Investing in America's Economy: A Budget Blueprint for Today and Tomorrow

Economic Policy Institute

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INTRODUCTION

The American economy continues to struggle after the end of the Great Recession and five years of historically austere federal spending during an economic recovery. Economic growth is half of what it normally should be after a recession and the labor market still displays signs of significant slack, with little wage growth and a high proportion of long-term unemployed. Even with the large spending cuts enacted in the Budget Control Act of 2011 (BCA) and a rapid decline in projected health care cost growth, the long-term budget outlook shows future deficits large enough to raise the country's debt-to-GDP ratio even if the economy reaches full employment. As a matter of arithmetic, this higher ratio results from increases in revenue relative to GDP that lag federal spending increases, which are in turn driven largely by rapid growth in nationwide health care costs.

Too many policymakers and economic observers treat budgeting as little more than an accounting exercise, in which the goal is simply to make the spending and revenue lines meet. While our budget plan achieves a sustainable debt path, it was crafted with a broader goal in mind: to create a better economy and society.

Our budget proposal starts from a vision shared by most Americans: rising living standards, greater economic opportunity and security, and provision for future generations. To this end, we propose a long-term budget that adheres to our set of guiding principles.

First, America needs to invest in the future by repealing the BCA spending cuts and increasing critical public investments. These investments will not only boost future economic growth by increasing public capital, human capital, and knowledge, but also will create good jobs in the near term to rebuild America's infrastructure.

Second, fiscal policy must address the enormous rise in economic inequality and improve economic opportunity. The tax system has become less progressive over the past 50 years, thus exacerbating income inequality. Our plan restores fairness and progressivity to the tax system by increasing tax rates at the top and on the intergenerational transfer of extreme wealth.

Lastly, the country's social protection system, which helps to soften the sharp edges of our market economy and to maintain public support for the market economy, must be preserved and strengthened. Our budget plan strengthens Social Security's finances, improves unemployment insurance (UI) extended benefits, restores funding for nutrition assistance, and builds on the Affordable Care Act (ACA) to contain long-term health care costs.

In recent years, pundits and policymakers have been far too quick to assume that budget deficits are always and everywhere too large, and that—practically if not rhetorically—job creation has taken a back seat to cutting federal spending. We reject this view and propose a budget that increases spending for critical needs and pays for this increased spending by raising revenue. Ultimately, our budget creates jobs in the near term, fosters future economic growth, and puts the federal budget on a long-term sustainable path.

SPENDING

Our spending policies are designed to promote immediate job creation, strengthen the middle class, expand economic mobility and opportunity, and foster future economic growth. Our plan includes proposals in the following categories:

Medicare, Medicaid, and Other Federal Health Programs

Our plan protects and strengthens the social insurance programs that ensure health coverage for those who are otherwise unable to receive affordable coverage. As the cost of providing health care escalates, however, it is imperative that we slow the rate of rising *national* health care expenditures instead of simply shifting rising costs from the federal government onto households or state governments.

Our budget establishes a public health plan in the ACA Health Insurance Exchanges, which would increase competitive pressures on other health insurers selling policies through the health exchanges.

Using government monopsony (single-buyer) power to contain costs, our plan would negotiate lower Medicare Part D drug prices, encourage bundling payments, accelerate generic drug availability, and finance investments in health information technology and research into comparative effectiveness.

Furthermore, our plan expands the jurisdiction of the Independent Payment Advisory Board (IPAB) to the private sector. This super-charged IPAB, in addition to our other health policies, should sufficiently contain nationwide (and thus government) health care costs. If it does not, we then propose an all-payer IPAB system that caps federal health spending at nominal GDP plus 1.85 percent beyond 2022. Lastly, our plan repeals the sustainable growth rate formula for Medicare physician payments.

Social Security

Social Security has kept more seniors, disabled persons, and children out of poverty than all other social welfare programs combined, and for 75 years it has provided economic support for millions more. As businesses continue to shift risk to individuals by replacing private pensions with tax-preferred personal savings accounts, Social Security is proving an increasingly important pillar of retirement.

However, as income inequality has increased over the past 35 years, a larger share of earnings has not been taxed, thus depriving the Social Security system of revenue. Our plan recognizes the need to shore up Social Security while protecting benefits: the maximum taxable earnings level for payroll tax contributions is increased so that 90 percent of covered earnings are taxable. Furthermore, our plan would expand Social Security coverage to newly hired state and local government workers.

Defense Discretionary

Our plan replaces the frontloaded BCA discretionary spending caps and sequester for defense spending with comparable cuts that are in line with those proposed by the Congressional Progressive Caucus budget. Additionally, we propose a 0.025 percent of GDP increase in defense discretionary spending for research and development.

Nondefense Discretionary

A balanced approach to fiscal sustainability requires boosting employment in the near term and investing in long-term growth. An excessive focus on restraining debt ignores ways in which simple-minded spending cutbacks can shortchange future generations by leaving them with inadequate roads, bridges, schools, knowledge, health, or environmental quality. The current budget trajectory underinvests in physical, human, and environmental capital. Consequently, our budget starts with the repeal of the entire BCA, which applies disproportionate cuts to the non-security discretionary budget, half of which consists of public investment.

Our budget further invests in our nation's infrastructure, education and training, and research and development by financing a permanent increase in public investments of $300 billion in 2017, which is then indexed to GDP growth in subsequent years. In addition, the Highway Trust Fund is fully funded on a permanent basis. Finally, our proposal substantially increases funding for research and development by the National Institutes of Health (NIH) and the National Aeronautics and Space Administration (NASA).

Other Mandatory

Our budget preserves and strengthens our country's social welfare system. It restores the Supplemental Nutrition Assistance Program benefits that were cut by the 2014 Farm Bill to help feed low-income families and children.

The Earned Income Tax Credit (EITC), which encourages work and reduces poverty, is expanded for childless workers. Additionally, the 2009 expansions of the child tax credit and the EITC, which expire in 2017, are made permanent.

Lastly, our budget improves UI extended benefits by creating a permanent, federally-funded program that provides benefits for up to 52 weeks. This proposal is in line with President Obama's fiscal year 2016 budget proposal.

REVENUES

The current tax code fails along many dimensions. First, tax receipts have been deliberately driven down over the past 15 years to levels that will produce unsustainable budget deficits as far as the eye can see. The Bush tax cuts, for example, are a core reason that sizable structural deficits are projected if fiscal policy remains unchanged. Second, changes in tax policy have exacerbated income inequality, and tax progressivity must be restored to address the large rise in inequality of incomes in recent decades. Third, tax code complexity for both individuals and corporations is such that a tax bill can depend as much on the quality of one's accountant as on the size of one's income.

High-income households and corporations now often pay far less in taxes than what an optimal tax system would collect from them. Under our proposals, higher-income earners and corporations would contribute more.

Individual Income Taxes

The Bush tax cuts were costly and ineffective, and the evidence shows their failure to boost economic growth. The tax system has also become less progressive over time as tax rates have been reduced. Our budget eliminates the reduced tax rates enacted in 2001 for taxpayers in the 25 percent tax bracket and above (the richest 20 percent). Two new tax brackets are added for the highest-income taxpayers: a 43 percent tax bracket on income between $2 million and $10 million, and a 47 percent tax bracket on income over $10 million. Furthermore, our plan taxes income derived from wealth—qualified dividends and capital gains (with a 35 percent exclusion)—as ordinary income rather than at the current reduced rates.

Corporate Income Taxes

The corporate tax code is rife with inefficient and costly special-interest tax breaks. First, our plan starts by adopting the Obama administration's proposals to eliminate fossil fuel tax subsidies, which are unnecessary and inhibit the transition to a more sustainable economy. Second, our plan eliminates the tax deferral of foreign-source active income and limits the ability of U.S. corporations to expatriate for tax purposes. Third, some inventory methods that are unjustified and unnecessarily complicate the tax code, such as last-in, first-out (LIFO) and lower of cost or market, are repealed. Fourth, debt financing of corporate investment is put on a more equal footing with equity financing by indexing the corporate interest deduction to inflation.

Tax Expenditures

Tax expenditures—special deductions, exclusions, and exemptions that are often characterized as "loopholes"—were added to the tax code for specific economic or social purposes. However, many tax expenditures are ineffective in achieving their stated purpose, and the tax benefits are often skewed toward higher-income taxpayers. Our budget broadens the tax base and increases tax collections by eliminating several unnecessary tax expenditures. Eliminating wasteful tax breaks will further improve tax compliance and administration.

Under the individual income tax, several itemized deductions are eliminated, and the tax benefits of the remaining itemized deductions are capped at 28 percent. The mortgage interest deduction is phased out over a 15-year period, and the deduction for state and local taxes is eliminated. The charitable contributions deduction is limited to donations that exceed 2 percent of adjusted gross income so as not to remove the marginal incentive to contribute to charity. These provisions will only affect taxpayers who itemize deductions—about one-third of all taxpayers, most of whom are higher-income individuals.

Other Revenues

Our plan shifts the burden of taxation away from work and emphasizes corrective taxes, seeking to minimize socially harmful outcomes and activities that produce "negative externalities" because their full social costs are unpaid. These include pollution, alcohol consumption, firearms and ammunition, the diabetes epidemic and other adverse health effects, concentrated wealth, and high degrees of financial leverage. To help mitigate pollution and improve public health, our plan prices carbon emissions (initially set at $30 per metric ton) and recycles over half of the revenue back to low- and middle-income households through a refundable tax rebate. Our plan also phases in an increase in the motor fuel excise tax, raises alcohol excise taxes, increases the excise tax rate on firearms and ammunition, and enacts a new sweetened-beverage tax. To reduce systemic financial risk, we adopt a leverage tax on "too big to fail" banks.

The estate and gift tax is an effective way to reduce the corrosive effects of concentrated wealth. Our plan reduces the estate tax exemption from the current $5.4 million to $2.5 million and increases the top tax rate on these intergenerational transfers of wealth from 40 percent to 50 percent.

CONCLUSION

Our budget blueprint navigates the current economic headwinds by expanding effective job creation measures and reorienting tax policy to help lower- and middle-income families while eliminating many costly, inefficient, and regressive tax provisions. Over the longer term, our plan reverses the decades-long erosion of public investment and declining tax code progressivity by boosting investments in future generations and financing these investments by asking more of those in society who can most afford it. Our plan preserves social insurance benefits and avoids cost-shifting measures that tend to exacerbate rather than address the underlying economic challenges.

The current austerity measures designed to reduce budget deficits have failed to improve the long-term budget outlook, increase economic growth, boost living standards, or provide security for current and future generations. To be successful, deficit reduction must be paired with policies that push the labor market back to full employment and that lay the foundation for long-run economic growth.

Percentage of GDP	2026	2040
Revenues	22.4	23.5
Spending	23.9	25.4
Deficit (-)/ Surplus (+)	-1.5	-1.9
Debt Held by the Public	58.4	54.2

Economic Policy Institute

MEMORANDUM

TO: The 45th President and 115th Congress

FROM: Economic Policy Institute

DATE: January 1, 2017

SUBJECT: Investing in America's Economy: A Budget Blueprint for Today and Tomorrow

Introduction

The American economy continues to struggle after the end of the Great Recession and five years of fiscal austerity measures. Economic growth is half of what it normally should be after a recession, and the labor market still displays signs of slack with little wage growth and a high proportion of long-term unemployed. Even with the ruinous austerity measures enacted in the Budget Control Act of 2011 (BCA), the long-term budget outlook sees rising debt ratios even if the economy reaches full employment, largely because too many members of Congress have pledged not to raise taxes.

Our budget proposal starts from a vision shared by most Americans: rising living standards, greater economic opportunity and security, and provision for future generations. To this end, we propose a long-term budget that invests in America's future by repealing the BCA austerity measures and increasing critical public investments, reduces economic inequality and improves economic opportunity, and strengthens our social protection system. Although our budget is crafted to meet these economic and social goals, our proposals also yield sustainable budget deficits and debt over the long term, with debt held by the public falling relative to GDP from its current 74 percent to less than 59 percent by 2026 and finally to 54 percent by 2040.

Policy recommendations

We offer several specific budget provisions to meet these goals, but three are particularly important: increasing public investments, strengthening the social welfare system, and paying for the goods and services Americans need and want from the federal government.

First, we propose to increase spending for public investments by about 1.5 percent of GDP per year (by almost $400 billion for fiscal year 2018, for example). These investments include increased infrastructure spending for repairing and improving roads, bridges, water and sewage systems, waterways, schools, and computer infrastructure for important agencies such as the Federal Aviation Administration and the National Weather Service. Our budget further increases spending for education (primary, secondary, and post-secondary), job training, and scientific research and development. These investments will not only boost future economic growth by increasing public capital, human capital, and knowledge, but also will create good jobs in the near term to rebuild America's infrastructure.

Second, our budget preserves and strengthens our country's social welfare system, which helps to soften the sharp edges of our market economy and to maintain public support for the market economy. Social Security finances are improved by raising the cap on taxable earnings. The Supplemental Nutrition Assistance Program (food stamps) cuts are repealed to help feed low-income families and children. The Earned Income Tax Credit (EITC), which encourages work and reduces poverty, is expanded for childless workers. The 2009 expansions of the child tax credit and the EITC, both of which expire in 2017, are made permanent. Our budget further improves unemployment insurance (UI) extended benefits by creating a permanent, federally-funded program that provides benefits for up to 52 weeks.

Lastly, our budget would pay for the increased spending by raising revenue, mostly by reversing recent decades' cuts in top tax rates and by closing tax loopholes. This reversal simply means asking for a bit more from those households that have seen the most rapid income growth in recent decades. Accordingly, we propose broadening the tax base by eliminating many wasteful tax expenditures and tax breaks, such as the mortgage interest deduction and corporate deferral of foreign source income. In addition, we propose increasing the top tax rates for taxpayers earning over $2 million per year and instituting a carbon tax. These proposals will raise needed revenue, simplify the tax code, help reduce income inequality, and reduce our reliance on fossil fuels. Eliminating wasteful tax breaks will also improve tax compliance and administration. The tax increases are designed to minimize any adverse effects on the economy.

Conclusion

Budget policies adopted in recent years under the misguided notion that budget deficits should be eliminated quickly and only through spending cuts have had devastating consequences. The long-term budget outlook still shows rising debt ratios even if the economy recovers. Our crumbling national infrastructure has caused many preventable deaths and contributes to low economic growth. The recovery from the Great Recession can best be described as anemic. We appear to be well on the road to leaving our children with substantial hurdles to future success: poor infrastructure as well as other substandard public assets, a tattered social safety net, and no ladder to upward economic mobility.

In closing, we strongly urge you to adopt our budget to put America on a long-term path for strong economic growth, rising living standards, greater economic opportunity, and a secure future for our children. The key feature of our budget is our proposal to pay for the necessary increases in federal spending. At the same time, our proposal lowers budget deficits to sustainable levels and gradually reduces the debt-to-GDP ratio from its current 74 percent to 58 percent by the end of the 10-year budget window in 2027. Even after raising taxes to pay for the increased spending, the United States will still have one of the lowest tax burdens of any developed country.

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