Background

What options would increase federal revenues?

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A. Policymakers can directly increase revenues by increasing tax rates, reducing tax breaks, expanding the tax base, improving enforcement, and levying new taxes. They can indirectly increase revenues through policies that increase economic activity, income, and wealth.

Policymakers can raise revenues by modifying existing tax policy, enacting new taxes, and boosting economic activity.

MODIFYING EXISTING TAX POLICY

1. **Congress could increase the tax rates that apply to personal income, corporate income, payrolls, estates, and specific products like gasoline and cigarettes.** Higher rates almost always yield higher revenues, even if people and businesses do less of the taxed activity. Capital gains, which are currently taxed at a top rate of 23.8 percent, are one exception; some estimates suggest revenues may peak at rates around 30 percent but then decline at higher rates.

2. **Congress could scale back or eliminate the myriad tax breaks in the existing code.** Prominent personal examples include the exclusion of employer-provided health insurance, retirement saving incentives, and the exclusion of capital gains on sales of principal residences. Prominent business examples include expensing of new investments, low tax rates on overseas income, and the 20 percent deduction for qualified business income.

3. **Congress could apply existing taxes more broadly.** For example, it could reduce the standard deduction in the individual income tax, increase the cap on earnings subject to the Social Security payroll tax, or reduce the estate tax exemption.

4. **The federal government could strengthen enforcement.** The IRS estimates that the "tax gap"—the difference between taxes owed and those actually paid—averaged about $458 billion annually in 2008–10 and that enforcement efforts and penalties recovered about $52 billion. Better enforcement could further reduce the remaining $406 billion gap.

ENACTING NEW TAXES

Policymakers could also boost revenues by introducing new taxes. The largest potential revenue sources would be a value-added tax (already levied in every other developed nation) or a carbon tax (which would target the pollutants causing climate change). Other recent proposals include taxes on financial transactions, wealth, and unhealthy foods and drinks.

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BOOSTING ECONOMIC ACTIVITY

All else equal, a bigger economy generates more tax revenue. Policies that boost economic activity, incomes, and wealth can thus lift revenues as well. Examples include policies that increase the number of people in the labor force, the number of hours they work, and their skills. Policymakers can also modify the tax code to increase workers' physical and intellectual capital.

Immigration reform is one way to boost economic activity. Bringing new workers into the country would expand the labor force and attract new capital; allowing unauthorized workers to enter the legal workforce would boost their productivity and taxable wages.

Other policies that might boost economic activity include investing in infrastructure, education, and innovation; reforming the rules of social programs that discourage some people from working; and restructuring the tax code to encourage domestic investment. Actual economic gains depend on policy specifics; poorly designed investments and reforms could boomerang, reducing economic activity.

Further Reading

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