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To Put Trickle-down Economics to Rest, We Need a New Tax Code

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Introduction

In 2017, former President Trump and congressional Republicans enacted sweeping changes to the tax code via the Tax Cuts and Jobs Act (TCJA). Many of the law's provisions were not made permanent, however, and hallmark changes to the individual income and estate tax will expire at the end of 2025.[1] As a result, a renewed debate over tax reform has kicked off among policymakers and will accelerate over the next year.

While the expiration of TCJA provisions creates an opportunity to revisit the tax code, today's tax reform conversation need not, and should not, be confined to the boundaries of the TCJA's provisions—with policymakers narrowly considering whether to return our tax code to its pre-2017 state or make current policy the permanent law of the land.

The path to the 2017 law was carved over more than four decades, under the false promise of trickle-down economics. As such, policymakers should view the tax debate as an opportunity to move the tax code beyond the failures of neoliberalism and cement an economic paradigm that rebuilds the middle class, rebalances power, and confronts racial and economic inequality.

The Reagan administration's embrace of supply-side economics underpinned its intense focus on tax reform (see Prasad 2019). Beginning with the Economic Recovery Tax Act of 1981 (ERTA)—enacted less than seven months into his tenure—former President Reagan slashed taxes for individuals, especially at the top end of the income distribution, and corporations. As his argument went, these cuts for high-income Americans and corporations, and those that followed during his administration, would trickle down, creating jobs and spurring economic growth that would lift all boats.

Yet we've seen the opposite unfold. Since 1980, inequality has soared. Mid—20th century progress on narrowing racial wealth and wage gaps stalled, and in some cases reversed course. Concentration and consolidation of economic power has exploded. Tax revenue, as a share of GDP, has plummeted. Corporations have shifted away from investing in innovation and workers and toward maximizing returns to shareholders. Mounting evidence suggests that tax cuts for the wealthy make the rich richer and have little effect on economic growth

[1] For a description of expiring provisions, see Joint Committee on Taxation 2018a. Notably, the decrease in the corporate tax rate (from 35 percent to 21 percent) was made permanent. Conversely, tax cuts for middle-class families, such as the doubling of the standard exemption and the increase in the Child Tax Credit, were intentionally sunsetted to conform with Senate budget reconciliation rules that required them to offset revenue loss from the corporate tax cut. The primacy of corporate tax cuts relative to other TCJA reforms is illustrative of the chokehold neoliberalism has on the tax debate among policymakers in Washington.

or employment.[2] Further, a growing body of literature finds that rising inequality constrains economic growth.[3]

Nevertheless, federal policymakers across the ideological spectrum continued to support and enact massive tax cuts for corporations and the wealthy during the some-40 years between the ERTA and the TCJA. Former President Clinton slashed the capital gains tax rate. Former President W. Bush lowered tax rates across the board for labor income, capital gains, and estates. Former President Obama made a majority of the W. Bush tax cuts permanent. Save for a few oscillations in various tax rates and bases since then, the trickle-down fallacy, despite mounting evidence against it, remains the bedrock of our tax code. While tax policy certainly isn't to blame for every economic problem of the past four-and-a-half decades, it quarterbacked the neoliberal era.

Since assuming office, President Biden has hearkened back to an earlier era of tax policy, proposing tax increases primarily levied on wealthy individuals and corporations (Treasury Department 2021), though only two have been enacted. That approach is part of a broader shift away from neoliberalism in the Biden administration's economic agenda, which has instead favored industrial policy, worker empowerment, and marketcrafting (see Tucker et al. 2023, Wong et al. 2024, and Hughes and Spiegler 2023). Biden has expanded the ambitions of his tax agenda throughout his first term, though many of his proposals are still anchored to the TCJA, simply adjusting rates between pre- and post-TCJA levels. His administration has said it supports extending some expiring TCJA provisions that, if allowed to sunset, would increase taxes for Americans making less than $400,000 per year (Condon 2024).

The jury is still out on whether the recent shift in policymaking toward a new economic paradigm will be short-lived or lasting. But given tax policy's outsized role in the reign of neoliberalism, reforming the tax code is an essential component for its lasting demise. If policymakers narrowly focus on tinkering within the confines of the TCJA, we compromise the opportunity for enduring change.

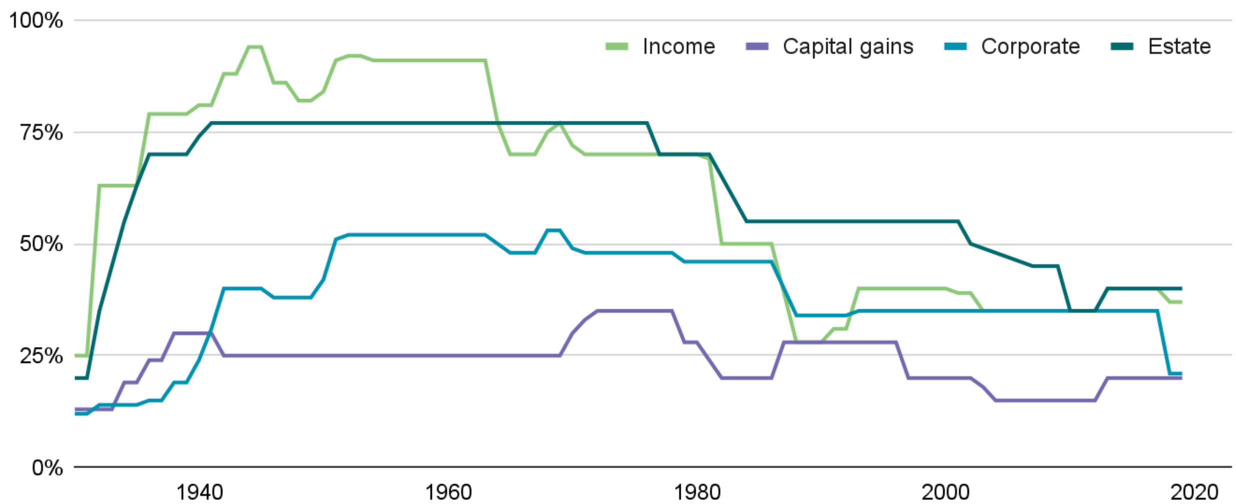
[2] See, for example, Harris Bernstein 2016; Hope and Limberg 2020; Kindsgrab 2022; Zidar 2019; Piketty, Saez, and Stantcheva 2014; Furman 2020; Gale and Haldeman 2021; Howell 2013; Hungerford 2012; Tanden 2013; and Avi-Yonah, DiVito, and Lusiani 2024.

[3] See, for example, Bivens and Banerjee 2022; Bivens 2017; Alici, Kantenga, and Sole 2016; Stiglitz 2018; Furman and Stiglitz 1998; and Ostry, Berg, and Tsangarides 2014.

The Neoliberal Tax Code's Path of Destruction

Between 1981 and 2017, trickle-down economics infiltrated the tax code through a series of tax cuts, heavily skewed toward corporations and the wealthy. The average tax rate for taxpayers in the top 0.1 percent fell from 42.2 percent in 1980 to 33.2 percent in 2018, compared to a reduction from 29.8 to 25.4 percent for median-income taxpayers and a slight increase from 22.2 to 24.2 percent for those in the bottom 10 percent. These cuts atrophied federal revenue streams. Following the ERTA, the share of revenue from corporate income taxes fell to a historic low in 1983 (6.2 percent), a reigning record until 2018, after the TCJA slashed the corporate tax rate by 40 percent (Tax Policy Center 2023c). Several significant cuts to the estate tax reduced the number of taxpayers subject to it from approximately 28,000 in 1982 to 2,600 in 2021 (Steele 2022). Beyond severe reductions in tax rates, there was a significant weakening in enforcement that led to a massive increase in tax avoidance.[4]

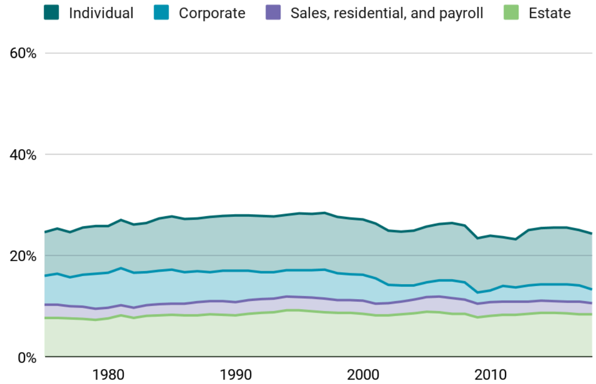
Historic Top Tax Rates by Type



Source: Saez and Zucman (2019)

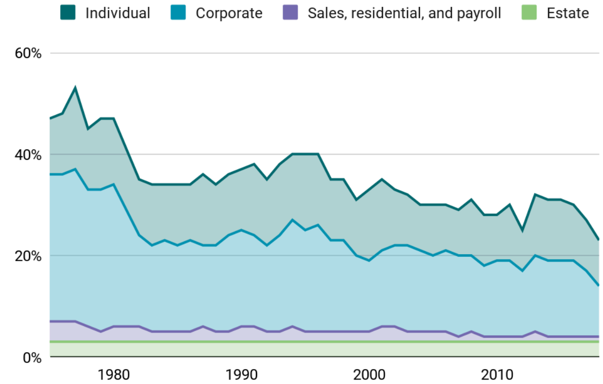
[4] See, for example Dubin et al. 1990; Leviner 2009; Willis 1997; Gale and Krupkin 2019; and Schechter 2021.

Average Tax Rate by Tax Type for the Bottom 50% Over Time



Source: Saez and Zucman (2019)

Average Tax Rate by Tax Type for the Top 400 Over Time

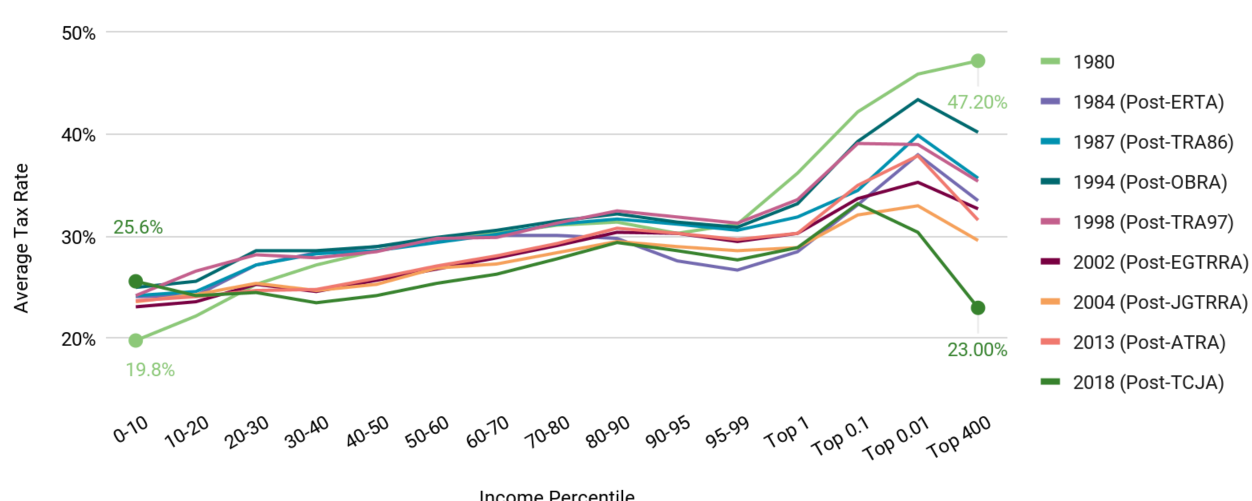


Source: Saez and Zucman (2019)

Despite mounting evidence after each law that the promise of job creation, wage increases, and economic growth failed to materialize, policymakers continued to enact further tax cuts—save for one brief experiment by the Clinton administration, described below. And far from trickling down, these tax cuts instead padded the pockets of wealthy shareholders, either by directly reducing their tax liability (e.g., capital gains and estate tax cuts) or incentivizing corporate behavior that benefited them (e.g., corporate profit and dividend tax rate cuts).

Average Tax Rates by Income Group after Tax Legislation between 1980 and 2018

While tax rates at the bottom have stayed relatively stable, or slightly increased, since 1980, tax rates for the wealthy have severely declined.



Source: Saez and Zucman (2019)

Between 1930 and 1980, the top marginal federal income tax rate averaged 78 percent (Tax Policy Center 2023c). In 1981, ERTA slashed the highest marginal income tax rate from 70 percent to 50 percent and reduced the capital gains tax rate by 40 percent (Joint Committee on Taxation 1981). Individual income tax revenue in 1983 was about $40 billion ($127 billion in today's dollars) lower than it would have been in the absence of the 1981 cuts (Congressional Budget Office 1986).

From 1951 to 1986, the top corporate tax rate ranged from 46 percent to 52.8 percent (Tax Policy Center 2024). The Tax Reform Act of 1986 (TRA86) reduced the top corporate tax rate from 46 percent to 34 percent and further reduced the top marginal income rate from 50 to 28 percent, the largest single drop in history (Joint Committee on Taxation 1987). By 1990, taxes for the top 1 percent had fallen by more than one-fifth (Congressional Budget Office 2022) and by nearly one-quarter for the richest 400 families over the decade (Saez and Zucman 2019).

When President Clinton took office, he initially took aim at the neoliberal tax regime. In 1993, when he signed the Omnibus Budget Reconciliation Act of 1993 (OBRA), Clinton claimed "after 12 years of trickle-down economics where taxes were lowered on the wealthiest Americans [and] raised on the middle class . . . we now have real fairness in the tax code" (Clinton 1993). OBRA raised the top marginal income tax rate to 39.6 percent and increased the top corporate tax rate to 35 percent—making a dent in, but far from reversing, the massive Reagan-era cuts—and applied the Medicare payroll tax to all wages (Joint Committee on Taxation 1993). Average tax rates on the top 1 percent increased significantly during Clinton's first term, from 29.6 percent to 34.8 percent (Congressional Budget Office 2022). By 1995, tax rates for the richest 400 families were the highest they had been since 1981 (Saez and Zucman 2019). GDP also saw a bump, growing at a 3.9 percent average annual rate during the seven years following tax hikes targeted at corporations and the wealthy, compared to 3.5 percent during the seven years following the ERTA (Tanden 2013).

That rejection of a trickle-down approach to taxation didn't last long. Four years later, Clinton embraced neoliberalism and signed into law the Taxpayer Relief Act of 1997 (TRA97), which further reversed previous increases in the capital gains tax rate—reverting to ERTA's 28 percent—and nearly doubled the estate tax exemption (Brumbaugh 1997). By the end of the Clinton administration, average tax rates on the top 1 percent ticked down to 32.2 percent, and income inequality hit a 20-year high (Congressional Budget Office 2022).

Former President Bush doubled down on the trickle-down fallacy. The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) cut income tax rates, including reducing the top marginal income rate to 35 percent—reversing the increase to 39.6 percent under

President Clinton—and significantly reduced the estate tax (Horton 2017). The Jobs and Growth Tax Relief and Reconciliation Act of 2003 (JGTRRA) further reduced the capital gains tax rate to 15 percent and established a 15 percent rate for dividends, which were previously taxed as ordinary income (Horton 2017). By 2011, the top 1 percent received 38 percent of the benefits of the Bush-era tax cuts—$700,000 in total over the course of a decade (Fieldhouse and Pollack 2011). These tax cuts raised the income of the top 1 percent of households by 6.7 percent, compared to 2.8 percent for the middle 20 percent and just 1 percent for the bottom 20 percent (Jacoby 2023).

Unsurprisingly, economists found no evidence that these tax credits generated economic growth (Gale and Samwick 2016). In fact, real wages fell by 2.3 percent between 2002 and 2007 (Fieldhouse and Pollack 2011). During the Bush administration, GDP growth averaged 2.5 percent per year and total jobs grew by 0.8 percent, despite considerable "growth-inducing" tax cuts. Comparatively, when the top marginal income tax rate was consistently above 90 percent and the corporate tax rate was 52 percent during the Eisenhower administration, annual GDP growth averaged more than 4 percent, and employment grew by 7.1 percent (Tanden 2013).

While the American Taxpayer Relief Act of 2012 (ATRA) let the W. Bush-era tax cuts expire for high-income taxpayers, it made permanent the sweeping cuts to the estate tax (Joint Committee on Taxation 2013). TCJA further eroded the estate tax, exempting the first $11 million passed down to each heir from taxes (Joint Committee on Taxation 2017). Between 1993 to 2017, the top corporate tax rate remained at 35 percent until the TCJA slashed it to a flat rate of 21 percent—the lowest it had been since 1939, at the end of the Great Depression.[5] Finally, the TCJA cut the top marginal income tax rate to 37 percent, dramatically increased the exemption for the Alternative Minimum Tax, and created a new deduction for pass-through income.

These massive cuts did wonders for the wealthiest taxpayers. Between 2016 and 2018, the average tax rate for the top 5 percent fell by 9.5 percent, by 19 percent for the top 0.01 percent, and by 25 percent for the richest 400 (Saez and Zucman 2019). Corporate income tax revenue as a share of GDP dropped by more than one-third (Tax Policy Center 2022).

The TCJA did little to spur new business investment, and it had a modest, if any, effect on GDP (Gale and Haldeman 2021). The pass-through income deduction, for which half of benefits go to households earning more than $1 million per year (Joint Committee on Taxation 2018b), provided no boost to economic activity—no wage increases, no new jobs, and no additional

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[5] In addition to reducing the rate, the TCJA eliminated the graduated structure of the corporate income tax, applying the 21 percent rate for all corporate profits.

investment—in the two years following the TCJA's enactment (Goodman et al. 2023). Further, research suggests that wage increases failed to trickle down: Increases in earnings stemming from the law have been concentrated among executives and companies' highest-paid workers, and workers in the bottom 90 percent have realized no wage gains (Kennedy et al. 2022). Eighty-one percent of wage gains from the corporate tax rate cut went to the top 10 percent of workers (Kennedy et al. 2022).

Who Benefits from the Trickle-down Tax Code

At the time Congress was considering TRA86, Daniel Halperin, assistant treasury secretary during the Ford administration, estimated that over 40 percent of American families would have either a tax increase or no change, and that the "biggest winners" would be people with the highest incomes (Steele 2022). His predictions were borne out almost immediately. Prior to Reagan's second set of tax cuts, taxpayers reporting at least $1 million in income paid an average income tax of $910,931, and by 1988, that same group paid $226,000 less, on average. Taxpayers earning $40,000 in income received an average tax cut from TRA86 of $603, and those earning between $500,000 and $1 million retained an additional $73,617 (Steele 2022).

This pattern of tax cuts overwhelmingly tilted in favor of the already wealthy continued for the next forty years. Though W. Bush-era tax legislation included modest tax cuts for most Americans, wealthy households reaped the vast majority of benefits. After-tax income for the bottom 20 percent of households increased by just 1 percent by 2010, compared to 4.6 percent for the top 20 percent and 6.7 percent for the top 1 percent (Horton 2017). In 2019 alone, the preferred tax rate for dividends, enacted in 2003, saved taxpayers earning $1 million or more a total of $16.2 billion.

The TJCA has only supercharged these trends. As a result of the TCJA, households in the top 1 percent will receive an average tax cut of more than $61,000 in 2025, compared to an average tax cut of less than $500 for households in the bottom 60 percent (Tax Policy Center 2017). The wealthiest 1 percent of taxpayers enjoy a larger tax cut in a single day ($131) from the TCJA than the poorest 20 percent families get in an entire year ($90) (Nieves et al. 2018). Because of the racial disparities in wealth and income distributions in the US, tax cuts tilted in favor of the wealthy overwhelmingly benefit white Americans. In 2018, researchers estimated that 80 percent of the benefits from the first year of the TCJA's tax cuts would go to white households (Nieves et al. 2018).

Tax cuts since 2018 have cumulatively saved the richest 20 percent of Americans nearly $3.5 trillion, with the top 1 percent reaping 22 percent of benefits. The top 5 percent benefited more than the bottom 80 percent combined (Wamhoff and Gardner 2018).

Consequences of the Trickle-down Tax Code

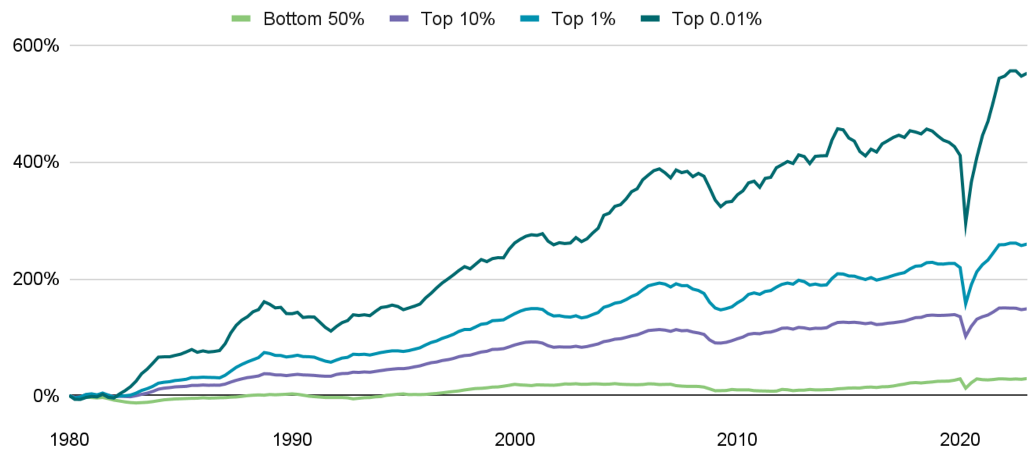
Reagan and his successors' claims that economic growth would trickle down from the top as a result of tax cuts for the wealthy and corporations never came to fruition. Instead of prompting investments in workers and business expansion, corporations increased returns to shareholders (Chang et al. 2023). The top capital gains rate has remained significantly lower than the top marginal income tax rate, shifting incentives toward investment income and away from labor income.

History has repeated itself with the TCJA. Trump administration press secretary Sarah Huckabee Sanders claimed that more than 70 percent of the TCJA's corporate tax cut would be returned to workers (Popken 2018). Instead, the TCJA led to an 88 percent increase in stock buybacks (Chang et al. 2023). GDP and employment growth due to recent tax cuts, as reviewed in the previous section, were modest at best.

The proliferation of neoliberalism in the tax code has fueled inequality. Between 1980 and 1983, real after-tax income among the bottom 50 percent declined by roughly 3 percent, while it increased by approximately 23 percent for those in the top 1 percent (Congressional Budget Office 1986). For those in the top 1 percent, income increased by 42.4 percent between 1980 and 1983, compared to an average 24.5 percent increase—the difference entirely explained by capital gains (Congressional Budget Office 1986). In 1980, the top 4 percent of taxpayers earned as much as the bottom 39 percent. By 2019, the top 4 percent earned as much as the bottom 57 percent (Steele 2022).

From 1980 to 2023, pre-tax income among the bottom 50 percent of Americans grew by 29.2 percent. Over the same period, it grew by nearly 150 percent for the top 10 percent, nearly tripled for the top 1 percent, and grew by a factor of nearly six for the top 0.01 percent (Blanchet, Saez, and Zucman n.d.). For workers in the bottom 50 percent, that equates to an increase of less than $6,000 per year, compared to $37 million per year for the top 0.01 percent.

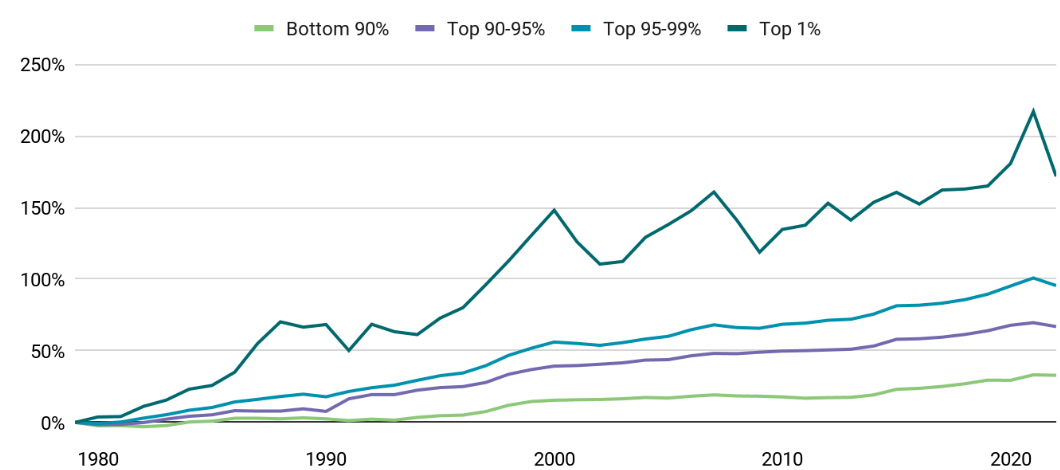
Real Pre-Tax Income Growth since 1980 by Income Group



Source: Blanchet, Saez, and Zucman (n.d.)

Despite the prolific claims that trickle-down tax cuts would raise wages for workers, this has failed to materialize beyond the highest wage earners, significantly increasing wage inequality. Between 1979 and 2022, average wages for the bottom 90 percent of American workers grew by 33 percent. Wages nearly doubled for the top 1 percent and more than tripled for the top 0.01 percent (Gould and Kandra 2023). In 1980, the top 10 percent earned 9.1 times more than the bottom 90 percent. By 2018, that gap had grown by 39 percent (Horowitz Menasce, Igielnik, and Kochhar 2020).

Real Wage Income Growth since 1979 by Income Group

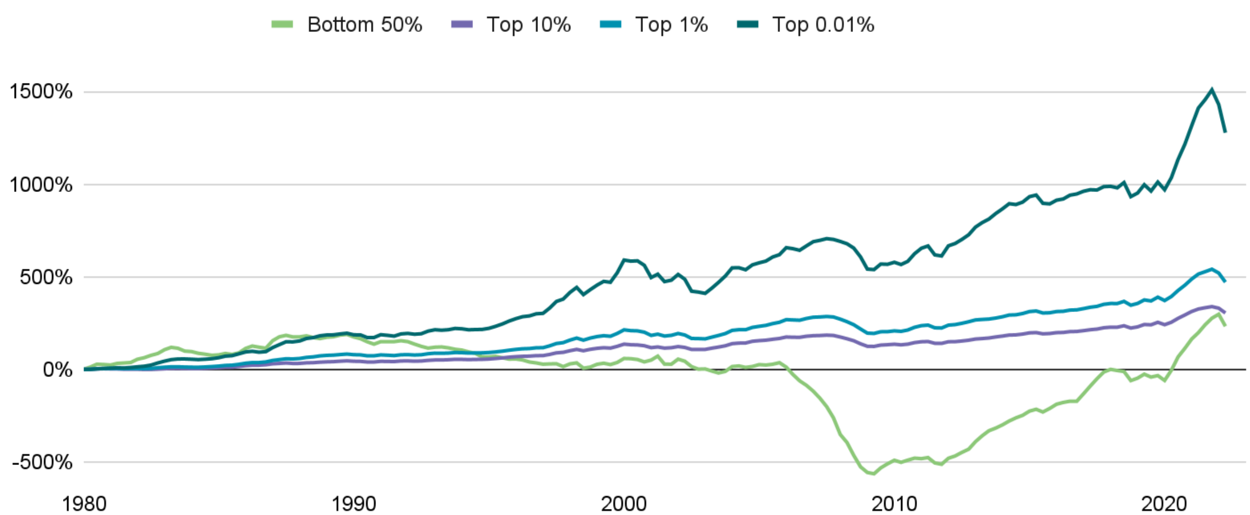


Source: Gould and Kandra (2023)

While the promise of trickle-down economics has failed on most measures, it has demonstrably succeeded in significantly worsening racial inequality. The Black-white wage gap shrunk substantially between 1950 and 1980, coinciding with the civil rights movement, minimum wage increases, and strong union density. However, since 1980, the wage gap has increased, erasing all gains since 1950 (Leonhardt 2020). The Black-white and Hispanic-white wage gaps have grown by 30 percent and 44 percent, respectively, since 1979. Though there has been some progress in narrowing racial wage gaps over the last five years, large gaps persist. The middle 20 percent of Black workers make 79 cents for every dollar their middle-wage white peers earn—compared to 83 cents in 1979. Middle-wage Hispanic workers make 75 cents for every dollar their middle-wage white peers earn—compared to 81 cents in 1979 (Gould and deCourcy 2024).

In addition to fueling income inequality, tax cuts for the wealthy have exacerbated wealth inequality. Since 1980, real wealth among the bottom 50 percent of Americans has grown by 233 percent ($9,000 per person). For the top 10 percent, it's grown by 305 percent ($3.7 million), approximately 470 percent ($18.6 million) for the top 1 percent, and by a factor of nearly 13 ($520 million) for the top 0.01 percent (Blanchet, Saez, and Zucman n.d.). There are now more than 800 billionaires in the US, and they own over 50 percent more wealth than the entire bottom 50 percent of Americans, amounting to about 65 million households ($5.8 trillion compared to $3.7 trillion) (Americans for Tax Fairness 2024).

Real Wealth Growth since 1980 by Income Group



Source: Blanchet, Saez, and Zucman (n.d.)

As of 2018, the wealthiest 10 percent of American households held 88 percent of all stocks, compared to 0.6 percent held by the bottom 50 percent (Board of Governors of the Federal Reserve System 2024). Given that corporations have favored using tax savings for shareholder returns rather than wage increases and job creation, it is unsurprising that tax cuts have fueled wealth inequality. Further, erosion in the estate tax has incentivized the wealthy to hoard their assets and pass them down, significantly reducing the tax penalty for the appreciation.

While the racial wealth gap has always existed, significant convergence between Black and white wealth occurred between 1950 and 1970; since 1980, however, progress has stalled, with white Americans having accrued 0.65 percentage points more per year in asset appreciation than Black Americans (Derenoncourt et al. 2022). Today, the typical Black household holds just 10 cents for every dollar the typical white household owns.

The failure of trickle-down economics has hit Black families hardest through two key mechanisms. First, two-thirds of the racial wealth gap can be accounted for by the wage gap (Barsky et al. 2002), which recent tax cuts have, at best, stalled progress on closing. Second, two-thirds of Black wealth is from housing assets, rather than stock ownership and retirement assets, which account for just 2 and 14 percent of Black wealth, respectively (Dean 2024). As a result, they benefited far less from tax-cut-fueled returns to shareholders over the past 40 years than white Americans. The upcoming tax policy debate must confront the racial inequities in the tax code, which existed long before the TCJA—and will persist if policymakers narrowly reform the tax code.

Conclusion

In 1985, as he rallied the American public behind a wave of tax cuts, President Reagan promised that "by lowering everyone's tax rates all the way up the income scale, each of us will have a greater incentive to climb higher, to excel, to help America grow" (Reagan 1985). That false promise fueled nearly five decades of tax reform that delivered for the very wealthy and large corporations, but withered the working class. The upcoming opportunity to reform the tax code should go further than merely addressing TCJA expirations: It should confront the legacy of neoliberalism woven in our tax system and reimagine a progressive tax code that promotes equitable growth, incentivizes investment in workers and innovation, and rebalances economic power.

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