Fiscal Therapy: Curing America’s Debt Addiction and Investing in the Future

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The Bottom Line

• America faces two intertwined problems
  • Rising debt
  • Lagging investment

• Three-part solution
  • Control entitlements (preserve anti-poverty and social insurance features)
  • Boost children’s programs, human capital, infrastructure, and research
  • Raise and reform taxes
Debt/GDP, 1790-2018

Percentage of GDP

106% World War II
78% Great Recession

Events:
- Revolution
- War of 1812
- Civil War
- World War I
- Great Depression
- Reagan
This Time is Different
A Fiscal Policy Rorschach Test

Source: Gale (2019)
The Changing Composition of Spending

- Healthcare: 8.5%
- Net Interest: 6.7%
- Social Security: 6.1%
- Non-Defense Discretionary: 2.6%
- Defense: 2.1%
- Other Mandatory: 2.1%
Effects of Debt on the Economy

• Not all debt is bad

• Not a crisis

• But our long-term debt situation is still a problem
  • Economic
  • Political / Fiscal space
A Debt Target

• 60% of GDP by 2050
  • Average over the business cycle
  • Higher than historical average (36% between 1957-2007)
  • Not zero debt / not a balanced budget rule

• Subjective and objective considerations
  • Balancing the “Blessing” and the “Curse”
  • Intergenerational burdens
  • How the resources are used
  • Current debt level (initial conditions)
  • Consider productivity, population, interest rates
Will Future Generations be Better Off than We Are?

Source: Chetty, et al. (2016)
Fiscal Gap = 4.0% of GDP
(To reach Debt/GDP = 60% by 2050, starting in 2021)
Healthcare and Social Security

• Healthcare
  • Expand coverage – reinstate the mandate (or equivalent), provide public option, expand Medicaid
  • Control costs – premium support in Medicare, provider payment reform, let Medicare negotiate drug prices and formulary

• Social Security (BPC Plan)
  • Raise retirement age and index benefits with chained CPI
  • Make annual benefits more progressive
  • Raise payroll tax rates and the payroll tax cap
Invest in the Future

• Extra 1% of GDP to strengthen social policy
  • Invest in children, child care, and education
  • Patch current holes and raise take-up rates
  • Provide job training and (if required for eligibility) jobs
  • Make work pay better

• Infrastructure/R&D
  • Invest an added 0.5% of GDP in infrastructure (to meet ASCE goals)
  • Double federal R&D relative to today’s share of GDP
Raise and Reform Taxes

• Carbon tax – $30 per ton rising at 5% above inflation (McKibbin, et. al), with offsets
• Value-added tax – 10% rate, with offsets

• Business taxes
  • Repeal TCJA pass-through provisions (or let them expire)
  • Raise corporate tax to a 25%, convert to “cash flow” tax
  • Revisit international rules

• Personal taxes
  • Close capital gains loopholes, raise capital gains rates
  • Repeal TCJA rate cuts and bracket changes (or let them expire)
  • Replace MID with a first-time homebuyers’ tax credit
  • Estate tax reform/inheritance tax

• Increase IRS funding and enforcement
Fiscal Outcomes under the Baseline

![Graph showing fiscal outcomes under the baseline. The graph illustrates the trends in Total Spending, Non-Interest Spending, Revenues, and Deficit from 2018 to 2048. The data source is Gale (2019).]
Fiscal Outcomes under the Proposal

[Graph showing trends in Total Spending, Non-Interest Spending, Revenues, and Deficit from 2018 to 2048.]

Source: Gale (2019)
Fiscal Outcomes under the Proposal
Fiscal Outcomes under the Proposal

Source: Gale (2019)
Fiscal Outcomes under the Proposal
Debt/GDP under the Proposal

- Baseline
- Proposal
- Revolution
- War of 1812
- Civil War
- World War I
- Great Depression
- World War II
- Reagan
- Great Recession
- Baseline
- Proposal

179%
Effects

• Raise Growth
  • Reduced debt
  • Corporate tax changes
  • Increased infrastructure and R&D
  • Increased investment in children, safety net, jobs/education

• Reduce inequality and increase mobility
  • Progressive tax changes
  • Increased investment in children, safety net, jobs/education

• Honest/transparent plan
  • Specified changes
  • Realistic and administrable reforms
  • No growth effects included in budget estimates
Critiques – 1

- Measure fiscal burden by net interest/GDP not debt/GDP
Critiques – 2

• Measure fiscal burden by net interest/GDP not debt/GDP

• From the right – right problem, wrong solution
Critiques – 3

• Measure fiscal burden by net interest/GDP not debt/GDP

• From the right – right problem, wrong solution

• From the left – great solution, but deficits aren’t a problem
  • Because of low interest rates
The Politics of Deficits, The Deficits of Politics

• Debt reduction is a classic “Olson” problem
  • Concentrated costs, diffuse benefits
  • Schultze: Hippocratic Oath for politicians

• Public opinion is conflicted

• No New Taxes pledge complicates any discussion

• Structure of government makes major change difficult

• Partisanship, polarization, tribalism … no trust

• No crisis

• No leadership
But There is Hope

• Fiscal sustainability is consistent with both conservative and liberal goals

• There is much to be gained from fiscal reform

• Two alternative paths:
  • “Get rid of the deductions that don’t affect me.”
  • “You can always count on Americans to do the right thing … after they have exhausted all of the other options.”