TAX REFORM AND THE BUDGET

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OASIS

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Part I: About the Budget
“How did you go bankrupt?” Bill asked.

“Two ways,” Mike said. “Gradually and then suddenly.”

--Ernest Hemingway, *The Sun Also Rises*

(quoted in Auerbach and Gale, “The Economic Crisis and the Fiscal Crisis: 2009 and Beyond”)
Deficit Projections for Obama Budget, in $billions

Ratio of Workers to Retirees

Source: Congressional Budget Office, 2009.
Total Public and Private Spending on Healthcare as Percent of GDP, 1980-2080

Source: CBO, 2009, Long-Term Budget Outlook
Primary Spending as % of GDP, with and without Excess Health Costs, 2062-2080

Source: Congressional Budget Office, 2009.
Composition of Nondiscretionary Federal Spending, 1962-2083

Source: CBO, The Long-Term Budget Outlook, June 2009.
Alternative Projections of Debt Held by the Public, 1962-2080

Source: CBO
Alternative Projections of Debt Held by the Public, 1962-2080

- With GDP response
- With rate response
- Alternative
- Extended
Federal, State, and Local Non-Interest Spending, as percent of GDP, 1980-2050

Source: CBO, 2009, Long-Term Budget Options; GAO, 2008, "STATE AND LOCAL GOVERNMENTS: Growing Fiscal Challenges will Emerge during the Next 10 Years," GAO-
Major Foreign Holders of US Debt, in $billions, July 2009

Total = $3.4 trillion, of which about ¼ is T-bills.

## Distribution of Defaults or Restructurings by Debt Level, Middle-Income Countries, 1970-2008

<table>
<thead>
<tr>
<th>External Debt/GNP at end of first year of default or restructuring</th>
<th>% of total defaults or restructurings</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt; 40</td>
<td>19.4</td>
</tr>
<tr>
<td>41-60</td>
<td>32.3</td>
</tr>
<tr>
<td>61-80</td>
<td>16.1</td>
</tr>
<tr>
<td>81-100</td>
<td>16.1</td>
</tr>
<tr>
<td>&gt; 100</td>
<td>16.1</td>
</tr>
</tbody>
</table>

Debt as Percent of GDP in OECD Countries, 2008

Figure 7. Debt Held by Public, by Maturity in Years, as of October 2009

Source: US Treasury, Monthly Statement of the Public Debt (MSPD), October 2009,
Part II. About our Tax System

Federal Revenues by Source as a Percentage of GDP, 1934-2015

Source: Office of Management and Budget, Budget of the US Government FY 2011, Historical Tables, Table 2.3; 2010-2014 are projections.
State and Local Taxes by Source as Percentage of GDP

Source: NIPA Table 3.2 and 1.1.5, accessed 2/4/11.
Federal, State, and Local Taxes as Percentage of GDP

Tax as Percent of GDP, OECD Countries, 2007

Source: OECD, 2009, Revenue Statistics
# Income Tax Rates Required to Cut Deficit to 2% of GDP in 2019, Administration Baseline

<table>
<thead>
<tr>
<th>Current Tax Rates</th>
<th>Raise All Rates</th>
<th>Raise Top Three Rates</th>
<th>Raise Top Two Rates</th>
</tr>
</thead>
<tbody>
<tr>
<td>10.0</td>
<td>14.9</td>
<td>10.0</td>
<td>10.0</td>
</tr>
<tr>
<td>15.0</td>
<td>22.3</td>
<td>15.0</td>
<td>15.0</td>
</tr>
<tr>
<td>25.0</td>
<td>37.2</td>
<td>25.0</td>
<td>25.0</td>
</tr>
<tr>
<td>28.0</td>
<td>41.7</td>
<td>60.8</td>
<td>28.0</td>
</tr>
<tr>
<td>33.0</td>
<td>49.1</td>
<td>71.7</td>
<td>85.7</td>
</tr>
<tr>
<td>35.0</td>
<td>52.1</td>
<td>76.1</td>
<td>90.9</td>
</tr>
</tbody>
</table>

Source: Altshuler, Lim, and Williams, 2010, Desperately Seeking Revenue, Tax Policy Center.
Tax Expenditures Compared to Other Spending, FY 2011

<table>
<thead>
<tr>
<th></th>
<th>Income Tax Expenditure</th>
<th>Mandatory</th>
<th>Discretionary</th>
<th>Defense</th>
<th>Non-defense</th>
</tr>
</thead>
<tbody>
<tr>
<td>$ Billions</td>
<td>1,177</td>
<td>2,165</td>
<td>1,415</td>
<td>744</td>
<td>671</td>
</tr>
<tr>
<td>Percent</td>
<td>24.7</td>
<td>45.5</td>
<td>29.7</td>
<td>15.6</td>
<td>14.1</td>
</tr>
<tr>
<td>% of GDP</td>
<td>7.6</td>
<td>14.0</td>
<td>9.1</td>
<td>4.8</td>
<td>4.3</td>
</tr>
</tbody>
</table>
## Tax Expenditures Compared to Other Taxes, FY 2011

<table>
<thead>
<tr>
<th></th>
<th>Income Tax Expenditures</th>
<th>Net Individual Income Tax</th>
<th>Corporate Income Tax</th>
<th>Payroll Tax</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td>$ Billions</td>
<td>1,177</td>
<td>1,121</td>
<td>297</td>
<td>935</td>
<td>214</td>
</tr>
<tr>
<td>Percent</td>
<td>31.4</td>
<td>29.9</td>
<td>7.9</td>
<td>25.0</td>
<td>5.7</td>
</tr>
<tr>
<td>% of GDP</td>
<td>7.6</td>
<td>7.2</td>
<td>1.9</td>
<td>6.0</td>
<td>1.4</td>
</tr>
</tbody>
</table>
Shares of Non-Interest Spending
FY 1982-2015

Source: GAO (via Lori Metcalf), FY 11 Budget, and authors' calculations.
Consumption Tax as Percentage of GDP, OECD Countries, 2007
Who Doesn’t Pay Income Tax?

Source: http://www.taxpolicycenter.org/taxtopics/federal-taxes-households.cfm
Income Share of Top 1 Percent, 1913-2008

Top Tax Rate on Individual Income, 1913–2006
"The poor are getting poorer, but with the rich getting richer it all averages out in the long run."
Effective Federal Tax Rates by Economic Income Class, 2006

Source: http://www.taxpolicycenter.org/T06-0306
What is the AMT?
Part III.
A Reform Plan
RESTORING AMERICA’S FUTURE

HIGHLIGHTS

✦ CREATE up to 7 million new jobs with a one-year payroll tax holiday
✦ STABILIZES the debt at less than 60% of the economy by 2020
✦ BALANCES the primary budget in 2014
✦ CREATE a simple, pro-growth tax system that cuts individual and corporate rates
✦ STRENGTHENS Social Security for the next 75 years
✦ FREEZE domestic and defense discretionary spending
✦ CONTROL health care costs for families, businesses, and government
✦ ACHIEVE a bipartisan agreement that is realistic and politically viable
Overview of Tax Reform

- Debt reduction sales tax (VAT) at 7%
- Cut top individual and corporate income tax rates to 27%
- Return-free 15% PIT for most taxpayers
  - Fully refundable child tax credit and payroll tax credit replace personal exemption, standard deduction, child-related credits (including EITC)
  - 15% withholding on wage&salaries, dividends, interest
- Nonfilers could receive credits through employers or via “smart card”
Eliminate most tax expenditures, simplify others

- Mortgage interest, IRA, and charity deductions replaced with 15% refundable credit, payable directly to institutions
  - Like UK gift aid
- Eliminate state and local tax deduction
- Replace education tax subsidies with expanded Pell grants and subsidized student loans
Restoring America’s Future: Breakdown of Budget Savings

- Debt Service Savings
- Healthcare
- Social Security Savings
- Other Spending
- New
Revenue Breakdown

- Other
- Tax
- Debt Reduction Sales Tax

New Revenues

Eliminate or restructure most tax

Restructure Itemized Deductions

Employer Health Benefit

Corporate Tax Rate Cut

Income Tax

% of GDP

2012 2016 2020 2024 2028 2032 2036 2040