Short- and Long-Run Fiscal Policy
&
The Rising Brick Wall Facing President Biden

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Harvard University
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A Tale of Two Deficits: Long-term & Short-term
This is not your grandparents’ debt problem.

• Debt in World War II scheduled to drop
• Debt now scheduled to rise

Source: Congressional Budget Office
Steuerle-Roeper Index of Fiscal Democracy

Percentage of federal receipts remaining after mandatory and interest spending

Most spending decisions increasingly made by "dead men" (Dead Men Ruling)


Notes: Calculations based on data from OMB FY2017 Historical Tables and CBO, An Update to the...
How today really is different

Traditional Budget

Revenues increase with economic growth. Spending increases only with new legislation. Real Dollars

Today's Budget

Spending scheduled to grow automatically faster than revenues. Real Dollars

Current Law: from massive future surpluses to massive future deficits
The Summers-Furman Argument in Context

- Summers I -- Furman
  - At 0 borrowing costs => borrow more and invest in positive yielding programs

- Summers II
  - Too much borrowing too soon & w/o investment => excess demand & inflation

- Even those debates largely ignore:
  - Long-term balance enhances growth no matter what the short-term policy
  - Continued growth in weak policies can’t easily be rescinded
  - “Free” money creates other economic and political consequences
Economists as Apologists for Political Give-Aways

Four Theories

- Keynesian stimulus when underemployment (when isn’t there some?)
- Supply-side economics when high tax rates reduce incentives (when aren’t they too high?)
- Borrowing when cheap (when isn’t it relative to good investment returns?)
- Modern monetary theory (why not always “print” some more?)

Some Consequences of All These Theories (despite occasional merit)

- Stimulative power comes from the “second derivative” or acceleration...which then requires deceleration
- All support politicians who want to give away more money & let others worry about how to pay for it
- All ignore political consequences of unsustainable commitments that voters treat as obligated contracts
- All encourage inefficient choices: today over tomorrow, public over private, & inattention to public vs public (Marvin Phaup)
- None justifies a budget that mandates spending to grow forever faster than revenues
Q: What are the Revealed Preferences in Today’s Budget?
A: --Investment & Ownership by the Rich
    --Consumption for Everyone Else
Forty years of tax cuts mainly on wealth & capital income

<table>
<thead>
<tr>
<th>Taxation of the Wealthy, 1980 and 2020</th>
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<tbody>
<tr>
<td></td>
<td>1980</td>
<td>2020</td>
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<tr>
<td>Top Rate Ordinary Individual Income</td>
<td>70%</td>
<td>37%</td>
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<tr>
<td>Top Effective Rate Qualified Dividends</td>
<td>70%</td>
<td>25%</td>
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<tr>
<td>Top Effective Rate Long-term Capital Gains</td>
<td>35%</td>
<td>25%</td>
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<tr>
<td>Top Rate Corporate Tax</td>
<td>46%</td>
<td>21%</td>
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<tr>
<td>Top Rate Estate Tax</td>
<td>70%</td>
<td>40%</td>
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<td>Corporate Income as Share of Total Corporate &amp; Pass-Through Income</td>
<td>79%</td>
<td>35%</td>
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<tr>
<td>Estate Tax Exemption</td>
<td>$161,000</td>
<td>$11,580,000</td>
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</table>
Eighty years of ever-higher Social Security and Medicare benefits
Ever higher replacement rates

Lifetime benefits and taxes as a percentage of lifetime earnings for a married couple with one average and one low earner
Q: Are We Getting Older or Younger
A: Longer lives => Younger
Fewer children => Older
Close to 3 decades of Social Security benefits for newly retiring couples

Notes: Calculations based on mortality data from the 2013 OASDI Trustees' Report. Calculations for a couple assume that at least one partner is still living. ERA was set at 62 for women in 1956 and men in 1961. C. E. Steuerle and C. Quakenbush, Urban Institute 2013.
It’s not clear we got older from about 1940 to 2010...or that we will get older from about 2040 onward
Who and What Gets Squeezed?
Other Domestic Spending
Programs to Promote Greater Equality of Opportunity
Domestic Spending Other Than Social Security & Healthcare Declines As a Share of GDP Under Almost Every Presidency Since Nixon/Ford
Growth in Social Security, Medicare & Medicaid Absorb 80 Percent of Real Domestic Spending Growth Since 1980
The Same Tax and Spending Trends Continue Even After $3.5 Trillion in Pandemic Relief in 2020

Increases in Revenue and Spending from 2019 to 2030

Billions of 2020 dollars

- Increase in Social Security and health outlays surpasses increase in revenues
- Total Revenues: $1,058
- Social Security: $484
- Major Health Programs: $632
- Net Interest: $174
- Other: $132
How Does This Relate to Income and Wealth Distributions?
Growth, 1979 to 2017
5th (highest) quintile >100%
1st quintile 86%
• but only 35% without the taxes and transfers.
(Top 1 percent 261%)

Source: Congressional Budget Office.
All dollar amounts are in 2017 dollars.
Elderly-Headed Households

-- From Poorest to Richest
(Caveat: counts Medicare at cost)
Lack of spending on programs to promote more inclusive ownership of human, real, and financial capital => greater wealth inequality
An Added Kicker: Large Post-1990 Increase in Wealth Valuations

Today’s huge wealth bubble

Huge protection for rich, leveraged, investors often investing in unproductive assets
Have Democrats or Republicans Been Winning?
Government spending has grown faster than the economy but mainly to support retirement & health and little else.
Republicans win most poorer counties

Murer, et al.
Brookings Institution
Via Tom Edsall

<table>
<thead>
<tr>
<th>Year</th>
<th>Candidate</th>
<th>Counties won</th>
<th>Total votes</th>
<th>Aggregate share of US GDP</th>
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<td>2016</td>
<td>Hillary Clinton</td>
<td>472</td>
<td>65,853,625</td>
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<td>Donald Trump</td>
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<td>2020</td>
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<td>509</td>
<td>79,804,027</td>
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<td>Donald Trump</td>
<td>2,547</td>
<td>73,776,924</td>
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Democrats lose working class voters

John Gramlich, Pew Research Center

Share of Democratic voters with no college experience has fallen sharply; much less change among the GOP

% of registered voters who have completed...

TOTAL

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Notes: Based on registered voters. Don’t know/Refused responses not shown. Source: Annual totals of Pew Research Center survey data (U.S. adults).

Pew Research Center
Strange Bedfellows: What Democrats & Republicans Have Wrought

• Larger government (as share of GDP)
• Smaller government for everything but retirement & healthcare

• Many supports for investment...but mainly for the rich
• More income supports for consumption...but not investment...for everyone else

• Democrats have become a party of elites
  ▫ without majority of white, working-class, elderly and poorer-region voters
• Republicans have become a party of business interests
  ▫ beholden to cultural warriors demanding more intrusive government
The Biden Dilemma
The Biden Dilemmas

(1) He wants to pursue an opportunity agenda, but...
   • He can only raise so much revenue from the rich

(2) Like predecessors, he fears asking anything from most voters

(3) Moving from unsustainable to sustainable policies
   => mainly identifies losers

(4) He fears enhancing the nation’s existential crisis
So...he attempts to pay for **some** of newly legislated increases,
   But not for the large unfunded increases already legislated