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THE 2021 JOINT ECONOMIC COMMITTEE DEMOCRATIC RESPONSE

R E S P O N S E

OF THE

JOINT ECONOMIC COMMITTEE DEMOCRATS

ON THE

2021 ECONOMIC REPORT OF THE PRESIDENT

JULY 28, 2021

JOINT ECONOMIC COMMITTEE DEMOCRATS

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Contents

117th CONGRESS
1st Session } HOUSE OF REPRESENTATIVES { REPORT
117-xxx

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MR. BEYER, from the Joint Economic Committee, submitted the following

REPORT

Response of the Joint Economic Committee Democrats on the 2021 Economic Report of the President

CHAIRMAN'S VIEWS

I am pleased to share the Joint Economic Committee (JEC) Democratic response to the 2021 Economic Report of the President. The JEC is required by law to submit findings and recommendations in response to the Economic Report of the President (the Report), which is prepared and released each year by the Council of Economic Advisers (CEA). This year's report was published by the outgoing Trump administration in January 2021.

Much has changed since the Report was originally released. President Biden has been sworn into office, the American Rescue Plan has been passed into law and coronavirus vaccinations have become available to all Americans over the age of 12. As I write this, the United States is in the midst of recovering from the economic downturn caused by the coronavirus pandemic. With vaccination rates increasing, a return to normal levels of economic activity is within reach. The stimulus provided by the American Rescue Plan is playing a crucial role in smoothing and facilitating this transition back to a more normal economy.

This response assesses where we are and how we got here, but it focuses primarily on forward-looking policies to invest in our future economic growth and establish a stronger, more equitable and more just economy. Achieving these goals requires making long-term investments in our physical and human infrastructure and addressing long-standing racial and gender inequalities.

This response will also consider and analyze concerns that have been raised that the federal government does not have the fiscal capacity to make these investments, especially on top of the stimulus funds already passed. As Congress considers the American Jobs Plan and the American Families Plan, or other legislative proposals, it is crucial to remember there are revenue-raising options to ensure public investments are not entirely deficit-financed.

But even more importantly, we must keep in mind that investing in our physical and human infrastructure will increase and enhance the two primary inputs of economic growth—capital and labor. Therefore, these investments will increase our economy's future potential output and improve future economic growth prospects. Regardless of the exact set of options we use to pay for these investments, their returns will be greater than the opportunity costs of financing them.

We have an opportunity to rebuild a stronger, more equitable, more just economy. It is the economically sound thing to do, it is the right thing to do and it will be a legacy we can be proud of.

DONALD S. BEYER JR.
CHAIRMAN

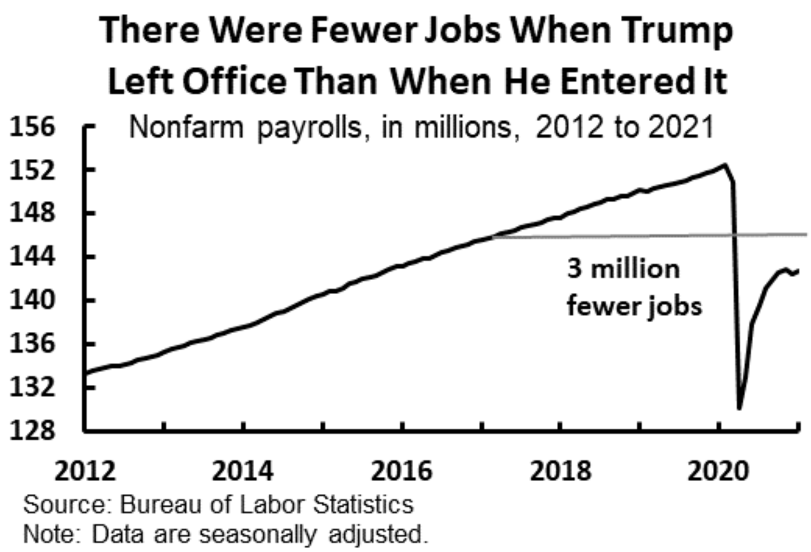
Chapter 1: Creating Shared Prosperity After An Unprecedented Crisis

Millions of Americans have returned to work and the United States is experiencing strong economic growth thanks to the American Rescue Plan and the successful vaccination program overseen by President Biden. President Trump's policies and his failed response to the coronavirus pandemic left him with the worst economic record of any modern U.S. president. Even before the pandemic, the Trump administration implemented policies that harmed working families.[1] Despite the strong economic recovery under the Biden administration and the 117th Congress, additional investments in physical and human infrastructure are necessary to advance long-term, broadly shared economic growth.

President Trump had the worst economic record of any modern U.S. president

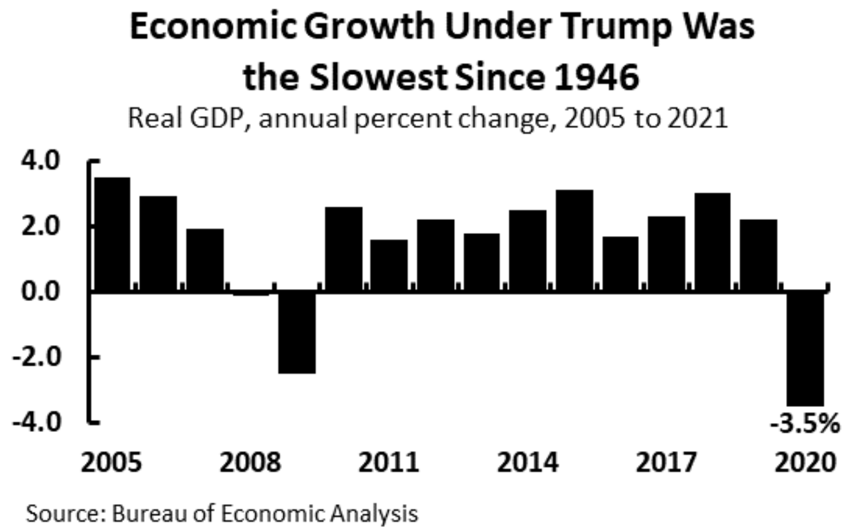
President Trump inherited the longest economic expansion in U.S. history from President Obama and left as the first president since World War II to oversee net American job loss during his term in office.[2] President Obama left President Trump an economy that was growing and adding jobs. Specifically, President Obama cut the unemployment rate from 10 percent to 4.7 percent in January 2017.[3] President Obama oversaw an economic comeback in which the U.S. economy grew by 15 million jobs over 76 consecutive months, and the economy grew by an average of 2.4 percent during his second term.[4] However, monthly job growth slowed under President Trump, even before his failed response to the coronavirus left millions of Americans without jobs.[5]

President Trump left office with 3 million fewer Americans employed than when he was sworn in.[6] Among the 22 million Americans who lost their job at the onset of the coronavirus pandemic in the spring of 2020, just over half had returned to work by January 2021, and there was a net loss of 10 million U.S. jobs from February 2020 to January 2021.[7] Despite inheriting an economy with 4.7 percent unemployment rate from President Obama, President Trump left office with an unemployment rate of 6.3 percent.[8] If unemployment statistics included workers who left the labor force and others who have been misclassified, the unemployment rate would have been 9.7 percent at President Trump's departure from the White House.[9]



Millions of workers left the U.S. labor force during President Trump's term in office. From February 2020 through the end of President Trump's term, 5 million Americans had stopped looking for work and left the labor force.[10] The labor force participation rate fell by 1.4 percentage points, and President Trump oversaw the biggest 12-month decline in labor participation in over 70 years.[11]

The U.S. economy's performance was particularly poor under President Trump, and annual real GDP growth averaged only 1 percent during his term—the worst record of any president since World War II.[12]



President Trump's policies hurt American workers and families before the coronavirus pandemic

President Trump's economic record before the coronavirus pandemic was unremarkable, and he implemented policies that hurt American workers and families. Average monthly job growth slowed under President Trump, with 183,000 new jobs on average added during his first three years in office compared to 220,000 new jobs on average each month during the last three years of President Obama's administration.[13] President Trump's trade war with China cost jobs and hurt farmers.[14] Job growth in manufacturing slowed significantly before the coronavirus pandemic, and manufacturing contracted in 2019.[15] President Trump's 2017 tax cuts gave a windfall to the wealthy and corporations without spurring promised business investment.[16]

The Trump administration consistently implemented policies that favored big businesses at the expense of workers and consumers.

The aftermath of President Trump's trade war with China was higher prices, fewer American jobs, more farm bankruptcies and a larger trade deficit. Studies found that U.S. businesses and consumers paid almost the entire cost of President Trump's tariffs, and an analysis estimated that the tariffs cost American families an average of $460 over the course of a year.[17] Moody's Analytics estimated that President Trump's trade war had cost the United States almost 300,000 job by September 2019.[18] In addition, farmers suffered because of the trade war, and bankruptcy filings among small and mid-sized farms increased 20 percent in 2019.[19] President Trump failed to deliver on American manufacturing, thanks in part to his destructive trade war with China. Manufacturing production fell in 2019, and the sector added just 70,000 new jobs that year, a significant reduction from previous trends.[20]

President Trump's 2017 tax cuts failed to deliver record growth or increased business investment, instead providing a major windfall for the wealthy and corporations. Despite promises that the 2017 tax cuts would yield 6 percent economic growth and pay for themselves, the economic results were paltry.[21] Even though the tax cuts increased the budget deficit by an estimated $1.9 trillion, real GDP growth in 2019 was just 2.2 percent—below the 2.4 percent average during President Obama's second term in office.[22] Business investment decreased after the tax cuts, slowing to 2.9 percent on average for the eight quarters after the tax cuts compared to 4.0 percent in the previous eight quarters.[23] The benefits of the tax cuts accrued mostly to the very wealthy and corporations. Households in the top 1 percent of income were expected to receive a tax break of $50,000 in 2020, while those in the lowest 20 percent of income were set to receive an average tax cut of only $60.[24]

The Trump administration pushed policies that hurt consumers and workers. President Trump signed a bill under the Congressional Review Act overturning the Consumer Financial Protection Bureau's rule to prohibit binding arbitration agreements, which can deprive consumers of their ability to protect their legal rights in a court of law.[25] President Trump's appointed director of the Consumer Financial Protection Bureau revised the payday lending rule, allowing lenders to give out high-interest loans without checking whether borrowers had the financial ability to repay the loans.[26] President Trump's Department of Labor issued a "joint employer" rule limiting how and when big businesses could be held accountable for violating the Fair Labor Standards Act, a rule that would have made it more difficult for temp workers and workers at franchises to seek adequate redress for wage-and-hours violations.[27] The Trump administration's final overtime rule covered 2.8 million fewer workers than under the proposal from the Obama administration.[28] The Economic Policy Institute estimated that the Trump administration's overtime rule would cost workers at least $1.2 billion in wages, a figure that would only grow over time.[29] The Trump administration used the power of the federal government to help large corporations at the expense of workers and consumers.

President Trump's failure to address the coronavirus pandemic had deadly consequences

President Trump repeatedly downplayed the dangers of the coronavirus, ignored the advice of public health experts and failed to use his powers as president to effectively address the coronavirus. At the onset of the pandemic, President Trump publicly downplayed the risks, repeatedly claiming the virus was "going to disappear."[30] Privately, however, President Trump told journalist Bob Woodward in February 2020 that the coronavirus was "more deadly than even your strenuous flus." Trump subsequently said to Woodward in a March 2020 private conversation, "I wanted to always play it down" and "I still like playing it down, because I don't want to create a panic."[31] President Trump publicly downplaying the risks of the coronavirus and his failure to act had deadly costs for Americans.

President Trump spread falsehoods that harmed public health and went against the advice of public health experts, with serious consequences for human lives and the U.S. economy. President Trump dismissed the need for coronavirus tests, touted unproven medical treatments, mocked the importance of wearing face masks to prevent the spread of the coronavirus and urged his supporters to attend crowded political rallies in violation of social distancing guidelines.[32] Researchers estimated that well over 100,000 lives could have been saved had Americans adopted universal mask usage in public—something that the Trump administration could have encouraged.[33] According to a study conducted by Goldman Sachs, the widespread adoption of face masks under a national mask mandate would have avoided the need for lockdowns and prevented GDP losses up to 5 percent, or about $1 trillion.[34]

President Trump resisted efforts to relieve economic suffering during the pandemic. The House Democratic majority and Senate Democrats worked on a bipartisan basis during the 116th Congress to deliver relief to American families, workers and small businesses affected by the coronavirus pandemic. Bills such as the Families First Coronavirus Response Act; the Coronavirus Aid, Relief, and Economic Security Act (CARES) Act; the Paycheck Protection Program Flexibility Act; and the Consolidated

Appropriations Act of 2021 passed through bipartisan votes to provide critically needed assistance to the American people during an unprecedented crisis. Thanks to these bills, unemployed workers received a $600 weekly supplement to unemployment benefits, direct payments helped families in need, state and local governments were able to keep essential workers on the job and small businesses received grants and forgivable loans to help them survive the pandemic.

However, these bills were not enough to relieve the full scope of economic suffering in the aftermath of the coronavirus pandemic. President Trump and his allies refused good-faith negotiations on a compromise economic relief bill as the $600 federal enhanced unemployment benefits expired in the summer of 2020, prolonging economic suffering for unemployed Americans. President Trump also refused additional federal assistance to state, city, tribal and territorial governments that employ first-responders in health care and law enforcement, even as these governments faced a significant drop in revenue in 2020.[35] President Trump exacerbated the human toll and economic suffering of the coronavirus pandemic through his public falsehoods about the coronavirus, mismanagement of the federal government and refusal to negotiate in good faith as economic relief programs under the CARES Act expired.

The American Rescue Plan and the Biden administration's successful vaccination program have delivered a robust economic recovery

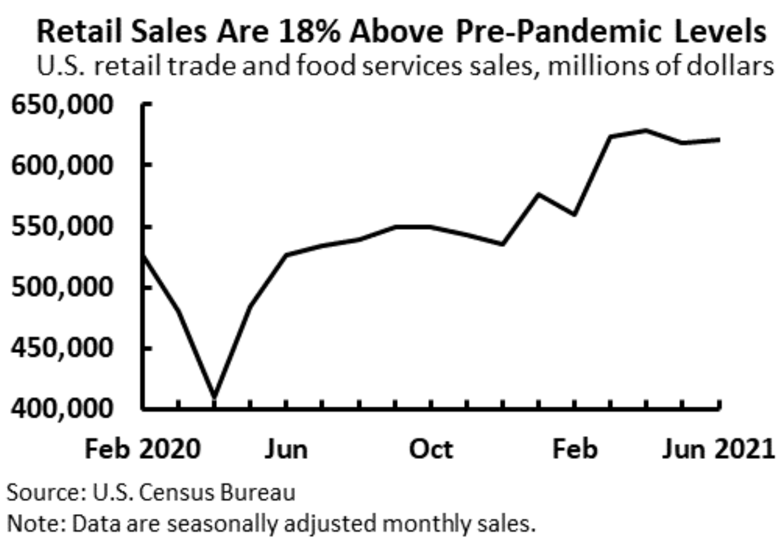
Under President Biden's administration and the 117th Congress, America's economic outlook has significantly improved with the passage of the American Rescue Plan and the implementation of a successful vaccination program. The American Rescue Plan provided vital assistance to small businesses, unemployed workers, families with children, public schools and the state and local governments that employ first responders. As of the end of July 2021, 163 million Americans were fully vaccinated, compared to just 3 million fully vaccinated Americans when President Biden took office.[36] As a result of these efforts, millions of Americans have returned to work, real GDP is expected to grow in 2021 at rates not seen in over 30 years and retail sales have exceeded pre-pandemic levels.

Projections of economic growth are strong and have only become stronger after the passage of the American Rescue Plan. As of July 2021, CBO projected that the United States would see 7.4 percent real GDP growth in 2021.[37] This was an upward revision in CBO's projected growth rate from its February 2021 projection of 3.7 percent real GDP growth, issued before the American Rescue Plan became law.[38] CBO said that its upward revision to real GDP growth projections for 2021 was due, in part, to "recently enacted fiscal policies" and "a more rapid return to normalcy." CBO also projected 3.1 percent real GDP growth in 2022—higher real GDP growth than any year under the Trump administration.[39]

Millions of American have returned to work under President Biden's administration and the 117th Congress. Total nonfarm employment rose by 850,000 in June 2021, and the United States has added over 3 million jobs in President Biden's first five months in office.[40] As of June 2021, all 50 states and the District of Columbia had more jobs and lower unemployment than a year before.[41] At the same time, the number of new unemployment claims has declined as more Americans have found jobs and returned to work. In mid-July 2021, new claims for unemployment benefits fell to 360,000—the lowest point since the beginning of the pandemic and far below the 1.5 million new claims for the same week a year earlier.[42]

The trend of Americans returning to work is expected to continue. CBO expects that in 2022 overall employment will exceed levels seen before the pandemic and the average unemployment rate will be 3.8 percent. CBO also projects that average unemployment rate will be 3.7 percent in 2023.[43]

Retails sales are also positive as the Biden administration's successful vaccination program has allowed more Americans to resume normal levels of economic activity. Retail sales rose 0.6 percent in June 2021 and were 18 percent above the pre-pandemic level.[44]



The outlook for federal budget deficits and public debt continues to improve under the current administration. From its February 2021 estimate to July 2021, CBO revised down its estimate of cumulative federal budget deficits for 2022 through 2031 by $173 billion, even as emergency measures temporarily increased the on-budget deficit in 2021. CBO projected the 2021 on-budget federal deficit will be $158 billion lower than in 2020 and expects the federal budget deficit to continually decline in 2022, 2023 and 2024. CBO also projected that federal debt held by the public as a percentage of GDP will decline in 2022, 2023 and 2024.[45]

Inflation expectations in the medium- and long-term are consistent with price stability and strong economic growth. In July 2021, CBO projected core PCE price index inflation of 2.0 percent in 2022 and 2.2 percent in 2023.[46] Similarly, the Federal Reserve projected core PCE inflation of 2.1 percent in 2022 and 2023.[47] Federal Reserve Chair Jerome Powell testified to Congress that "longer-term inflation expectations remain well anchored at 2 percent," and at the Federal Open Market Committee's June meeting, officials reaffirmed the Fed's commitment to using its full range of tools to promote its goals of maximum employment and price stability, including its goal of 2 percent inflation on average over time.[48] Market-based measures of inflation expectations, including 10-year Treasury breakeven rates also remain within normal ranges, which suggests that investors share the Fed's assessment of inflation risks.[49]

Thanks to the efforts of the Biden administration and Congress, the U.S. economy continues to rebound and millions of Americans have safely returned to work. To promote sustained growth and shared prosperity, the federal government needs to make long overdue investments in physical and human infrastructure.

Broadly shared economic growth requires real investments in physical infrastructure and care economy infrastructure

The American Rescue Plan has put the United States on a course of rapid economic recovery, but the federal government must make significant additional investments in physical infrastructure and the care economy to promote long-term, broadly shared economic growth. Investing in deteriorating physical infrastructure will yield long-term dividends for economic output. Federal investment in lagging transportation infrastructure, water systems, public schools, the power grid and other physical infrastructure will help maintain America's economic competitiveness and increase the productivity of capital.

Investing in care infrastructure will strengthen the overall economy and support working families, particularly women, participating fully in the labor market. High-quality investments in families and children lead to higher human capital and improve long-term labor productivity. While investing in care infrastructure will help all Americans, it will be particularly beneficial for women of color who bear a disproportionate burden of care duties.[50] To bolster economic resilience and long-term prosperity, the time is now for investing in our crumbling infrastructure and building new kinds of infrastructure to help working families participate in the modern economy.

Congress can invest in America's future without burdening working families

The United States has the fiscal space to make investments that generate broadly shared economic growth, and the federal government can invest in America's future without burdening working families. Low interest rates make it possible for policymakers to invest in infrastructure at a low cost. Inflation expectations are moderate, and the Federal Reserve has the tools to maintain long-term price stability. In addition, public investments offset by new revenue would not have any expected impact on inflation.

The United States can bring in additional revenue simply by enforcing the tax laws already on the books. Strengthening IRS enforcement after years of underfunding and staffing cuts would bring in additional revenue without forcing anyone to pay more than they already owe. The IRS has options to ensure that wealthy taxpayers and big corporations pay what they owe, without burdening working families or saddling small businesses with egregious audits. In addition, Congress should ensure the very wealthy and big corporations pay their fair share for public investments that benefit all Americans.

CHAPTER 2: PUBLIC INVESTMENT IS KEY TO FUTURE ECONOMIC GROWTH

Even before the pandemic and resulting recession, decades of underinvestment in physical infrastructure—and a failure to invest in a 21st century care and human infrastructure—limited the economy's growth potential. The United States needs to make real investments in physical and care infrastructure to create long-term, broadly shared economic growth. Investing in the main drivers of economic growth—capital and labor—as well as innovation-enhancing policies will increase future U.S. economic output.

Investing in physical infrastructure to increase U.S. capital stock and power future economic growth

In 2018, infrastructure investment was only 1.5 percent of the United States' GDP, the third lowest percentage among high-income countries.[51] As a 2015 report from the Business Roundtable noted, public investment in transportation infrastructure in the United States has fallen from its 1960s high of 2.2 percent of GDP to only 1.6 percent—well below the five percent spent by comparable advanced economies.[52] In addition, the federal government's share of investment in water infrastructure has fallen from 31 percent in 1977 to only four percent in 2017, contributing to an $81 billion gap between total local, state and federal spending and investment needs, according to an analysis by the American Society of Civil Engineers.[53] The failure of government investment to keep up with water infrastructure needs means that rising consumer costs are forced to make up the difference, putting undue pressure on households with the most demand and the lowest financial capacity. For example, one analysis found that water bills exceed 10 percent of monthly disposable income in 11 U.S. cities, including cities considered to have relatively low costs of living, such as Houston and Indianapolis.[54]

Investment in other types of physical infrastructure, such as housing and schools, has also fallen behind in recent decades. Today, there are only 1.1 million public housing units in the United States and since 1973 the number of public housing units has fallen by more than 200,000.[55] A Government Accountability Office survey found that 41 percent of school districts need to replace or update their heating, ventilation and air conditioning (HVAC) systems in at least half of their schools.[56] More than half of school districts still use local revenues as the primary financing for school facilities, which may risk widening existing inequalities.[57]

Investments in physical infrastructure will have positive spillover effects for the broader economy as well. One literature review of the research into the macroeconomic benefits of infrastructure investment found that "the median and average estimates of a review of dozens of studies on infrastructure indicate that each $100 spent on infrastructure boosts *private-sector* output by $13 (median) and $17 (average) in the long run."[58]

There is strong evidence from the American Recovery and Reinvestment Act that investing in physical infrastructure creates long-term economic benefits that exceed the budgetary costs. Research by the U.S. Conference of Mayors found that $1 in water and sewer infrastructure investment increases GDP in the long-term by $6.35, and that adding one job in water and sewer creates almost four jobs in the national economy to support that job.[59] Further, past analysis of the American Recovery and Reinvestment Act by the Congressional Budget Office estimated that $1 spent on infrastructure brought an economic benefit of up to $2.20.[60]

Addressing racial inequities must be central to future investments in U.S. physical infrastructure. For example, access to plumbing is not equitably distributed.[61] American Indian or Alaskan Native households represent 6.2 percent of U.S. households that lack a plumbed connection to potable water and sewage despite representing only 1.5 percent of the overall population. Black households make up 16.6 percent of the households lacking complete plumbing but only 12.8 percent of the U.S. population, and Hispanic families represent 16.7 percent of the un-plumbed households but only 12.5 percent of U.S. households.[62]

New investments in transportation infrastructure should correct harms done by past transportation infrastructure investments. For example, as NYU School of Law professor Deborah N. Archer writes, when the federal interstate system was built, "In states around the country, highway construction displaced Black households and cut the heart and soul out of thriving Black communities as homes, churches, schools and businesses were destroyed. In other communities, the highway system was a tool of a segregationist agenda, erecting a wall that separated White and Black communities and protected White people from Black migration. In these ways, construction of the interstate highway system contributed to the residential concentration of race and poverty, and created physical, economic and psychological barriers that persist."[63]

Investment in broadband infrastructure will give communities access to jobs and improve the productivity of the labor force, particularly in rural areas. While 75 percent of U.S. adults overall have access to broadband, only 63 percent of rural residents do.[64]

Research has found that access to broadband is associated with a 1.8 percent increase in the employment rate, with a greater impact in rural and isolated areas. In the most rural locations, the effect of changing from no broadband availability to full availability is more than 2.2 percent increase in the employment rate.[65]

These are all examples of how underinvestment in physical infrastructure is a long-standing, pre-existing problem that needs to be addressed as the United States recovers from the impact of the coronavirus pandemic. By making these investments that will improve both the quality and productivity of physical capital, as well as using the opportunity to address racial inequities in current physical infrastructure, the United States will also be making investments in future potential output, powering and driving long-term economic growth.

Increasing U.S. labor force participation and labor productivity

In addition to investing in physical infrastructure, investing in human infrastructure will increase labor force participation and productivity. Specifically, investing in child care will facilitate greater labor force participation—particularly among women—as well as improve children's human capital development in ways that will drive future economic growth for decades to come.

Women's labor force participation stalled out by 2000 likely in part because of the failure to invest in paid leave and child care infrastructure.[66] The stalled labor force participation of women hurts economic growth. One Brookings analysis found that if American prime-age women's labor force participation had kept pace with that of Japanese women's from 2000 to 2016, for example, U.S. GDP would have been nearly four percent higher, or $800 billion greater, than it actually was.[67] Because responsibility for child care continues to fall disproportionately on women, affordable child care is crucial to facilitating greater labor force participation by women.[68] The experience of mothers over the past year of the pandemic particularly underscores this point. Mothers' labor force participation fell dramatically in 2020, first as schools transitioned to distance learning and again in fall of 2020 as the new school year started—online in many places—after only partially regaining some of the losses in the summer of 2020.[69] Women's labor force participation is now near its lowest level in 33 years.[70]

In addition to helping facilitate greater labor force participation among women, investment in child care would also boost future economic growth by increasing the human capital of future workers. Early childhood environments are crucial for the development of both cognitive and noncognitive skills, which are the foundation on which later learning capabilities and earning potential are built. Research into the effects of early childhood education have found benefits not only for the individual children in terms of better school performance, graduation rates and future earnings, but also for the economy at large with rates of return between seven and 20 percent depending on the exact program analyzed.[71]

Investment in broadband availability will create long-term benefits for the labor force by helping students access reliable, high-speed internet. During the pandemic, widespread remote learning has brought into stark relief the role of reliable internet in children's learning and ability to accumulate human capital. Analysis by the Pew Research Center had previously found that "roughly one-third (35 percent) of households with children ages 6 to 17 and an annual income below $30,000 a year do not have a high-speed internet connection at home, compared with just 6 percent of such households earning $75,000 or more a year."[72]

This digital divide is further exacerbated by racial disparities, with 25 percent of Black teens reporting that they are sometimes or often unable to complete homework assignments because of a lack of a reliable computer or internet connection, compared to 13 percent of White teens and 17 percent of Hispanic teens.[73] As schools have relied on online learning during the pandemic, children's ability to fully participate in their learning and grow their human capital has differed based on their family's economic and racial demographics.

Racial discrimination in the labor market hurts Americans in innumerable ways, including hindering workforce productivity by influencing the career pathways that people pursue. Research shows that, as social dynamics have shifted over the last 50 years, Black Americans and women of all races have been able to pursue careers better suited to their interests and talents. This progress towards a more equitable distribution of talent across occupations can account for up to 40 percent of growth in U.S. GDP since 1960.[74] When people lose the ability to pursue their talents and interests, whether through outright hostility, unwelcoming and unsupportive environments or systemic barriers to advancement, such as the high costs of higher education, they and society lose their full labor market potential.

Investing in people can improve the economy's future potential output. Facilitating greater labor force participation among women through greater access to child care, improving human capital development for American children and providing access to the technology and opportunities that will allow people to fulfill their full potential will improve productivity to drive long-term economic growth.

Growth through innovation

The United States should make public investments in order to use two key inputs of production—capital and labor—more efficiently and intensely, thereby increasing future potential output and driving economic growth. Improving total factor productivity, commonly thought of as innovation, will also increase future potential economic output. Total factor productivity refers to the part of output that cannot be explained by the inputs of labor and capital alone but by the way in which they are combined.[75] Policymakers should look for opportunities to improve rates of future innovation and increase future potential output.

Increasing participation in STEM fields among women and marginalized communities is one way to drive future innovation. Research has shown that if more women and Black Americans were engaged in the technical innovation that leads to patents, U.S. GDP per capita could be 0.6 to 4.4 percent higher.[76] Policies that encourage more women and underrepresented minorities to go into and stay in STEM fields will stimulate new innovation and help ensure that future generations of researchers have supportive mentors and welcoming work environments. Facilitating wider participation in STEM fields by skilled and talented people who are more likely to be sidelined by lack of opportunity or support, the United States can increase the chances of transformational leaps forward in innovation that drive future potential output.

CHAPTER 3: THE CARE ECONOMY IS CRITICAL INFRASTRUCTURE

Investing in the care economy is a critical tool for helping working families and making the economy more productive. Policymakers should consider the care economy as an important part of American infrastructure—a concept that has expanded and evolved over time. The word "infrastructure," originally a technical term from railway engineering that referred to the structure supporting train tracks, has changed drastically through time to meet the needs of the economy. Today, it broadly refers to "long-lived, capital-intensive systems and facilities."[77] During the time of the New Deal, for example, academics and policymakers expanded the definition of public infrastructure to include universal access to electricity, a utility few Americans live without today.[78]

Similar to the crises of the Great Depression and the Dust Bowl, the coronavirus pandemic has highlighted the technologies and resources required to meet the needs of an evolving economy. The past year made it all too clear that the ability of workers to get to their job and work may depend just as much on broadband and care workers as on roads and bridges. It also highlighted the role of the workers who sustain these essential supports, and how unlivable wages, poor working conditions and tight margins prevent the care industry from growing to meet the needs of workers and families safely and affordably.

The coronavirus pandemic and economic crises have also highlighted the tragically incomplete and unequal reach of existing U.S. infrastructure. All Americans, regardless of race, ethnicity, gender, national origin and religion deserve to be able to care for their families without risking financial ruin or leaving the labor force entirely. The American Families Plan and the efforts of the Biden administration will help families balance the demands of care and work through strengthened care infrastructure. Ultimately, care work infrastructure supports the balance between work and family, strengthens ties to the labor force—especially for women—and increases the resilience of working families in the face of crises to come.

Care work supports the balance between work and family, and care workers should be valued accordingly

Human capital infrastructure requires policymakers' most urgent attention. In the United States, four out of five parents of young children report that finding quality, affordable child care in their area was a serious problem.[79] More than 50 percent of families with young children lived in areas where the demand for licensed child care far outpaced the local supply, known as "child care deserts."[80] This is especially true for families of color. One study that analyzed state-funded preschools found that not one of the 26 states analyzed provided both high quality and high access preschool for Black and Latino 3- and 4-year-olds.[81]

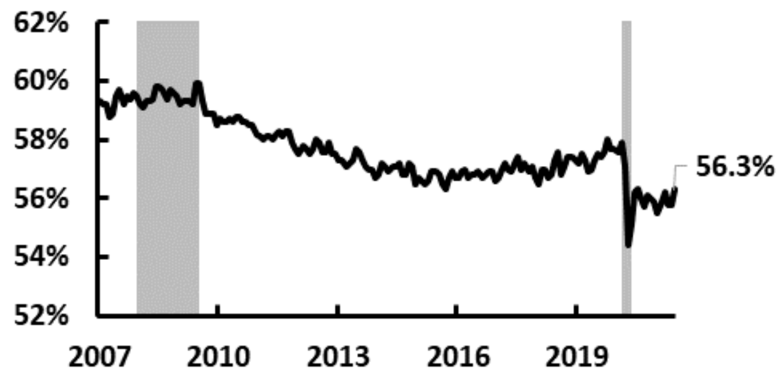
The disconnect between the demand for care work and the supply of care workers can be explained by the low value placed on doing this work. Care workers, in both child care and elder care, frequently do not make a living wage. In 40 states, the median hourly wage for a child care worker is below the living wage, and in 17 states, the median hourly wage for a child care worker is below 90 percent of the living wage. The result is that many care workers are forced to search for alternatives in order to meet their basic needs like food, rent, medication and their own family's care needs.[82]

Care work strengthens labor force ties, especially for women

The future growth of the U.S. economy depends in part on increasing the labor force participation rate, or the share of the working-age population that is employed or looking for a job.[83] From the mid-1960s through 2000, the U.S. labor force participation rate rose significantly, partly as a result of millions of women entering the workforce—mainly those with young children.[84] Women's labor force participation in the United States reached a peak in 2000 and then plateaued until the Great Recession when it declined slightly and settled at a lower plateau until March 2020. It then fell precipitously as a result of the pandemic.[85]

Women's Labor Force Participation Has Fallen During the Pandemic Recession

Labor force participation rate, women ages 16+, 2007 to 2021



Sources: Bureau of Labor Statistics, National Bureau of Economic Research
Note: Shading indicates a recession.

Providing adequate and affordable child care is an important lever for increasing labor force participation—particularly for women, who shoulder a disproportionate share of child care responsibilities.[86] OECD countries that offer better family policies including affordable child care have higher rates of female labor force participation than the United States.[87] Research consistently reveals that maternal labor force participation rises when affordable child care is available—as much as five to 10 percentage points when the care is available at no cost.[88] A study by the Economic Policy Institute found that capping child care expenditures at 10 percent of family income could increase overall women's labor force participation enough to boost GDP by roughly $210 billion (1.2 percent).[89]

The participation rate for mothers with school-age children declined by 3.3 percentage points between February and September 2020, while it only declined 1.3 percentage points for fathers with school-age children.[90] As child care centers and schools closed or shifted to remote learning, mothers shouldered most of the burden. The resulting decline in women's participation is happening at time when women again comprised half of the U.S. workforce right before the pandemic began.[91] For the first time since April 1986, women's labor force participation dipped below 55 percent in April 2020.[92]

The resilience of working families is dependent on expanding access to quality, dependable and affordable care

In the wealthiest country in the world, parents and adult children should not be forced to choose between work and providing quality care for a relative.[93] The pain and complexity of those decisions has been widely publicized in the news of the last year. For example, many Americans have watched their children struggle to learn remotely or their parents experience low quality of care at nursing homes, all while trying to perform their jobs in an unfamiliar and capricious economic landscape.[94]

As Americans live longer, more families are facing difficult choices between work and caring for their aging relatives.[95]

Although between 65 and 70 percent of people ages 65 and older will need long-term care, the cost of this care is cripplingly expensive in the United States.[96] The median annual cost of home health care varies among states from almost $40,000 to over $75,000. In 16 states, the median cost of home health care is above $60,000 a year.[97]

Many Americans who are aging, who are ill or who live with a disability cannot afford to cover the cost of their care, requiring their relatives to step in and cover the costs. Only slightly more than one-half of people with severe long-term service and support needs could fund two years of paid home care themselves, even if they liquidated all available assets. Only two out of 10 people with severe long-term service and support needs could fund paid home care with their income alone.[98]

Similarly to home health care, the cost and availability of quality, dependable and affordable child care is not adequate to meet the needs of all Americans. Nearly 12 million children under age five are in some form of child care in the United States.[99] More than four out of five (83 percent) parents of young children report that finding quality, affordable child care in their area was a serious problem.[100] One study that analyzed state-funded preschools found that not one of the 26 states analyzed provided both high quality and high access preschool for Black and Latino 3- and 4-year-olds.[101]

In 31 states, a typical married couple with two children (an infant and a four-year-old) in child care spends on average more than 20 percent of their income on child care. In six states, a typical married couple with two young children in child care spends more than 25 percent of their income on child care. In every state, the average cost of child care for a typical family with two young children exceeds the median cost of rent.[102] These costs are not sustainable and are too often the reason workers choose to leave the labor force to care for their families.

The long-term benefits of investing in care work infrastructure are enormous

The failures in American human capital infrastructure discussed above have enormous consequences and costs for the United States' economic prospects. If more Americans were given the resources to care for their families and pursue work without taking on the strain of costs pushing them toward personal fiscal cliffs, the U.S. economy would be more prosperous.[103]

With access to quality, affordable and dependable child care, parents can remain in the workforce and earn needed income. Those who leave the workforce to care for children—disproportionately mothers—can suffer depressed earnings throughout their careers.[104] The lack of affordable child care is a major factor driving the gender wage gap, with the median woman earning 82 percent of what the median man earns.[105] Closing the gender wage gap would add $541 billion to GDP and would reduce poverty for working women by 40 percent.[106]

Child care also provides an excellent return on investment in the children themselves. Economists at the Federal Reserve Bank of Minneapolis found that investments in child care and early education are "the most efficient means to boost the productivity of the workforce 15 to 20 years down the road."[107] Early education interventions are estimated to have produced returns of $3 to $17 for every dollar invested, with lower crime and teenage birth rates, higher high school graduation and college attendance rates, and higher lifetime earnings.[108]

Economists have measured particularly high rates of return for certain types of human capital infrastructure, including investment in childhood education and health. Indeed, these policies are so cost-effective that they often pay for themselves through higher tax revenues from the increased incomes earned by beneficiaries of the programs later in life.[109] One study found that every dollar spent on an early childhood program targeting disadvantaged families in North Carolina resulted in up to $7.30 in benefits in education, health, social behaviors and employment.[110]

Low interest rates continue to make timely investment in infrastructure particularly cost-effective. These economic conditions also make concerns about crowding out private investment much less relevant.[111] Indeed, present-day conditions make it more likely for public infrastructure investment to "crowd in" private activity by promoting overall economic growth, a primary determinant of business investment.[112]

Today's low interest rates and low employment levels mean that infrastructure investment is at its most cost-effective now. Lawmakers should take advantage of favorable economic conditions by investing in a broad set of policies aimed at addressing the nation's declining infrastructure quality. In addition to providing the nation with crucial public goods, if targeted correctly, these investments will promote racial and economic equity and help lay the groundwork for stronger, cleaner future growth.[113]

CHAPTER 4: AMERICA HAS THE FISCAL SPACE TO INVEST FOR THE FUTURE

The United States has enough fiscal space to make necessary investments in physical infrastructure and the care economy. Hypothetical concerns about future Consumer Price Index (CPI) increases at a time of low interest rates and low projected long-term inflation should not outweigh the current empirical evidence that there is sufficient fiscal space to make the kind of investments proposed by the Biden administration, or the existence of revenue-raising options.

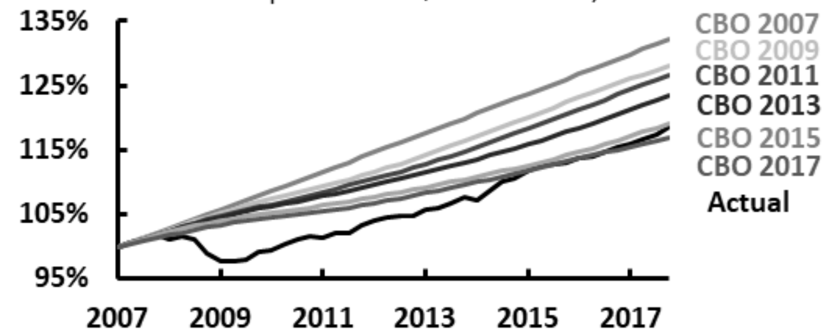
"Output gap" criticisms of government fiscal policies do not pass muster

Some critiques of government spending have relied on the "output gap," which purports to measure the difference between the actual and potential output of the economy.[114] Hawkish macroeconomic commentators have said that the American Rescue Plan exceeded the output gap by at least three times.[115] The risk of the stimulus exceeding the output gap is that it could cause the economy to overheat, which, over time, could lead to inflation.

However, inflation concerns based on estimates of the output gap rely on models of potential output that are imperfect and coming under increased scrutiny. Potential output is an imperfect policy target because it is hard to estimate accurately, as Federal Reserve Chair Jerome Powell pointed out in his 2018 speech at Jackson Hole. Powell referred to the practice of formulating policy using estimates of the output gap and the natural rates of unemployment and interest as "navigating by the stars" because the values are often denoted by an asterisk in economic literature. He warned that "[g]uiding policy by the stars in practice, however, has been quite challenging of late because our best assessments of the location of the stars have been changing significantly."[116] As an example of how difficult it can be to estimate potential output, the Congressional Budget Office (CBO) revises its estimates of the output gap every year.

Potential GDP Estimates Took 10 Years to Recognize Post-Great Recession Trend

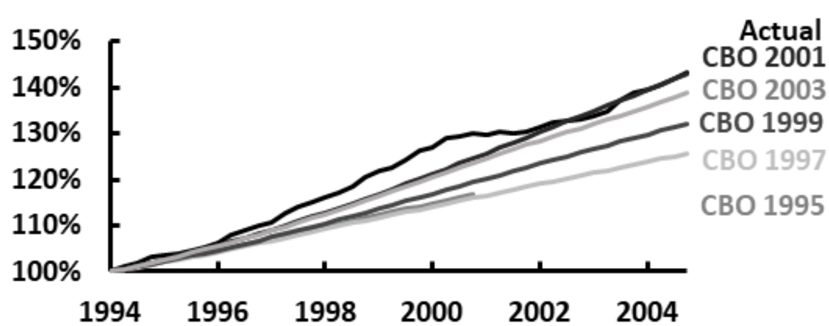
Potential GDP as percent of Q1 2007 value, 2007 to 2017



Source: Congressional Budget Office, "Potential GDP and Underlying Inputs"

And Took 7 Years to Recognize the 1990s Productivity Boom

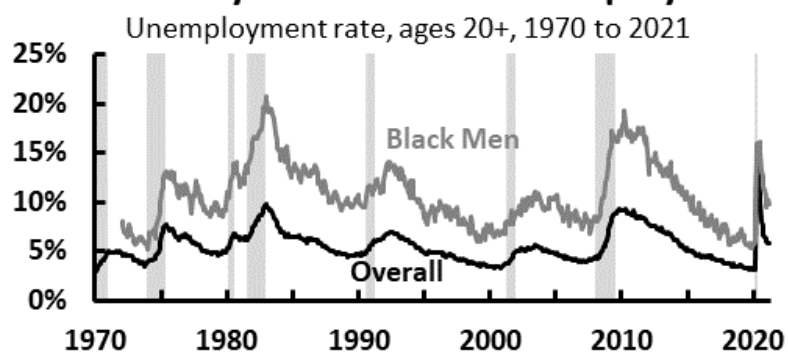
Potential GDP as percent of Q1 1994 value, 1994 to 2004



Source: Congressional Budget Office, "Potential GDP and Underlying Inputs"

The economic policy research group Employ America points out that models for calculating potential output use outdated assumptions and methodologies that bake racial inequality into estimates for the future. For example, they explain that the CBO's estimates for potential output rely on a model that assumes that the 2005 unemployment rates for different demographic groups in the United States are representative of their "natural" rate of unemployment. This means that the CBO's estimates assume that the "natural" rate of unemployment for Black Americans is 10 percent and that policies to drive down that unemployment rate are unattractive because of their inflation risk.[117]

The Unemployment Rate for Black Men Is Consistently Twice Overall Unemployment



Sources: Bureau of Labor Statistics, National Bureau of Economic Research
Notes: Data are seasonally adjusted. Shading indicates a recession.

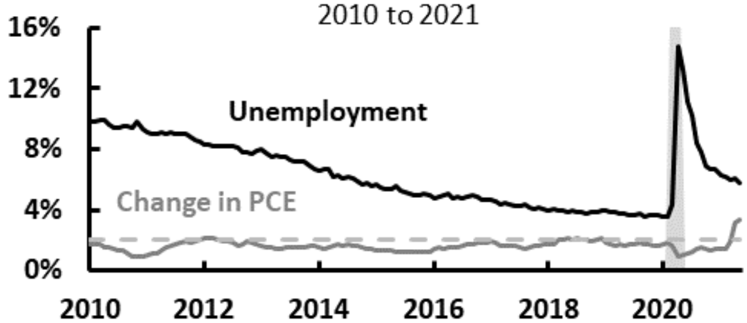
Given the difficulty of precisely estimating, or even defining, the current output gap, policymakers would do better to pursue policies that will increase the potential output of the economy in the long-run.

Expectations of medium and long-term inflation are modest and well within normal ranges for recent inflation

Official projections and market expectations for medium and long-term inflation are modest and within normal ranges for recent inflation. In July 2021, the Federal Reserve projected that core PCE inflation will be 2.1 percent in 2022, similar to projections by the Congressional Budget Office of 2.0 percent core PCE inflation in 2022.[118] The Federal Reserve has failed to reach its own two percent inflation target for most of the past decade, even as unemployment fell dramatically over the same time.

Unemployment Fell as Inflation Remained on or Below Target

Unemployment rate and percent change in core PCE, 2010 to 2021



Sources: Bureau of Labor Statistics, Bureau of Economic Analysis, National Bureau of Economic Research

Notes: "Change in PCE" refers to the percent change from one year ago in core PCE. Dashed line denotes Fed target of 2% inflation. Unemployment rate is for ages 16+.

Evidence suggests that the Phillips Curve—the inverse relationship between unemployment and inflation—has flattened, meaning that the relationship between the two has weakened.[119] One reason for this is that long-run inflation expectations have become more firmly anchored.[120] As noted by Federal Reserve

Chair Jerome Powell recently in testimony to Congress, "[w]ell-anchored inflation expectations enhance our ability to meet both our employment and inflation goals, particularly in the current low-interest rate environment in which our main policy tool is likely to be more frequently constrained by the lower bound."[121] Powell has also said that the Fed would be able to take the necessary actions if expectations became unanchored.[122]

The central macroeconomic challenge of recent decades has been a shortfall in aggregate demand, rather than the risk of inflation.[123] This is the "secular stagnation" advanced by some to explain the rate of recovery from the Great Recession.[124] In fact, concerns that inflation expectations had become anchored *below* two percent led the Federal Reserve to formulate a new monetary policy framework, according to which they seek to balance out periods of below two percent inflation with periods of above two percent inflation.[125] Given that the reality for the past decade has been weak demand and low inflation, short-term increases in demand and inflation after an extraordinary year are unlikely to change these longer-term trends.

The past year has been characterized by a lack of demand as public health policies to slow the spread of the coronavirus meant people couldn't engage in many economic activities, such as dining out, traveling or going to see a movie. As more people become vaccinated and demand returns, there have been some immediate, short-term bumps in CPI because of "base effects"—distortions in year-over-year measures due to abnormally high or low numbers in the preceding year. As the Council of Economic Advisers explained in a blog post on this issue, "[t]welve months later, due to the suddenness and scale of this earlier decline, we expect year-over-year inflation growth rates for the next few months to be temporarily distorted by these sorts of base effects."[126]

Supply chain bottlenecks as demand comes back have also contributed to some short-term increases in CPI. As companies re-adjust to new levels of demand, these bottlenecks should clear. Federal Reserve Chair Powell does not expect them to be contributors to long-term inflation.[127]

These short-term increases will not actually affect long-term trends in inflation because one-off events will not influence inflation expectations. As Chair Powell said recently when testifying before Congress, "[i]nflation dynamics do change over time, but they don't change on a dime."[128]

Low interest rates provide an opportunity to make long-term investments

Low interest rates continue to make timely investment in infrastructure particularly cost-effective.[129] These economic conditions also make concerns about crowding out private investment much less relevant. Indeed, present-day conditions make it more likely for public infrastructure investment to "crowd in" private activity by promoting overall economic growth, a primary determinant of business investment.[130]

While there are many possible causes for today's low real interest rates, they provide a strong signal that now is the right time for bold public investments. Many investments—particularly investments in the human capital of today's children—are all but guaranteed to generate a social rate of return greater than the cost of borrowing, even very long-term borrowing, for the U.S. government—possibly even generating more in future tax revenue than it takes to fund them today. If the private sector had similar or better opportunities, here or overseas, for productive investment, or if owners of capital collectively preferred current consumption to the growth opportunities presented by available infrastructure investments, then the competition for loanable funds would have pushed interest rates above their current, rock bottom levels.[131]

Low real rates and high expected GDP growth rates make it quite possible that we are experiencing a period when GDP growth exceeds the interest rate on U.S. government debt. Under those circumstances, the national debt will tend to shrink over time, relative to GDP, even without the government running budget surpluses.[132] In addition, the real cost of servicing the debt—in other words, interest payments—is currently smaller relative to GDP than it was in 2000.[133]

CHAPTER 5: RAISING REVENUE THROUGH CONSISTENT TAX ENFORCEMENT AND A FAIR TAX CODE

There are also opportunities to increase total spending capacity by raising additional revenues. The easiest way to do this is by simply enforcing the tax codes already on the books. In April 2021, IRS Commissioner Charles Rettig estimated that the tax gap—the difference between the taxes that are owed and the taxes that are actually paid—"could approach and possibly exceed $1 trillion" each year.[134] Commissioner Rettig attributed much of the growing tax gap to the lightly regulated cryptocurrency sector, foreign-source income and the abuse of pass-through provisions.[135] As some taxpayers continuously develop ever more sophisticated methods of tax evasion, it has become increasingly difficult for the IRS to maintain strong enforcement efforts, particularly as its budget and staffing levels have been slashed in recent years.

As a result, not all taxes that are owed are actually paid, and this tax gap translates into lower revenue, reduced fiscal health for the nation as a whole, a less progressive tax system and greater economic inequality. It means that the burden of paying for public services falls disproportionately on taxpayers who are compliant and on wage earners whose income is reported and transparent. Changes to the tax code, particularly as it relates to wealthy individuals and corporations, are necessary to improve tax fairness, raise revenue and make the United States more competitive. But the federal government must also do a better job of collecting the taxes that are already owed.

Collecting taxes is a basic function of the federal government, and the IRS needs to be restored with multiyear funding and investment to better perform this duty. Cracking down on tax avoidance does not increase the amount any individual or company owes in taxes but rather increases the amount actually paid—adding revenue that can be used to invest in workers and families. The Biden administration's FY 2022 budget request includes needed investments in the IRS and would provide the IRS with greater resources to stop sophisticated forms of tax evasion, collect more information about obscure forms of income and overhaul outdated technology.[136] These increased IRS investments have the bipartisan support of five recent Treasury secretaries, who have stressed the importance of collecting unpaid taxes, as well as economists and former IRS commissioners.[137]

Estimates of the tax gap reach the trillions of dollars

The tax gap is projected to total $7 trillion over the next decade, according to the Treasury Department.[138] The last official IRS estimate revealed that the tax gap averaged $441 billion each year from 2011 to 2013, and the Treasury Department estimates that after extrapolating for growth in the intervening years, the tax gap reached $584 billion in 2019.[139] Each year, the tax gap costs the federal government around 3 percent of GDP.[140]

The tax gap has grown substantially in recent years. Commissioner Rettig's estimate of a $1 trillion tax gap would be more than double the $441 billion average annual gap from 2011 to 2013.[141] For those three years, the bulk of the tax gap (80 percent) was due to the underreporting of income on timely filed tax returns. Failure to file a tax return on time or at all and the underpayment of reported taxes accounted for the rest.[142] Total unpaid taxes amount to more than the collective individual income taxes paid by the bottom 90 percent of earners.[143] The top 1 percent account for as much as 70 percent of the tax gap.[144]

Much of the tax gap, particularly among the wealthy, is due to different reporting requirements for different forms of income.

Roughly 99 percent of the taxes due on wage and salary income, which is documented by employers and taxpayers and almost universally automatically withheld, is reported to the IRS. Only 45 percent of more opaque forms of income—such as capital gains, rental income, self-employment income and pass-through business income—is reported.[145]

The IRS's budget and staff have been slashed, leading to deteriorating tax enforcement

The IRS's overall budget has declined by 20 percent over the last decade, while its enforcement budget has decreased by more than 20 percent.[146] The number of IRS staff is down by 23 percent, or more than 22,000 employees, over the same period.[147] Lower budgets translate into fewer auditors. In 2017, the IRS had 9,510 auditors—down from over 14,000 in in 2010. The last time the IRS had so few auditors was in the mid-1950s, when the U.S. population was half the size it is today.[148]

Other estimates confirm these trends. In 2020, while testifying before the House Ways and Means Committee, Chye-Ching Huang (now the executive director of the Tax Law Center at NYU Law) showed that, since 2010, overall IRS funding was cut by 21 percent and enforcement funding was cut by 24 percent, while the number of income tax returns grew by 9 percent.[149] At the same time, the number of operations staff fell by 31 percent, and the number of revenue agents with the expertise to conduct audits of complex returns fell by 35 percent.[150]

At the same time, the IRS has taken on more responsibilities, particularly since 2020. These include two consecutive tax filing seasons with delayed filing deadlines, three rounds of Economic Impact Payments (EIPs), a retroactive change to the taxation of unemployment benefits to provide up to $10,200 in relief and the administration of the new enhanced child tax benefit.[151]

Between 2000 and 2018, the share of individual income tax returns examined by the IRS plummeted by 46 percent, and the share of corporate income tax returns examined fell by 37 percent.[152] The audit rate for filers with more than $1 million in annual income fell by 61 percent, while the audit rate for corporations with more than $1 billion in assets is down 51 percent.[153]

Audit rates have plummeted across the board but especially for wealthy taxpayers. The audit rate for millionaires fell from 8.4 percent in 2010 to just 2.4 percent in 2019.[154] In the mid-2010s, the richest 0.01 percent of taxpayers saw close to 30 percent of their tax returns audited. Just a few years later in 2019, that number fell to under 10 percent.[155] A 2020 report from the Treasury

Inspector General for Tax Administration (TIGTA) found that the IRS failed to investigate more than 369,000 high-income individuals, with estimated tax due of $21 billion, that did not file a tax return from 2014 to 2016.[156] The IRS successfully detected tax noncompliance among these households but did not have the staff to work the cases. Another 510,000 individuals, with an estimated tax liability of $25 billion, are sitting in the agency's inventory streams but are unlikely to be pursued.[157]

The collapse in enforcement—mainly due to decreased IRS budgets and staff but also due to a lack of political will—also manifests itself in taxes on particular forms of income. The audit rates for both S Corporation and partnership returns—two forms of pass-through income—have fallen by more than 40 percent since 2010. High-income individuals, who have seen their audit rates fall overall, disproportionately own such pass through businesses.[158]

The wealthy take advantage of lax tax enforcement

Fewer enforcement capabilities within the IRS mean more opportunities for the wealthy to take advantage. Estimates suggest that the top 1 percent account for at least 28 percent and potentially as much as 70 percent of the tax gap.[159] New research from IRS analysts John Guyton and Patrick Langetieg and economists Daniel Reck, Max Risch and Gabriel Zucman shows that tax evasion is significantly higher at the top of the income distribution. Underreported income rises from 7 percent in the bottom 50 percent of the income distribution to over 20 percent in the top 1 percent of the income distribution.[160] This evasion among the top 1 percent is costing the federal government $175 billion per year. The researchers also demonstrated that random audits underestimate tax evasion at the top of the income distribution and do not capture more sophisticated forms of tax evasion, such as utilizing offshore accounts and manipulating pass-through business income.[161] Similarly, economists Natasha Sarin and Larry Summers found that underreporting of income is more than five times as high for individuals who earn $10 million or more each year than it is for those who make under $200,000.[162] The 2020 TIGTA report found that almost 880,000 high-income individuals, with an estimated collective tax liability of nearly $46 billion, did not file tax returns from 2014 to 2016.[163]

Increased enforcement and reporting requirements will boost revenue

Increased IRS enforcement and reforms to reporting requirements will significantly boost federal revenue. Economists Natasha Sarin and Larry Summers posited in a 2019 paper that the IRS could shrink the tax gap by around 15 percent over the next decade and generate over $1 trillion in additional revenue by increasing enforcement resources, performing more targeted audits of high-income earners, raising information reporting requirements and investing in information technology. Sarin and Summers found that increasing audit rates to 2011 levels could generate over $700 billion in additional tax revenue between 2020 and 2029.[164]

Audits of high-income earners are a more efficient use of IRS resources and yield greater revenue. In 2013, the IRS estimated that an extra hour spent auditing someone who earns $200,000 a year generated only $650, while an extra hour spent auditing someone who makes $5 million or more a year generated around $4,900.[165] Wealthier individuals tend to have larger tax liabilities, so discrepancies between what is owed and what is paid can be larger in magnitude. They also have more complex returns, as their income frequently comes in more opaque forms where information reporting and compliance are lower, as well as more incentives to evade or avoid taxes.

Improved information reporting can increase compliance and shrink the tax gap. Underreporting of income on filed tax returns accounts for 80 percent of the tax gap, and underreporting is most common among categories of income that are less visible to the IRS, such as capital gains, rental income, self-employment income and pass-through business income.[166] Wealthier Americans are more likely to have these forms of income, and the IRS estimates that up to 55 percent of such income can go unreported.[167] Sarin and Summers find that increasing reporting requirements for individual income categories subject to "some information reporting" and for income subject to "little or no information reporting" would generate nearly $2 trillion in tax revenue.[168]

Overhauling antiquated IT systems and increasing IT outlays can also help shrink the tax gap. In 2018, the IRS spent only $2.5 billion on IT investments—just 15 percent of what Bank of America spent to serve only a quarter of Americans. Most of the IRS's hardware is beyond its useable life, while some of its software is several releases behind the most up-to-date version.[169] Some of the IRS's IT systems are over 50 years old—the oldest and highest risk systems in the federal government.[170] Maintaining the antiquated IT systems that layer new systems on top of an obsolete infrastructure is actually more costly for the IRS than switching to a modern system.[171] Better systems for matching taxpayer filings with third-party information returns and increased investigation of mismatches can also yield significant revenue.[172]

Economists Daniel Reck, Max Risch and Gabriel Zucman also find that greater fiscal support for the IRS is necessary to combat widespread tax evasion by the top income earners in the United States. They propose a number of strategies to clamp down on tax evasion: greater scrutiny of pass-through businesses, more comprehensive audits, more thorough litigation of tax disputes, new regulations that explicitly prohibit legally questionable avoidance strategies and programs to encourage whistle-blowing.[173]

The Congressional Budget Office (CBO) estimates that increasing IRS funding for examinations and collections by $20 billion over 10 years would increase revenue by $61 billion and that increasing funding by $40 billion over 10 years would increase revenue by $103 billion. These estimates only capture the direct effect of enforcement and do not include the indirect effects, such as deterrence and greater voluntary compliance.[174] Additionally, the estimates understate the level of investment necessary to restore the IRS, assume rapidly diminishing returns to modest increases in investment, exclude the long-run benefits of increased enforcement beyond a 10-year window and consider a limited range of IRS interventions (excluding better information reporting and IT improvements).[175]

CBO acknowledges that increased funding for IRS enforcement activities could improve tax compliance and increase federal revenue, but due to the scorekeeping rules used by Congress, it does not count this additional revenue in formal cost estimates or for budget enforcement purposes.[176] Under these scorekeeping rules, CBO does not include added revenue or reductions in mandatory spending that might result from additional spending. Congress established these rules to avoid crediting uncertain potential savings as an offset against certain upfront spending. CBO does not count potential revenue from legislation in a cost estimate if that revenue does not come from changes in the tax code; it also does not count budgetary savings if they result from funding in authorizing legislation for administrative or program management activities (such as increased IRS enforcement).[177]

President Biden's FY 2022 budget request boosts the IRS's funding. The Biden administration's budget calls for a $13.2 billion baseline budget for the IRS in fiscal year 2022, which would amount to a $1.2 billion or 10.4 percent increase over the 2021 enacted level. Part of that increased baseline budget, combined with an additional increase of $417 million for tax enforcement as part of a multiyear initiative to increase tax compliance and revenues, would boost resources for tax enforcement by a total of $0.9 billion.[178] The IRS would use this funding to increase oversight of high-income and corporate tax returns.[179]

President Biden's American Families Plan includes significant investment in the IRS to help pay for the American Families Plan, President Biden has proposed giving the IRS more enforcement power and an extra $80 billion over the next 10 years to help crack down on tax evasion by high-earners and large corporations.[180] The plan also includes new disclosure requirements for individuals who own pass-through businesses and for other wealthy individuals who may use sophisticated methods to hide income. The Treasury Department believes that reforms to the IRS and more aggressive tax enforcement will generate an additional $700 billion in tax revenue over the next decade ($460 billion from expanded information reporting and $240 billion from increased IRS staff and upgraded IT systems).[181] This is a conservative estimate, as studies have shown that investments of this magnitude could generate more than $1 trillion over a decade.[182] The Treasury Department also finds that these reforms will raise $1.6 trillion in the second decade, as investments in the IRS often take several years to reach their ultimate payoff.[183]

The Treasury Department has outlined reforms that will provide the IRS with greater resources to stop sophisticated forms of tax evasion, provide the agency with more complete information, overhaul outdated technology and give the IRS the authority to regulate tax preparers.[184] Specifically, the Biden administration "would require financial institutions to report information on account flows so that earnings from investments and business activity are subject to reporting more like wages already are."[185] Importantly, this would not create an additional burden on the taxpayers affected (with income from financial accounts) as financial institutions would report information they already know about taxpayers in reports they already file.[186] But the IRS would have the information to verify income, incentivizing taxpayers to accurately report their income. President Biden has committed to focusing more aggressive tax enforcement on the most wealthy individuals, rather than Americans with incomes of less than \$400,000.[187]

The extra \$80 billion would be an increase of two-thirds over the IRS's entire funding levels for the past decade. President Biden's commitment over the 10 years is important because it signals to potential tax evaders that stronger enforcement is here to stay, and it will take time to build up the necessary infrastructure and technology and to train IRS staff to conduct complex audits. The disclosure requirements are important because as former IRS commissioner Fred Goldberg said, "audits alone will never do the trick."[188] Investment in the IRS truly pays for itself. The IRS estimates that each additional dollar spent on tax enforcement yields \$4 in revenue. The potential deterrence effects, given that the U.S. tax system largely depends on voluntary compliance, are even greater, with an estimated return of \$24 for each dollar invested.[189]

Only multiyear funding, such as that included in the American Families Plan, will enable the IRS to make the necessary reforms—to hire and train staff, make multiyear investments in upgrading information technology (IT) and build up enforcement capabilities. IRS Commissioner Rettig told Congress earlier this year that "mandatory, consistent, adequate, multiyear funding allows us to plan appropriately."[190] More IRS staff must be hired and trained. It takes four to five years for the IRS to train new staff to become revenue auditors capable of detecting fraud in the most complex cases, such as those common among high-income individuals, partnerships and large corporations.[191] IRS staffing suffered from a hiring freeze from 2011 to 2018, which has contributed to a generation gap at the agency with as much as 40 percent of the agency's current workforce eligible to retire in the next several years.[192]

The IRS also must overhaul its antiquated IT systems to better match information and more efficiently process and examine tax returns. In 2019, the IRS outlined its multiyear IRS Modernization Plan, which is a six-year strategy to modernize the agency's IT infrastructure expected to cost approximately $2.3 billion to $2.7 billion.[193] Incremental, yearly funding will not enable the IRS to fully implement this plan. Many economists and tax policy experts have consistently made the case for multiyear funding provided directly through authorizing law, as well as a "multi-year 'allocation adjustment' to appropriations" that would allow for additional appropriations for the IRS that would not count toward its overall appropriations and thus would not be forced to compete with other discretionary spending priorities.[194]

Reforms to and reinvestment in the IRS are necessary to administer a more fair and effective tax system—one in which individuals of different income levels and with different sources of income contribute equitably. A foundational principle of good taxation is that individuals with the same level of income, regardless of the type, should pay the same in taxes. Increased funding and staff as well as improved disclosure requirements, information and technology will help the IRS pursue high-income taxpayers who evade their tax liability, ensure that more opaque forms of income are reported, investigate cases of underreported income and begin to close the tax gap. Even in its current state of continued disinvestment, the IRS collected more than $3.5 trillion in taxes in 2018 with a budget of just $11.4 billion; greater investment will empower the IRS to be even more effective.[195] Reforms to the IRS will lead to greater revenue, improved fiscal health for the nation and a more progressive tax system.

Corporations and the wealthy should pay their fair share

The United States can raise revenue for public investments by asking corporations and the wealthy to pay their fair share. The Biden administration has proposed restoring the top individual marginal tax rate to its pre-2017 Tax Cuts and Jobs Act level and taxing labor and capital income at the same rates for households with incomes exceeding $1 million.[196] Going beyond current law, the Biden administration has announced intentions to reform corporate taxes to raise an additional $2.5 trillion over the next 15 years.[197] The plan would set the corporate tax rate at 28 percent, which is higher than the current 21 percent, but still lower than the 35 percent rate before the passage of the Trump administration's tax law. [198] The changes would also bring U.S. corporate taxes more in line with those of other advanced economies. The only OECD countries whose corporate taxes account for a lower share of their GDP than the United States' are Hungary and Latvia.[199] The changes would also help end the "race to the bottom" in international tax laws, in which countries compete against one another by lowering their tax rates to attract multinational corporations' profits and activities.[200] This harms all countries' abilities to raise adequate revenue to fund necessary public investments.

U.S. Corporate Taxes Account for a Lower Share of GDP Than in Other OECD Countries

Taxes levied on corporate profits, as a share of GDP

Source: Organisation for Economic Co-operation and Development

Note: Tax on corporate profits is defined as taxes levied on the net profits of enterprises. It also covers taxes levied on the capital gains of enterprises.

In June of 2021, the G7 reached an agreement on a U.S. proposal for international corporate taxation, which was then accepted by the G20 in July.[201] This agreement is evidence of renewed international cooperation under the Biden administration and could lead to the largest change in international corporate taxation in a century, solving a long-running structural problem with international tax and contributing to the fiscal sustainability of the American Families Plan and American Jobs Plan.[202]

The agreement would be an important step in preventing large companies from shifting their profits to tax havens by requiring them to pay taxes in the place where they actually sell their products. The agreement also would institute a global minimum tax of at least 15 percent on a country by country basis. These measures would increase tax revenue in the United States and places with similar tax rates, while making large companies pay taxes in the places where they actually do business. The Organisation for Economic Co-operation and Development

(OECD) has estimated that the agreement could generate an additional $150 billion a year overall in tax revenues.[203]

The OECD announced in early July that 130 countries had agreed to the proposal on a global minimum tax of at least 15 percent on multinational corporations. The 130 countries, which include major economies such as China and India and major tax havens such as Bermuda and the Cayman Islands, represent more than 90 percent of global GDP.[204] The agreement, which is identical to the one agreed to by the G7 and G20, is a significant accomplishment for the Biden administration after just six months in office, and as Treasury Secretary Janet Yellen said, marks "an historic day for economic diplomacy."[205] The 130 countries endorsed a blueprint for a global minimum tax and pledged to work for final approval by the end of October with the new rules set to be implemented by 2023.

In short, there are ample opportunities for raising additional revenue from the very wealthy and big corporations that will benefit from long-term investments that boost capital and labor productivity.

Conclusion

The United States has chronically underinvested in the inputs to economic growth—capital and labor—for decades. This hurts our long-term economic prospects. The American Rescue Plan and the successful roll out of coronavirus vaccinations have led to a robust economic recovery. Additional investments in our physical and human capital that will increase our future potential output are needed to drive long-term economic growth.

Policies to invest in our crumbling physical infrastructure, bring it into the 21st century, facilitate the greater labor force participation of women and allow everyone to make investments in and make good on their investments in their human capital will all increase the capital and labor stocks and their productivity, increasing the future potential output of our economy and driving long-term economic growth.

We have the fiscal capacity to make these investments, with well-anchored expectations about inflation as well as continuing low interest rates that make the cost of servicing debt minimal. We also have revenue-raising options, even before discussion of raising taxes, with the low-hanging fruit of ensuring that existing tax laws are enforced, especially so that the wealthy pay their fair share.

This is a unique moment to rebuild our economy to be stronger, more equitable and more just. We have the policy tools to meet the moment.

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