

Principles for the upcoming tax reform debate

Reject tax cuts for the rich and fear-mongering about deficits

Policy Memo • By [Josh Bivens](#) • April 20, 2017

Progressives won (or least witnessed) a key first victory when efforts to repeal the Affordable Care Act (ACA) collapsed. The next policy battle will be over tax reform. There are a million details that will come up in this debate. And many of those details will actually matter. But going into it, there are two relatively broad-based principles that progressives should adhere to, both to help win the tax reform fight ahead but also to avoid putting us in a worse position for future fights. In brief, these principles are:

- Stand firm against any plan that includes net tax cuts for high-income households and corporations.

This means rejecting plans that include net tax cuts for high-income households and corporations but also offer crumbs to progressives, either in the form of “middle-class tax cuts” or infrastructure spending.

- Resist the urge to base opposition to tax cuts for high-income households on concerns about increasing the federal budget deficit.

Stand firm against any plan that includes net tax cuts for high-income households and corporations

Since 1979, the share of total national income claimed by the richest 1 percent of households has increased substantially. Yet the effective tax rate (including the incidence of corporate income taxes) on this group was lower in 2013 (the latest year for which data are available) than in 1979. The U.S. economy has worked extraordinarily well for those in the top 1 percent of the income distribution in recent decades (see **Figure A**). Tax cuts that give these families a vastly disproportionate share of the benefits should not be a policy priority.

In the longer run, with a different Congress, the progressive priority should be to *increase* effective tax rates on the top 1 percent. These top effective rates were

SECTIONS

1. Stand firm against any plan that includes net tax cuts for high-income households and corporations • 1
2. Resist the urge to base opposition to tax cuts for high-income households on concerns about increasing the federal budget deficit • 6

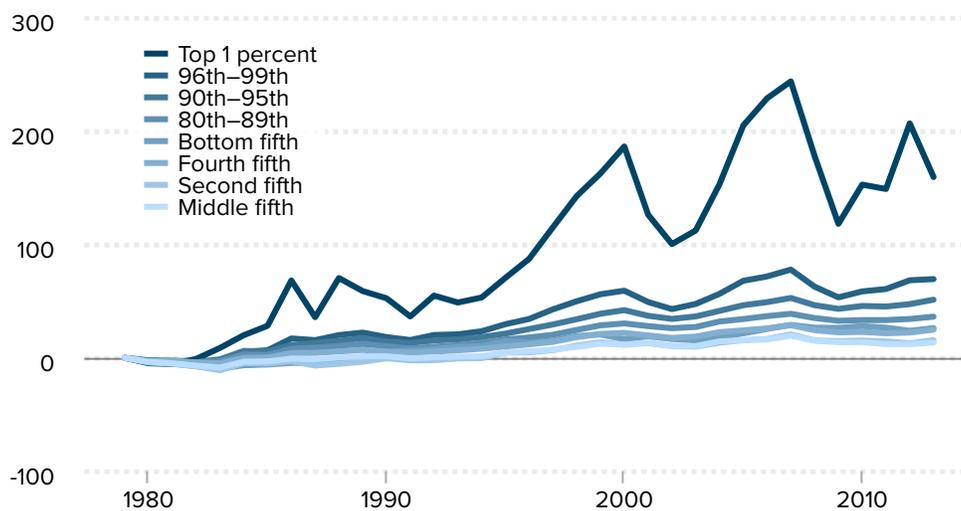
About the author • 8

Endnotes • 8

Figure A

The top 1 percent clearly does not need a tax cut

Cumulative household income growth by income fifths and fractiles, 1979–2013



Source: Author's analysis of data from the Congressional Budget Office, *The Distribution of Household Income and Federal Taxes, 2013*, 2016

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boosted in the later years of the Obama administration, but they remain below their 1979 levels, even as incomes of top 1 percent households grew several times faster than incomes of middle-class households. While the long-run fiscal situation of the United States is fundamentally strong, we will need more revenue in the future to honor existing commitments to social insurance, income support, and public investment, let alone to expand these commitments. It just makes sense that this revenue should come from the group that has done extraordinarily well over recent decades.

Further, a growing research base indicates that the decline in top effective rates has contributed substantially to rising inequality in recent decades.¹ Essentially, these rate cuts have powerfully boosted incentives for well-placed economic agents (think CEOs and finance sector professionals) to rig the rules of the economy to direct a disproportionate share of the benefits of economic growth to themselves. In simple terms, they have more reason to use their political and economic power to steer the fruits of economic growth their way because lower taxes means they get to keep a greater share of what they claim. While progressives should aim to stop the rigging of these rules in each particular case (through financial regulation or improved corporate governance, for example), tax reform that raised the effective rate on top income households could significantly blunt the incentive for this rule-rigging across-the-board.²

In this hypothetical policymaking world—one with a more progressive and evidence-based Congress—one could also imagine corporate tax reform that lowers the statutory rate yet closes loopholes to keep net revenue collected from the corporate income tax unchanged (or even increase it). We could also imagine proposals that radically scale back the

corporate income tax yet boost progressive taxes on the individual side (or through financial transactions taxes) to keep the overall system at least as progressive as it is today. These theoretical possibilities are why we formulate this principle as opposing “*net* tax cuts for high-income households *and* corporations.” In reality, though, in the current debate this will almost surely end up meaning that *any* cuts in either individual or corporate rates should be opposed, since today’s Republican majority is not interested in reform that does anything but increase the post-tax incomes of the richest households.

To be sure, today’s corporate income tax system is riddled with damaging loopholes that intelligent tax reform should close. The most important one to close is the ability of U.S. firms to defer taxation on profits earned abroad (or at least profits engineered to *appear* to have been earned abroad). Deferral is why it is rational for firms to shift their profits abroad, and it is why more than \$2.5 trillion in profits are now sitting offshore untaxed.³ This overseas hoard of profits will put enormous pressure on policymakers to cut a deal to have this money brought back into the country at a very low tax rate. The economic case that repatriating this money at a preferential tax rate will yield large-enough benefits to justify the revenue loss is extraordinarily weak.⁴ Today’s U.S. economy remains glutted with savings, as demonstrated by interest rates that remain historically low and corporate balance sheets that are so awash in cash that they could essentially finance planned capital investment with internal funds.⁵ There is no benefit to either near-term or long-term U.S. growth from giving a select group of some of the world’s richest corporations an enormous tax break in exchange for their repatriation of overseas profits, a repatriation that will only increase the savings glut without boosting job growth. But there is a benefit from preserving the corporate income tax, as it is among the most progressive parts of the U.S. tax system; mainly it falls heaviest on capital-based income, which is concentrated at the top of the income distribution (**Figure B**).

Reject plans that offer crumbs to progressives, either in the form of “middle-class tax cuts” or infrastructure spending

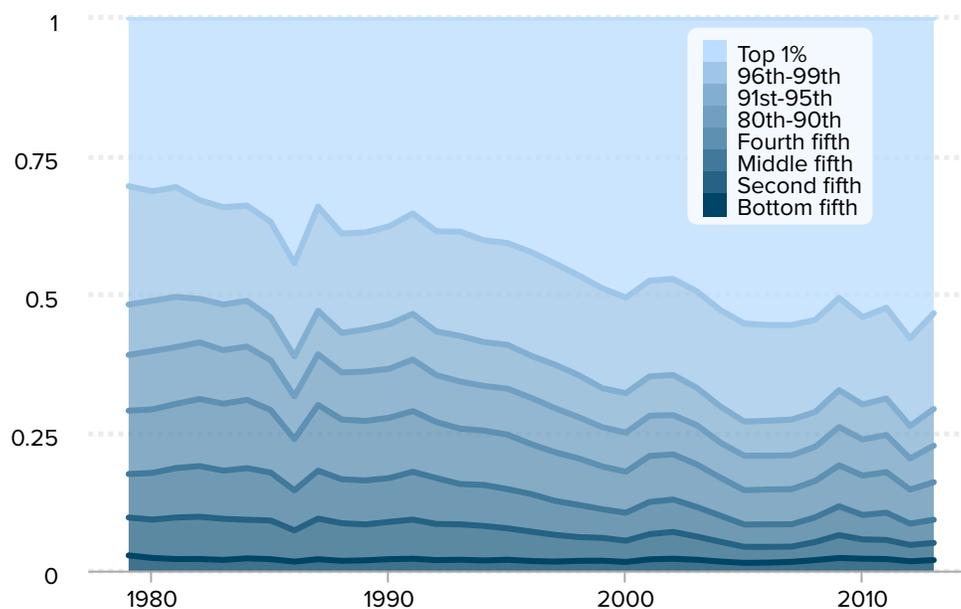
Some Democrats in Congress might seek to avoid being labeled the “party of no” by trying to strike a deal on taxes. It is almost inconceivable that any deal driven by the Republican majority will not include large tax cuts for the richest households and/or corporations. Given this, hopes for an acceptable deal should be very low. Crucially, appending some small-scale progressive priorities to a tax bill that provides huge benefits to the richest households should be unacceptable.

One common locus of potential dealmaking concerns “middle-class tax cuts.” Progressives should be clear about something: the federal income tax rates faced by middle-class Americans have *nothing* to do with their struggles to maintain economic security amid stagnating living standards in recent decades. In fact, the effective federal income tax rate faced by the bottom 80 percent of American households has *fallen* enormously between 1979 and 2013 (see **Figure C** below). And yet pretax income of this group has fallen ever-further far behind economy-wide averages, held down by rising inequality (see the red line

Figure B

Growing concentration of capital-based incomes

Share of capital-based incomes by household income group, 1979–2013



Note: Capital-based incomes are defined as the sum of the following CBO categories: capital income, capital gains, and business income.

Source: Author's analysis of data from the Congressional Budget Office, *The Distribution of Household Income and Federal Taxes, 2013, 2016*

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in Figure C). At some point, policymakers genuinely concerned about boosting incomes for middle-class families will have to realize that middle-class tax rates are a pathetically weak lever to pull, and they should move on to other policies that will actually help these families.⁶

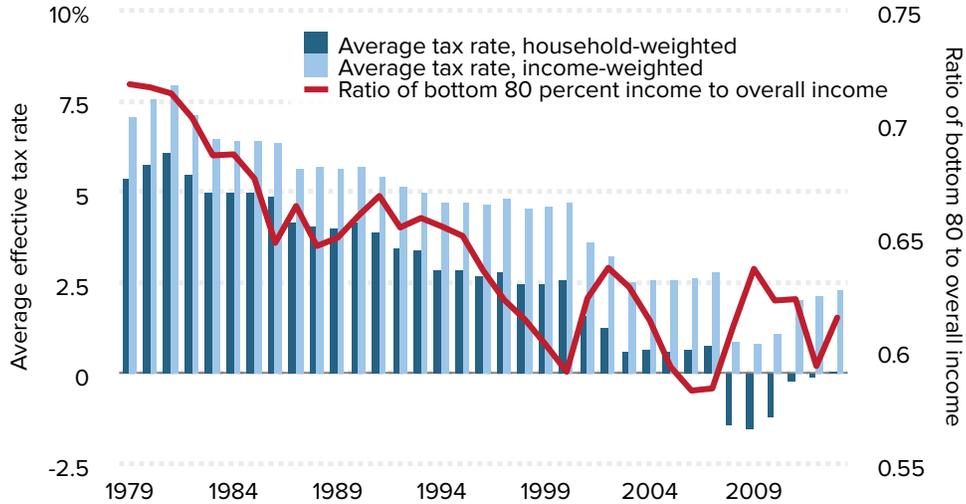
Demands that progressives present “their plan” for boosting middle-class incomes should be easy to answer. First, we want to raise more revenue from the top, both to honor—and even expand—current commitments to social insurance and income support and to fund public investments in the future. Second, we want to use every lever in the policy toolkit—not just tax policy—to shift economic leverage and bargaining power toward low- and moderate-wage households.⁷ What we refuse to do is engage in voodoo economics by claiming that cutting effective middle-class income tax rates from 4 percent to 3 percent will somehow be game changing for the middle class.

Besides calls for “middle-class tax cuts,” the other siren song for Democrats who want to make deals during the upcoming tax debate will be promises to bundle infrastructure investments in a package of tax cuts. Expanded public investment of all types—including infrastructure—have been a progressive priority for years.⁸ And yet it is enormously unlikely that any forthcoming tax deal will include an attractive-enough infrastructure plan to be worth swallowing enormous, regressive tax cuts.

Figure C

Bottom 80 percent has lost ground even as their tax rates have been cut

Pretax income of bottom 80 percent of households as a share of average overall income, and their effective tax rate



Notes: Income of the bottom 80 percent is a simple average of CBO income data for the bottom four fifths of the income distribution. The average of the bottom 80 percent incomes is then divided by the overall average income reported by CBO. Effective income tax rates are both weighted by households and by incomes.

Source: Author’s analysis of data from the Congressional Budget Office, *The Distribution of Household Income and Federal Taxes, 2013, 2016*

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For one, any policy package that includes both large tax cuts *and* increased infrastructure spending will almost by definition need to come with steep cuts in other parts of the federal budget. We know such cuts are a Republican priority, as exemplified both by the Better Way plans forwarded by Speaker Ryan as well as by President Trump’s recent “skinny budget.” Any such federal budget cuts would completely neutralize any near-term job-creation benefit from infrastructure spending, eliminating much of the rationale for infrastructure investment.⁹

Further, the infrastructure proposals that have been issued by Republicans in recent years have been exercises in marketing rather than serious economic proposals. Their common theme is putting minimal amounts of federal spending into these plans and then making large, unfounded claims that this small amount of federal spending will “leverage” massive amounts of private capital to invest in infrastructure.¹⁰ The plan issued in 2016 by Peter Navarro and Wilbur Ross for the Trump campaign is essentially a recipe for giving tax breaks to firms that were going to be involved in infrastructure projects anyhow, without inducing any *additional* investment; roughly \$400 billion in infrastructure investment happens each year even without any particular policy intervention to increase it.¹¹

Resist the urge to base opposition to tax cuts for high-income households on concerns about increasing the federal budget deficit

Arguing against regressive tax cuts by amplifying fears about too-large federal budget deficits is bad economics and bad political strategy. It is bad economics because the U.S. economy's fiscal position is fundamentally solid.¹² There is no evidence that fiscal profligacy is either harming us now or is poised to harm us anytime soon. Long-term interest rates and inflation remain low. The single largest driver of long-run spending trends is the growth in per capita health care costs, and these costs have slowed significantly over the past decade. The estimated 30-year fiscal gap—how much (starting today) taxes would need to be raised or spending would need to be cut to hold the debt-to-GDP ratio constant—has also narrowed. In its 2016 Long-Term Budget Outlook, the Congressional Budget Office (CBO) has the 30-year fiscal gap at under 2 percent, down significantly from estimates made a decade ago.

Further, the economy remains damaged by the Great Recession, with several indicators demonstrating a remaining gap between aggregate demand and potential supply (see **Figure D**). For example, the share of 25- to 54-year-olds with a job is still too low: the prime-age employment-to-population ratio (EPOP) remains substantially below its 2007 peak, and far below the peak it reached in 2000. Because this is a fixed-age group, this is not a story of rising college enrollments or retirements caused by demographic change. Key evidence that this historically depressed prime-age EPOP is due to the slack in demand comes from the still-sluggish growth in nominal wages, which have yet to break 3 percent annualized growth over the entire course of the recovery from the Great Recession. This growth rate is far below the level—3.5 percent and above—needed to restore the economy's overall price growth and labor share of income to historically normal levels.¹³ Finally, core prices remain below the Fed's target for a healthy economy, and have been below this target for years now.

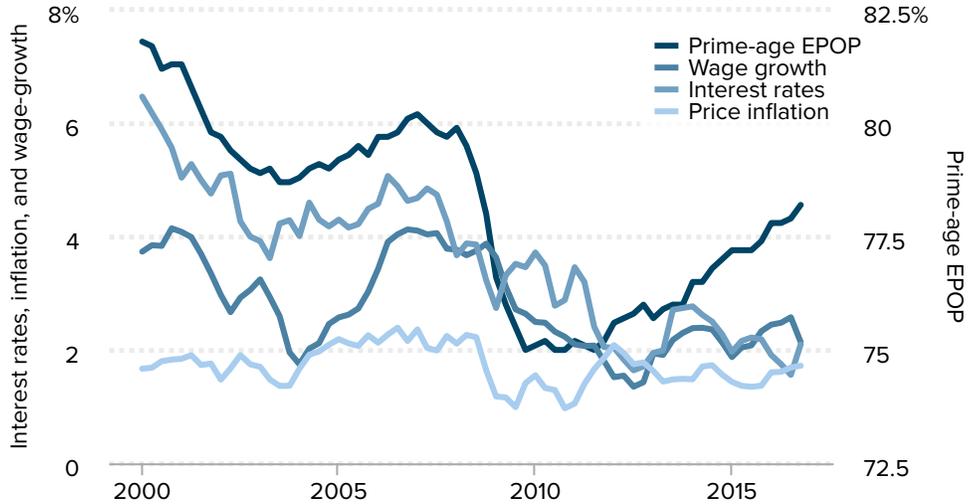
The relevance of this demand-slack for fiscal debates is that anything that convinces policymakers to prioritize rapid reductions in the federal budget deficit will drag on growth and prolong the years-long failure to engineer a full recovery. This is not an academic concern. The enormously premature “pivot to austerity” that characterized fiscal policy in 2011 became by far the single biggest reason why the recovery from the Great Recession has been the slowest on record.¹⁴ If concerns about budget deficits somehow convince Congress to pair regressive tax cuts with spending cuts, this would be a near-term macroeconomic disaster, as the fiscal drag from spending cuts would easily swamp any stimulus from high-income tax cuts.

Crucially, fomenting the misperception that the federal budget deficit is always too large and growing is pure poison for long-run progressive goals. As public opinion expert Ruy Teixeira has put it, “Arguably, there is no greater obstacle to progressive change than the

Figure D

All signs point to continuing weakness in aggregate demand

Inflation, wage growth, interest rates, and the share of adults between the ages of 25 and 54 with a job



Source: Author’s analysis of data from the Bureau of Labor Statistics (BLS), the Bureau of Economic Analysis (BEA), and the U.S. Treasury. Inflation is the four-quarter change in the price index for core personal consumption expenditures from the BEA. Wage growth is the four-quarter change in average hourly earnings of production and nonsupervisory workers from the Current Employment Statistics program of the BLS. Interest rates are rates on 10-year constant maturity Treasury bonds. The prime-age EPOP—share of adults between the ages of 25 and 54 with a job—is reported by the Current Population Survey (CPS) program of the BLS.

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idea of austerity.”¹⁵ Pollster Celinda Lake has also noted evidence that stirring up deficit concerns in the short run to fight destructive tax cuts boomerangs, harming progressive efforts to boost social insurance, safety net, and public investment spending.¹⁶ The broader public often quickly translates concerns over budget deficits into concerns over spending, and convincing the broader public that any growth in spending programs is doing damage to the U.S. economy is the linchpin of conservative efforts to pare back the already pretty threadbare American system of social insurance, income support, and public investment.

While invoking deficit fears is bad economics and bad strategy, noting implicit trade-offs can be illuminating. That is, regardless of the pluses or minuses of what regressive tax cuts do to budget deficits, they unambiguously represent resources that the federal government will no longer have. It seems perfectly reasonable to ask why, for example, Speaker Ryan believes that the federal government has \$3 trillion in revenue to give away to the top 1 percent (literally 99.6 percent of his plan’s benefits accrue to the top 1 percent by 2025), but not \$3 trillion to boost health coverage, or fix the nation’s eroded unemployment insurance system, or expand Social Security, or undertake substantial public investments.¹⁷ But it is not economically rational or politically astute to claim that tax cuts should be dedicated to “paying down debt,” or that today’s fiscal situation is already

dire and hence tax cuts just make it worse. Today's fiscal situation is not dire; the only thing standing between the United States and the ability to not just honor, but expand, the federal programs that provide crucial help to low- and moderate-income households is the tax-cuts-over-everything-else ideology of the Republican Party.

About the author

Josh Bivens joined the Economic Policy Institute in 2002 and is currently the director of research. His primary areas of research include macroeconomics, social insurance, and globalization. He has authored or co-authored three books (including *The State of Working America, 12th Edition*) while working at EPI, edited another, and has written numerous research papers, including for academic journals. He often appears in media outlets to offer economic commentary and has testified several times before the U.S. Congress. He earned his Ph.D. from The New School for Social Research.

Endnotes

1. The overview and empirical evidence linking falling top tax rates and rising inequality can be found in Thomas Piketty, Emmanuel Saez, and Stefanie Stantcheva, "[Optimal Taxation of Top Labor Incomes: A Tale of Three Elasticities](#)," *American Economic Journal: Economic Policy*, vol. 6, no. 1, February 2014.
2. For more on this argument see Josh Bivens and Lawrence Mishel, "[The Pay of Corporate Executives and Financial Professionals as Evidence of Rents in Top 1 Percent Incomes](#)," *Journal of Economic Perspectives*, vol. 27, no. 3, summer 2013.
3. For estimates of the scale of corporate profits parked offshore deferring taxation see Richard Phillips et al., *Offshore Shell Games 2016: The Use of Offshore Tax Havens by Fortune 500 Companies*, U.S. PIRG, Citizens for Tax Justice, Institute of Taxation and Economic Policy, October.
4. The benefits of the last repatriation holidays in 2014 are surveyed in Chuck Marr and Chye-Ching Huang, *Repatriation Tax Holiday Would Lose Revenue and Is a Proven Policy Failure*, Center on Budget and Policy Priorities, 2014.
5. See a forthcoming EPI report by Josh Bivens and Hunter Blair for evidence that corporate internal funds can finance planned investment to a historically large degree (working title: "[Competitive Gibberish: The Flawed Evidence and Logic behind Claims that Corporate Tax Rates Are Too High](#)," Economic Policy institute, 2017).
6. For more on why middle-class income tax cuts are such a limited strategy, and a review of policies that would actually help middle-class families, see Lawrence Mishel, "[Even Better than a Tax Cut](#)," *The New York Times* [op-ed], February 23, 2015.
7. EPI's "[Agenda to Raise America's Pay](#)" presents a comprehensive set of policies for boosting American workers' pay.
8. EPI, for example, was recommending a substantial increase in infrastructure spending as an alternative to the Economic Stimulus Act of 2008—fully a year before the American Recovery and Reinvestment Act (ARRA). See John Irons, Lawrence Mishel, and Ross Eisenbrey, *Strategy for*

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9. For the finding that cuts to federal spending (particularly transfers) will near-totally neutralize the short-term job-creation benefits of infrastructure spending, see Josh Bivens, *The Short- and Long-Term Impacts of Infrastructure Investments on U.S. Employment and Economic Activity*, Economic Policy Institute, 2014.
10. For a review of common weaknesses regarding claims of the benefits of “engaging the private sector,” see Hunter Blair, *No Free Bridge: Why Public–Private Partnerships or Other ‘Innovative’ Financing of Infrastructure Will Not Save Taxpayers Money*, Economic Policy Institute, 2017.
11. For an analysis of how to evaluate public investment plans see Josh Bivens and Hunter Blair, *A Public Investment Agenda that Delivers the Goods for American Workers Needs to be Long-lived, Broad, and Subject to Democratic Oversight*, Economic Policy Institute, 2016.
12. See Harry Stein, “America Can Still Do Big Things: Dispelling the Fiscal Hysteria that Thwarts Good Public Policy,” *Harvard Law & Policy Review*, vol. 11, 2017, for an excellent overview of the fundamentally sound fiscal position of the United States.
14. See Josh Bivens, *Why Is Recovery Taking so Long—and Who’s to Blame?*, Economic Policy Institute, 2016, on the role played by austerity in leading to slow growth following the Great Recession.
15. See Ruy Teixeira, “Austerity: The Biggest Roadblock To Progressive Change,” ThinkProgress (Center for American Progress blog), April 26, 2013.
16. Pollster Celinda Lake made this point in a talk during remarks delivered at *The New Populism Conference* in Washington, D.C., May 22, 2014.
17. See James R. Nunns et al., *An Analysis of the House GOP Tax Plan*, Tax Policy Center, 2016, for an analysis of the House Republican tax plan from last year.