Raising Revenue to Address the U.S. Debt Trajectory

The United States does not have a spending problem; it has a revenue problem. Republican tax cuts for the wealthy have reduced revenues and driven up the national debt. Despite this reality, Republicans want to further cut important social programs, harming millions of Americans while doing little to correct the country's fiscal balance.

The United States should reduce the deficit, but not on the backs of working people. The deficit can and should be reduced by closing tax loopholes for the wealthiest of the wealthy and going after tax cheats among the wealthiest of individuals and big corporations—a move that requires maintaining funding for the Internal Revenue Service. Next year, there is also a crucial opportunity for Congress to put the country's fiscal path back on track by letting key provisions of the 2017 Republican tax package expire.

Rising debt levels are due to Republican tax cuts for the wealthy, not increased spending to invest in American families

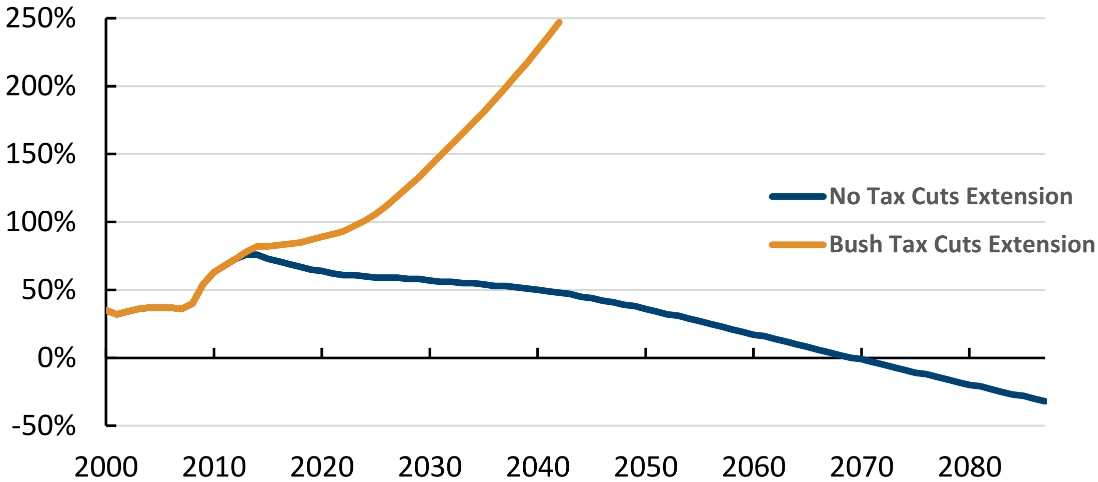
Debt levels are increasing over the long run because of tax cuts for the wealthy

For most of the 20th century, the United States did not run budget surpluses. Small deficits were paired with strong economic growth, which enabled the size of the debt to shrink from 106% of gross domestic product (GDP) at the end of World War II to approximately 30% by the end of the Clinton administration. The debt-to-GDP ratio began to grow in the 2000s following the passage of the Economic Growth and Tax Relief Reconciliation Act under the George W. Bush administration. Though the law contained tax cuts for people of all income levels, its benefits flowed largely to the wealthiest 20% of taxpayers.

Prior to the extension of the Bush tax cuts in 2012, when the cuts were due to expire, CBO estimated that revenues would exceed outlays every year for at least the following 75 years. Instead, Congress extended the Bush tax cuts, which dramatically increased the size of the debt. In 2017, President Trump pushed through a further round of partisan tax cuts, the Tax Cuts and Jobs Act, which also largely benefited the wealthiest taxpayers. By the time President Biden took office in 2021, debt held by the public was over 98% of GDP.

The Bush Tax Cuts Dramatically Increased the Level of Debt

Debt held by the public as a percentage of GDP, 2012 Long-Term Budget projections



Source: Congressional Budget Office
Note: Data after 2015 are projections.

Currently, the Congressional Budget Office (CBO) projects that the national debt will continue to rise. Federal debt held by the public[1] is expected to be 99% of GDP at the end of fiscal year 2024 and is projected to increase as a share of the country's GDP over the next 30 years to 172% by 2054. This trajectory is the result of repeated Republican tax giveaways to the wealthy.

Low revenues, as opposed to high spending, have driven recent increases in the debt

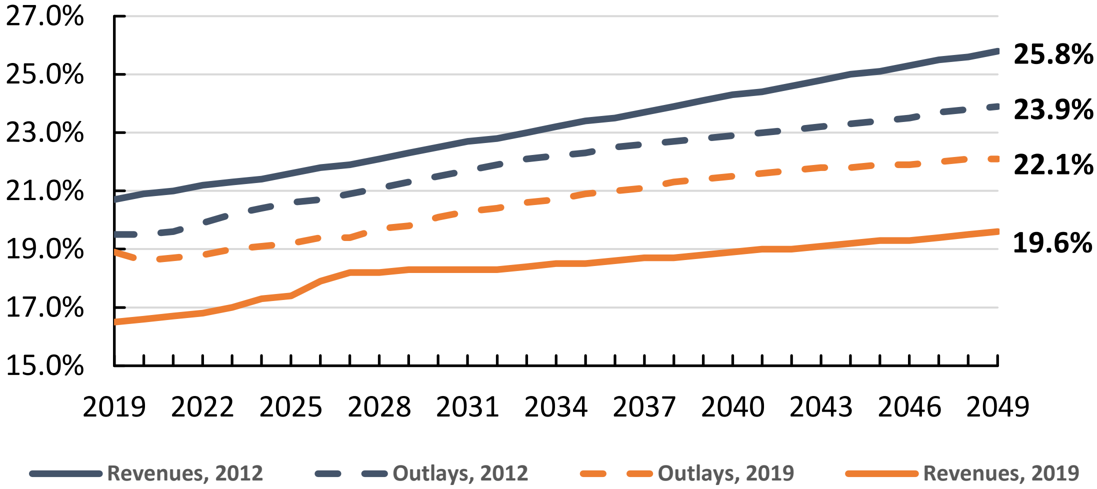
The Bush and Trump tax cuts massively increased deficits by decreasing net revenue over the long term. One analysis even found that the Bush and the Trump tax cuts are responsible for the entirety of the fiscal gap (the total increase in debt beyond what is needed to maintain a stable debt-to-GDP ratio). According to the Office of Management and Budget, revenues were 20.0% of GDP in 2000, while by 2019, they had fallen to only 16.4% of GDP.

Rising deficits due to falling revenues have masked the fact that projected spending is also lower than previously estimated. Projected federal spending over the next half-century is 1% to 2% of GDP lower compared to estimates made in the early 2010s, driven largely by savings in health care spending. Much of these savings are due to provisions of the Affordable Care Act.

[1] There are two main measures of the national debt: the total debt, which includes intragovernmental debt (such as special Treasury assets that reflect past surpluses in the Social Security and Medicare trust funds), and debt held by the public, which only counts debt owed to entities outside the federal government. Since total debt includes money owed from one part of the government to another, debt held by the public is a better measure of the overall indebtedness of the United States.

Projected Revenues and Spending Have Fallen Since 2012

Projected revenues and outlays as a share of GDP, 2012 and 2019

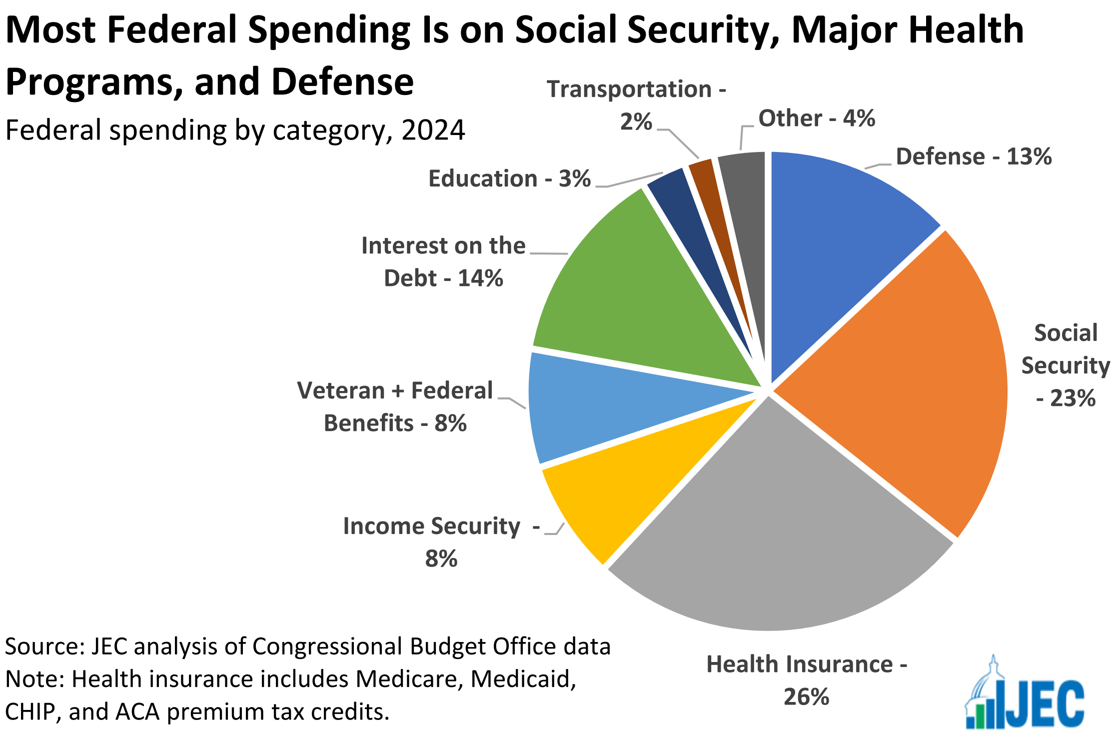


Source: Congressional Budget Office
Note: Outlays do not include interest.

Finally, one-time spending packages like the Coronavirus Aid, Relief, and Economic Security (CARES) Act and the American Rescue Plan (ARP) Act during the COVID-19 pandemic, had little effect on the long-term trajectory of the debt. These pieces of legislation only increased spending temporarily and will ultimately not be a driver of the debt moving forward.

Cuts to non-defense discretionary spending will not stabilize the debt, let alone balance the budget

Most discussions of the national debt take place during the yearly appropriations process, which only covers a small part of federal spending. Indeed, these programs only made up 14% of total federal spending in fiscal year 2023. Most government spending is instead on major health programs like Medicare and Medicaid, Social Security, and national defense. A recent Committee for a Responsible Federal Budget analysis found that it would be impossible to balance the budget just through cuts to non-defense discretionary spending, and that higher revenues must be a part of any plan to stabilize the debt.



Stabilizing the level of debt should be a long-term goal

The debt-to-GDP ratio serves as the best measure of national debt, as it measures not just the nominal level of debt but the ability to pay the debt based on the size of the U.S. economy. While the nominal level of debt is important to track, stabilizing the debt level by closing the fiscal gap is a more realistic goal. This would ensure the United States maintains a stable debt burden over the long term without requiring punishing spending cuts or tax increases that come with balancing the budget.

Ensuring that the wealthy pay their fair share will raise revenue

Tax measures focused on the wealthiest of the wealthy would raise significant revenue

A number of tax measures proposed by President Biden and Democrats in Congress would raise significant revenue and improve the country's fiscal path. President Biden's budget for fiscal year 2025 would cut the deficit by nearly $3 trillion over a decade and reduce long-term fiscal risks. These tax proposals would help equalize the treatment of different taxpayers and different types of income, ensuring that wealthy individuals and corporations pay their fair share.

For individual taxpayers, these proposals include instituting a minimum tax on billionaires and restoring the top income tax rate that applies to the wealthiest individuals. Wealthy individuals often pay lower tax rates because they make money in different ways (some of which are subject to lower tax rates or no taxation at all). Because of this, they can take advantage of tax loopholes and utilize sophisticated tax planning. A minimum tax on billionaires would ensure that the wealthiest 0.01% of Americans pay a tax rate of at least 25%, well above the 8% average tax rate that many of them currently pay and more in line with the average federal tax rate.

Additionally, restoring the top income tax rate to 39.6%, from 37%, would ensure those with more than $400,000 in taxable income pay their fair share, reversing the change made by the Tax Cuts and Jobs Act and raising $246 billion in revenue over 10 years.

Democrats have also proposed tax changes that would ensure corporations pay their fair share by raising the corporate tax rate and bringing the country in line with the global minimum tax deal. President Trump and Republicans in Congress cut the corporate tax rate from 35% to 21%—which effectively put the tax rate at under 8% after accounting for tax credits, loopholes, and other benefits—as part of the Tax Cuts and Jobs Act in 2017. Raising the corporate tax rate to 28% would raise $1.3 trillion over a decade.

Additionally, adopting the global minimum tax would make it more difficult for multinational companies to avoid paying U.S. taxes. The Organisation for Economic Co-operation and Development recently estimated that the global minimum tax will raise $155 billion to $192 billion each year—none of which is currently set to flow to the U.S. government. These measures would build on the corporate alternative minimum tax included in the Inflation Reduction Act (IRA), which requires corporations with over $1 billion in reported income to pay at least a 15% tax rate and which President Biden has proposed raising to 21% as part of his budget for fiscal year 2025. This minimum tax is applied to roughly 150 large companies and is projected to raise more than $200 billion over 10 years.

Limiting tax expenditures and loopholes for the wealthy would also raise revenue

The U.S. tax code includes a number of so-called tax expenditures, where the law reduces the tax rates for certain types of income or allows taxpayers to subtract certain things from what counts as taxable income. Several of these tax expenditures mainly benefit wealthy taxpayers, largely valuing wealth over work and allowing the richest Americans to pay lower tax rates than the average family by taking advantage of various loopholes and exceptions. Limiting these tax expenditures that overwhelmingly benefit the wealthy, like the lower tax rates for capital gains and stock dividends, the stepped-up basis loophole, and the carried interest loophole, would raise revenue and reduce the deficit.

For example, income earned from capital gains (i.e. the sale of stocks or bonds) or from dividends paid to stockholders is taxed at a lower rate than income earned on the job. This preferential treatment was estimated to cost the United States $265 billion in 2023 alone, much of which flows to wealthy people who own most stock. Taxing capital gains at the same rate as wage income would equalize the tax treatment of different types of income and raise significant revenue.

Another loophole known as the “stepped-up basis” permits wealthy families to shield their investment gains from *ever* being taxed. This loophole allows capital gains tax on the sale of an asset like a stock, a bond, or real estate to be based on the price of the asset when it is inherited, not on the gain from when it was originally purchased. This allows families to skirt capital gains taxes by passing assets to their heirs at death and avoiding *any* taxes owed, compared to if the original owner had sold it instead. Closing this loophole would mean that the new recipient of an asset pays taxes on its increased value, just like if it was sold on the open market.

Finally, Congress should close the carried interest loophole, which allows hedge fund, private equity, and real estate managers to treat some of their income as investment income to either pay a lower tax rate or put off paying taxes indefinitely. Closing this loophole would force these wealthy individuals to pay their fair share by paying the same tax rate as others do on wage income and would generate more than $60 billion over 10 years.

The IRS is already using Inflation Reduction Act funding to bring in more revenue

The Internal Revenue Service (IRS) is already using funding from the Inflation Reduction Act (IRA) to make significant improvements and ramp up tax enforcement on wealthy individuals, large corporations, and complex partnerships. The agency is focusing enforcement on high-income, high-wealth taxpayers and has already collected $520 million from individuals who have more than $1 million in income and more than $250,000 in outstanding tax debt. The IRS is also closely examining 75 of the largest and most complex business partnerships for potential tax noncompliance. Prior to the passage of the Inflation Reduction Act, audit rates for the wealthiest taxpayers had fallen to historical lows following years of IRS budget cuts.

Maintaining adequate funding for IRS enforcement and modernization would also help close the tax gap—the difference between the taxes owed and revenues collected each year—which totaled an estimated $688 billion in tax year 2021. The Treasury Department recently estimated that the IRA's original $80 billion investment in the IRS would increase revenue by up to $561 billion over 10 years. Unfortunately, Republicans in Congress subsequently cut $21.4 billion from the IRS's funding as part of the Fiscal Responsibility Act, which is estimated to reduce revenues by $44 billion and increase the deficit by $24 billion over ten years. That cost is likely an underestimate, as the Treasury study linked above and other research have found even larger impacts from each dollar of IRS funding. The IRS is still able to invest the IRA's multiyear funding and make significant progress toward modernizing the agency and improving tax enforcement, but Republicans continue to threaten the agency with further budget cuts.

Conclusion

Shrinking the deficit through unpopular, often unfeasible spending cuts is not a viable path to reducing the national debt. Instead, the United States must take a more balanced approach that includes forcing the wealthiest Americans and largest companies to pay their fair share. Smart fiscal policy now will allow the federal government to stabilize the national debt without resorting to punishing spending cuts on American families in the future.