top-end rates, where total taxes for high earners already surpass 50 percent, making them among the most heavily taxed in the developed world.[55]

Journal of Economic Perspectives 25, no. 4 (2011): 165-90, https://doi.org/10.1257/jep.25.4.165; Aparna Mathur, Michael R. Strain, and Sita Nataraj Slavov, "Should the Top Marginal Income Tax Rate Be 73 Percent?", American Enterprise Institute Tax Notes (November 19, 2012), https://www.aei.org/wp-content/uploads/2012/11/-should-the-top-marginal-income-tax-rate-be-73-percent_085518416524.pdf?x85095.

[53] Note that the top marginal rate is expected to go back to 39.6 percent in January 2026 when some provisions from the TCJA expire.

[54] The size of this deadweight cost is disputed by Raj Chetty, although he does not dispute the high sensitivity to marginal tax rates by those prone to tax avoidance. Also note that a high rate would increase tax evasion, as some individuals would find it less costly to run the risk of illegally not paying taxes, but this is not easy to estimate. Martin Feldstein, "Tax Avoidance and the Deadweight Loss of the Income Tax," *The Review of Economics and Statistics* 81, no. 4 (1999): 674-80, https://doi.org/10.1162/003465399558391; Raj Chetty, "Is the Taxable Income Elasticity Sufficient to Calculate Deadweight Loss? The Implications of Evasion and Avoidance," *American Economic Journal: Economic Policy* 1, no. 2 (2009): 31-52, https://doi.org/10.1257/pol.1.2.31.

[55] Alex Mengden, "Top Personal Income Tax Rates in Europe, 2024," Tax Foundation Europe (February 13, 2024), https://taxfoundation.org/data/all/eu/top-personal-income-tax-rates-europe-2024/; Andrey Yushkov, "State Individual Income Tax Rates

Figure 3-11: Personal Income Tax Revenue as a Share of GDP Compared to the Top Marginal Tax Rate

Source: Office of Management and Budget (OMB); U.S. Department of the Treasury, Office of Tax Analysis

Taxing capital gains is central to left-leaning tax reform agendas for various reasons. First, it applies mostly to the wealthy. It is a negligible part of most households' income, but about half for those with an AGI of $10 million and above.[56] Second, the tax rate on long-term investments is lower than for ordinary income. Third, the tax is paid upon realization, meaning that some gains go

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and Brackets, 2024," Tax Foundation (February 20, 2024), https://taxfoundation.org/data/all/state/state-income-tax-rates-2024/.

[56] According to the latest data from the IRS, this value is above 57 percent, but the two years when COVID-19 hit the hardest on the economy were atypical. Internal Revenue Service, *Statistics of Income —2021 Individual Income Tax Returns* (U.S. Department of the Treasury, 2021), Table 1.4, https://www.irs.gov/pub/irs-pdf/p1304.pdf; John Ricco, "The Revenue-Maximizing Capital Gains Tax Rate: With and Without Stepped-up Basis at Death," Penn Wharton Budget Model blog, December 4, 2019, https://budgetmodel.wharton.upenn.edu/issues/2019/12/4/the-revenue-maximizing-capital-gains-tax-rate-with-and-without-stepped-up-basis-at-death.

untaxed indefinitely if the asset is not sold.[57] Moreover, if the person dies or donates the asset to charity, the gains are reset; the recipient never pays taxes on them. The reforms proposed not only seek to raise the rates but are also a response to an impatient desire to tax gains before realization.

However, there is uncertainty as to the revenue that would be raised from an increase in the capital gains tax rate. As with other taxes, there is some evidence that tax revenue would increase, but collection also depends on the frequency of the realizations.[58] The sensitivity of the gains realized to changes in the tax is measured by the "elasticity of realization."[59] On the aggressive end of estimates, a recent study by Agersnap and Zidar find this elasticity to be between -0.5 and -0.3, meaning that the maximum rate for capital gains is somewhere between 38 and 47 percent.[60] Their findings indicate that an increase of 5 percentage points in the capital gains tax rate would yield $18 to $30 billion in annual Federal tax revenue (0.08 to 0.13 percent of GDP in 2021). Note that their estimations have a large margin of error, with the true maximum rate being somewhere between 0 and 94 percent.[61]

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[57] Batchelder and Kamin, "Taxing the Rich."

[58] For example, a profitable portfolio taxed at a 100 percent rate has no incentive to be sold and, therefore, will not collect any tax.

[59] The percent change in amount realized given a 1 percent change in the tax rate.

[60] Note that some of these papers express the results in dollar value. Given that the goal is to compare the effects regardless of when the studies were made, we transformed the values to percentage of GDP. Ole Agersnap and Owen Zidar, "The Tax Elasticity of Capital Gains and Revenue-Maximizing Rates," *American Economic Review: Insights* 3, no. 4 (2021): 399-416, https://doi.org/10.1257/aeri.20200535; Natasha Sarin, Lawrence H. Summers, Owen M. Zidar, and Eric Zwick, "Rethinking How We Score Capital Gains Tax Reform," NBER Working Paper no. 28362 (January 2021), https://doi.org/10.3386/w28362.

[61] Robert McClelland, "A New Study Suggests Congress Could Raise Money By Increasing Capital Gains Tax Rates To 47 Percent. But There Is A

Sarin, Summers, Zidar and Zwick, using these estimations, calculate that, given that a sizeable portion of the capital is invested in fixed terms, raising the rate to 40 percent can raise an additional 0.4 percent of GDP in revenue, which is still far short of the magnitude of the deficit.[62]

Nevertheless, these findings are outliers. Scorekeepers (such as CBO and JCT) and most research find that most capital investment is very sensitive to changes in the tax rate, with the maximum revenue-raising rate being around 30 percent.[63] There are several reasons to believe that the current rate is close to the maximum rate. The historical data is not consistent with the assertion that raising rates would increase revenue, as shown in Figure 3-12 below. Moreover, while a sizeable portion of capital investment is indeed inelastic to changes in the rate, this is because the majority of stocks are in non-taxable accounts, which are, by nature, unresponsive to changes in the tax rate.[64] This is an important

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Catch," Tax Policy Center TaxVox, September 16, 2020, https://www.taxpolicycenter.org/taxvox/new-study-suggests-congress-could-raise-money-increasing-capital-gains-tax-rates-47-percent.

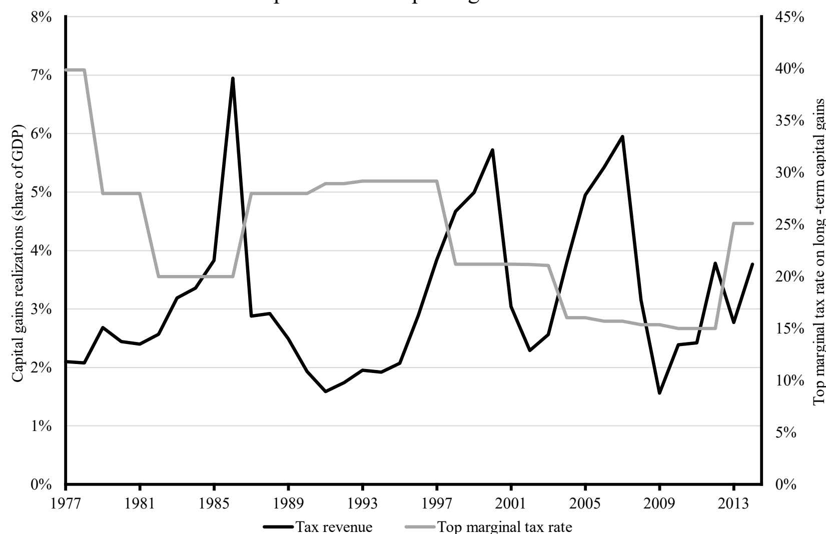
[62] Sarin, Summers, Zidar, and Zwick, "Rethinking How We Score Capital Gains Tax Reform."

[63] However, John Ricco estimates that the rate could go from 33 percent to 42 percent if stepped-up basis at death is eliminated. Timothy Dowd and Robert McClelland, "The Bunching of Capital Gains Realizations," Tax Policy Center research report (February 7, 2017), https://www.taxpolicycenter.org/publications/bunching-capital-gains-realizations/full; Joint Committee on Taxation, *New Evidence on the Tax Elasticity of Capital Gains: A Joint Working Paper of the Staff of the Joint Committee on Taxation and the Congressional Budget Office* (JCX-56-12) (June 2012), https://www.jct.gov/getattachment/c0efd05d-a7a4-47b6-91cf-a9981301d97d/x-56-12-4472.pdf; John Ricco, "The Revenue-Maximizing Capital Gains Tax Rate: With and Without Stepped-up Basis at Death."

[64] Also, note that changes in the rate will have a bigger effect on those paying the tax in full, but very little on those who are skilled at avoiding

point; large changes in the rate would drive more investors to tax-free type of investments, even if the pre-tax ROI is lower.

Figure 3-12: Capital Gains Realizations as a Share of GDP Compared to the Top Marginal Tax Rate



Source: U.S. Department of the Treasury, Office of Tax Analysis

While there is disagreement on the additional revenue that can be raised from increased capital gains tax rates, the economic consequences of doing so are almost all negative. Increasing tax rates on capital gains would mean an exodus of capital, lower employment, and a bias against saving, leading to a lower level of national income in the long term.[65] A study finds that the Biden

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taxes. Steven M. Rosenthal, "Only About One-Quarter of Corporate Stock is owned by Taxable Shareholders," Tax Policy Center TaxVox, May 16, 2016, https://www.taxpolicycenter.org/taxvox/only-about-one-quarter-corporate-stock-owned-taxable-shareholders.

[65] This is not unlikely even in Agersnap and Zidar's paper since their margin of error was large. Agersnap and Zidar, "The Tax Elasticity of Capital Gains and Revenue-Maximizing Rates."; Note also that a drop in employment will also mean a drop in collections of personal income and payroll taxes. Martin Feldstein, "The Effect of Taxes on Efficiency and Growth," NBER Working Paper no. 12201 (May

Administration's proposal to raise the capital gains tax rate for those with income over $1 million to the top-end marginal tax rate (currently 37 percent), would lower long-run GDP by 0.3 percent.[66]

Changes in the capital gains tax rate will dramatically affect the volume and type of investments in capital, which are the backbone of long-run economic growth. This has a bigger impact on risky investments, like tech startups or healthcare research, where investors compete to be the first to develop innovative products, such as drugs.[67] It will also distort the timing of realization, with some investors suboptimally delaying the realization of gains, slowing the flow of capital to more dynamic markets. Finally, not all gains are profit. Part of the appreciation is due to inflation but would be taxed nevertheless ("inflation tax").[68] In real terms, the "real" capital gains rate is much higher than the statutory.[69]

2006), https://doi.org/10.3386/w12201; Erica York, "An Overview of Capital Gains Taxes," Tax Foundation (April 16, 2019), https://taxfoundation.org/research/all/federal/capital-gains-taxes/.

[66] John W. Diamond, "The Economic Effects of Proposed Changes to the Tax Treatment of Capital Gains," Rice University's Baker Institute for Public Policy Working Paper (October 2021), https://www.bakerinstitute.org/research/economic-effects-proposed-changes-tax-treatment-capital-gains.

[67] The one coming second would not be awarded with a patent. There is a substantial focus on the profits of the winner but, in some industries, every winner loses a significant number of (costly) races.

[68] That is, if a stock is bought at $10 and then sold at $20, but out of the $10 gain, $5 is due to inflation, the true gains from this sale would be $5, but the investor would pay taxes on the $10 stock appreciation Garrett Watson, "Efforts to Combat Inflation's Impact on the Tax Code Should Remain a Priority in 2023," Tax Foundation (February 16, 2023), https://taxfoundation.org/blog/index-for-inflation-tax-adjustments/.

[69] Note that the higher fluctuations due to risk, the inflation tax, and the higher elasticity of certain capital (due to its ease to move across jurisdictions) are some of the main reasons why tax rates on capital are lower than those on labor.

The distortive policy of taxing unrealized capital gains has been promoted by far-left economists.[70] The Biden Administration attempts to implement this in two provisions. First, it proposes treating transfers of appreciated property by gift or on death as realization events.[71] While eliminating the step-up basis (that erases taxable gains of assets at death) reduces distortions, treating the transfer at death as a realization would create a liquidity crisis, especially for households that hold high value but illiquid assets (e.g., land and equipment), such as farms. In addition, the Administration proposes expansions to the estate tax, double taxing some inheritances if both reforms materialize.[72]

The second proposed change imposes a minimum tax of 25 percent on total income, generally inclusive of unrealized capital gains, for all taxpayers with wealth greater than $100 million.[73] This is not only potentially even more harmful, but also administratively unfeasible. While, according to OMB, it would be the largest source of increase in personal income tax revenue, external scorekeepers continue to be reluctant to score such a

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[70] Emmanuel Saez and Gabriel Zucman, "How to Get $1 Trillion from 1000 Billionaires: Tax their Gains Now," Working Paper (April 2021), https://eml.berkeley.edu/~saez/SZ21-billionaire-tax.pdf; Emmanuel Saez, Danny Yagan, and Gabriel Zucman, "Capital Gains Withholding', Working Paper (January 2021), https://eml.berkeley.edu/~yagan/CapitalGainsWithholding.pdf.

[71] U.S. Treasury, *General Explanations FY2025*, 80.

[72] Note that both changes combined could lead to partial double taxation of certain assets. U.S. Treasury, *General Explanations FY2025*, 120.

[73] The same tax was proposed for FY 2024, and a similar one was proposed for FY 2023. U.S. Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2024 Revenue Proposals* (March 9, 2023), https://home.treasury.gov/system/files/131/General-Explanations-FY2024.pdf; U.S. Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2023 Revenue Proposals* (March 28, 2022), https://home.treasury.gov/system/files/131/General-Explanations-FY2023.pdf.

policy.[74] Given that many assets are neither publicly traded nor readily valued, yearly valuation presents a considerable hurdle not only to taxing unrealized gains, but also to determining who is affected by the tax.[75] While the proposal allows for delays in payments for taxpayers with illiquid assets, it will likely nevertheless cause them to sell part of their businesses or property to meet the tax obligation. This problem will be exacerbated by shocks in the market from other individuals speculating with this quest for liquidity.

The Biden Administration also proposes to increase the Net Investment Income Tax rate from 3.8 to 5 percent and expand it to pass-through businesses. While this looks like a minor change, OMB projects an additional revenue of $800 billion, which, in comparison, is more than three times what it expects to collect from raising the income tax to 39.6 percent, with similar negative consequences as the ones described above.[76]

Payroll Taxes

There have been multiple attempts to strengthen the trust funds of Social Security and Medicare through increases in payroll tax rates in recent years.[77] As rising payroll taxes are partially borne by employers, the cost of labor increases, depressing wages, reducing employment and, ultimately, precautionary savings toward old

[74] Watson, York, McBride, Muresianu, Li, and Durante, "Details and Analysis."

[75] David Kamin, "How to Tax the Rich," *Tax Notes* 146, no. 1 (2015), https://ssrn.com/abstract=2550936.

[76] OMB, *Budget of the U.S. Government Fiscal Year 2025*, Tables S-6

[77] The office of the Chief Actuary of the Social Security Administration scores some of these proposals and updates the effect of some of these provisions every year. Social Security Administration, "Provisions Affecting Payroll Taxes," https://www.ssa.gov/OACT/solvency/provisions/payrolltax.html.

age.[78] In the medium and long term, wage dynamics will depend on the capacity of each type of worker to negotiate their employment situation and the employers' demand for employees. Furthermore, most of the income subject to this tax is also subject to personal income tax (double taxation). Also, lower wages from increases in the payroll tax rate mean offsetting revenues on the personal income tax since its base is eroded, increasing the on-budget deficit.[79]

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[78] This is because employers base their cost-benefit analysis on total compensation of the employee, not just the wage. For example, if employers and employees pay a payroll tax equal to 10 percent of the wage, a wage of $100 will pay $10 and the cost of the employee would be $110. If the rate is hiked to 20 percent, the cost will remain at $110, but the employee would be paid $91.67, and each side would pay $18.33 in taxes, which is 20 percent of $91.67.

[79] Joint Committee on Taxation, *The Income and Payroll Tax Offset to Changes in Payroll Tax Revenues* (JCX-89-16) (November 18, 2016), https://www.jct.gov/getattachment/df6ad7a8-d3f8-4f39-b465-1cbe5b077d20/x-89-16-4962.pdf.

Box 3-2: Who Pays for Medicare?

The FY2025 Budget proposes "wealthy people to pay their fair share toward Medicare."[80] This misconception arises due to the Medicare tax not being as progressive as the rest of the tax code.[81] However, the payroll tax only funds the HI Trust Fund (Part A), which only accounts for about 40 percent of total Medicare spending, a proportion that is expected to continue its decline in the future.[82] Most of the expenses originate in Parts B and D, which are almost entirely funded through premiums and general revenue. Figure 3-13 below breaks down the sources of funding of Medicare.

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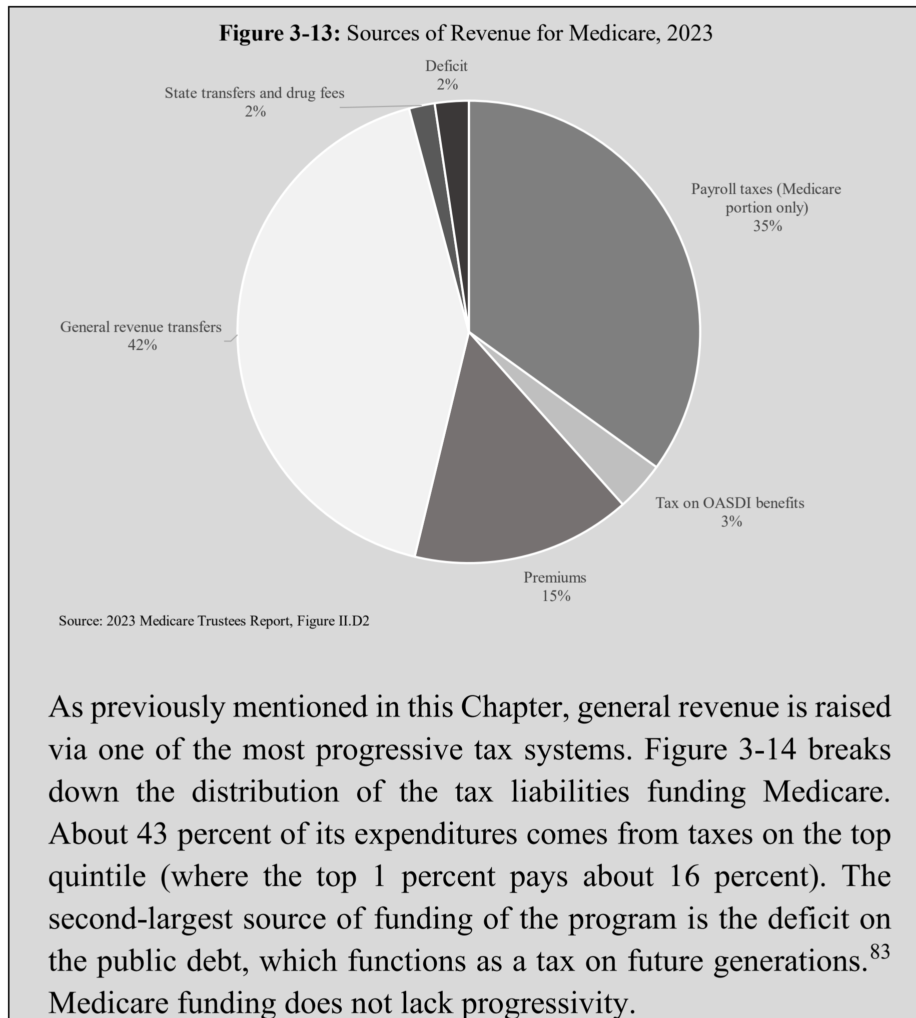
[80] There are numerous bills proposed over the past decade with a similar intent, for instance the Medicare and Social Security Fair Share Act. The White House, "FACT SHEET: The President's Budget Cuts Taxes for Working Families and Makes Big Corporations and the Wealthy Pay Their Fair Share," Press Release, March 11, 2024, https://www.whitehouse.gov/briefing-room/statements-releases/2024/03/11/fact-sheet-the-presidents-budget-cuts-taxes-for-working-families-and-makes-big-corporations-and-the-wealthy-pay-their-fair-share/; Senator Sheldon Whitehouse, "Medicare and Social Security Fair Share Act," Fact Sheet, https://www.whitehouse.senate.gov/wp-content/uploads/imo/media/doc/Medicare%20&%20Social%20Security%20Fair%20Share%20Act%20fact%20sheet.pdf.

[81] There is a 2.9 percent on payroll earnings (split between employers and employees), plus an additional 0.9 percent on wages paid in excess of $200,000.

[82] Centers for Medicare & Medicaid Services (CMS), *2023 Medicare Trustees Report* (March 31, 2023), https://www.cms.gov/oact/tr/2023.

Figure 3-13: Sources of Revenue for Medicare, 2023



Source: 2023 Medicare Trustees Report, Figure II.D2

As previously mentioned in this Chapter, general revenue is raised via one of the most progressive tax systems. Figure 3-14 breaks down the distribution of the tax liabilities funding Medicare. About 43 percent of its expenditures comes from taxes on the top quintile (where the top 1 percent pays about 16 percent). The second-largest source of funding of the program is the deficit on the public debt, which functions as a tax on future generations.[83] Medicare funding does not lack progressivity.

[83] JEC Republicans calculations using data from the 2023 Medicare Trustees Report and CBO. Note that, from the CBO report, JEC Republicans used 2019 data instead of 2020 data (the latest) because the latter was an anomalous year in terms of income distribution. Also note that if there was available data on the breakdown by quintiles of the "other sources" component, the top quintile would be closer to 50 percent. CMS, *2023 Medicare Trustees Report*; CBO, *The Distribution of Household Income in 2020* (November 2023), https://www.cbo.gov/publication/59757.

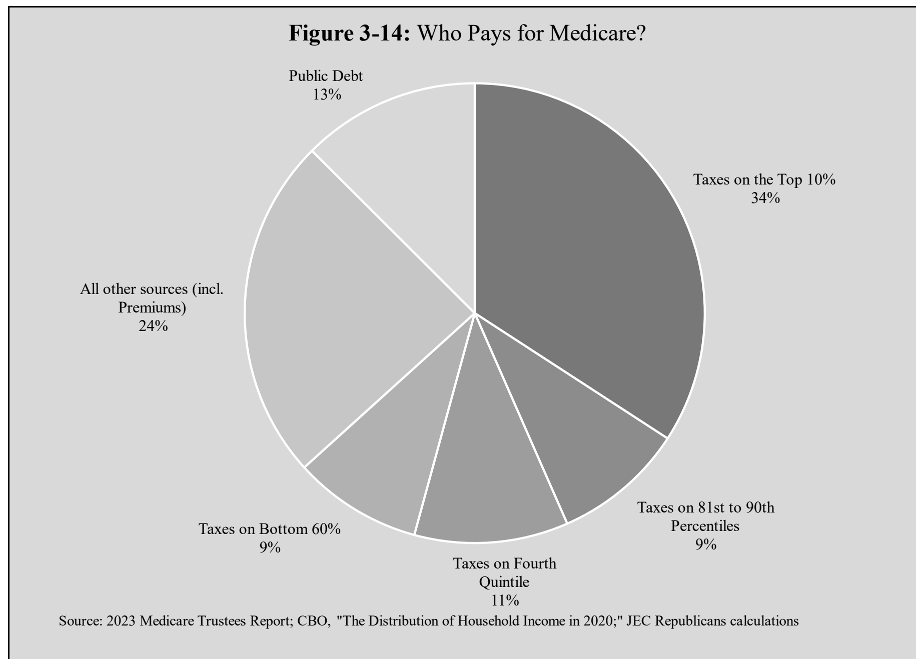


Figure 3-14: Who Pays for Medicare?

Source: 2023 Medicare Trustees Report; CBO, "The Distribution of Household Income in 2020;" JEC Republicans calculations

Whose Taxes Will Rise?

In total, President Biden's proposals to increase taxes on businesses and high-income taxpayers would raise $2.4 trillion dollars ($4.95 trillion in additional receipts, minus outlays), which is relatively small compared to the $19.5 trillion increase in the deficit over the same period.[84] CBO estimates $20 trillion for the same period, but while the OMB's deficits decrease over time, CBO's worsens (see Figure 3-15).[85] As mentioned above, the effects of these policies on growth would reduce the projected revenue by more than a third.[86] When examined, it becomes clear

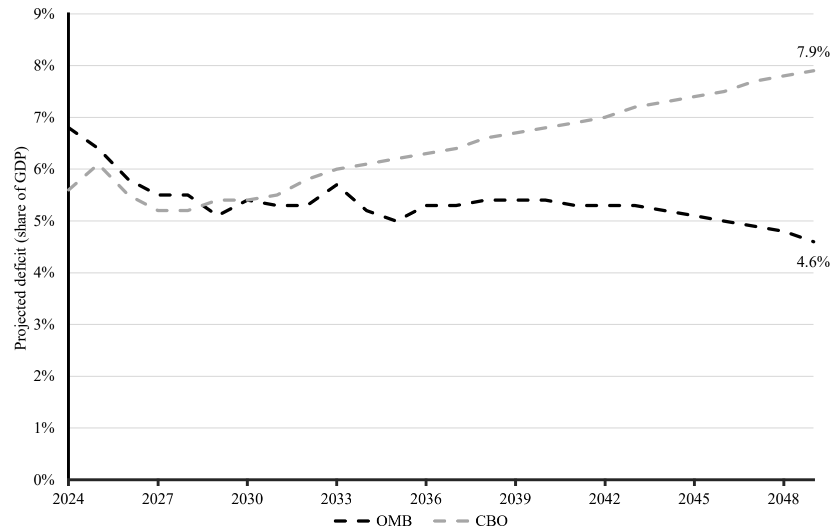
[84] U.S. Treasury, *General Explanations FY2025*, 247.

[85] This difference is relevant. According to OMB, even without changing current law, debt-to-GDP would stabilize before the year 2050. OMB, *Analytical Perspectives Budget of the U.S. Government Fiscal Year 2025*.

[86] Watson, York, McBride, Muresianu, Li, and Durante, "Details and Analysis."

that taxing successful businesses and affluent individuals will not only be a drag to the economy but would also fail to stabilize the debt. Thus, if revenues are the only target to rectify fiscal policy, individuals other than the rich would likely see their tax bills rise.

Figure 3-15: Differences between OMB and CBO Baseline Deficit Projections



Source: Congressional Budget Office (CBO); Office of Management and Budget (OMB)

Box 3-3: Taxes Are Not Independent of Each Other

One major difficulty in scoring multiple tax provisions is dealing with their interacting effects. The most common practice is to use individual estimations, then aggregate them. However, this approach is incorrect. The sum of the individual effects of ten different 10 percent taxes on income are not equivalent to a 100 percent income tax.

It is easy to see this when taxes are applied to the same base, but it is less straightforward when it involves different types. One

approach is to transform each tax as a percentage of income, then calculate the combined effect as if it was one larger tax on income. For example, suppose there is a tax on businesses of 20 percent, the same rate on dividends, and 5 percent on consumption. If the company has profits for $100, after paying taxes on profits and dividends (assuming all profits are disbursed), the owner is left with $64 that can be used to pay for $60.8 in goods and services (because of sales tax). Now, suppose that each tax rate is raised by 5 percentage points. Disposable income would drop by 12 percent (from $64 to $56.25) and purchasing power by 17 percent (from $60.8 to $50.6). As suggested by the Laffer curve, the marginal economic cost of raising taxes increase with the rate. Adding the effects of the three tax increases of 5 percent is more optimistic than the estimated effect of a 17 percent drop in disposable income. The disparity of both scenarios is going to be greater closer to the peak of the Laffer curve.

This method is also useful to evaluate a new tax, especially if the description could mislead on its true costs. Suppose that a 2 percent wealth tax is applied to net worths over $10 million if filling individually, and $20 million if filing as a married couple. This type of tax is commonly advertised as "only two cents for every dollar of excess wealth."[87] Of course, this is misleading, as that dollar in excess is taxed every year ad infinitum (or until the person loses enough wealth to no longer face the tax). The true size of the burden is clear when measured as a percentage of total

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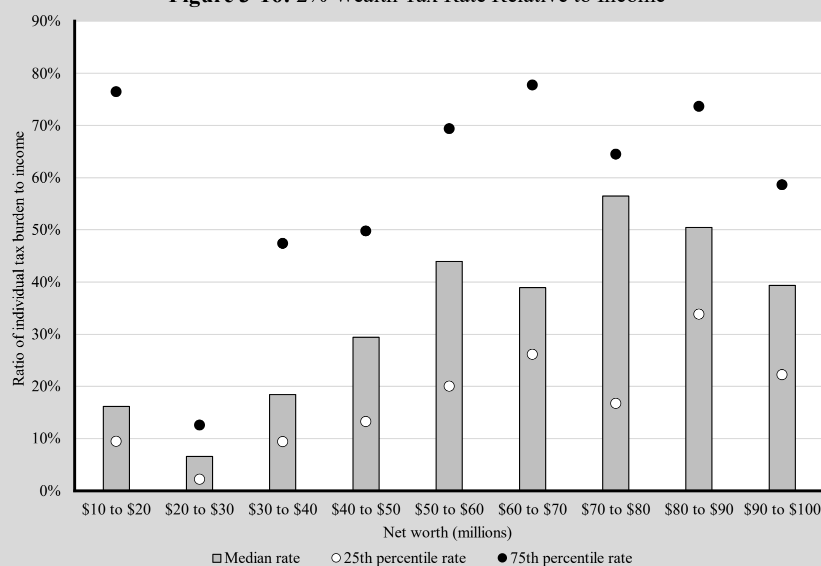
[87] "[…] on that next dollar, you pitch in two cents, so everyone else can have a chance." Senator Elizabeth Warren, "Warren, Jayapal, Boyle Reintroduce Ultra-Millionaire Tax on Fortunes Over $50 million," Press Release, March 19, 2024, https://www.warren.senate.gov/newsroom/press-releases/warren-jayapal-boyle-reintroduce-ultra-millionaire-tax-on-fortunes-over-50-million.

income.[88] Figure 3-16 uses the 2022 Survey of Consumer Finances of the Federal Reserve to estimate this.[89] The chart shows that a significant number of households would have to pay 40 percent or more of their income, on top of all the other taxes paid on income.

Figure 3-16: 2% Wealth Tax Rate Relative to Income



Source: Board of Governors of the Federal Reserve System, "2022 Survey of Consumer Finances;" JEC Republicans calculations

Adding a wealth tax to existing taxes could bring the tax burden of some households to levels close to 100 percent of their income.

[88] Of course, total income is not the only way to accumulate wealth. Most households at the top do so through the growth in the value of their assets. However, not all these gains are realized while the tax is applied regardless of the liquidity of the taxpayer.

[89] JEC Republicans acknowledge that the data is based on a survey that might not reflect true net worths and income, but it is one of the best sources available. Aditya Aladangady et al., "Changes in U.S. Family Finances from 2019 to 2022: Evidence from the Survey of Consumer Finances" (Board of Governors of the Federal Reserve System, 2023), https://doi.org/10.17016/8799.

This example emphasizes the importance of calculating the aggregate tax burden before estimating the effects on the economy.

This is because there is a limit on how much tax the government can "extract" from the highest earners. Brian Riedl, researcher at the Manhattan Institute, estimates that, at most, the Federal government can raise revenues by another 2.1 percent of GDP through increasing the top marginal rate.[90] Moreover, when including dynamic effects on the economy, tax revenue can only be raised by between 1.1 and 2 percent of GDP, far short of the 2.5 percent needed in the long term to keep the debt ratio at 100 percent.[91] As explained in Box 3-3, simultaneous tax hikes have spillovers effects; the aggregate effect of more than one tax increase is greater than the sum of the individual parts. This means that the maximum revenue from taxing the highest earners, after accounting for dynamic effects, would most likely be closer to the lower bound of Riedl's estimation.

Pursuing fiscal solvency through more progressive taxation is a mistaken and partisan approach.[92] The U.S. tax code is already

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[90] Note that this calculation includes 0.4 percent from aggressive tax enforcement, which is significantly more optimistic than OMB's or any other work cited in this Chapter. Riedl, "The Limits of Taxing the Rich."

[91] Note that the deficit reduction required would be larger if the debt is stabilized at a higher ratio, since the net interests paid will be larger as well. JEC Republicans calculated the 2.5 percent value using CBO's long-term budget projections. CBO, *The Long-Term Budget Outlook: 2024 to 2054*.

[92] The bipartisan Simpson Bowles commission in 2010 prescribed lower taxes and expanding the tax base. The National Commission on Fiscal Responsibility and Reform, *The Moment of Truth: Report of the National Commission on Fiscal Responsibility and Reform* (The White House: December 2010), https://www.ssa.gov/history/reports/ObamaFiscal/TheMomentofTruth12_1_2010.pdf.

among the most progressive in the developed world, and attempts to increase the progressivity may not produce the expected outcomes.[93] The reason European countries collect more tax revenue is because income levels across the distribution are taxed at similar rates, while the U.S.' budget is funded overwhelmingly by the top 10 percent of taxpayers.[94] Blanchet, Chancel and Gethin calculated the tax burden for each percentile of the income distribution. They found that the top one percent of income earners pay a similar tax rate on both sides of the Atlantic, but the middle and lower quintiles pay a larger portion of their income in Europe (almost a flat rate) compared to the United States.[95] Emulating their tax code would not raise taxes on the rich but instead would increase taxes for middle- and lower-income taxpayers. As a result, the number of households on the lower end of the income distribution who would struggle to afford basic goods would likely increase, which could result in increased pressure to raise social spending.[96] Fortunately, raising taxes is not the only fiscal policy lever that can be adjusted to achieve fiscal balance.

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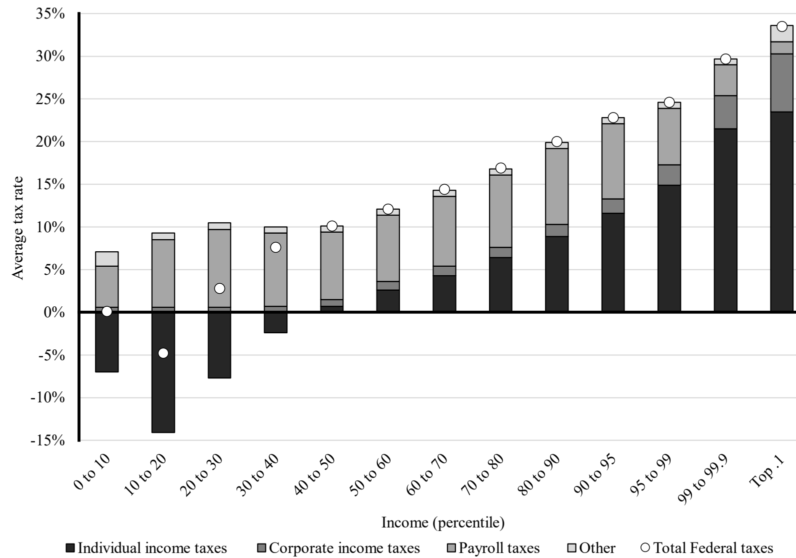
[93] Howard Gleckman "How Should We Tax The Rich," Tax Policy Center TaxVox, September 10, 2019, https://www.taxpolicycenter.org/taxvox/how-should-we-tax-rich.

[94] Blanchet, Chancel, and Gethin's appendix replicates the data for each country. Note that the United States is still at the top in progressivity even after including social spending. Blanchet, Chancel, and Gethin, "Why Is Europe More Equal than the United States?"; CBO, *The Distribution of Household Income in 2020*.

[95] This is not only because of consumption-based taxes like VAT. The paper shows that direct taxes on incomes are also higher for the bottom quintiles. Blanchet, Chancel, and Gethin, "Why Is Europe More Equal than the United States?"

[96] Blanchet, Chancel, and Gethin find that when comparing the progressivity of the systems on both sides of the Atlantic, the United States comes out on top because the lower levels of taxation for families at the bottom more than compensate for the smaller safety net. They conclude that the greater inequality in the U.S. is due pre-tax income distribution. They find that the post-tax-and-transfers relative inequality is even lower than the pre-tax. It is outside of the scope of this Chapter, but this does not necessarily mean that there is a bigger

Figure 3-17: Distribution of Average Tax Rate



Source: U.S. Department of the Treasury, Office of Tax Analysis (2024 estimates)

Box 3-4: Value-Added Tax

Another peculiarity of the U.S. tax code is the low reliance on taxes on consumption. The most commonly used consumption tax globally is the Value-Added Tax (VAT), which is applied to all increases in the value of a product through the supply chain. Proponents list many reasons why such a tax would be advantageous, for instance the simplicity to implement, ability to raise large amounts of tax revenue, and ability to produce a higher level of saving and productivity in the economy.[97] For example,

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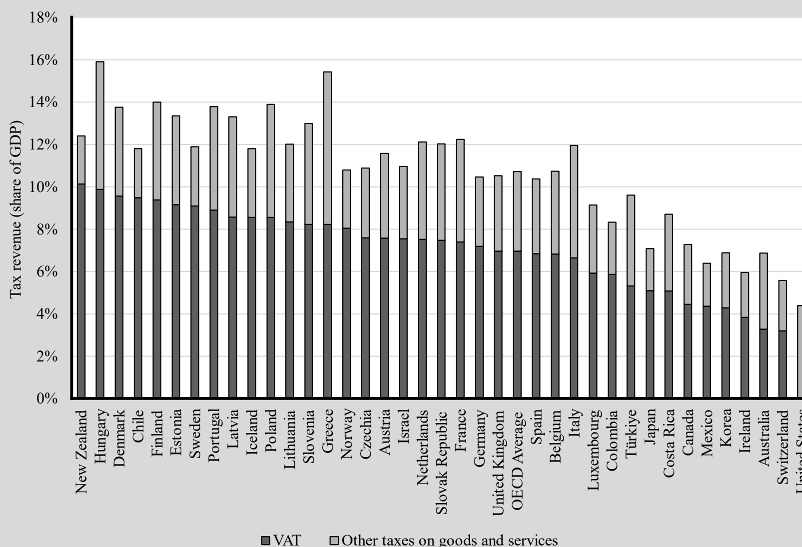
flaw in our private sector. For example, a welfare system plagued with benefits cliffs and valleys could discourage growth of pre-tax earnings.

[97] William G. Gale, "Raising revenue with a progressive value-added tax," in *Tackling the Tax Code: Efficient and Equitable Ways to Raise Revenue*, ed. Jay Shambaugh and Ryan Nunn, (Brookings, January 2020), https://www.brookings.edu/articles/tackling-the-tax-code-

Figure 3-18 shows that collection of a VAT in several OECD countries is higher as a percentage of GDP than the personal income tax in the US (8.1 percent in 2023).[98]

Figure 3-18: Importance of VAT on Tax Revenue in the OECD



Source: OECD Revenue Statistics 2023

Consumption is a substantial potential source for additional tax revenue. CBO estimates that a 5 percent VAT can raise more than $3 trillion over ten years.[99] William Gale calculates that the gross revenue from a 20 percent VAT (as seen in many European

efficient-and-equitable-ways-to-raise-revenue/; Donald J. Marples, "Consumption Taxes: An Overview," Congressional Research Service report (January 24, 2023), https://crsreports.congress.gov/product/pdf/R/R44342.

[98] OECD, "Effective Tax Rates;" CBO, *The Budget and Economic Outlook: 2024 to 2034*.

[99] CBO, *Options for Reducing the Deficit, 2023 to 2032—Volume I: Larger Reductions* (December 7, 2022), 84-87, https://www.cbo.gov/publication/58164.

countries) could decrease the budget deficit by more than $10 trillion dollars over the next ten years.[100]

It is critical to note that the VAT has major shortcomings. A primary concern is its regressivity, since consumption represents a much larger portion of the lower quintiles' incomes than that of the top ones. Taxes on consumption are the main reason why the tax burden distributions in European countries are flat.[101] According to the Congressional Research Service, transitioning to a VAT would increase aggregate savings, but also lower savings rates for the bottom two quintiles because their consumption represents a larger part of their earnings).[102] Given that in 2019 the bottom and second quintiles consumed 239 and 123 percent of their earnings respectively, a 20 percent VAT would represent a higher percentage of their earnings while the top quintiles (who have positive levels of savings) would pay a much lower tax rate (See Figure 3-19).[103] According to the same report, there would also be an age gap, with those 75 and over and those under 25 disadvantaged. The negative impact in purchasing power would come from price increases or reduced wages, and it would generate additional pressure on social spending, decreasing its potential for deficit reduction.[104]

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[100] Note that these are pre-inflation 2019 estimations. Gale, "Raising revenue with a progressive value-added tax."

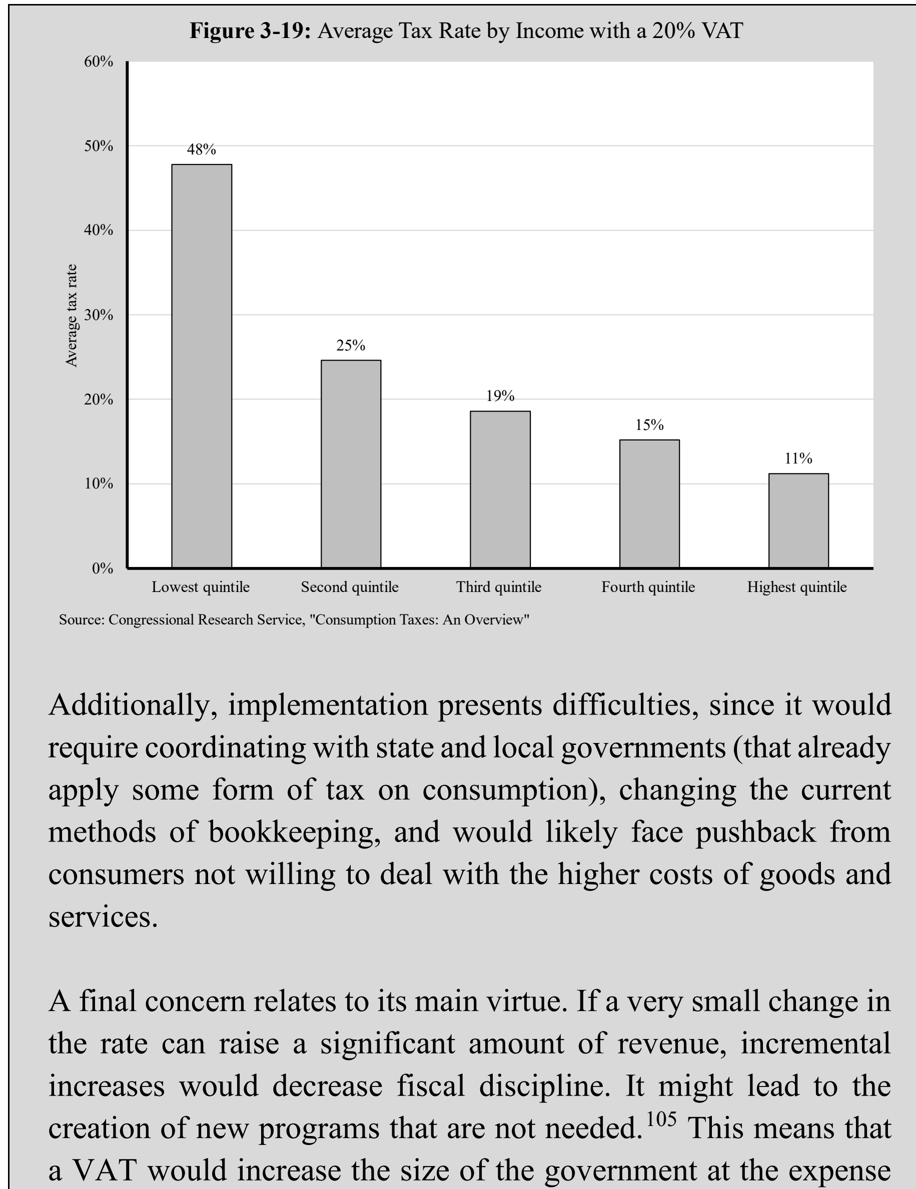
[101] Blanchet, Chancel, and Gethin's appendix replicates the data for each country. Note that the United States is still at the top in progressivity even after including social spending. Blanchet, Chancel, and Gethin, "Why Is Europe More Equal than the United States?"

[102] CRS, *Consumption Taxes: An Overview*.

[103] Values over 100 percent indicate population requiring supplemental income to their earnings to afford their consumption levels.

[104] Some economists propose solutions to counter this. For example, William Gale proposes implementing a universal basic income, but this would reduce net revenue significantly. Gale, "Raising revenue with a progressive value-added tax."

Figure 3-19: Average Tax Rate by Income with a 20% VAT



Source: Congressional Research Service, "Consumption Taxes: An Overview"

Additionally, implementation presents difficulties, since it would require coordinating with state and local governments (that already apply some form of tax on consumption), changing the current methods of bookkeeping, and would likely face pushback from consumers not willing to deal with the higher costs of goods and services.

A final concern relates to its main virtue. If a very small change in the rate can raise a significant amount of revenue, incremental increases would decrease fiscal discipline. It might lead to the creation of new programs that are not needed.[105] This means that a VAT would increase the size of the government at the expense

[105] Daniel Mitchel, *How a Value Added Tax Would Harm the U.S. Economy*, The Heritage Foundation report (May 11, 1993), https://www.heritage.org/taxes/report/how-value-added-tax-would-harm-the-us-economy.

of workers and businesses, while increasing dependency on government.

A More Efficient Fiscal Consolidation

Raising taxes is a harmful tactic to balance the long-run budget deficit and harms GDP growth.[106] Growth not only affects the denominator in the debt-to-GDP ratio equation (making stabilization of the debt-to-GDP ratio more challenging), but also increases taxable income and alleviates poverty. Alternatively, spending reduction has proven to be a better approach to achieve fiscal consolidation. A series of studies by Alesina, Favero and Giavazzi found that fiscal adjustments based on spending reductions are much less costly to the economy than tax-based ones.[107] Although in general these adjustments have been mixtures of revenues and expenditures, the latter were the main component in successful cases, including Canada and Finland (85 percent), and Netherlands, Sweden, and the United Kingdom (75 percent).[108] Of course, fiscal adjustment may have a short-term cost due to the observed reduction in government spending in the economy. But de Rugy and Salmon find that while both revenue- and spending-based fiscal consolidations can have an initial contractionary effect on the economy, the latter is milder and lasts

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[106] JEC Republicans, *Response*.

[107] Two of their most representative works on this issue are: Alberto Alesina, Carlo Favero, and Francesco Giavazzi, "The Output Effect of Fiscal Consolidations," NBER Working Paper no. 18336 (August 2012), https://doi.org/10.3386/w18336; Alberto Alesina, Omar Barbiero, Carlo Favero, Francesco Giavazzi, and Matteo Paradisi, "The Effects Of Fiscal Consolidations: Theory And Evidence," NBER Working Paper no. 23385 (May 2017), https://doi.org/10.3386/w23385.

[108] Joel Chiedu Okwuokei, "Fiscal Consolidation: Country Experiences and Lessons from the Empirical Literature," in *Caribbean Renewal. Tackling Fiscal and Debt Challenges*, ed. Charles Amo Yartey and Therese Turner-Jones (International Monetary Fund, 2014): 126, https://doi.org/10.5089/9781484369142.071.

for a much shorter period.[109] Tax hikes are more severe, and the negative economic effects tend to last longer.

Addressing spending excesses does not explicitly mean that the working poor and elderly will see their benefits impacted. Instead of broad-based changes to transfer programs, targeted reforms could mean reducing inefficiencies and maintaining programs for those that need them most. Pro-market competition reforms to the heavily regulated healthcare sector could be translated into lower spending on Medicare, Medicaid, and greater economic independence for retirees. Additionally, the Federal government could use the information at its disposal to evaluate programs, doing a longitudinal cost-benefit analysis to make spending more efficient. Finally, base broadening and simplifying the tax code would level the field, increasing revenue and reducing the tax-gap without raising tax rates.[110] Pro-growth measures would also be helpful, like restoring the full expensing as well as expensing for research and development that were successfully implemented with TCJA but have since expired.[111]

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[109] Veronique de Rugy and Jack Salmon, "Flattening the Debt Curve: Empirical Lessons for Fiscal Consolidation," Mercatus Center research paper (July 22, 2020), https://www.mercatus.org/research/research-papers/flattening-debt-curve-empirical-lessons-fiscal-consolidation.

[110] Moreover, Feldstein mentions that tax credits are mostly subsidies to high-income individuals. Martin S. Feldstein, "Raising Revenue by Limiting Tax Expenditures," NBER Working Paper no. 20672 (November 2014), https://doi.org/10.3386/w20672.

[111] Jason Furman argues that full expensing can act as a full tax break on investments with normal profits. Adam N. Michel, "Expensing and the Taxation of Capital Investment," Cato Briefing Paper no. 159 (June 7, 2023), https://www.cato.org/sites/cato.org/files/2023-06/BP159.pdf; Martin Feldstein and Lawrence Summers, "Inflation and the Taxation of Capital Income in the Corporate Sector," *National Tax Journal* 32, no. 4 (1979), https://doi.org/10.1086/NTJ41862265; Furman, "How to increase growth while raising revenue."

Unfortunately, given the nature of Federal spending and the trajectory of the deficit, there is no silver bullet sufficient to solve the country's fiscal woes. It is also unlikely that any fiscal stimulus (spending or tax cuts) could pay for itself through growth, especially when projections tend to be more optimistic than reality.[112] The reforms needed require both sides of the aisle to work for this common goal of tempering the bloating of the public debt.

Policymakers must look to novel approaches and disruptive technologies to provide breakthrough solutions. The following Chapters discuss tackling obesity and greater adoption of artificial intelligence as two possible areas for exploration.

[112] Note that changes in global affairs would likely contribute to this as well. Niall Ferguson, "Biden Can't Pay His Way Out of Fighting Cold War II," *Bloomberg*, May 19, 2024, https://www.bloomberg.com/opinion/articles/2024-05-19/us-can-t-pay-other-countries-to-wage-cold-war-ii-against-russia-china.