MEMORANDUM

TO: The Administration and Congressional Leaders

FROM: Ben Ritz and Brendan McDermott

DATE: June 11, 2019

SUBJECT: Funding America's Future

INTRODUCTION

America's fiscal policy is in dire need of a course correction. Spending on public investments that lay the foundation for long-term economic growth has fallen to historically low levels, threatening our future prosperity. Meanwhile, a perfect storm of fiscally irresponsible tax cuts and an unwillingness to tackle escalating health and retirement spending are feeding trillion-dollar deficits as far as the eye can see. These shortsighted policies promote consumption by the current generation at the expense of investment in the next.

The Progressive Policy Institute champions a new approach that invests in our country without leaving the bill to young Americans. Our fiscal blueprint powers the engines of American innovation by investing in infrastructure, education, and scientific research. We tackle the greatest challenges facing our society, from rising economic inequality to climate change, through dynamic tax and spending policies that are also designed to smooth the business cycle. And we pay for all of it: our plan would put the national debt on track to fall below 50 percent of GDP within 25 years of enactment, giving future policymakers the fiscal space necessary to respond to other unforeseen challenges.

MAJOR POLICY RECOMMENDATIONS

Policymakers' top priority should be restoring America's commitment to public investment. Measured as a percent of GDP, the federal government now spends roughly half as much on infrastructure, education, and scientific research as it did in 1965. The consequences: China has now overtaken the United States as the world leader in R&D spending, our deficient infrastructure is costing the average family up to $3,400 per year, and millions of workers cannot get the skills they need to compete for next-generation jobs.

PPI's fiscal blueprint boosts public investment spending as a percent of GDP to pre-1980s levels, which in dollar terms represents a more than 50 percent increase above current-law projections. Specifically, PPI proposes to triple investment in basic R&D over a decade and spend an additional $280 billion over the same time period on the development of technologies that help combat climate change. We recommend enacting a $1 trillion infrastructure package that begins during the next recession and leverages additional investment from the private sector and state and local governments. To make higher education affordable, PPI proposes to expand Pell Grants, make them available for more professional credentialing programs, and push universities to transition from four-year to three-year degree programs over a decade.

Next, we propose to rebalance the intergenerational compact for 21st-century demographics. Fifty years ago, Congress and the president had the ability to annually appropriate two thirds of federal spending, while one third went to finance categories of spending that operate on autopilot. Today the ratio is reversed, primarily due to the growth of federal health care and retirement programs. This trend both limits the "fiscal freedom" of elected officials to respond to the changing needs of their constituents and results in a budget that is more oriented towards present consumption than investments in long-term economic growth.

PPI recommends shoring up Social Security's finances by transitioning to a new formula that awards benefits based on the number of years a person worked rather than on their lifetime average earnings. PPI also recommends a number of other changes to Social Security that would strengthen work incentives and retirement security in a way that is fair to both younger workers and older beneficiaries. PPI's proposed health-care reforms build upon what works in the ACA by expanding premiums subsidies, automatically enrolling uninsured people in health plans, and creating a deficit-neutral Medicare buy-in program for Americans ages 55-64. PPI recommends adopting a default-price health care regime to bend the cost curve. To modernize Medicare, we recommend consolidating Parts A, B, and D into a streamlined "Medicare One" benefit and adopting an average-bid subsidy model for Medicare Advantage. Taken together, PPI's Medicare reforms would reduce government spending with no net cost increase for the average beneficiary.

Finally, America needs real pro-growth tax reform that rewards work, not wealth, and raises adequate revenue to finance federal obligations. PPI proposes to repeal the fiscally irresponsible giveaways given to wealthy Americans in the GOP's 2017 tax law, but we would expand and make permanent provisions in the law that incentivized investment and limited regressive tax deductions. We support raising the top marginal rate on annual earnings over $10 million to 50 percent and taxing unearned incomes from inheritances and capital gains at revenue-maximizing rates. To put more money in the pockets of workers, PPI proposes to replace regressive payroll taxes with taxes on carbon and consumption, and transform the EITC into a more-generous Living-Wage Tax Credit.

We acknowledge that such sweeping reforms are unlikely to be enacted before the 2020 election, hence we designed most of our recommendations to take effect in the first full fiscal year of the next administration. However, there are some important steps that policymakers must take in the near term. Before October, Congress and the president should prevent sequester cuts from taking effect and avoid a catastrophic debt default by raising, suspending, or repealing and replacing the debt limit with a less-dangerous debt control mechanism. Lawmakers should adopt a mileage-based user fee to plug the Highway Trust Fund's financial shortfall. As part of PPI's proposal to consolidate traditional Medicare benefits, the Part A Hospital Insurance program should either be moved to general-revenue financing (as Parts B and D currently are), or all of Medicare should have a trust-fund financing mechanism with a dedicated revenue source sufficient to fully fund benefits.

CONCLUSION

PPI's fiscal blueprint rebalances the federal budget to fund important public investments in long-term economic growth and strengthen social programs. Our blueprint is fully paid-for by enacting pro-growth tax reform that rewards work instead of wealth. By putting the national debt on a downward trajectory during economic expansions, we create the fiscal space for future policymakers to respond to the unforeseen needs of their constituents without being limited by real or perceived fiscal constraints. The PPI blueprint for funding America's future demonstrates that fiscal responsibility and investing in the American people are not mutually exclusive—they are in fact complementary.

FUNDING AMERICA'S FUTURE

Progressive Policy Institute

Ben Ritz, Brendan McDermott

INTRODUCTION

America suffers from a shortsighted fiscal policy that promotes consumption by the current generation at the expense of investment in the next. Measured as a share of gross domestic product, federal spending on public investments in education, infrastructure, and scientific research has fallen by more than 40 percent from pre-1980s levels. As PPI documented in its recent report, *Ending America's Public Investment Drought*, this trend has enormous consequences: China has now overtaken the United States as the world leader in R&D spending, our deficient infrastructure is costing the average family up to $3,400 per year, and millions of workers cannot get the skills they need to compete for next-generation jobs.

Meanwhile, a perfect storm of fiscally irresponsible tax cuts and an unwillingness to tackle escalating health and retirement spending are feeding trillion-dollar deficits as far as the eye can see. Under current law, the federal government is projected to begin spending more than twice as much money servicing our growing national debt as it will spend on the three major categories of public investment *combined* within the next few years. This is not a fiscal policy for strengthening America's future—it's blueprint for American decline.

The Progressive Policy Institute offers a better alternative: an innovative agenda that pairs robust public investment with the responsible fiscal policy needed to sustain those investments for generations to come. In addition to reversing the harmful across-the-board cuts to discretionary spending imposed by sequestration in recent years, PPI proposes new investments to tackle pressing social problems ranging from income inequality to climate change. We would curtail the growth of health care costs while expanding coverage to ensure every American has access to affordable health care. Our proposed reforms to Social Security modernize the benefit structure to strengthen work incentives, retirement security, and financial sustainability in a way that is fair to both younger workers and older beneficiaries.

PPI also presents a plan for comprehensive tax reform that would transform our tax code to reward work, not wealth. Our plan slashes taxes on workers by repealing the regressive payroll tax and replacing it with taxes on consumption and carbon. We tax wealthy people's unearned income from sources such as inheritances at a higher rate than we tax earnings to allow Americans across the income distribution to keep the fruits of their labor. Finally, we propose to repeal and replace the GOP's disastrous 2017 tax law with real tax reform that incentivizes private investment without starving public investment of much-needed revenue.

Our plan, if adopted in its entirety during the first year of the next administration, would put the national debt on track to fall below 50 percent of GDP within 25 years of enactment. But bringing debt all the way down to this level is not our primary goal; in fact, during national emergencies and economic downturns, we believe increasing debt isn't just acceptable—it is *necessary*. That's why our plan introduces new automatic stabilizers to boost public investment, strengthen the social safety net, and further cut taxes on lower- and middle-income Americans during economic downturns. By putting the national debt on a downward trajectory during economic expansions, we create the fiscal space for future policymakers to respond to these circumstances and the other unforeseen needs of their constituents without being limited by real or perceived fiscal constraints.

SPENDING

Fifty years ago, Congress and the president had the ability to annually appropriate two thirds of federal spending, while one third went to finance categories of spending that operate on autopilot. Today the ratio is reversed, primarily due to the growth of federal health care and retirement programs. This trend both limits the "fiscal freedom" of elected officials to respond to the changing needs of their taxpaying constituents and results in a budget that is more oriented towards present consumption than investments in long-term economic growth. PPI's spending proposals rebalance the federal budget to fund these investments while strengthening social programs, particularly for our nation's most vulnerable citizens.

Boost Discretionary Spending and Create a Public Investment Budget

Our plan urges Congress and the president to raise the caps on both defense and non-defense (domestic) discretionary spending by $67 billion in Fiscal Year 2020—the same amount domestic discretionary spending was increased for FY 2019. We then propose to separate spending on public investments—research, education, and infrastructure—into its own budget category, distinct from other non-defense discretionary spending. While caps on other domestic spending would be indexed to grow with inflation plus population growth, public investment spending (including the new initiatives we propose below) would be indexed to grow with GDP to ensure that a consistent share of economic resources are devoted to pro-growth spending.

Federal investments in scientific research have contributed to developing hundreds of technologies that benefit Americans every day, ranging from modern cancer treatments to the Internet. But over the past 50 years, non-defense R&D spending as a percent of GDP has been cut in half. We propose to reverse this trend by tripling federal investment in basic R&D over a decade and committing an additional $280 billion over the same time period to researching renewable energy and carbon capture technologies that will help mitigate climate change.

Within the past three years, independent estimates by the American Society of Civil Engineers and McKinsey both found that the United States needed to increase projected infrastructure spending by roughly $1.4 trillion over the coming decade. We recommend the federal government spend $1 trillion above baseline projections on infrastructure in the form of well-structured matching grants and other financial instruments that leverage the remaining investment needed from the private sector and state and local governments. PPI also recommends automatically increasing the matching rate for infrastructure spending during recessions to ease pressure on state and local budgets, prevent project disruption, and provide timely economic stimulus.

We propose to shift spending from most education-related tax expenditures—which primarily benefit relatively wealthy families—to a "Super Pell" grant program that will help the majority of lower- and middle-income students access affordable higher education. PPI recommends enabling students to access this support for more professional credentialing programs and other alternatives to a traditional college education. To cut costs for students who choose to pursue traditional degrees, the federal government would push universities to transition from four-year to three-year degree programs over ten years and limit the growth of tuition and fees. It would further support the transition by funding more "pre-college" programs to give high-school students a head start on their post-secondary education.

PPI has long advocated for a strong, superior national defense. The sudden and deep spending cuts scheduled to occur in FY 2020 due to the return of sequestration must be prevented to avoid jeopardizing national security. However, the Pentagon must do its part to wring inefficiencies out of military spending. We support bringing defense spending caps down to levels in line with CBO's long-term baseline projections, but we propose to do so gradually over a decade rather than immediately this year. This change would leave U.S. defense spending roughly halfway between today's levels and the NATO target of 2 percent.

Revamp Health Care Programs to Expand Coverage and Reduce Costs

PPI is committed to ensuring all Americans have access to affordable, high-quality health insurance. The most immediate priority here is to build upon what worked in the Affordable Care Act. Our plan starts by reversing recent Republican policies that sabotaged the ACA marketplace and increased premiums for consumers. We would also raise the threshold required to qualify for premium subsidies from 400 percent of the federal poverty level to 600 percent, thereby eliminating the "subsidy cliff" and expanding access to affordable coverage for the middle class.

To further lower premiums throughout the individual market, we recommend two policy changes to make the patient pool healthier and cheaper to cover. The first proposal is to create an automatic enrollment system that replaces the ACA's now-repealed individual mandate for purchasing health insurance. This system will bring more young Americans with lower medical costs into the insurance pool and reduce instances of uncompensated care that drive up prices for other payers. Second, we recommend allowing individuals ages 55-64 who do not receive employer-sponsored insurance to buy into Medicare, with ACA subsidies, at a sufficient premium to make the buy-in deficit-neutral. Moving older people with more expensive medical needs from the market would result in a healthier pool and reduce costs for everyone left.

The high cost of health care in the United States is primarily due to high prices. We propose to tackle the price problem directly by setting maximum rates—based on a multiple of Medicare reimbursement rates—on what providers can charge payers for out-of-network care. Providers would be prohibited from passing the costs of this care onto consumers through balance billing for emergency services or any non-emergency service without adequate disclosure in advance. We anticipate that this policy will force providers to compete more on quality and enter into contracts with insurers that reward value-based care over fee-for-service reimbursements.

Finally, we propose to streamline and modernize Medicare. Our plan would consolidate the three parts of traditional fee-for-service Medicare—Hospital Insurance (Part A), Supplemental Medical Insurance (Part B), and Prescription Drug Coverage (Part D)—into a simplified "Medicare One" benefit with one premium and one set of rules for co-insurance, deductibles, reimbursements, etc. We also propose to base Medicare Advantage subsidies on the average bid in a competitive bidding process to lower costs. Taken together, our Medicare reforms would reduce government spending with no net cost increase for the average beneficiary.

Strengthen Social Security with Pro-Worker Reforms

As a result of increasing life expectancy and falling birthrates, the ratio of working Americans paying into Social Security per person receiving benefits in 2045 will barely be half of what it was in 1965. The failure of policymakers to modernize Social Security in reaction to changing demographics jeopardizes the program's finances: under current law, beneficiaries face the prospect of a 23 percent benefit cut when the program's trust funds exhaust in 2035. Our innovative framework for strengthening Social Security prevents this benefit cut and improves retirement security for millions of seniors without placing an undue tax burden on young Americans, who face many financial challenges that their elders did not.

Under a more egalitarian benefit formula developed by PPI, individuals would earn a flat "work credit" for each year they spent in the workforce regardless of what they were paid, meaning a low-skilled worker and their college-educated boss would receive the same benefit in retirement if they work hard for the same number of years. A person can also earn up to five years of work credits for time taken out of the workforce to serve as a caregiver. This formula is more progressive and has better incentives for older Americans to remain in the workforce than does the current one. Our formula would be phased in over 10 years and ensure everyone who works for at least 20 years would receive a large enough benefit to keep them out of poverty.

Additionally, we would index both the ages at which someone can claim reduced and maximum monthly benefits to longevity. However, our plan retains a special early retirement age that allows low-income workers to claim an unreduced benefit at age 62 because longevity gains have been smaller among low-income Americans. Annual cost-of-living adjustments under our plan would initially be linked to chained-CPI—a slower-growing but more-accurate measure of inflation. However, after a beneficiary has been eligible for Social Security for 15 years, their COLAs would be indexed to average wage growth to better insure against the possibility of outliving their savings. We would increase benefits for widow(er)s who are at risk of falling into poverty when their spouse dies, while capping and means testing spousal benefits so that wealthy couples don't receive additional benefits that they neither need and nor earned through work.

Improve Other Social Programs

PPI believes policymakers should commit more resources to strengthening the social safety net for workers and families. We recommend bolstering the automatic expansion of unemployment benefits that is triggered during recessions. Our budget allocates funding to create a paid-family leave program and provide children in need with universal access to affordable pre-kindergarten, both of which would support childhood development and make parenting easier for those in the workforce. PPI also recommends policymakers find new ways to shift the emphasis of anti-poverty policy from income transfers to saving and wealth building.

REVENUES

Our government needs a tax code that meets the needs of the 21st century, which means raising adequate revenue to support both our aging population and public investments in our future. To counteract our declining ratio of workers to retirees and the rise of income inequality, the tax code should incentivize and reward work, not entrenched wealth. The 2017 Republican tax bill failed all of these goals. PPI proposes a plan to reverse its regressive features while modifying its provisions for business.

Create a Simpler, Fairer, and Fiscally Sustainable Income Tax Code

The deep cuts to personal income taxes in the GOP tax law are simply unaffordable and unfair. PPI would replace the current rate structure with one more similar to the rate structure that was in place from 2013 to 2017. We would also add two new rates to curtail income inequality: a 45 percent rate on individual earnings over $1 million ($2 million for couples) and a 50 percent rate on individual earnings over $10 million ($20 million for couples).

We support retaining and expanding upon the law's provisions to limit itemized deductions that increase complexity and reduce the progressivity of our income tax code. PPI would make permanent the new standard deduction and cap on deductions for state and local taxes, although we would make changes to eliminate the SALT cap's marriage penalty. We would also phase out other expensive deductions such as the home mortgage interest deduction and impose a cap on the value of itemized deductions at 30 percent to reduce their benefit to high-income taxpayers.

Replace the Payroll Tax with a Dynamic Value-Added Tax

Increased many times to cover benefit increases and shortfalls in Social Security and Medicare funding, the payroll tax has become a highly regressive tax on workers' wages. It imposes a flat rate of over 15 percent on most wages (half of which is paid by the employer but nearly all of which is taken out of the employee's compensation), but less than four percent on earnings above a certain threshold. By taxing wages but not capital, the payroll tax disincentivizes hiring and reduces wages. And it does not raise nearly enough money to pay promised benefits, forcing the government to rely on general revenues and public borrowing to make up the difference.

We believe America's new demographic realities—a rapidly aging population and slowing workforce growth—have made the payroll-tax financing system obsolete. We propose to modernize funding for America's major social insurance programs by phasing out the regressive payroll tax and replacing it with a broad-based value-added tax. Establishing adequate and equitable sources of revenue for Social Security and Medicare, together with changes we proposed earlier in the way benefits are calculated, would rebalance America's implicit intergenerational compact to no longer disfavor young workers.

PPI would also tailor our VAT to function as a strong automatic stabilizer. The standard VAT rate would be 15 percent, but under the PPI framework, this rate would adjust automatically to the state of the economy (much in the same way that emergency unemployment benefits are triggered by a rise in the unemployment rate). During recessions, this structure provides tax relief to workers and low-income people. As the economy recovers, the VAT rate would rise back to 15 percent. Because consumers will know the tax cut is temporary, our policy will stimulate demand and consumption when the economy needs it most.

Combat Climate Change through the Tax Code

Climate change may pose an even greater threat to future generations than our myopic fiscal policy does, and like our national debt, the challenge will be easier to solve the sooner we grapple with it. PPI proposes to harness the power of market competition to reduce carbon emissions by putting in place a long-overdue tax on emissions. The tax would begin at $30 per ton and increase by inflation plus 5 percent each year. We propose dedicating this revenue to three areas: increasing federal R&D, funding green infrastructure improvements, and providing tax incentives to encourage the adoption of electric vehicles and improve to energy efficiency in the private economy. Our budget also repeals tax breaks that subsidize fossil fuel production, which will accelerate America's transition to a green economy.

Replace the EITC with a Living-Wage Tax Credit

Although the switch from payroll taxes to taxes on carbon and consumption will be good for most workers, low-income and non-workers spend more of their income on consumption than do wealthier Americans, and thus could face higher taxes under this regime. To ensure that doesn't happen, PPI proposes to replace the Earned Income Tax Credit with a much larger Living Wage Tax Credit. The LWTC would function similarly to the EITC, however the LWTC would provide far larger benefits that stretch further up the income distribution. It would also provide more generous benefits to childless individuals and a flat benefit to even people with no earnings (which will effectively function as a VAT and carbon tax rebate).

Tax Wealth, Not Work

One of the most egregious provisions of the GOP tax bill was slashing estate tax, thereby allowing the children of rich families to inherit over $10 million tax-free. There is no justification for taxing the income someone earned through their own hard work at a higher rate than income they received simply because they were born to wealthy parents. PPI proposes replacing the current estate tax with a progressive inheritance tax. Our proposal would tax inherited income at the beneficiary's top marginal income tax rate plus 15 percent (after a $1 million lifetime exemption). We would also repeal the step-up basis provision that allows heirs to forever avoid paying capital gains taxes on inherited assets, and we would tax capital gains for taxpayers in our top two tax brackets at the revenue-maximizing rate.

Adopt Real Corporate Tax Reform

The GOP's corporate tax reform should also be modified. It's true that the old U.S. corporate tax rate of 35 percent was too high and hampered our competitiveness internationally, but the GOP did not close nearly enough loopholes to finance the cost of cutting the rate down to 21 percent. PPI would bump the corporate rate back up to 28 percent—the level proposed by President Obama in his final budget. PPI would also repeal the 199A deduction that allows wealthy individuals to avoid paying their fair share of taxes by masquerading as small businesses. One positive change the GOP made was allowing more businesses to adopt full expensing, under which the full cost of an investment can be deducted the year it is made rather than depreciating it over the asset's lifecycle. We would expand and make permanent full expensing while ending the deduction for interest costs that encourages debt-financing of these investments.

End the Trump Trade Wars and Cut Regressive Tariffs

Donald Trump's senseless trade wars are a disaster for hardworking Americans. His protectionist tariffs have raised prices on everyday goods and incited our trade partners to implement tariffs of their own that hurt American exporters. We propose to repeal Trump's tariffs and find smarter ways to sanction China for its systematic abuses of free trade rules. But we would go one step further and repeal tariffs on apparel and footwear that predated the Trump administration. These tariffs primarily raise the price of goods purchased by lower-income people, making them a regressive tax. Repealing these tariffs would cut total U.S. tariffs in half—a boon for free trade.

Replace the Gas Tax with a Mileage-Based User Fee

Taxes on motor fuels are supposed to function as user fees to fund federal investments in highways and mass transit, but their value has been eroded over the last few decades by inflation and rising fuel efficiency. By 2021, the federal government's highway trust fund is projected to be insolvent, jeopardizing much-needed infrastructure investments. We would close this shortfall by replacing fuel taxes with a vehicle miles-traveled tax that better captures the cost of driving.

Enact Comprehensive Immigration Reform

President Trump's immigration policy is both cruel and economically shortsighted. Increasing legal immigration levels would help to offset the falling birthrates of our native-born population, improving our worker-to-retiree ratio and strengthening the finances of programs such as Social Security. In 2013, a bipartisan proposal to grant legal status to millions of undocumented immigrants, increase spending on border security, and promote merit-based immigration passed the Senate with a two-thirds supermajority and would have become law if not for obstructionist House Republicans. PPI recommends returning to this framework, which CBO estimated would grow our economy and boost federal revenues by far more than it would increase spending.

CONCLUSION

PPI's plan for funding America's future gives the next administration a framework for investing in our country without leaving the bill to young Americans. Our fiscal blueprint powers the engines of American innovation by increasing investments in infrastructure, education, and scientific research by more than 70 percent relative to what they would be under current law. We tackle the greatest challenges facing our society, from rising economic inequality to climate change, through dynamic tax and spending policies that also help smooth the business cycle. And we pay for all of it, giving future policymakers the fiscal space necessary to respond to other unforeseen challenges and demonstrating that fiscal responsibility and investing in the American people are not contradictory—they are in fact complementary. By supporting both growth and equity, our blueprint would once again make fiscal policy an instrument of national progress.

Percentage of GDP	2019	2029	2049
Revenues	16.5	21.8	23.5
Spending	20.8	23.8	24.0
Deficit	-4.2	-2.1	-0.5
Debt Held by the Public	78.3	76.7	46.2