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Budget Model

Sens. Manchin and Schumer's 2021 Senate Budget Reconciliation Agreement: Macroeconomic and Distributional Effects

Summary: PWBM projects that the long-run aggregate macroeconomic effects of Senator Joe Manchin's $1.5T reconciliation framework would be negligible. The economic benefits would largely accrue to younger, poorer households while the economic costs would fall mostly on richer households.

Key Points

- The $1.5 trillion spending framework outlined by Senator Manchin in a July 2021 memo would be partly offset by tax increases on corporations and high-income households. We project these new taxes would raise $1.3 trillion over the budget window and fully offset new spending beyond the budget window, consistent with the Byrd Rule.

- We project that spending and taxes outlined in Manchin's memo would redistribute resources from high-income to low-income households without any material impact on GDP, as productivity effects of the new spending offsets the distortions produced by higher taxes.

- For example, we estimate that the average 30-year-old in the lowest 20 percent income group is about $3,200 better off under the Manchin memo. In contrast, the average 30-year-old in the top 20 percent of income distribution is about $6,800 worse off.

Introduction

In a July 28th, 2021 memo, Democratic Senator Joe Manchin outlined a framework for a budget proposal to be taken up under the budget reconciliation process. Compared to the August 9th, 2021 Senate budget resolution that called for $3.5 trillion in additional spending, Senator Manchin's framework outlines $1.5 trillion in new spending and tax incentives centered on family policy, health policy, and climate policy. The Manchin memo calls for new outlays to be offset by new revenues from tax increases on high-income households and corporations.

Compared with the broader Senate budget resolution, Senator Manchin's framework is more limited in scope, for example, calling for spending caps and means testing for other proposed programs such as universal preschool. Similarly, the proposed tax increases are narrower than that of the House Ways and Means reconciliation bill and related proposals from the Biden administration. Manchin's proposal does not increase the primary deficit at its projected levels outside of the 10-year budget window, consistent with the Byrd Rule.

New Spending

We construct a policy package consistent with the framework outlined in the memo. PWBM has previously estimated the effects of a number of these policies including preschool and childcare programs. Our current projection methodology is consistent with our earlier estimates.

To evaluate the economic effects of the different spending programs, we decompose spending into "tax expenditures," labor productivity boosting spending, total factor productivity increasing public infrastructure investments, and other federal spending.

Table 1 shows the distribution of spending.

Table 1. Illustrative $1.5 Trillion Budget Reconciliation Proposal Modeled on Senator Manchin's Proposal

Billions of dollars

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Category	**Total 10-Year Spending**
Public infrastructure investment	$260
Childcare and preschool	$541
CTC extension until 2026	$439
Other spending	$260
Total	**$1,500**

Senator Manchin's memo sets the maximum amount of new spending and tax expenditures at $1.5 trillion. Two categories of spending are highlighted as being priorities: family and health policy, and climate policy. Drawing on these descriptions, as well as proposals through various iterations of the Build Back Better agenda, we analyze the following illustrative scenario over the 10-year budget window: $541 billion for means-tested childcare and means-tested childcare programs, $439 billion for the Child Tax Credit extension (until 2026), $260 billion for public infrastructure investments, and $260 billion for other government spending. We extend these policies beyond the budget window, except for the Child Tax Credit that expires in 2026, consistent with the House Ways and Means reconciliation bill.

Budgetary Offsets

Senator Manchin's memo calls for budgetary offsets centered on new taxes on corporations and high-income households. The memo calls for raising the corporate tax rate from 21 percent to 25 percent and imposing a new 15 percent minimum tax on corporate book income. For households, the top tax rate on ordinary income would increase to 39.6 percent, and the combined top rate on long-term capital gains and qualified dividends would rise from 23.8 percent to 28 percent (with carried interest taxed as ordinary income). The memo also calls for budgetary savings from reducing the “tax gap” (modeled here as an $80 billion increase in IRS funding directed towards enforcement efforts and systems modernization) and repealing the implementation of a “rebate rule” scheduled to increase prescription drug-related outlays beginning in 2023.[1]

We project these changes would raise approximately $1.3 trillion over ten years. Table 2 shows the projected budget effects of each provision.

Table 2. Estimated Budgetary Effects of Tax Increase and Spending Reduction Provisions

Billions of dollars

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Provision	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Budget window
Increase the corporate rate to 25%	26.5	39.3	42.0	45.3	54.4	59.0	61.0	61.9	62.3	64.7	**516.4**
Impose a 15% minimum tax on corporate book income	5.8	9.7	12.1	15.4	19.2	21.6	23.6	25.3	26.3	27.5	**186.6**
Raise the top rate on ordinary income to 39.6%	22.0	29.7	31.0	32.2	7.3	4.4	1.3	0.0	0.0	0.0	**127.9**
Raise the top rate on long-term capital gains and and qualified dividends to 24.4%	6.4	8.6	8.9	9.4	9.2	9.1	9.4	9.9	10.4	11.4	**92.7**
Tax carried interest as labor income	1.6	1.9	1.8	1.7	1.8	1.8	1.8	1.8	1.8	1.9	**17.9**
Increase IRS funding by $80B over the next ten years	-1.4	-0.8	3.4	9.5	17.4	25.6	31.8	34.4	35.1	34.9	**189.9**

Provision	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Budget window
Repeal the "Rebate Rule"	0.0	11.9	15.5	18.3	19.1	20.0	20.9	21.7	22.5	23.6	**173.5**
Total	**60.9**	**100.2**	**114.8**	**131.9**	**128.2**	**141.5**	**149.8**	**155.0**	**158.6**	**163.9**	**1,304.9**

Macroeconomic Effects

Each of the components of spending and taxation contributes differently to the proposal's overall effect on the U.S. economy.

Some spending programs, such as preschool and childcare programs increase productivity. These programs provide education at an earlier age and assist with childcare for lower income parents. These childcare and educational programs lead to a slight increase in labor productivity as caregivers gain flexibility to work more hours in a greater variety of jobs. Furthermore, additional preschool education leads to increases in productivity when affected children eventually enter the workforce.

Table 3 shows the combined effects of the different tax and spending policies in the proposal. Overall, the proposal leads to a fall in government debt of 1.2 and 1.8 percent in 2040 and 2050, respectively. Private capital declines by 0.8 and 0.9 percent in the same years, as additional government spending and higher tax rates offset the benefits of the lower government debt. The decline in private capital leads to less efficient workers which is reflected in lower wages. However, this effect is nearly offset by the productivity increases from the childcare, education, and public infrastructure investments.

Table 3. Macroeconomic Effects of Senator Manchin's Proposal

Percent Change from Baseline

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Year	GDP	Capital Stock	Hourly Wage	Hours Worked	Government Debt
2031	-0.1	-0.8	-0.1	-0.1	-0.3
2040	0.0	-0.8	-0.1	0.0	-1.2
2050	0.0	-0.9	-0.1	0.1	-1.8

Distributional Effects

Table 4 shows PWBM's dynamic distributional analysis using its dynamic model for the proposal. As described in PWBM's earlier dynamic distributional analysis of the Social Security 2100 Act, the equivalent variation for a policy reform is the one-time payment or charge to a person that makes that person indifferent between living in a world where the policy is enacted and a world with no policy changes. A positive equivalent variation means that the person would be better off under the policy reform; a negative equivalent variation means that the person would be worse off under the policy reform.

Table 4. Equivalent Variation for Senator Manchin's Proposal

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Age at start of simulation	Adjusted Gross Income (Percentile)				
	Bottom Quintile	Second Quintile	Middle Quintile	Fourth Quintile	Top Quintile
-15	$2,800	$2,400	$3,100	$6,000	$15,000
-10	$2,100	$2,200	$3,100	$5,200	$12,500
-5	$2,400	$2,200	$2,800	$4,300	$10,400
0	$2,100	$1,900	$2,200	$3,100	$7,700
5	$1,400	$400	-$800	-$3,500	-$10,600
10	$1,500	$300	-$1,200	-$4,300	-$12,200
15	$2,000	$1,100	-$700	-$3,900	-$12,900
20	$2,300	$1,500	$400	-$2,200	-$10,900
25	$5,600	$6,300	$3,900	$1,700	-$3,600
30	$3,200	$4,400	$3,400	$300	-$6,800
35	$1,400	$2,100	$500	$900	-$3,900
40	$600	$1,200	$700	-$300	-$4,600
45	$500	$800	$600	-$700	-$4,500
50	$100	$600	$500	-$500	-$4,000
55	$700	$1,400	$1,000	$400	-$2,700
60	$700	$1,800	-$900	$900	-$1,500
65	$400	$500	$200	-$600	-$900

-12,900 0 15,000

In the left column of Table 4, we show that people in the bottom 20 percent of income benefit from the proposal. For example, the average 30-year-old in this income group receives about $3,200 in total economic benefit because Pre-K and childcare programs in the proposal allow them to work more at higher wages. In contrast, the average 30-year-old in the top 20 percent of income distribution is about $6,800 worse off due to higher income taxes. Nonetheless, as government debt decreases (shown in Table 3), smaller tax increases are needed in the future to stabilize government debt, which benefits future high-income households.

This analysis was produced by PWBM staff. Report was written by Jon Huntley, Maddison Erbabian, and John Ricco. Prepared for the website by Mariko Paulson.

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1. The Bipartisan Infrastructure Framework delays the rebate rule through 2025; if passed, any potential budgetary savings from further delaying the bill would only accrue after 2025. ↩