AGENDA

• Current Budget Projections
• Social Security Reform
• Corporate Taxes and Loopholes
• Infrastructure
• Defense
• Education
• Social Issues
• Economic Outlook
Federal budget deficit is projected to grow from 3% of GDP this year to 6% of GDP in 2040.

Federal debt held by the public will be 103% of GDP in 2040 (up from 74% at present) if current laws are maintained; highest level of public debt since the end of World War II.

To keep the debt-to-GDP level at 75% in 2040 we need to increase revenue or decrease spending 1.1% of GDP each year. For instance to keep debt-to-GDP at 75% we need an increase of 6% of revenues per year or cut 5.5% of spending.
CBO Revenue Projections 2015-2040

- Revenues are projected to increase by 1.7% of real GDP over the next 25 years
- Tax on high premium health plans (Cadillac Tax) goes into effect without modification helping moderate increase in health program costs
- Income growth will account for an increase of revenues equal to 1.3% of real GDP
- Scheduled introduction of new provisions and expiration of existing provisions will increase revenues by 0.7% of real GDP
CBO Spending Projections 2015-2040

- Net interest costs are expected to rise from 1.3% to 4.3% of real GDP
- Spending for Medicare, Medicaid, and ACA subsidies will rise from 5.2% to 8% of real GDP in 2040
- Spending for Social Security is expected to rise from 4.9% to 6.2% of real GDP
- Other federal spending is projected to fall to 9.1% to 6.9% of real GDP due to constraints imposed by Budget Control Act of 2011 that dictated cuts in spending in return for an increase in the debt ceiling
Twenty Year Debt to GDP Ratio Projections

Source: CBO
Savings vs. Deficit

Source: CBO
SOCIAL SECURITY PROJECTED DEFICIT

• Social Security Trust Fund is projected to run out of funds by 2029 according to a 2015 CBO Report
• At that point, revenues will be able to cover about 75% of current benefits and decline each year thereafter
• This deficit is due to the baby boomer generation leaving the workforce and drawing benefits
SAVING SOCIAL SECURITY: ELIMINATE PAYROLL TAX CAP

- Current cap is set at $118,500 for 2016
- In 2015, only richest 6.1% of earners would pay higher taxes
- Tax would predominantly affect workers older than 45
- Projected to solve about 80% of future deficit
- Congressional Research Service projects this will keep fund solvent for 75 years

**TABLE 2**

<table>
<thead>
<tr>
<th>Age Group</th>
<th>Percent</th>
<th>Number</th>
<th>Percent</th>
<th>Number</th>
<th>Percent</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>All</td>
<td>6.1</td>
<td>9,034,430</td>
<td>1.5</td>
<td>2,278,795</td>
<td>0.7</td>
<td>1,032,121</td>
</tr>
<tr>
<td>16-24</td>
<td>0.1</td>
<td>23,933</td>
<td>0.0</td>
<td>6,909</td>
<td>0.0</td>
<td>2,447</td>
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<tr>
<td>25-34</td>
<td>2.4</td>
<td>783,626</td>
<td>0.4</td>
<td>127,847</td>
<td>0.2</td>
<td>58,431</td>
</tr>
<tr>
<td>35-44</td>
<td>7.4</td>
<td>2,370,546</td>
<td>1.7</td>
<td>552,120</td>
<td>0.9</td>
<td>271,941</td>
</tr>
<tr>
<td>45-54</td>
<td>9.2</td>
<td>3,071,818</td>
<td>2.4</td>
<td>791,406</td>
<td>1.1</td>
<td>362,921</td>
</tr>
<tr>
<td>55-64</td>
<td>8.9</td>
<td>2,180,529</td>
<td>2.4</td>
<td>592,650</td>
<td>1.0</td>
<td>251,032</td>
</tr>
<tr>
<td>65+</td>
<td>8.2</td>
<td>603,978</td>
<td>2.8</td>
<td>207,863</td>
<td>1.2</td>
<td>85,349</td>
</tr>
</tbody>
</table>

Source: CEBR
SAVING SOCIAL SECURITY: INCENTIVES TO DELAY RETIREMENT

Incentives to work beyond retirement age:

• No payroll tax on income earned past official retirement age for individuals who choose to work longer and delay receiving benefits

• This payroll tax break would also apply to companies who employ these older individuals

• Raise ability to contribute to a 401k for those working past traditional retirement age so they accumulate disposable income and savings in the time leading up to actual retirement
CORPORATE TAX & LOOPHOLE REFORM

Estimated $90 billion is lost annually through corporate tax loopholes

- U.S. companies hold $2.1 trillion of profits in offshore tax havens. Set long term goal to eliminate tax havens. (in light of Panama Papers and Treasury Dept. actions)
- Currently the U.S. receives a relatively small share of its total revenue from corporate taxes despite having the highest marginal corporate tax rate of any major economy (See chart below)
- Lowering the maximum corporate tax of 35% as a concession
- End tax breaks for moving operations offshore
- Tax income in the year that it is earned
- The Congressional Research Service estimates that this would raise $600 billion over the next 10 years
- Tax carried interest at normal income tax rates; we estimate it will generate $11 billion annually

Source: Congressional Research Service
**VALUE-ADDED TAX**

- 5% tax on everything besides education and healthcare
  - VAT is paired with cash payment of $450 per adult, $200 per child to offset effects to poor families. It would be like refunding the VAT owed on $26,000 of spending
  - That would raise **$160 billion** per year
- This is low compared to the 15% average in Europe
- Effectively taxes consumption and is harder to avoid

Source: Treasury.Gov
INFRASTRUCTURE: SHORTFALLS IN HIGHWAY SPENDING

• Nearly all Highway spending takes the form of grants to local/state governments
  • 33%-40% are allocated solely based on number of road miles and not need
  • Problems such as highway use, congestion, and quality are often ignored
• Cost of servicing highways have grown rapidly over the past decade
• Revenue from main source of Highway funding (Highway Trust Fund) is becoming insufficient

• Fixing America’s Surface Act (FAST)
  • $70 billion funded mainly from Fed’s Capital Surplus Account
INFRASTRUCTURE: REFORM SUGGESTIONS

• Increase Tolls for Heavily Used Roadways
• Gasoline Tax
  • Excise taxes on motor fuel accounts for 87% of the Highway Trust Fund’s Revenue have not been raised since 1993 and are not indexed for inflation (18.4 cents per gallon)
  • According to the Joint Committee on Taxation, a 1 cent increase in would initially raise $1.7 billion annually
  • Fuel Tax places the burden of payment on users, while resulting in less fuel usage
DEFENSE SPENDING

• Integral part of our discretionary budget that serves a necessary purpose

• Comprises approximately 14% of total budget (largest discretionary program) - $533 billion in 2017 projection

• General agreement that spending can be more effective e.g. government contracts like F-35 Lightning II project $200 billion over budget in 15 years
**DEFENSE SPENDING: PROPOSALS AND SOLUTIONS**

- Maintaining nuclear capability will cost **$500 billion** over next 20 years
- Continue to reduce size of Armed Forces
- Cut the Overseas Contingency Operations Fund to cut **$20 billion** a year
- Pressure NATO members to pay larger proportion of their GDP as agreed towards NATO budget
  - Currently US is **$649 billion** of **$900 billion** budget

![US Defense Spending vs. Competitors](chart.png)

Source: NATO
E D U C A T I O N :  P R O P O S A L S

Increase federal subsidies for education to generate faster economic growth and higher government revenues

• Each additional year of schooling boosts long run growth by 0.58 percentage points
• By 2040, 5% increase in GDP
Education: Proposals

• America loses $192 billion in income and tax revenues with each cohort of high school dropouts. Over 25 years, that’s a saving of approximately $5 trillion.

• The average high school dropout will cost taxpayers over $292,000 in net revenue.

• To increase high school graduation rates:
  • **Universal preschool programs** - If preschool reduces the dropout rate by 24 percent, this could generate between $4 billion to $10 billion in present-value tax revenues.
  • **Improving the quality of education provided by public high schools** - e.g. smaller class sizes, mentoring programs, providing incentives for teen parents, etc.
OTHER POLICIES

• Capital Gains Tax Reform: $2.4 trillion
• Healthcare Reform: $900 billion
• TIPS Reform: $118 billion
• Impose Carbon Tax: $3.8 trillion
• Eliminate pennies: $3.6 billion
Conclusion
HEALTHCARE: ACA

• The Affordable Care Act reduces the deficit, saving more than $200 billion over 10 years and more than $1 trillion in the second decade.
• The American Health Association made the following suggestions to reduce the budget deficit.

<table>
<thead>
<tr>
<th>Health Care-Related Revenues</th>
<th>Standardize the base on which the federal excise tax on alcohol is levied by using the proof gallon as the measure for all alcoholic beverages. Replace the 0.9% surtax on high-income taxpayers with a 1.0 percentage point increase in the total HI tax on all earnings. The HI tax rate for both employers and employees would increase by 0.5 percentage points to 1.95%, resulting in a combined rate of 3.9%. Impose the excise tax on employment-based health care coverage above certain limits beginning in 2014 instead of in 2015.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>CBO Options</td>
</tr>
<tr>
<td></td>
<td>$64 Billion</td>
</tr>
<tr>
<td></td>
<td>CBO Options</td>
</tr>
<tr>
<td></td>
<td>$650.8 Billion</td>
</tr>
<tr>
<td></td>
<td>CBO Options</td>
</tr>
<tr>
<td></td>
<td>$310 Billion</td>
</tr>
</tbody>
</table>

In our proposal, we’d keep the ACA Act and introduce additional reforms as suggested by the AHA.
• Implementing these reforms would save at least $1024.8 billion over the next ten years.
CARBON TAX

• A carbon tax could lead to revenue increases in “ranging from 0.5 percent of GDP for a $15 per ton tax (McKibbin, Morris and Wilcoxen 2012) to 0.8 percent of GDP for a $31 per ton tax (Metcalf 2010) with intermediate estimates including CBO (2011) and Rausch and Reilly (2012).”
• Already implemented around the world, proven to be effective
• More efficient than current cap and trade system
• Raises revenue for the Federal Government

Table 2. Carbon Tax Revenue, 2015

<table>
<thead>
<tr>
<th>Author</th>
<th>Level of Tax (S/tCO₂)</th>
<th>Net Revenue (Percent of GDP)</th>
<th>Net revenue after distributional offsets (Percent of GDP)</th>
</tr>
</thead>
<tbody>
<tr>
<td>McKibbin et al. (2012)</td>
<td>15</td>
<td>0.51</td>
<td>0.32</td>
</tr>
<tr>
<td>CBO (2011)</td>
<td>22</td>
<td>0.60</td>
<td>0.37</td>
</tr>
<tr>
<td>Rausch and Reilly (2012)</td>
<td>23</td>
<td>0.66</td>
<td>0.41</td>
</tr>
<tr>
<td>Metcalf (2010)</td>
<td>31</td>
<td>0.79</td>
<td>0.49</td>
</tr>
</tbody>
</table>
Barreled Oil Tax

- President Obama recently announced $10 a barrel tax on oil
  - Revenues would be spent on upgrading infrastructure and national transportation system
- Besides increasing government revenue, would also remedy externalities
- Could be phased in over a ten year time horizon
- Once fully implemented would raise $32 billion annually
- Inevitably the price of gasoline per gallon would raise $0.25
  - would affect demand in the long run
- Potentially could incentivize the development of clean-fuel industry
End fossil fuel subsidies

• Federal subsidies for fossil fuels total $17.2 billion annually
• White House estimates eliminating some fossil fuel production tax preferences would save over $44 billion by 2025
• US has by far the largest amount of subsidies of developed economies
**Exploration and Production Fossil Fuel Subsidies**

- Value of exploration subsidies doubled from $2.5 billion in 2009 to $5 billion in 2015
- Production subsidies account for **$4 billion** annually in lost revenue mainly due to improper royalty assessment for use of public land
- Low fossil fuel price environment, increasing costs, and decreasing price of renewables present an opportunity to cut subsidies without harming consumers

<table>
<thead>
<tr>
<th>Subsidy</th>
<th>2009 Value (million $)</th>
<th>2013 Value (million $)</th>
<th>Percentage Increase</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage depletion allowance</td>
<td>3.4</td>
<td>900</td>
<td>165%</td>
</tr>
<tr>
<td>Amortisation of oil and gas geological and geophysical expenditures</td>
<td>40</td>
<td>110</td>
<td>150%</td>
</tr>
<tr>
<td>Deduction for intangible oil and gas drilling costs</td>
<td>1,600</td>
<td>3,500</td>
<td>119%</td>
</tr>
<tr>
<td>Domestic manufacturing deduction</td>
<td>605</td>
<td>587</td>
<td>-9%</td>
</tr>
<tr>
<td>Expensing of coal exploration and development costs</td>
<td>N/A*</td>
<td>36</td>
<td>-</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>2,585</strong></td>
<td><strong>5,123</strong></td>
<td><strong>99%</strong></td>
</tr>
</tbody>
</table>

*Prior to FY 2013, this subsidy value was included as part of the overall value of the deduction for intangible drilling costs. Sources: OMB (2014).

<table>
<thead>
<tr>
<th>Subsidy Name &amp; Description</th>
<th>Fossil Fuel Type</th>
<th>Annual Subsidy Amount (most recent available estimate)</th>
<th>Source</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lost/Reduced royalties from leasing of federal lands for onshore and offshore drilling</td>
<td>Oil &amp; Gas</td>
<td>$2.2 billion (2013)</td>
<td>GAO</td>
</tr>
<tr>
<td>Temporary 50% expensing for liquid fuel refining equipment</td>
<td>Oil</td>
<td>$610 million (2013)</td>
<td>OMB</td>
</tr>
<tr>
<td>Dual capacity/taxpayer deduction</td>
<td>Oil &amp; Gas</td>
<td>$530 million (2013)</td>
<td>OMB</td>
</tr>
</tbody>
</table>
"If the income share of the top 20 percent increases by 1 percentage point, GDP growth is actually 0.08 percentage point lower in the following five years, suggesting that the benefits do not trickle down. Instead, a similar increase in the income share of the bottom 20 percent (the poor) is associated with 0.38 percentage point higher growth.” (Source: IMF)

- Effect on U.S. GDP -8% from 1990 to 2010
- This will continue to be a long term problem going forward
Capital Gains Tax Reform

• Top 5% of Americans make 80% of Capital Gains. Top 0.1% makes 50%.

• Current long term rate is 20%, + 3.8% from ACA, for top income bracket.

• Recent Study by Len Burman, Syracuse University, found no correlation between Capital Gains tax rate and Economic Growth historically.

• Recommendation: Equalize long term Capital Gains rate with income tax bracket rate.

• Projected revenue increase: ($800 billion * 39.6% = $316.8 billion) - ($800 billion * 23.8% = $190.4 billion) = $126.4 Billion Net Extra Revenue
  • *2007 Total Long Term Capital Gains = $861 Billion.
SMALL CHANGE

• The type of US fiat money creates extra waste and expenditures that could be negated

• Switching dollar bills to dollar coins would save the US government $150 million every year and up to $4.4 billion in 30 years

• Dollar coins last 10x as long paper money and their metals can be 100% recycled
INTEREST ON THE NATIONAL DEBT

• Ditch TIPS
  • 1,167.9 Billion in TIPS outstanding at .32% risk adjusted per year > 3.7 Billion per year
  • Treasury inflation protected security
  • TIPS earn higher yield than t-notes
• Place emphasis on longer dated securities
  • Take advantage of low interest rates
• Low Inflation Rate
  • Assume low inflation rate in future

Table 2. The return and volatility of TIPS and nominal Treasuries

<table>
<thead>
<tr>
<th>Time period measured</th>
<th>Bond issues</th>
<th>Average monthly total return (%)</th>
<th>Standard deviation (%)</th>
<th>Risk-adjusted return (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>August 1992–July 1993</td>
<td>5-year nominal Treasury, June 2002</td>
<td>0.49%</td>
<td>0.06%</td>
<td>0.73%</td>
</tr>
<tr>
<td>March 1997–July 1997</td>
<td>10-year constant maturity nominal Treasury bonds</td>
<td>0.59%</td>
<td>2.01%</td>
<td>0.29%</td>
</tr>
<tr>
<td>December 2005</td>
<td>10-year constant maturity TIPS</td>
<td>0.59%</td>
<td>1.40%</td>
<td>0.42%</td>
</tr>
<tr>
<td>May 1996–December 2005</td>
<td>30-year nominal Treasury with maturity date of February 2027</td>
<td>0.68%</td>
<td>3.48%</td>
<td>0.24%</td>
</tr>
<tr>
<td>December 2005</td>
<td>30-year TIPS with maturity date of April 2028</td>
<td>0.93%</td>
<td>2.59%</td>
<td>0.61%</td>
</tr>
</tbody>
</table>

Source: Vanguard Investment Counseling & Research.