

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

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4th Annual Lubick Symposium

April 10, 2019

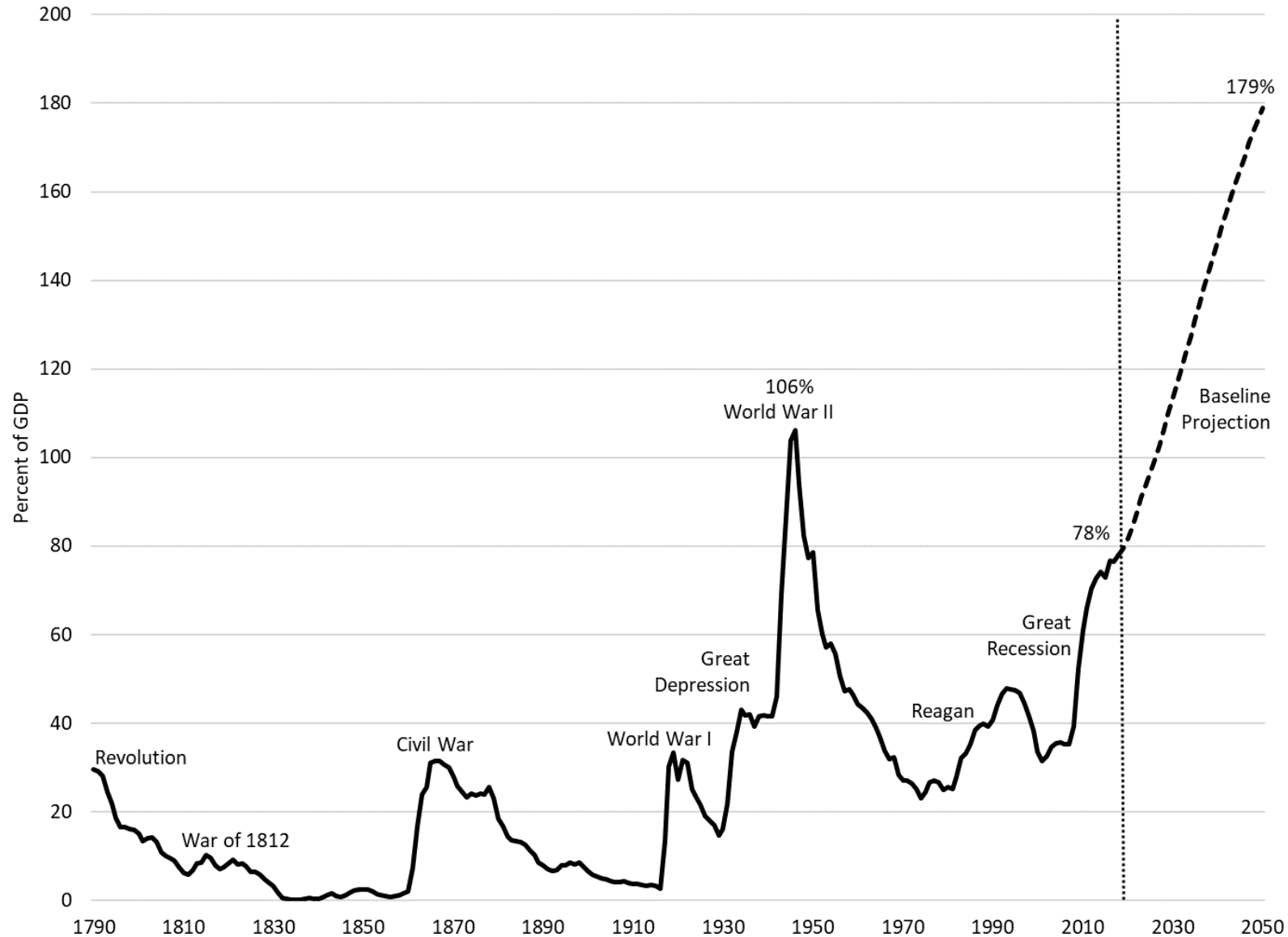
The Bottom Line

- 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

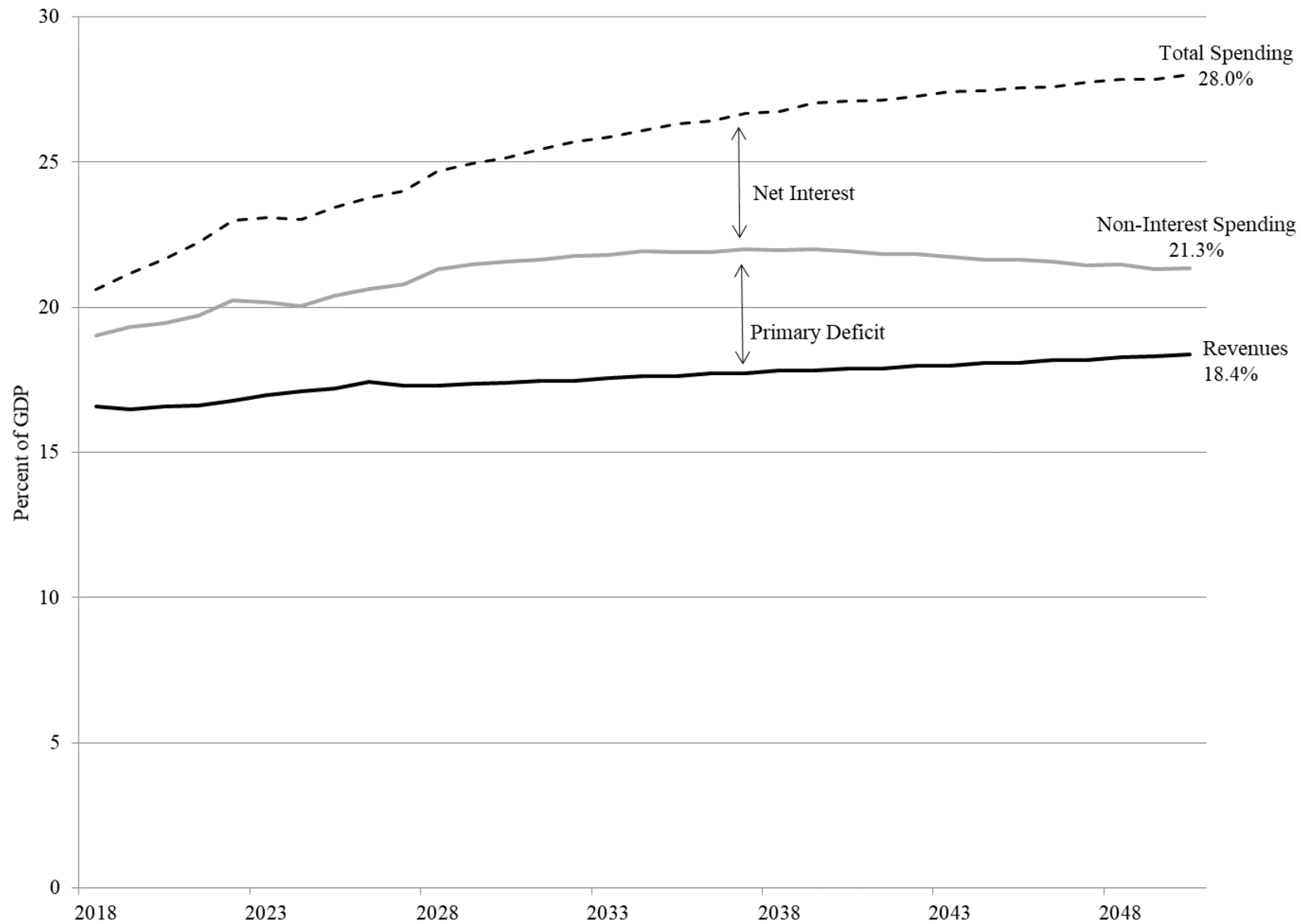
Debt/GDP, 1790-2018



This Time is Different

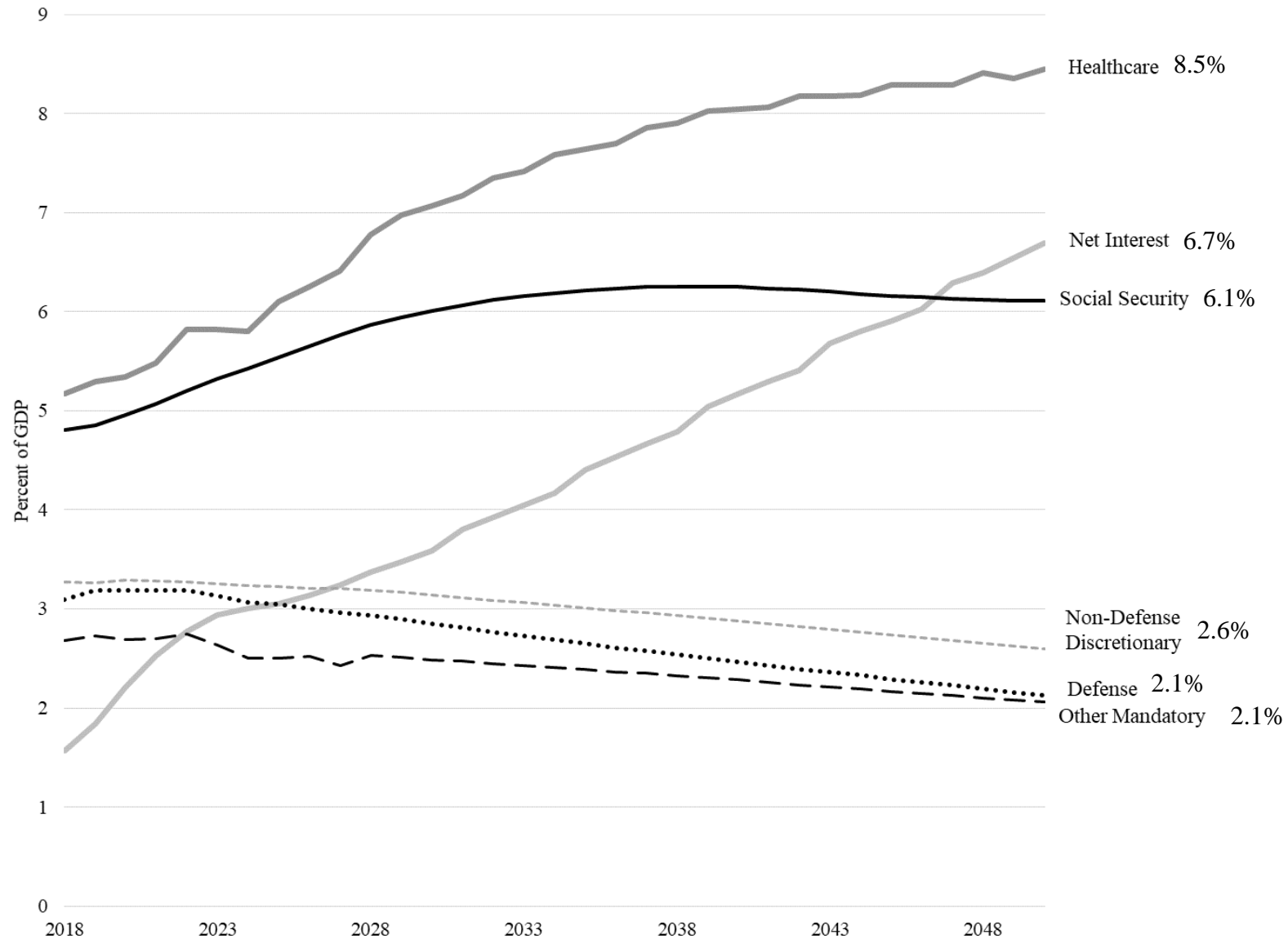


A Fiscal Policy Rorschach Test



Source: Gale (2019)

The Changing Composition of Spending



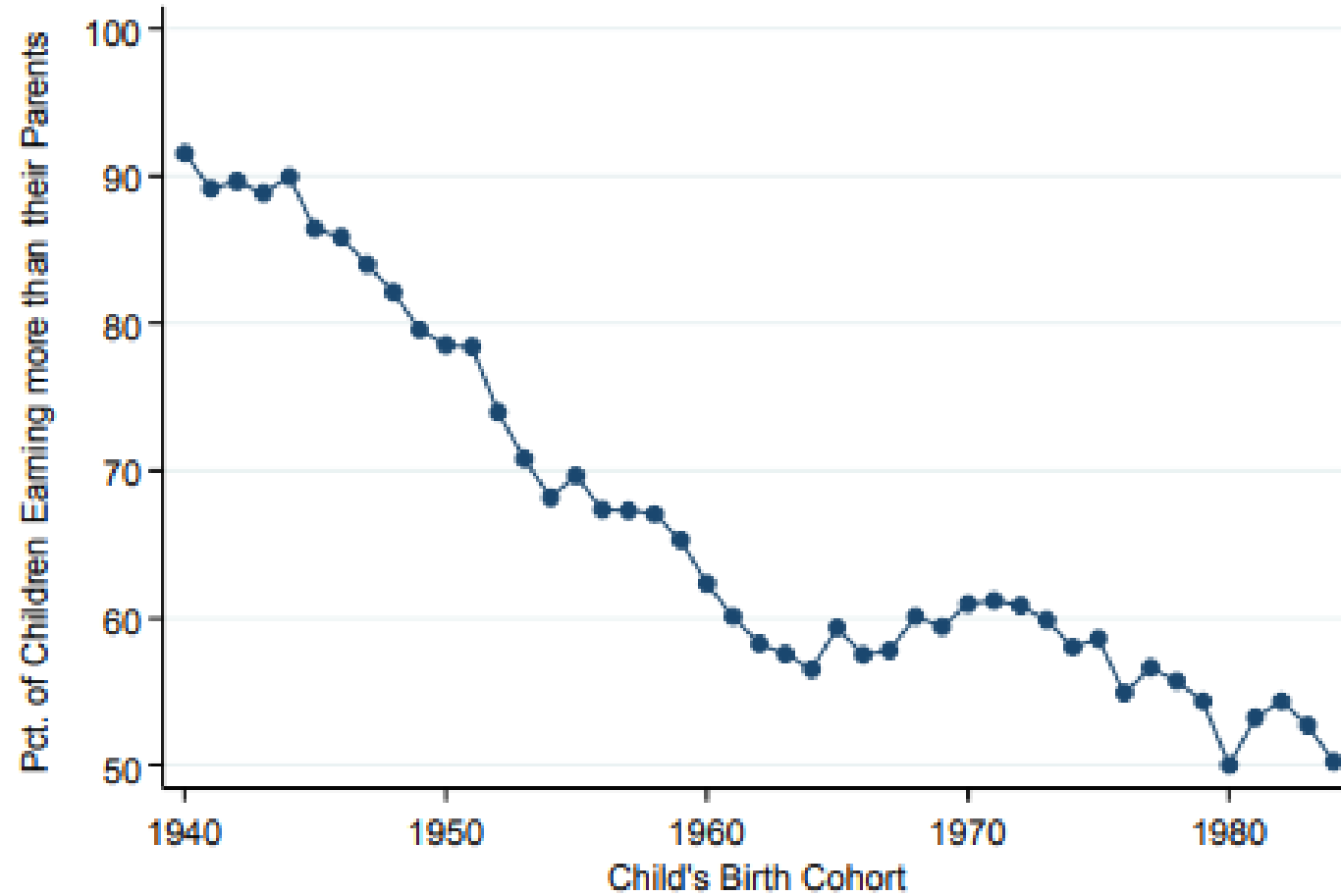
Effects of Debt on the Economy

- 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
 - Not zero debt / not a balanced budget rule
- Higher than historical average (36% between 1957-2007)
 - Interest rates likely to be lower than in the past
 - More investment => higher sustainable debt
 - Baseline debt level is so high
- But not higher because it is not clear how much better off future generations will be

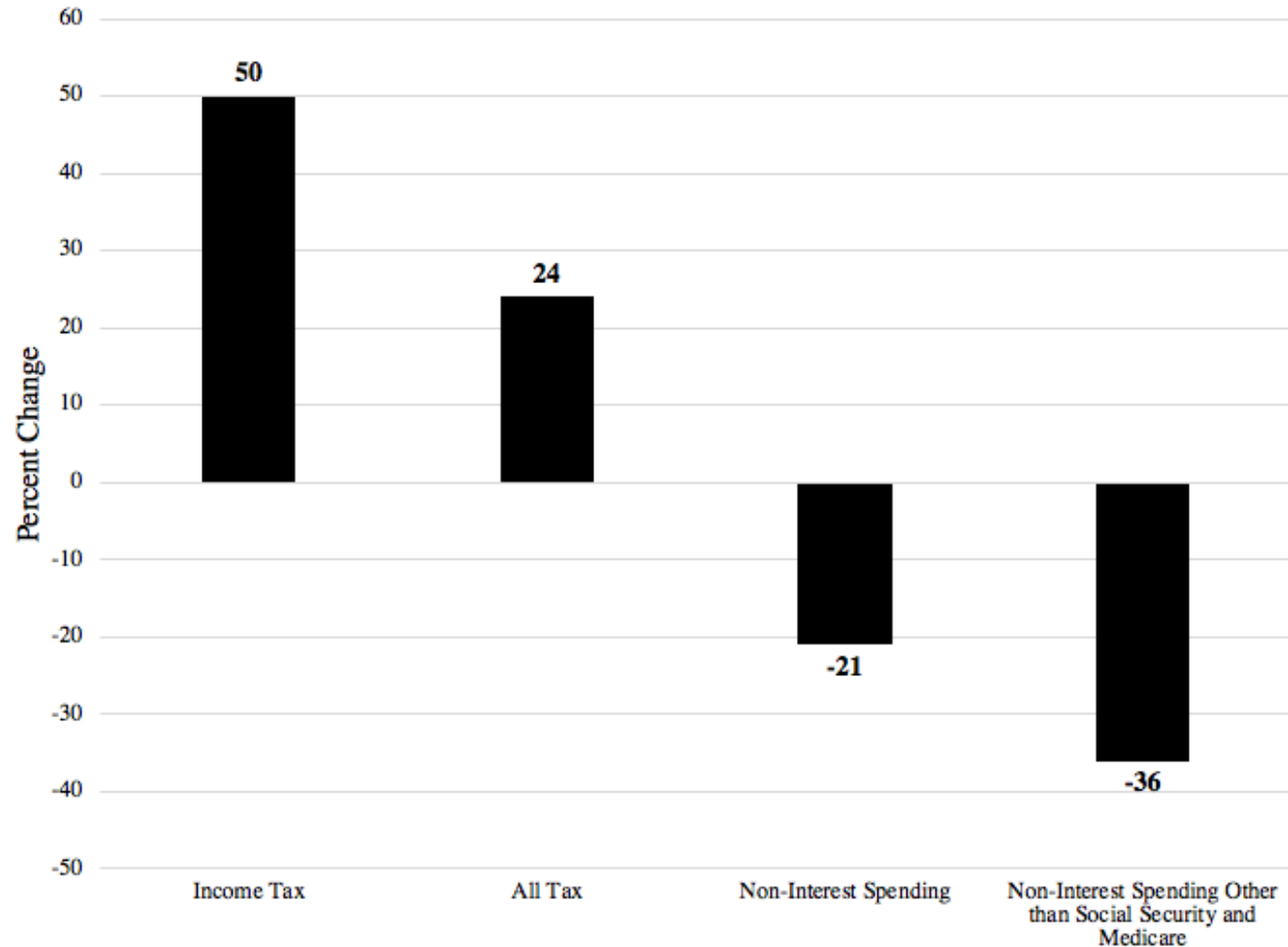
Will Future Generations be Better Off than We Are?



Source: Chetty, et al. (2016)

Fiscal Gap = 4.0% of GDP

(To reach Debt/GDP = 60% by 2050, starting in 2021)



False Solutions

- “Foreign aid”
- Inflation
- Growth – could help, but not enough
- Tax Cuts

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

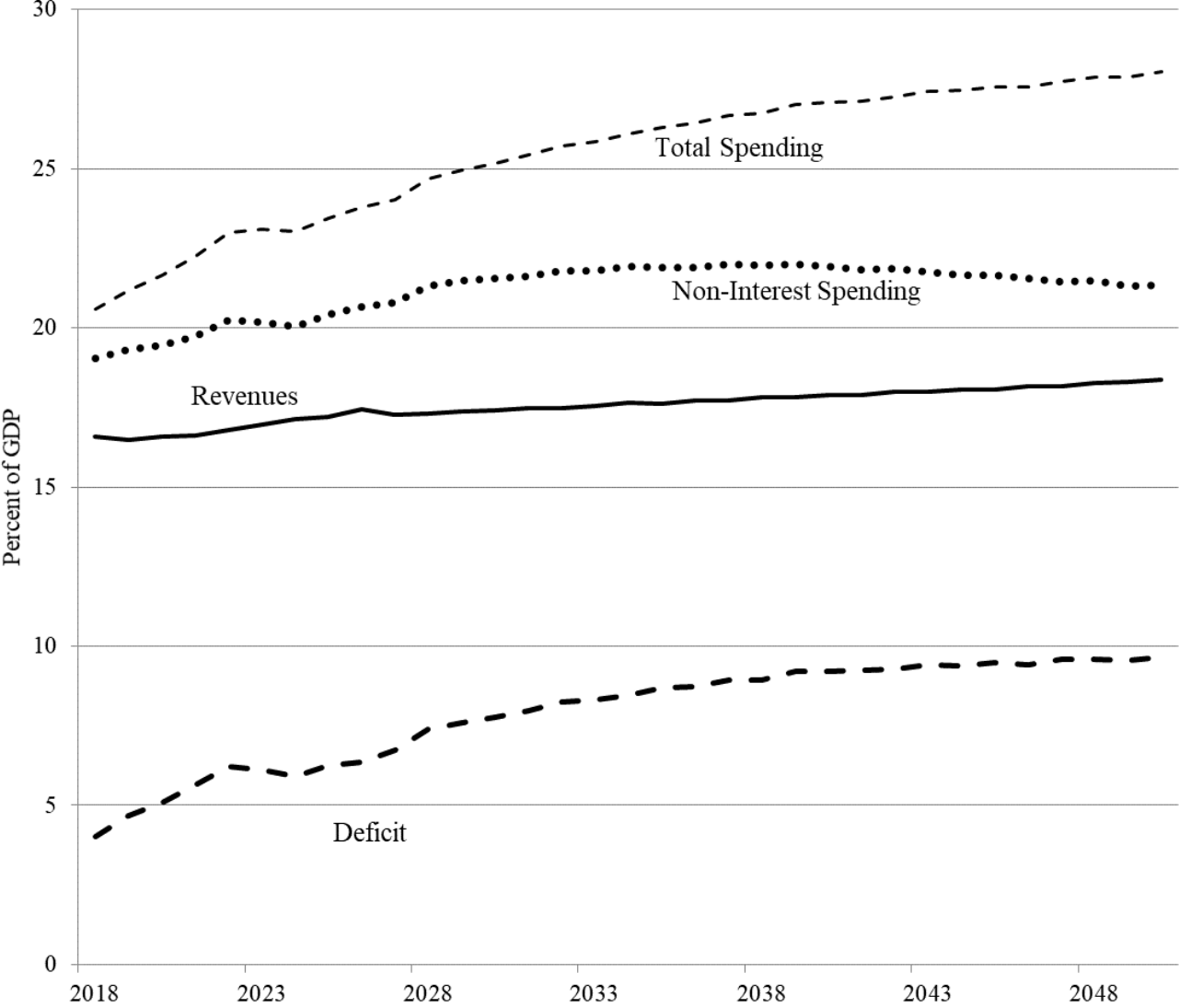
Invest in the Future

- 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

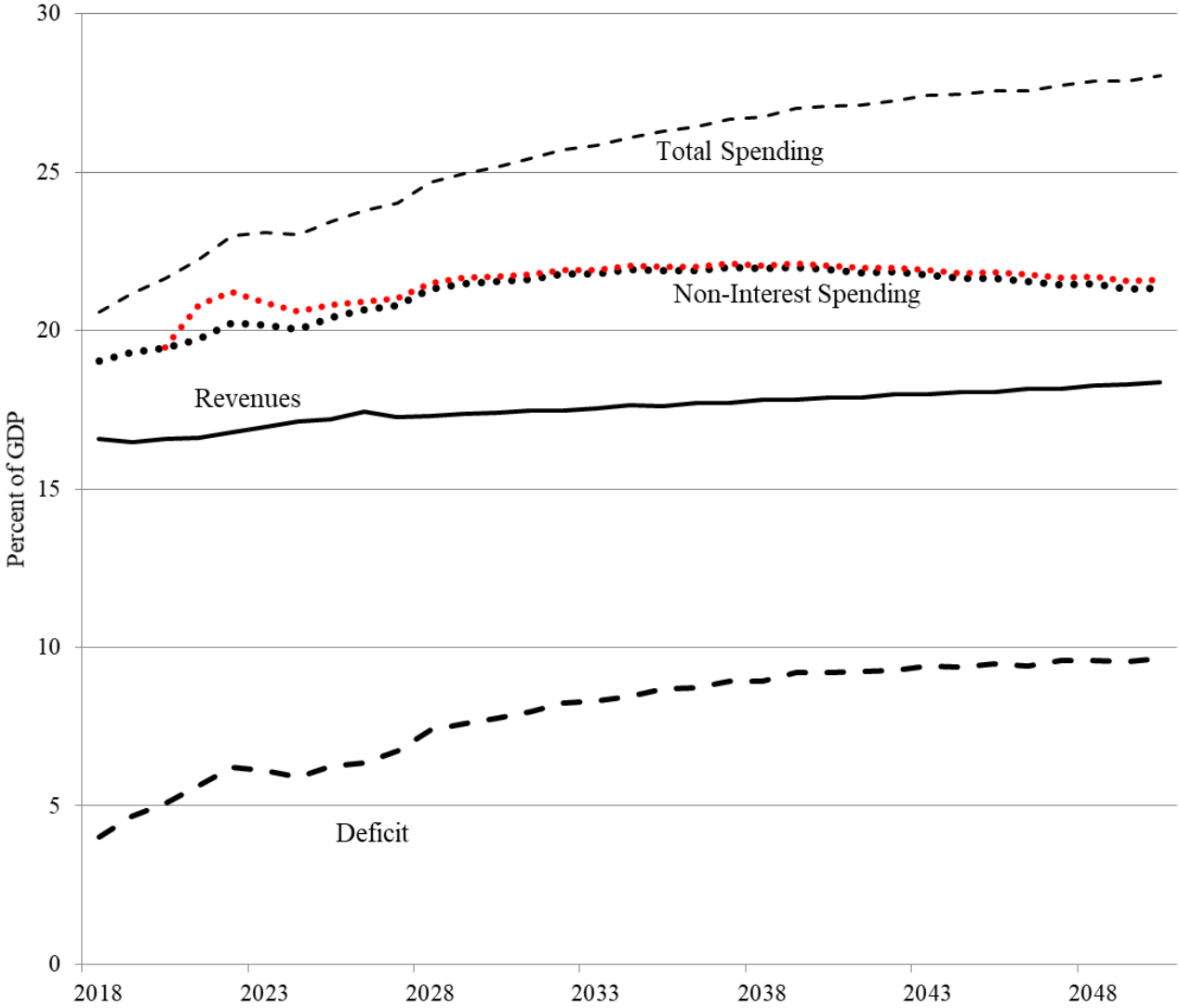
- Carbon tax – \$30 per ton rising at 5% above inflation (McKibbin, et. al), with offsets
- Value-added tax – 10% rate, with offsets
- Business taxes
 - Repeal TCJA pass-through provisions (or let them expire)
 - Raise corporate tax to a 25%, convert to “cash flow” tax
 - Revisit international rules
- 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



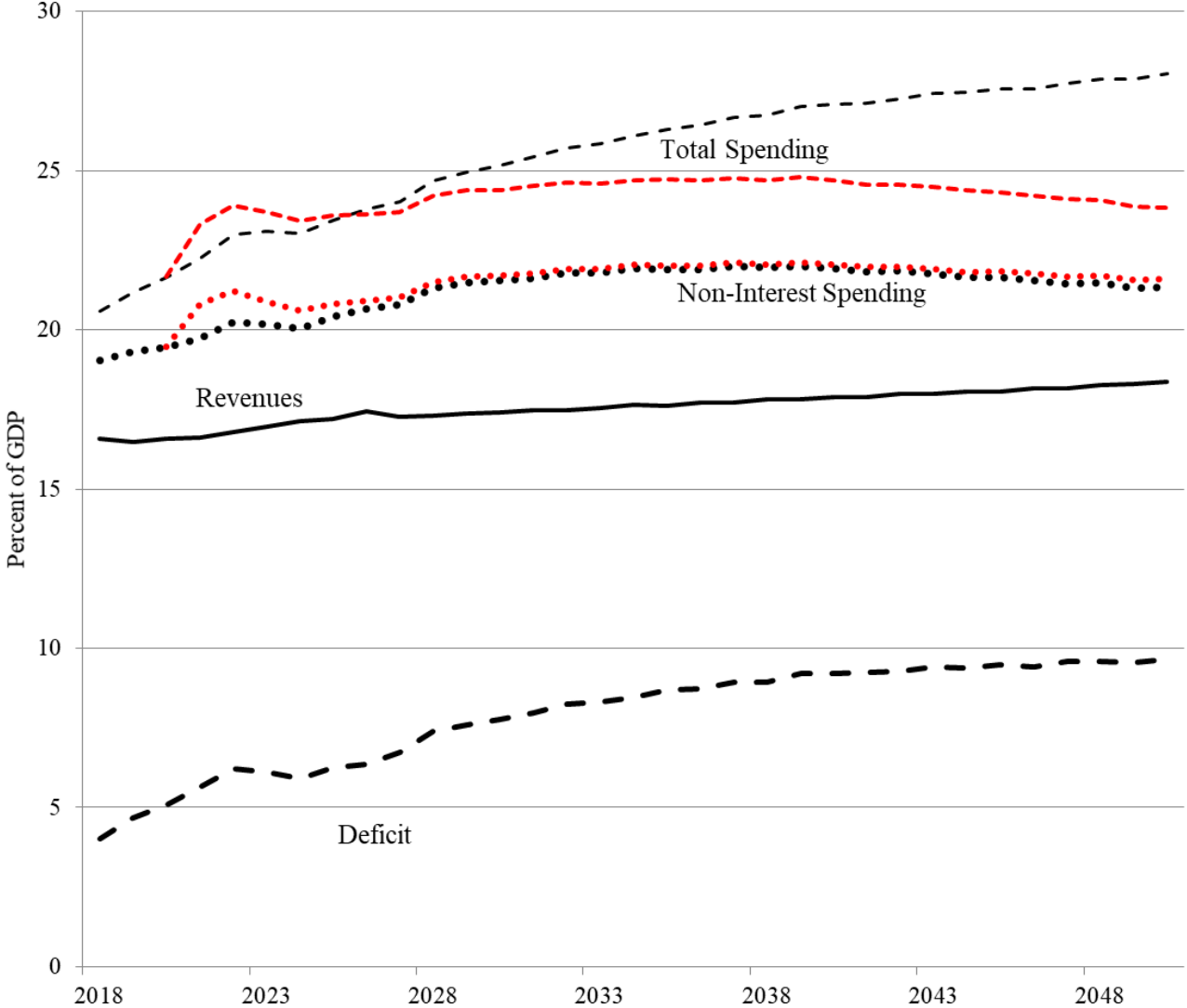
Source: Gale (2019)

Fiscal Outcomes under the Proposal



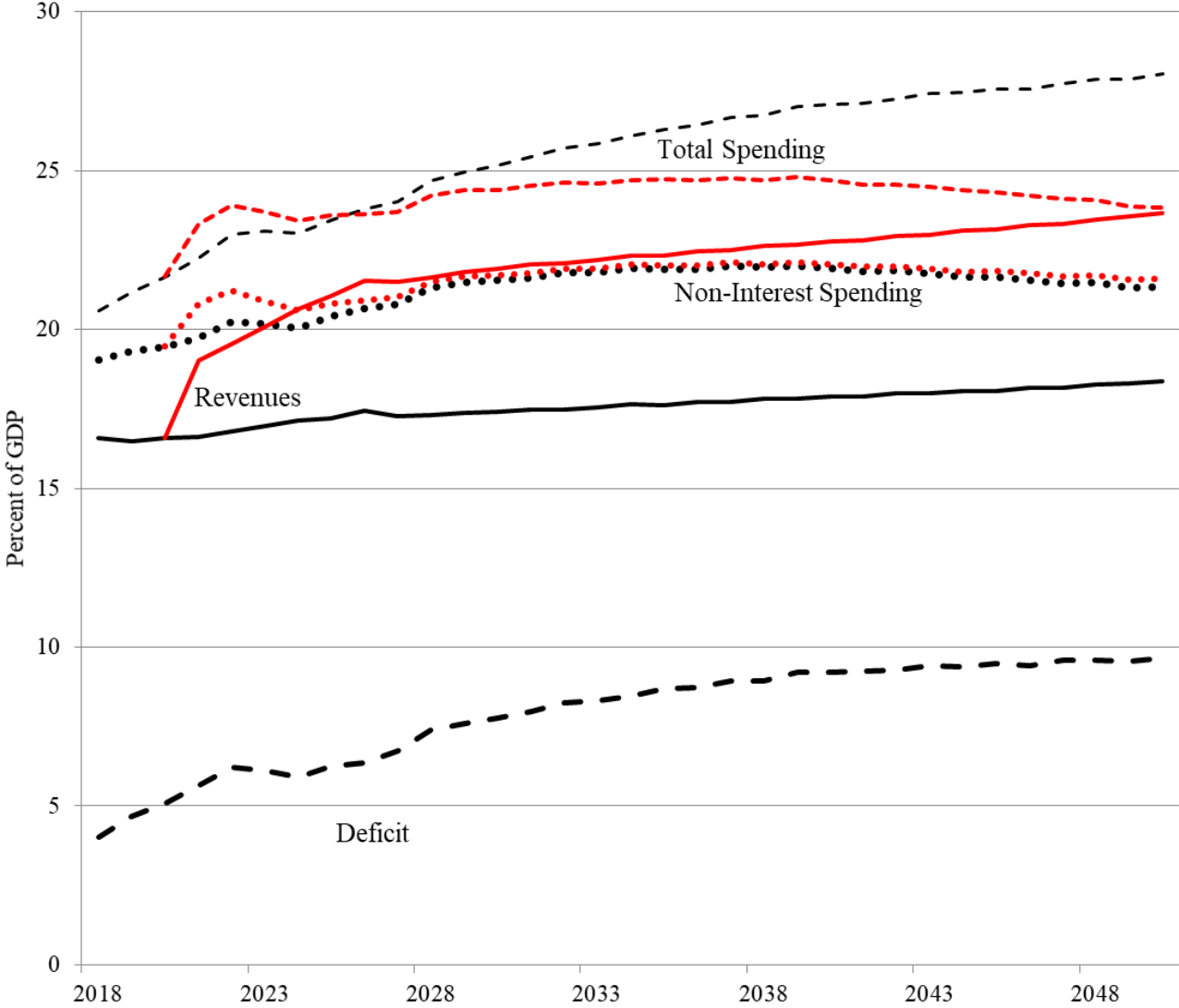
Source: Gale (2019)

Fiscal Outcomes under the Proposal



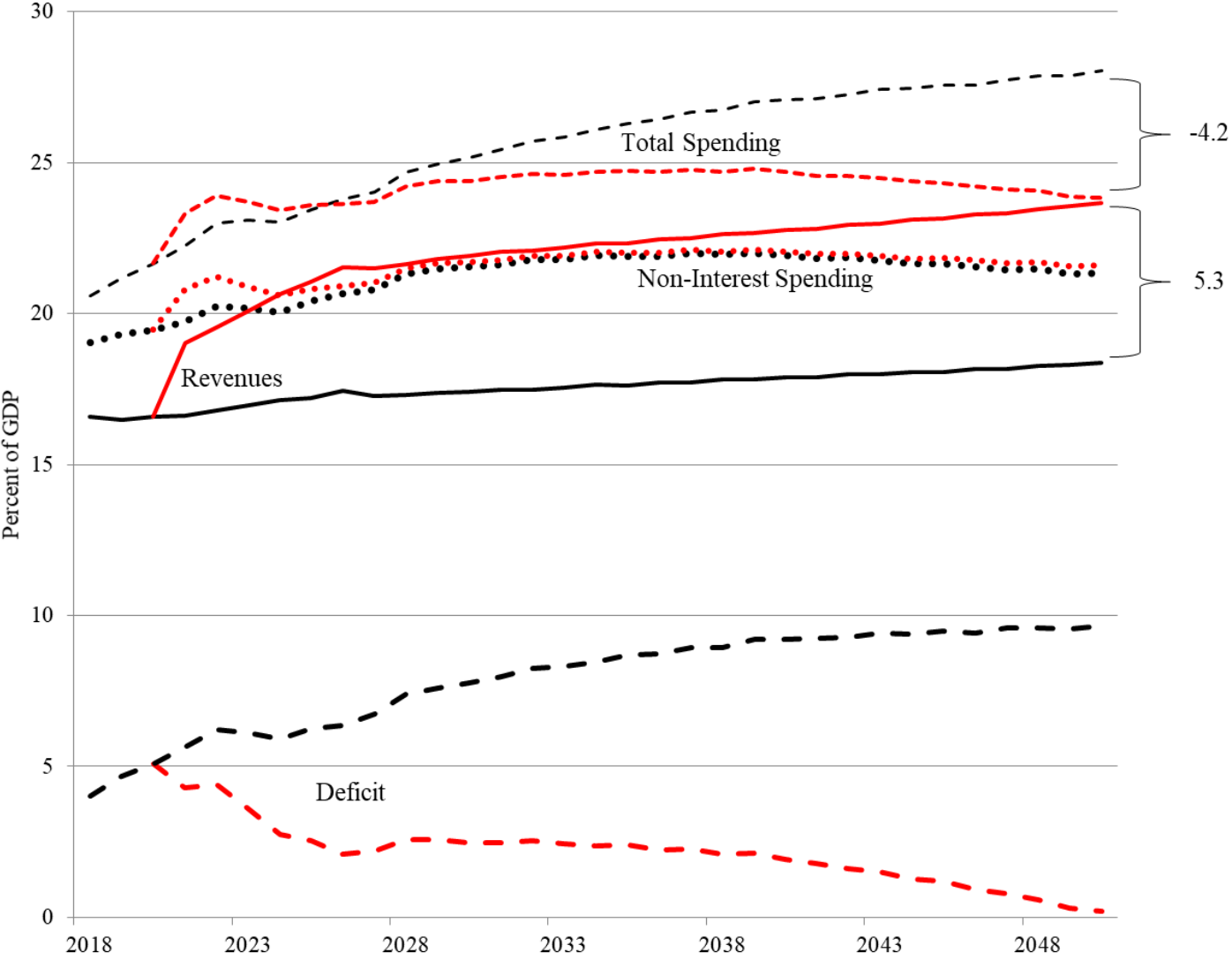
Source: Gale (2019)

Fiscal Outcomes under the Proposal



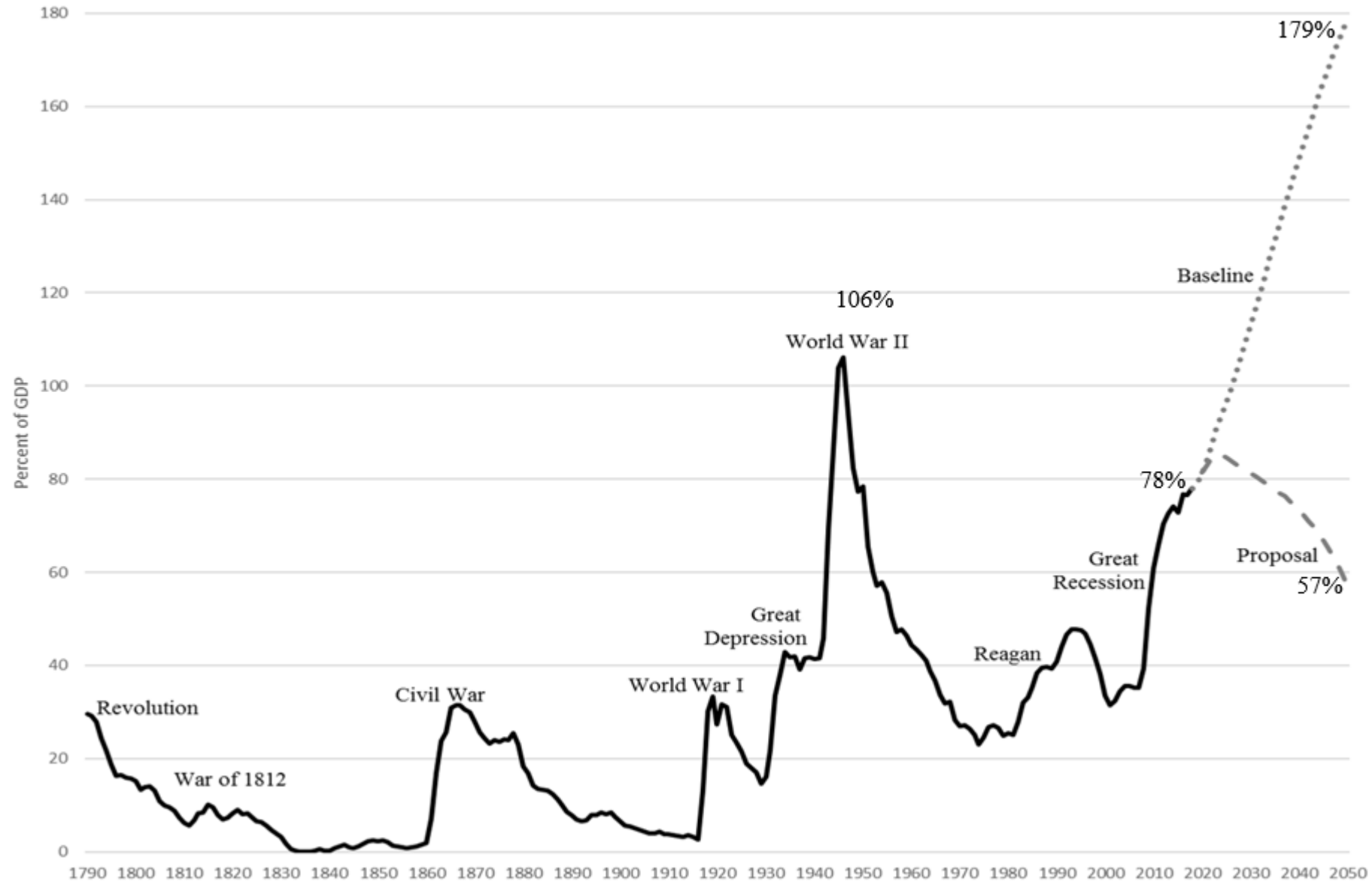
Source: Gale (2019)

Fiscal Outcomes under the Proposal



Source: Gale (2019)

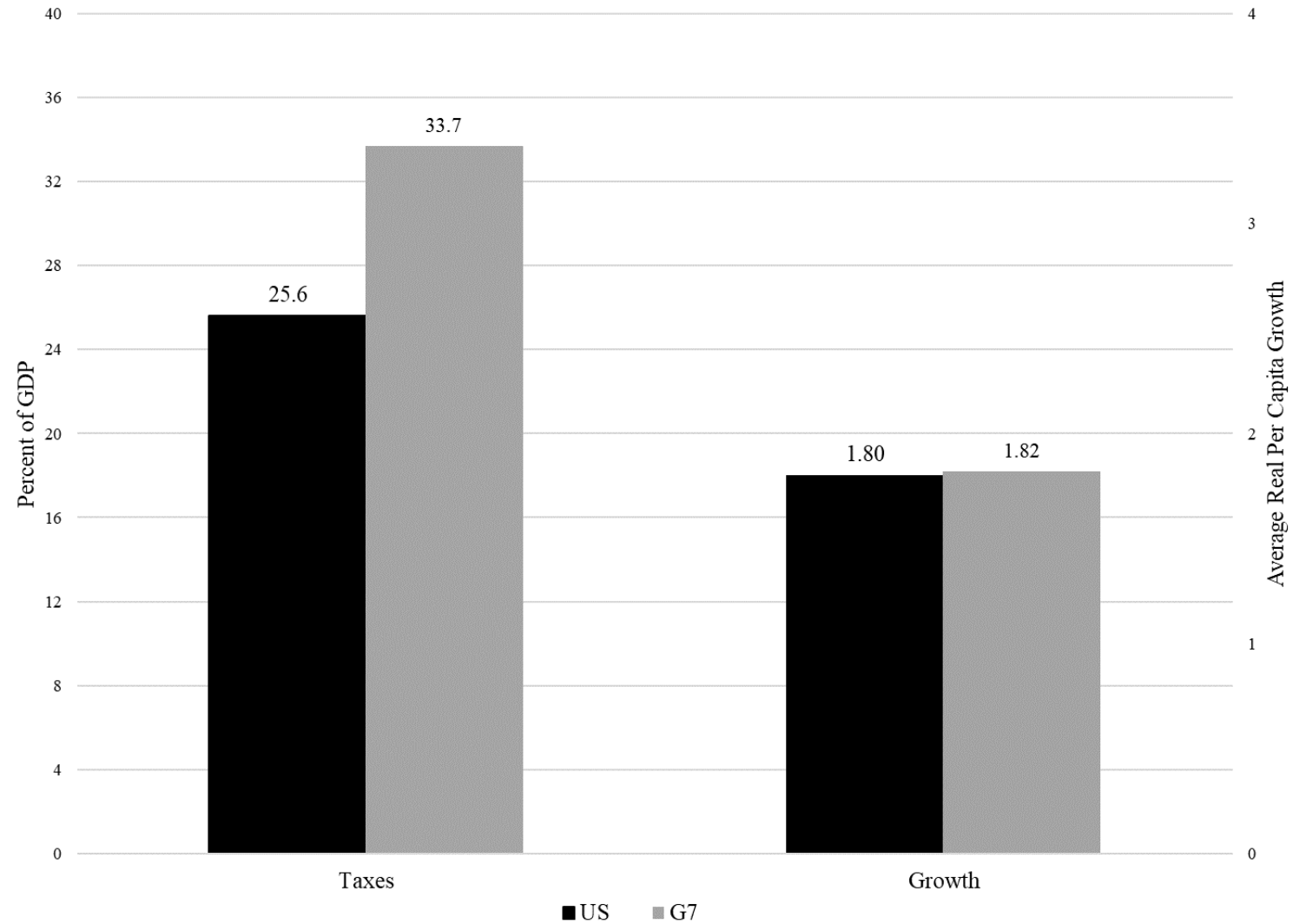
Debt/GDP under the Proposal



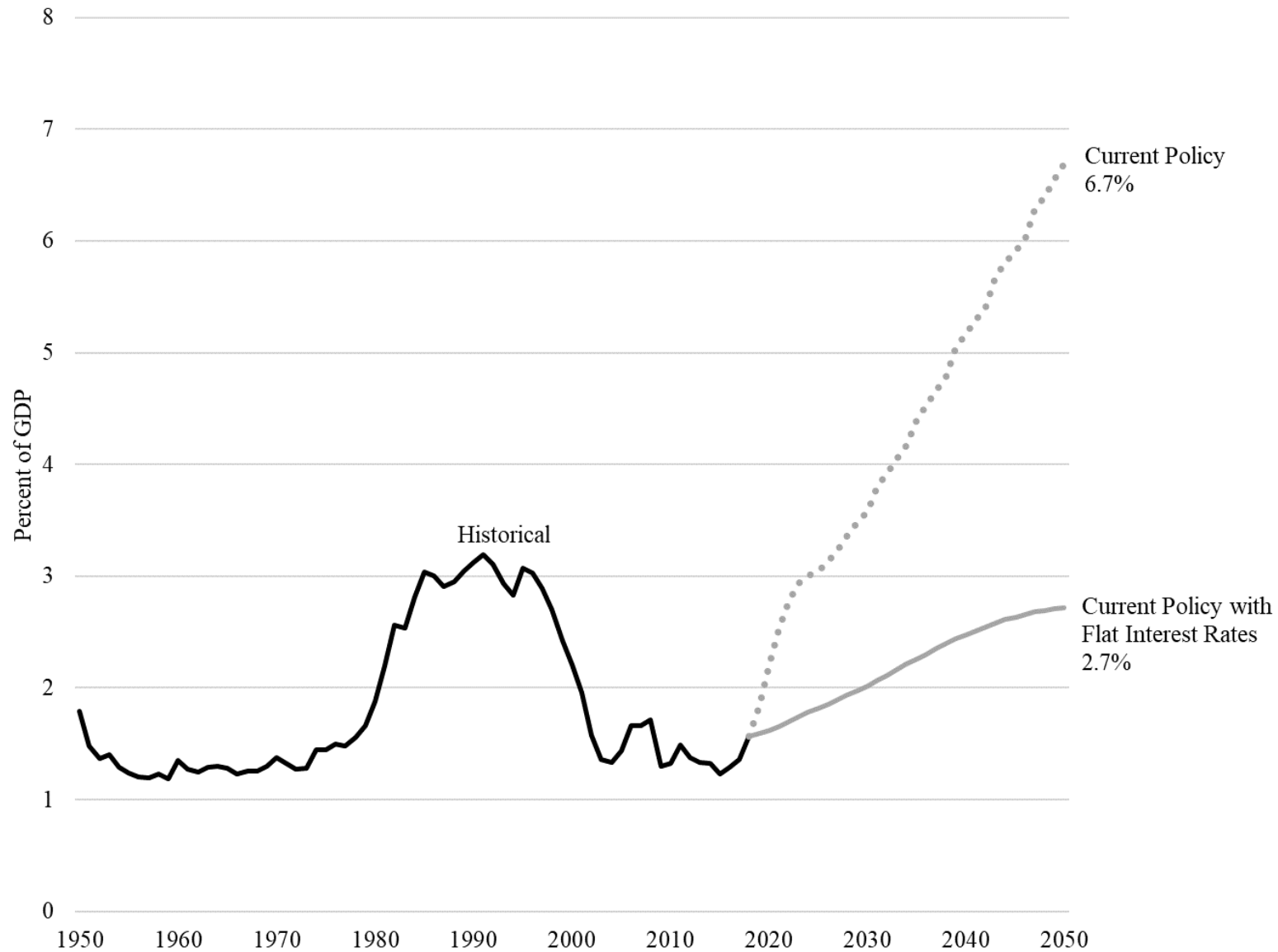
Effects

- 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

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



Interest payments, 1950-2050



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

Cause for 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.”