Returning to Fiscal Sustainability: Efficiency and Timing

Fiscal Challenge 2018
Outline

• Current Fiscal Outlook

• Proposal for Fiscal Sustainability

• Revised Fiscal Outlook
Is the U.S. in a Bad Fiscal Position?
Cross-country Comparison of Debt-to-GDP

Countries

Source: OECD
Fiscal Unsustainability: Expanding Debt/GDP and Deficit/GDP

Source: Congressional Budget Office
Drivers of Rising Debt: *Entitlements*

**US Population 65+ years old**

- 1960: 9
- 1970: 11
- 1980: 12
- 1990: 13
- 2000: 14
- 2010: 15

**Life expectancy at Birth, Total for US**

- 1960: 64
- 1970: 67
- 1980: 70
- 1990: 72
- 2000: 74
- 2010: 76

Source: World Bank
Drivers of Rising Debt: *Entitlements*

Medicare and Medicaid (% of GDP)

Source: Congressional Budget Office
Drivers of Rising Debt: *Low Economic Growth*

Projections of Potential RGDP of the United States'

Source: CBO
Drivers of Rising Debt: *Net Interest Payments*

*Effective FFR* 

*Median Projection of Federal Open Market Committee*

Source: US Office of Management and Budget, Board of Governors of Federal Reserve System
Growth in Entitlements Means Less Money to Budget

**1970**
Total Mandatory 38%
- Mandatory Programs 31%
- Discretionary 62%
Net Interest 7%

Total Spending: $900 Billion

**2012**
Total Mandatory 64%
- Mandatory Programs 58%
- Discretionary 36%
Net Interest 6%

Total Spending: $3.4 Trillion

**2040**
Total Mandatory 82%
- Mandatory Programs 47%
- Discretionary 18%
Net Interest 35%

Total Spending: $12.3 Trillion (p)

Source: Office of Management and Budget, Government Accountability Office, Congressional Budget Office data via the Peter G. Peterson Foundation.
Data Note: All figures are in constant 2009 dollars. Authors' calculations for 2012. Produced by Jason Fichtner and Veronique de Rugy, Mercatus Center at George Mason University.
A Widening Gap: Projections of Revenues and Outlays

Source: Congressional Budget Office
Current Economic Conditions

UR Surpassing Natural Rate of Unemployment

- UNRATE
- NROU

Source: BEA, BLS, CBO

Actual RGDP Surpassing Potential

- GDPC1
- GDPPOT

Source: BEA, BLS, CBO
A Widening Gap: Projections of Revenues and Outlays

Source: Congressional Budget Office
Proposal for Fiscal Sustainability

• Goal:
  • Achieve a path of Fiscal Sustainability that will ultimately stabilize Debt/GDP at current level (75%) by end of 2047
  • Efficiency and Optimal Timing of Stimulus

• Proposal Outline:
  • Tax Code Reform
  • Entitlement Reform
  • Discretionary Spending Cuts
  • “One-Time Fiscal Stabilizer”
Tax Code Reform

• Lower tax deductibles for ages 45-65 and raise tax deductibles for ages 25-44.
  • Incentivizes saving for ages 45-65 and increases consumption for ages 25-44.
  • **Increased Revenue: 50 Billion**

• Keep unemployment benefits eligibility at 26 weeks.
  • Eligibility increases to 52 weeks during recessions, provided the beneficiary seeks a job or receives training.
  • **Savings: 33 Billion**
Tax Code Reform

• Revert to previous tax brackets.
  • More progressive and increases revenues.
  • Estimated revenue similar to 2016 US revenue (3.27 trillion)

• Lower the cap of the estate tax and close GRAT loophole.
  • Increases number of taxable estates.
  • Keep estate tax rate of 40%.
  • Revenue increase: 100 billion

• Raise the excise tax on alcohol and tobacco.
  • Revenue Increase: 64 Billion
Entitlement Reform

• Convert multiple assistance programs (e.g., SNAP) for lower income people into smaller block grants for states.
  • Savings: 367 billion

• Incrementally eliminate Title 1 agriculture programs.
  • Savings: 25.4 billion

• Reduce subsidies to crop insurance programs.
  • Savings: 27 billion
Growing pains:
Social Security outlays as percent of GDP

Source: CBO
Social Security Reforms

• Link Social Security to a progressive pricing index.
  • **Savings: 72 billion**

• Reduce benefits for all current and future SS beneficiaries by 5% over a 10 year savings horizon.
  • **Savings: 104 billion**

• Raise the early retirement SS benefits age to 65.
  • **Savings: 23.2 billion**
Medicare and Medicaid

• Limit Medical Malpractice Claims
  • **Savings: 54.9 Billion**
  • Cap awards for noneconomic damages and punitive damages
  • Shorten the statute of limitations

• Impose Caps on Federal Spending for Medicaid.
  • **Savings: 583.5 Billion**
  • Place a cap on spending per enrollee through which each state would have a limit on spending
Discretionary Spending: Defense vs Non-Defense

![Graph showing discretionary spending as a percentage of GDP for defense and non-defense categories from 1967 to 2015. The graph indicates a trend of decreasing spending over time.]
Defense Spending Comparison Across Countries

Source: Peter G. Peterson Foundation
Discretionary Cuts: Defense

• Replace the Joint Strike Fighter Program with F-16 and F/A18s
  • Savings: 41 billion

• Replace some military personnel with Civilian Employees
  • Savings: 20.6 Billion
Discretionary Cuts

• Reduce funding for International Affairs Program by 25%
  • Savings: 131 billion

• Reduce the size of the Federal Workforce through attrition
  • Savings: 49.7 billion
Infrastructure Spending Plan

• Current infrastructure is leading to economic deficiencies.

• Our Infrastructure Plan:
  1. Allocates funds to projects that “lead to long-term changes in how infrastructure is designed, built, and maintained.” (White House)
  3. Promote Public-Private relationships.

• Novelty of Our Plan: Timing of implementation…
Infrastructure Spending Plan

• Auerbach and Gorodnichenko 2017, NBER:
  • “Fiscal stimulus in a weak economy may help improve fiscal sustainability”

• Comes into effect at the onset of the next recession.
  • Recession timing will be based on the GDP-Based Recession Indicator Index (Hamilton, 2018).

• Eliminates inside-lag of policy making during periods when immediate action is critical.
Infrastructure Spending Plan

• Maximum Budget:
  • One Trillion Dollars in Infrastructure Investment

• Per Year:
  • Maximum: 300 Billion Dollars
  • Minimum: 150 Billion Dollars

• Special Council of One-Time Infrastructure Stabilizer
Revised Debt and Deficit to GDP Outlook
Thank You!

Questions?
Appendix
References


Drivers of Rising Debt: *Unsound Fiscal Policy*

Under the new tax plan, will RGDP be substantially higher in a decade?

Will current tax plan lead to higher debt-to-GDP ratio?

Source: IMG
Drivers of Rising Debt: *Entitlements*

Not in Labor Force with a Disability (16 years and over)

Drivers of Rising Debt: *Entitlements*

Health Expenditures and Price Level

- **US Dollars**
- **Price Index Ratio**

**Health Care Expenditures Per Capita**

**CPI medical/ CPI total**

Source: US Bureau of Economic Analysis
Hamilton’s GDP-Based Recession Index
Where is the money going?

Breakdown of Total Outlays

- Discretionary: 27%
- Programmatic Outlays: 62%
- Net Interest: 6%
- Offsetting Receipts: 5%

Source: CBO
Where is the money coming from?

2016 Revenues as percent of GDP

- Individual Income Tax
- Payroll Taxes
- Corporate Income Taxes
- Excise Taxes
- Estate and Gift Taxes
- Customs Duties
- Miscellaneous Receipts

Source: Congressional Budget Office
Components of Discretionary Spending

Discretionary Spending in Billions of Dollars

- Military: 54%
- Education: 6%
- Energy & Environment: 4%
- Medicare & Health: 6%
- Veterans' Benefits: 6%
- Housing & Community: 6%
- International Affairs: 4%
- Science: 3%
- Social, Unemployment & Labor: 3%
- Transportation: 2%
- Food & Agriculture: 1%

Source: Office of Management and Budget