

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

William Gale
Brookings Institution and Tax Policy Center

4th Annual Lubick Symposium
April 10, 2019

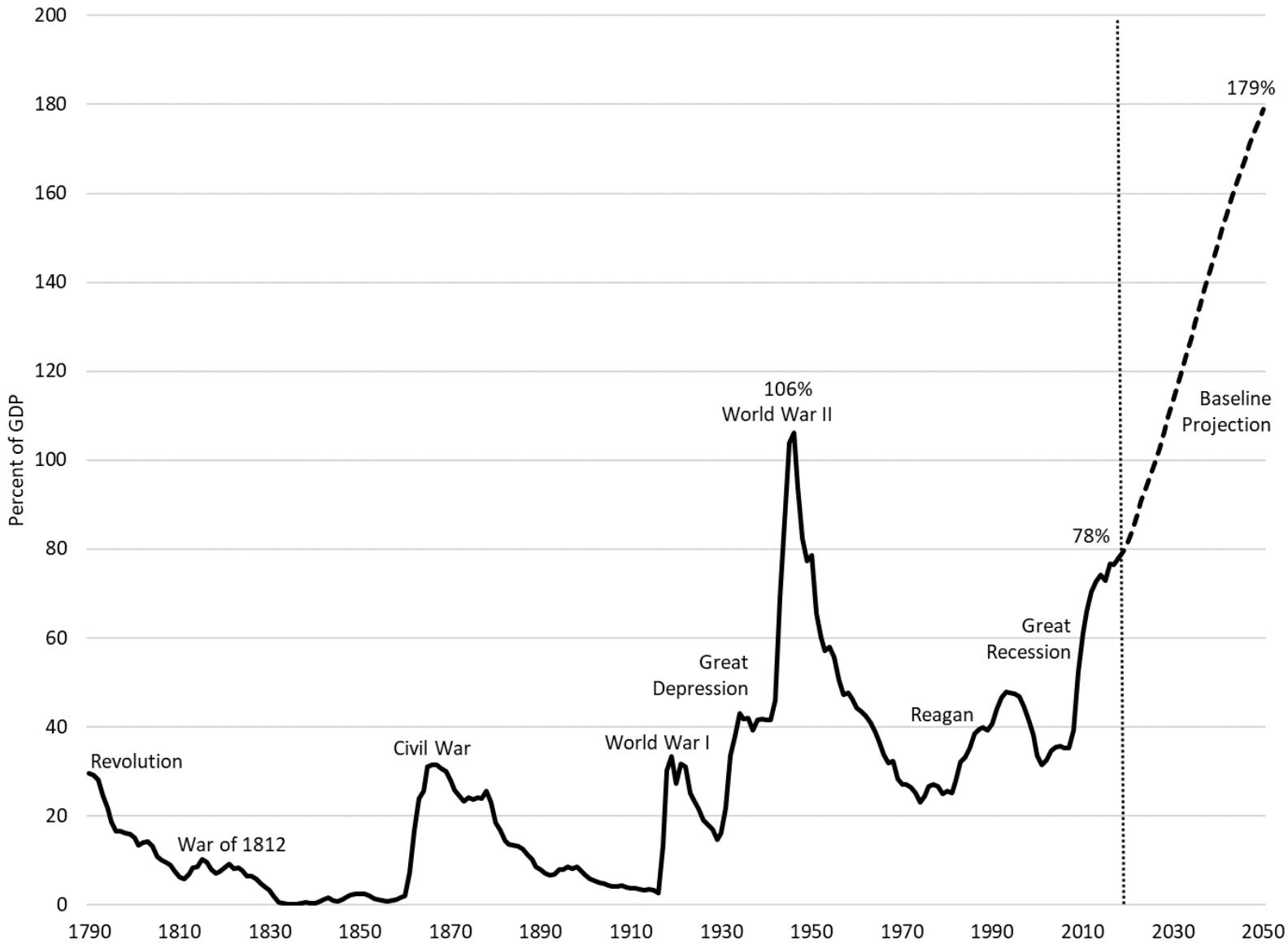
The Bottom Line

- 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

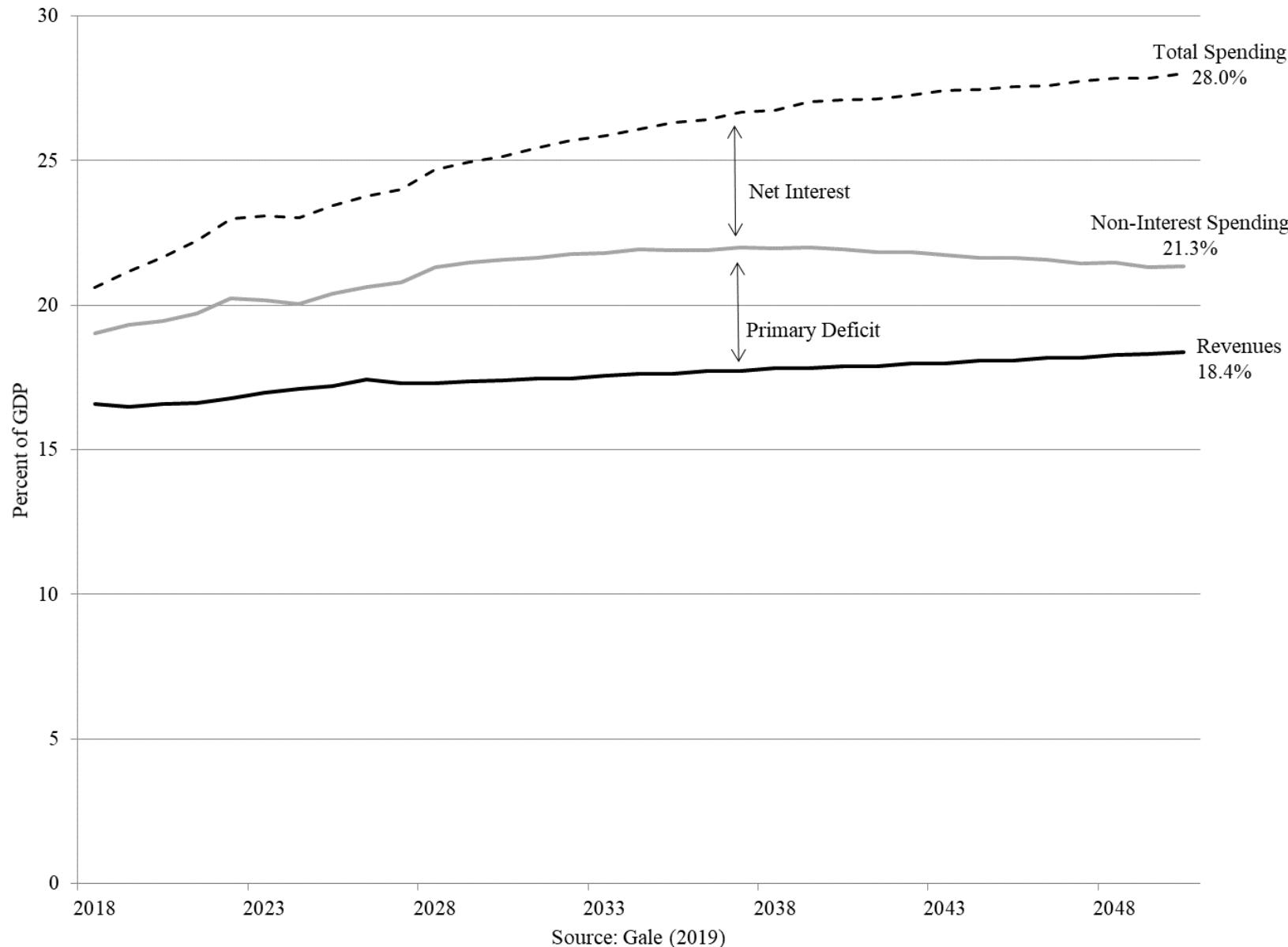
Debt/GDP, 1790-2018



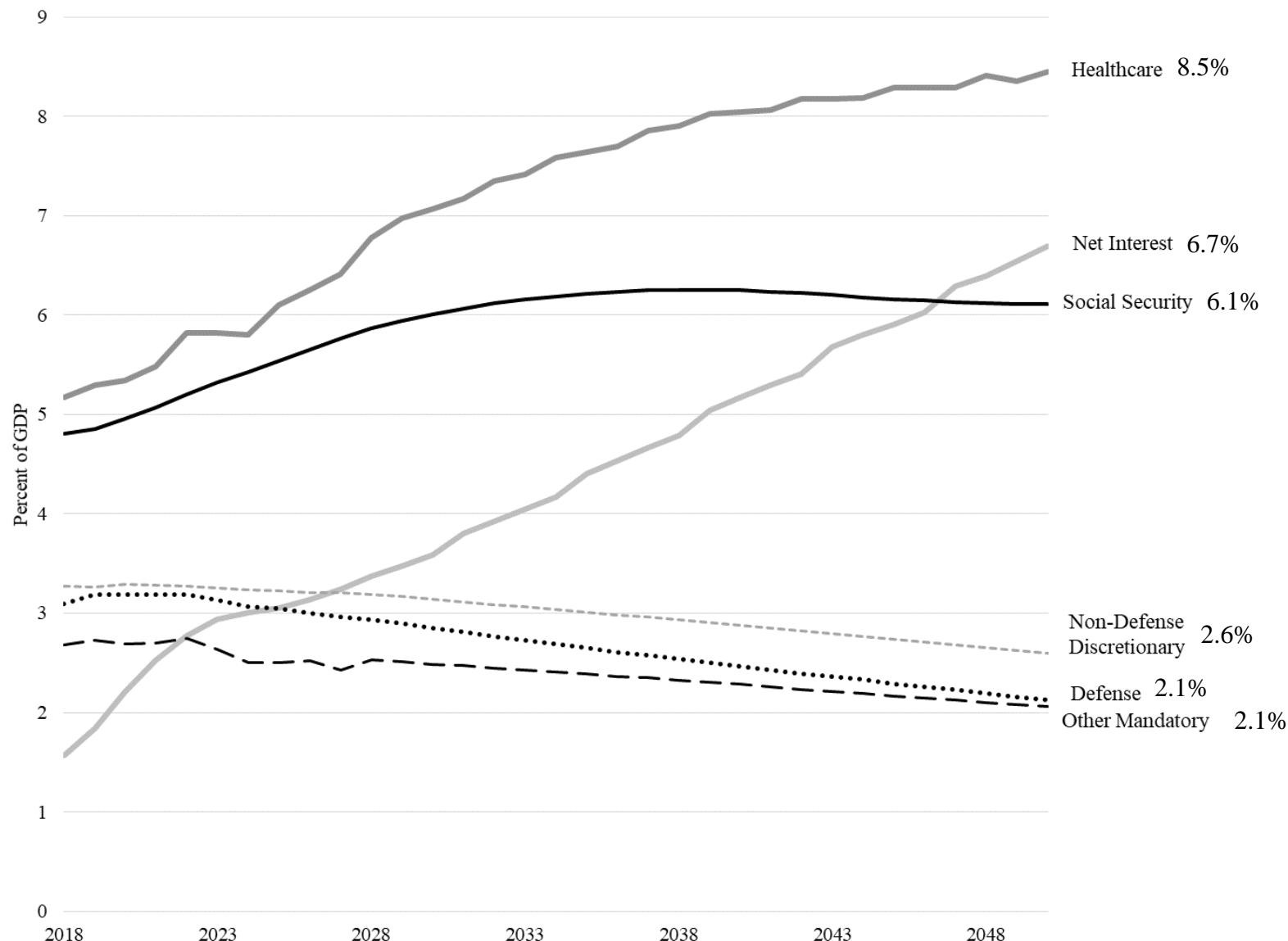
This Time is Different



A Fiscal Policy Rorschach Test



The Changing Composition of Spending



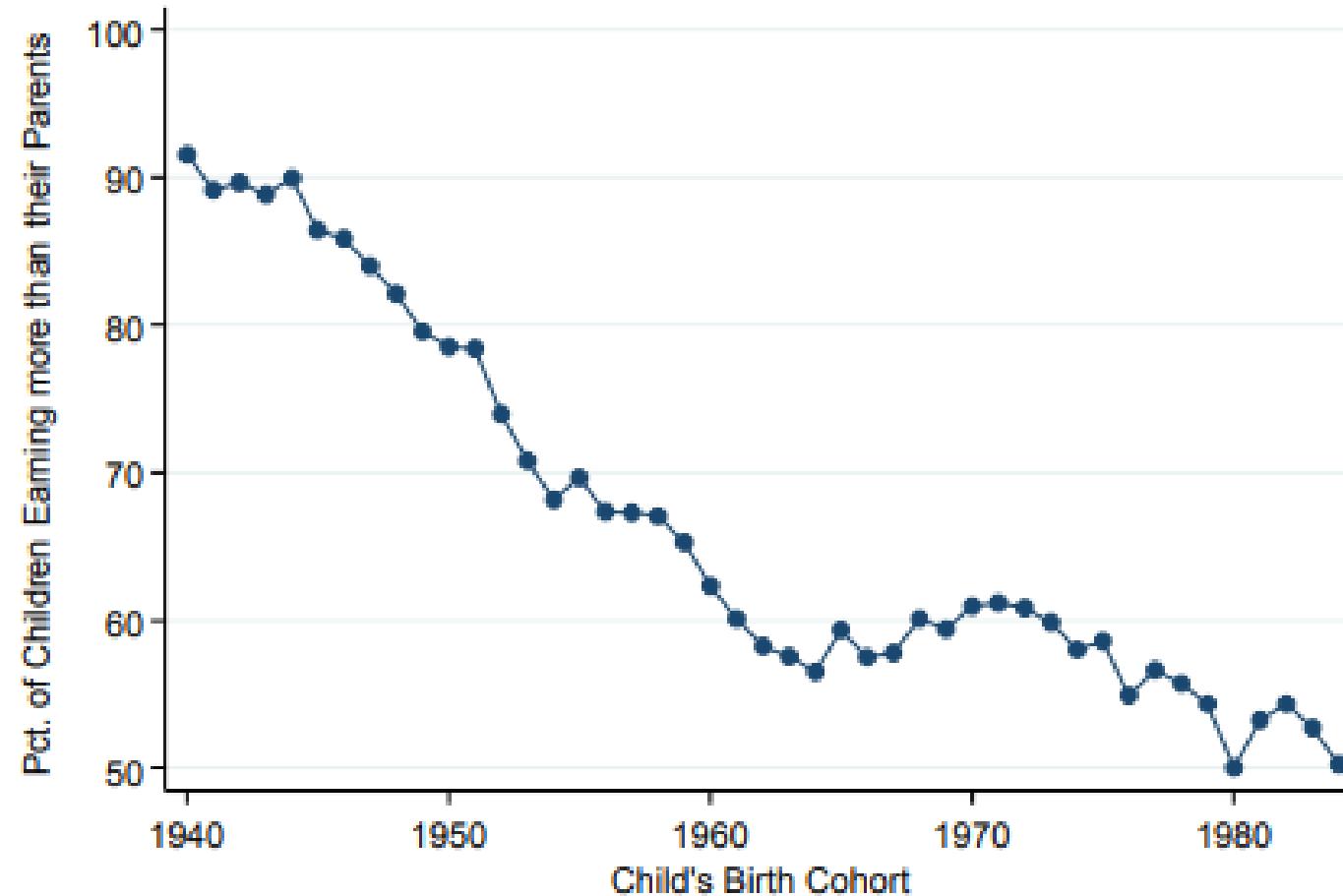
Effects of Debt on the Economy

- 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

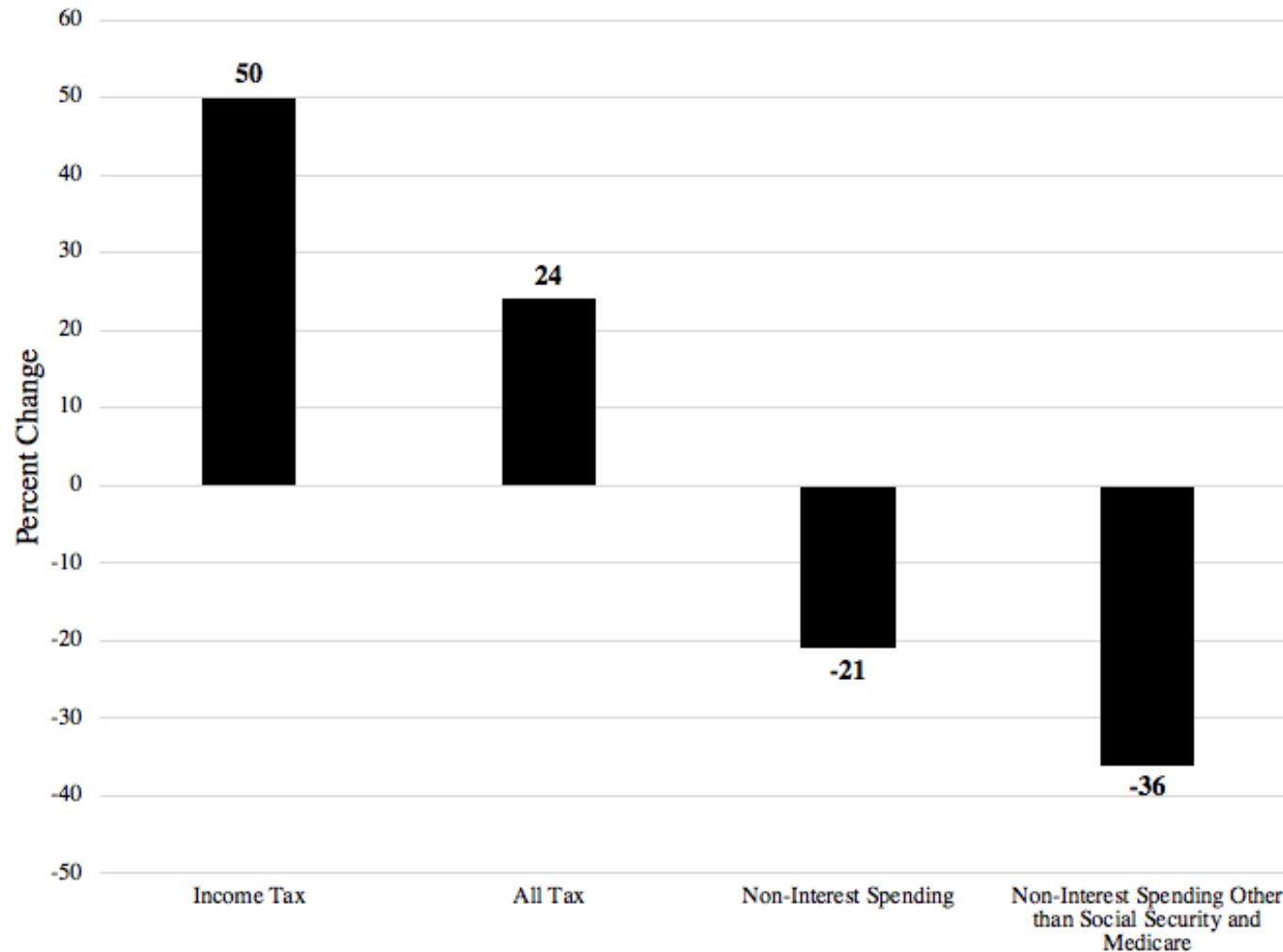
Will Future Generations be Better Off than We Are?



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

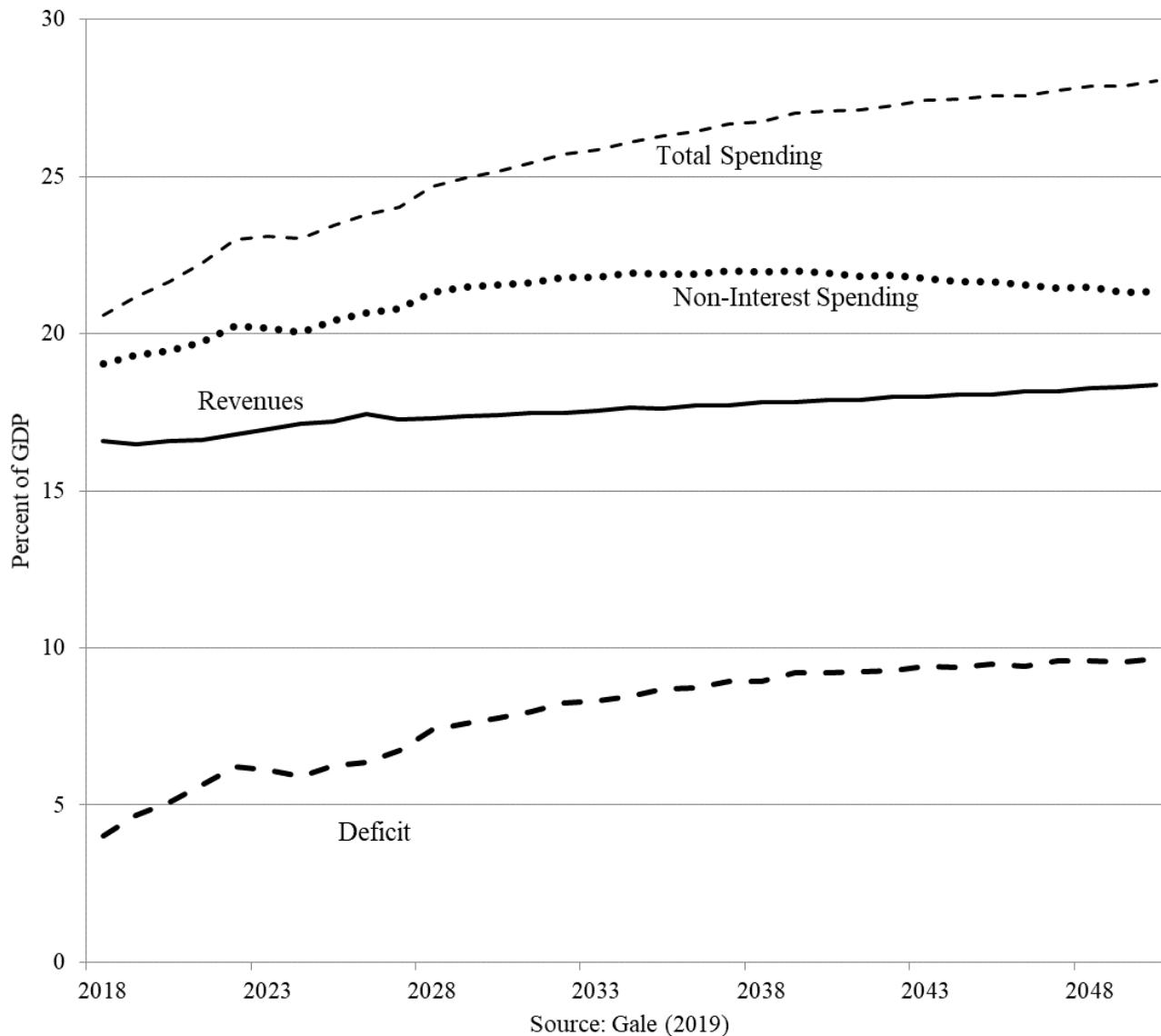
Invest in the Future

- 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

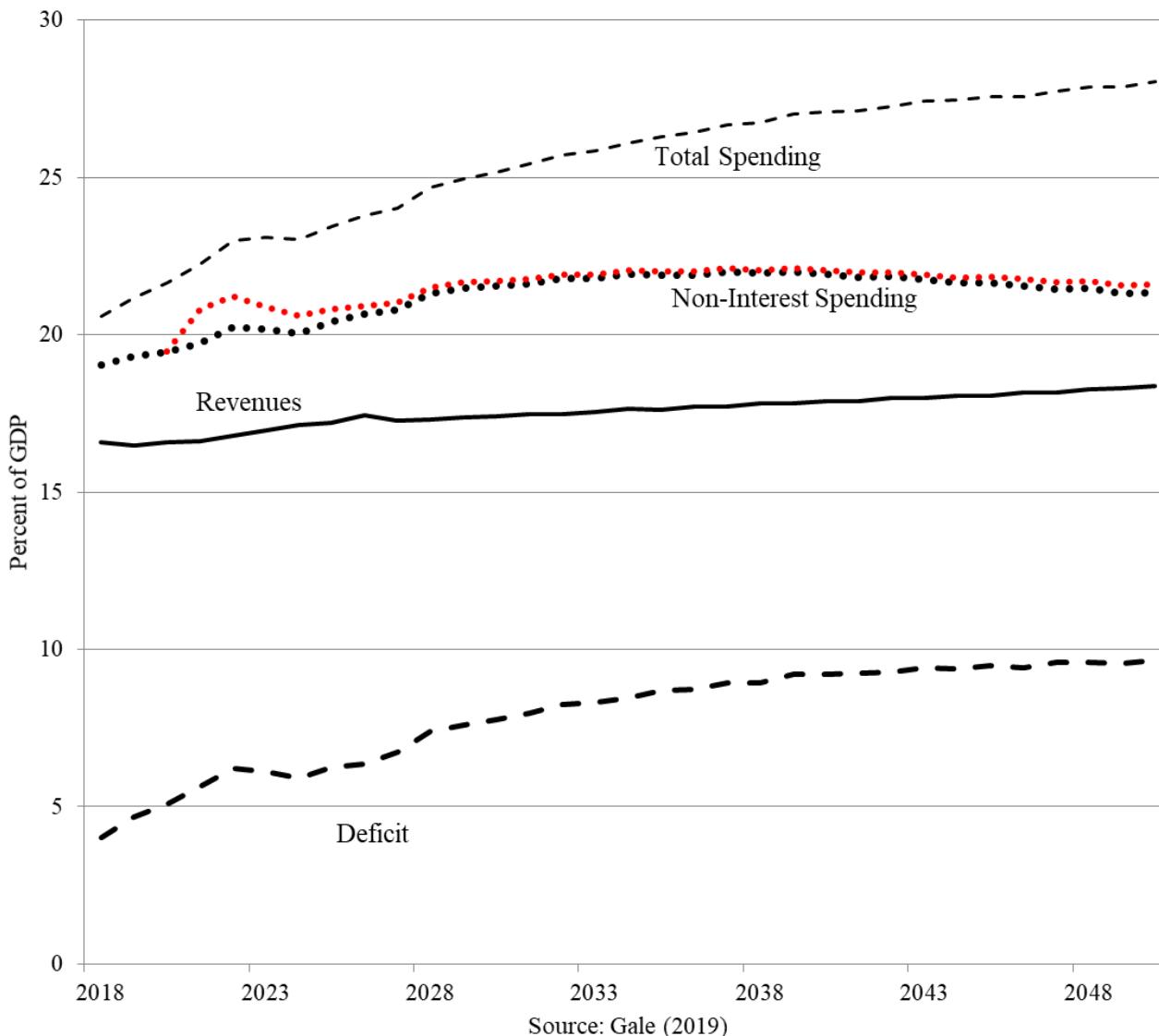
Raise and Reform Taxes

- 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

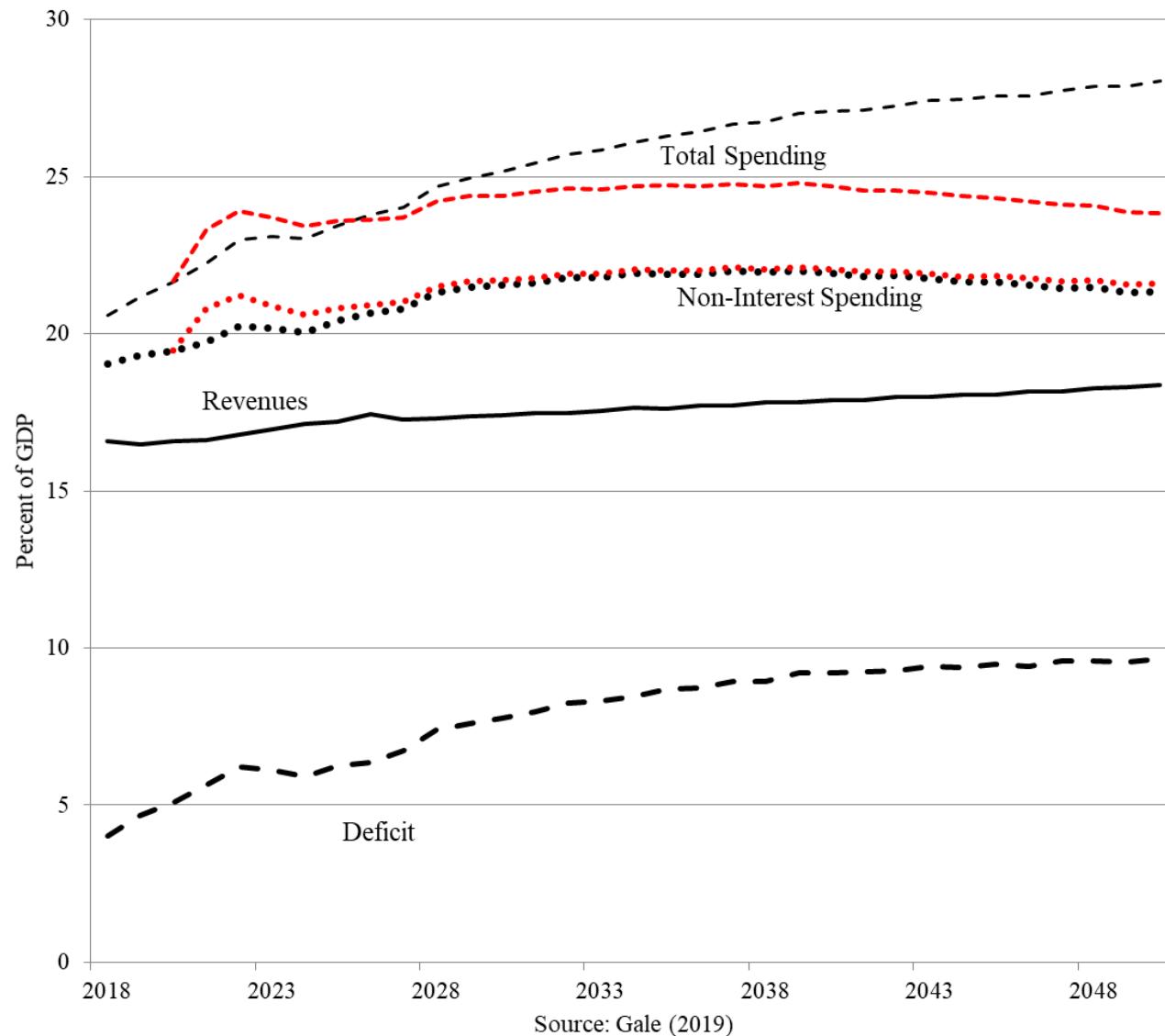
Fiscal Outcomes under the Baseline



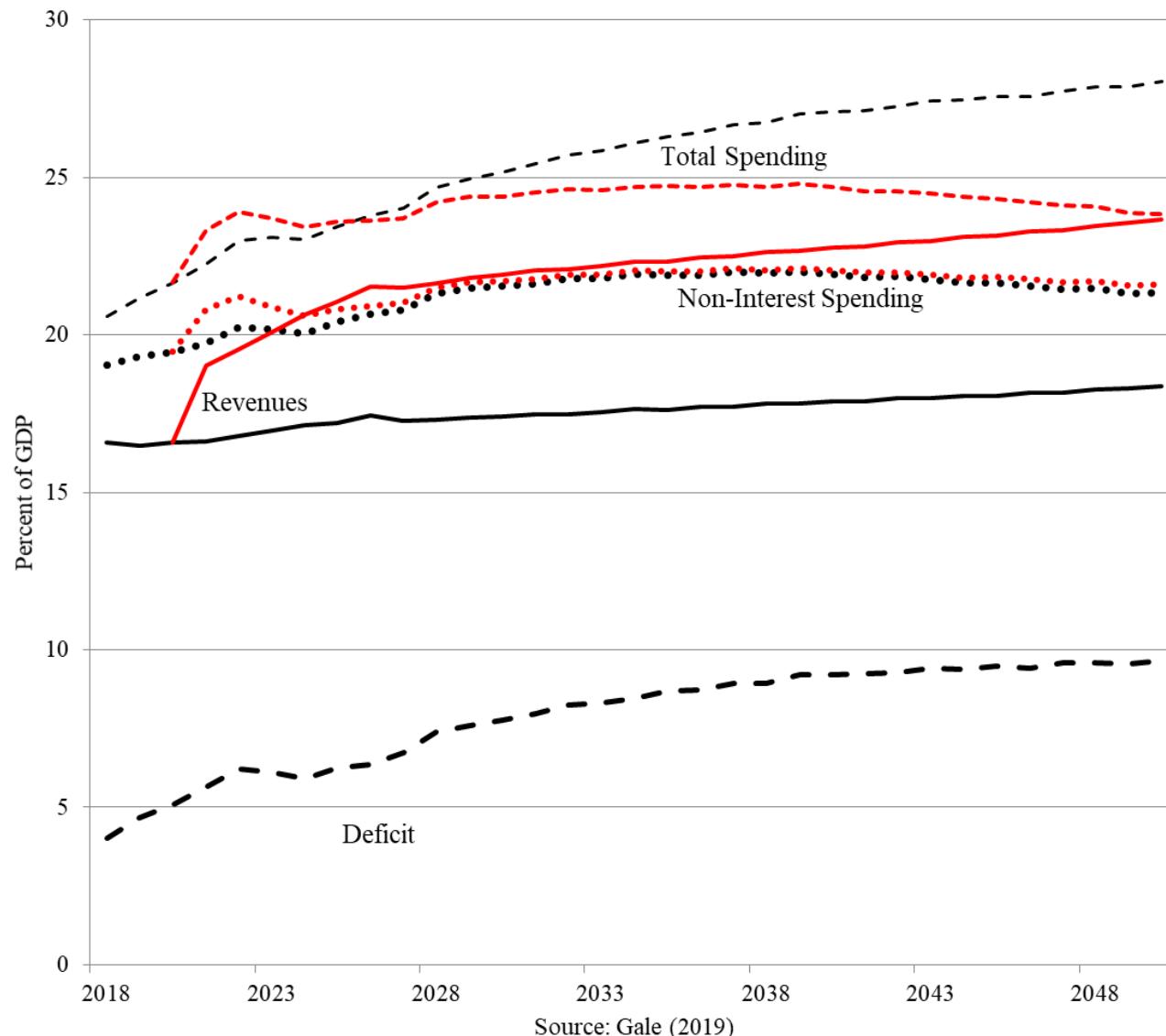
Fiscal Outcomes under the Proposal



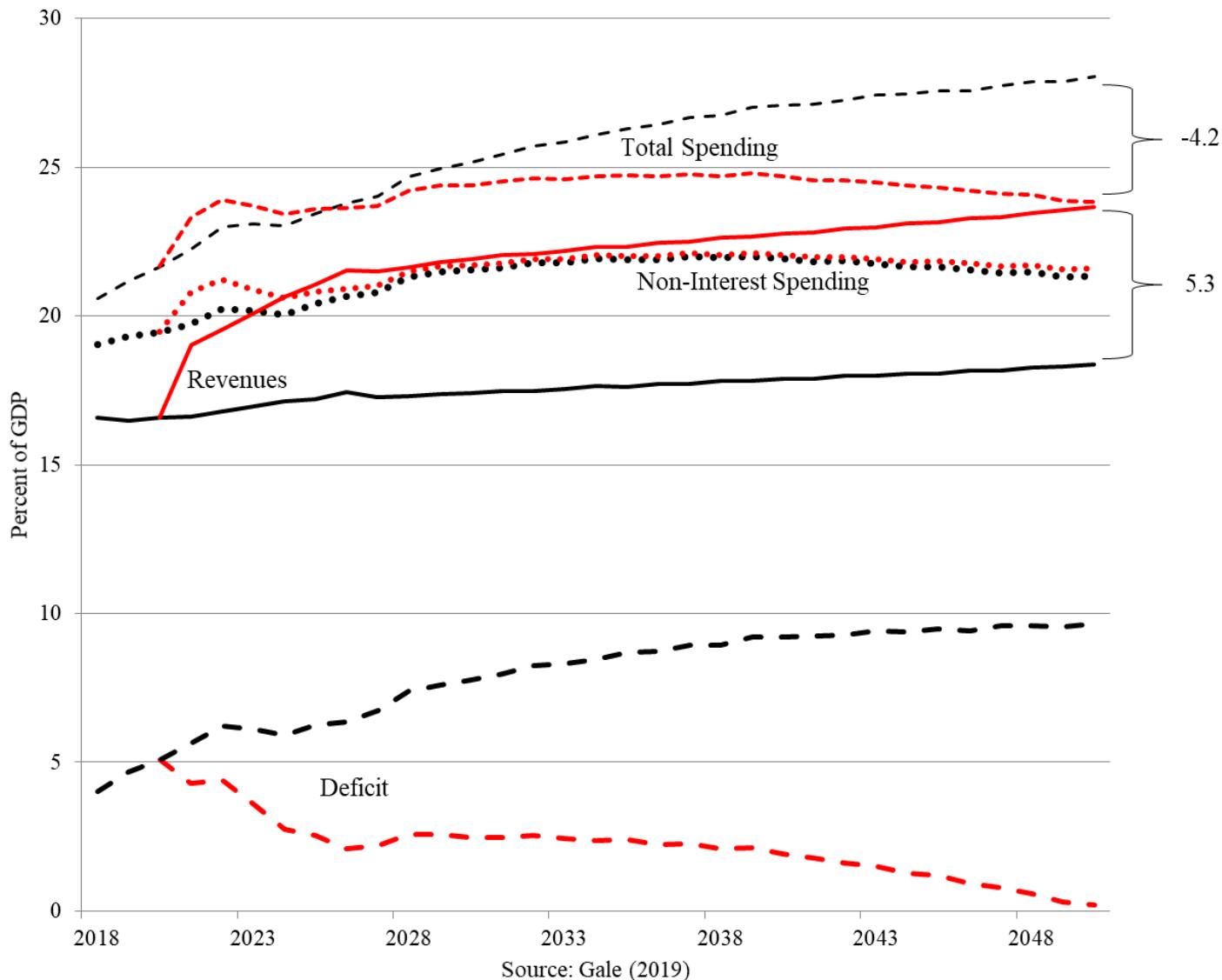
Fiscal Outcomes under the Proposal



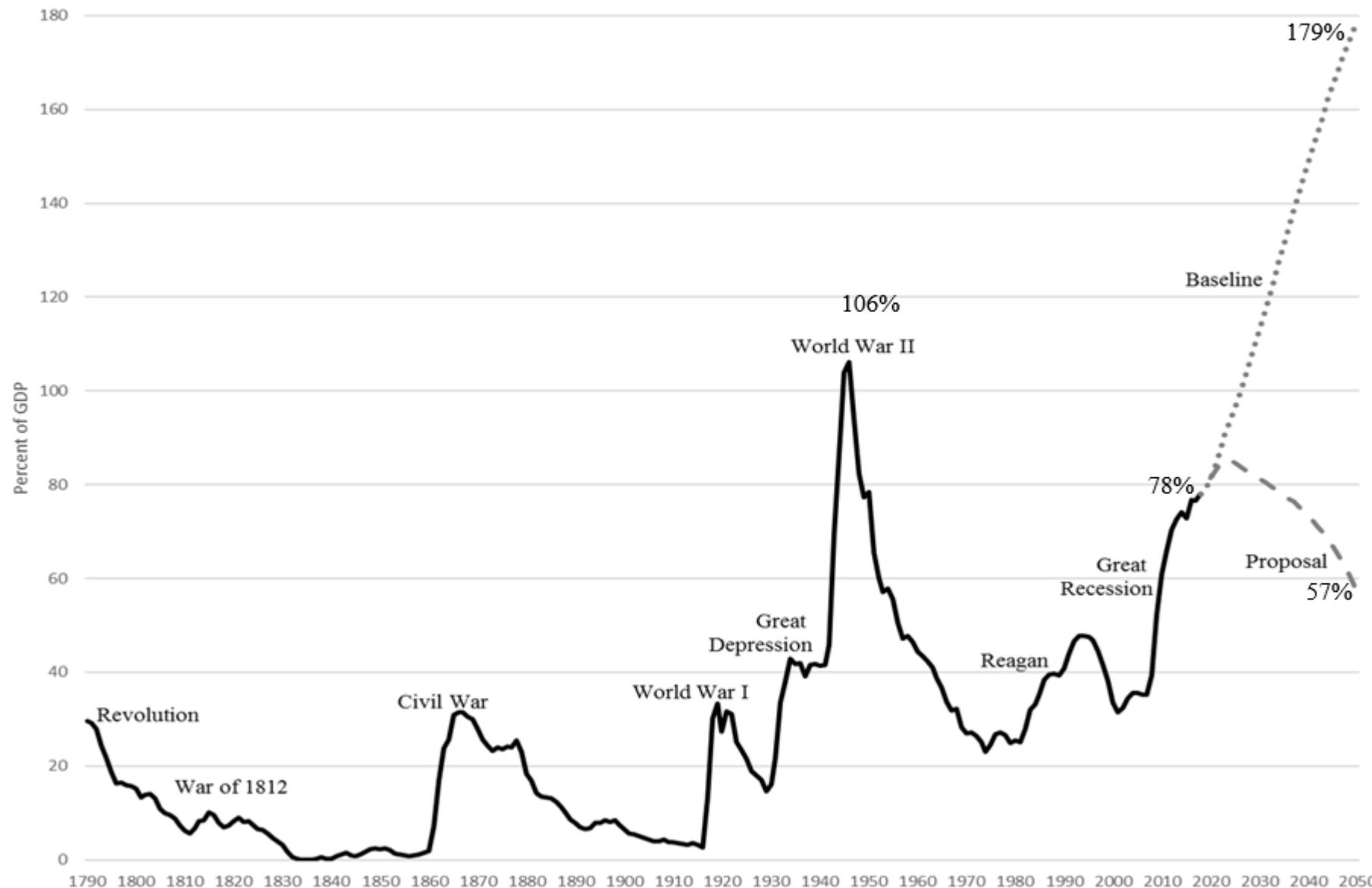
Fiscal Outcomes under the Proposal



Fiscal Outcomes under the Proposal



Debt/GDP under the Proposal



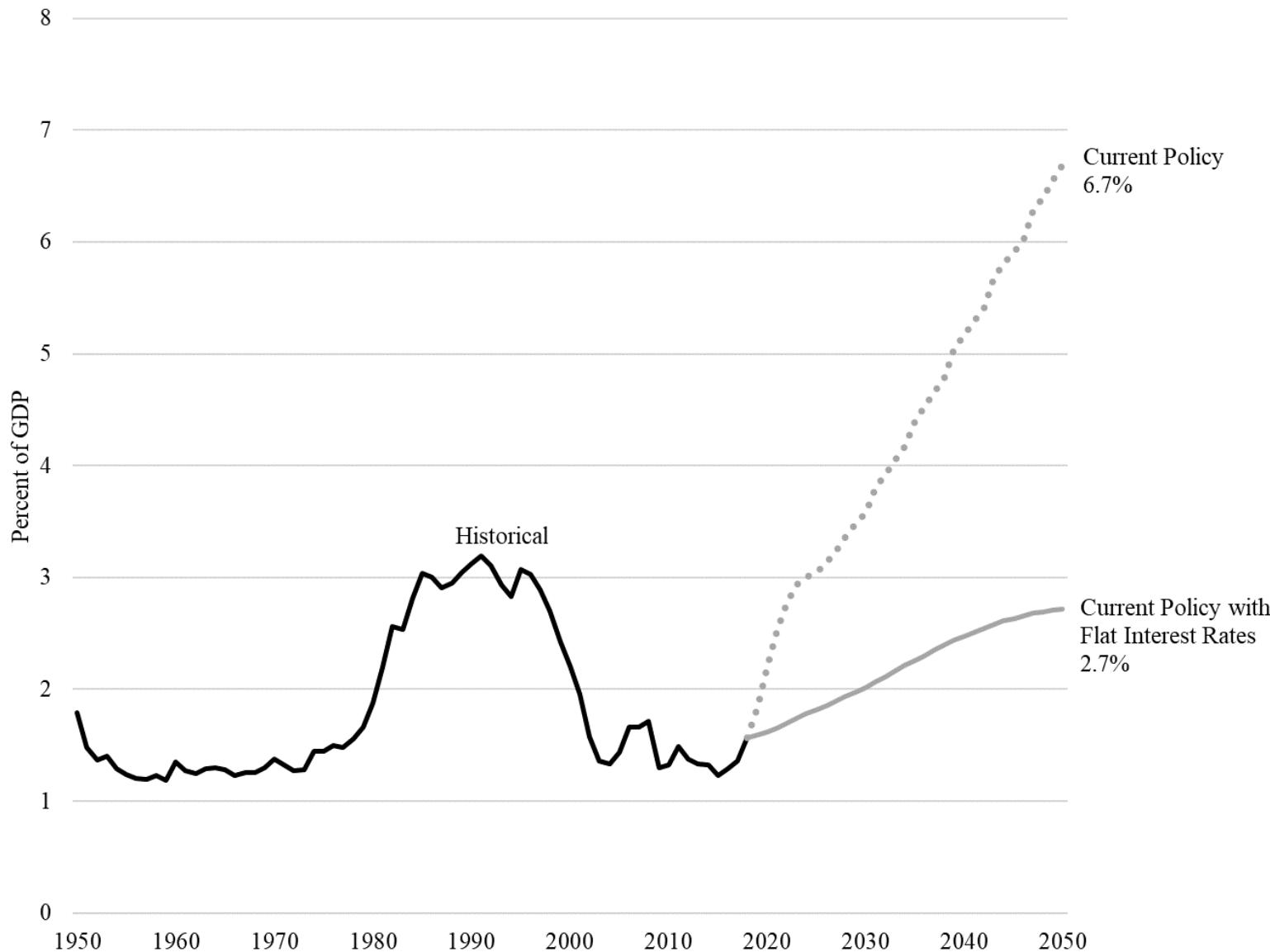
Effects

- 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

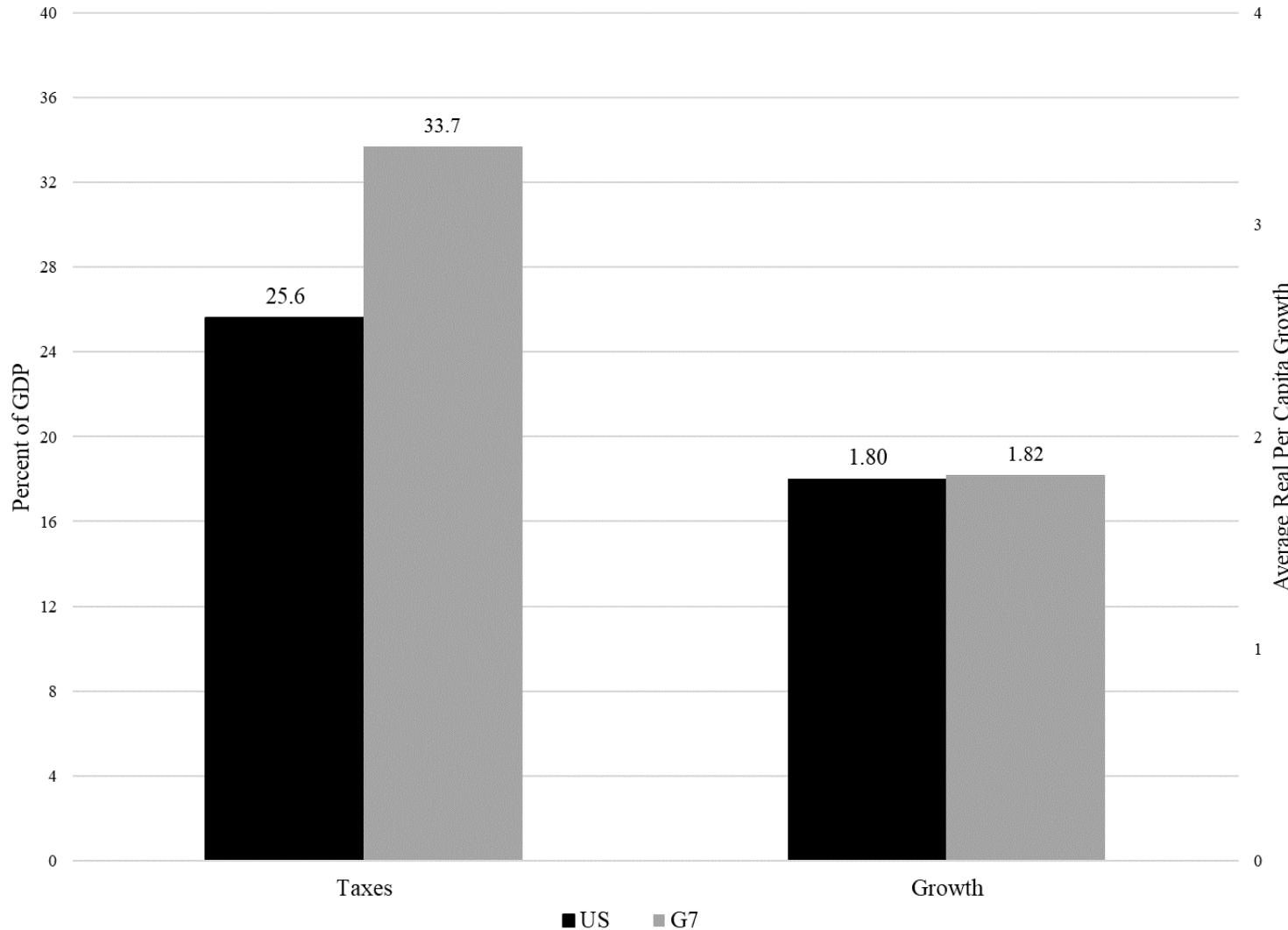
Net Interest, 1950-2050



Critiques – 2

- Measure fiscal burden by net interest/GDP not debt/GDP
- From the right – right problem, wrong solution

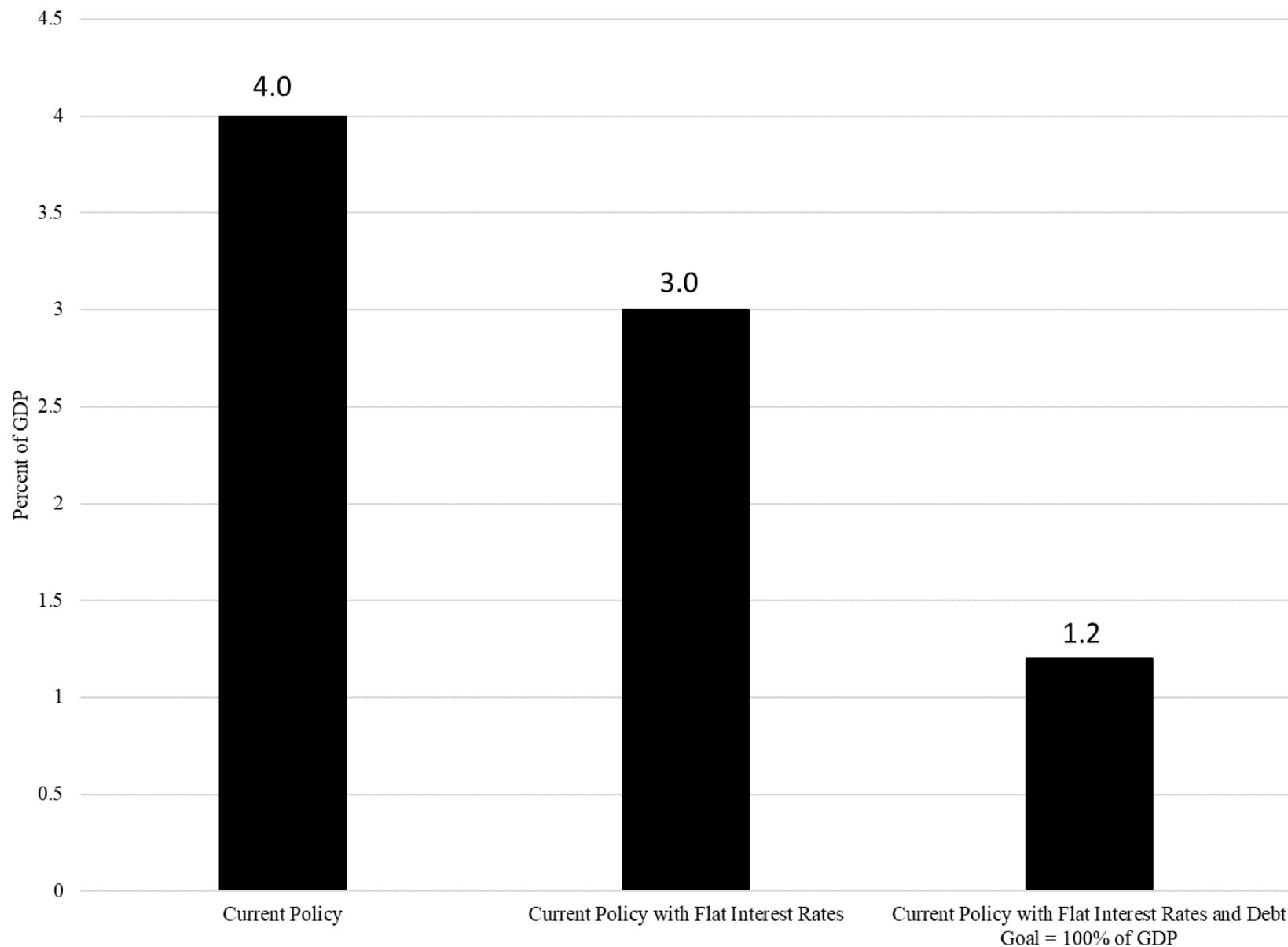
Tax Levels and Growth, US vs G7, 1970-2015



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

Fiscal Gap Estimates



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.”