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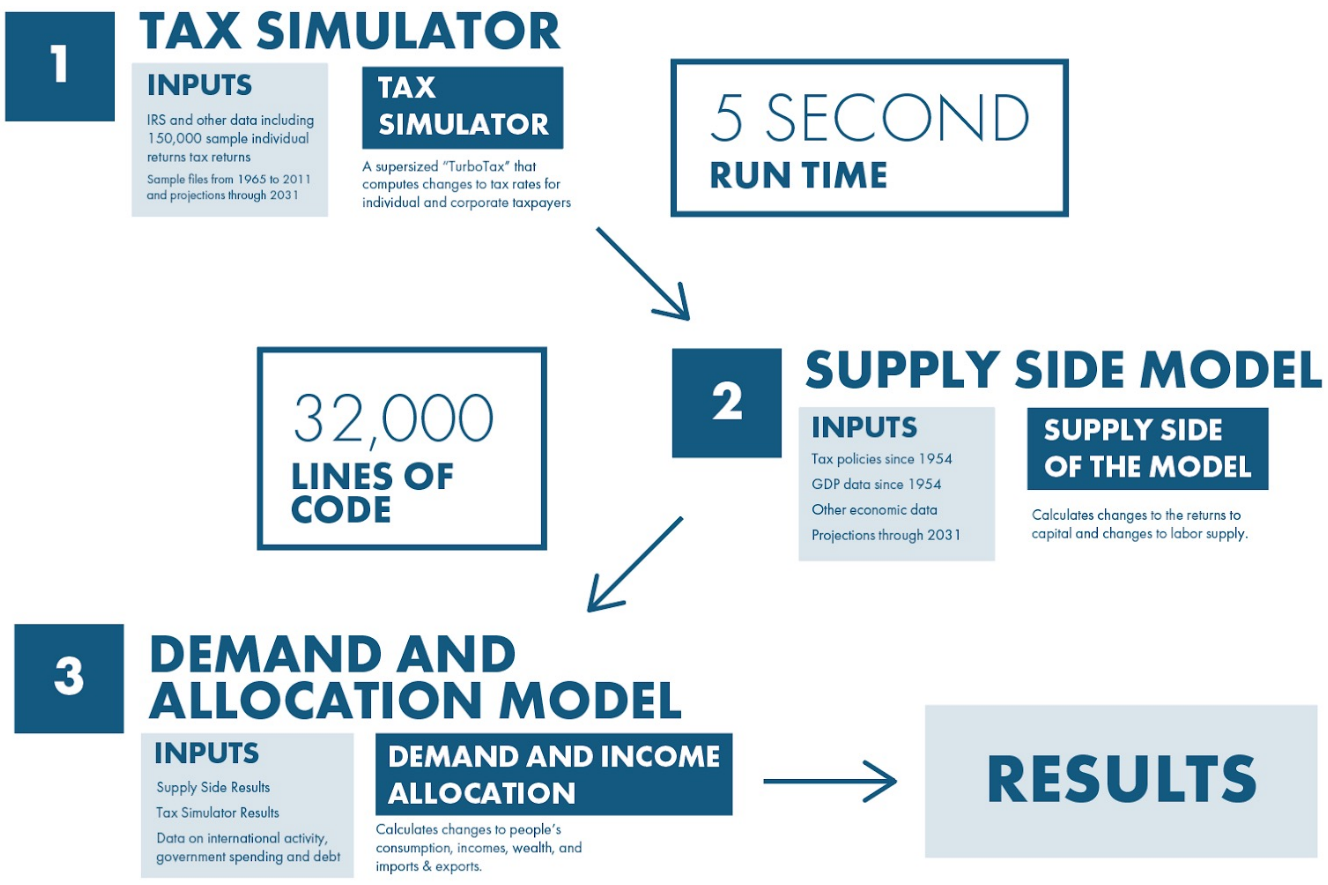
Tax Foundation University

Week 3: Taxes and Growth Model and 10 Tax Reforms for Growth and Opportunity

How Tax Modeling Works

- Conventional or static analysis: How does tax policy impact government revenues (typically over a 10-year horizon)
- Historical norm for Congressional Budget Office and Joint Committee on Taxation
- Dynamic analysis: How do taxes impact the economy (GDP, employment, wages, capital stock)
- Since 2015, due to changes in budgetary rules, the CBO and JCT now include their dynamic analyses with their official estimates

Our Model


1
TAX SIMULATOR
INPUTS
IRS and other data including 150,000 sample individual returns tax returns
Sample files from 1965 to 2011 and projections through 2031
TAX SIMULATOR
A supersized "TurboTax" that computes changes to tax rates for individual and corporate taxpayers
5 SECOND
RUN TIME
32,000
LINES OF CODE
2
SUPPLY SIDE MODEL
INPUTS
Tax policies since 1954
GDP data since 1954
Other economic data
Projections through 2031
SUPPLY SIDE OF THE MODEL
Calculates changes to the returns to capital and changes to labor supply.
3
DEMAND AND ALLOCATION MODEL
INPUTS
Supply Side Results
Tax Simulator Results
Data on international activity, government spending and debt
DEMAND AND INCOME ALLOCATION
Calculates changes to people's consumption, incomes, wealth, and imports & exports.
RESULTS

Results

- Long run estimates (comparative statics approach)
- Year-by-year estimates over a 10-year window
- Distributional tables

Our Assumptions: Labor Supply

- Economists have studied how responsive labor supply is to changes in tax policy (what they refer to as a “labor supply elasticity”)
- We assume that labor supply (hours worked) is somewhat responsive to changes in tax policy, using a labor supply elasticity of 0.3 (an elasticity of 1 would imply that hours worked changes in the exact proportion to the change in the tax)
- Some workers have a greater ability to work less/more than others

Our Assumptions: Small Open Economy

- The U.S. is what we call an open economy: We allow foreign investment from other countries and also allow U.S. residents to invest abroad
- However, as the other countries continue to develop, the U.S. represents a smaller share of world output (this is what we mean by "small")
- Implications
  - Deficit-financed tax cuts (like the Tax Cuts and Jobs Act) will tend not to increase interest rates, because foreign savers are willing to finance our spending by buying U.S. bonds
  - Tax hikes on capital (like an increase in the capital gains tax rate) will only slightly impact the U.S. capital stock, because foreigners can buy U.S. assets
  - But bad for growth because they increase foreigner ownership of U.S. assets and reduce incomes earned by U.S. residents (GNP, or gross national product)

Model Demo

- Increase the corporate tax rate to 28 percent

Growth & Opportunity Agenda

- Grow incomes
- Create opportunities for upward mobility
- Promote entrepreneurship and innovation
- Build more resilient supply chains against future shortages and inflation
- Make the U.S. more competitive
- Create opportunities for families to build wealth
- Simplify the tax code

TAX FOUNDATION

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10 Tax Reforms for Growth and Opportunity

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Key Findings

- The waning pandemic and robust economic recovery have come with many benefits—plentiful jobs and fast-growing (nominal) incomes—but also serious challenges such as high and rising inflation.
- Rather than pushing for more fiscal stimulus or leaving it to the Federal Reserve to handle inflation through higher interest rates, policymakers should focus on boosting the productive capacity of the economy by reforming the tax code to prioritize economic growth and opportunity.
- In terms of business taxation, the tax code should be improved to encourage investment, innovation, dynamism, and competitiveness, leading to more and better jobs.
- In terms of individual taxation, streamlining benefits, cleaning up complicated provisions, and eliminating tax penalties on saving would help families enjoy financial security and the returns to their work and saving.

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Business Tax Reforms

- Better cost recovery for capital investment
  - Making full expensing permanent for short-lived capital investment
  - Extending this tax treatment to buildings and structures (neutral cost recovery)
  - Reversing scheduled amortization of R&D expenses
- Maintain a competitive corporate tax system
  - Remove the double taxation of corporate income
  - Look to Australia (credit imputation) or Estonia (dividend exemption)
- Return to competitive, free trade policies
  - Eliminate the Trump/Biden tariffs

Individual Income Tax Reforms

- Streamline social benefits
  - Simply and reform the CTC and EITC
  - Both are administratively complex to administer and increase burden on IRS
  - Remove marriage penalties in EITC
  - Shift administration of child care benefits to another agency
- Remove tax barriers from personal saving
  - Consolidate all savings accounts into one universal account, with either traditional or Roth style treatment
  - Increase maximum contributions and remove restrictions on withdrawals
- Inflation indexing in the tax code
  - Fix tax treatment of capital gains

Questions

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