Budget Model

President Biden's FY2023 Budget Proposal: Budgetary and Economic Effects

Summary: We project that President Biden's FY2023 Budget, taken as a whole, would reduce debt and grow the economy by 0.4 percent over time, with two major components of the Budget---"Build Back Better" and "New Provisions"---working in opposite directions.

Key Points

- In 2032, we project that the Biden FY2023 budget, taken as a whole, would reduce debt on a conventional scoring basis while increasing debt after dynamics are considered. In 2050, debt is reduced by 1.7 percent including dynamics.
- We project that GDP would grow by 0.3 percent in 2032 and 0.4 percent in 2050.
- Different components of the Biden FY2023 budget have largely offsetting effects on revenue and economic growth, with the "Build Back Better" (BBB) component lowering economic growth and "New Provisions" (implemented on top of BBB) adding to growth.

Introduction

On March 28th, the Biden Administration released the President's Budget for Fiscal Year 2023. The Budget calls for new spending initiatives focused on public health, education, housing, crime prevention, and more. These provisions would be offset, in part, by new taxes on high-income and high-wealth households, including a new proposal to tax unrealized capital gains of households worth more than $100 million.

The Budget also includes a line item indicating a deficit-neutral reserve fund ("DNRF") for "legislation that reduces costs, expands productive capacity, and reforms the tax system."[1] The Treasury Green Book specifies that administration budget estimates are scored "relative to a baseline that incorporates all revenue provisions of Title XIII of H.R. 5376 (as passed by the House of Representatives on November 19, 2021), except Sec. 137601." Thus, PWBM interprets the DNRF as proposing legislation akin to H.R. 5376, the "Build Back Better Act," excluding the

State and Local Tax Deduction provision (henceforth, referred to as "Modified H.R. 5376"). Accordingly, we first present updated budgetary and economic estimates for H.R. 5376, then we layer new Budget proposals on an H.R. 5376 -inclusive baseline (henceforth, referred to as "New Provisions"). Our combined estimate ("FY 2023 Budget Total") represents the score for the entire Budget.

Tax Reforms and Other Budgetary Offset Provisions: Conventional Analysis

The deficit-reducing provisions of H.R. 5376 are described and analyzed in detail in a previous brief. Our updated estimates presented herein differ slightly from our previous analysis for two reasons. First, the updated estimates reflect new macroeconomic projections with higher-than-expected inflation. Second, the ten-year budget window for the current Budget begins in FY 2023 rather than FY 2022.[2]

Beyond H.R. 5376, the New Provisions in the Budget include dozens of budgetary offsets used to reduce the deficit impact of the spending provisions. The most significant proposed tax changes are as follows:

Key Corporate and International Tax Provisions

- Increase the corporate tax rate. The Budget would increase the statutory corporate income tax rate from 21 percent to 28 percent.
- Adopt the Undertaxed Profits Rule. The Budget would repeal the Base Erosion and Anti-Abuse Tax (BEAT) enacted in 2017 and replace it with an Undertaxed Profits Rule (UTPR). Combined with international tax changes in H.R. 5376, the UTPR would ensure that U.S. multinationals and foreign multinationals with U.S. operations pay a minimum effective tax rate of at least 15 percent in each country in which they earn profits, including the U.S. With these changes, U.S. taxation of multinationals would be broadly consistent with proposed rules for a global minimum tax negotiated through the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting, which more than 130 countries have agreed in principle to adopt. However, the Budget proposal also states that it would "ensure that taxpayers continue to benefit from tax credits and other tax incentives that promote U.S. jobs and investment." These benefits typically lower effective tax rates, in many cases below 15 percent. The proposal does not describe how such benefits would be preserved under the global minimum tax regime.
- Eliminate fossil fuel tax preferences. The Budget would repeal a number of tax provisions that encourage development and production of oil, gas, and other fossil fuels. These include tax credits for production from sources that are costly to exploit, immediate or accelerated recovery of some capital costs, and favorable tax treatment of certain income and losses.

Key Individual Tax Provisions

- Increase the top rate on ordinary income. Under current law, the top rate on income rate would be 37 percent until 2026 when it is scheduled to rise to 39.6 percent. The Budget would accelerate this increase to begin in tax year 2023. It would also lower the threshold over which it applies. Currently, the top bracket for joint filers is $647,850 in taxable income ($539,900 for single filers) in 2022; the provision would set the 2023 top bracket at $450,000 ($400,000) and adjust for inflation thereafter.

- Reform the taxation of capital income. Under current law, long-term capital gains and qualified dividends are subject to preferred tax rates, the top rate of which is 20 percent (23.8 percent when including the Net Investment Income Tax) starting at $517,200 for joint filers ($459,750 for single filers). The Budget would add a new 39.6 percent rate starting at an inflation-adjusted top bracket of $1 million in taxable income. This provision also reforms the current-law treatment of unrealized gains at death. Rather than asset basis being “stepped up” at death, unrealized gains above an exclusion amount ($5 million) would be subject to capital gains tax as if the asset were sold. The primary residence home exclusion would apply, and tax owed on non-publicly traded assets would be payable over 15 years.
- Impose a minimum income tax on taxpayers with net worth greater than $100 million. The Budget would enact a new 20 percent alternative minimum tax on the income (inclusive of unrealized capital gains) of taxpayers with net worth greater than $100 million. Minimum tax liability attributable to unrealized gains would generate credits against future liability when assets are eventually sold. Affected taxpayers whose net worth is comprised of more than 80 percent non-publicly traded assets would be exempt from including unrealized gains on such assets and would instead be assessed a deferral charge upon realization.

Other key tax provisions

- Modify estate and gift taxation. The Budget would make several modifications to estate and gift tax rules, most notably limiting tax avoidance strategies using grantor retained annuity trusts.
- Tax carried interest as labor income. Under current law, certain general partners of investment firms are compensated through a “carried interest” in profits as remuneration for services provided to the firm. The income is subject to preferential rates. The Budget would instead treat this income as labor income subject to ordinary tax rates.
- Disallow deferral of gain on certain like-kind exchanges. The Budget would repeal a current-law tax avoidance channel wherein capital gains taxes can be deferred on the condition that appreciated real property is exchanged for property of a “like kind”.

As shown in Table 1, PWBM projects that the New Provisions described above will raise about $2.6 trillion on a conventional basis (without macroeconomic dynamics) over the 10-year budget window. Because the New Provisions are part of a larger reform proposal that includes Modified H.R. 5376, we project the New Provisions against a modified baseline that includes the passage of Modified H.R. 5376. Doing so captures “interaction effects” that would be missed if comparing against current law. For example, a corporate tax rate increase will raise more revenue if base-broadening international provisions have been adopted as in Modified H.R. 5376. A comparison against this modified baseline is also consistent with the stated intention of the New Provisions in the Budget to be on top of the DNRF.

Table 1. Estimated Annual Budgetary Effects of New Offset Provisions

Billions of dollars

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Provision	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	Budget window (2023-2032)
Raise the corporate income tax rate to 28 percent	0	65	93	100	117	124	126	125	122	123	124	1,119
Adopt the Undertaxed Profits Rule	0	0	20	33	29	27	26	26	25	26	27	239
Eliminate fossil fuel tax preferences	0	2	3	3	3	2	3	3	3	3	3	27
Other business tax provisions	0	4	7	7	7	7	7	7	7	7	6	68
Increase the top marginal income tax rate for high earners	0	35	48	50	17	6	6	6	7	7	7	188
Reform the taxation of capital income	3	16	23	25	21	23	25	28	30	33	34	259
Impose a minimum income tax on the wealthiest taxpayers	0	0	45	50	54	59	65	66	67	67	68	542
Modify estate and gift taxation	0	1	2	3	3	5	6	6	6	7	7	46
Other tax provisions including tax administration	0	15	16	14	14	13	14	14	14	15	16	145
Total	**3**	**139**	**259**	**285**	**265**	**267**	**276**	**280**	**281**	**288**	**293**	**2,633**

Table 2 combines the updated Modified H.R. 5376 estimates with those of the New Provisions to generate ten-year totals for the Budget as a whole.

Table 2. Estimated Budgetary Effects of Offset Provisions, FY 2023-2032

Billions of dollars

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Provision category	Modified H.R. 5376	New provisions	Total
Raise income taxes on corporations	325	1,119	1,444
Modify international tax rules	343	239	583
Other business tax provisions including fossil fuel tax preferences	391	95	485
Raise income taxes on high-income households	564	988	1,553
Other tax provisions including tax administration and IRS funding	274	145	418
Other provisions	322	46	368
Total	**2,219**	**2,633**	**4,852**

Overall, we project that the FY 2023 budget, including both Modified H.R. 5376 and the New Provisions, will raise $4.9 trillion in revenue and cost offsets.

Spending and Tax Expenditure Provisions: Conventional Analysis

The Budget calls for new direct spending and tax expenditures primarily related to health and education, with smaller amounts dedicated to affordable housing and crime prevention. The spending proposals in the Budget do not include some initiatives, like universal preschool and expanding the Child Tax Credit, which the administration proposed in the FY 2022 Budget and the related American Jobs Plan and American Families Plan. We assume the FY 2023 Budget contains the spending initiatives from Modified H.R. 5376 via the DNRF. Refer to our previous analysis for a discussion of these provisions.

As shown in Table 3, we estimate that the New Provisions spending and tax expenditures would cost about $792 billion over the ten-year budget window. When added to Modified H.R. 5376, we estimate total Budget spending equal to $3.1 trillion over the 10-year window, on a conventional basis before macroeconomic effects.

Table 3. Spending Initiatives by Model Input Classification, FY 2023-2032

Billions of dollars

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Category	Modified H.R. 5376	New provisions	Total
Public infrastructure and other productivity-enhancing investment	680	471	1,151
Labor productivity-boosting spending	398	0	398
Transfers & tax expenditures	486	0	486
Other	727	321	1,048
Total	**2,291**	**792**	**3,083**

Economic Effects

To evaluate the economic effects of the different spending programs, we categorize spending provisions into the discrete buckets (each with distinct macroeconomic effects) shown in Table 3: public infrastructure and other productive investments (including the effects of carbon abatement), labor productivity-boosting spending, transfers and tax expenditures, and other federal spending.

Of the new initiatives in the Budget, education-related proposals are the largest component, accounting for almost half of the total. Most funds are allocated to fund Pell Grants and funding for schools with large number of students from low-income families. We categorize this spending as productivity-improving. Health expenditures represent 45 percent of the new spending within the budget window. These provisions include the expansion of behavioral health and substance abuse benefits as well as funding for vaccination efforts. Housing expenditures are largely directed towards the production of new units to be rented at below-market rents (for example through the establishment of the Community Development Financial Institutions Affordable Housing Supply Fund), rather than direct subsidies for low-income households. The remainder of new initiatives, which includes security-related outlays, election-related mail services among other provisions, is allocated to the "other federal spending" category.

Table 4 presents the estimated effects on various macroeconomic aggregates of the Modified H.R. 3576 plan, which we implement as part of the FY2023 budget.

Table 4. Projected Economic Effects of the President's FY 2023 Budget

Contribution to percent difference from baseline

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Year	Provision	GDP	Capital Stock	Hourly Wage	Hours Worked	Government Debt
2032	*Modified H.R. 5376*	*-0.5*	*-1.0*	*0.3*	*-0.8*	*3.9*
	New provisions	*0.8*	*2.4*	*0.8*	*-0.1*	*-1.7*
	FY 2023 Budget Total	**0.3**	**1.4**	**1.2**	**-0.9**	**2.1**
2040	*Modified H.R. 5376*	*-0.6*	*-1.6*	*0.3*	*-0.9*	*4.3*
	New provisions	*1.0*	*3.1*	*0.9*	*0.1*	*-3.8*
	FY 2023 Budget Total	**0.3**	**1.4**	**1.2**	**-0.9**	**0.3**
2050	*Modified H.R. 5376*	*-0.7*	*-1.9*	*0.1*	*-0.8*	*4.7*
	New provisions	*1.1*	*3.5*	*1.3*	*-0.2*	*-6.2*
	FY 2023 Budget Total	**0.4**	**1.5**	**1.4**	**-1.0**	**-1.7**

The macroeconomic effects are similar to our analysis of H.R. 3576 with differences as a result of a variety of changes including more detailed modeling of climate provisions (as detailed here), updated estimates of the cost of building preschools, and updates for more recent economic changes.

We project a 2.1 percent increase in government debt in 2032, despite our conventional estimates presented above producing almost $1.8 trillion more in revenue and offsets relative to spending during the same period. The main difference is that our dynamic estimates incorporate feedback effects from reduced labor supply that lowers reported household income, especially for lower-income households. Lower-income households face higher marginal effective tax rates due to phaseout rules in new programs as well as income effects from larger transfers. This reduction in household income expands qualifications for existing welfare programs, including nutrition assistance programs, housing assistance, other income security programs, federal unemployment, and Medicaid.[3]

In 2050, government debt is estimated to be 4.7 percent higher than the current law baseline and GDP is estimated to be 0.7 percent lower. The additional revenue provisions of the FY2023 President's budget include revenue raised from increasing taxes on high-income households and on businesses. These revenues reduce government debt by 6.2 percent in 2050 relative to the Modified H.R. 5376 baseline. Higher taxes on capital gains and dividends facing the wealthiest Americans, as well as the tax on high-net-worth households' unrealized capital gains, lowers their after-tax return on equity investment and, therefore, produces some investment disincentive. However, the reduction in government debt crowds-in private capital investment. Higher capital along with some productivity boosting spending effects leads to a higher wage level. Higher effective corporate

tax rates incentivize investment expensing and raise the value of business debt deductions. These effects offset the reduction in equity returns from the higher tax rate and lead to 0.4 percent higher GDP in 2050.

This analysis was produced by PWBM staff.

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1. The description continues in a footnote: "The Budget includes a reserve for legislation that reduces costs, expands productive capacity, and reforms the tax system. While the President is committed to reducing the deficit with this legislation, this allowance is shown as deficit neutral to be conservative for purposes of the budget totals. Because discussions with Congress continue, the Budget does not break down the reserve among specific policies or between revenues and outlays." ↩
2. Any legislation that passes through the FY 2022 reconciliation process will be analyzed over the 2022-2031 window. ↩
3. Changes in program qualifications are sometimes presented as part of conventional estimates, where we incorporate various tax and spending responses, including methods to reduce tax burdens. For this analysis, we incorporate changes in program qualifications as part of dynamic analysis to include the offsetting increase in hourly wages as labor supply is reduced. Incorporating this wage increase mitigates some of the projected fall in household income and, therefore, mitigates some of the projected increase in program qualifications. ↩