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Perversion of the Tax Policymaking Process

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Political Economy – The Short Course

- Only Congress holds the power of the purse!
  - Treasury once wielded large influence, but reduced to minor role in TCJA
  - Two tax-writing Congressional committees; tax legislation technically must originate in the House
- Two nonpartisan Congressional offices/staffs
  - CBO – an "office"
  - Staff of Joint Committee on Taxation (JCT) – "staff"
  - Plus honorable mention for Treasury OTA
- And four highly partisan staffs
  - House and Senate, R and D
- Elaborate budget laws and internal Committee rules
  - But Congress never meets its deadlines and can waive its rules

JCT's Budget Process Deliverables

- "Conventional" revenue estimates
  - "Dynamic" within fixed GNP constraint
  - Process requires single point estimates
  - Played critical role in TCJA – Budget Committee set $1.5 trillion ceiling on conventional revenue estimate cost
  - Under budget laws CBO must follow and fold into its work
- Distribution tables
  - Purport to distribute burdens of tax law change across incomes
  - Normally required (by fiat) to tie into revenue estimates
- Macroeconomic/"Dynamic" revenue analyses
  - Now required by Congressional majorities through rules
  - Again requires a single point estimate (!?!!)

Troubling Policy Implications of Process

- ***These Four Things Cannot Peacefully Co-Exist***
  - Conventional JCT revenue estimates
  - Conventional JCT distribution tables
  - Macroeconomic/ "Dynamic" JCT revenue analyses
  - **Large additions to deficit**
- Large deficits undercut relevance of everything else
  - Macro models become pie in the sky exercises
    - Assumptions would shock policymakers
  - Distributional tables become hopelessly inaccurate
- And each revenue/distribution table troubling on its own

Conventional Revenue Estimates

- The standard joke: they may not be perfect, but at least we are confident we have the sign right

- Many decades of experience and model development

  - Dynamic estimates, but fixed GNP constraint

- But TCJA raises at least 3 issues:

  - Obfuscation through grouping of changes; stacking; etc.

    - Repatriation tax example

  - Troubling inclusion of second-order "outlay effects"

    - Medicaid savings (later)

  - Implication of any revenue losing bill means that tax cuts = 'giving people their own money back'

Distribution Tables

- JCT distribution table ties into conventional estimate

- Distribution tables should "distribute" changes in *welfare*

  - Meaning *total fiscal impact* on welfare [spending + taxes]

- JCT distribution tables are fundamentally misleading when applied to big deficit-increasing laws

  - Remember the maxim: to spend is to tax! Conversely:

  - Big tax cut law = commitment to raise taxes or cut spending later

  - E.g. tax "cut" followed by a cut in social insurance is not welfare-enhancing for lower income Americans, but all we see is the reduction in current tax rates

- Distribution of 25% of corporate tax savings to labor income is a macro story – inconsistent with conventional revenue est.

  - Alleged labor benefits come from increased firm investments over time, expanding GNP (and GDP)

TCJA and Individual Mandate Repeal

- JCT revenue ests. include "outlay effects" of tax changes
  - Example: Refundable portion of EITC
- For mandate repeal, JCT scored:
  - Small direct tax cost from loss of tax payments
  - ~$180 billion outlay savings from smaller PTCs
    - Analogous to refundable EITCs – part of IRC
  - ~ $180 billion outlay effect from reduced *Medicaid* spending
    - Do Medicaid "savings" belong as *tax revenues*?
  - Predicted higher nongroup market premiums are like private taxes, but do not flow through budget and so are ignored
- Meanwhile, JCT *distribution* tables *ignored* the $180 billion loss in value from Medicaid "savings"
  - Also didn't distribute new estate tax rules, although easy to do
  - So where is relation to revenue estimates now?

CBO Distribution Tables

- CBO has taken steps to fill the gap by looking at spending as well as tax changes

- But work is ad-hoc and not part of tax policymaking process

  - Most complete spending/tax distribution: letter to Sen. Sanders 12-21-17

  - Dueling CBO letters to Wyden and Hatch on individual mandate repeal

- What is needed is clear division of responsibilities and integration of broadest feasible fiscal accounting of distributional implications

This Technical Stuff Matters
(positive number = more tax or lower benefits)

TCJA Distributional Analyses
2025

INCOME CATEGORY	JCT	CBO
	CHANGE IN FEDERAL TAXES	CHANGES IN NET FEDERAL REVENUES & SPENDING
	($mm)	($mm)
Less than $10,000 …….	314	8,790
$10,000 to $20,000 ……	2,847	11,320
$20,000 to $30,000 ……	2,980	11,430
$30,000 to $40,000 ……	105	2,840
$40,000 to $50,000 ……	-1,701	-590
$50,000 to $75,000 ……	-14,349	-14,380
$75,000 to $100,000 …..	-16,652	-17,240
$100,000 to $200,000 …	-48,439	-49,790
$200,000 to $500,000 …	-47,460	-48,140
$500,000 to $1,000,000 .	-13,623	-13,790
$1,000,000 and over …	-9,600	-9,960
Total, All Taxpayers ….	-145,581	-119,500

Macro (Dynamic) Scoring

- Dynamic scoring = *indirect* revenue estimating exercise, by modeling future economic growth induced by tax bill, and knock-on implications for tax revenues

  - Does *not* model who gets what – i.e. distribution either of economic growth or tax burdens – more generally, *welfare*

  - "Growth" effects can come by taking from the poor to give to the rich

- Competing theoretical models, all relying on handful of "representative agents"

  - Highly stylized models of economy

  - Highly sensitive to economic assumptions (e.g. Fed response)

  - Does not model strategic responses by other countries

- "OLG" model typically shows biggest growth effects

  - But arguably is the most unrealistic

    - E.G. assumes "perfect foresight"

Macro Scoring & Deficits

- **Problem post-TCJA is size of deficits**

  - Deficits @5% of GDP (CBO 1-2018) in world of 3% or even 4% growth mean that deficits will devour the world!

- Deficits mean JCT macro work *must make up fiscal policy*

  - "[T]he OLG model assumes that individuals have perfect foresight about the economy, including unsustainable Federal budget conditions. Thus, in the OLG model there is no equilibrium solution when Federal budget conditions appear unsustainable in the long run. *It is necessary to create counterfactual stable ratios of debt to GDP within both the baseline and policy simulations of the OLG model."* JCX-22-14.

  - MEG model is the exception

    - "The MEG model, which does not require a fiscal balance assumption, is better suited to analyze proposals that produce large, conventionally estimated deficits."

- *How many Members understand that most aggressive macro model assumes "counterfactual stable ratios of debt to GDP"?*

Macro Scoring – The TCJA Counterfactual

- Deficits > Growth in TCJA mean that OLG model *cannot* analyze bill as written

  - JCT therefore *assumes* large cut in future social services in distant future, to not upset current policymakers, who will be dead by then

    - *"*In the baseline, the OLG model maintains a constant debt to GDP ratio primarily by reducing government purchases. For the proposal analyzed in this document, which is expected to increase the debt to GDP ratio, the OLG model simulates the policy as stipulated for 30 years, *and adjusts transfer payments thereafter to stabilize the debt to GDP ratio.*" – JCX 69-17, Appendix, p. 11

  - Appendix? Really? Who reads the Appendix?

- What exactly are those assumed adjustments?

- And why is the "better suited" MEG only 40% of the weighted average in TCJA analysis?

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Macro Scoring – Whose Growth?

- GDP/GNP growth ≠ aggregate growth in welfare

  - "In the OLG simulations, individuals can foresee changes in government spending or taxation after the ten-year tax cut policy period, and adjust their behavior immediately in response to these changes. In the OLG model anticipated cuts in future "non-valued" government spending will result in less growth over the first ten years relative to anticipated cuts in "valued" government transfer payments or anticipated increases in taxes on labor. People work and save more over the first ten years in anticipation of a future loss of valued spending or tax increases, because they recognize the need to accumulate more assets against the anticipated lean period later in their life cycle." – JCX-19-06

- In short, making people suddenly poorer in future induces them to work more now to make up for their losses, so GDP now goes up

  - Compare with broken window fallacy

- Is working longer hours and saving rather than consuming to make up for a loss in "valued" benefits welfare enhancing?

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Macro Scoring vs Distributional Analysis

- Macro scoring models 'growth effects' of tax changes, and the indirect implications for tax revenues

  - Those growth effects in turn depend on assumptions about which government spending is cut, but the focus is on aggregate growth

- Macro scoring says *nothing* about Americans' welfare

- Distributional analysis is JCT's nod in direction of welfare

  - But it ties into conventional estimate, not macro estimate

  - And it does not distribute the burden of current or future cuts in government services – it is not a *fiscal policy* distributional analysis

  - Creates inference that much government spending is worthless

- Deficits + assumption of future spending cuts mean that "dynamic" score is strongly misleading guide to fiscal policy

  - If government is not drastically pared back, then model is hiding large future tax increases

  - And if services drastically pared, those are real burdens to some

APPENDIX: TAX RATES AFTER TCJA

Top Marginal Statutory Tax Rates Post TCJA

[Ignores 3.8 % HI or 1411 tax]	2017	2018 - ?
Corporate Income	35%	21%
Individual: Dividends + Cap Gains	20%	20%
"All in" Corporate + Dividend Tax on Distributed Profits	48%	36.8%
Individual: top marginal rate (interest, salary, non-QBI income etc.)	39.6% ($480,051)	37% ($600,001)
Individual: "Pass Through Business Income" ("QBI")	39.6%	29.6%

Top Marginal Tax Rates Post TCJA

- *Business earns $100 TI (pre-interest) and distributes to individual owner or lender*
  - Statutory tax rate if partnership and QBI?
    - 29.6%
  - Statutory tax rate if partnership *but not* QBI?
    - 37%
  - All-in statutory tax rate if corporation + dividend?
    - 37% [36.8%]
  - Statutory tax rate if corp *or* ptnrshp + interest?
    - 37%
  - Statutory rate if paid as salary instead?
    - 37%

Reminder: Where Did We Begin?

- ## House (Ryan) DBCFT Proposal!
  - $1.2 trillion revenue *pickup* from BAT over 10 years (TPC)
  - Overall corporate tax cost $900 billion/10 years
    - TCJA: closer to $600 billion
    - Total conventional revenue loss under Ryan = $3 trillion/10 years
  - Even larger deficit cost than TCJA, but DBCFT was the one new revenue idea that really moved the needle
    - 25% tax rate + TCJA rates on repatriation taxes would have been close to revenue neutral corporate tax reform

- *Pre TCJA, USA was the lowest taxed, smallest government big economy*
  - And now, even more so – TCJA systematically adds nearly 1% of GDP per annum to deficits (CBO 1-2-2018)

Substantive Policy Errors in TCJA

- Section 199A ("Pass-Through Businesses)

  - $415 billion cost/10 years

  - Distorts *both* labor and capital income tax rates

- Corp tax rate + expensing + weak thin cap too generous

- No glide path for changes to itemized deductions

- WW rather than C-B-C GILTI tax

- Incentives to locate real investment outside USA

- Failure to address the corporation as tax shelter

- Step up basis /nonrealization at death, particularly for $22 million of estate tax-excluded assets.