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Chairman Enzi, Ranking Member Sanders and members of the Committee, thank you for the very high honor and opportunity to testify today to the Senate Committee on the Budget on the topic of "The Economy and Private Sector Growth."

In this brief testimony, I will argue that the continued reliance by both parties on tax cuts to spur private-sector growth is doomed to fail. A sound long-term budget strategy should be built on increased public outlays funded by increased tax revenues as a share of GDP, with budget deficits low enough to ensure a steadily diminishing ratio of the public debt to GDP. Of all of the FY2018 budget proposals before the Congress, the People's Budget proposed by the Congressional Progressive Caucus comes closest to fulfilling America's policy needs.[i]

To explain my reasoning, it is useful to start by summarizing briefly America's ongoing economic crisis:

(1) Stagnant or falling earnings of working-class Americans, defined here as workers with less than a Bachelor's (BA) degree;[ii]
(2) Worsening health conditions for working class white, non-Hispanic, middle-aged Americans;[iii]
(3) Sharply higher Income inequality between rich and poor Americans;[iv]
(4) The richest 1% of American households earning far more than the poorest 50% of households;[v]
(5) Sharply falling life satisfaction of Americans in contrast with the trends of other high-income countries.[vi]

Our nation's budget strategy should aim to end these highly adverse and unprecedented trends. The solution requires increased public outlays for higher

education, job training, income support for low-income workers, research and development, infrastructure, and other public goods.

*The Mainstream Republican Party Strategy*

I would characterize the mainstream Republican Party budget strategy as follows:

(1) Tax cuts, whether financed by cuts in government spending or increased budget deficits, will raise the net-of-tax return to investment and thereby raise the investment rate of private business;
(2) Some of these tax cuts should aim to spur private investments in infrastructure, for example toll roads and oil and gas pipelines;
(3) Environmental and financial deregulation will accelerate the flow of private investments;
(4) Higher private investment will raise economic growth;
(5) High economic growth will boost job creation;
(6) Higher job creation will raise wages and working-class incomes;
(7) Higher working-class incomes will raise the wellbeing of working-class Americans.

*The Democratic Party Strategy*

The mainstream Democratic Party strategy of recent years has also repeatedly espoused tax cuts and infrastructure spending. There are also, of course, key differences between the two parties. I would characterize the mainstream Democratic Party budget prescriptions as follows:

(1) Tax cuts should be directed towards the middle-class and the working-class (for example through an expanded Earned Income Tax Credit) rather than towards corporations and high-income households;
(2) Corporate tax reform should aim at closing loopholes rather than cutting rates;
(3) Infrastructure spending should be financed by government outlays rather than private investments spurred by tax credits;
(4) Tax cuts should aim at "demand stimulus," especially increased consumption spending by working-class and middle-class;

(5) Government programs, especially safety-net programs, should not be cut to offset tax cuts.

*Both Parties Have Been Too Lax on Budget Deficits*

Both parties have been short-sighted regarding budget deficits and the public debt. Larger deficits in the present require higher taxes or lower government spending in the future to service the build-up of public debts. Republicans argue, wrongly, that corporate and personal income tax cuts largely pay for themselves, a claim that was thoroughly disproved by the Reagan and Bush Jr. tax cuts.

Democrats argue, wrongly, that the future costs of debt servicing will in any event be negligible compared with the great benefits of short-run stimulus. Unfortunately, this view is also too good to be true. During the Obama Administration, the public debt rose from 37 percent of GDP in 2008 to 75 percent of GDP in 2016. As interest rates are now likely to rise by 2-3 percentage points from their recent lows, the extra 38 percent of GDP will impose a heavy financing burden, roughly an incremental 1 percentage point of GDP in interest servicing costs per year.

The current trajectory of public debt is frightening. The CBO projects the average budget deficit during the coming decade on current budget policies to be around 4 percent of GDP. On a business-as-usual scenario, according to the CBO, the debt-GDP ratio would reach around 150 percent of GDP in three decades (2047).[vii] The consequences, including large tax hikes and deep spending cuts, would likely prove devastating for American society, and especially for today's young people who would bear the heaviest burden of the future fiscal retrenchment.

The Republicans claim that corporate tax cuts would lower taxes on capital income and thereby spur investment and growth. But they forget that US national saving will be needed to fund the higher domestic investment, unless the Republicans' idea is to rely heavily and dangerously on foreign borrowing. Under the Republican tax-cut proposals, national saving would fall steeply because of the fall in government saving. Thus, even if a cut in corporate tax rates successfully stimulated investment demand at current interest rates, the decline in national saving would push up interest rates and tend to crowd out any

increase in private investment, or alternatively, would cause a sharp rise in US borrowing from abroad.

Many Democrats are similarly naïve about the growth effects of tax cuts financed by budget deficits, especially when the economy is already at high employment. Tax cuts today would have to be offset by future tax increases, or by future cuts in government spending such as Social Security. Under such circumstances, households will tend to save rather than spend during a new round of tax cuts, as they anticipate future tax increases. The budget deficit would therefore soar but without producing any boost to growth, even in the short term.

The real conclusion is that federal government should pay its way by collecting adequate tax revenues. Otherwise the rapid build-up of federal debt will cripple our country in future years with few if any growth benefits in the short term. The only "winners" from another round of tax cuts would be taxpayers who garner large tax cuts today and are able to avoid the rebound in tax rate increases in the future.

*Both Parties are Mistaken on the "Automatic" Linkage of Growth and Jobs*

Both parties have assumed that faster economic growth will almost automatically translate into more jobs, higher wages, and improved household incomes. Yet the linkage of growth and decent jobs is not as strong as widely believed and less strong than in the past. A considerable amount of current investment spending is on labor-saving machinery such as robots and artificial intelligence (AI) systems. Such investments raise the US national income but also decrease the demand for lower-skilled workers and shift the national income even more towards capital owners. Recent growth has thereby been associated, somewhat counterintuitively, with a *widening* of income inequality and an absolute *decline* in the earnings of less-educated workers.

Consider a simple numerical illustration to elaborate the point. Suppose that annual GDP is $18 trillion. Suppose also that the workforce totals 150 million, made up of 50 million workers with a college degree and 100 million will less than a college degree. Suppose also that the college graduates own all the capital income, a reasonable approximation of the facts. (Recent estimates suggest that the richest 10 percent of households own around 78 percent of US wealth.[viii])

Initially, the $18 trillion GDP is divided as follows: $6 trillion for college-educated households; $6 trillion for high-school educated households; and $6 trillion for capital owners (all rich households). Thus, per capita income of college-educated workers is $120,000 per worker, and per capita income of high-school educated workers is $60,000 per worker. The college-educated also have another $120,000 per worker in capital income, for a total income of $240,000.

Now, suppose that economic growth accelerates the shift into high-productivity technologies such as robotics and AI. The GDP rises to $20 trillion, now divided as $7.5 trillion in earnings of college graduates, $7.5 trillion in capital income, and $5 trillion for high-school graduates. The earnings of college graduates have increased to $300,000, a gain of $60,000 per worker, while the earning of high-school educated workers has declined to $50,000 per worker, a decline of $10,000 per worker.

The economic pie is larger, though the slice going to the working class – constituting two-thirds of all workers – has gone down. Should we stop economic growth? Should we smash the machines? Hardly. In order to ensure that economic growth indeed raises all boats, we should ensure that the "winners" compensate the "losers" in the economy.

Suppose, for example, that the 50 million college graduates are levied an incremental $40,000 in taxes. Their net-of-tax income still rises by $10,000 per worker while the incremental government revenues (=$2 trillion) can finance a transfer of $20,000 per worker to the 100 million less-educated workers. On net, the workers with only a high-school diploma would thereby also enjoy an incremental $10,000 per worker (= $20,000 in transfers minus $10,000 in lower market earnings).

*Both Parties Confuse "Jobs" with Decent Jobs*

Both parties routinely confuse the creation of "jobs" with the creation of **decent** jobs. Many of the millions of jobs created in recent years have not been decent jobs in the sense that they do not provide the conditions for a dignified and secure life out of poverty. This is especially true for most of the new jobs

occupied by less-educated workers, notably workers who lack a bachelor's degree or higher.

The market demand for less-educated workers is already low and still declining as the result of rapid advances in robotics and artificial intelligence. Yes, millions of new service-sector jobs have been created for less-educated workers, but these jobs have been at very low wages, with high job insecurity and few if any non-wage benefits. The low earnings cannot cover the costs of health care, college tuitions for children, leisure time for the family, maternity and paternity leave, quality child care, and pre-K (except government funded). In communities dominated by less-educated workers, the local property and sales taxes are not enough to maintain decent local infrastructure, such as safe, lead-free drinking water, storm protection, clean-up of toxic sites, and a decent quality of local education.

There are two key ways to foster **decent** jobs. The first is to provide more students with the opportunity to complete a college education free of crippling student debt. The second is to provide **government supplements** to market earnings, either through direct transfer payments, refundable tax credits (such as the Earned Income Tax Credit, or EITC), and the public funding of essential needs such as health care coverage and college tuition costs.

Such government policies would of course require more, not less, government spending and revenues. Yet for the U.S. society as a whole, they would represent a lower cost than today. Consider health care. The US currently spends around 18 percent of GDP on healthcare while other high-income countries (like Canada and Germany) achieve universal health coverage with only around 12 percent of GDP. In the US, the 18 percent of GDP is divided roughly half and half between the private and public sectors, with each spending around 9 percent of GDP. In a U.S. single-payer system, such as Medicare for All, the public costs would probably rise from 9 percent of GDP to perhaps 12 percent of GDP, but the private costs would fall from around 9 percent of GDP to around 1 percent. The net saving would be perhaps 5 percent of GDP, or roughly $1 trillion per year.

*The Republican Party's Confusion Regarding Deregulation and Growth*

In addition to tax cuts, the Republican Party position is that market deregulation is a key policy measure towards faster growth and higher national income. This view reflects a mass of confusion. Consider first the issue of fossil-fuel regulation and then of financial regulation.

The Republicans aim to "save jobs" by removing the EPA regulations on $CO_2$ emissions from coal-burning power plants. Yet they fail to appreciate that coal mining is remarkably capital intensive while renewable energy deploys far more workers, for example, in installing solar panels on residential and commercial buildings. There are only 20,000 or so coal miners left in the US, while there are hundreds of thousands of workers deployed in renewable energy. Deregulating coal is therefore a triple mistake. It leads to fewer, not more, jobs; more air pollution; and more global warming, which is already imposing enormous costs on the US economy.

The Republicans also aim to create jobs by deregulating Wall Street. This general approach is a conceptual embarrassment just 9 years after the second greatest financial crisis in the country's past century. Financial deregulation of the Savings and Loan industry in the 1980s led quickly to a real-estate boom and bust during the Reagan years. Financial deregulation of Wall Street in the late 1990s led similarly and quickly to a real-estate boom and bust during the Bush Jr. years. The proper issue is not whether to regulate Wall Street but how to do it. The current call for financial deregulation is merely pandering to the Wall Street lobby, rather than addressing the underlying instability of our financial system.

*A Growth Strategy to Achieve Decent Jobs for All*

The economy today is creating jobs but not decent jobs. A true growth strategy to create decent jobs should include the following policies:

(1) A long-term rise in the proportion of individuals completing a college degree through increased public outlays to cover tuition costs.
(2) A long-term rise of public infrastructure spending financed by an increase in tax revenues (e.g. through a new carbon tax) as well as a new class of public infrastructure bonds backed by future user fees and general revenues; increased public outlays to ensure that new jobs are also "decent jobs," especially for less-educated workers.

(3) For less-educated and lower-earning workers, public outlays to ensure adequate take-home pay (e.g. through an expanded EITC); access to quality healthcare, education, childcare, and pre-K; leave time for vacations, maternity, paternity, and illness; and a safe physical environment at work and in the community.
(4) Policies to speed the transformation to a low-carbon economy, also thereby creating millions of new jobs in green tech.
(5) Transition to a single-payer health system (such as Medicare for All), paid by increased government outlays that are more than offset by the elimination of payments for private health insurance;
(6) Higher government revenues to pay for the above measures, with total federal tax revenues rising gradually from around 18 percent of GDP to around 23-25 percent of GDP over the coming decade (2018-2028).
(7) Tax reforms to include an end of corporate loopholes, higher marginal tax rates on high-income earners; a new carbon tax, and a wealth tax on very high net worth (e.g. 1 percent per year on net worth above $10 million).
(8) Reductions in effective corporate tax rates (e.g. *expensing* of new equity-funded investment) only as part of an overall increase in federal revenues.

*Budget Policy for the Long Term*

Senators, in conclusion, please let me emphasize the importance of a federal budget framework that looks forward to the kind of America we want in 2030 and beyond. In our current politics, we sometimes feel lucky to think ahead a week, month, or year. Yet to build a stronger and sustainable future for our country, we need to retrain ourselves to think ahead for a generation and more. We need to contemplate the dynamics of technology, demography, global warming, public debt, and other long-term trends, if we are to get our policies right. We need to stop drafting legislation by lobbyists, and begin again to draft legislation based on long-term needs and the best knowledge of scientists, engineers, and public managers. Most importantly, we need to plan ahead in an honest, transparent, and deliberative manner.

In my recent book, *Building the New American Economy: Smart, Fair, and Sustainable*, I urge America to adopt clear and bold Sustainable Development Goals for the year 2030 – to slash poverty by half, narrow income inequality, drop the crippling mountain of student debt, and decarbonize our energy system,

among others.  By adopting bold goals and a budget framework to match, we would demonstrate again America's remarkable ability to innovate and succeed, when we put our brains, energy, and resources in the service of a common cause.

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[i] See "The People's Budget: A Roadmap for the Resistance," Congressional Progressive Caucus, May 1, 2017

[ii] David Autor, "Skills, education, and the rise of earnings inequality among the 'other 99 percent'," *Science*, 23 May 2014: Vol. 344, Issue 6186, pp. 843-851

[iii] Anne Case and Angus Deaton, "Mortality and morbidity in the 21st century," *Brookings Papers on Economic Activity* Conference Drafts, March 23–24, 2017

[iv] Thomas Piketty Emmanuel Saez Gabriel Zucman, "Distributional National Accounts: Methods and Estimates for the United States," *NBER Working Paper* 22945, December 2016

[v] Thomas Piketty Emmanuel Saez Gabriel Zucman, op. cit.

[vi] Jeffrey Sachs, "Restoring American Happiness," *World Happiness Report* 2017

[vii] CBO, *The 2017 Long-Term Budget Outlook*, March 2017

[viii] Emmanuel Saez and Gabriel Zucman, "Wealth Inequality in the United States Since 1913: Evidence from Capitalized Income Tax Data," *The Quarterly Journal of Economics*, Vol. 131, May 2016 Issue 2