A BUDGET FOR INCLUSIVE GROWTH

Center for American Progress

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Introduction

The Biden administration inherited an economy with millions out of work, a rapidly climbing inflation rate owing to supply chain disruptions, and a failed pandemic response. Its combination of aggressive fiscal policy and targeted public investments has led to a strong economic recovery that is the envy of other advanced economies. The CAP plan builds on these successes with new public investments that will reduce families' cost of living while promoting productivity growth.

Largely as a result of two decades of unpaid tax cuts, America's fiscal trajectory has moved from a projection of an ever-declining debt-to-GDP ratio to one rising indefinitely. The CAP plan places America on the appropriate fiscal trajectory: slowing down the growth rate of the debt-to-GDP ratio so it peaks below 120 percent of GDP and begins falling modestly as the federal government begins running a primary budget surplus toward the end of the 30-year budget window. More important than the specific level is that the debt-to-GDP ratio stabilizes and begins to fall.

The CAP plan meets these fiscal goals while safeguarding our commitments to seniors: it not only prevents cuts to Social Security or Medicare benefits but also expands them. It funds many of the Medicare enhancements by reducing Medicare Advantage overpayments, drawing on bipartisan legislation such as Senators Cassidy and Merkley's "No Unreasonable Payments, Coding, or Diagnoses for the Elderly" (No UPCODE) Act. At the same time, it makes several investments in the next generation such as child care, early education, and higher education.

The plan shows that America does not have to choose between debt stability and inclusive growth. The CAP plan manages to balance the two by raising revenue as a share of the economy by three percentage points. The United States would remain a low tax nation—it would move from the 29th highest tax country in the OECD to the 28th. It also highlights that policymakers must use the expiration of many of former President Trump's tax cuts at the end of 2025 to raise revenue by raising taxes on the wealthy and corporations.

The plan would also support economic growth. In particular, the investments in childcare and paid leave will support higher labor force participation. The effects of these proposals are not included in the analysis here but would boost revenues as parents' increased earnings would raise tax revenues. The plan also includes several investments that will make growth inclusive: in particular, making permanent the American Rescue Plan's Child Tax Credit changes would dramatically reduce child poverty and, evidence suggests, boost children's earnings later in life.

The upcoming expiration of the individual Trump tax cuts as well as exhaustion of the Social Security and Medicare trust funds will provide policymakers with an opportunity to assess their priorities—do they prioritize lower taxes for the wealthy and large corporations or preserving and expanding programs that serve as the bedrock of the American social contract? Extensive public opinion research demonstrates Americans' support for Social Security and Medicare as well as raising taxes on the wealthy and corporations. This can provide the political momentum for Congress to adopt this approach. CAP's plan presents a realistic and responsible path forward.

Spending

Medicare, Medicaid, and Other Federal Health Programs

CAP's plan incorporates our "Medicare 2.0" proposal released earlier this spring. It would modernize Medicare by turning Medicare Parts A, B, and D into a single, streamlined plan that covers hospitals, physicians, prescription drugs, dental, vision, hearing, and long-term services and supports (specifically home and community-based services). Out-of-pocket expenses would be capped at $5,000 for all, with no out-of-pocket expenses for beneficiaries below 200 percent of the federal poverty level.

It pays for these improvements to Medicare through further prescription drug reforms (those included in the Elijah Cummings Lower Drug Costs Now Act), building on those passed in the Inflation Reduction Act, as well as ending overpayments for Medicare Advantage plans, which CAP has previously calculated amount to $87 billion to $127 billion in 2024 alone.

CAP's plan extends the enhanced Affordable Care Act subsidies that expire after 2025, as well as provides Medicaid-like coverage to individuals in states that have not adopted the Affordable Care Act's Medicaid expansion.

Social Security

CAP's plan protects Social Security for decades to come by eliminating the taxable wage cap ensuring that all earnings are taxed under Social Security—which the trustees have estimated would ensure that Social Security remains solvent until the mid-2050s. Our plan also makes modest improvements in Social Security benefits.

Defense and Nondefense Discretionary

One of the CAP plan's key priorities is bringing nondefense discretionary spending—which funds some of the federal government's most critical priorities—to an appropriate level. Some of the key specific discretionary spending the CAP proposal includes are doubling the size of Pell grants, Public Education Opportunity grants to provide significant additional funding to the highest-poverty districts in each state, and Targeted Grants for Education Excellence to improve working conditions in schools with the highest teacher turnover.

The CAP plan immediately increases nondefense discretionary spending by 0.75 percent of GDP after FY 2025. After that, it grows with inflation and population. The CAP plan also right-sizes our defense budget by bringing down inflation-adjusted defense discretionary spending to where it was under President Obama by the end of the decade. After that, defense spending would also grow with inflation and population.

Other Mandatory

The CAP plan includes several additional investments that will save families in the short term while, in the longer term, increasing productivity through higher education attainment, greater labor force attachment among young parents, and more. They include:

- **Child Care and Early Childhood Education**: The CAP plan incorporates the Child Care for Working Families Act. The legislation from Sen. Patty Murray and Rep. Bobby Scott ensures that no low- or middle- income family pays more than 7 percent of its income on child care, guarantees a living wage for early childhood educators, and invests in improving quality in child care programs and increasing the number of child care slots in child care deserts or areas with an undersupply. The bill also provides funding and incentives for states to expand high-quality preschool programs to serve 3- and 4-year-olds.
- **Free Community College and Other Higher Education Investments**: The CAP plan incorporates the Biden administration's proposals to expand free community college and provides two years of subsidized tuition for students from families earning less than $125,000 enrolled in a participating four-year Historically Black College or University, Tribally-Controlled College or University, or Minority-Serving Institution. Combined with doubling the Pell grant as part of the discretionary investments, this would make attending college far more affordable for low- and moderate-income students.

  It also makes an investment in school construction and enacts legislation restoring the Biden administration's original student debt forgiveness proposal that the Supreme Court struck down (the plan the administration released in 2024 is not part of the baseline for this exercise).
- **Housing**: The CAP plan tackles one of the most difficult affordability challenges families face today with a public-private initiative to support modular housing construction for low- and moderate-income households. Funding should support states and localities that encourage innovations in constructing affordable, resilient, and energy-efficient housing. It also provides subsidies for low- and moderate-income renters in targeted multifamily housing shortage markets and for low- and moderate-income first-time borrowers of FHA-insured loans to offset current high premiums and incentivize lenders in underserved markets.
- **Paid Leave**: The CAP plan also incorporates the FAMILY Act, sponsored by Rep. DeLauro and Sen. Gillibrand, which creates a comprehensive national family and medical leave insurance program. The plan provides up to 12 weeks a year of paid leave for workers with serious health conditions, including pregnancy and childbirth; for workers to care for parents, spouses, domestic partners, or children with serious health conditions; to care for new children; and for other specific military caregiving and leave purposes.
- **Climate**: The CAP plan builds on the momentum the Inflation Reduction Act is generating for clean energy investment with a targeted set of additional investments that fill in areas that it did not address such as funding for rural electrification, industrial decarbonization, and more. This is a 10-year, one-time investment intended to address the current foreseeable challenges to building a 100 percent clean energy economy.

Revenues

Individual Income Taxes

The CAP plan prioritizes raising taxes on the highest income Americans who have benefitted the most from economic growth and rising income inequality over the last several decades. It starts with introducing a new top tax rate of 44.6 percent—five percentage points above the 39.6 percent top rate that takes effect after 2025—starting around $1 million of taxable income.

The CAP plan directly addresses the shortfall in the Medicare trust fund by directing revenue from the net investment income tax (NIIT) to the Medicare trust fund as originally intended in the drafting of the Affordable Care Act. It further shores up the trust fund by raising the NIIT and Medicare payroll tax rate from 3.8 to 5 percent and ensuring that the profits of active business owners face Medicare taxes.

The CAP plan addresses the flaws in the income tax that allow the nation's very wealthiest families to pay a lower tax rate than some middle-income families. Using a broad measure of income that includes unrealized capital gains, economists have estimated the average individual tax rate paid by the United States' 400 wealthiest families was 8.2 percent between 2010 and 2018. The CAP plan addresses this flaw by adopting the Biden administration's proposal to introduce a 25 percent minimum income tax on households worth over $100 million. Critically, the income measure used would include unrealized capital gains and would function as a pre-payment of the tax that would ultimately be owed when the gain is recognized at sale or death.

Finally, the CAP plan would add fairness to our tax system by adopting the American Rescue Plan's Child Tax Credit (CTC) and Earned Income Tax Credit (EITC) expansions. The CTC expansion would restore a tax credit that helped cut the child poverty rate almost in half in 2021 while the EITC expansion would ensure the federal tax code does not tax low-income childless workers into poverty.

Corporate Income Taxes

The CAP plan addresses several flaws of the 2017 tax law, which dramatically cut corporate taxes while introducing new incentives for multinationals to shift profits and investments overseas. This massive corporate tax cut was sold as benefitting ordinary Americans by increasing investment and thus wages, but the evidence suggests that the increase in investment was minimal and the wage gains overwhelmingly went to the highest income 10 percent of workers and especially firm managers and executives.

The CAP plan begins by raising the corporate tax rate to 30 percent, which is still below the pre-2018 rate of 35 percent. This will raise much-needed revenue and evidence suggests that it overwhelmingly falls on excess profits above the level firms need to justify an investment, making it an efficient source of tax revenue.

It raises the minimum tax rate on U.S. corporations' foreign earnings to 21 percent and eliminates several of the incentives for corporations to book profits offshore in tax havens. These changes would bring the United States into compliance with the Organization for Economic Cooperation and Development's Pillar Two Framework, which establishes a global minimum tax on very large multinational corporations and penalizes profit shifting to low-tax jurisdictions. Following that framework, it would replace the base erosion and anti-abuse tax with an under-taxed profits rule that would protect U.S. revenue from similar rules imposed by other countries while allowing U.S. taxpayers to continue to benefit from U.S. tax incentives that promote U.S. competitiveness. It would also eliminate the foreign-derived intangible income deduction.

Corporations can return profits to shareholders in two ways—issuing dividends or repurchasing their own stock ("stock buybacks"). The tax code places these two methods on an unequal playing field. Taxable shareholders must pay tax on dividends when they receive the dividend while buybacks, by increasing the share price, only face tax when the shareholder sells the stock. The tax treatment of buybacks also allows foreign owners of equity in U.S. corporations—who owned 42 percent of ownership interests in 2022—to often avoid paying U.S. tax entirely. The Inflation Reduction Act began to address this disparity with a 1 percent excise tax on buybacks, but the CAP plan quadruples the tax to 4 percent. This both raises revenue and makes the tax code more neutral between ways of returning profits to shareholders.

Tax Expenditures

The CAP plan would target two of the largest tax expenditures that entrench wealth and income inequality: lower tax rates on capital gains and dividend income than wage income and the stepped-up basis loophole that allows taxes on capital gains to go uncollected. It would end preferential tax rates on investment income for households making over $1 million while taxing unrealized capital gains at death with an exemption of $2 million per couple. This would be on top of the existing $500,000 per couple exemption on capital gains from residence while allowing heirs to family-owned and operated businesses to defer paying the tax until they sell the business.

Other Sources

The CAP plan would further address intergenerational wealth inequality by strengthening the estate tax and restoring it to its 2009 parameters of a 45 percent tax on estates over $7 million per couple. It would also discourage unproductive financial speculation with a 3-basis-point financial transactions tax. It would also raise and modernize excise taxes by taxing all forms of nicotine equally and raising the alcohol tax.

The Inflation Reduction Act included a transformational investment in IRS enforcement reversing years of declining real funding that have eroded the IRS's ability to enforce the nation's tax laws. This investment is allowing the IRS to modernize its technology and hire the staff it needs to enforce the nation's tax laws. In particular, the wealthy and large corporations use complicated tax structures that make it difficult for an underfunded and understaffed IRS to audit. The CAP plan makes the IRS funding increase permanent.

Conclusion

The CAP plan demonstrates that inclusive growth is fiscally sustainable—that we can keep our commitments to our seniors, make further investments in the American people, and prevent rising interest costs from crowding out the private and public investments that will make our economy greener and more resilient.

Percentage of GDP	2024	2034	2054
Revenues	17.5	20.8	21.8
Spending	23.1	26.0	25.7
Deficit (-) or Surplus	-5.7	-5.2	-3.9
Debt Held by the Public	99.0	110.8	118.3