Budget deficits as far as the eye can see…
Projected Budget Deficit, 2009-2019
(CBO, Current Law, March 2010)

Cumulative 10-year deficit = $8.1 trillion
Is this a realistic scenario?

- **Current law assumes**
  - 2001 and 2003 tax cuts sunset as scheduled in 2010
  - Congress stops “patching” the alternative minimum tax

- **Alternative Baseline A assumes**
  - 2001 and 2003 tax cuts are extended
  - Estate tax is maintained at 2009 parameters
  - 2009 AMT patch is extended
  - AMT exemption, rate bracket threshold and phase-out exemption thresholds are indexed for inflation
  - and includes the budgetary effects of the 2010 healthcare reform act
Projected Budget Deficit, 2009-2019
Alternative Baseline A

Cumulative 10-year deficit = $11.8 trillion
Is this a realistic scenario?

- Alternative Baseline B is
  - Alternative Baseline A plus
  - extension of several expiring provisions of American Recovery and Reinvestment Act of 2009 including Making Work Pay credit, American Opportunity Tax Credit, exclusion of certain amounts of unemployment benefits
  - extension of expiring provisions
Projected Budget Deficit, 2009-2019
Alternative Baselines A and B

Cumulative 10-year deficit = $14.0 trillion
An unsustainable path

Fed Chairman Ben Bernanke, April 27, 2010

"History makes clear that failure to achieve fiscal sustainability will, over time, sap the nation's economic vitality, reduce our living standards, and greatly increase the risk of economic and financial instability."
Can we bring federal budget deficits under control?

- We could cut spending or raise taxes
- Both routes face obstacles
  - Congress
    - Members are reluctant to make the spending cuts needed to make a serious dent in outlays
    - A substantial number have pledged not to raise taxes
  - President Obama
    - No tax increases on families making < $250,000 a year and single taxpayers making < $200,000
- But we have seen tax increases in the past two decades, so maybe we could see increases towards the end of the current budget window
Our Goal

- Won’t try to balance the budget!
- Examine tax increases that would reduce the average deficit over the 2015-2019 period
- Two revenue goals
  - Reduce average deficit to 2% of GDP
    - Sustainable in a growing economy since growth would reduce debt as a share of GDP over time
  - Reduce average deficit to 3% of GDP
    - “Administration” goal voiced by Peter Orszag in November 2009
    - Goal of Bipartisan Fiscal Commission
Projected Budget Deficit, 2009-2019
Percentage of GDP
Revenue targets, 2015-2019

- 3% revenue target
  - Alternative baseline A: Requires an increase of about 5 percent of GDP in every year
  - Alternative baseline B: Requires an increase of almost 7 percent of GDP in every year
Alternative ways to increase revenues

- Raise individual income tax rates
  - Raise all rates proportionately
  - Raise top three tax rates proportionately
  - Raise rates proportionately on single taxpayers with income over $200,000 and married couples filing jointly with income over $250,000

- Change treatment of itemized deductions
  - Eliminate itemized deductions
  - Limit value of itemized deductions to 15%
3% Deficit Target: Alternative Baseline B, 2019

Statutory Marginal Tax Rates

- Current tax rates
- Raise all rates
- Raise top three rates
- Raise top two rates

Bar chart showing tax rate changes for different scenarios.
Tax units by statutory rates, 2019
Administration baseline

Percent of tax units
Percent of cash income

Statutory Marginal Income Tax Rates

Non-filers
0%
10%
15%
25%
26%
28%
33%
35%

Percent of cash income
How would taxpayers respond?

- We have ignored behavioral responses
- Likely to be large as a percent of revenue
- Likely to require larger tax increases once taken into account
Conclusions from exercise

- None of the options considered provide a realistic approach to reducing the deficit
- All would be progressive
  - Cutting spending could be regressive --- need to look at combined effects
- All would generate potentially large efficiency costs
- Suggests that reducing the deficit to a sustainable level will likely require either more comprehensive tax reform or tapping a new source of revenue
What can we do?

- Raise corporate revenues
  - But corporate tax revenue is projected to be less than 20% of individual tax revenue over the next 10 years
  - If anything, we should be lowering rates
    - OECD countries have all been lowering their rates
    - Currently have second highest combined federal-state statutory rate

- Add a VAT
  - All roads lead to the VAT
  - Senate has voted 84-13 for the following proposition
    - "It is the sense of the Senate that the Value Added Tax is a massive tax increase that will cripple families on fixed income and only further push back America's economic recovery."
What can we do?

- Gas tax
  - Could raise some serious revenue but difficult to imagine will succeed politically as major revenue raiser
- Carbon tax or cap and trade
  - Every proposal that has been seriously considered involves giving the money back either to consumers or to businesses
- Broaden the base
- Let the Bush tax cuts expire
Revenue effects of limiting or eliminating itemized deductions, 2019

<table>
<thead>
<tr>
<th>Percentage of Required Revenue</th>
<th>Current Law Baseline</th>
<th>Alternative Baseline A</th>
<th>Alternative Baseline B</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Eliminate all itemized deductions</strong></td>
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<tr>
<td>Reduce deficit to 3% of GDP</td>
<td>-</td>
<td>60%</td>
<td>37%</td>
</tr>
<tr>
<td><strong>Limit value to 15%</strong></td>
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<tr>
<td>Reduce deficit to 3% of GDP</td>
<td>-</td>
<td>33%</td>
<td>21%</td>
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</tbody>
</table>
3% Deficit Target: Current Law 2019
(Bush tax cuts expire)
What can we do?

- Raise corporate revenues
- Add a VAT
- Gas tax
- Carbon tax or cap and trade
- Broaden the base
- Let the Bush tax cuts expire
- Fundamental tax reform