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Budget Model

President Biden's American Families Plan: Budgetary and Macroeconomic effects

Summary: PWBM projects that the American Families Plan (AFP) would spend $2.3 trillion, about $500 billion more than the White House's estimate, over the 10-year budget window, 2022-2031. We estimate that AFP would raise 1.3 trillion in new tax revenue over the same period. By 2050, the AFP would increase government debt by about 4 percent and decrease GDP by 0.3 percent.

Key Points

- PWBM estimates that President Biden's American Families Plan (AFP) would spend $2.3 trillion over the 10-year budget window (2022-2031), about $500 billion more than the White House's estimate.

- We estimate that AFP would raise $1.3 trillion in new tax revenue over the same period, including almost $480 billion in additional revenue from enhanced IRS tax collection enforcement.

- By 2050, we estimate that the AFP would increase government debt by almost 5 percent and decrease GDP by 0.3 percent, as the effects from larger debt on the economy outweigh the productivity gains associated with the new spending programs.

Updated on May 24, 2021 to correct a modeling error related to the Premium Tax Credit (PTC) provision. PWBM scored a more expansive version of the PTC proposal taken from Biden's presidential campaign, which overstated the budget impact of this provision. The changes reduced PWBM's 10-year spending estimate from $2.5 to $2.3 trillion, and reduced the estimate of the negative long-run GDP effect by less than 0.1 percentage points.

Introduction

On April 28, 2021, President Biden released the American Families Plan (AFP). The plan calls for $1.8 trillion in new federal spending focused on childcare, education, healthcare, transfers to low-income households, and more. The AFP proposes to offset this new spending with new taxes on high-income households and by increasing IRS enforcement.

Projected Budgetary Effects

In total, PWBM estimates that the spending provisions proposed in the AFP would cost $2.3 trillion over the next 10 years, 2022 to 2031, about $500 billion more than the White House's estimate. Some of this difference in cost estimates arises from PWBM's estimates of the cost of the AFP's tax credits as well as the universal pre-K and free community college provisions. The proposal establishes permanent programs (such as universal pre-K) and therefore PWBM assumes that the additional spending continues beyond the budget window.

The AFP proposes several tax increases on high-income households, including:

- Increasing the top individual rate from 37 percent to 39.6 percent,
- Taxing unrealized capital gains above $1 million at death,
- Taxing long-term capital gains and qualified dividends at ordinary rates for individuals making more than $1 million,
- Taxing carried interest at ordinary rates,
- Disallowing deferral of tax on like-kind exchanges for gains greater than $500,000,
- Forcing all income above $400,000 to face the 3.8 percent Medicare tax,
- Extending the limitation of business losses for noncorporate taxpayers

The AFP also proposes increasing IRS funding by $80 billion over ten years, directing the additional resources towards audits, IT modernization, the establishment of a new information reporting regime for financial institutions, and more.

The AFP calls for extending several tax benefits that passed in recent legislation, including:

- Extend the expansion of the Child Tax Credit under the American Rescue Plan (ARP) through 2025,
- Make the Child Tax Credit fully refundable permanently,
- Extend the ARP's expansion of the Premium Tax Credit,
- Extend the ARP's expansion of the Earned Income Tax Credit,
- Extend the ARP's expansion of the Child and Dependent Care Tax Credit

The budget effects of these tax –related changes shown in Table 1.

Table 1. Budget Effects of AFP Tax Changes, 2022-2031

Billions of dollars, Change from Current-Law Baseline

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Provision	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2022 - 2031	202 - 20
Raise the top rate on ordinary income to 39.6%	17	23	24	25	16	4	1	0	0	0	111	1
Tax unrealized gains above $1M at death; tax long-term capital gains and preferred dividends at ordinary rates for filers making more than $1M; tax carried interest at ordinary rates	9	23	31	37	39	40	44	46	51	55	376	6
Disallow deferral of tax on like-kind exchanges for gains greater than $500,000	3	4	4	4	4	4	4	5	5	5	41	6
Ensure all income above $400,000 faces 3.8% Medicare tax	10	14	15	17	13	13	14	14	14	15	139	2

Provision	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2022 - 2031	202 20
Extend limitation on business losses for noncorporate taxpayers	0	0	0	0	0	25	32	33	35	36	162	3
Increase IRS funding for audits; institute information reporting regime for gross flows in financial institutions	2	5	11	20	30	43	59	78	101	129	480	1,3
Total revenue-raisers	**40**	**69**	**85**	**103**	**103**	**130**	**155**	**176**	**205**	**241**	**1,308**	**2,8**
Extend the ARP's expansion of the Child Tax Credit through 2025; remove refundbility requirements permanently	-78	-107	-108	-112	-30	-1	-1	-1	-1	-1	-439	-4
Extend the ARP's expansion of the Earned Income Tax Credit for childless workers	-9	-12	-12	-12	-13	-13	-13	-13	-13	-14	-125	-1

Provision	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2022 - 2031	202 20
Extend the ARP's expansion of the Premium Tax Credit	0	-14	-19	-20	-21	-22	-23	-24	-26	-27	-197	-3
Extend the ARP's expansion of the Child and Dependent Care Tax Credit	-6	-8	-9	-9	-9	-10	-10	-10	-10	-11	-92	-1
Total budget effect of tax credits	**-93**	**-141**	**-148**	**-153**	**-73**	**-46**	**-47**	**-48**	**-50**	**-53**	**-853**	**-1,**
Net budget effect of tax-related provisions	**-53**	**-72**	**-63**	**-50**	**30**	**84**	**108**	**128**	**155**	**188**	**455**	**1,6**

Over the 10-year budget window, 2022 to 2031, PWBM projects the revenue-raising tax provisions of the AFP would raise $1.3 trillion. PWBM estimates that the AFP’s tax credit provisions would cost about $850 billion, bringing the net revenue raised via the tax code to $455 billion. Our estimate includes almost $480 billion in additional revenue from enhanced IRS tax collection enforcement. We will discuss our modeling of greater IRS enforcement on revenue in more detail in a separate brief.

Projected Economic Effects

We now report the impact of AFP on the economy in three distinct settings: (i) including the proposed new spending programs without the new tax changes; (ii) including the proposed tax changes without new spending; (iii) with proposed new spending and taxes combined, including their interactions.

Spending Only

Table 2 shows the economic effects of only the new spending in the AFP, considered without the proposal’s tax changes.

Table 2. Economic Effects of the AFP's Spending Provisions, 2031-2050

Percent Change from Baseline

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Year	GDP	Capital Stock	Average Hourly Wage	Hours Worked	Government Debt
2031	-0.31	-0.80	0.07	-0.39	5.81
2040	-0.39	-1.45	-0.11	-0.28	8.74
2050	-0.60	-2.36	-0.39	-0.21	10.79

The spending on education, childcare and paid leave increases government debt by about 11 percent in 2050. Although the public investments boost productivity, the crowding-out effect of higher government debt dominates and decreases the capital stock by 2.4 percent in 2050. The wage rate is higher initially due to the productivity boost from public investments. Over time, however, as the capital stock declines further, the wage rate starts to decrease as well. In 2050, GDP is 0.6 percent lower relative to baseline.

Transfer payments which substitute for existing spending (for instance, childcare) increase the household budget and can disincentivize work, which is no longer needed to pay for childcare. On the other hand, transfer payments which allow a switch from domestic production (e.g., childcare provided by a working-age member of the household) to market production may increase output, but only if there are scaling and efficiency effects. That is, if the new, government-paid caregiver was working at another job comparable to the job taken by the parent who is now able to work in the market, then no net benefit has been realized—only a switch in jobs.

Taxes Only

Table 3 shows the economic effects of the AFP’s tax provisions, considered without the proposal’s spending increases.

Table 3. Economic Effects of the AFP’s Tax Provisions, 2031-2050

Percent Change from Baseline

DOWNLOAD DATA

Year	GDP	Capital Stock	Average Hourly Wage	Hours Worked	Government Debt
2031	0.01	0.79	0.33	-0.32	-4.10
2040	0.09	0.94	0.41	-0.32	-5.91
2050	0.29	1.44	0.54	-0.24	-7.03

The revenue raised from increasing taxes on high-income households and reducing the tax gap reduces government debt by 7.0 percent in 2050 and thus crowds in capital investment. In the meantime, higher taxes on capital gains and dividends facing the wealthiest Americans would lower their after-tax return on equity investment and therefore disincentive saving. However, since only a very small portion of Americans are subject to the tax increases, the capital stock ends up 1.4 percent higher, which in turn increases the wage rate by 0.5 percent. In the meantime, the increase in the top individual tax rate also discourages labor by high-productivity households. Overall, GDP ends up 0.3 percent higher in 2050.

Taxes and Spending Combined (Full AFP)

The overall macroeconomic effects of enacting the AFP, including both its spending and tax provisions, are shown in Table 4.

Table 4. Economic Effects of the American Families Plan, 2031-2050

Percent Change from Baseline

DOWNLOAD DATA

Year	GDP	Capital Stock	Average Hourly Wage	Hours Worked	Government Debt
2031	-0.32	-0.03	0.44	-0.76	1.76
2040	-0.31	-0.54	0.31	-0.62	2.87
2050	-0.32	-0.96	0.19	-0.50	3.80

The AFP increases government debt by about 4 percent in 2050 as new spending exceeds additional revenues raised. The capital stock is 1 percent lower due to the crowding-out effect that new debt has on private capital formation. The economy-wide average wage rate is 0.2 percent higher due to the productivity boost from public investments. However, those productivity effects are not enough to offset the negative effect of higher government debt on GDP, which ends up 0.3 percent lower in 2050.

Appendix

Table A.1 Conventional Spending Estimates for the American Family Plan, Fiscal Years 2022-2031 and 2022-2036

Billions of dollars, Change from Current-Law Baseline

DOWNLOAD DATA

Provision	2022-2031	2022-2036
Free, universal pre-kindergarten for all three- and four-year-olds	426	671
Tuition-free two-year community college	299	497
Increase Pell Grants for low-income students	66	104
Other education initiatives	117	191
Family and childcare initiatives	493	806
Child Tax Credit expansion	439	443
Earned Income Tax Credit expansion	125	199
Premium Tax Credit expansion	197	355
Child and Dependent Care Tax Credit expansion	92	152
IRS funding	80	176
Total spending	**2,334**	**3,594**

This analysis was conducted by Zheli He, Victoria Osorio, and John Ricco under the direction of Richard Prisinzano.