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### Testimony of Maya MacGuineas

#### Hearing before the Senate Budget Committee: “Ending a Rugged Tax Code: The Need To Make the Wealthiest People and Largest Corporations Pay their Fair Share of Taxes” March 25, 2021

Chairman Sanders, Ranking Member Graham, and Members of the Committee, thank you for inviting me here today to discuss the crucial subject of federal revenue and how we can help shore up our nation's finances.

Let me start by saying, we have engaged in an unprecedented amount of borrowing over the past year, *which is exactly what we should have been doing*. This has been a terrible and traumatic crisis, and while the most recent package was larger and less targeted than we thought was warranted, the overall COVID response has been very successful in fighting the pandemic, alleviating financial hardships, and fostering an economic recovery.

The good news is that we seem to be coming out of the worst part of this public health emergency. With vaccinations on the rise and a good deal of increased savings and pent-up demand – not to mention trillions of stimulus dollars in the pipeline – signs point to what we can all hope will be a very strong recovery.

The bad news is we had a mountain of debt before this crisis hit, and after the sharp downturn and \$6 trillion of relief, we have a much larger mountain now. The national debt eclipsed the size of the economy last year for the only time since just after World War II. We project it could hit a record 108 percent of Gross Domestic Product (GDP) by the end of this year, 113 percent of GDP by 2031, and 207 percent of GDP by 2051.

Along with the high and rising debt, four major trust funds face large imbalances and are projected to be depleted in the next 14 years – the Highway Trust Fund in 2022, the Medicare Hospital Insurance trust fund in 2026, the Social Security Old Age and Survivors Insurance trust fund in 2032, and the Social Security Disability Insurance trust fund in 2035.

On top of the massive borrowing we engaged in to fight the pandemic, there are huge structural imbalances in our budget. They have been there for quite some time, driven by growth in our major spending programs and by revenues and spending levels that are inconsistent with each other. During the three-year period prior to the pandemic – a period of high economic growth when there was little economic justification for such significant borrowing – we irresponsibly passed legislation that



added \$4.7 trillion to the debt, almost evenly divided between tax cuts (\$2.4 trillion) and spending increases (\$2.3 trillion).<sup>i</sup>

Currently, our country is on pace to borrow more than \$15 trillion over the next decade. Going forward, spending is projected to grow from its historic average of 20.6 percent of GDP to 23.4 percent by 2031 and 31.8 percent by 2051. Revenue, meanwhile, will rise modestly from about the historic average of 17.3 to 18.4 percent of GDP by 2051.

This debt trajectory leaves us vulnerable on many fronts: it leaves people who depend on these important trust fund programs vulnerable given all the uncertainty; it leaves the economy vulnerable to economic shifts both here and abroad; and it creates a major national security threat as well.

The good news is that the Federal Reserve and other forecasters expect robust GDP and jobs growth this year. Assuming they are right, now is the appropriate time to start paying for new initiatives. Once the economy is even stronger, we should begin phasing in measures to address faltering trust funds and slow the unsustainable growth of our debt.

So I appreciate the topic of the hearing today, because revenues will have to be a significant part of the solution.

We also need to reduce the growth of spending. Changes should be made gradually, but decisions about how to structure them should be made as soon as possible.

The topic of today's hearing is making corporations and the wealthy pay their "fair" share. One of the tricky things in public policy is that "fair" of course is in the eye of the beholder. Some key facts on income and taxation rates:

- The top 1% of earners pay 25% of federal taxes, and they make 16% of the income
- The top 10% of earners pay 52% of federal taxes, and they make 39% of the income
- The top 40% of earners pay 86% of federal taxes, and they make 74% of the income<sup>ii</sup>

Corporate income taxes have been on a steady downward trajectory for some time now. They fell from 23 percent of revenue in 1966 to 15 percent in 1978 and then held steady around 10 percent of federal revenues from 1981 until passage of the Tax Cuts and Jobs Act (TCJA) in 2017. Since the TCJA, corporate tax revenue has totaled about 6 percent of federal revenues. That said, some of this drop represents the trend of corporations structuring themselves as passthrough businesses and also reflects inevitable changes in the global economy, as it becomes increasingly difficult to efficiently tax capital.



I personally believe it is the right thing to do to make the tax code more progressive than it already is in light of the disturbing trends in income inequality, wealth inequality, economic mobility, economic security, and economic opportunity. Again, reasonable people will disagree on what the right level of progressivity is in our tax and spending programs, but I favor more progressivity *on both sides of the ledger*.

We also need to consider effects on growth. Demographics are already putting downward pressure on economic growth, which going forward will be about one percentage point lower than its historical average, due in large part to the aging of the population and retirement of the Baby Boomers. Thus, *it will also be particularly important to keep economic growth as a consideration when developing policy options*.

So, while the Committee is right to focus on fairness in tax policy, we should keep a number of factors in mind including:

- Imposing taxes based on ability to pay (progressivity)
- Taxing similar people and activities similarly (horizontal equity)
- Reducing distortions in the tax code (efficiency)
- Allowing taxpayers to understand the rules (simplicity)
- Supporting or not substantially hindering economic activity (growth)
- Discouraging undesirable activities and encouraging desirable ones (externality)

On the individual side, we should start by looking at tax expenditures. This year alone, the United States will forgo \$1.8 trillion of revenue through various credits, deductions, exclusions, and other preferences. Some of these tax breaks are worthwhile, but most are expensive, regressive, and distorting, and they could be repealed or reformed. There could also be changes to estate taxes and how we tax capital.

On the corporate side, the rate reduction to 21 percent far exceeded what anyone expected – including many companies – and we can bring that rate up somewhat, though concerns about our competitiveness in a global marketplace are a real and an important consideration. My preference, for economic reasons, has always been to tax relatively less on the corporate side and more on the individual side, but there is certainly room to increase the corporate rate considerably from where it is now. Further, there are a number of corporate tax breaks that could and should be reformed. To begin, we could expand the cap on state and local tax deductions to businesses, or look at the subsidy that the current tax code provides for debt financing new investments.

One thing we absolutely must avoid is further tax *cuts* for high earners, and this would clearly include agreeing not to repeal the cap on the deduction for state and local taxes, which would provide an average \$40,000 annual tax cut for millionaires.



To think about this, one starting point is the ideas President Biden put forward during the campaign. His tax increases include:

- Raising the corporate tax rate from 21 to 28 percent
- Setting minimum corporate taxes for domestic and foreign income
- Restoring the top individual tax rate from 37 to 39.6 percent
- Taxing capital gains as ordinary income and at death for very high earners
- Limiting various tax breaks for higher earners
- Subjecting wages above \$400,000 to the Social Security payroll tax

We estimate these policies would generate in the neighborhood of \$4 trillion in new revenue.

**Fig. 1: President Biden's 2020 Campaign Tax Plan (billions)**

Policy	Ten-Year Savings
Increase corporate tax rate from 21% to 28%	\$850 billion
Setting minimum corporate tax rates –15% minimum on book income, increase worldwide minimum rates)	\$800 billion
Repeal TCJA above \$400,000 – restore top rate to 39.6%, restore Pease limitation, phase out pass-through deduction	\$300 billion
Increase capital gains taxes – tax at 39.6% for incomes over \$1 million, repeal step-up basis, limit like-kind exchanges	\$500 billion
Increase the estate tax – restore 2009 parameters	\$250 billion
Cap itemized deductions at 28%, reduce tax gap	\$300 billion
Impose financial fee on large banks	\$100 billion
Eliminate Social Security taxable maximum above \$400,000	\$850 billion
<b>Total, Biden Campaign Tax Increases</b>	<b>\$3.95 trillion</b>

Source: Tax Policy Center and Committee for a Responsible Federal Budget staff estimates.

So how far would that get us?

Barring further policy or economic shifts, it would require roughly \$4 trillion of non-interest savings to **stabilize the debt to 100 percent of GDP by 2031**, which is still a very high level. (The historical average over the past 50 years is 44 percent.) If we were to do that just on the revenue side, it would require enacting *all* of President Biden's proposed tax increases, and it is doubtful we'd have enough to keep the debt stable in future decades. But at least in the near-term, we could get there.

In addition to assuming a very high level of debt, this doesn't include any new spending. Last fall, we estimated President Biden's campaign proposals would have a cost of roughly \$11 trillion. So if you wanted to enact all the new proposals and keep debt to the size of the economy, you would need about \$15 trillion in revenue or offsets.

Though President Biden's proposals already represent a fairly aggressive set of tax increases on the rich and on corporations, you could go even further – by imposing a wealth tax (assuming it is found to be constitutional), adding a financial transaction tax, and boosting the top individual and corporate rates even more (to 50 percent and 35 percent, respectively, for example). Doing so



could perhaps get you another \$4 trillion or \$5 trillion of new revenue, but still leaves you with a \$6 trillion hole.

To pay for the remaining \$6 trillion of the cost we estimated for Biden's campaign agenda, the revenue hike would have to be much higher and more broad-based. For instance, increasing all individual income tax rates by 7 points would get you another \$6 trillion. That would mean raising the bottom rate almost three-quarters, from 10 percent to 17 percent, and bringing the top individual income tax rate to 57 percent. Including payroll and state taxes, that would bring the top rate to well above 70 percent – which is likely about its revenue maximizing level.

A **more expansionary set of policies**, such as Medicare for All, free college, student debt cancellation, broad-based Social Security benefit increases, or the Green New Deal would cost far more. Even if net revenue needs could be kept to \$30 trillion, you would need to impose either a 32 percent payroll tax, a 25 percentage point increase in *all* income tax rates – including raising the bottom rate to 35 percent and the top rate to percent 62 – institute a 42 percent Value-Added Tax, more than double all individual and corporate income tax rates, or some combination.

So while I think it is fair to argue that those who have done the best in the shifting economy over the past decades should pay the most, we also need to be realistic about how much revenue we will be able to get from high earners alone.

To state the obvious, we need to look at both sides of the ledger and, in all likelihood, broad-based taxes as well.

Going forward, the growth in deficits is driven primarily by growing health and retirement costs and interest, which are responsible for 86 percent of the projected growth in spending over the next decade.

The types of spending reforms we might consider include:

- **Restore fairness on the spending side** – It makes little sense to scrutinize the tax breaks granted to the wealthiest Americans while ignoring what we spend on them. Policymakers should consider further income-relating Medicare premiums, means-testing or flattening Social Security benefits, and other similar types of changes to make these programs more progressive.
- **Lower health care spending** – The United States spends massive amounts on health care and could easily be getting better value for our dollars. We can generate ample savings by paying for quality instead of quantity, reducing excessive provider payments, lowering the cost of prescription drugs, and better aligning incentives throughout the health care system. Many of these ideas have bipartisan support.
- **Secure Social Security** – Social Security is only 14 years from insolvency. A common-sense combination of changes to the payroll tax base or rate, retirement age, benefit





formula, and cost-of-living adjustment should be able to secure it for 75 years while also strengthening retirement security.

- **Extend budget caps** – The discretionary caps in effect since 2012 are set to expire at the end of this year. The caps should be extended at reasonable levels that, unlike the sequester, Congress plans to stick to.
- **Built in Growth** – One of the challenges in our budget is that many spending programs have built in growth so that even without changes, they are growing faster than the economy and squeezing out other parts of the budget. (Revenues also have more modest built in growth.) I have always thought it would be easier if taxes grew faster than the economy and spending more slowly so politicians would have more space to do what their tendency is – to provide tax cuts and more generous spending programs. But short of that, we should fix our major spending programs so they are more structurally sound, like fixing their default indexing so it requires an affirmative decision to grow them faster than the economy and so programs adjust based on demographic and economic changes.<sup>iii</sup>

Another option that may prove to be low-hanging fruit, relatively speaking, is to ensure people and corporations are paying the taxes they already owe. The current [tax gap](#) is likely larger than \$500 billion per year, and there are many [bipartisan ideas](#) to reduce it. I don't want to overpromise here – this is not a magic panacea. But we should enforce the laws we have in place.

The fiscal hole is so deep that basically all credible options will need to be on the table, and the longer we wait, the longer that list will have to grow. It is already going to be much more difficult than if we had phased in these changes gradually in past years.

To conclude, fiscal responsibility is not about big government or small government—it is about being willing to pay for the priorities you want to spend money on. Shifting costs to the future is at odds with the principle of serving as a good steward for the economy, the nation, and the next generation, even when it is money well spent.

Thank you for hosting this hearing – it is important that we focus on this issue for so many reasons.



<sup>i</sup> Between 2017 and 2019, policymakers approved legislation that is projected to add [\\$4.7 trillion](#) to the debt.

<b>Legislation</b>	<b>2017-2029 Cost</b>
<b>Tax Cuts</b>	<b>\$2.4 trillion</b>
Tax Cuts and Jobs Act of 2017	\$1.8 trillion
Consolidated Appropriations Act, 2020	\$500 billion
January 2018 Continuing Resolution (Delay of ACA taxes)	\$31 billion
<b>Spending Increases</b>	<b>\$2.3 trillion</b>
Bipartisan Budget Act of 2018	\$445 billion
Bipartisan Budget Act of 2019	\$1.7 trillion
Other Legislation	\$135 billion
<b>Total Increase in Debt</b>	<b>\$4.7 trillion</b>

Source: Committee for a Responsible Federal Budget staff calculations based on Congressional Budget Office data. Numbers may not add due to rounding. A small portion of the Bipartisan Budget Act of 2018 that continued expired tax provisions is included in the total for tax cuts.

<sup>ii</sup> Data from the Tax Policy Center. State taxes are less progressive so including taxes at all levels of government would decrease the share paid by high earners. <https://www.taxpolicycenter.org/model-estimates/baseline-distribution-income-and-federal-taxes-february-2020/t20-0017-baseline>

<sup>iii</sup> For instance, Peter Orszag, Robert Rubin, and Joseph Stiglitz recently recommended indexing permanent programs to respond automatically in the face of uncertainty. <https://www.piie.com/publications/policy-briefs/fiscal-resiliency-deeply-uncertain-world-role-semiautonomous-discretion>