MEMORANDUM

TO: The Administration and Congressional Leaders

FROM: Josh Bivens and Hunter Blair, Economic Policy Institute

DATE: June 11, 2019

SUBJECT: The Budget for Shared Prosperity

INTRODUCTION

The United States faces pressing economic challenges that can be most efficiently and equitably met with a substantially larger federal fiscal footprint. These challenges include: keeping aggregate demand strong in the face of structural headwinds ("secular stagnation"); ensuring the fruits of economic growth are broadly shared, even as inequality of market income is at historic levels; and making public investments at a sufficient scale to provide meaningful economic mobility and opportunity for all families, as well as to aid the fight against global climate change.

Meeting these challenges will require a substantially higher level of federal spending—which in turn will require a substantially higher level of revenue. The first tranche of revenue should come from progressive sources. Income growth has been enormously skewed towards the top of the distribution in recent decades, so financing the spending expansion that the economy needs should be disproportionately borne by those who have benefited the most. However, the scale of spending we call for in our budget—particularly that demanded by the introduction of publicly financed health care for all—will require broader-based revenue changes. We think Americans are ready to hear this message, and we think the extra revenue raised will pay off in services that come to be greatly valued—as evidenced by past legacies of social insurance expansions like the introduction of Social Security, Medicare, and Medicaid.

TOP THREE POLICY RECOMMENDATIONS

Our largest spending increase provides publicly financed health care for all Americans. We think a single-payer plan will reap large savings in the long run by reducing administrative costs and providing a check on the pricing power of health care providers like pharmaceutical companies, device makers, and hospital chains. We also think that a single-payer plan will keep families from falling through the cracks of the current system and provide everybody the fundamental right to health care that does not make them poorer throughout the rest of their lives. We target two specific taxes for this expansion: a broad-based payroll tax and an income-based premium. These taxes will largely mimic the spending flows that finance how Americans with employer-sponsored insurance today finance their health care.

On overall revenue, we recommend boosting the effective tax rate on capital income (income accruing to households through their ownership of wealth) and the abolition of all tax expenditures except for the earned income tax credit (EITC). Incomes at the top of the income distribution are dominated by capital-based sources, and current law taxes capital very lightly—keeping households at the top from contributing their proper share to financing the federal budget. Effectively taxing capital will require the full suite of tax changes in our budget—there is no single silver bullet. The fiscal cost of tax expenditures today rivals the entire discretionary portion of the federal budget, and their benefits accrue to the richest fifth of the income distribution. Moreover, the 2017 tax law further increased their regressivity. Many of the social objectives that provide the rationale for tax expenditures can be better served by direct spending. We model this by replacing the child tax credit with a universal child allowance—a change that will radically reduce child poverty.

Finally, we call for a large expansion of public investment—in traditional infrastructure, in green investments, and in public education. Federal investment has been squeezed for years, and private investment has been relatively weak for nearly two decades, leading to a slowdown in economy-wide productivity growth. The most direct tool to reverse these adverse trends is a substantial boost to public investments.

These recommendations to raise revenue progressively and boost spending will also provide strong "balanced budget multiplier" effects to aggregate demand growth, helping the economy escape the chronic shortfall of spending that has held back growth for more than a decade.

SHORTER-TERM ISSUES

We would replace current caps on discretionary spending after 2019 with permanent increases in this spending that hold it constant as a share of gross domestic product (GDP). Our recommendation for the statutory debt limit is to abolish it. It serves no useful economic purpose and only allows irresponsible actors in Congress to cause economic uncertainty for political gain when it threatens to bind. We would completely undo the 2017 Tax Cuts and Jobs Act (TCJA) and replace it with the tax provisions in this budget. While we raise the federal gas tax in part to forestall the exhaustion of the Highway Trust Fund (HITF), we also finance other infrastructure spending with general revenue. Finally, we would authorize the payment of Medicare Part A services with general revenue in the event of the HITF exhaustion.

CONCLUSION

In recent decades, American economic growth has been too slow and too skewed towards the rich. This slow and unequal growth has caused great—and unnecessary—economic distress for the vast majority of American families. A much-larger footprint of federal spending and revenue can make a substantial contribution to fixing the problems of slow and unequal growth. It can do this by boosting public investments to make up for years of slow federal investment and the slowdown in private-sector investment growth. These public investments can boost economy-wide productivity growth, as well as provide meaningful pathways for economic mobility and opportunity. Additionally, the federal government's taking on the task of financing health care will provide great benefits to American families, both in access to health care—a fundamental human right—as well as to reducing costs and wringing out inefficiencies and corporate rents. Health care currently accounts for roughly a sixth of the entire U.S. economy, and per unit health costs are routinely twice as high as in other advanced economies. Fundamental reform in this sector is a crucially important economic issue for American families.

Financing these increases in spending in a macroeconomically responsible way requires substantial new revenue. But the U.S. is a rich country that is very lightly taxed relative to international peers. Further, effective tax rates on the richest households have fallen in recent decades, even as their share of national income rose enormously. In short, the U.S. has enormous untapped fiscal capacity to give its residents the economic security and opportunity they deserve.

A BUDGET FOR SHARED PROSPERITY

Economic Policy Institute

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INTRODUCTION

EPI's budget plan is informed by a number of stylized facts about the U.S. economy. First, economic growth has been slow for almost two decades. The roots of this slow growth are too-slack aggregate demand for most of this period, anemic growth in private-sector investment, and productivity growth. Second, the slow growth in recent decades has not been accompanied by any progress at all in reversing the huge upward redistribution of income that characterized previous decades—in fact, by many measures inequality has continued to rise. Third, the public sector footprint in the United States is far smaller than in many other rich countries around the world. This small public sector footprint in turn means that we expend far less fiscal effort in income support programs to fight poverty, social insurance programs to provide broad-based economic security, and public investments to spur growth. Fourth, the most-glaring outcome of the small public footprint in the U.S. economy is a health sector that is inefficient and unfair. Our health care system provides coverage to a smaller share of our population, delivers less health care, obtains worse health outcomes, and yet places a far greater economic burden on households than in almost any other rich country. Given the enormous economic heft of the health care system, any budget aiming to boost living standards must provide strong reform for this sector.

A greater commitment to providing stronger public investment, social insurance and safety nets over the long-run requires a willingness to pay more in taxes. The enormous upward distribution of income in recent decades means we can get a long way with explicitly progressive tax increases. But our adoption of a fully-public health care financing system is expensive enough in fiscal terms to require broader-based tax increases. It is important to note that these broad-based taxes are not a new "cost" to households for healthcare. Instead, they will largely replace the current health costs these households face. In the long-run, much evidence indicates that the pace of health care cost growth—and hence the economic burden it places on families—can be substantially reduced with a fully public plan. So, even as the fiscal cost of health and tax rates facing families rises, these families' post-tax, post-health care living standards will increase.

Our plan would address the slow pace of economic growth in two broad ways. First, the larger public footprint and a tax and transfer system that redistributes away from the top and towards the bottom and middle will mechanically help strengthen aggregate demand growth (as households at the top of the income distribution save more than those in the middle and bottom). Second, because the slow pace of private investment has held back growth in recent years, our plan ramps up public investment. Much research shows that investing in basic infrastructure, green infrastructure, and in early childhood care and investment would have profound effects in boosting growth for the future. Reducing inequality and ramping up public investment in early childhood care and education will also provide a huge spur to economic mobility and opportunity.

What's the Political Opportunity for this Budget?

This is obviously not a budget that many current members of the Republican party in Congress would support. But Congress has failed to even pass a budget resolution in 6 of the last 8 years, in either Republican or Democratic-controlled Congresses. The extreme polarization of politics means that a strategy of finding votes in the middle of both parties by figuring out which policies code as "centrist" is obsolete, for good or bad. So, our budget is not one that has a micro-targeting political strategy of bundling together a few votes here and there to become law. Instead, it is a budget blueprint for a progressive governing majority, should one ever take power.

That said, there are elements of the budget that are broadly popular across the public who identify as either Republican or Democratic. The most popular aspects might surprise those in the DC policymaking bubble: substantially raising taxes on the rich and corporations. A Fox News Poll found that 54 percent of Republicans favored a proposal to raise income taxes on rich families. Perhaps the most-crippling false impression in Beltway politics today is the reluctance to make full-throated calls for progressive taxes. There are many good reasons to undertake these progressive tax changes, and the public is broadly on-board.

SPENDING

All policies are assumed to start at the beginning of 2020. The largest practical implementation challenge is posed by our M4A program, which would need to be integrated with Medicaid and Medicare over time into a more-seamless public plan. The substantial increase in taxation—including new forms of taxation such as a wealth tax - will present the challenge of increased incentives for tax avoidance. Our plan deals with this by ensuring a broad base of taxation, for example the repeal of tax expenditures, as well as including a substantial increase to IRS funding to ensure that the IRS has the resources necessary to enforce the new tax code.

Overall, our spending proposals raise the federal government's spending by roughly 10.1 percentage points of GDP in 2029 relative to baseline, and raise them by 7.9 percentage points in 2049.

Medicare, Medicaid, and Other Federal Health Programs

In our plan, we propose to raise enough revenue to supplant all private health insurance coverage with a new public plan (a plan we'll call **M4A**). We will keep the existing structure of Medicaid and Medicare in place and introduce a public plan that covers all non-elderly, non-poor households who are currently covered by employer-sponsored insurance or insurance purchased on individual marketplaces or who are uninsured. We will keep intact military and VA plans.

We have obviously not accounted for all implementation details in this plan—such an ambitious restructuring of the American health system would take many years to complete. But we have tried to specify where we think the financing flows of this plan would come from, and, have identified evidence as to why we think such a plan would considerably reduce the trajectory of health costs over time. We would also hope to over time integrate M4A, Medicaid and Medicare into a more-seamless public plan with a common payment structure and reimbursement rates.

Essentially, we call for raising enough revenue to supplant the 6.5 percent of GDP currently spent on private health insurance, as well as covering the currently un- and underinsured and reducing out-of-pocket costs system-wide by half. Given that a large share of these out-of-pocket costs is paid by current Medicare beneficiaries, this implies a large boost to the protectiveness of current Medicare coverage—something we think should be a prime policy goal. A portion of the revenue needed for the expansion of public coverage can be claimed by the eliminated need to continue the subsidies for private purchase of insurance in the exchanges set up by the Affordable Care Act (ACA).

We achieve some health care savings by instituting tougher negotiations over pharmaceutical and medical device prices in Medicare, Medicaid and the new M4A plan. We would address issues of Medicare trust fund accounting by mandating that general revenue be used to fund Medicare Part A services in the event of a trust fund shortfall. We think the much more pressing economic challenge to sustaining and strengthening Medicare is ensuring the entire federal budget is on a sound footing, which is the purpose of this exercise.

Social Security

Like the Medicare Part A Trust Fund, we do not specify a full actuarial reform that ensures no shortfall in the Social Security Trust Fund. We think such an accounting reform of Social Security should be done outside of an omnibus tax and budget plan like the current exercise. Again, the compelling economic challenge to sustaining and strengthening Social Security is ensuring that the overall tax and budget is on a sound and sustainable footing. Given that we do this overall budget reform, we would instruct full Social Security payments to be made even in the event that the trust fund becomes exhausted.

In our budget, we do make some low-hanging changes to Social Security, even if we do not undertake a full accounting reform. For example, we raise the taxable maximum payroll cap to a level that would cover 90 percent of earnings, the level it was set at in the latest large reform in 1983. The erosion of this cap's coverage since then has been driven entirely by increased inequality— a development not foreseen by the 1983 reformers. We see this largely as a simple technical fix to ensure that federal revenues are not lost to unforeseen economic developments.

On the spending side, we adopt the coverage expansions called for in the Sanders-DeFazio Social Security Expansion Act. Given what we view as the clear and colossal failure of the 401-K experiment in providing retirement security for all, we think eventually even more ambitious Social Security expansions will likely have to be done.

Defense

Regarding defense spending, we propose drawing down the budget authority of Overseas Contingency Operations (OCO) funding (under budget items 050 and 150) after FY 2019. This would be a clear win for budget honesty and transparency. Besides this, we essentially hold defense spending at a constant level of GDP for the budget window, at a level that is fairly low by historical standards.

Non-Defense Discretionary

We propose a permanent boost to non-defense discretionary (NDD) funding in our budget, reversing deep Budget Control Act (BCA) cuts to make needed investments. We increase NDD spending so that it reaches its historical average of 3.53 percent of GDP by 2024 and then hold it relatively constant as a share of GDP. Similarly, we repurpose the one-time disaster relief package included in the baseline into this broad permanent boost to NDD spending—this money will surely be needed as natural disasters become more common because of global climate change. The NDD budget houses a range of critical public investments in areas such as education, energy, basic scientific research, workforce training, and health. These investments ramp-up over 5 years, and then are assumed to be maintained as a percentage of GDP thereafter. We think a key permanent boost to NDD spending is increased appropriations for the Internal Revenue Service's enforcement initiatives. This is spending that literally saves the government money—and by a large margin.

Other Mandatory

Our major new other mandatory expenditures include ramped-up levels of infrastructure spending, including investments in better-paid teachers and new and renovated schools. We also create a new, paid-for social insurance benefit for paid family leave. We provide for universal, high-quality early education and a plan for debt-free college attendance.

For other mandatory spending, we restore levels of spending on SNAP benefits that were in the American Recovery and Reinvestment Act (ARRA) and repeal farm bill cuts to SNAP. We also boost mandatory child nutrition programs by $10 billion over the next 10 years, and then hold that amount constant as a share of GDP going forward. Finally, we strengthen the unemployment insurance program by adopting a proposal from the Obama Administration's FY17 President's budget which would establish a new Extended Benefits program to provide additional benefits during economic downturns. The program would provide as many as 52 weeks of additional federally-funded benefits to states experiencing elevated unemployment levels, with the number of weeks tied to the state's unemployment rate.

REVENUES

Our revenue changes are substantial. We look to both broaden the tax base and raise tax rates. Overall, our revenue changes increase revenue as a share of GDP by 15.2 percentage points in 2029 relative to baseline, and by 15.6 percentage points by 2049.

Individual Income Taxes

We introduce a new set of income tax rates and brackets. They can be thought of as largely returning to pre-2001 individual tax rates, though we keep a 10 percent tax bracket. The pre-TCJA top tax rate (40 percent) now hits at $275,000 for singles. At $1,000,000 the rate rises to 45 percent, and then it tops out at 49 percent for $1,000,000,000.

Given how ambitious our budget is, it might strike some as strange that our top rate is 49 percent, given recent calls for marginal rates as high as 70 percent. We would note that this top rate does not include the Medicare surcharge of 3.8 percent, and, while we do not call for a complete uncapping of the Social Security taxable maximum in our budget, we keep this top rate low to accommodate this potential uncapping in the future. Between the Medicare surcharge and the potential uncapping of the Social Security tax, this would leave our top federal effective marginal rate at roughly 65 percent.

To help finance our new M4A plan, we impose an income-based premium for taxpayers not covered by Medicare or Medicaid. For those with income 400 percent of the federal poverty line or greater, this premium will be $3,000 per adult and $1,200 per child. The premium will be capped as a share of income for households below 400 percent, on a sliding scale.

Corporate Income Taxes

The best summary description of our corporate tax proposal is that we completely undo the TCJA, return to pre-TCJA 35 percent corporate tax rates, and in the return to worldwide taxation that was the pre-TCJA regime, we do away with the ability of firms to defer taxes on profits earned abroad.

Tax Expenditures

Our reforms to tax expenditures are possibly the most transformative part of the budget. We get rid of all tax expenditures except the EITC and the differential taxes paid on Social Security benefits. This includes the preferential tax rates on capital gains, dividends and pass-through business income—three extraordinarily regressive parts of the current tax code. The single-biggest tax expenditure in revenue terms—the tax exclusion for employer-provided health insurance premiums—is rendered largely moot by our publicly-financed M4A plan which would supplant employer plans.

We replace the child tax credit with a universal child allowance (UCA)—the allowance is "scored" as a budget outlay rather than a tax cut. Besides the UCA being more effective in alleviating child poverty, we think its adoption is a model of how to think about tax expenditures: often the social good policymakers are hoping to accomplish with tax expenditures can be more-usefully fulfilled with direct spending. This same logic applies, for example, with the abolition of the tax expenditure that allows the deduction of state and local taxes in our budget. While this makes it a bit harder for state governments to raise revenue for taxpayers who can no longer write-off this revenue on federal returns, the total resources going to states from the federal government in our budget is substantially larger; making it near-impossible to think that state and local governments wouldn't see our budget in toto as a huge boost to their resources.

Besides eliminating the extremely costly and regressive tax expenditure that allowed capital gains to be taxed a lower rate, we implement a suite of reforms to close loopholes that could allow households to avoid the now-higher capital gains rate. Most fundamentally, we introduce marked-to-market taxation of unrealized gains. It is now widely recognized that fundamental changes (at least on the scale of marked-to-market, if not exactly that) will be needed to effectively tax capital income in the future. Our budget recognizes this reality.

Corrective Taxes

Many of the rest of our tax proposals fall into the "corrective" tax bin. The largest and most important is a substantial tax on carbon—starting at $80 per ton and rising to $120 per ton. 200 percent of the revenue from this tax is recycled as a lump-sum payment to all households. This recycled lump-sum, along with the UCA, gives our budget two income flows that can be thought of as universal basic incomes.

We also institute a broad-based financial transactions tax (FTT). The FTT is an extraordinarily progressive tax, and, it will either raise significant amounts of revenue or it will crowd-out a large number of financial transactions. Given the complete lack of evidence that marginal financial transactions in recent decades have meaningfully boosted economic growth, we think these transactions essentially constitute rent-seeking, and squeezing them out of the economy will raise incomes in other sectors.

Payroll Taxes

As noted previously, we raise the taxable maximum on the payroll tax that funds Social Security so that it covers 90 percent of all earnings, the way it did in 1983 when the last major reform to Social Security happened. More importantly, we institute a 3 percent employer-side payroll tax to finance part of our M4A plan. Employers currently pay substantially more than this (close to 8 percent) for health insurance premiums for their workers. We also propose a small payroll tax to finance our plan for paid family and medical leave.

Other Taxes

We also raise substantially more revenue through taxes on wealth—including a small (0.1-1 percent) wealth tax on all holdings over $10 million, and with an expanded estate and gift tax.

CONCLUSION

The overall effects of our budget plan are summarized below in Table 1. Given CBO projections, we targeted deficits of roughly 2 percent of GDP in coming years, as these were consistent with stabilizing the debt to GDP ratio at a level at or below overall GDP.

Percentage of GDP	2019	2029	2049
Revenues	16.2	32.4	33.1
Spending	20.8	33.0	35.0
Deficit	-4.6	-0.6	-2.0
Debt Held by the Public	78.4	62.1	46.5