Economic Growth and Real Estate Summit

Coastal Carolina
2017
The federal government’s long-run finances are miserable, largely because of demographic change and poorly designed entitlement programs.

With spending restraint and entitlement reform, it is very difficult to adopt good (and permanent) changes in tax policy.
A Grim Fiscal Future

- The economy already is mired in what some call “secular stagnation” and others call “Europeanization.”
- To make matters worse, the United States is on a very bad fiscal and demographic trajectory.
- Key issue is whether something (good or bad) will happen to alter policy.
Population Pyramid > Cylinder
The Federal Budget Under the Extended Baseline

Source: Congressional Budget Office.

The extended baseline generally reflects current law, following CBO’s 10-year baseline budget projections through 2027 and then extending most of the concepts underlying those baseline projections for the rest of the long-term projection period.

a. Consists of excise taxes, remittances to the Treasury from the Federal Reserve System, customs duties, estate and gift taxes, and miscellaneous fees and fines.

b. Consists of all federal spending other than that for Social Security, the major health care programs, and net interest.

c. Consists of spending for Medicare (net of premiums and other offsetting receipts), Medicaid, and the Children’s Health Insurance Program, as well as outlays to subsidize health insurance purchased through the marketplaces established under the Affordable Care Act and related spending.
Figure 1.

Federal Debt, Spending, and Revenues

Percentage of Gross Domestic Product

In CBO’s extended baseline, federal debt held by the public rises . . .

. . . because growth in total spending outpaces growth in total revenues, resulting in larger budget deficits.

Source: Congressional Budget Office.

The extended baseline generally reflects current law, following CBO’s 10-year baseline budget projections through 2027 and then extending most of the concepts underlying those baseline projections for the rest of the long-term projection period.

GDP = gross domestic product.
Federal Debt, Spending, and Revenues
Percentage of Gross Domestic Product

Certain components of spending—Social Security, the major health care programs, and net interest—are projected to rise in relation to GDP; other spending, in total, is projected to decline.

A projected boost in one type of revenues—individual income taxes—accounts for the rise in total revenues in relation to GDP. Receipts from all other sources, taken together, are projected to decline slightly.

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### Figure 5.
**Spending and Revenues in the Past and Under CBO’s Extended Baseline**

Percentage of Gross Domestic Product

#### Spending

<table>
<thead>
<tr>
<th>Year</th>
<th>Social Security</th>
<th>Major Health Care Programs</th>
<th>Other Noninterest Spending</th>
<th>Net Interest</th>
<th>Total Spending</th>
</tr>
</thead>
<tbody>
<tr>
<td>1967</td>
<td>2.5</td>
<td>0.4</td>
<td>14.6</td>
<td>1.2</td>
<td>18.8</td>
</tr>
<tr>
<td>1987</td>
<td>4.3</td>
<td>2.1</td>
<td>11.7</td>
<td>2.9</td>
<td>21.0</td>
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<tr>
<td>2017</td>
<td>4.9</td>
<td>5.5</td>
<td>8.9</td>
<td>1.4</td>
<td>20.7</td>
</tr>
<tr>
<td>2027</td>
<td>6.0</td>
<td>6.9</td>
<td>7.8</td>
<td>2.7</td>
<td>23.4</td>
</tr>
<tr>
<td>2047</td>
<td>6.3</td>
<td>9.2</td>
<td>7.6</td>
<td>6.2</td>
<td>29.4</td>
</tr>
</tbody>
</table>

#### Revenues

<table>
<thead>
<tr>
<th>Year</th>
<th>Individual Income Taxes</th>
<th>Payroll Taxes</th>
<th>Corporate Income Taxes</th>
<th>Other Revenue Sources</th>
<th>Total Revenues</th>
</tr>
</thead>
<tbody>
<tr>
<td>1967</td>
<td>7.3</td>
<td>3.9</td>
<td>4.1</td>
<td>2.5</td>
<td>17.8</td>
</tr>
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<td>8.6</td>
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<td>17.8</td>
</tr>
<tr>
<td>2027</td>
<td>9.7</td>
<td>5.9</td>
<td>1.6</td>
<td>1.2</td>
<td>18.4</td>
</tr>
<tr>
<td>2047</td>
<td>10.6</td>
<td>5.9</td>
<td>1.6</td>
<td>1.5</td>
<td>19.6</td>
</tr>
</tbody>
</table>

Source: Congressional Budget Office.

The extended baseline generally reflects current law, following CBO’s 10-year baseline budget projections through 2027 and then extending most of the concepts underlying those baseline projections for the rest of the long-term projection period.

a. Consists of spending for Medicare (net of premiums and other offsetting receipts), Medicaid, and the Children’s Health Insurance Program, as well as outlays to subsidize health insurance purchased through the marketplaces established under the Affordable Care Act and related spending.

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Figure 7.

Federal Spending on the Major Health Care Programs, by Category

Percentage of Gross Domestic Product

The projected rise in federal spending for the major health care programs results from the aging of the population and the expectation that health care costs per person will continue to grow more quickly than potential GDP per person.

Source: Congressional Budget Office.

The extended baseline generally reflects current law, following CBO's 10-year baseline budget projections through 2027 and then extending most of the concepts underlying those baseline projections for the rest of the long-term projection period.

CHIP = Children's Health Insurance Program; GDP = gross domestic product.

a. "Marketplace Subsidies" refers to spending to subsidize health insurance purchased through the marketplaces established under the Affordable Care Act and insurance provided through the Basic Health Program and spending to stabilize premiums for health insurance purchased by individuals and small employers.

b. Refers to net spending for Medicare, which accounts for offsetting receipts that are credited to the program. Those offsetting receipts are mostly premium payments made by beneficiaries to the government.
### The Size of Policy Changes Needed to Make Federal Debt Meet Two Possible Goals in 2047

If lawmakers aimed for debt in 2047 to equal...

| 40% of GDP  
(Its 50-year average) | 77% of GDP  
(Its current level) |
|------------------------|----------------------|

Each year, they would need to **increase revenues** or **reduce noninterest spending** by...

| 3.1% of GDP,  
which is equal to a | 17%  
increase in revenues  
or a  
15%  
cut in spending |
|----------------------|----------------------|
| 1.9% of GDP,  
which is equal to a | 10%  
increase in revenues  
or a  
9%  
cut in spending |

In 2018, that would amount to...

| $620 billion,  
which is equal to $1,900 per person | $380 billion,  
which is equal to $1,100 per person |

If the changes were increases (of equal percentage) in all types of revenues, one effect in 2018 is that **taxes per household** would be higher than under current law by...

- **$2,100**
- **$1,300**

Values are for households in the middle fifth of the income distribution. Under current law, their taxes are projected to average $12,400.
U.S. Debt – 450 Percent of GDP
Figure 1.12. **Budgetary consolidation requirements to reduce government debt to 60% of GDP**

Average change in the underlying primary balance (2010-2030), percentage points of GDP

Note: The average measure of consolidation is the difference between the underlying primary balance in 2010 and the average underlying primary balance between 2015 and 2030, except for those countries for which the debt target is only achieved after 2030, in which case the average is calculated up until the year that the debt target is achieved.

Source: OECD (2013), OECD Economic Outlook 93 Long-Term Database.

StatLink: [http://dx.doi.org/10.1787/888932983870](http://dx.doi.org/10.1787/888932983870)
Figure 14. Illustrative Fiscal Adjustment and Projected Age-Related Spending Increases in 2011–2030 (In percent of GDP)

Source: IMF staff estimates and projections; IMF (2010c).

Note: Fiscal adjustment refers to improvement in the cyclically adjusted primary balance needed to achieve the illustrative gross government debt target. Circles indicate debt ratios above 60 percent for advanced economies and 40 percent for emerging economies, projected at end-2012 (higher debt); triangles indicate debt ratios below 60 percent for advanced economies and 40 percent for emerging economies, projected for the same period (lower debt). See note in Figure 11 for further details. The vertical and horizontal lines represent unweighted averages.

For Australia, the figures do not take into account the federal government budget, released on May 11, which envisages a return to federal government surpluses by 2012/13. For Greece (not shown), the illustrative 2011–30 adjustment need is 9.2 percent of GDP, after measures of 7.6 percent of GDP undertaken in 2010. The increase in health and pension spending is projected at 7.6 percent of GDP.
A Race against Time

Is there any hope of restoring limited government by reforming entitlements?

Yes, but the possibility of change shrinks with each passing year.

Once a majority of voting-age population lives off government...

Is this our last chance to reform?
America’s Future?

WE MIGHT WANT TO RETHINK THIS:

TAXPAYERS

MEDICAID

STIMULUS

MEDICARE

OBAMACARE

DAVIS-BACON ACT

GOVT. WASTE

SOC. SEC.

PUBLIC EMPLOYEE UNIONS
Are Tax Increases an Option?

- If we don’t restrain spending, better tax policy is very difficult to achieve.
- Indeed, if we don’t restrain spending, there will be enormous pressure to increase taxes.
- If taxes increase, what will that mean for the economy and fiscal policy?
Class-warfare agenda is driven by a desire to “soak the rich”.

But also to double tax income that is saved and invested.

Such policies are very contrary to public finance academic literature.

You don’t eat your seed corn.
Best Way to Harvest Apples?

Pick from tree?  Chop down tree?
Why Tax Increases Won’t Work

- Higher tax rates reduce growth by undermining incentives to earn and produce.
- Higher tax rates reduce competitiveness, making nations less attractive for jobs and investment.
- Higher tax rates “feed the beast” by financing bigger government.
Do Higher Taxes Result in Less Red Ink?

Tax burden has jumped by about 10 percentage points of GDP since late 1960s. Did all that added tax revenue get used to reduce red ink?

- **1965-1969**
- **2010-2014**

- **Tax Burden/GDP**
- **Debt/GDP**
Rising Tax Burden Leads to More Debt in European Nations

- Tax burden has jumped by about 10 percentage points of GDP since late 1960s

- Added revenue was used to expand burden of spending and led to more red ink

- Graph showing:
  - Tax Burden/GDP
  - Debt/GDP

- Comparison between 1965-1969 and 2010-2014
Value-Added Tax

- There is no way to finance a European-sized welfare state without a European-style tax system.
- In the absence of genuine entitlement reform, this means a VAT.
- A VAT will poach on a traditional source of revenue for states.
The Laffer Curve Constraint

- Politicians simplistically assume that there is a linear relationship between tax rates and tax revenue.
- They forget another very important variable: Taxable income.
- High tax rates reduce incentives to earn – and report – taxable income.
- The Laffer Curve.
The Laffer Curve

- Tax Revenue
- Revenue Maximizing Point
- Region of Increasing Revenue
- Region of Declining Revenue
- Growth Maximizing Point
- Tax Rate
- $0
- 0%
- 100%
In 1980, there were 116,800 rich people. Those rich people reported $36.2 billion of income to the IRS. They paid $19.0 billion of income tax to the federal government.
Tax Rates, the Rich, and Revenue

- In 1980, there were 116,800 rich people.
- Those rich people reported $36.2 billion of income to the IRS.
- They paid $19.0 billion of income tax to the federal government.

- By 1988, there were 723,700 rich people.
- Those rich people reported $353.0 billion of income to the IRS.
- They paid $99.7 billion of income tax to the federal government.
Tax Rates Determine Incentives
The Spending Problem

- Good fiscal policy is small government.
- The way to achieve good fiscal policy is to have government grow slower than the private sector.
- Under current law, the opposite is happening.
- Left on auto-pilot, we become Greece.
Solving the Spending Problem

- Fiscal progress is achieved when government grows slower than the private sector.
- So if nominal GDP grows by 3 percent-4 percent per year, then government at most should grow 2 percent-3 percent.
- A spending cap is a reasonable rule, as opposed to deficit/debt rules that are dependent on cyclical revenue flows.
All You Need to Know...

**MITCHELL’S GOLDEN RULE**

The Private Sector Should Grow Faster than the Government
<table>
<thead>
<tr>
<th>Nation</th>
<th>Years</th>
<th>Average Annual Spending Growth</th>
<th>Change in burden of Government/GDP</th>
<th>Change in Deficit/GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ireland</td>
<td>1985-1989</td>
<td>1.5%</td>
<td>-12.2%</td>
<td>-9.9%</td>
</tr>
<tr>
<td>New Zealand</td>
<td>1991-1997</td>
<td>0.5%</td>
<td>-11.0%</td>
<td>-5.8%</td>
</tr>
<tr>
<td>Sweden</td>
<td>1992-2001</td>
<td>1.9%</td>
<td>-15.0%</td>
<td>-10.5%</td>
</tr>
<tr>
<td>Canada</td>
<td>1992-1997</td>
<td>0.8%</td>
<td>-9.4%</td>
<td>-9.3%</td>
</tr>
<tr>
<td>Netherlands</td>
<td>1995-2000</td>
<td>1.5%</td>
<td>-5.2%</td>
<td>-3.8%</td>
</tr>
<tr>
<td>Italy</td>
<td>1996-2000</td>
<td>1.1%</td>
<td>-6.2%</td>
<td>-6.0%</td>
</tr>
<tr>
<td>Singapore</td>
<td>1998-2007</td>
<td>-1.1%</td>
<td>-15.9%</td>
<td>-10.4%</td>
</tr>
<tr>
<td>Slovakia</td>
<td>2000-2004</td>
<td>1.3%</td>
<td>-14.5%</td>
<td>-9.9%</td>
</tr>
<tr>
<td>Taiwan</td>
<td>2001-2006</td>
<td>-0.6%</td>
<td>-5.9%</td>
<td>-7.0%</td>
</tr>
<tr>
<td>Israel</td>
<td>2002-2005</td>
<td>0.8%</td>
<td>-5.7%</td>
<td>-2.7%</td>
</tr>
<tr>
<td>Germany</td>
<td>2003-2007</td>
<td>0.2%</td>
<td>-5.4%</td>
<td>-4.3%</td>
</tr>
<tr>
<td>Switzerland</td>
<td>2004-Present</td>
<td>1.9%</td>
<td>-3.2%</td>
<td>-1.4%</td>
</tr>
<tr>
<td>Estonia</td>
<td>2008-2011</td>
<td>1.1%</td>
<td>-5.4%</td>
<td>-4.3%</td>
</tr>
<tr>
<td>Lithuania</td>
<td>2008-2012</td>
<td>0.8%</td>
<td>+1.3%</td>
<td>-0.4%</td>
</tr>
<tr>
<td>Latvia</td>
<td>2008-Present</td>
<td>-4.2%</td>
<td>-7.1%</td>
<td>-7.0%</td>
</tr>
<tr>
<td>Iceland</td>
<td>2009-Present</td>
<td>1.9%</td>
<td>-6.7%</td>
<td>-6.8%</td>
</tr>
</tbody>
</table>

Source: IMF World Economic Outlook database, spending at all levels of government.
Modest Restraint = Balanced Budget

Deficits disappear by 2027 if spending grows 2.63% per year.

Source: CBO
Spending Restraint = $3 Trillion Tax Cut

- **Current Law Revenue Baseline**
- **Balanced Budget in 2027 if Spending Grows 1.96% Annually**
- **Revenues with $3 Trillion Tax Cut**

Source: CBO 2017

2027
Burden of Government Spending Declines During Obama's Tenure

Source: CBO, OMB
Trump Tax Cut: The Good News

- Lower marginal tax rates on households, small business, and corporations.
- Death tax repeal.
- AMT repeal.
- Territorial taxation.
- Double standard deduction*
Trump Tax Cut: The Bad News

- Trump and the GOP are doing nothing to restrain spending.
- Therefore, the only way to “pay for” a permanent tax cut is loophole closing.
- The plan (sort of) envisions eliminating state and local tax deduction and business interest deduction.
- That’s not enough for a $5 trillion tax cut.
The Bottom Line

Three takeaways

- The United States (and most of the rest of the developed world) faces a very dismal future.
- There are good solutions, but not politically popular solutions.
- Will Washington do what is best for America?
Conclusion

Website: www.freedomandprosperity.org
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Policy videos: www.youtube.com/afq2007
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