# Post-Election Fiscal Drama in the United States: A Real Cliffhanger

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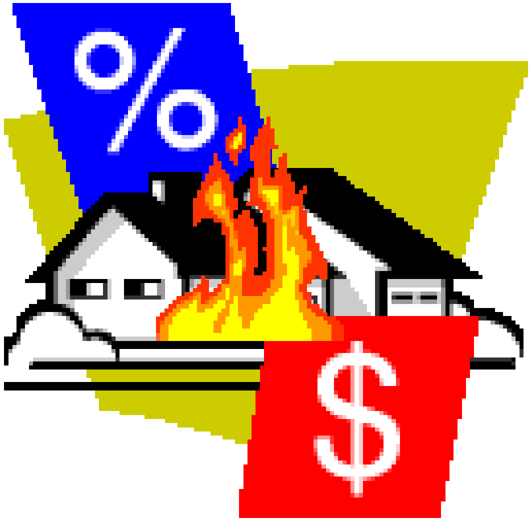
# 2010 Canon Institute Presentation

## The Global Economic Crisis: Mitigating the Impact and Preventing a Recurrence



- Accumulation of fuel for the fire:
  Underlying causes of the crisis
- Lighting the fire: Short-term triggers for the crisis
- Pouring fuel on the fire: Accelerants for the crisis
- Scorched earth and unburned terrain:
  Current and potential magnitude of the crisis
- Responses to the crisis: Liquidity, solvency, and trust
- A new global financial architecture:
  A post-Bretton Woods world order

# 2011 Canon Institute Presentation

## Keynes vs. Hoover: Finding the Path to Prosperity Amidst the Ruins of the GEC


## *Hottest Issues at Present*

- Fiscal Policy:

  Deficit (Keynes) or Balanced Budget (Hoover)

- Monetary Policy:

  Expansionary (Keynes) or Contractionary (Hoover)

→ ***Like U.S. after Great Depression or Japan today?***

# 2012 Canon Institute Presentation

## The Ailing U.S. Economy in 2012: Rehab or Relapse?

- Results to Date:

  Did the monetary stimulus work?

  Did the fiscal stimulus work?

  Does austerity foster growth?

- The Road Ahead:

  Balancing long-term concerns with short-term needs?

  Context of the upcoming presidential election?

→ ***Is the U.S. on the path of a slow and painful recovery (rehab) or will the U.S. end up back in the ICU with a double-dip recession (relapse)?***

# 2013 Canon Institute Presentation

# Post-Election Fiscal Drama in the U.S.: A Real Cliffhanger

- Results of 2012 Economic Health Check-Up:
  Is the U.S. better off than it was four years ago?
- The Fiscal Cliff:
  The Perfect Storm?
- Alternative scenarios:
  Cost of inaction?
  The grand compromise?
  Kick the can down the road?

# Results of 2012 Economic Health Check-Up: Is the U.S. better off than it was four years ago?

| Indicator | 2008 | 2012 (through Sept.) |
|---|---|---|
| Average unemployment rate | 5.8% | 8.2% |
| Average monthly job growth | -300,000 | 155,000 |
| Economic growth rate | -0.3% | 1.7% |
| Inflation rate | 0.1% | 2.0% |
| Average household income | $52,546 | $49,680 |
| Home sales (Sept., seasonally adj. annual rate) | 4.3 million | 4.8 million |
| Median home price (Sept.) | $191,000 | $183,900 |
| Average mortgage rate | 6.03% | 3.75% |
| Foreclosure filings | 2.2 million (approx.) | 1.8 million (proj.) |

*Sources*: Labor Dept., Commerce Dept., National Association of Realtors, Realty Trac, Moody's Analytics, Freddie Mac.

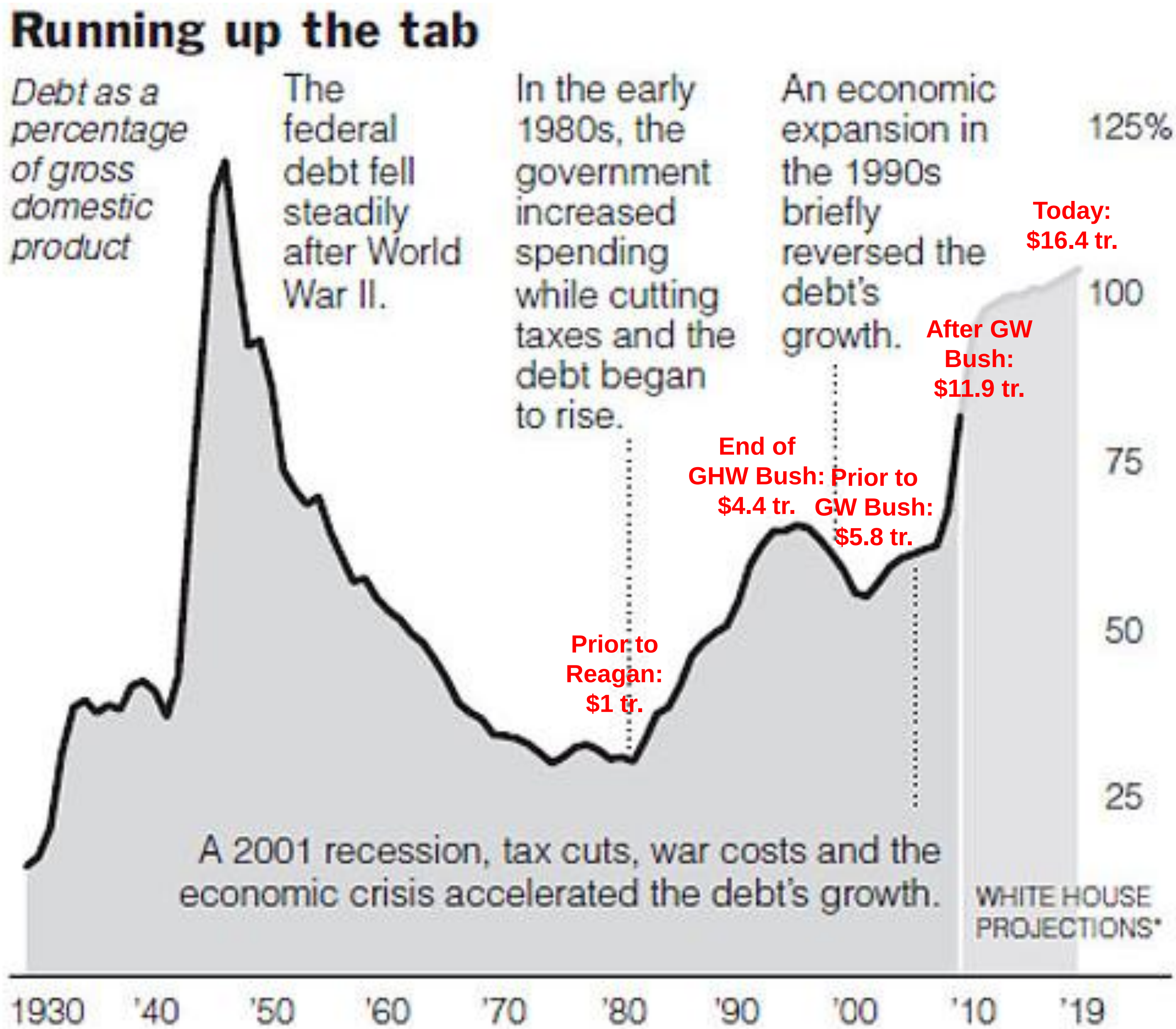
# The Fiscal Cliff: The Perfect Storm?

| Item | Potential Impact in 2013 |
|---|---|
| Expiration of Bush income/investment/inheritance tax cuts + increased coverage of AMT | $330 billion (through 9/13) |
| Expiration of Obama payroll tax cut | $95 billion |
| Expiration of tax extenders | $65 billion |
| Mandatory cuts in domestic programs | $55 billion |
| Mandatory cuts in defense programs | $55 billion |
| Expiration of benefits for long-term unemployed | $26 billion |
| Cut in Medicare reimbursements | $11 billion |
| Total deficit reduction through September 2013 | $500 billion (CBO estimate) |
| Total deficit reduction through December 2013 | $700 billion (CBO estimate) |

Bonus Challenge: Congress must increase the government's borrowing cap ("debt limit")

# Long-Term Concerns: Deficit and Debt

- In 2001, generated a budget surplus and gross federal debt as a share of GDP was half of its current level
- Since 2007, 7-fold increase in federal budget deficit as share of GDP (now 8.5%) and 62.2% increase in gross federal debt as a share of GDP (now 104.8%)
- Interest in the federal debt as a share of GDP will also increase (projected to reach 2.8% in 2017, or $565 b and 12.5% of total federal expenditures)
- Need for fiscal consolidation combining increased revenue and decreased expenditures
  - 2009 fed receipts 15.1% of GDP, lowest since 1950; usually 18-20% since WW II, still only 15.8% in 2012 (est.)
  - 2009 fed outlays 25.2% of GDP, highest since 1945; increased 27.9% since 2007, still 24.3% in 2012 (est.)


Running up the tab
Debt as a percentage of gross domestic product
The federal debt fell steadily after World War II.
In the early 1980s, the government increased spending while cutting taxes and the debt began to rise.
An economic expansion in the 1990s briefly reversed the debt's growth.
A 2001 recession, tax cuts, war costs and the economic crisis accelerated the debt's growth.
WHITE HOUSE PROJECTIONS*
Today: $16.4 tr.
After GW Bush: $11.9 tr.
End of GHW Bush: $4.4 tr.
Prior to GW Bush: $5.8 tr.
Prior to Reagan: $1 tr.
125%
100
75
50
25
1930
'40
'50
'60
'70
'80
'90
'00
'10
'19

# Scenario One:
# The Cost of Inaction?

- Combination of tax increases and expenditure cuts (“austerity budget”) ≈ Obama stimulus package → double-dip recession → virtuous to vicious cycle?

- No increase in government borrowing authority → credit rating downgrade → increased borrowing costs?

# Scenario Two: The Grand Compromise?

## Obama Administration

- 10-year savings: $4.4 trillion
- New savings: $2.0 trillion
  - New tax revenue: $1.6 tr
  - New spending: -$0.2 tr
  - Health spending cuts: $350 b
  - Mandatory spending cuts: $250 b
- Previously planned savings: $2.4 trillion
  - 2011 Budget Control Act: $1.0 tr
  - War drawdown: $800 b
  - Interest savings: $600 b

## Congressional Republicans

- 10-year savings: $4.6 trillion
- New savings: $2.2 trillion
  - Reduced tax breaks: $800 b
  - Entitlement cuts: $200 b
  - Health spending cuts: $600 b
  - Mandatory spending cuts: $300 b
  - Discretionary cuts: $300b
- Previously planned savings: $2.4 trillion
  - 2011 Budget Control Act: $1.0 tr
  - War drawdown: $800 b
  - Interest savings: $600 b

# Contextual Observations for Scenario Two: The Grand Compromise?

- How to raise more revenue efficiency and equitably
  - Can both increase tax revenue <u>and</u> decrease tax rates by broadening the tax base (reduce tax expenditures)
  - Most paid less in taxes in 2010 than those with the same inflation-adjusted incomes paid in 1980 because of cuts in federal income taxes; offset at lower income levels by higher federal payroll taxes, state sales taxes, local property taxes
- Where to cut expenditures so that it really matters
  - Mandatory spending now comprises ⅔ of all expenditures
  - U.S. accounts for > 40% of money spend on defense worldwide, and as much as the next 14 countries combined

# Scenario Three: Kick the Can Down the Road?

- Wait for new Congress?
- Bad agreement worse than no agreement?
- Fiscal cliff or fiscal slope?

# Scenario Three, Step #1: Prevent Widespread Tax Increases

- Tax bill passed by Senate and House on 1 Jan 2013
  - Permanent extension of Bush income tax cuts on incomes to $400,000 for individuals and $450,000 for couples; earnings above these amounts taxed at 39.6%, up from 35.0%
  - Permanent increase in taxes on l-t capital gains & dividends (15%→20%), estates (35%→40%) for wealthy taxpayers
  - Permanent end of 2.0% cut in the social security payroll tax for all taxpayers, reverting to the previous 6.2% tax rate
  - Permanent inflation indexing of AMT
  - 5-year extension of expansions of the child tax credit, EITC, and college tuition tax credit
  - 1-year extension of selected business tax credits
  - 1-year extension of jobless benefits for l-t unemployed
  - >90% of tax increases fall on HHs with incomes ≥ $1 m

# Scenario Three, Step #2: Prevent Default on National Debt

- Bill passed by House (23 Jan) and Senate (31 Jan) to temporarily suspend $16.4 tr debt ceiling until 18 May
- Formal debt ceiling reached on 31 December 2012
- Postpones actually likely default from Feb to Aug 2013
- Allows government to borrow necessary ≈ $450 b
- Political compromise
  – Democrats: Not contingent on matching budget cuts
  – Republicans: "No budget, no pay"; "re-sequencing"

# Scenario Three, Step #3: Prevent Sequestration

- Sequestration delayed until 1 March 2013 as part of new tax law (see Step #1)
- Still requires across-the-board automatic spending cuts to military and domestic programs
- $110 b for 2013 reduced to $85 b by new tax law
- Medicare, Medicaid, and food stamps exempted

→ Key remaining challenge is formulating a budget that balances the need for long-term fiscal consolidation with the vulnerabilities of short-term economic fragility