Laying the Foundation for Inclusive Prosperity

Center for American Progress

By Harry Stein and Alexandra Thornton

INTRODUCTION

The central challenge of our time is building an economy that works for everyone, not just the wealthy few. The economy is growing, corporate profits have soared, and unemployment is falling. But wages have remained stagnant as the benefits of the recovery have flowed mostly to those at the very top. This is not a new challenge—productivity growth has not translated into consistent wage growth since the 1970s. But while wages remain stagnant, the pillars of middle-class economic security—such as higher education, child care, retirement, health care, and housing—have grown disproportionately expensive and out of reach for American families. The Center for American Progress quantified this phenomenon in a report titled "The Middle-Class Squeeze."

Fortunately, this is a challenge that the United States can solve. The Center for American Progress recently released the "Report from the Commission on Inclusive Prosperity," which convened progressive policymakers from the United States, the United Kingdom, and other industrial democracies. This report identified a set of policies to grow the economy by strengthening the middle class and helping more working families achieve middle-class economic security.

Our plan implements an agenda based on the recommendations of the Inclusive Prosperity Commission and other CAP policy development. These policies would create jobs and raise wages, help families afford the pillars of middle-class security, and level the playing field for American workers and businesses. However, this agenda cannot be implemented as long as lawmakers continue to insist on fiscal austerity—a misguided and premature effort to hit arbitrary budget targets that has caused unnecessary economic harm in both the United States and Europe in recent years. A budget that works for all Americans cannot be sustained as long as lawmakers continue to make arbitrary spending cuts and reject any proposal to increase revenue even through reforms that would make the tax code more fair and efficient.

Our plan demonstrates that the United States can afford modern infrastructure, quality education from preschool through college, and a strong safety net to lift up Americans who fall on hard times. Our plan further demonstrates that the United States can sustain fundamental retirement and health care guarantees for the long term, and that there is no fiscal imperative to cut Social Security. The United States can cultivate an innovative and competitive business environment, where Americans can balance their work and family obligations. In short, the United States can afford to build an economy that works for all.

SPENDING

Building an Economy that Works for All

A healthy budget requires a healthy economy with full employment and rising wages. The centerpiece of our plan is a comprehensive set of policies to create good jobs and lower the barriers that keep people on the sidelines of the economy. Federal budget terminology tends to place these policies in boring-sounding categories called "nondefense discretionary spending" or "other mandatory programs," but this is exactly where the United States will need to invest to lay the foundation for an economy that works for everyone.

Our plan includes the Inclusive Prosperity Commission's recommendation to increase federal infrastructure spending by $100 billion each year for 10 years to create over 1 million jobs. There are more than enough productive uses for this funding, since the American Society of Civil Engineers estimates that bringing American infrastructure into a state of good repair by 2020 will require an additional investment of about $1.6 trillion.

In addition to infrastructure, our plan doubles federal investment in general science and basic research to create new jobs in cutting-edge fields, and strengthens the American education and workforce development system to make sure Americans can compete for those 21st-century jobs. Our plan implements President Obama's Preschool for All initiative, provides $5 billion in annual K-12 education grants for states that increase the rigor of their teacher preparation and development programs, and provides financial support for all students to afford higher education through CAP's College for All plan. For today's workers, our plan expands apprenticeships, creates 600,000 summer and year-round jobs for struggling youth, increases in-person career counseling for the long-term unemployed, and improves industry-recognized credentialing programs. Finally, our plan also includes the paid leave benefits provided by the FAMILY Act for caregiving and short-term disability.

Our plan puts Americans directly to work by fully funding the 250,000 national service positions authorized by the Serve America Act, and automatically creates additional positions in times of high long-term unemployment to engage the engine of service when it will deliver the most economic benefit. Additionally, our plan helps struggling workers get a foothold in the labor market with a subsidized jobs program along the lines proposed in CAP's recent report titled "A Subsidized Jobs Program for the 21st Century."

The economy works best when everyone can fully participate. In a society as wealthy as ours, hunger should not be preventing children from growing up healthy and achieving their full potential. Our plan reorients federal food subsidies by expanding nutrition assistance for children during summer months when school lunches are unavailable and implementing the farm subsidy reforms recommended by President Obama. Our plan also brings people off the sidelines of our economy by enacting the Smarter Sentencing Act to reform the criminal justice system, which reduces federal spending on incarceration.

Immigration has always been a source of strength for the United States, but a broken immigration system keeps millions of undocumented immigrants on the sidelines, not able to contribute to their full potential. Our plan enacts comprehensive immigration reform, which grows the economy and reduces the deficit.

The nondefense discretionary budget includes many vital programs that have been undermined by recent budget cuts. Our plan prevents further cuts by increasing nondefense discretionary funding to account for inflation and population growth. After the first 10 years, our plan matches the recommendations CAP made in Solutions Initiative II to ensure stable funding for nondefense discretionary programs.

Social Security

Social Security is the cornerstone of American retirement security, with about 90 percent of elderly Americans, defined as age 65 and above, collecting Social Security in 2012. Also in 2012, Social Security reduced the elderly poverty rate from 44.4 percent to 9.1 percent. Many elderly and disabled Americans still live in poverty, however, so our plan increases the minimum benefit provided by Social Security and Supplemental Security Income.

Our plan prevents a sharp cut to Social Security Disability Insurance by allowing a routine payroll tax reallocation between the retirement and disability trust funds. The scorekeeping rules for the Solutions Initiative assume that Congress will take this action "to keep the program solvent in 2016 if necessary."

Health Care

Health insurance is vital to middle-class economic security. Our plan protects Medicare by permanently repealing the automatic cuts imposed by sequestration. Our plan also permanently extends the Children's Health Insurance Program, which would otherwise expire on September 30, 2015. To ensure that health care remains affordable, our plan builds on the cost control policies in the Affordable Care Act by implementing further cost control measures contained in President Obama's budget and a CAP report titled "The Senior Protection Plan."

Finally, our plan includes CAP's "Accountable Care States" proposal to keep health care costs in check for both government and American families. This plan empowers state governments to control health care costs and share the resulting savings with the federal government.

National Defense

Our plan replaces the arbitrary spending caps imposed by sequestration with the funding levels in President Obama's budget, which includes the recommendations made by military leaders for the next 5 years as part of the Department of Defense Future Years Defense Program. Additionally, our plan phases out the Overseas Contingency Operations budget to prevent it from being used as a slush fund. After the first 5 years, our plan grows the defense budget at the rate of inflation plus 1 percent of GDP to ensure that the military remains prepared to respond to new threats around the world.

REVENUES

How government raises revenues plays a significant role in creating an economy that works for everyone, not just the wealthy few. Our current tax code contains many special tax breaks that enable people with high incomes and accumulated wealth to avoid tax while middle-class working people pay tax on all of their wages. Meanwhile, many businesses and corporations take advantage of tax loopholes and engage creative tax advisers, with the result that some companies pay little or no tax while others pay close to the top tax rate. Another problem with our tax system is that less of our tax revenue today comes from income and estate taxes, which can be tied to the level of income and wealth and historically have offset the burden of payroll and excise taxes on low- and middle-income workers.

If everyone paid their fair share of taxes, that would go a long way toward creating a sound budget plan, while contributing substantially to tax simplicity and creating a level playing field for American workers and businesses.

But, in the long term, closing loopholes will not be enough. Our population is growing and it is aging, which means fewer workers relative to the overall size of the population and more demands on Social Security, Medicare and other safety net programs. The hard truth is that we will need more revenues to sustain our budget in the long term, especially if we want to invest in modern infrastructure, high-quality education, and innovation. We can raise reasonable additional revenues and remain one of the lower-taxed countries among our major competitors. Doing so will also help us maintain our economic strength in an increasingly global and technologically savvy world.

A Fair Tax Code

We have included a number of tax provisions from our earlier Solutions Initiative plans that are aimed at restructuring the tax code for greater fairness and simplicity. As we recognized in our earlier plans, most major tax expenditures are heavily skewed to upper incomes. Thus, a key feature repeated here is to turn the standard and itemized deductions into tax credits so that the tax benefit is the same for most taxpayers.

As before, we have simplified the tax code by making the new standard credit large enough to reduce the number of taxpayers who will need to itemize. Another measure repeated in this plan is a substantially higher child tax credit, as well as a credit for non-child dependents. Together, these credits replace the personal and dependent exemptions in current law and further simplify the tax code for individuals.

To address the fact that wages have not caught up with the economic recovery, we have included a temporary tax credit for the middle class. This will support their wages in the short term and in turn will help grow the economy as they spend those funds.

Affordable child care is a critical element of any pro-family economic agenda, due to the increasing number of families with two working parents. Studies increasingly show that the quality of child care for children under 5 years of age has significant ramifications for success later in life; yet high-quality child care is out of reach for many working families, which ultimately impacts the economy. We believe the most efficient and fair way to deliver high-quality child care to young children is through a tax benefit delivered directly from the government to certified high-quality child care providers. This would be available to all low- and middle-income families, phasing out above $90,000 of income.

More Revenue in the Long Term

Tax return data shows that the average tax rate paid by individuals with incomes above half a million dollars is relatively flat. Even though individuals with incomes in the top 1 percent and especially the top 0.1 percent have seen their incomes increase dramatically in the recovery, they pay the same top marginal income tax rate of 39.6 percent on all of their wage income above roughly half a million dollars. Our plan would add an additional 5 percent tax on income over $1 million. Also, because more than 90 percent of the benefits of reduced tax rates on capital gains and dividends accrue to the top 20 percent of taxpayers, our plan would tax dividends as ordinary income, tax capital gains at a top rate of 28 percent, and close the stepped-up basis loophole that currently allows wealthy families to avoid paying any income tax at all on the gain from capital assets they transfer at death.

Many of the above policies would help create jobs and raise wages, address inequality and help families afford the pillars of middle-class security. Our plan also would ask corporations to pay their fair share, primarily through the elimination of corporate loopholes which in turn would help level the playing field for American businesses. It also includes a small tax on financial transactions to discourage high-frequency trading and a tax on large financial institutions—two measures that would increase financial stability and ensure that Wall Street is paying its fair share of taxes. At the same time, we have retained and made permanent corporate tax spending aimed at research and experimentation, as well as innovation that will help prepare the U.S. economy for a clean energy future.

We believe that the corporate tax code should raise more revenue than it has in recent decades. We envision a higher effective tax rate on corporations, while leaving open the potential for lowering the statutory corporate tax rate through loophole closers and other base-broadening measures. Because we believe that the corporate tax code should be reformed to raise additional revenue over current levels, we have included certain corporate tax measures in our plan as a first step for corporate tax reform. For example, we include the President's proposed changes to the international tax system to address growing concern about tax avoidance by large multinational companies.

Finally, to strengthen Social Security and Medicare for the long term and avoid sharp cuts in benefits due to trust fund exhaustion, we include two measures that would increase revenues going into the trust funds: removing the cap on the employer's share of the Social Security tax and making income in cafeteria plans subject to Social Security and Medicare payroll taxes. And our plan would impose a carbon tax beginning in 2027, in recognition of the fact that climate change poses a serious threat to our economy, as well as the natural environment.

CONCLUSION

Our plan demonstrates that progressive ideas to build an economy that works for everyone, such as the policies advocated by the Inclusive Prosperity Commission, are fiscally responsible. We put an end to misguided short-term austerity and instead focus on the more important goal of growing the economy. Under our plan, the national debt would be on a declining path as a share of GDP, and the budget would gradually reach full balance. When spending and revenue decisions are based on fairness and investment for the long term, the choices become clear.

Percentage of GDP	2026	2040
Revenues	20.8	23.2
Spending	22.8	22.6
Deficit (-)/ Surplus (+)	-2.0	0.6
Debt Held by the Public	66.6	45.8

Center for American Progress

MEMORANDUM

TO: The 45th President and 115th Congress

FROM: The Center for American Progress

DATE: January 1, 2017

SUBJECT: Laying the Foundation for Inclusive Prosperity

The beginning of a new Administration and a new Congress presents an opportunity to take a fresh approach to the federal budget, one that lays the foundation for a strong economy that works for everyone.

There are three tests that any budget plan must pass to be taken seriously: it must contain measures to grow the economy by strengthening and expanding the middle class, slow the growth of health care costs for both American families and the federal government, and increase federal revenues over the long term.

A healthy budget requires a healthy economy, and a healthy economy requires a thriving middle class. Recent analysis from the Organisation for Economic Co-operation and Development finds that "income inequality has a negative and statistically significant impact on subsequent growth." Excessive inequality and a struggling middle class also weaken critical federal programs. For example, a CAP analysis found that the surplus currently in the Social Security trust funds would be more than $1 trillion larger if payroll taxes still covered 90 percent of wages. Excessive inequality is fiscally irresponsible.

The Center for American Progress quantified the economic struggles facing middle-class families in a report titled "The Middle-Class Squeeze," and published a detailed policy agenda to address these challenges and build an economy that works for everyone in the "Report from the Commission on Inclusive Prosperity." The Inclusive Prosperity Commission's recommendations included investing in infrastructure, innovation, and national service to create jobs; helping middle-class families afford child care, higher education and retirement; and making the tax code more fair and efficient for everyone, in part by eliminating preferences that give special treatment to the wealthy few.

Health care is among the most significant expenses squeezing family budgets, and rising health care costs are also a primary driver of the federal government's long-term fiscal imbalance. The Affordable Care Act included many policies to slow the growth of health care costs, and these costs have indeed grown unusually slowly over the last few years. Those who care about fiscal discipline should be highly skeptical of any plan that repeals the Affordable Care Act and starts from scratch, given the tremendous difficulty of enacting lasting policy to control health care costs.

A fiscally responsible budget should build on the successful cost control policies of the Affordable Care Act. President Barack Obama has proposed smart Medicare reforms in his budgets, and "The Senior Protection Plan" from the Center for American Progress offers a set of policies to reduce costs in federal programs without harming patients. To control health care cost growth over the long term, CAP's "Accountable Care States" proposal would enable states to partner with the federal government to improve their health care systems, with federal and state governments sharing in the savings from these improvements.

Finally, a responsible budget must increase tax revenues over the long term. Maintaining the fiction that tax cuts will lead to economic growth is dishonest, as recent history demonstrates, and creates the false impression that all Americans will benefit. The truth is that the long-term gap between spending and revenues cannot be closed with spending cuts alone—not without damaging or even eliminating programs that are critical to retirement security, poverty reduction, infrastructure, and security, as well as programs that will ensure America continues to innovate and meet the challenges of a digitally connected world.

Bipartisan fiscal commissions consistently recognize that a responsible long-term federal budget plan requires additional tax revenue. Unfortunately, a majority of the House of Representatives and nearly half of the Senate have sworn to oppose any attempt to raise revenue, by signing the "Taxpayer Protection Pledge" circulated by Americans for Tax Reform. As long as so many members of Congress remain sworn opponents of bipartisan fiscal responsibility, the prospects for sustainable action on the long-term debt will remain dim.

We encourage you to review our proposed budget, which increases tax revenues through reasonable measures that also ensure every American and every corporation is paying their fair share. It eliminates wasteful spending through the tax code on both the wealthy, who are better able to pay their fair share, and on industries that do not need special treatment. Where it does spend through the tax code, it does so because the tax code is an efficient and appropriate tool for the specific purpose. For example, we use it to ensure that young children receive high-quality child care so that both of their parents can work. And we use the tax code responsibly, providing a temporary tax credit for middle-income families to share the prosperity of the recovering economy until their wages catch up with the growth in profits of corporations.

Balancing targeted spending cuts with reasonable tax increases prevents the need for catastrophic measures. The good news is that, if done properly and combined with measures to strengthen the middle class and control health care costs without losing the progress from the Affordable Care Act, the benefits to the U.S. economy will be immediate.

We can have an economy that works for all if we have a budget that works for all.

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