Investing in America's Economy: A Budget Blueprint for Economic Recovery and Fiscal Responsibility

Economic Policy Institute
John Irons, Andrew Fieldhouse, Ethan Pollack, and Rebecca Thiess

INTRODUCTION

In the wake of the largest recession since the Great Depression, the United States continues to face serious economic challenges. Nearly one in 10 workers is unemployed, and long-term unemployment is at record levels. Millions of other families face stagnant or declining incomes and worry about their economic futures. Out of these depressed economic conditions has emerged a national debate on the best pathway to restored economic growth and shared prosperity. While the right approach could accelerate our recovery, the wrong approach could deepen the economic slump while failing to restore fiscal balance.

One of the nation's economic challenges comes from the long-run imbalance between revenue levels and national spending, which will create an unsustainable deficit in the future. Bush-era tax cuts and a shrinking economy have led to significant budget deficits since the start of the recession. Revenue levels initially will recover as the economy picks up, but over the next few decades, public debt is projected to increase in the face of both inadequate revenue and rising health care costs.

While there are many paths to fiscal balance, only a path that fosters broadly shared economic growth and security will be viable in the long run. National economic policy should be designed to address not only the need to put the federal budget on a sustainable course for the future, but also the need to create jobs today and invest in America's future.

Our budgetary path is based on "Investing in America's Economy," a joint project with Demos and The Century Foundation. This path achieves the goals of creating jobs and investing in America while putting the federal budget on a sustainable course. The path stabilizes debt as a share of the economy without demanding draconian cuts to national investments or vital economic security programs. It provides substantial and sustained increased funding for job creation and investments, particularly in the near term, all while improving both the 10- and 25-year budget windows. Our path achieves primary budget balance by 2017, and improves the course of public debt in the long term. It provides a solid footing for Social Security, Medicare, and Medicaid in the long term, and modernizes the tax code in a way that raises adequate revenue fairly and efficiently.

An investment-oriented approach to economic policy helped create a strong middle class in the postwar period, and an ideology of disinvestment has helped to erode it in recent years. Another path—away from erosion of the middle class—is not only possible, but necessary.

SPENDING

Public investments are essential for economic growth and family security. Our spending priorities are guided by the notion that policies should strengthen the middle class and expand economic opportunities for everyone.

Public investments

With the above criteria in mind, we include significant public investments in our budget. Our investment path includes $300 billion in annualized investments for 2011, $250 billion for 2012, and $200 billion for 2013. Beyond 2013 we grow investments with the economy through 2021, after which we sustain inflation-adjusted, per-capita spending levels. This funding is designed to create badly needed jobs in the short run while also sustaining longer-term investments in our nation's economic future.

Our path would invest significantly in areas that promote growth and prosperity. Investments in areas such as education, infrastructure, and basic research have been shown to have high rates of return and should be expanded. Specifically, we recommend increasing investments in transportation, early childhood education and quality childcare, energy and broadband infrastructure, and general research and development. We believe investments in these high-return areas now can boost our human and physical capital and promote robust long-run economic growth. Finally we include upfront investments in health care to improve outcomes and lower costs.

Medicare, Medicaid, and other federal health programs

We propose the following policies to increase the efficiency of health care delivery by improving care while lowering costs:

- Establish a "public option" of government-provided health coverage—similar to Medicare—to complement health care reform by reining in costs while expanding access.

- Allow the Medicare program to negotiate prescription drug prices.

- Encourage caregivers to coordinate patient care by bundling Medicare payments for post-acute care, leading to better health outcomes and reduced cost.

- Enhance the Centers for Medicare & Medicaid Services program integrity authority, pursue other Medicare and Medicaid savings, and strengthen prescription drug reforms—building on the recently passed health care reform to promote savings and efficiency.

We additionally propose upfront investments in health information technology and comparative effectiveness research, which will provide additional efficiency savings in the long run and could reduce long-run health care costs. Our plan expects savings from these investments beginning in 2025, while recognizing that the savings are uncertain, as are all projections of future health care costs. If the growth rate of health care does not decelerate starting in 2025, we propose establishing a trigger that would limit the tax preference on financial firm debt (which is currently tax deductible). Our fiscal path also includes an adjustment to Medicare physician payments at 2011 levels, extending the "doc fix."

Department of Defense

Any serious approach to cutting the deficit or dealing with long-term debt issues must also include reductions in spending by the Department of Defense, which comprises the largest portion of the discretionary budget. The Sustainable Defense Task Force, a bipartisan group of defense experts, released a report in June 2010 that detailed a series of options, which, if taken together, would save $960 billion over the next decade. We consider that total savings—$960 billion by 2020—a reasonable amount by which to cut the Department of Defense budget. Beyond the 10-year window, our plan would freeze defense spending at inflation.

Social Security

Millions of elderly Americans rely on the economic security that comes from the Social Security system. Our plan recognizes the need to shore up the Social Security system while protecting the benefits of current and future retirees. In short, we do not propose any reductions in benefits.

Under the current system, income above a taxable maximum is not subject to any Social Security tax, meaning that high-income individuals pay less as a share of their income than everyone else. To increase the financial stability of the system, we propose raising the taxable maximum to include 90 percent of total earnings, and to eliminate the maximum that employers pay on behalf of their high-income employees. This proposal would put Social Security on a sustainable trajectory by closing three-fourths of the long-run shortfall.

Other mandatory programs

The plan eliminates commodity payments to large farms (farms with more than $250,000 in annual farm or non-farm income), reduces the value of direct payments, and reforms the crop insurance program.

REVENUES

The current tax code is ill-equipped for the 21st century and needs to be modernized. First, revenue levels are inadequate, and are a core reason deficit levels are projected to rise in the future. Second, more and more of our national income in recent decades has been flowing to those on the top rungs of the economic ladder while tax changes have overwhelmingly benefited those very same people. Third, the complexity of the code, both for individuals and for corporations, has led to an environment in which one's tax bill can depend as much on the quality of one’s accountant as on the size of one’s income. Finally, with many families struggling to make it into the middle class, the tax code should work with people in their struggles, not present additional barriers.

Our proposals would result in high-income earners and corporations contributing more to the country’s fiscal solvency. Finally, the proposals would strengthen and expand pro-family and anti-poverty tax benefits for low-income households.

Our plan includes the following proposals:

Individual income taxes

- Extend middle-class tax changes as outlined by President Obama, modifying certain tax cuts enacted in 2001 and 2003. Our path rescinds the upper-income tax cuts included in the December 2010 tax “compromise” and allows these cuts to expire permanently.

- Lower taxes on low- and moderate-income workers by permanently extending the Making Work Pay and American Opportunity refundable tax credits, making the Child Tax Credit fully refundable, and expanding the Earned Income Tax Credit for large families, childless families, and joint filers.

- Enact a 5.4 percent millionaire surcharge on adjusted gross income (AGI) above $500,000 for a single filer and $1 million for joint filers.

Corporate income taxes

- Eliminate fossil fuel tax preferences as detailed in the president’s budget.

- Tax U.S. corporate foreign income as it is earned rather than waiting until it is repatriated.

Tax expenditures

- Tax capital gains and dividends as ordinary income, with a 33.4 percent top rate on capital gains for millionaires.

- Cap the benefit on itemized deductions at 15 percent.

- Expand the charitable and housing tax preferences to low- and moderate-income households by converting the charitable giving deduction to a refundable credit of 25 percent and the home mortgage interest deduction to a refundable credit of 15 percent on primary mortgages under $500,000.

Other revenues

- Enact a carbon tax or a cap-and-trade program in order to address the societal cost of greenhouse gas emissions.

- Enact a progressive estate tax with a higher threshold and a graduated rate structure while maintaining current law revenue.

- Institute a financial transactions tax and a tax on financial leverage (the financial crisis responsibility fee as proposed in the president's budget).

- Gradually increase the motor fuel excise tax by 15 cents in 2019 and 25 cents in 2024.

- Tax sweetened beverages by introducing an excise tax on the manufacture and importation of beverages sweetened with sugar or high-fructose corn syrup.

CONCLUSION

Americans have a choice as to how best to solve our long-term fiscal challenges. Our path achieves fiscal sustainability while increasing investments in important national priorities. It does so mainly by asking more of those in society that can most afford it and by avoiding both cost-shifting and band-aid solutions that do not address underlying economic problems.

The current recession should not be used as justification for punitive fiscal austerity, but rather an opportunity to show how investing in the middle class can help us grow our way through tough fiscal times. The policies we have included work against the erosion of investment we have seen over the past 30 years while modernizing our tax code. We believe sustained investment in the economy will provide a strong foundation for job creation and future economic growth. Growing productivity can then help trim deficits and pay down the national debt.

Economic Policy Institute

Percent of GDP	2021	2035
Revenues	21.6	24.1
Spending	24.5	27.8
Deficit (-)	-2.9	-3.7
Debt Held by the Public	76.5	81.7