

THE AMERICAN ECONOMY IN A NEW ERA



EXECUTIVE SUMMARY

\$15 Trillion on the Table in 2039: Ordinary Taxes to Meet an Extraordinary Fiscal Moment

by Kimberly Clausing and Natasha Sarin

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Introduction

The US is facing an unsustainable fiscal outlook. The federal debt-to-GDP ratio passed 100 percent in March 2026 and is projected to reach nearly 130 percent by 2039. In this paper, Kimberly Clausing and Natasha Sarin argue that achieving fiscal sustainability will require tax increases that can be implemented via a number of ordinary tax instruments, rather than through untested mechanisms or particularly high tax rates. They identify five buckets of time-tested reform options that together would generate \$15 trillion (roughly 3.3 percent of GDP) in revenue over the 2030–2039 budget window, highlighting three—corporate tax reforms, Internal Revenue Service (IRS) funding, and sin taxes—as top priorities capable of stabilizing the debt-to-GDP ratio through the mid-2050s.

In doing so, the authors push back against two common misperceptions about tax policy. First, they reject the idea that the US can continue funding government programs and spending obligations without significantly increasing tax revenue. Second, they dispute the notion that novel tax instruments are needed to raise meaningful revenue. While policy proposals such as wealth taxes face steep legal and implementation hurdles, well-established tax mechanisms can accomplish the same goals.

The Current Fiscal Picture

The nation's deteriorating fiscal position is largely due to the failure of political leaders of both parties to take the hard steps required to trim deficits: the last major policy-based effort at deficit reduction occurred in the 1990s with a series of bipartisan reforms. Since then, policymakers have taken the politically easier path of cutting taxes and raising spending—instead of undertaking the harder opposite actions. As a result, US debt is currently high in both historical and comparative terms, and interest costs have risen to roughly \$1 trillion per year, an amount that exceeds the US defense budget.

The authors argue that deficit reduction is important for four reasons. First, unsustainable fiscal trajectories can raise interest rates, increasing costs for households through higher consumer debt costs, mortgage payments, and small business loan payments. Second, the accumulation of deficits entails large intergenerational transfers that harm future taxpayers relative to past taxpayers. Third, high debt levels can reduce the “fiscal space” that governments have to respond to unforeseen events such as pandemics, recessions, or wars. Finally, while a fiscal crisis is unlikely at any particular moment, any crisis brings large and damaging consequences for the entire economy, bolstering the case for prudential fiscal policy.

To reduce the deficit, Clausing and Sarin propose a menu of options for raising revenue. They focus on the revenue side of the budget, rather than propose spending cuts, because in their view, most spending is in areas that are difficult to trim. In fiscal year 2026, Social Security, Medicare, Medicaid, national defense, and interest on existing debt account for 74

percent of government fiscal expenditures. Another 13 percent is committed to other mandatory programs, such as veterans' benefits and the Supplemental Nutrition Assistance Program (SNAP), leaving little room for meaningful cuts.

In contrast, there are meaningful opportunities to raise revenue. The US currently ranks 32nd out of 38 OECD countries in tax revenue collected relative to GDP, in part due to a series of tax cuts over the past 25 years that have reduced federal tax collections by more than \$300 billion per year. One benefit of the country's low-tax status, Clausing and Sarin point out, is that there are plentiful options for tax revenue that can be collected in ways that are unlikely to be highly distortionary.

Five Revenue Buckets

Clausing and Sarin divide their policy proposals into five buckets: corporate and international tax reform; investment in the IRS; a robust sin tax agenda; adjustment of individual income tax parameters; and personal capital income taxation reform.

Bucket 1: Reform corporate taxation to meet the challenges of the modern global economy. The corporate tax is a flexible tool that automatically collects more tax on companies with excess profits, wherever they arise. Taxing corporate income is also highly progressive and achieves goals similar to those of individual-level capital taxes, such as taxes on wealth or unrealized capital gains, because most top wealth originates in businesses. The authors propose raising the corporate rate to 27 percent for the largest-profit taxpayers, covering less than 2 percent of firms, with a surtax of 2.7 percentage points for less than 0.5 percent of firms. These higher headline rates would need to be coupled with international tax reforms to prevent profit shifting.

Bucket 2: Invest in the IRS. The IRS has lost nearly 28,000 employees since January 2025, including approximately 31 percent of its auditing staff, and is currently operating at a staffing level not seen since the 1960s. The agency's enforcement capacity has also long been eroding, with audit rates for high-income taxpayers declining from 16.5 percent in 2010 to 2 percent in 2021. The authors propose investing \$80 billion in the IRS over the ten-year budget window, which would strengthen the agency's capacity and allow more than \$1 trillion in revenue already owed under current law to be collected.

Bucket 3: Expand tax efficiency and revenue through new "sin" taxes. While excise taxation of harmful activities such as gambling and pollution is often criticized for being paternalistic, the long-term internal and external harms of these activities ultimately justify their use. Clausing and Sarin propose two measures. The first is a gambling tax of 5 percent on the value of sports wagers, accompanied by a tax on prediction market winnings. The second is a tax on carbon emissions that begins at \$40 per metric ton and rises by 5 percent in real terms over the budget window, which would raise substantial revenue and align the US with global emissions-reduction efforts.

Bucket 4: Adjust income tax parameters. Clausing and Sarin explore a number of adjustments to individual income tax parameters, including returning individual rates to 1990s levels for most taxpayers, while leaving the bottom two tax brackets at current levels, and repealing the pass-through business income deduction under Section 199A. Repealing the Section 199A deduction would improve horizontal equity by treating labor and capital income more similarly, reducing incentives for economically unproductive forms of tax planning.

Bucket 5: Reform capital income taxation. Capital income's preferential tax status under current law is both regressive and inefficient, allowing much of the income accruing to the wealthiest Americans to escape taxation entirely. At the top of the income distribution, wages and salaries taxed at ordinary rates make up a small share of income. Capital gains and dividends, which make up the majority, enjoy lower statutory rates, benefit from deferral until realization, and can escape taxation altogether through step-up in basis at death. The authors propose raising tax rates on long-term capital gains and dividends by 5 percentage points. Complementary reforms include ending step-up in basis at death, moving to carryover basis, broadening the estate tax base by lowering thresholds, and closing commonly used tax loopholes such as the carried interest loophole. Importantly, this suite of reforms is time-tested and can be implemented without requiring novel infrastructure.

Meeting the Fiscal Moment

By the authors' estimation, the five buckets would raise nearly \$15 trillion (approximately 3.3 percent of GDP) over the ten-year budget window. The authors argue that the first three buckets—corporate and international tax reform, investment in the IRS, and a robust sin tax agenda—provide the most compelling combination of revenue potential, economic efficiency, and political feasibility, and would generate nearly \$7 trillion (about 1.6 percent of GDP) over the same window.

Importantly, the distributional effects of the full five-bucket package remain highly progressive. Increased tax burdens at the bottom of the income distribution are largely driven by increases in sin taxes, as consumption-based taxes are regressive. However, there are numerous ways policymakers could offset this increased tax burden, including allocating revenue to poverty-reduction efforts such as the Earned Income Tax Credit (EITC) and Child Tax Credit (CTC).

Using the Yale Budget Lab's Small Macro Model, the authors find that a \$7.5 trillion package would roughly stabilize the debt-to-GDP ratio through the mid-2050s, while a \$15 trillion package would bring the debt-to-GDP ratio down to approximately 57 percent by 2056. They point out that lower debt also reduces US borrowing costs: by 2056, ten-year Treasury yields are about 1 percentage point lower under the \$7.5 trillion scenario and about 2 percentage points lower under the \$15 trillion scenario.

Comparing to Other Reform Options

The authors note that their approach is complementary to other reform proposals, such as that of Zidar and Zwick (2023), whose proposal is similarly based on the view that time-tested tax policy instruments are well-suited to address the country's fiscal challenges. Both proposals also emphasize that, since business income is a sizable portion of the overall tax base and particularly of the income and wealth that accrue to those at the top of the distribution, reforming the business tax code can achieve many desirable revenue and progressivity objectives.

Clausing and Sarin would address wealth inequality through reforms to the existing corporate tax system. This approach would achieve revenue-generation and progressivity objectives without the legal uncertainty associated with novel instruments such as a wealth tax or tax on unrealized capital gains. The authors also reject calls to adopt a destination-based cash flow tax (DBCFT) because while such a tax shares many of the same objectives as the corporate reforms they favor, they view international coordination around such a reform as unlikely. They further note that unilateral adoption by the US risks double-tax and double-nontax outcomes, as well as significant business disruption and a large currency appreciation that is unlikely to be desirable.

ABOUT THE AUTHORS

Kimberly Clausing

Eric M. Zolt Chair in Tax Law and Policy, UCLA School of Law; Nonresident Senior Fellow at Peterson Institute for International Economics

Kimberly Clausing holds the Eric M. Zolt Chair in Tax Law and Policy at the UCLA School of Law. Professor Clausing is also a nonresident senior fellow at the Peterson Institute for International Economics, a member of the Council on Foreign Relations, a research associate at the National Bureau of Economic Research, and a research fellow at the Center for Economic Policy Research. During the first part of the Biden Administration, Clausing was the Deputy Assistant Secretary for Tax Analysis in the US Department of the Treasury, serving as the lead economist in the Office of Tax Policy. Professor Clausing's research examines how government decisions and corporate behavior interplay in the global economy. She has published numerous articles on taxation, climate policy, and international trade, and she is the author of *Open: The Progressive Case for Free Trade, Immigration, and Global Capital* (Harvard University Press, 2019). Clausing has worked on economic policy research with the International Monetary Fund, the Hamilton Project, the Brookings Institution, the Tax Policy Center, and the Center for American Progress. She has testified before the House Ways and Means Committee, the Senate Committee on Finance, the Senate Committee on the Budget, and the Joint Economic Committee. Professor Clausing has received two Fulbright Research awards (to Belgium and Cyprus), and her research has been supported by external grants from the National Science Foundation, the Smith Richardson Foundation, the International Centre for Tax and Development, the U.S. Bureau of Economic Analysis, and the Washington Center for Equitable Growth. Professor Clausing received her B.A. from Carleton College in 1991 and her Ph.D. from Harvard University in 1996, both in economics.

ABOUT THE AUTHORS

Natasha Sarin

Professor of Law, Yale Law School; President and Co-Founder, The Budget Lab at Yale

Natasha Sarin is a Professor of Law at Yale Law School with a secondary appointment at the Yale School of Management in the Finance Department. She is also the President and Co-Founder of the Budget Lab at Yale. Previously, Natasha served as Deputy Assistant Secretary for Economic Policy and later as a Counselor to Treasury Secretary Janet Yellen at the United States Treasury Department. Her work focused on narrowing the gap between the taxes owed by the American public and those collected by the Internal Revenue Service. Prior to her government service, Sarin was a Professor at the University of Pennsylvania Carey Law School and the Wharton School. Her research centers on public finance and financial regulation, with work on tax policy, household finance, insurance, and macroprudential risk management. Her scholarship has been covered in *The New York Times*, *The Washington Post*, and the *Financial Times*, among other publications. Natasha is a Washington Post contributing columnist and a frequent guest on CNBC's Squawk Box.

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