

Campaign 2016: Eight Big Issues the Presidential Candidates Should Address



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Eight Big Issues for the 2016 Campaign

Ron Haskins and Isabel Sawhill

It's entertaining, if somewhat discouraging, to watch presidential candidates throw mud at each other. But it's far more important for the candidates to identify the major problems the nation faces and what they would do to attack them if elected. The issues emphasized by candidates and their promises should be a major determinant of how people vote. Personal characteristics, party loyalty, political philosophy, and many other factors play an important role in voters' decision about who to support, but the candidates' position on major issues and the issues they choose to emphasize should and often do play a big part in voter decisions.

Although many voters, editorial page writers, and analysts are skeptical about whether campaign promises mean much, most candidates, including or even especially presidential candidates, take their campaign promises on the issues very seriously. Research shows that presidents from Woodrow Wilson through Jimmy Carter kept their word on about 75 percent of their campaign promises.¹ Politifact.com reviewed about [500 promises President Obama made](#) during his two campaigns and found that he has delivered or tried to deliver on nearly 80 percent of them.

Thus, despite the personal attacks that are a part of many campaigns, presidential candidates nonetheless lay out their positions on major issues and then try to implement their ideas if elected. This being the case, it makes great sense to influence candidates to be as explicit as possible about how they would address major issues that face the nation. The purpose of this report is to examine a set of eight issues that we think should play an important part in the 2016 presidential campaign. It is by no means an exhaustive list, but the issues we selected for examination are economic growth, taxes, the federal debt, health care policy, defense, avoiding another financial crisis, reducing poverty and increasing economic opportunity, and improving the nation's infrastructure. Each of these issues is addressed by our authors in a separate chapter of this report.

The papers were written by a group of scholars organized ten years ago by Brookings and other organizations as part of what we have called "the fiscal seminar." We formed the seminar to bring attention to the need to reduce the nation's deficits and debt. At first, we initiated the current project to encourage the 2016 presidential candidates to give the public a clear indication of how their administration would reduce the debt, and to propose and analyze specific spending cuts and revenue increases the candidates should consider as they formulated their plan. However, being honest with ourselves about the diminished status of debt issues in the current political environment, we realized that there were many other important issues that the candidates should address. So we broadened our original idea of concentrating exclusively on the debt and decided to take up additional issues that should be tackled by every 2016 presidential candidate.

After extensive discussion, we selected eight issues and recruited members of the seminar and a few scholars outside the seminar, to write a paper on each of the eight topics. The goal of each paper was to define the issue and then explore, in as objective and evidence-based a manner as possible, reasonable approaches to tackling the issue in a way that would produce favorable outcomes. Of course, for many issues, the approaches favored by the left and the right are diametrically opposed. On taxes, Democrats want to raise them on the rich;

Republicans don't want to raise them at all. On spending, Republicans want less; Democrats want more. But most of the issues we examine, if we set aside issues of financing, do not create such sharp differences between Republicans and Democrats.

Economic Growth. In the chapter on economic growth, former Congressional Budget Office (CBO) Director Rudy Penner examines one of the nation's most important problems; namely, the slow rate of growth of the economy. The CBO is projecting a growth rate of 2.1 percent per year between 2015 and 2025. This number looks pretty bad when compared with the average growth rate of 3.3 percent between 1950 and 2014. According to Penner, the biggest reason for the slowdown is the reduction in the rate of growth in hours worked, which in turn is caused primarily by the retirement of baby boomers and lower birth rates in the generations after the baby boomers. A related cause of slow growth is that businesses are unlikely to invest as much in physical capital if the population is expanding more slowly than in the past.

Given these causes of slower growth, Penner turns to an analysis of policies that would increase the rate of growth by increasing hours worked, improving the quality of the labor force, increasing the quantity and quality of investment, reducing the negative impact of regulations, and increasing public and private spending on research and development. In general, the news on all these factors affecting economic growth is less than encouraging. As Penner points out, policies to improve these determinants of growth all cost money. Yet, federal spending on entitlements for the elderly is squeezing out spending on nearly everything else, including education, infrastructure, and public investment in research and development. Unless the growth of entitlements is reined in, there will not be more than modest funding for these other purposes.

Taxes. Turning to taxes, William Gale and Aaron Krupkin begin by stating the widely held view that a good tax system collects enough money to finance government spending in a way that is simple, equitable, and friendly to growth. The first problem candidates should face is that our tax system does not collect enough revenue to pay for spending that is already baked into the cake, primarily spending on net interest, Social Security, and Medicare and other health programs. Projections show that under current law, in 2040 revenue will equal about 19 percent of GDP and spending about 25 percent. For a nation that already has a total debt approaching \$19 trillion, these numbers don't work very well.

The Gale and Krupkin essay analyzes five major issues regarding taxes. Many analysts might expect an essay such as theirs to lay out a grandiose plan for reforming the tax code. They, however, wisely point out that such a plan is "quixotic." Given the state of partisanship in the nation's capital, comprehensive tax reform is about as likely as humility from Donald Trump. Gale and Krupkin focus on five issues: raising revenue for the long-term, increasing environmental taxes, reforming corporate taxes, treating low- and middle-income earners equitably and efficiently, and ensuring appropriate taxation of high-income households. They conclude that despite the political obstacles to a reasonable resolution of these five issues, the success of the next president might be determined by how many of these issues the president addresses successfully.

The National Debt. The tax issues raised by Gale and Krupkin provide a good background for the analysis of the federal debt by Bob Bixby and Maya MacGuineas. Although falling deficits and the recent budget accord have diverted attention from the issue, the long-term debt picture is still alarming. Since 2007, the federal debt has grown from 35 percent to 74

percent of GDP and is projected to be greater than 100 per of GDP by 2039. A major consequence of the nation's debt explosion is that interest payments on the borrowing to finance the debt are the single most rapidly growing part of the federal budget. In 2017, the nation will spend more than \$300 billion to finance the debt; by 2025, we'll spend more than \$800 billion. If Congress and the president don't change course, by 2030 it will require all federal revenue just to make the nation's interest payments.

Equally alarming are figures from CBO about what it would take just to hold the debt steady as a percentage of GDP. Their estimate is that it will require spending cuts or revenue increases equal to 1.1 percent of GDP between now and 2040 just to hold debt service payments constant. In 2016, that's about \$210 billion. And the longer the nation waits to begin controlling its debt, the higher the costs of control become. Bixby and MacGuineas say that waiting just 5 years to begin would add another \$850 billion to the cost.

The authors go on to examine three key debt issues the presidential candidates should address: Social Security, Medicare and other health care programs, and taxes. Social Security is an extremely popular program, in large part because it provides income to 59 million Americans, many of whom are completely dependent on the benefit. Since 2010, Social Security has been paying out in benefits more than it collects in taxes. As a result of this imbalance, by 2034, according to the Social Security Trustees, the trust fund that supports Social Security benefits will be completely dry. Politicians know that this will never happen because, given the popularity of Social Security, Congress will eventually take action. But the longer Congress waits, the more radical the solution will have to be in the form of huge tax increases or major benefit cuts or both.

Another major cause of the nation's debt is spending on health care. Despite the fact that the growth of health care costs has slowed in recent years, federal health care spending will nonetheless continue to grow as a share of all federal spending. Over the next 8 years, annual federal spending on health care will grow to \$1.9 trillion from \$1.1 trillion, an increase of more than 70 percent. It follows that a key to reducing the growth of the federal debt is to control the growth of health care spending. In fact, it is difficult to see how progress can be made on stabilizing the debt unless the growth of health care spending is reduced.

As we have seen, federal revenue is not keeping pace with the growth of spending and the problem is becoming more serious, in large part because of the growth of Social Security and health care spending, both of which will be difficult to cut very much because of the large number of people who rely on these programs and their political popularity. So a long-term solution to growing debt will almost certainly have to include revenue increases. As Gale and Krupkin argue in their chapter on taxation, the prospects for federal tax reform are not good. Unless they are wrong, progress on the debt during the term of the next president will be exceptionally difficult. All the more reason the presidential candidates should tell the public how they intend to deal with the debt.

Health. Robert Reischauer and Alice Rivlin, both former CBO directors, provide a succinct overview of three major health care issues that should be addressed by all the presidential campaigns, two of which deal with the same budget issues that are the focus of the Bixby and MacGuineas chapter. The three issues are resolving the future of the Affordable Care Act (ACA), slowing the growth of health care spending, and reforming Medicare in a way that preserves its trust fund for the future.

Regarding the ACA, Rivlin and Reischauer recommend that the Republican candidates, all of whom say they would repeal Obamacare, provide details of the health plan they would put in place of Obamacare. These details would allow health analysts at CBO and elsewhere to evaluate the plan and provide estimates of its “costs, coverage and distributional impacts.” For their part, the Democratic candidates should go beyond merely defending Obamacare. The authors recommend that the candidates propose an alternative to the Independent Payment Advisory Board, eliminate the employer mandate, restructure the Cadillac tax on employers, and propose an alternative way to expand the coverage of low-income individuals and families for states that refuse to expand Medicaid.

There are a host of additional health issues the candidates should address, but that do not rise to the level of what to do about the ACA, how to slow the growth of health care spending, and how to preserving Medicare. Among these issues are addressing the health problems associated with consumption of unhealthful food, with drug abuse, and with violence; reducing the disparity in health between the affluent and the poor; and encouraging biomedical innovation which has slowed in recent years.

Defense. By contrast with the uncertain and fluid status of the nation’s health policy, the nation’s defense policy has been stable and more or less supported on both sides of the aisle for many years. To be sure, Republicans usually want to spend more money on defense, and Democrats less, but this distinction has diminished somewhat since the Tea Party revolution of 2010 and ensuing Budget Control Act of 2011. Moreover, this traditional difference in the predispositions of the two parties has not led to any radical changes or upheavals in defense spending in recent years (in contrast to debates over how to handle ISIS in specific cases or how to deal with Russia and China, where there is significant disagreement and policy volatility). Against this background, the defense chapter by Michael O’Hanlon contains several recommendations for issues the presidential candidates should address, but O’Hanlon makes neither recommendations for expensive additions to the nation’s defense strategy (in fact, he suggests some reforms that would save money—though no further cuts in force structure for the four military services) nor fundamental changes in the strategic principles that dictate the structure of the nation’s defense.

The nation’s defense policy rests on four basic principles: limiting the spread of nuclear weapons, protecting international air and maritime space, deterring the rise of powers that could challenge the “generally stable international system,” and preventing crises or serious conflicts. From these four general goals, O’Hanlon proposes nine more specific goals of defense strategy that include deterring Iran; defeating or at least diminishing the strength of al Qaeda, ISIS, and other terrorist groups; sustaining NATO; maintaining a nuclear deterrent; and retaining the world’s best scientific and defense industrial base. To secure these goals, he presents an analysis of defense spending and the reasons he thinks a reasonable budget for defense would be a base annual budget of about \$535 billion with additions for defense spending in the Department of Energy and for defense contingencies. Combined spending across these categories would bring annual defense spending to around \$600 billion a year. That level would be roughly the same as that agreed to for 2016 in the October 2015 budget deal between President Obama and the GOP Congressional leadership.

O’Hanlon recommends that the candidates communicate their defense goals to the public through both a major speech and a white paper that lay out the goals and provide a

“detailed description” of why their ideas are the best way to protect the nation. The candidates should also specify how much spending will be necessary to achieve their goals.

The Financial System. If the essence of defense policy is the protection of American interests when they are threatened by violence, the essence of the nation’s financial system is to provide enough credit to keep the economy growing at a healthy rate while simultaneously avoiding the type of excessive risk that caused the economic meltdown of 2008. As David Wessel argues in his chapter, “anyone with any sense wants to reduce the chances of anything resembling a repeat of 2008-2009.” After all, about \$13 trillion in family wealth went up in smoke during that period, wiping out nearly 20 years of gains and requiring six years to return the nation’s per capita output to pre-2008 levels.

Wessel argues that the Dodd-Frank law has led to some important improvements in the financial system, especially because banks are in better financial position now than before the financial crisis. The major reason they’re in better shape is because regulators have forced them to hold capital cushions that are bigger than before the crisis, thereby increasing the chances that losses will not threaten their existence. In addition, the stress tests called for by Dodd-Frank have forced banks to make loans to customers with better balance sheets than in the past. As Wessel points out, the “fraction of loans that aren’t being paid is half what it was at its peak in 2010.”

Another reason for the improved condition of banks is that Congress has given financial regulators legal authority they didn’t have before the 2008 meltdown. For example, regulators, using provisions in Dodd-Frank, have the authority to liquidate large financial companies that are close to failing. This authority has not yet been used, so there’s no way to know if it will work. Even so, on its face the expanded authority for closing banks that are near to failing constitutes a significant new tool whose very existence may well compel banks to engage in less risky investing.

Despite these new provisions bestowed on regulators by Dodd-Frank, there are still a number of problems with the financial regulatory system that may render the system subject to periodic crisis. Perhaps the most important problem is that the regulatory system is still fragmented. Wessel says that a major cause of the 2008 crisis was that “turf battles and inconsistent mandates [among regulatory agencies] interfered with effective response.” Despite Dodd-Frank, the various agencies involved in financial regulation are still fragmented and uncoordinated and seem likely to remain so in the foreseeable future because regulatory agencies such as the Securities and Exchange Commission and the Commodities Futures Trading Commission are under the jurisdiction of different Congressional committees that refuse to give up jurisdiction or to have the independence of these agencies threatened. The Dodd-Frank law did create a coordinating body, called the Financial Stability Oversight Council (FSOC), but it lacks authority to require the other bodies that share regulatory power to act in coordinated fashion. In addition, members of the FSOC have authority over specific institutions or markets but are not charged with improving the stability of the entire financial system.

These and related problems of the nation’s financial system are, as Wessel puts it, “mind-numbingly complex.” Still, candidates have a responsibility to tell the public whether they want “stricter, more intrusive regulation,” or whether they want only to “strengthen the banks’ financial footings and let them figure out how to run their businesses.” Whichever approach to financial regulation the candidates prefer, they should explain their approach to voters and be

transparent about whether they think the system still has too much risk or whether Dodd-Frank represents an adequate balance between risk and growth.

Economic Mobility. Another important issue we think the candidates should address is economic mobility. Although candidates from both parties recognize that economic mobility is lower than mobility in many other advanced countries and have called for greater opportunity in the U.S., Isabel Sawhill and Edward Rodrigue argue in their chapter that candidates should move beyond broad generalities and spell out in more detail how they would promote economic mobility.

Sawhill and Rodrigue begin with a descriptive analysis of the three factors that are most closely associated with poverty reduction and economic mobility. Drawing on an earlier analysis by Haskins and Sawhill,² they report that adults are rarely poor if they do just three things: graduate from high school, work full-time, and do not have children until they are married and out of their teen years. Specifically, only 2 percent of people who followed these three norms, which the authors refer to as the “success sequence,” were poor in 2012 and slightly more than 70 percent had achieved a middle-class income (about \$57,000 in 2014). Given the importance of these three factors in accounting for economic success, Sawhill and Rodrigue review evidence on programs that promote education, work, and avoiding births outside marriage.

Of the three factors in the success sequence, work is by far the most highly correlated with economic success. Sawhill and Rodrigue urge the candidates to support policies and programs that have been shown to get more people working. These include maintaining full employment through judicious use of fiscal and monetary policy; making work pay by raising current earnings supplements (such as the Earned Income Tax Credit), creating a bonus for full-time work, and providing a second-earner deduction for two-parent families; making work easier for parents by expanding child care subsidies or providing paid family leave; and providing transitional jobs for those who can’t find employment (possibly combined with conditioning more forms of assistance on work). The authors argue that many of these policies would over the long-run pay for themselves because more work means higher tax payments to government as well as less social spending.

The major point of their chapter is that there are many ways to promote work, reduce single parenthood, and improve education—the factors most closely associated with economic success. Candidates should select and explain the policies and programs they would implement to promote economic mobility if they were elected. As the authors put it, the public “need[s] to hear less rhetoric and more substantive proposals” from the candidates.

Infrastructure. The final chapter in our report examines what the presidential candidates should say about investment in infrastructure. As William Galston and Robert Puentes show, the nation has underinvested in its infrastructure for at least the past three decades. The result is that we have fallen to twelfth in the world in the overall quality of our infrastructure according to the World Economic Forum’s 2014-2015 Global Competitiveness Report. In fact, the U.S. ranks poorly in every category. There are several consequences of the nation’s aging and poorly maintained infrastructure. These include impaired economic efficiency, fewer stable middle-class jobs, and increased costs imposed on individuals and businesses. Galston and Puentes cite several studies showing, for example, that poor road conditions are imposing higher costs for vehicle maintenance on all who use the nation’s roads.

Thus, the authors believe it is imperative for the presidential candidates to offer a plan for using the federal government to increase investments in infrastructure, especially investments in roads, bridges, and transit. In addition, the candidates should explain what financing mechanisms they would use to increase infrastructure investments. Finally, candidates should explain how, if elected, they would select infrastructure projects that make the most economic sense and then explain how they could be financed, at least in part with private capital.

According to expert estimates, between now and 2020, the nation should invest around \$150 billion annually in transportation and port projects, water and sewage systems, the energy grid, and other infrastructure. Our economy is already being slowed by the poor condition of the nation's infrastructure. Unless the next president reverses this underinvestment, the toll on our economy will increase with repercussions for the entire nation. Although infrastructure is far from a glamorous issue for presidential candidates, there are few issues in which good ideas and substantial investment would produce greater returns.

Summary. Reasonable people can disagree about what to do about each of the eight issues we selected for examination. But the voters deserve thoughtful and informed answers. Ideally, the media should be educating the public about the problems addressed by each issue and the costs of solving them, not just reporting on who's up and who's down or the latest developments on the campaign trail. Candidates, for their part, need to go beyond criticism of existing policies or of an opponent's views and provide instead some specificity on their own positions and be held accountable when they mislead the public with half-truths or pure rhetoric. A presidential election is a good time to catalyze a national conversation on the issues of the day. These eight chapters are an attempt to provide a basic framework and some key facts as a guide to that vital national discussion.

Economic Growth

Rudolph G. Penner

Economic growth enhances living standards and provides resources to the public and private sectors that are helpful in curing all sorts of social ills. It is, therefore, distressing that for the period between 2015 and 2025, the [Congressional Budget Office \(CBO\) is projecting](#) a GDP growth rate of only 2.1 percent per year—a much lower rate than the 3.3 percent that the United States enjoyed on average from 1950 to 2014.

The most important reason for the slowdown is a reduction in the rate of growth of the number of hours worked as baby boomers retire in large numbers while relatively fewer people are entering the labor force due to lower birth rates. The growth rate of hours worked in the nonfarm business sector is expected to fall from an average of 1.3 percent per year in the previous 64 years to 0.6 percent in 2015-2025.

The rate of increase in physical capital stock is another important source of economic growth, but businesses are unlikely to invest as much when the labor force is growing slowly. CBO expects the growth in the volume of services derived from capital stock in the nonfarm private sector to fall from 3.7 percent annually in the 1950-2014 period to 2.9 percent in 2015-2025. The growth in capital stock has also been harmed significantly by low investment during the Great Recession and during the period of slow growth that followed.

Growth that cannot be explained by the growth in the labor force or capital stock is called total factor productivity (TFP). Growth in TFP is mainly the result of technological progress, but many other factors play a role. The quality of the labor force is important and that is enhanced by education and training. Improvements in management practices can enhance TFP while regulations can retard it. Many other small factors, such as the amount that the private sector must spend to protect itself against crime, are also at work.

CBO expects only a minor decline in TFP growth to 1.3 percent in the next ten years in the nonfarm private sector compared to 1.4 percent in the 1950-2014 period. [Robert Gordon](#), a well-known economist at Northwestern University, is much more pessimistic. He believes that inventions in the future will not be nearly as important as the inventions of the past such as the telephone, the automobile, and the computer. If that is true and there is a dramatic fall in the growth of TFP, future growth will decline far more than expected by CBO. It is difficult to judge the validity of Gordon's hypothesis, but one must be skeptical of any prediction of the end of a trend that has lasted for centuries. This paper assumes that the more optimistic forecast of the CBO is accurate.

In some economic models it is assumed that physical investment is necessary to implement technological improvements. That may be true, but for the purposes of this discussion, little harm is done by considering investment and TFP separately.

The policy discussion that follows will not be complete because almost everything that the government does either enhances or retards growth. And, as usual, there are not many opportunities for a free lunch. Enhancing growth often means saving more privately or publicly. That means giving up current consumption, which is not very popular given that the reward is slow to materialize. Moreover, growth enhancing policies often conflict with other social goals. For example, a flat tax may be more conducive to growth than a progressive tax, but many will object to a flat tax's distributional implications. Environmental rules delay infrastructure

investments and make them more expensive. The rules could be more efficient, but some rules are tolerated in order to reduce environmental damage.³

Economic growth is most commonly defined to mean a sustained increase in income per capita, that is to say, an increase in average living standards. Most of the policies discussed in what follows focus on improving living standards at a more rapid pace. However, enhanced growth accompanied by an increase in population growth can be beneficial even though living standards do not improve. The combination of growth in the economy and the population, for example, makes it easier to sustain a certain absolute level of defense expenditures and can be helpful in dealing with problems inherited from the past, such as pension liabilities or the national debt.

Because growth enhancing policies often impose a sacrifice or conflict with other social and economic goals, it is necessary to be modest about what can be accomplished. But modest accomplishments can have a very large impact. Increasing the real rate of economic growth by only 0.2 percent per year for the next 10 years does not sound like much, but the implied increase in 2025 GDP is over 2 percent and is worth well over \$400 billion in 2015 dollars.

Some political candidates and academics think that raising the growth rate to 4 percent per year is a reasonable goal. This would require quickly reversing the damage done by the Great Recession which slowed capital investment and damaged the quality of the labor because of long periods of unemployment. But that would be no easy trick and even if it could be accomplished, 4 percent growth would only be possible for a brief period. Rapid growth would soon run into the constraint imposed by the slowly growing labor force. Consequently, it is difficult to imagine growth of 4 percent lasting for as long as 10 years, and the following analysis is about periods at least that long.

My emphasis is on important policy issues involved in promoting economic growth that are almost certain to arise in the 2016 presidential campaign and on some issues that might be ignored, but should not be.

Policies That Would Enhance the Rate of Growth of Hours Worked

Because the slowdown in the rate of increase of hours worked is by far the most important cause of the expected decline in potential GDP growth, it is natural to focus on policies that would increase the size of the labor force.

Immigration

Increasing legal immigration is the most direct response to the problem of slow increases in hours worked, but then the question becomes: "What sort of immigrant do we want to attract?" The nation could follow Canada's lead and give highest priority to attracting the highly skilled. That would have the biggest positive impact on the standard of living of the rest of the population, but it means paying less attention to the humanitarian goal of uniting families, which has been an important goal of U.S. policy. There is a delicate balancing act here, but an increase in immigration would make it possible to attract more skilled workers without greatly deemphasizing the goal of uniting families.

Improving the Labor Force Participation Rate of Older Americans

The retirement of baby boomers is a major reason for the decline in the rate of growth of the labor force. More people apply for Social Security benefits at 62 than at any other age. Many seeking early retirement are in good health and have a long expected life ahead of them. Some will outlive their financial resources.

Increasing the labor force participation of older workers is not an issue that is frequently debated, but it deserves more attention. Many of our institutions evolved when it was considered beneficial to encourage early retirement, so that baby boomers would have more opportunity for advancement. Those few defined benefit plans remaining in the private sector and more common public defined benefit plans are structured to encourage retirement at an early age. Such plans can and should be reformed to encourage longer work.

High health costs discourage employers from taking on older workers. At the moment, private insurers must absorb medical costs before Medicare steps in. That could be reversed. It is not expensive, because the youngest among the elderly are not very costly.

The availability of Social Security encourages retirement, including early retirement. But the system is not now financially sustainable. Slowing the growth in average benefits by phasing in an increased age at which full benefits are available would induce many to work longer while improving the sustainability of the system. Increasing the early retirement age of 62 would have a more dramatic effect, but there would have to be some provision for hardship cases.

Improving the Quality of the Labor Force

Education and Training

Data clearly show that high school graduates do better economically than dropouts and that college graduates do much better than high school graduates. Presumably these differences indicate the worth of the workers to the economy and that longer periods in school could have a beneficial effect on productivity and economic growth.

The federal government finances a relatively small portion of K-12 education, but it exercises much influence through its grant making powers. Some believe that it exercises too much authority and that decisions are better left to state and local government. That is a topic worthy of debate, especially now with the controversy about the Common Core. The issues in which the role of the federal government is important and usually controversial include: the amount to be spent on pre-school activities; the role of school choice and charter schools; whether national achievement tests should be required; and the amount of financial aid provided for school lunches and breakfasts.

The federal government plays an even more important role in higher education than in K-12 education. The federal government provides tuition assistance with a bewildering array of tax incentives that badly needs simplification. But the biggest programs are student loans and Pell grants. It was decided many decades ago that it was better to provide assistance directly to students rather than to colleges. This approach was based on the assumption that colleges would then go out and compete for students by becoming more effective. It appears that this approach has failed. Tuition has soared—perhaps partly because of the increase in demand caused by student loans—and too many students are graduating or dropping out with huge debts.

We need candidates who engage in fundamental rethinking of federal support for postsecondary institutions. Perhaps it would be better after all to provide more aid to institutions rather than to students. This approach would be especially appealing if it were possible to structure assistance in a way that would encourage efficiency and limit tuition increases. However, that would not be easy, and it is necessary to beware of unintended consequences. Nevertheless, the nation needs new ideas and proposals from the candidates.

Nor is the need for new ideas any less pressing in deciding what the federal government should do to increase the effectiveness of worker training programs. It is not easy to design a program that provides a sufficient boost to income to make up for the loss of income and private sector experience while training. There have been many evaluations of training programs and there is a great need to identify those with the biggest impacts and to support these effective programs while dropping the many programs that do not pass muster.

Increasing the Quantity and Quality of Investment

Budget Deficits

In 2014 net private saving was \$1,220 billion and federal dissaving was \$582 billion. As the economy approaches full employment, the federal deficit is a major negative force reducing the amount of saving available to finance private investment. This reduces future wages and living standards. The impact can be mitigated to the extent that the United States borrows from foreigners, but then a higher proportion of future income has to be devoted to paying interest and dividends to nonresidents.

In its [June 2015 long-run budget projections](#) CBO estimates that if, during the period through 2025, deficits, excluding interest payments, could be held a cumulative \$2 trillion below the levels implied by CBO's 2015 baseline and with the reduction then continued at the same percent of GDP through 2039, real GNP per capita would be 3 percent higher in 2040.⁴ If a cumulative \$4 trillion reduction was possible, the increase in real GNP per capita would rise to 5 percent in 2040 or by \$4,000 measured in 2015 dollars.

The estimated increases in income may seem small, but the changes in policy are not dramatic. A \$2 trillion reduction in the deficit, excluding interest, equals only 2.3 percent of the cumulative value of spending plus tax revenues expected over the period. A \$4 trillion change amounts to 4.7 percent.

Tax Reform

The current tax system is inefficient, inequitable, and extremely complicated. There is little doubt that it is a drag on economic growth because of the way it distorts economic choices. The elimination of deductions, credits, and exclusions in individual and business taxation would allow lower marginal tax rates and reduce disincentives for saving and work effort. Moreover, if investment and labor were allocated to where they were most productive instead of to where they enjoy the largest tax benefits, the productivity of the capital stock and labor force would be much improved.

Our current income tax system is not really an income tax system. It contains elements of both income taxation and consumption taxation. Taxing consumption more heavily and savings and investment less heavily would be more conducive to economic growth. Michael Graetz has suggested a system that would rely heavily on a VAT while using some of the proceeds to relieve the lower part of the income distribution of any income tax burden.⁵ The income tax would be retained for the upper part of the distribution. Alternatively, a progressive, cash flow consumption tax can be designed for the whole population. Whatever the direction of reform, almost all public finance scholars would agree that a pure income tax system or a pure consumption tax system would be much more efficient than the mess that we have now.

The last major tax reform in 1986 was preceded by a long period of discussion that some would date back to the late 1970s. The debate could not have been successfully

culminated without strong presidential leadership. That will be needed if current efforts are to be successful.

Infrastructure Investment

Public investment must complement private investment as the nation seeks more economic growth. Although it is now said that there is a crying need for public infrastructure investment, it must be admitted that such investment has been allocated very inefficiently in the past. Indeed, wasteful boondoggles have been too common; e. g., the Tombigbee Waterway and the bridge to nowhere. Probably for that reason, CBO estimates that the rate of return to public investment is only one-half of what can be earned from private investment. Consequently, if the country is to do more infrastructure investment, it is important to do it better.

The basic problem is rooted in the political nature of the federal system. It is impossible to provide highway funds to Virginia, where they are desperately needed, without also giving them to Montana, where there are very few cars per mile of road. Our approaches to the geographical allocation of highway and other types of infrastructure funding are in dire need of reform. Efficiency may be enhanced by devolving more functions to the states, reforming the current grant structure, and relying more on public-private partnerships.

Reducing the Negative Impact of Regulations

Regulations have a profound impact on growth.⁶ Very often there would be an increase in efficiency if command and control regulation were replaced by market forces. A carbon tax would be far more efficient than regulatory approaches to combating climate change and other pollution taxes could also be used to improve the environment.

Unfortunately, command and control regulation is generally more politically acceptable than using the price mechanism. That increases the urgency of subjecting much more regulation to benefit-cost analysis. The Office of Information and Regulatory Affairs (OIRA) in the Office of Management and Budget analyzes the efficiency of regulations, but can cover only a tiny portion of those issued. Presidential candidates should indicate whether they would greatly expand the cost-benefit analysis of regulations and if so, how.

Public and Private Spending on Research and Development

Public Research and Development Spending

Direct federal spending on R&D peaked relative to GDP in 1964 at 2.1 percent. In 2014 it was 0.8 percent of GDP. The fall is, in large part, the result of the relative decline in defense spending which is more heavily weighted toward R&D than nondefense spending. But civilian R&D spending has also declined relatively from 1.0 percent of the GDP in the mid-1960s to 0.4 percent for most of the early part of the 21st century. The [president's 2016 budget](#) indicates that it will decline further to 0.3 percent of GDP in fiscal 2015.

Public R&D spending is now so low that its impact on economic growth must be trivial. It is worth debating whether it should be increased back to 1960s levels.

Private R&D Spending

Private R&D spending is heavily favored by the tax system. Although it is in the nature of an investment, R&D expenditures can be expensed. This essentially eliminates any tax burden on the return to the investment. If the investment is financed by debt with deductible interest, the tax burden is pushed into negative territory.

In addition, some R&D expenditure is favored by the research and expenditure tax credit. There is considerable debate over the effectiveness of this credit and it is difficult to administer. It deserves some careful scrutiny and perhaps, a simplifying reform. Generous tax treatment is often justified because it is believed that innovators do not enjoy the full pecuniary gains resulting from their inventions and substantial benefits spill over to the rest of the population.

Conclusions

Many of the policies discussed above involve more spending. However, spending on education, infrastructure, public R&D, and many other programs is being squeezed out by rapidly growing entitlements for the elderly and by a strong reluctance to raise taxes. Getting these programs under control and accepting modest tax increases is a very indirect approach to furthering economic growth, but it may open the way to much more productive spending.

The foregoing analysis does not pretend to be a complete review of all federal policies that presidential candidates could address to enhance economic growth. However, the policy options that are included do suggest that there is much that could be done. The future generations that would benefit will not be voting in the 2016 presidential election. Nevertheless, the country has a moral obligation to represent their interests—and so do the presidential candidates.

Major Tax Issues in 2016

William G. Gale and Aaron Krupkin

A good tax system raises the revenues needed to finance government spending in a manner that is as simple, equitable, and growth-friendly as possible. The United States does not have a good tax system. Long considered an outrageous affront by many observers, the U.S. tax system has generated perennial calls for everything from minor tune-ups to comprehensive reform. There is massive disagreement, however, about which issues are the most important and how they should be addressed.

In this essay, we highlight five areas where tax policy could be improved: raising long-term revenue; increasing environmental taxes; reforming the corporate tax; treating low- and middle-income earners equitably and efficiently; and ensuring appropriate taxation of high-income households.

Before addressing these issues, we start with two caveats. First, whether a Presidential candidate wishes to discuss these issues in a political campaign is a different question than whether the issues are important. As experiences over the last few years have shown, in particular with dealings between a Republican Congress and a Democratic President, often times the worst way to advance change is to talk openly about a particular proposal. This constraint may prove relevant in a campaign, too. Hence, our essay is less about what policies the candidates should propose and more about describing the important issues that they should address. We leave the political strategy questions to the political strategists.

Second, picking just five areas out of the entire tax system surely omits important issues. Comprehensive tax reform is easy to talk about, but hard to do. The pursuit of sweeping tax simplification is a noble goal, but quixotic. The effects of taxes on entrepreneurship are important, but elusive. These and other issues are worth addressing, but they are beyond the scope of this essay.

Long-Term Revenue

Under current law projections, federal debt as a share of the economy will rise from its current level of 74 percent—the highest level ever except for a few years around the Second World War—to about 103 percent by 2040 under generous assumptions, and to as much as 120 percent under reasonable alternative policy scenarios.⁷ Current law revenues will slightly increase to 19 percent of GDP in 2040 from about 18 percent currently. Total spending is projected to reach 25 percent of GDP, up from 21 percent currently, with the rise largely due to increases in net interest, Social Security, and health spending.

High and growing levels of debt will crowd out future investment and stymie growth. They will also reduce fiscal flexibility, or the ability to respond to future recessions.

Alan Auerbach of the University of California at Berkeley and William Gale of Brookings estimate that, in order to return the debt level to its 1957-2007 average of 36 percent of GDP by 2040, immediate and permanent (through 2040) [spending cuts and/or tax increases equal to 3.0 percent of GDP](#) will need to be implemented. It seems unlikely that changes of this magnitude could be managed on the spending side. Entitlements have proven difficult to reform, especially Social Security, as there is significant public and political backlash against cutting benefits. Moreover, any Social Security changes would likely be phased in slowly, and reasonable changes in the program would not affect the overall fiscal balance that much. In addition,

discretionary spending has already been cut dramatically and is already slated to fall to historically low shares of GDP over the next 25 years. As a result, tax increases need to be part of a long-term fiscal solution.

Increasing federal revenues does not mean that marginal income tax rates have to go up. New revenue sources could be explored through energy taxes (discussed in the next section), a change in the treatment of tax expenditures, or a value-added tax (VAT).

[One way to raise revenue](#) is to broaden the tax base by reducing the number of specialized credits and deductions in the tax code. For example, under current law, a dollar's worth of deduction reduces taxable income by a dollar and hence reduces the tax burden in proportion to the marginal tax rate. A high-income household saves 39.6 cents for a given dollar of deduction, whereas a low-income household only saves 10 cents or nothing at all for each dollar's worth of deduction. Setting the tax benefit of each dollar of itemized deductions to 15 cents would affect mostly high-income households and raise, on average, about 0.6 percent of GDP per year over a decade, or roughly a cumulative \$1.4 trillion over the next 10 years. Current itemized deductions are expensive, regressive, and often ineffective in achieving their goals. The mortgage interest deduction, for example, does not seem to raise home ownership rates, yet it costs around \$70 billion per year. Limiting the benefits of the deductions for high-income households is a way of reducing the distortions created by the tax code, making taxes more progressive and raising revenue. Alternatively, the United States could cap the total amount of tax expenditures that an individual can claim. For example, [Martin Feldstein, Daniel Feenberg, and Maya MacGuineas propose](#) that tax expenditure benefits be capped at 2 percent of a taxpayer's adjusted gross income. According to their model, this would have increased revenues in 2011 by 1.8 percent of GDP.⁸

An alternative way to raise revenue is through the creation of a VAT, as a supplement to the current system, rather than a replacement.⁹ A VAT is essentially a flat-rate consumption tax with administrative advantages over a national retail sales tax. Although it would be new to the United States, the VAT is in place in about 160 countries worldwide and in every OECD country other than the United States. Experience in these countries suggests that the VAT can raise substantial revenue, is administrable, and is minimally harmful to economic growth. Additionally, a properly-designed VAT might help the states deal with their own fiscal issues. Although the VAT is regressive relative to current income, the regressivity can be offset in several ways, and we should care about the distributional impact of the overall tax and transfer system, not just specific taxes. While the VAT is not readily transparent in many countries, it would be easy to make the VAT completely transparent to businesses and households by reporting VAT payments on receipts just like state sales taxes are reported today. While the VAT has led to an increase in revenues and government spending in some countries, higher revenues are precisely why the VAT is needed in the U.S., and efforts to limit spending should be part of an effort to enact a VAT. Making the VAT transparent should also reduce the extent to which a VAT would fuel an increase in government spending, a concern that is sometimes [overstated by critics](#) in the first place. While a VAT may lead to a one-time increase in prices, it is not the case empirically that VATs inevitably, or even usually, lead to continuing inflation.

Specifically, a [new 10 percent VAT, applied](#) to all consumption except for spending on education, Medicaid and Medicare, charitable organizations, and state and local government, could be paired with a cash payment of about \$900 per adult and about \$400 per child to offset

the cost to low-income families (the equivalent of annually refunding each two-parent, two-child household the VAT owed on the first \$26,000 of consumption).¹⁰ In all, this VAT could raise about a net 2 percent of GDP or about \$360 billion in 2015, after allowing for the offsetting effect on other taxes. None of this implies that the VAT would unilaterally solve the country's fiscal problems; nor would it be painless. Nevertheless, the VAT is a relatively attractive choice, given the need to close the fiscal gap and the other options for doing so.

Higher overall tax burdens do not necessarily hurt the economy. Over the 1970-2012 period, taxes as a share of GDP were 7 percentage points higher in the rest of the OECD countries (32 percent) than in the United States (25 percent). Yet, per capita annual growth was virtually identical in the rest of the OECD (1.80 percent) compared to the United States alone. Even the massive [tax increases during and after World War II](#)—amounting to a permanent rise of ten to fifteen percent of GDP—did not hamper U.S. economic growth.

None of this means that the United States needs to move to European levels of taxation. But between the very low tax revenues we raise now and the high levels of taxation in other developed countries, there is room to raise revenue in a way that achieves serious medium- and long-term debt reduction and supports a reasonable level of government.

Environmental Taxes

The discovery and exploitation of natural resources by humans gave rise to the advanced civilization in which we live today. Coal, petroleum, and natural gas fueled industrialization, which raised living standards and life expectancy for most. Energy use continues to fuel economic growth and development today. But along with the benefits of energy consumption come substantial societal costs—including those associated with air and water pollution, road congestion, and climate change. Many of these costs are not directly borne by the businesses and individuals that use fossil fuels, and are thus ignored when energy production and consumption choices are made. As a result, there is too much consumption and production of fossil fuels.

Economists have long recommended specific taxes on fossil-fuel energy sources as a way to address these problems. The basic rationale for a carbon tax is that [it makes good economic sense](#): unlike most taxes, carbon taxation can correct a market failure and make the economy more efficient. It could also serve to raise revenue as an alternative to the taxes described above.

Although a carbon tax would be a new policy for the federal government, the tax has been implemented in several other countries. In 2007, the carbon tax raised revenue equivalent to about 0.3 percent of GDP in Finland and Denmark, and 0.8 percent in Sweden. A well-designed tax in the United States could raise similar amounts. In fact, according to [Tax Policy Center](#) and Congressional Budget Office (CBO) estimates, a reasonably designed U.S. carbon tax alone could, on average, raise revenue by about 0.7 percent of GDP each year from 2016-2025 (around \$160 billion per year). Revenue from a carbon tax could be used to reduce other tax rates or pay down the debt.

Carbon taxes are a good idea even if we did not need to increase revenues because they can contribute to a cleaner, healthier environment by providing price signals to those who pollute. They have foreign policy benefits as well, as they plausibly reduce U.S. demand for oil and dependence on oil-producing nations.

Not surprisingly, most analyses find that a carbon tax could indeed significantly reduce

emissions. [Gilbert Metcalf of Tufts University](#) estimates that a \$15 per ton tax on CO₂ emissions that rises over time would reduce greenhouse gas emissions by 14 percent, while [Jenny Sumner, Lori Bird, and Hillary Smith of the National Renewable Energy Laboratory](#) estimate that the European countries' carbon taxes have had a significant effect on emissions reductions, attributing reductions of up to 15 percent to the carbon tax. Furthermore, the [University of Ottawa](#) found that the carbon tax implemented in British Columbia led to a 9.9 percent reduction in greenhouse gas emissions in the province, compared to just 4.6 percent for the rest of Canada, where comprehensive carbon taxes were not applied.

In addition to reducing emissions, [a carbon tax could improve other economic incentives](#) by reducing other tax rates or paying down the deficit. It would also reduce the U.S. economy's dependence on foreign sources of energy and create better market incentives for energy conservation, the use of renewable energy sources, and the production of energy-efficient goods. The permanent change in price signals from enacting a carbon tax would stimulate new private sector research and innovation to develop new ways of harnessing renewable energy and energy-saving technologies. The implementation of a carbon tax also offers opportunities to reform and simplify other climate-related policies that affect the transportation sector.

While it receives high marks on efficiency criteria when looking at the United States in isolation, a carbon tax could hurt the country if other countries do not adopt similar measures. [Robert Stavins of Harvard](#) notes that the largest efficiency gains would come in the form of internationally-shared reduced greenhouse gas emissions. While the United States is the largest per capita emitter of carbon dioxide, China is the largest overall emitter, and the European Union makes a significant contribution as well. Therefore, enacting a program that would lead to better cooperation with other countries, and reduce emissions across the world, would more effectively deal with the well-known problems brought about by climate change, such as rising sea levels, and higher frequency of extreme temperatures, among others.

However, no one claims that the carbon tax is a perfect solution. For example, it can have a large impact on low-income households who use most of their income for consumption. Nevertheless, this regressivity could be offset in a number of ways, including refundable income or payroll tax credits. Thus, while distributional effects are clearly a concern, they can be minimized and should not prohibit the implementation of a carbon tax.

Another way to raise revenue through energy taxation, and a method that may be more feasible than a carbon tax, is to increase the gasoline tax. The current federal rate on gas has been fixed in nominal terms at 18.4 cents per gallon since 1993. An increase in the gas tax would generate revenues to finance repairs to our crumbling infrastructure, stabilize the Highway Trust Fund, and help pay down the debt. Ian Parry of Resources for the Future estimates that raising gasoline and diesel fuel taxes to the levels justified by the externalities that gasoline consumption creates would increase revenue by around \$100 billion per year, while [CBO estimates](#) that an inflation-indexed 35 cent increase in the gasoline excise tax alone would raise about 0.2 percent of GDP (about \$46 billion per year) over 10 years. Raising the gas tax by 25 cents per year for 10 years would raise substantially more revenue, but would still leave U.S. gas tax rates well below those of European countries.

Corporate Taxation

In the standard textbook setup, the major problem with the current approach to corporate taxation is the double taxation of corporate equity. The earnings of equity holders are taxed

under the corporate tax when they are earned, and then again, under the individual income tax, when they are paid to shareholders as dividends or capital gains. This standard summary both overstates and misstates the real problem. First, no corporate income is fully taxed under the individual income tax, since dividends and capital gains are taxed at preferential rates and capital gains are only taxed when the asset is sold. Second, a significant share of dividends and capital gains accrues to non-taxable entities—non-profits or pensions—thus reducing the tax burden further. Third, a large share of corporate profits is never taxed at the corporate level in the first place. Aggressive corporate tax avoidance, including shifting funds out of the country through transfer pricing or other mechanisms, is an important factor in corporations reducing their tax burden.

The United States has the highest top corporate rate in the world at 35 percent. For many businesses, the tax distorts choices in favor of the non-corporate sector over the corporate sector. For other businesses, the corporate tax burden is offset by tax preferences. In the corporate sector, the tax favors debt over equity and retained earnings over dividends. As a result of numerous loopholes, aggressive corporate tax avoidance, and the large share of U.S. businesses that takes the form of non-C-corporation activity (which is in itself a form of corporate tax avoidance), U.S. corporate tax revenues as a share of GDP are only average compared to other countries, despite the high tax rate. In recent years, for example, corporate profits have equaled 12 percent of GDP, but corporate tax revenues have hovered around 2 percent of GDP.

Hence, the problem is not just that some forms of corporate income face two levels of tax; it is also that some forms face no tax. As a result, the main goal of corporate tax reform should be to tax all corporate income once and only once, at the full income tax rate. Given all of the flaws in the corporate tax, it should not be surprising there are several approaches to reform that could help. None is without problems; each would address different aspects of the system.

One option, [emphasized by Robert Pozen of Harvard](#) and others, is to reduce or limit the interest deduction and use the resulting revenues to reduce rates. This would reduce the bias toward debt in the tax system. Allowing firms to deduct some part of dividend payments could put dividends and interest on the same tax footing. Other ways to close loopholes and broaden the base would generate additional reductions in rates.

A totally different, and radical, approach would be to replace the corporate income tax with a tax on shareholder wealth accumulation, as proposed by Eric [Toder and Alan Viard](#). Under this approach, there would be no corporate tax. Instead, “American shareholders of publically-traded companies would be taxed on both dividends and capital gains at ordinary income tax rates, and capital gains would be taxed upon accrual,” rather than realization.

Alternatively, [Auerbach proposes](#) that the United States convert the corporate income tax into a corporate cash-flow tax. This would encourage new investment by replacing deductions with immediate expensing for physical investment. Auerbach also calls for applying the tax on a destination basis, which essentially limits the focus of the tax to transactions occurring exclusively on domestic soil and thus avoids all international transfer pricing issues.

A major change in the treatment of foreign source income should be considered as part of any overall corporate tax reform. In a pure worldwide system, all income from around the world is taxable, and all costs are deductible. In a pure territorial system, income earned outside

the country is not taxable, and costs incurred outside the country are not deductible. A key issue, of course, is how income and expenses are allocated to each country because firms go to great lengths to move income to low-tax countries and deductions to high-tax countries. Most advanced countries lean toward a territorial system. The United States, on the other hand, leans toward a worldwide system, but there is an important exception—taxes on actively-earned foreign income are deferred until the income is repatriated to the United States. Currently, US firms have an estimated \$2 trillion in actively-earned funds that have not been repatriated and therefore go untaxed.

This income is often described as being [trapped](#) outside the United States. This characterization is only partially correct, though. The money may actually be in a bank in the US and funding investment in the US. However, the funds cannot be used to pay dividends to shareholders or to buy back firm shares until the funds are “repatriated” to the corporation, a legal procedure that then generates a tax liability. There are two general proposals to deal with the issue of funds sitting “abroad.” One is to move to a worldwide system [without deferral](#). The other is to move toward a [territorial system](#). As noted, a big issue with territorial systems is that they increase the incentives that already exist to shift income into low-tax countries and deductions/costs into high-tax countries. So, the implementation of a territorial system would need to be accompanied by very stringent rules about income and cost-shifting. There has been a desire on the part of [some lawmakers](#) to have a one-time repatriation tax holiday, perhaps to finance infrastructure. This [would be a mistake](#) and would simply encourage firms to shift more funds overseas in an effort to gain a future tax advantage.

A related issue was raised by a recent [wave of corporate inversions](#), which occur when an American company is bought by a foreign firm and thus qualifies as a non-U.S. company for tax purposes. Although they are not quite “stroke of the pen” transactions, inversions can be accomplished without moving actual factories or human resources to another country. As a result, most observers believe that companies [invert for tax reasons](#). Some argue the companies are [showing a lack of patriotism](#).

Some recent, well-publicized inversions, coupled with the absence of Congressional action, led the Obama Administration to issue [new regulations](#) that limited the practice. These new regulations and the potential threat of additional ones [may have slowed](#) the pace of new inversions. Still, Congress has not addressed the underlying tax causes of inversions, including high statutory U.S. corporate tax rates. Some believe that converting the U.S. corporate tax to a territorial system would curb inversions, but this is controversial, as Berkeley lawyer Eric Talley has [noted](#).

“Patent boxes” raise another issue concerning cross-national income. Patent boxes, or intellectual property (IP) boxes, give preferential tax treatment for profits generated by IP investments. Ireland created the first [patent box regime](#) in the 1970s. Currently, around a dozen European countries, including the United Kingdom and France, offer patent boxes with preferential rates ranging from 5 to 15 percent, considerably lower than the standard corporate tax rates in those countries. Recently, Senators [Portman and Schumer](#) proposed similar treatment for the United States.¹¹

The hope is that lower rates will attract research and development to the country with the patent box. But critics argue that patent boxes will just lead to a “race to the bottom” since IP income is easy to shift across countries without any effect on the location of real activity. It is

therefore unclear whether these tax benefits actually increase research expenditures in the country in question. Studies have generally [failed](#) to identify a definitive relationship between similar U.S. strategies such as Section 174 and the research investment. To address these coordination issues, the OECD released an [agreement](#) in February 2015, tightening the conditions under which tax benefits from IP income would be awarded, but the issue is not settled.

Taxation of Low- and Middle-Income Earners

Under a progressive income tax, the highest statutory marginal tax rates are placed on the highest-income households. Under our current system, however, low- and middle-income earners often face very high effective marginal tax rates. These earners are in income ranges where increased earnings cause phase-outs of tax subsidies and benefit programs. The net effect of earning more—including higher wages, higher income tax payments, and lower program benefits—can turn out to impose quite significant effective tax rates on such households. This situation is unfair to those families, is inefficient, and discourages actions that would enhance social and economic mobility.

For example, [Melissa Kearney and Lesley Turner](#) note that a secondary earner in a married household typically pays a higher effective tax rate on the margin than the primary earner. This issue arises because the two incomes are combined to form one tax unit even though the secondary earner often has a lower *individual* income than the primary earner (and would have a lower marginal tax rate if filing as a single person). This is particularly problematic for low- and middle-income households because it discourages additional work to support their family which could result in extra income that may reduce their benefits or even render the family ineligible for programs such as food assistance or the Earned Income Tax Credit (EITC). On both fairness and economic grounds, Kearney and Turner propose a 20 percent secondary-earner tax deduction until a cap is reached. This deduction would improve the incentive to work, provide more economic security to working low- and middle-income families, and mitigate the secondary earner penalty. On net, the authors estimate their proposal would cost the federal government \$8.2 billion per year.

[Eugene Steuerle of the Urban Institute](#) points out that as a worker's income increases, marginal tax rates may increase, and benefits from social programs may be phased out. This creates higher effective tax rates for beneficiaries of welfare programs such as SNAP and government-subsidized healthcare and reduces the incentives for work and marriage. According to Steuerle, as a family's income rises, the phase-out of benefits from social programs effectively results in a combined marginal tax rate of about 60 percent for low- to middle-income earners, as compared with top income tax rate of 39.6 percent for high-income households. Those who receive more means-tested benefits initially may face combined rates closer to 75 percent. This is all compared to the earner's statutory marginal tax rate of 25 percent if filing single or 15 percent if married. To combat this issue, Steuerle proposes that the government should "make combined tax rates more explicit and make work a stronger requirement for receiving some benefits."

Of course, another option to mitigate the tax burden faced by low- and middle-income earners is to [expand eligibility](#) for the Earned Income Tax Credit (EITC) or [transform the Child and Dependent Care Credit](#) (CDCC) to a refundable benefit. Both of these programs are already executed through the tax code in an effort to aid low- and middle-income families, and changes

to the programs could expand economic opportunity or increase the degree of fairness in the system. Specifically, EITC benefits could be raised for families with fewer than two children. This improves the incentives for work in these households, and it can lead to better economic outcomes for the associated families. By converting the CDCC to a refundable credit, low-income families would be able to reap greater benefits from the program and retain more disposable income. Additionally, it would incentivize the use of higher-quality child care. In order to make these options revenue-neutral and prevent them from exacerbating the long-term revenue issues described above, the income eligibility caps for these programs could be lowered or other provisions could be removed.

Taxing the Rich

There are three major reasons to increase the tax burden on high-income households. First, their income has increased dramatically over the past several years, yet their tax payments have not kept pace. Second, if the fiscal reforms described above are implemented, the main benefit will be economic growth, but such growth in the past several decades has accrued largely to high-income households, who should thus be expected to pay for it. Third, despite much rhetoric to the contrary, reasonable variations in taxes on high-income households do not appear to have any negative discernible impact on growth.

Over the past several decades, the share of income accruing to high-income households has gone up dramatically. In 1979, the top 1 percent received about 10.5 percent of all market income. By 2011, that figure had risen to 16.9 percent. In real terms, market income among households in the top 1 percent was 174.4 percent higher in 2011 than in 1979. In contrast, for the middle three quintiles, real market income was only 15.6 percent higher.

In a progressive tax system, when someone's income rises, their average tax rate is supposed to rise. Adjusting for overall growth of the economy, this means that as a group's income rises relative to average, its tax burden ought to rise relative to average. This has not happened in the United States. The average federal income tax rate for households in the top 1 percent was 23 percent in 1979 compared to 20 percent in 2011. Thus, one reason to impose more taxes on high-income households is simply that they are not bearing their fair share of tax payments.

It is worth emphasizing that top income households currently pay the vast share of overall federal taxes (and income taxes in particular), and that the share of taxes paid is not a good metric of how progressive the tax system is. For example, suppose we changed to a tax system where no one paid any taxes except the richest person, who paid \$1. This change would obviously provide the biggest benefits to the richest people in the country, who would be relieved of the current progressive tax burdens they face. Yet, under this new system, it could be pointed out that the rich are now paying 100 percent of all taxes. The point is that the share of taxes paid is not a good measure of burden when either tax revenues or income levels are changing.

A second reason for increasing the tax burdens of wealthy households has to do with paying for the benefits of fiscal reform and consolidation. If fiscal reform could boost growth (as estimates suggest), but the benefit of that growth accrues disproportionately to high-income households (as the experiences of the last 35 years suggest it will), then the burdens of fiscal retrenchment should be disproportionately placed on high-income households. One such policy would be to means-test Social Security and Medicare, or otherwise adjust benefits downward

for high lifetime income earners. But in practice, having the rich pay more means increasing their taxes, since neither the major entitlements nor any other government spending program affect the very wealthy that much.

The notion of increasing taxes for high income earners will cause horror in some circles, but a wide variety of evidence suggests that high tax rates are only weakly related to economic growth. For example, the vaunted Reagan tax cuts in the early 1980s produced a period of average growth, when growth is (appropriately) measured from peak to peak of the business cycle. Indeed, [research](#) by Martin Feldstein, President Reagan's former chief economist, and Doug Elmendorf, the former Congressional Budget Office Director, concluded that the 1981 tax cuts had virtually no net impact on growth. They found that the recovery in the early 1980s could be ascribed wholly to monetary policy. It's also worth noting that they found no evidence that the big 1981 tax cuts induced people to work more.

Virtually no one now claims that the 2001 and 2003 Bush tax cuts stimulated growth. The two enabling acts did have the word "growth" in their titles (the Economic Growth and Tax Relief Reconciliation Act of 2001, and the Jobs and Growth Tax Relief Reconciliation Act of 2003) and slashed tax rates on ordinary income, capital gains, dividends, and estates, but economic growth remained sluggish between 2001 and the beginning of the Great Recession in late-2007. Again, the gains that did occur are generally attributed to the Fed's easy money policy.

Even the 1986 Tax Reform Act, the standard bearer in terms of broadening the base and reducing top rates, generated little impact on growth.¹² Moreover, in 1993, the top income tax rate in the United States rose to 39.6 percent, yet [the economy flourished](#) for the rest of the decade. Cross-country research provides similar evidence. [Research by Thomas Piketty, Emmanuel Saez, and Stefanie Stantcheva](#) found no relationship between how a country changed its top marginal tax rate and how rapidly it grew between 1960 and 2010. The United States, which cut its top rate by over 40 percentage points during that period, grew just over 2 percent annually per capita. Germany and Denmark, which barely changed their top rates at all, experienced about the same growth rate.

There are many ways to boost revenue collected from high-income households. The most prominent examples would include higher taxes on capital gains and dividends, restrictions on tax expenditures, higher income tax rates, or a tighter estate tax. Taxing carried interest as ordinary income also makes sense in principle, but is difficult to implement without creating new forms of avoidance and, as a result, would raise very little revenue.

Conclusion

Reforming the tax system so that it pays for government spending, treats taxpayers fairly, and improves incentives for productive activity can only be a plus from an economic standpoint. Even though the politics have been, and will continue to be, a major barrier to reform, the next President may well be judged a success or failure in significant part based on how he or she handles tax policy.

Why the Federal Debt Must Be a Top Priority for the 2016 Presidential Candidates

Bob Bixby and Maya MacGuineas

The Debt Remains a Problem That Transcends Partisan Agendas

The next president will face an array of pressing issues; everything from income inequality to crumbling infrastructure, terrorism, retirement security, tax reform and health care costs. One issue, however, transcends them all: the unsustainable projected growth of the federal debt. No candidate's vision of the future, regardless of party or ideology, will be credible if it rests on the premise of unsustainable debt.

With the annual deficit having come down by more than two-thirds from its trillion dollar heights during the Great Recession, (never mind that this follows an unprecedented increase of 800 percent) candidates may be tempted to conclude that our fiscal problems are behind us. That would be a mistake. Deficits are projected to begin rising again as the next president prepares his or her first budget. Over the coming decade, the debt is on track to grow by more than \$7 trillion and resume a long-term path that is unsustainable.¹³

The debt is already at a post-World War II high as a share of the economy (GDP). It has grown from 35 percent of GDP in 2007—about the post-World War II average—to 74 percent today, and is projected to be bigger than the entire economy by 2039.

Interest on the debt will become the fastest growing part of federal spending. In 2017, the next president will inherit a government projected to spend over \$300 billion on interest payments that year alone, an amount that grows to more than \$800 billion by 2025—more than the current combined federal spending on the Defense Department, education, transportation, and medical research. Absent change, by 2030 all federal government revenue will be needed just for interest payments and mandatory spending (the spending programs that grow on auto-pilot), putting increased pressure on spending controlled through the annual appropriations process, which includes investments in human and physical capital and national defense.

By the end of the next president's theoretical second term (2025), the major health and retirement programs, along with interest on the debt, are projected to account for over two thirds of total spending—up from 58 percent of spending in 2017. Thus, ignoring the debt problem will not make it go away. In fact, the longer corrective actions are delayed, the more difficult the choices will become.

According to the Congressional Budget Office (CBO), it would take spending cuts or tax increases totaling 1.1 percent of GDP in every year, relative to current law, just to keep the debt from rising as a share of GDP through 2040. That translates to roughly \$210 billion in 2016. Similar sized cuts or tax increases relative to the size of the economy would be needed in each successive year.¹⁴ These estimates assume, however, that corrective actions begin immediately. Waiting just five years to begin would require annual deficit reduction totaling 1.4 percent of GDP to keep the debt at today's level in 2040, which would add another \$850 billion to the cost. More ambitious goals, such as reducing the debt to its pre-Great Recession share of the economy, would necessitate much larger cuts.

The bottom line is that current and future spending promises cannot be paid for with today's level of revenues. The end result is an unsustainable budget. It's a matter of arithmetic, not ideology.

While incremental progress is possible over the next two years—as is more backsliding, such as we have seen in the past few years—it is very unlikely that a major initiative to alter the budget's unsustainable path will be undertaken. The next opportunity for such an initiative will likely come with the first budget of the next president. First budgets have often set the tone and the agenda for the years ahead: Reagan in 1981, Clinton in 1993, George W. Bush in 2001 and Obama in 2009 all serve as examples.

It is therefore important for the 2016 presidential candidates to present not just a vision of new spending or lower taxes, but a vision that fits within a sustainable budget. It is also important for voters and the media to carefully scrutinize the candidates' fiscal proposals. Presidential candidates should craft their campaign promises with a realistic appreciation for the magnitude of the debt problem, its root causes, and the consequences of doing nothing. If they believe that it is premature to set out detailed deficit reduction proposals during the campaign, they should at least be careful not to box themselves in with pledges of what they will not do; pledges that would make it impossible to actually solve the problem. They should also avoid new proposals that are not paid for and would accelerate the projected growth of debt.

Addressing the debt need not be a candidate's top priority. It must, however, be among the top priorities so that voters can assess the trade-offs involved in each candidate's budgetary proposals. Moreover, unlike other policy issues, putting forward a budget is something a president is required to do. Having a sustainable fiscal vision should be important to all candidates no matter what their priorities, because a failure to address our fiscal outlook will limit a president's ability to address a range of issues.

Reducing the Long-Term Debt Burden Will Pay Dividends

A long-term fiscal sustainability plan is, in fact, an economic growth plan. Too often a false choice is posed between addressing our fiscal challenges and growing the economy. They are not mutually exclusive policy goals. In fact, when properly structured, they are mutually supporting. Failing to address the unsustainable long-term growth in the debt will have negative ramifications for the economic well-being of Americans. On the other hand, putting the debt on a sustainable long-term path would pay dividends in the future for jobs, wages, opportunity and growth.

Government debt crowds out productive investments in people, machinery, technology, and new ventures. This diminished private investment results in fewer job opportunities and lower wages. And as the share of federal resources pledged to retirement, health care and interest on the debt grows, it will leave shrinking amounts for all other purposes including investments in national defense, education, infrastructure, low-income support, or basic research. [Spending on children's programs](#), for example, are already declining. Meanwhile, rising debt can lead to higher interest rates, increasing costs of mortgages, car loans, student loans, and credit card debt.

The currently projected path of fiscal imbalance not only threatens the health of the economy, it also places ever-tighter constraints on the ability of future generations to determine their own priorities or to meet challenges that cannot be foreseen. In the extreme case, failure to get the national debt under control could also eventually cause a crisis where investors are no longer willing to loan money to the government at affordable rates. By contrast, addressing deficits now can be a source of strength even if implemented gradually. According to a CBO analysis, a responsible deficit reduction plan could boost per-person economic growth by as

much as \$6,000 after 25 years, in today's dollars, and could be phased in to avoid slowing the economic recovery.¹⁵

A Structural Mismatch is Driving the Problem

If candidates are to make sense on the debt issue, they must understand what's causing it and be willing to explain the facts to voters. The root cause is not "waste, fraud and abuse," which is often targeted on the campaign trail. Is there waste? Of course there is and we should ferret it out, but the possible savings here will amount to little more than a rounding error. Another frequent target, foreign aid, makes up just 1 percent of total federal spending.

Economic growth is crucial but alone can't solve the debt problem. The amount of growth required would be unprecedented. Furthermore, many spending programs—including the large retirement and health care programs—grow faster when the economy grows, which counteracts some of the deficit-reduction benefits of economic growth. Productivity growth would have to be 50 percent higher over the next quarter century just to hold debt at its current record-high levels.

The real cause of projected deficit growth and rising debt is a built-in mismatch between projected revenues and popular benefit programs that operate on autopilot, especially Medicare, Medicaid and Social Security. Those three programs already comprise 47 percent of the budget. As the population ages and per-person health care costs continue to rise, these programs will steadily become more expensive. Revenues are not projected to keep up.

The Congressional Budget Office (CBO) projects that over the next 25 years, Social Security and the major federal health care programs will grow from roughly 10 percent of GDP to more than 14 percent. All other federal programs are projected to shrink as a share of GDP over that time.

Rising deficits will increase interest costs on the debt. The CBO projects that interest costs will add another 3 percent of GDP to the budget by 2040, digging the hole deeper. Revenues, while already above their historical average, are projected to grow, but not by enough to keep up. Moreover, many Americans have become accustomed to huge tax-code subsidies for everything from home mortgage payments to employer-provided health care benefits. In total, "tax expenditures" amount to more than \$1 trillion per year.

Key Issues the Candidates Should Discuss in their 2016 Campaigns

Borrowing our way through the problem is not a viable option because the rising cost of Social Security, Medicare and Medicaid is not a temporary blip. All three programs get bigger with time. Finding solutions means coming to grips with the demographic and health care cost dynamics that will drive spending and revenues farther apart. We can't simply grow our way out of this problem; we can't simply cut our way out; and we can't simply tax our way out. We need a combination.

Finding such a solution will take leadership, which will require conducting a straightforward conversation with the American people, setting priorities, avoiding short-term gimmicks, and negotiating difficult choices across party lines. The president and Congressional leaders who have the courage to attack the debt will need broad public support to face down opposition from special interests.

Voters have a right and a responsibility to find out what the candidates are prepared to do about this problem in their first budget as president.

At a minimum, candidates should:

1. Acknowledge that the long-term debt is a serious problem.
2. Make dealing with the debt a top policy priority in their campaign.
3. Put forward a plan for what they would do, not what they wouldn't do.
4. Explain how they would pay for their policy initiatives.
5. Use their speeches, white papers, press briefings, and party platform to engage and educate the public about the tough choices.

More specifically, candidates should commit in their first budget to:

1. Achieve declining debt levels with debt (as a percent of the economy) lower at the end of the first term (2021) than when taking office; with debt even lower at the end of a second term (2025); and set on a continuous downward path thereafter.
2. Include policies that grow the economy and address pressures on the budget by:
 - Slowing the growth of federal health care spending and improving the health care delivery system so that it is less of a drain on our economy and the budget
 - Making Social Security sustainable and secure, strengthening it for future retirees and generations
 - Reforming the tax code by eliminating, reducing or reforming tax preferences in order to simplify the code, grow the economy, enhance competitiveness and reduce the deficit
 - Protecting or even expanding critical investments (such as education and infrastructure) to promote economic growth and opportunity
3. Work closely with Members of Congress in both parties to enact the budget into law.

In preparing their campaign proposals with an eye towards the first budget, candidates should be mindful of some key considerations regarding the three crucial programs for long-term sustainability: Social Security, health care and taxes.

Social Security

Social Security is a vital program that provides retirement and disability income to 59 million Americans. It is also the largest federal program, accounting for nearly one-quarter of all federal spending. Despite its dedicated revenues, Social Security promises more benefits in the future than it can deliver. Since 2010 Social Security has been paying out more than it takes in on an annual basis and its Trustees warn that the program cannot sustain its projected long-run costs:

- The combined Social Security trust funds are projected to be depleted in 2034, which would result in an across-the-board 21 percent benefit cut. The [Social Security Disability Insurance fund](#) is projected to be depleted even earlier, in late 2016.
- In 1960 there were approximately five workers for each Social Security beneficiary. As the baby boom generation retires, today's ratio of nearly three workers for each beneficiary will shrink to roughly two workers per beneficiary by 2030. This means without placing a larger tax burden on workers or cutting benefits, the program will incur large deficits.
- Waiting to address Social Security's finances will require larger cuts or tax increases in the future; even worse, waiting will spread this larger burden over fewer people, necessitate abrupt and less targeted changes, and leave workers with less time to plan and adjust. Making changes sooner rather than later will make it easier to design thoughtful, pro-growth, and well targeted reforms.

Health Care

Despite recent slowdowns in federal health care spending, it remains a large piece of the federal budget and is still projected to grow faster than the economy. The recent slowdown has led to lower growth projections in Medicare and other government programs, yet great uncertainty remains about how much of the slowdown represents a permanent shift to a more efficient health care system. Our aging population is the main driver of future health care spending because aging results in more Medicare and Medicaid beneficiaries:

- One-sixth of all economic activity in the United States involves health care. Health care spending is the largest piece of the federal budget, [comprising over one-quarter of all federal spending in 2015](#) (more than \$900 billion).
- Over an 8-year term, the next president would see annual [federal health spending grow by more than 70 percent](#), from \$1.1 trillion to \$1.9 trillion.
- Spending on federal health care programs is projected to grow from 5 percent of the economy (GDP) to 8 percent of GDP over the next 25 years faster growth than in any other government programs both because of health care cost inflation and an aging population.¹⁶
- Historically, health care costs have grown more quickly than the economy, putting pressure on businesses, wages, and government programs. Every nonpartisan projection shows health care costs continuing to grow more quickly than the economy.
- The recent slowdown in cost growth makes this an important moment to address health care costs, with an opportunity to inject changes into the health care system and federal programs that can have long-lasting positive effects on the budget as well as the quality of care.

Tax Reform

Federal revenues are not keeping pace with expenditures, a trend that will continue as federal spending on health and retirement programs increase. At the same time the U.S. tax code is complicated, inefficient, and hurts our competitiveness. There is little wonder that there is bipartisan agreement on the need for reform:

- The exemptions, deductions, credits and preferential rates within the income tax system are often called “tax expenditures” because they are essentially spending programs in disguise. They have much the same impact as if the government had simply written checks to the beneficiaries but they generally receive far less scrutiny than direct spending.
- Tax expenditures total more than \$1 trillion a year in foregone federal revenue.¹⁷
- Many bipartisan groups have suggested cutting these provisions to make the tax code simpler and fairer and to promote economic growth.
- Comprehensive tax reform is possible to achieve in a way that lowers tax rates for everyone, retains or increases progressivity, and brings in additional revenue to reduce the deficit.

Conclusion

In the past, we have seen some elections in which the candidates competed to be fiscally responsible, and other elections in which they pandered and ran from the issue. This is a critical moment for the United States and the debt; the next president, whoever he or she is, will

have to face a number of looming fiscal issues from the depletion of the Social Security disability fund, to a likely increase in interest rates, to the ongoing extremely expensive retirement of the baby boom generation. Growing the economy is one of the themes of this campaign and yet it cannot happen without a sustainable fiscal plan. Citizens are willing to be part of sensible reforms that would help control the debt and grow the economy, but they will need presidential candidates—and ultimately a president—who is willing to honestly talk about and tackle the issue.

Health Policy Issues and the 2016 Presidential Election

Robert D. Reischauer and Alice M. Rivlin

Health policy has become a highly charged partisan issue in American politics and there is no question it will be debated in the 2016 campaign. The question is: will the campaign debates allow candidates to articulate realistic positions, help voters understand the options, and provide a basis for legislation when the new president and congress take office in 2017? Or will electioneering degenerate into trading slogans (“Repeal Obamacare!” “Save Medicare!”) and mutual accusations of nefarious intentions that deepen the partisan divide and make it more difficult to agree on constructive action, no matter who wins at the polls?

The next president and congress will have to deal with at least three big health policy issues:

- Resolving the future of the Affordable Care Act (ACA).
- Slowing projected growth of national health spending, including private, state, and local, as well as federal health spending.
- Reforming the Medicare program in a way that extends the life of the Medicare trust fund and ensures the viability of Medicare for the rapidly increasing population of beneficiaries.

These issues are necessarily complex, because the American system of delivering and paying for health care is extraordinarily complex. Hence, proposed policy changes are inevitably complicated and hard to make clear to most voters. The three issues are also highly interrelated. For example, the ACA increased federal spending for health by creating subsidies for the purchase of health insurance and expanding Medicaid. At the same time the ACA reduced spending for Medicare and introduced reforms likely to make health care delivery more efficient. Hence, repealing the ACA in its entirety would make the other two issues harder to resolve.

Partisan Ideology and Political Reality

While there are diverse views on health policy within both parties, candidates in the 2016 election are likely to continue emphasizing traditional Republican and Democratic themes. Republicans will talk a lot about market solutions, empowering consumers to make choices, reducing waste and regulation, and giving states more flexibility to design and execute health programs. They will tout tort reform as a way of reducing malpractice premiums, health savings accounts as a way of giving consumers more control over health spending, and selling health insurance across state lines as a way of enhancing competition. They will demonize Obamacare as a federal power grab that is forcing people to buy health insurance even if they don’t want it, punishing small business, and raising premiums for everyone. They will paint a grim picture of the future of Medicare if Democrats resist changes in the program.

Democrats for their part will talk about families getting life-saving care under the ACA and point to dire consequences of repeal, such as going back to denial of health coverage to people with pre-existing conditions or high health costs. They will talk about the millions of elderly and vulnerable people benefiting from Medicare and Medicaid and accuse Republicans of wanting to gut Medicaid by making it a block grant to the states and destroying Medicare by turning it into a voucher program. They will push for expansions in coverage and benefits on the

grounds that current programs are still inadequate to meet the goal of affordable health care for all.

When a new president and congress begin to tackle these challenges, however, they will find their options quite limited no matter who has won. The American public is generally nervous about change in anything as vital and personal as health care. Medicare, for example, is such a popular program that any changes to it must be carefully designed to assuage the fear of current beneficiaries and their families that they might end up worse off. Moreover, the current health care establishment—providers, insurers, suppliers—is a large, politically sophisticated part of the economy whose jobs and income derive from the current health system and which resists changes they fear will hurt them. So any new team proposing major health policy changes will face a daunting negotiation with powerful stakeholders determined to defend and enhance their varied interests. Candidates: be careful what you wish for!

The Affordable Care Act in 2017 and Beyond

Viewed from early in the primary season, the clearest policy divide between the Republican and Democratic presidential candidates is over the future of the Affordable Care Act. The Republican candidates all promise to “repeal and replace” the ACA fulfilling the unsuccessful four year effort of Congressional Republicans and meeting what will undoubtedly be a major plank in the party’s platform. The Democratic candidates extoll the accomplishments of the Act, promise to protect it or move to a more generous program. Neither of these polar positions represents an adequate response to the situation that will face the next president. It would be highly desirable for both parties to modify and clarify their stances on the ACA by the time of the general election.

If Republicans recapture the White House, they will almost certainly retain control of both chambers of the Congress and be in a good position to repeal Obamacare early in 2017. A Democratic party smarting from losing the presidency would be unlikely to stop them. But then, what?

While Republican presidential primary candidates are unanimous in calling for “repeal,” they have not coalesced around a concept of “replace.” Some have proposed tax credits for the purchase of health insurance and either retaining the ACA insurance market reforms or replacing them with federally supported state-based high-risk pools or other devices. Others have been silent. If the Republican nominee sticks to a vague “repeal and replace” formula, health insurance markets could be badly disrupted. Indeed, many ACA beneficiaries, insurers and employers are likely to face great uncertainty that will make them reluctant to adhere to the ACA’s requirements starting as early as mid-2016. If a Republican electoral victory looks plausible in the spring and summer of 2016 and there is no clarity on what “replace” implies, insurers may be reluctant to submit premium bids for 2017 to the exchanges or they may propose significantly increased rates to compensate for heightened uncertainty; some healthy individuals may drop their coverage reasoning that the penalties will not be enforced by a new administration; many providers may drive harder bargains with insurers and plans in anticipation of reduced pressure to control costs; and states may constrain their Medicaid rolls fearing that a less generous block grant will replace the ACA’s Medicaid expansion in 2018. Alternatively, some states might expand their Medicaid program in anticipation of a block grant that will be based on each state’s current level of spending.

To avoid this kind of chaos, the public, providers, insurers and the media should insist that the Republican candidate reduce this uncertainty during the campaign by providing the details of the “replace” component of the Republican plan and the time table for the changes. These details might include plan specifications or even draft legislative language which non-partisan analytical organizations like CBO and independent think tanks could evaluate and provide estimates of the proposal’s likely costs, coverage and distributional impacts. Clearly, it would be unusual to specify such policy detail during a political campaign, but the potential disruptive consequences of the repeal and replace policy to society and the economy are also likely to be highly unusual and consequential.

The Democratic nominee would also be wise to do more than praise and promise to defend Obamacare. If the Democrats retain control of the White House they are likely to continue to encounter major difficulties engaging Republicans on legislation to fix the difficulties that have emerged in implementing the ACA. They should make clear that they would like to find some common ground with Congressional Republicans who will likely control at least one congressional chamber. This should be more than a long-overdue technical corrections bill. The Democrats should be willing to consider some alternative to the Independent Payment Advisory Board (IPAB), which is unlikely to be constituted as long as Republicans control the Senate, the elimination of the employer mandate which [some independent analysts](#) have concluded has only a marginal impact on coverage (but not on costs), a restructuring of the Cadillac tax on employers that is scheduled to take effect in 2018, and other modifications that three years of experience suggest are warranted.

[A recent paper by analysts at the Urban Institute](#) suggests that the accomplishments of the ACA could begin to erode as the premium and cost-sharing requirements of exchange policies become increasingly unaffordable for middle income and elderly families and as the consequences of inadequate funding for administration become more apparent. The Democratic campaign should lay out those areas that its health policy experts feel need fixing. The list should include a more generous tax credit and cost-sharing schedule for exchange participants; a fix for the employer-based insurance “glitch;”¹⁸ and augmented federal grants for IT development and operations, education, outreach, enrollment and oversight and enforcement of insurance regulations. While congressional Republicans may find such enhancements unacceptable, they may be more receptive to the Urban Institute’s researchers suggested compromise relating to the ACA’s Medicaid expansion. Under this proposal, states that have not expanded Medicaid eligibility to 138 percent of the Federal Poverty Level (FPL) as the ACA required—and the Supreme Court decision made optional—would be given the option of allowing their residents with incomes between 100 percent and 138 percent of the FPL to enroll in fully federally subsidized exchange plans if they agreed to increase the state’s threshold for Medicaid eligibility to 100 percent of the FPL.¹⁹

Moderating the Growth of National and Federal Health Care Spending

The United States devotes an extraordinary 18 percent of its GDP to health care—a substantially larger fraction than other advanced countries with modern health care systems. For several decades, health spending per capita grew faster than other spending. Continuation of past trends seemed likely to push the fraction of economic resources devoted to health care ever higher—to 20 percent and beyond—squeezing out spending for competing needs in public and private budgets, including investment needed to give young people the skills and tools to

ensure future prosperity. However, in the last few years health spending slowed markedly. Over the past 5 years (2009-14) National Health Expenditures (NHE) have risen at an average rate of 3.5 percent a year on a per capita basis, compared with 6.5 percent in the previous decade (1999-2009). [Medicare spending has risen](#) at a rate of 1.3 percent per beneficiary and the comparable figure for Medicaid is 0.5 percent. The causes of the recent spending slowdown are the subject of a lively debate. The great recession and the slow recovery, the ACA's cost reduction measures and other federal initiatives, efforts by employers to constrain spending by shifting costs onto workers through high deductible and narrow network plans and other mechanisms, the shift to generic drugs, a slowdown in the introduction of expensive new interventions and blockbuster branded drugs, and provider efforts to improve efficiency have all played some role in slowing the growth in per capita costs.

Even without disruption in the health sector that could result from election-related policy turmoil, spending growth is projected to accelerate in the future. Per capita NHE are projected to rise at an annual rate of 5.1 percent over the next 10 years, Medicare spending at a rate of 4.2 percent per beneficiary, and Medicaid expenditures at a rate of 1.6 percent per enrollee. And when looking at total, rather than per capita, health care spending, demographic trends will exacerbate the situation. Over the next decade the baby boomers will expand Medicare's rolls by almost 3 percent a year. While the under 65 population will be growing at an anemic rate of 0.4 percent a year, an increasing fraction of them will be concentrated in the 50-64 age group where medical expenditures tend to be high.

The lull in new expensive medical innovations seems to be coming to an end. Pharmaceutical manufacturers are introducing new drugs for cancer and other chronic conditions with extremely high price tags—often in excess of \$50,000 per year—and costly innovations based on genomic and nano technology breakthroughs are being developed. In addition, provider consolidation (hospital, nursing home, and home health agency mergers), acquisitions of insurance companies by other insurers, and the purchase of physician groups by hospitals threaten to reduce what little effective competition exists in the health care sector.

Faced with the prospect that rapid health care spending growth will resume on their watch, the presidential candidates should use the campaign to lay out their view on the seriousness of the challenge and how their administration would address it. Republicans who advocate repealing the ACA should specify what they would do to replace the ACA's health spending reductions. The ACA contains initiatives—such as the Cadillac tax (an excise tax on high cost employer sponsored plans), medical loss ratio limits and premium rate reviews that are intended, at least in part, to dampen expenditure growth by private plans. What measures, if any, would replace these?

The ACA also reduces the growth of Medicare's spending significantly. It cut payments to most institutional providers and to MA plans, initiated multiple demonstrations and pilot programs designed to test the efficacy of various approaches to reducing costs, and established the Innovation Center within CMS to explore new payment methods for government programs and a non-profit Patient-Centered Outcomes Research Institute to sponsor clinical comparative effectiveness research of medical treatments that hopefully will reduce costs and improve the efficiency of care delivery. It also called for an IPAB, a body that can institute cost reducing measures if Medicare's spending exceeds specified target growth rates.²⁰ While many of these initiatives have yet to show significant impacts on the pace of cost growth, CBO has estimated

that Medicare's direct spending would increase \$802 billion over the 2016-25 period if the ACA were repealed.²¹ Advocates of repeal should make clear which, if any, of the ACA's cost saving measures they would retain and what alternative approaches they would propose.

Reforming Medicare to Extend the Life of the Trust Fund

Even if the future of the ACA were not an issue of political contention, a continuation of current policy would not be sufficient to address the challenges facing Medicare. [The Trustees project](#) that the Trust Fund out of which Medicare pays hospital claims will be depleted in 2030 even assuming realization of all of the ACA's savings. At that point revenues dedicated to Medicare will be sufficient to pay only 86 percent of Medicare's Hospital Insurance's costs. Unlike other components of the federal budget, Medicare has no legal authority to run a deficit in the trust fund and would have to cut spending. Repealing the ACA would accelerate, possibly to the middle of the next decade, the date of trust fund depletion. This would occur because trust fund spending would increase when the productivity-related reductions in payment updates for institutional providers (hospitals, Skilled Nursing Facilities, etc.) and other cost-reducing measures disappeared and when the increase in payroll taxes on those with high earnings required by the ACA was terminated, thereby reducing the Trust Fund's revenue.²²

Moderating the growth of spending of the physician and drug components of Medicare (Parts B and D) is also important. Under current law, general revenues automatically cover the any difference between spending in parts B and D and premiums collected. In other words, the extra spending increases the federal deficit. With total Part B and Part D spending projected to rise by an average of 7.6 percent and 8.9 percent a year respectively over the next decade, these two programs will impose an increasing burden on federal budget resources as well as on beneficiaries who will face rising premiums tied to increased program costs. Over the next two decades, expenditures for part B and D are projected to grow from 2.04 percent to 3.38 percent of GDP.

It would be highly desirable for the next president and congress to address the future of Medicare and not wait until trust fund depletion forces hasty action. Taking action sooner rather than later will permit consideration of a wider range of solutions, solutions that can distribute the unavoidable burden across a broader array of stakeholders and generations. Furthermore, significant policy modifications to Medicare (and Social Security) must be phased in gradually to allow affected individuals, businesses and institutions adequate time to adjust.

However, Medicare, perhaps even more than Social Security, is the third rail of American politics. The millions of older and disabled people who depend on Medicare—and their children—are extremely fearful of proposals to limit Medicare benefits, and they tend to show up at the polls. The list of policies that have been suggested for putting Medicare's finances on a more sustainable path is long but all the items are controversial. The policies include transforming Medicare into a system of premium supports in which beneficiaries receive a government subsidy that enables them to purchase insurance through an exchange; raising the age at which Medicare is available from 65 to the age at which unreduced Social Security benefits are available (or even higher); increasing Part B and D premiums; increasing deductibles and cost sharing; moving to new payment mechanisms such as reference pricing, and episode-, bundled-, or value-based payments; limiting payments for expensive pharmaceuticals; and raising Medicare Hospital Insurance payroll taxes. The efficacy and political appeal of any of these policies, of course, depends critically on the detail.

Any viable plan for moving Medicare onto a sustainable track for the future would have to include controversial elements. A candidate that put forward such a plan would risk scaring older people and being demonized by the other side. Hence, we suspect that both major party nominees will stick to generalities about the need to preserve Medicare, but avoid saying how they would do it.

Conclusion

There are of course other health policy issues that the next president will have to address. Examples include: the poor health of Americans associated with unhealthful food, drug abuse, violence and other non-medical factors that impact health; the disparities in health between the affluent and low-income populations; and how to encourage and share the benefits of biomedical innovation. But the issues we have focused on in this paper—how to improve the Affordable Care Act, how to control rising health spending, and how to preserve Medicare for the growing elderly population—are likely to dominate election debate. If the candidates present realistic proposals and explain them well, the campaign can be a constructive step toward crafting future health policy solutions. If the candidates mainly bash each other and talk vaguely about panaceas they cannot defend, the public will be confused and it will be harder for the next administration and congress to work together to improve health policy.

U.S. Defense Strategy and the Defense Budget

Michael O'Hanlon

Introduction and Summary

How much should the next American president spend on the nation's armed forces? Although this question can never be definitively answered, since events around the world can throw any plan quickly to the wind, it is important that each presidential candidate develop a thoughtful draft of how he or she would proceed.

This short paper makes the case for a base U.S. defense budget that grows modestly relative to current levels. (By base budget, or core budget, I mean the funds provided in the normal appropriations process to build and sustain the nations' defense. Additional costs for overseas missions like the conflicts in Afghanistan, Iraq, and Syria, or for disaster response to tragedies like Ebola outbreaks or earthquakes, are harder to foresee and control. One hopes these additional costs would continue their overall decline beyond the \$64 billion spent on such purposes in 2015 or the \$51 billion requested for 2016, down from annual levels well in excess of \$100 billion during the latter Bush and early Obama years.

The Obama administration requested \$612 billion for national defense for 2016. About \$534 billion is for base funding for the Department of Defense, another \$27 billion is principally for the Department of Energy's nuclear weapons activities, and, as noted, a final \$51 billion is for overseas contingencies operations. Those numbers were up modestly from the 2015 grand total of \$585 billion, including, as mentioned, \$64 billion for contingencies. The administration's five-year plan would then have base funding for Defense decline slightly, from \$534 billion in 2016 to around \$525 billion in 2021. Sequestration or similar cuts, were they to recur, would drop the base budget to just under \$500 billion (all these figures and others in this paper are expressed in constant, inflation-adjusted 2016 dollars).²³

In my view, a reasonable level of spending the candidates should propose would be around \$535 billion annually in the base defense budget. That figure is similar to the Obama request for 2016 but is modestly greater than Obama's plan for the following years. I would describe it as a plan for modest real defense budget increases. Adding in money for the Department of Energy and other agencies, the base total might be about \$560 billion. Further adding in costs for contingencies, assuming modest and ongoing reductions in these accounts, would bring the grand total for national defense to nearly \$600 billion a year. Under this proposal, however, the base budget would still be modestly less than what was projected after the 2011 Budget Control Act was first passed—so one might quarrel with the description of such a budget as an increase. It all depends on the reference point.

Thus, I think the presidential candidates should propose that military spending tick up gently in real terms, relative to the Obama plan, for the following reasons. Operating and support costs for Defense continue to trend upward slightly faster than inflation due to aging equipment and other factors. Procurement budgets to buy new equipment are reasonably healthy today, but they were suppressed for so long after the Cold War ended that equipment stocks remain rather old and in need of replacement across many sectors of Defense. Modernizing weapons tends to be expensive, even if done judiciously. Force structure and uniformed personnel totals have been shrinking for a quarter century, and the military is now about 40 percent smaller than under Ronald Reagan, so there is little basis for hoping that

further cuts can be easily made. Indeed, as the independent [National Defense Panel argued in 2014](#), today's military is smaller than the 1990s armed forces, yet the world seems more dangerous and certainly more complex than it was during that earlier period. Various reforms and efficiencies, some advocated below, can still yield savings—but generally only incrementally and slowly. As such, holding the line more or less in real defense dollar terms, with a slightly positive real-dollar trend to allow for modernization, is the soundest course.

More significant growth in defense budgets will be needed, however, if various defense reforms are not made in the years ahead. These include the reforms recommended by the Obama administration related to base closures and military compensation, and the additional reforms I recommend below in areas such as weapons modernization as well as management and operations. My defense budget recommendations to the candidates are part and parcel of a broader plan for Department of Defense reform, and should not be viewed in isolation.²⁴

Perspectives on Defense Spending

Today's U.S. defense budget, nearly \$600 billion in round numbers, is down substantially from the peak of some \$750 billion a year that characterized the late Bush and early Obama period. But it is up considerably from the \$400 billion level at the turn of the century—and even from the \$500 billion average of the Cold War decades. (Again, all these figures are expressed in 2016 dollars; they include Department of Energy nuclear costs and Defense war costs—but do not include Veterans Affairs, Homeland Security, or foreign aid and security assistance spending.)

Those defending the magnitude of current Pentagon spending often point out that in recent times the military's share of the nation's economy has been modest by historical standards. During the 1960s, national defense spending was typically 8 to 9 percent of gross domestic product (GDP), but it declined to just under 5 percent by the late 1970s. During the Reagan buildup of the 1980s it reached 6 percent of GDP before declining to around 3 percent by the late 1990s after the cold war ended. During George W. Bush's first term, the figure rose and ultimately approached 5 percent of GDP, but is now again headed back down and will be just 3 percent within a year or two. As a percent of federal spending, defense has also declined dramatically, from typically 40-50 percent of the total in the 1950s and 1960s to the range of 20-30 percent in the 1970s and 1980s to about 15 percent today. Seen in this light, current levels, even including wartime supplemental budgets, seem relatively moderate.²⁵

On the other hand, those who criticize the Pentagon budget often note that it constitutes about 35 percent of aggregate global military spending, and that American allies contribute another third or more of global spending.²⁶ Or they note that recent real-dollar defense spending levels, attaining at one point \$750 billion a year, exceeded the Cold War inflation-adjusted spending average of \$500 billion by about 50 percent, and that current budgets still exceed the Cold War norm.

The bottom line is that the U.S. defense budget is, and will remain, large relative to the budgets of other countries, and relative to historical precedent. Yet at the same time, it is modest as a fraction of the nation's economy, in comparison with the Cold War era. That means the next president will need to determine the size of any future defense budget cuts based on careful analysis, not hand waving or ideology.

Purposes of American Military Power

As the United States seeks to shape defense strategy and spending, presidential candidates must have a clear view of the purposes of defense spending as well as the ability to articulate the purposes to the American public. Foundational U.S. defense objectives typically include limiting the spread of nuclear weapons, protecting the global commons (the international airspace and maritime space in which trade and travel occurs), deterring the rise of powers that might challenge today's generally stable international system, and preventing crises or conflicts from metastasizing into large regional wars in strategically crucial parts of the world. More specifically, I would translate these broad goals into the following somewhat more specific requirements, similar to those of current official U.S. national security and military strategy:

- Deter an assertive Iran in the broader Persian Gulf and Middle East;
- Degrade and ideally defeat al Qaeda, the Islamic State of Iraq and the Levant, and associated movements from Iraq and Syria to other parts of the Middle East and Africa to Afghanistan and South Asia;
- Preserve stability in East Asia in the face of major structural changes due to the rise of China as well as the threat posed by North Korea;
- Help sustain a sufficiently robust NATO alliance to provide some basis for global action by a community of democracies, while reducing risks from Russian aggression;
- Maintain enough combat capability to deter or, if necessary, wage and win one substantial war in a key strategic location (for example against nuclear-armed North Korea), while also carrying out perhaps two smaller multilateral but protracted stabilization or deterrence operations at the same time;
- Retain a reliable, safe nuclear deterrent that is the equal of Russia's and superior to China's, even as the United States pursues lower force levels through arms control, and also deploys limited missile defense capabilities;
- Maintain some capacity to help stop genocide and other mass atrocities as part of a coalition, since America's values are part of what helps it hold together a large network of nations for a common strategic cause;
- Maintain a strong all-volunteer military, with quality of personnel comparable to that of recent years; and
- Retain the world's best scientific and defense industrial base.

To achieve these goals, the United States presently fields a military that remains excellent, though relatively small and still somewhat strained by the wars in the Middle East—as well as the additional nationally self-imposed wounds resulting from sequestration and other types of budgetary constraints. Politicians often say that the U.S. military remains “second to none;” this point is obvious, and so banal that it should be banned from future American policy lexicon when discussing the nation's armed forces. Since the United States has far more security responsibilities than any other country—for good reason—it had better be heads and shoulders ahead of all other armed forces. But more tellingly, the U.S. military does indeed remain as good as it has ever been by most measures, and better than ever by a number of metrics. The presidential candidates may not agree with all the goals set forth above, but they should at least be clear about the goals that would be pursued in their administration and communicate those goals to the public. Each candidate should devote a major address as well as a white paper to presenting the defense goals that would guide their administration and to a

detailed description of why those goals are necessary to protect the nation. The statement should include a detailed discussion of how much the nation should spend on defense.

Defense's total active-duty uniformed personnel number some 1.31 million, with a planned further reduction to about 1.275 million by 2020 (even if sequestration-like cuts can be averted). These totals are down from late Cold War totals of more than 2 million, and from Clinton-era figures around 1.4 million. Another 815,000 reservists and 775,000 full-time civilian employees of the Department round out the official workforce (not counting contractors). The 2020 Army will have some 450,000 soldiers and 30 brigade combat teams in the active force (it will have 27 more brigade combat teams in the National Guard). The Navy's 330,000 active-duty sailors will maintain a fleet of 304 ships then, including 11 large-deck aircraft carriers and 14 ballistic-missile submarines. The Air Force, with its 310,000 active-duty airmen and airwomen, will operate 49 squadrons of aircraft (including reserve units) and about 100 bombers as well as 450 ICBMs. The Marine Corps, at 182,000 active-duty uniformed strength, will continue to maintain three divisions and three associated air wings.

Of the requested \$534 billion in base budget for 2016, some \$210 billion was planned for Operations and Maintenance, nearly another \$140 billion for Military Personnel compensation, almost \$110 billion for procurement, and \$70 billion for Research, Development, Testing and Evaluation (with small amounts for construction and housing). Broken down a different way, that \$534 billion was allocated as follows: \$161 billion for the Navy (including the Marine Corps); \$127 billion for the Army; \$153 billion for the Air Force (including many intelligence-related expenditures, since the U.S. intelligence budget of some \$70 billion is hidden throughout the defense budget); and almost \$95 billion for defense-wide activities or organizations.

Some might argue that the above list of strategic requirements that leads to such a large American defense budget is too long. They might assert, for example, that the United States need not focus as intently on the Middle East as in the past, especially since the boom in North American energy production may make this continent energy-independent within a decade or so. But in addition to the fact that a number of key American friends are found there, the Middle East remains the location of [more than a quarter of today's global oil](#) production and more than half of world oil reserves. And the global oil market is interconnected and interdependent. Creative new thinking for how to enhance Middle East and Persian Gulf stability is appropriate, but U.S. disengagement from the region is not.

Others might argue that America's allies, which on average spend about 1.5 percent of GDP on their armed forces in contrast to the U.S. level more than twice as high, should share more of the collective western military burden. Indeed, Washington periodically attempts to shame its European allies in particular into higher levels of defense spending—and the NATO alliance has a formal goal for each member that defense spending should reach 2 percent of GDP. But the United States does not make decisions for its allies. It can be no other way, in fact. The United States could choose to break certain alliances, but then it would have to run the risks of arms races and nuclear proliferation, as well as greater instability, in parts of the world where the U.S. has important interests but has nonetheless chosen to withdraw militarily. I would personally favor some U.S. distancing, or other creative strategies, for dealing with allies whose behavior is particularly destabilizing or dangerous—Egypt and perhaps Pakistan may top the current list. But in fact, the United States does not allocate a large fraction of defense resources to prepare for the defense of either of these countries at present. In summary, the

goal of greater burden-sharing is laudable; the means for achieving such an outcome are less clear.

Further Reforms and Efficiencies

The Pentagon may be, on balance, slightly underfunded today. But that is not to say that everything it currently wishes to buy is needed, every way it currently operates is optimal, or every dollar spent is used efficiently.

Still, there are several dilemmas that confront the defense reformer—as well as the future president—who would propose that Pentagon efficiencies become the primary means of funding new investments needed for the nation's defense. For one thing, one person's waste is often another's useful capability or insurance policy. Planning for the nation's defense is not so scientific a matter as to determine which weapons and forces are truly needed. Second, even when desirable reforms can be identified, they usually take time to implement, meaning that savings can be delayed. Third, existing budgets are inadequate to fund the programs and plans that the Pentagon already has on the books. The Department of Defense is perennially optimistic in its projections of what future forces will require—meaning that some reductions in planned forces and planned purchases will be needed just to balance the checkbook and bring resources in line with requirements. Right now, the Department projects that it can afford its plans for the rest of the decade with about \$525 billion annually in base funding, as noted; in late 2014, the Congressional Budget Office estimated the needed average funding level as closer to \$540 billion.²⁷ We have little choice other than to simultaneously pursue greater efficiency in order to modestly expand available resources.

The presidential candidates should spell out how they would resolve the need for budget efficiencies so that Defense can continue doing its part to control the national debt. What follows are a set of recommendations for cuts in specific areas of Pentagon spending that illustrate how fiscal efficiencies can be achieved while allowing for needed expansions in selected areas.²⁸ Presidential candidates may disagree with some or all of these recommended cuts, but they should present a plan for achieving the level of defense spending—including possible expansions in selected areas—they think is necessary to protect the nation.

- The Navy wishes to enlarge its fleet modestly in coming years—partly to give backbone to the notion of the Asia-Pacific rebalance and partly to reduce strains on the fleet that come from maintaining the current pace of deployments with an inadequate number of ships. These concerns are valid. Rather than increase its fleet, however, the Navy could employ innovative approaches like “sea swap,” by which some crews are rotated via airplane while ships stay forward-deployed longer than is currently the norm. This idea, and more forward home porting of attack submarines at Guam, could eventually allow the Navy to get by with perhaps 270 ships rather than the current 285 or the planned 305 or so.
- The F-35 joint strike fighter is a good plane but an expensive one. Moreover, it is more stealthy and expensive than what is needed for the kinds of wars the nation has typically been fighting of late. In an era of improving sensors and munitions, and improving unmanned aerial systems, the Pentagon does not need to prioritize purchase of so many high-end manned fighter jets. The program could be scaled back by roughly half from its current intended buy of 2,500 planes.

- Rather than designing a brand new submarine to carry ballistic missiles with nuclear warheads, as now planned, the Navy might reopen the production line for the existing Trident submarine or a close approximation. In addition, on the nuclear weapons front, the Lawrence Livermore National Laboratories could be converted largely away from the nuclear weapons design mission.
- Military compensation could be streamlined further as well, despite Congress's recent reluctance to go along with even the modest changes proposed by the administration. Some stateside commissaries and exchanges could be closed. Military health care premiums could be increased even more than the administration has proposed—while still keeping them less than the average in the United States for civilian-employer plans. Military pensions could be reformed too, with somewhat lower payments for working-age military retirees having 20 years or more of service, and introduction of a 401k-like plan for those who never reach 20 years (and who currently receive nothing). This could be done in a way that would achieve modest net savings.
- Another idea could save substantial sums, although it would require help from allies and would have to be phased in over time. At present the United States relies almost exclusively on aircraft carriers, each carrying about 72 aircraft, to have short-range jets in position for possible conflict, with Iran in particular. Over the past decade, most land-based combat jets formerly based in Saudi Arabia, Kuwait, and Iraq have come home. While the United States occasionally rotates fighter jets through the small states of the Gulf Cooperation Council, and while it maintains command and control and support assets in states like Qatar and the UAE, permanent ashore combat power is very limited. By seeking two or more places to station Air Force combat jets continuously in Gulf states, the United States could facilitate a reduction of one or two carrier battle groups in its fleet.
- Other more modest changes—for example scaling back purchases of the Littoral Combat Ship, curtailing production of the V-22 Osprey, carrying out another round of base closures, making more purchases through “strategic sourcing” methods, streamlining the defense acquisition workforce by reducing paperwork requirements and other steps, adopting best practices for weapons maintenance such as performance-based logistics more widely, and modestly constraining intelligence spending—could save perhaps another of \$40 billion to \$50 billion over a decade.

Conclusion

America's defense policies today are generally sound. The majority of what the Department of Defense does around the world—in terms of combat, other operations, deterrence missions, engagement with allies, training and building up partner capacity, and other activities—is desirable. The Department of Defense undergirds a U.S. national security strategy that, despite numerous mistakes and challenges, has won the Cold War, prevented another 9/11, limited the scale of nuclear weapons proliferation, sustained a U.S.-led coalition of allies and partner nations accounting for two-thirds of global GDP and military spending, and maintained a mostly peaceful international environment conducive to trade and prosperity.

Some improvements to defense capabilities are needed in light of current and projected challenges. Yet, there are ways to make American defense posture and policy more efficient.

Modest budgetary increases should be adequate in the years ahead. An annual U.S. defense budget of around \$535 billion in base funding, plus another \$25 billion or so for nuclear-weapons-related activities in the Department of Energy, plus up to \$40 billion or so in supplemental funds for wartime operations and related matters makes sense. The presidential candidates should spell out the defense spending level they would seek as well as a detailed specification of the ways the money would be spent.

Policymakers looking to achieve fiscal balance by cutting the defense budget will be disappointed. Defense spending is already down below 15 percent of total federal spending and equals just over 3 percent of GDP—very modest figures by post-World War II standards. Indeed, under my proposal, its share of federal spending and GDP would probably continue to decline. To be sure, at nearly \$600 billion a year, defense spending will remain large. But the world is challenging and dangerous, and American military power is a generally stabilizing force within it. Thankfully, while the Pentagon cannot provide an easy panacea for fiscal reformers looking for painless budget cuts, its additional needs are eminently affordable as well.

Avoiding another Big Financial Crisis

David Wessel

The global financial crisis of 2008-09 was devastating. Nearly 9 million Americans lost their jobs. More than 5 million lost their homes. Nearly \$13 trillion in family wealth was destroyed, [wiping out almost two decades of gains](#). It took nearly six years for U.S. per capita output to return to pre-recession levels, and many workers, consumers, homeowners, investors, borrowers, banks, and businesses haven't recovered fully. Even worse, the Great Recession appears to have done [lasting damage](#) to the U.S. economy's long-run growth rate.

Anyone with any sense wants to reduce the chances of anything resembling a repeat of 2008-09. A lot has been done to accomplish that. Some has been done well, some hasn't, and some essential steps have yet to be taken. Presidential candidates should take a close look at what was done in the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 and what has been done by financial regulators in the U.S. and globally—and then decide what needs altering. The next president cannot avoid these issues so the candidates shouldn't avoid them during the campaign. Candidates should spell out the actions they would take in the White House to shield the nation and the rest of the world from another financial meltdown.

The politics of this issue are treacherous. Wall Street has regained its clout and its kvetching. Some Republicans in Congress would repeal Dodd-Frank, and that is interfering with bipartisan efforts to fine-tune it. Some Democrats and some Republicans are deeply suspicious of big banks and are pressing to break up the biggest ones, toughen regulation, and limit further the discretion of regulators. Financial institutions and some of their customers, meanwhile, point to unwelcome consequences of the new rules. They argue regulation is starving the economy of credit, burdening the banks with costly oversight and making it costlier to buy and sell bonds quickly, which could be a big problem in a crisis if a lot of people want to sell bonds at once. But the stakes are too high to let the politics scare presidential candidates away from revisiting these issues. Making the financial system more resilient is a work in progress, and there's more progress to be made.

A short essay like this one cannot be comprehensive; it can hit only a few salient points. For more comprehensive accounts, all of which helped inform this piece, see the [Volcker Alliance proposals](#) and a [Bipartisan Policy Center critique](#) and this [PowerPoint presentation](#) by Martin Baily of the Brookings Institution and Aaron Klein of the Bipartisan Policy Center.

What Has Been Done Well

Sometimes lost in the often-partisan argument over Dodd-Frank is one simple fact: there is solid evidence that the Dodd-Frank requirements have made the financial system safer and more resilient. First, big U.S. banks are in better shape now than they were at the time of the financial crisis, in large measure because regulators have forced them to hold bigger capital cushions (which means they can absorb bigger losses without endangering each other and the whole financial system). Had today's capital framework been in place in 2007, the largest, most complex financial institutions would have been required to hold roughly twice as much common equity as they actually did. With greater common equity, perhaps fewer banks would have needed [government rescue](#). Now, periodic stress tests, supervised by regulators, have forced bank managers to prepare for worst-case scenarios. The fraction of loans that aren't being paid is half what it was at its peak in 2010. Metrics that track the risks that banks pose to the financial

system are reassuring. The bottom line, according to the [International Monetary Fund](#): “Compared to the pre-crisis period, [U.S.] banks have strengthened their capital positions, including relative to their international peers, hold more liquid assets and are less levered.”

Equally important, Congress has given financial regulators legal authority they didn’t have when Bear Stearns, Lehman Brothers and AIG ran aground. In 2008, the Federal Reserve and other policymakers faced an ugly choice: bail out (Bear, AIG) or bankruptcy (Lehman). The former was unpopular and arguably unfair; the latter was perilous in the midst of a financial crisis. The new mechanism created by [Title II of Dodd-Frank](#) creates a process to liquidate a large, complex financial company that is close to failing. It’s untested. Thus, it’s not clear it will work in the event of a large financial institution that sprawls across national borders. And not everyone endorses it. But regulators are far better equipped than they were in 2008-09.

Consumer protection is no longer a step-child for financial regulators, whose primary job is preserving the safety and soundness of the banking system. The new Consumer Financial Protection Bureau has the sole mission of looking out for consumers and a very broad mandate to look across the financial system, and it’s off to a strong start. As [Martin Baily and Aaron Klein](#) put it: “It’s hard to think of any new federal regulatory agency that has had as much impact in its first few years.”

What Has Not Been Done Well

The financial crisis exposed the weaknesses of the archaic and fragmented financial regulatory system. Financial institutions—most notably AIG—exploited the crevices between regulatory agencies. No agency had overall responsibility for monitoring financial stability. Even when risks were noticed, turf battles and inconsistent mandates interfered with effective response. Dodd-Frank did require the agencies to sit at a single table—the Financial Stability Oversight Council (FSOC) that is chaired by the Secretary of the Treasury. But the law failed to streamline or consolidate what [Treasury Secretary Jack Lew](#) calls the “spaghetti” regulatory structure. The Obama administration decided that Congress simply wouldn’t do that because congressional committees so jealously guard their turf. Merging the Securities and Exchange Commission (SEC) and the Commodities Futures Trading Commission (CFTC), a proposal that has been made repeatedly, has gone nowhere, largely because the SEC reports to congressional banking committees and the CFTC to the agriculture committees (because commodity trade began with agriculture). For the past century, every decade—except, for some mysterious reason, the 1950s—has seen debate over consolidating federal financial regulatory agencies with almost no success. (For the long, sad history, see Elizabeth F. Brown’s “[Prior Proposals to Consolidate Federal Financial Regulators](#).”)

The shortcomings of the FSOC are abundantly clear: “The regulatory landscape remains fragmented, resulting in gaps, overlaps and the potential for delayed responses to emerging risks, and should be simplified over time,” the [IMF advises](#). My Brookings colleague, [Donald Kohn](#), a former Federal Reserve vice chairman and an external member of the Bank of England’s Financial Policy Committee, lists several shortcomings of the FSOC. It is composed of several independent regulators, some of which have mandates to focus on specific institutions or markets, not on stability of the overall financial system. Gaps in regulatory oversight may leave the financial system vulnerable in the future; important financial institutions or activities remain largely unregulated even after Dodd Frank. Data isn’t shared among the FSOC agencies to the extent that it could be. The FSOC is likely to face big hurdles in

implementing policies designed to make credit less plentiful in boom times and more plentiful in busts, known to insiders as “countercyclical macroprudential tools.” Even after the FSOC reaches consensus on a policy, which can take a long time, it has limited power to force a federal regulatory agency to act. There are a variety of proposals to alter this structure. Kohn, for instance, would give each agency an explicit mandate to aim for financial stability and would remove the Treasury Secretary as FSOC chair and give the job to a presidential appointee. The Bipartisan Policy Center would create a single prudential regulator (to assure the safety and soundness of individual institutions) and another to regulate capital markets. Paul Volcker would create a new independent prudential supervisor overseen by a Fed vice chairman. About the only issue on which there is consensus is that the current FSOC structure is far from optimal.

Financial regulators failed to foresee and prevent the financial crisis. (Of course, just about every other check on the system failed, too. The credit-rating agencies. The lawyers. The supposedly sophisticated investors who bought mortgage-linked securities. Bank managers and their risk-management committees. Politicians. The press.) The Fed, Treasury and other arms of the government drew enormous criticism when they intervened to prevent the financial crisis from triggering a repeat of the Great Depression. That’s understandable. To a lot of Americans, Wall Street got bailed out and Main Street didn’t. Congress responded by giving regulators some new authorities (see above) by underscoring its determination to prevent future bail outs of bank shareholders, bondholders, and management, and by limiting the discretion of the Fed, Treasury, Federal Deposit Insurance Corporation (FDIC) and others to respond in a future financial crisis. Some observers applaud this third element or argue, as [Stanford University’s John Taylor](#) does, that regulators still have too much discretion. To them, the crisis demonstrated the importance of clearly articulated rules that will reduce uncertainty and discourage banks or their investors from taking big risks with the wink-wink understanding that the government will be there if the bets go sour. But just as the president has the authority to respond quickly if the U.S. were to be attacked by North Korean missiles or terrorists, financial regulators need to be able to react swiftly in a financial panic—especially given the inability of Congress to act swiftly. Former Treasury Secretary Timothy Geithner says Congress unwisely created new hurdles to the FDIC guaranteeing the debts of the banking system—a move that proved a potent tool during the crisis—and some Fed veterans, [Ben Bernanke among them](#), worry that Congress overreacted and put too many restrictions on the Fed’s “lender of last resort” ability to make emergency loans to solvent financial institutions. There are proposals in Congress to further constrain the Fed’s emergency lending powers in order to encourage bankers to be more prudent. Bernanke says this approach is roughly equivalent to shutting the fire department to encourage fire safety.

Bernanke and his successor, Janet Yellen, argue that the Fed should use interest-rate increases to avoid or let the air out of an asset-price financial bubble only as a very last resort. They’d use interest rates to steer the economy away from too-high (or too little) unemployment or too much (or too little) inflation. To manage the financial system, they’d rely on what’s known as “macro-prudential tools,” essentially targeted use of regulatory power. “Monetary policy faces significant limitations as a tool to promote financial stability,” [Yellen has said](#). “A macroprudential approach to supervision and regulation needs to play the primary role.” One category of these tools is intended to make the financial system more resilient, such as the tougher capital requirements and the stress tests; on these, the U.S. has made substantial progress. Another

category is intended to allow the Fed to—in the jargon of the trade—“lean against the wind.” In practice, this usually means restraining mortgage lending because real estate lending almost always is a major factor in financial crises. In the UK, for instance, the Financial Policy Committee has set limits on the mortgage debt-to-income ratios. Compared to regulators in other countries, the Fed and other U.S. regulatory agencies have very few macroprudential tools to deploy, particularly on housing. A lot more work needs to be done if macroprudential tools are to be a workable alternative to hiking interest rates to avoid or burst a real-estate bubble.

Fannie Mae and Freddie Mac, the two government-sponsored mortgage companies, were essentially nationalized during the crisis because they held or guaranteed so many mortgages that weren’t paid back and were secured by houses worth less than the mortgage. Along with the Federal Housing Administration, Fannie and Freddie were [behind 70 percent](#) of the new mortgages made in the first quarter of 2015. When then-Treasury Secretary Hank Paulson took over Fannie and Freddie in 2008, he didn’t expect them to be wards of the federal government seven years later. But they are. Fannie and Freddie are making money again, and barring an adverse decision in pending lawsuits by some Fannie and Freddie investors, this arrangement can go on for a long time. Proposals to phase out Fannie and Freddie and/or replace them have been floating around for years, but haven’t moved.²⁹ Congress is in no rush to revive the private mortgage market—but, at some point, presumably, it will, so candidates need to weigh the competing alternatives.

What’s Not Clear

An overarching goal of Dodd-Frank was to end “too big to fail” (TBTF); that is, to prevent banks from getting so big and interconnected that the government can’t let them go under because that’d do so much damage to the economy. A lot has been done to implement this idea, including requirements that the biggest banks hold more capital and the creation of “orderly liquidation authority” in Title II of Dodd Frank. FDIC Chair Marty Gruenberg recently stated that “the progress [towards ending TBTF] has been impressive and somewhat under-appreciated.” But the eight biggest banking institutions in the U.S. now hold \$10.6 trillion in total assets and account for 57 percent of total assets in the U.S. banking system—not materially different from the \$9.4 trillion and 60 percent of total assets in 2009.³⁰ There are credible analyses suggesting that investors still are willing to lend to TBTF institutions more cheaply than to others because they still expect the government to stand behind them in a crunch. On the other hand, pending capital surcharges for systemically important financial institutions have offset some of these advantages. Moody’s Investors Services, [in a milestone announcement](#), says it no longer assumes the government will stand behind big banks’ debts. Progress has undoubtedly been made towards alleviating the “too big to fail” problem. The open question: Has enough been done?

New rules, guidelines and regulatory pressures have pushed risk-taking out of the core of the American banking system. That is by design: letting banks gamble with federally insured deposits poses unwelcome risks to taxpayers. Let the government supervise and stand behind banks that take deposits and make loans, the thinking goes, and let other entities—entities that can safely be allowed to fail—make riskier investments. As bank regulatory requirements are ramped up, financial activity has been and will continue to migrate outside the banks where there is less oversight and less transparency. The FSOC has the authority to designate non-

bank financial institutions as systemically important (and thus more intensely supervised), although companies resist such designations aggressively. The open question: Is the U.S. fragmented regulatory system equipped to monitor and mitigate risks outside the banks—in securities and derivative markets, for instance?

Financial regulation always involves a trade-off: If regulation is too light, the odds of financial catastrophes rise. If regulation is too tough, the economy is starved of credit and grows too slowly. Financial crises often provoke an overreaction, a plethora of regulation that snuffs out even economically constructive risk-taking. British finance minister [George Osborne once warned](#) against “the financial stability of the graveyard.” But failing to learn the right lessons from a crisis and failing to take advantage of the weakened political clout of big finance after a crisis to modernize regulation is just as big a mistake. Predictably, Wall Street says the U.S. has gone too far; Wall Street’s critics say the U.S. hasn’t gone far enough. With so many actors, both domestic and international, it’s very hard to sum the effects on the economy of all the new financial regulations and very hard to be sure the benefits of that last percentage point or two of new capital and liquidity requirement outweigh the cost. The open question: Have we gone too far? Or not far enough?

Candidates will be pressed to take stands on a host of issues from reviving the fortunes of the American middle class to managing an assertive Vladimir Putin. To many politicians and voters, matters of financial stability are mind-numbingly complex. But we learned the hard way in 2008-09 what happens when we neglect this sphere of public policy or leave it entirely to technocrats in competing fiefdoms. Candidates will have different views on the shape and form of financial regulation. Some will want stricter, more intrusive regulation; others will want to strengthen the banks’ financial footings and let them figure out how to run their businesses. Candidates will have different views on striking the balance between too much regulation of finance and credit and too little. But the issues enumerated above will inevitably confront the next president. Candidates owe it to voters to consider these issues seriously enough to describe their approaches and their stance on the big questions raised in this essay.

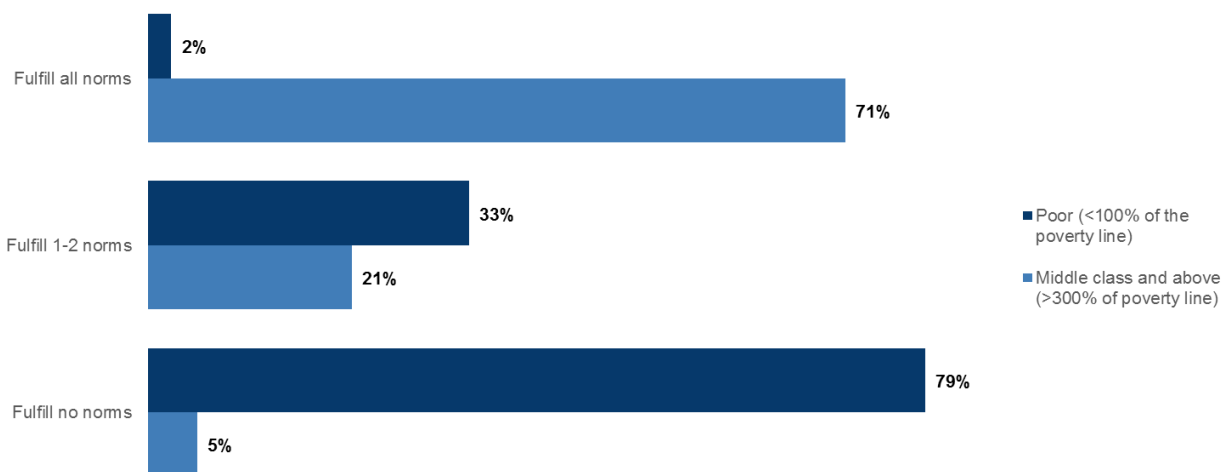
An Agenda for Reducing Poverty and Improving Opportunity

Isabel Sawhill and Edward Rodrigue

America's lack of social and economic mobility is now well documented, and both parties acknowledge the need to expand opportunities for hardworking Americans of modest means. The next president, however, needs to offer more than rhetoric—he or she must propose and fight for policies that allow government to foster greater mobility.

In an earlier analysis, Ron Haskins and Isabel Sawhill found three “norms” of American life—graduating from high school, belonging to a family with at least one full-time worker, and having children while married and after age 21—correlated closely with economic success. We call this the success sequence. Individuals who follow it almost never live in poverty. In Figure 1, we have updated this analysis. Only 2.4 percent of Americans who follow the success sequence live below the poverty line, while over 70 percent enjoy at least middle-class incomes, defined as 300 percent of the poverty line or more. For Americans who—for a host of reasons—don't follow the sequence, the picture is reversed.

Figure 1: Percent of Each Norm-Group in Poverty



Source: Author's tabulations of 2013 March CPS

Note: Statistics refer to calendar year 2012, since survey respondents are asked about income in the previous calendar year; data only include families with heads age 25-64 who do not report receiving disability payments.

BROOKINGS

How can a new set of policies give people a fair chance to succeed in the classroom, the workplace, and the home? Economic success requires people's initiative, but it also requires us, as a society, to untangle the web of disadvantages that make following the sequence difficult for some Americans. There are no silver bullets. Government cannot do this alone. But government has a role to play in motivating individuals and facilitating their climb up the economic ladder. Here are the three arenas of mobility that candidates should focus on, and some suggestions to get them started.

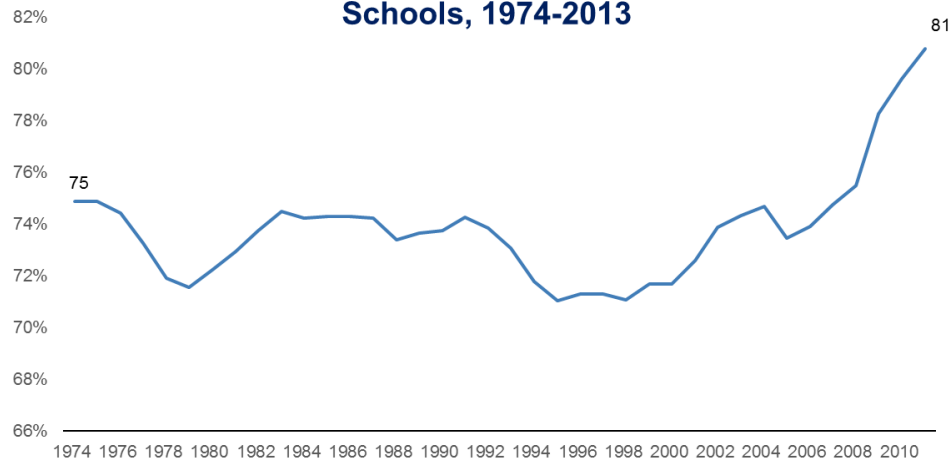
Education

Improving High School Graduation and Achievement

High school graduation rates, for the country as a whole, have improved in recent years and are now at reasonably high levels, as shown in Figure 2.³¹ In the [urban districts of the](#)

[nation's 50 largest metropolitan areas](#) however, only 59 percent of students that started high school in 2005 graduated four years later; in the suburbs, the figure was 77 percent. Figure 3 shows the urban-suburban graduation gap in the ten largest cities by population, plus Cleveland and Baltimore (two major cities with some of the largest gaps) for comparison. The next president will need to address these areas of concentrated poverty (which have migrated to the suburbs as well) to further improve educational achievement.

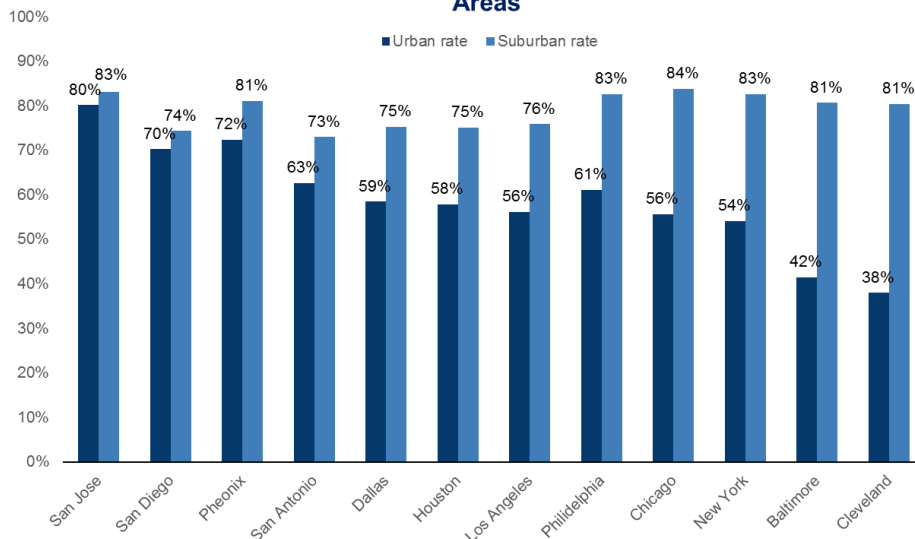
Figure 2: Average 4-Year Graduation Rate for Public Schools, 1974-2013



Source: National Center for Education Statistics

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Figure 3: Urban and Suburban Graduation Rates Within Metro Areas



Source: Editorial Projects in Education Research Center, 2009

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A high school diploma is no guarantee that students have learned the skills needed for a career or for college. Twenty percent of all college freshmen in 2008 had to take at least one [remedial course](#). [Only 26 percent](#) of ACT test-takers in 2014 met college readiness benchmarks in English, reading, math, and science.

How do we help students complete high school with the skills needed to pursue their goals? Raising graduation rates will require not just new kinds of high schools, but investment in children at all stages of life: home visiting, early childhood education, and new efforts in the primary grades.³² Home visiting programs improve parenting and connect families to adequate medical care. The effects ripple well into adolescence.³³ Similarly, [research suggests that low-cost interventions](#), like providing parents with books and texting them reminders to read to their children, can have substantial effects on child literacy skills.

The evidence around preschool expansions is [somewhat mixed](#), but we should experiment further and evaluate the results. Any successful initiative must pay for well-trained teachers, small classes, and proven curriculum; programs should [target low-income children](#), who stand to benefit most.

Sustaining early gains requires renewed investment in elementary and middle schools. Success for All (SFA) and Social-Emotional Learning (SEL) are examples of [proven models](#) that improve elementary school performance through greater individual attention and innovative curriculum.

With respect to high school, several reforms have proven effective. Specific examples include Small Schools of Choice and Career Academies. Small Schools of Choice (SSC) was an initiative started in 2002 in New York City to replace large, troubled public schools with schools that have about 100 students per grade. Using a lottery-based evaluation, the research group [MDRC found](#) that SSCs increased average graduation rates by almost 10 percentage points, from 62 to 72 percent—at lower cost per graduate. That’s equivalent to 44 percent of the graduation gap between white students and students of color in New York.

Career Academies (CA) is a model developed nearly 40 years ago that has been adopted by more than 8,000 schools today. It gives students smaller classes and more personalized instruction, but it combines these elements with technical curriculum and apprenticeship opportunities with local employers. MDRC studied nine CA programs across the country. Eight years after graduating from high school, participating young men earned an [average of \\$361 more per month](#) relative to the control group men.

Expanding these kinds of effective programs would substantially narrow the opportunity gap and, based on increased tax revenue and reduced use of the social safety net, would almost surely pass a cost-benefit test from the perspective of the taxpayer. The next president should expand these programs, or similar ones, with rigorous evidence of effectiveness.

Improve Post-Secondary Education

Although our analysis suggests that high school graduation combined with full-time work can keep most people out of poverty, some postsecondary education is increasingly vital for employment and earnings. Presidential candidates should present ideas on how to help young people from poor families attend and graduate from post-secondary institutions. An initial problem is that the nation’s tax-based educational financing programs are not focused on the neediest. The Pell program, which provides grants to low-income post-secondary students, on the other hand, is relatively well targeted; most spending goes towards students who would otherwise struggle to attend college. A new president could reduce education-related tax breaks for the well-off and use the savings to increase the maximum Pell grant, which covers 30 percent of the average cost of attending a public 4-year college, [a record-low share](#). Similarly, the Free Application for Federal Student Aid (FAFSA) form is unnecessarily complicated; it

could be reduced to two questions—adjusted gross income and attendance status—to radically [simplify the process](#) and to provide cash-strapped families with an immediate estimate of the aid they can expect.

Finally, if we're going to increase income-targeted aid and participation, we need to spend smarter; college financial assistance could be tied to performance both in high school and in college. The principle is to provide assistance conditional on an individual's willingness to study hard, and [some research suggests](#) this would have a modest effort-inducing effect as well. In most Northern European countries (whose high school students routinely out-score U.S. students on international assessments), college attendance is more heavily subsidized than in the U.S. but also more conditional on a student's academic performance and college readiness.

Another option is to give more generous state and federal funding to schools with higher graduation rates and greater enrollment of low-income students. Ohio, Indiana, and Tennessee, among other states, have moved in this direction.³⁴ In a similar vein, institutions could be made to pay part of their students' defaulted federal loans back to the government—another way to hold schools accountable for poor student outcomes.³⁵

Working Full Time

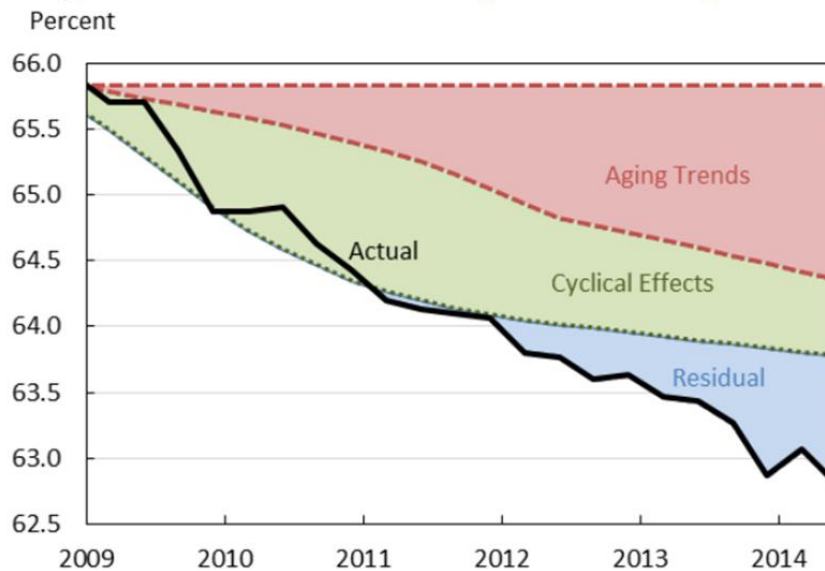
Of the three pillars (education, work, family), working full-time is by far the most important for reducing poverty, and every candidate needs to have concrete jobs proposals. Closing the jobs gap (the difference in work rates between lower and higher income households) [has a huge effect](#) on the number of people in poverty, even if the new workers hold low-wage jobs. [An analysis by Sawhill and Karpilow](#) shows that nearly a fifth of nonelderly household heads in the bottom third of the income distribution did not work at all in 2011. When asked why they weren't working, male household heads gave a variety of answers, but only 31 percent said it was because they couldn't find work. Among female household heads, that proportion was 20 percent. Nearly a third of non-working heads lived in households with no reported income that year (suggesting that they had savings or received help from others), while 58 percent relied mostly on government programs such as unemployment insurance and public assistance. Using simulations based on the March Current Population Survey, we found that work-based interventions had the largest effect on income for families in the bottom-third of the income distribution.

At the individual level, work connects people to mainstream institutions, helps them learn new skills, provides structure to their lives, and provides a sense of self-sufficiency and self-respect.

At the aggregate level, work is one of the most important engines of economic growth. The addition of immigrants and of women to the labor force over the past half-century has fueled GDP growth and the rise in our collective standard of living.

Much of the recent decline in labor force participation can be attributed to the aging of the population (see Figure 4). Another portion is due to a lack of adequate demand (cyclical effects). The third element is a residual that may reflect growing structural unemployment related to the deterioration of skills and experience or the failure of education and training to keep pace with the rising demand for skilled workers.

Figure 4: Labor Force Participation Decomposition



Source: Executive Office of the President, “The Labor Force Participation Rate Since 2007: Causes and Policy Implications” (Washington: EOP, July 2014).

Here are four ways the presidential candidates might propose to get more people working. First, nothing is more important for reducing poverty than maintaining full employment. Using data from 1979 to 2011, Jared Bernstein of the Center on Budget and Policy Priorities, and Dean Baker of the Center for Economic and Policy Research, [find that](#) workers at the 20th percentile of the wage distribution receive a 10 percent wage increase for every 10 percent decrease in the unemployment rate. Many of these lower-wage workers are marginally attached to the labor market. A full employment economy pulls them into jobs and allows them to build work histories and skills.

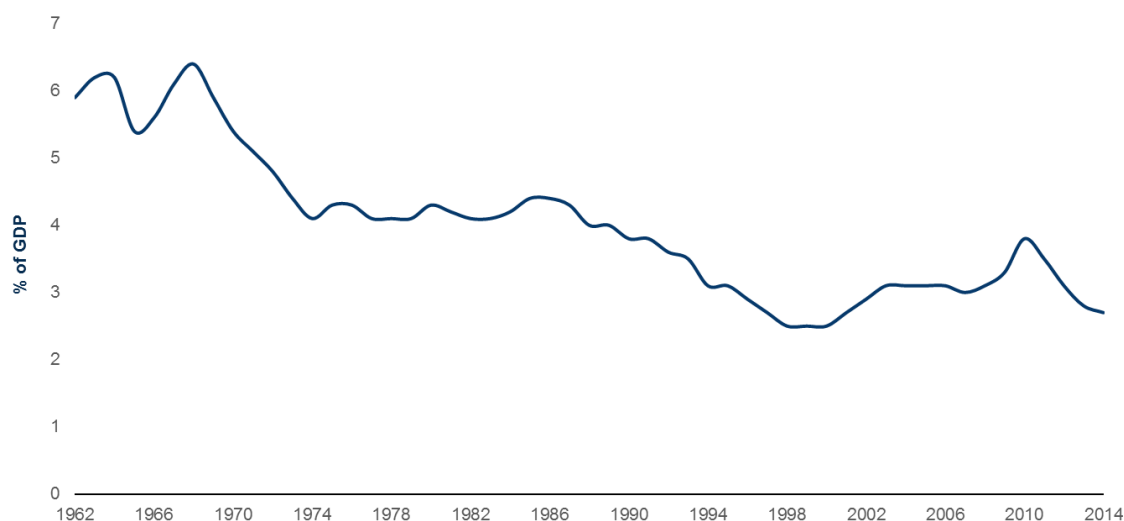
There is considerable uncertainty about the “natural rate of unemployment”—the rate beyond which stimulative monetary or fiscal policy would only create more inflation. The experience of the late 1990s—when wages rose at the bottom of the distribution in response to a falling unemployment rate—suggests how much could be achieved with a more stimulative set of labor market policies.

On monetary policy, the Federal Reserve should not undermine the recovery out of a misplaced fear that inflation is just around the corner. Inflation creates some inefficiencies, can feed on itself, and harms creditors and those on fixed incomes. However, the risks of too little stimulus are greater than the risks of too much, because in the face of a new recession both monetary and fiscal policy would have little leeway to restore economic growth in today’s low-interest and high debt environment.

On the fiscal front, most economists agree that we need short-run stimulus when the unemployment rate is high and longer-term restraint aimed at reducing the ratio of debt to GDP. Today’s low-interest environment represents a rare opportunity for government to borrow cheaply and invest in physical capital projects, like a smarter energy grid, that would [boost](#)

[employment](#) and provide other social returns. Similarly, the president should invest in the nation's human capital and in basic research, after decades of falling investment (see Figure 5).

Figure 5: Federal Investment Spending as % of GDP, 1962-2014



Source: Office of Management and Budget

Note: Includes total investment outlays for major public physical capital, R&D, education, and training; includes both military and nonmilitary spending.

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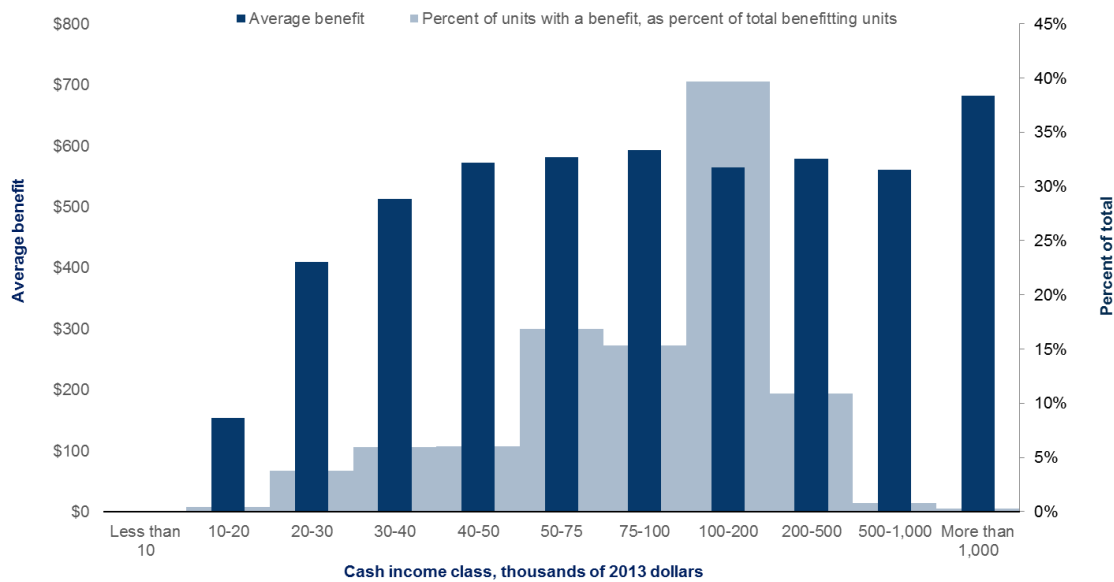
A second set of policies the presidential candidates could propose would be making work pay. Perhaps the most important policy here is to raise the minimum wage and increase the EITC. [A proposal by Sawhill and Karpilow](#) would raise the EITC for families with very young children, eliminate the marriage penalty, and redirect some benefits from larger to smaller families and to single individuals. These provisions both incentivize work and encourage marriage and responsible child bearing. A reform with these elements—combined with an increase in the minimum wage to \$10.10—would reduce poverty by seven percentage points at virtually no cost to the government because a higher minimum wage reduces reliance on public programs. We could also provide an EITC bonus to those who work full-time as a way to encourage more hours of work; [the UK has done this with some success](#).

A second-earner deduction would also make work more rewarding by softening the blow of child care costs and other work-related expenses that affect two-earner households, while encouraging marriage.

A third policy for getting more people working is to make it easier for Americans to work and raise families. The next president needs to provide more childcare assistance and paid leave. For the average single mother with a child under age 5, [out-of-pocket childcare expenses](#) constituted 16 percent of family earnings over the period from 2012 to 2013. When these costs are mitigated, [many mothers respond](#) by entering the labor force.

Currently, our tax system tries to cover some child care expenses through the Child and Dependent Care Tax Credit (CDCTC). But because the [credit is non-refundable](#), much of the money goes towards families with incomes between \$100,000 and \$200,000 (see Figure 6). Making the CDCTC refundable and capping it at \$100,000 in income would make the program more equitable and facilitate low-income parents' labor force participation at little to no cost above current spending on the CDCTC.

Figure 6: Distribution of Child and Dependent Care Tax Credit



Source: Urban-Brookings Tax Policy Center Table T14-0084

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Meanwhile, the U.S. is the only advanced country that does not provide paid family leave as a matter of national policy. In 2011, only 11 percent of private-sector workers had access to [paid family leave](#). The three states that have shown the way here—California, New Jersey, and Rhode Island—can serve as models for the rest of the country. Critics contend that paid leave will impose costs on employers, impede hiring, and reduce women’s incentive to work. Yet 90 percent of employers surveyed after California’s paid family leave law was implemented said it had either a positive or neutral effect on productivity, profit, morale, and costs. Subsequent research found that women were more likely to take leave during the first 6 months after birth, but by nine months the law increased the probability that a new mother worked by 5 to 6 percentage points, because some [California mothers were less likely to quit their jobs](#) and more likely to return to their old employer after giving birth.

Finally, there will always be some people who want to work and can’t find jobs—even when the economy is at full employment. They may have a prison record, the wrong skills, or be new entrants to the job market. For people who can’t find a job on their own, the presidential candidates should consider transitional job programs that provide subsidized low-wage work in either the public or the private sector.

[Evaluations of these programs](#) have a mixed record of success, but some promising models stand out. Florida’s “Back to Work” program, for example, employed roughly 5,600 low-income people (mostly parents) from 2009 to 2010, by placing them directly into subsidized jobs in the private sector. [A quasi-experimental study](#) found that these individuals earned an average of \$2,000 more in the year after the program ended than a comparison group.

And earnings are only one metric of success; a 2004-2005 work program for ex-convicts in New York City reduced recidivism among recently released individuals by 16 to 22 percent. Because incarceration is so expensive, [the program more than paid for itself](#), even though the employment effect faded after the intervention period.

These jobs also provide a way to identify which of the currently jobless are “truly unemployed” and how many are not interested in work. A transitional job offer could be tied to applications for extended unemployment insurance, for example, to reveal who has the greatest need for such assistance, while simultaneously screening out those who refuse to work and reducing program costs.

Marriage or a Stable Relationship before Children³⁶

The third prerequisite to forging an opportunity society is stable families. Too many young adults are having children before they have formed enduring ties with another adult and some are parenting children with more than one partner. Increasingly, it takes two paychecks to join the middle class; those who have children too soon and without a committed partner frequently end up not just with less education and job experience, but also without sufficient means to support a child on their own.³⁷ They end up [experiencing less social mobility](#) and more poverty as a result; their children have poorer outcomes as well.

The solutions here are often nongovernmental and involve changing social norms around the importance of responsible, two-person parenthood.³⁸ Nonprofit and faith-based organizations have a role to play. Some have called for a new generation of government-sponsored marriage or relationship programs and for reducing marriage penalties in tax and benefit programs. But with some exceptions, these do not appear to be a cost-effective way to bring back the two-parent family.³⁹ More promising are efforts to make the most effective forms of birth control (IUDs and implants) more widely available at no cost to women. IUDs and implants provide a virtually fool-proof way for couples to delay parenthood until they are committed to each other for the long term and feel ready to be parents.

Conclusion

The poverty rate in the U.S. has been stuck at around 15 percent for years. For the most part, politicians don’t like to talk about poverty but they do recognize the importance of helping low-income families climb the ladder into the middle class. Mobility rates out of poverty are not high. About 40 percent of children born into the bottom quintile remain there as adults—double the rate you would expect from chance alone.

Lack of access to quality education, joblessness, and family structure are three cause of poverty that the candidates need to address. Of the three, joblessness is the most urgent, but the others are critical to the nation’s long-term health. We’ve suggested some steps that could be taken to improve opportunities for the poor in each of these three areas.

Many of our proposals would not only improve the life prospects of less advantaged children; they would pay for themselves in higher taxes and less social spending. The candidates may have their own blend of responses, but we need to hear less rhetoric and more substantive proposals from all of them.

What the Presidential Candidates Need to Know about Infrastructure: Issues and Options

William A. Galston and Robert J. Puentes

Introduction: Why Infrastructure Matters

Since the beginning of our Republic, infrastructure—starting with transportation and water management—has played a central role in advancing the American economy. From the railroads that linked the heartland to industrial centers to the interstate highway system that forged regional connections, a sharp focus on prioritized, strategic, and rational infrastructure investments underscored periods of regional growth and national prosperity. But what the United States once understood, we seem to have forgotten. During the past three decades the United States has significantly underinvested in infrastructure. This shortfall has made it difficult to maintain existing infrastructure assets and impossible to create a globally competitive system. Our failure to meet long-term infrastructure requirements has impaired economic efficiency, impeded the creation of stable middle-class jobs, and slowed our response to the threat of climate change. It also is imposing direct costs on individuals and businesses. [Several studies have documented](#) sharply higher costs for vehicle maintenance and have attributed much of that increase to poor road conditions.

Our nation's infrastructure is in desperate need of upgrading and modernization. From highly publicized bridge collapses and levee breaches to airport delays and traffic congestion, every American has experienced the frustration—and in some cases the dangers—of aging, overcrowded, under-maintained facilities.

Closing the infrastructure investment gap would have at least four beneficial consequences. First, it would [boost the creation of jobs](#) that often provide middle-class wages and opportunities to workers with modest levels of formal education. Second, it would enhance economic growth by [decreasing overhead cost to business](#) while efficiently moving people, goods, and ideas. Third, it would [better connect households](#) across metropolitan areas to higher quality opportunities for employment, health care, and education. Fourth, it could [reduce greenhouse gas emissions](#) while helping to protect the nation from an increasingly unpredictable natural environment. For these reasons, among others, presidential candidates would be well advised to address infrastructure issues.

The Problem

“In a growing economy,” a Congressional Research Service paper notes, “infrastructure should hold its own, but other data show that that has not been the case. While total government spending on infrastructure adjusted for inflation increased from \$92 billion in 1960 to \$161 billion in 2007, it actually declined from \$1.17 per capita in 1960 to \$0.85 per capita in 2007.”⁴⁰ According to one expert, “from 1950 to 1970 we devoted 3 percent of GDP to spending on infrastructure....[s]ince 1980 we have been spending well less than 2 percent, resulting in a huge accumulated shortfall of needed investment.”⁴¹ Just since 2002, CBO estimates, inflation-adjusted spending for highways at all levels of the federal system has fallen by 19 percent.⁴²

The problem runs from top to bottom. Political wrangling and dysfunction mean that the federal government has ceased to be a reliable partner and effective leader. Furthermore, the rise in federal interest payments, the increase in entitlement spending, and the decline in traditional sources of government revenue, such as the gasoline tax, mean that competition for limited resources is fierce.

By contrast, some cities and states now see budget surpluses due in part to increases in property tax revenues and state level sales tax collections. However, it will take years for most localities to build back their reserves, repay debt incurred during the Great Recession of 2007-2009, and pay for deferred maintenance on a range of infrastructure assets. Cities and states typically rely on the bond market to finance long-term projects, yet even though interest rates remain at historically low levels, the ability of many governments to borrow from the capital markets is hindered by debt caps and weak credit ratings. Plus, because virtually all state and local governments have balanced budget requirements, they must establish their ability to repay before borrowing. In addition to managing the lingering effects of the Great Recession, many states and localities must confront a limited fiscal capacity, as they are squeezed between soaring costs for health care and for criminal justice but slowly growing revenue sources.⁴³ Combined, these circumstances constrain their ability to self-finance projects, leading officials to scale back, delay, or cancel projects altogether.

This shortfall renders the United States less competitive in the global market. The World Economic Forum's 2014-2015 Global Competitiveness Report ranks the overall quality of U.S. infrastructure twelfth in the world, down from seventh place just eight years ago. We rank poorly in every category, with especially low marks for the quality of our roads, ports, railroads, and—most precipitously—air transport infrastructure and electricity supply.⁴⁴ As the Urban Land Institute succinctly put it: “to be competitive in today’s world, it is imperative to invest in infrastructure.”⁴⁵

Possible Responses

Fix the Basics

First, presidential candidates should explain how they intend to use the federal government to fix the basics and shore up existing programs, especially for surface transportation (roads, bridges, and transit).

The Highway Trust Fund. Funded primarily through the federal gas tax, the Highway Trust Fund distributes grants to the states to support the interstate system and other highway projects.⁴⁶ These grants, however, are not subject to scrutiny, competition, or even basic calculations to assess need. Instead, [they are allocated based on formulas](#), yielding not only inefficiencies, but also perverse incentives. The U.S. Government Accountability Office found that the federal transportation program is functioning to some extent as a “cash transfer, general purpose grant program.”⁴⁷ The federal government must lead in those areas where there are clear demands for national uniformity to match the scale or geographic reach of certain problems, such as [global logistics and freight movement](#).

The gas tax, which currently stands at 18.4 cents per gallon, has not been increased since 1993—despite the fact that project costs have gone up significantly. As cars and trucks become more efficient and infrastructure ages, revenues cannot keep up with demand. But public resistance to a federal gas tax increase to support the current program is intense.⁴⁸ The result: an endless series of short-term funding patches that make planning and completing long-term projects much harder than it should be. If raising federal gas taxes is politically infeasible, lawmakers and candidates should propose viable alternatives.

Passenger facility charges. The federal government should allow greater flexibility for states and cities to innovate on projects that connect metropolitan areas. For example, passenger facility charges, which are used to fund airport modernization, are artificially capped

at \$4.50 and do not come close to covering many airports' operating and long-term investment costs. The busiest passenger airports need to be empowered to meet their larger-than-average congestion and investment costs [without federal impositions or caps](#).

Tolling and pricing mechanisms. The archaic restrictions on interstate tolls should also be lifted. Acting in conjunction with the states, [metropolitan and local leaders are in the best position](#) to determine which interstate roadway segments are the strongest candidates for tolling strategies.

Innovation and Financing

Second, presidential candidates should explain how they would use the federal government to enhance existing innovative financing mechanisms.

Tax-credit bonds. Tax credits bonds such as Build America Bonds (BABs) are a cost-effective means of subsidizing borrowing because every dollar of federal revenue forgone by the tax credit is transferred directly to the borrower (states or localities) rather than the investors (purchasers of the bonds). They also offer a more generous subsidy of interest costs and have the added benefit of broadening the pool of investors to include those that do not normally hold tax-exempt debt, such as pension funds (which are already exempt from taxes) and sovereign wealth funds (which also have no U.S. tax liability). By attracting new investors, BABs have eased the supply pressure in the municipal bond market and brought down borrowing costs. [Tax-credit bonds could also be used](#) to support a wide array of infrastructure investments, among them transportation, water and sewer projects, environmental and energy projects, public utilities, and the renovation of schools and hospitals.

Transportation Infrastructure Finance and Innovation Act (TIFIA). TIFIA bonds leverage federal funds with local and private investment by providing credit assistance through direct loans, loan guarantees, or lines of credit. While TIFIA assistance must be repaid through a dedicated revenue source (such as tolls, user fees, and other special assessments such as sales taxes), the terms are very favorable. Unfortunately, arguably the greatest strength of TIFIA—the competitive nature of the process and strong selection criteria—was eliminated in the 2012 transportation bill—a retrograde action that should be reversed.⁴⁹

Other financing mechanisms. There are a handful of other federal programs that have expanded funding for transportation infrastructure and encouraged private sector participation in major projects. These programs include the Transportation Investment Generating Economic Recovery grants, Railroad Rehabilitation and Improvement Financing loans, and Private Activity Bonds. One benefit of these programs is that they can be combined with TIFIA loans as well as local and private investments to further leverage federal dollars. Additionally, each program takes an innovative approach to funding and does not rely on the classic formula-based grant distribution that defines the majority of federal investments in this area.⁵⁰

Although these programs are helpful, they are not sufficient to meet the United States' 21st century infrastructure demands. The public funds available for appropriation fall far short of the needs, and as long as the ongoing squeeze in federal discretionary programs continues, significant increases will remain unlikely at best. In addition, all of the innovative funding strategies reviewed in this section (save for BABs, which have expired) deal primarily with surface transportation and are unable to address other areas that require investment—to our aviation system, electric grid, and so forth.

Technical assistance for states and localities. State and local governments often lack the technical capacity to ensure project quality and to protect the public interest. For that reason, presidential candidates should consider recommending the creation of a national-level Public/Private Partnership Unit. Housed within the Office of Management and Budget, the largest component of the Executive Office of the President, [the Unit would provide](#) states, cities, and metropolitan entities with support and technical assistance, create an environment that encourages private infrastructure investment, and begin the process of forging an integrated national infrastructure agenda.

Selecting Projects

Third, presidential candidates could advocate for a new mechanism to select projects that make economic sense and finance them with mostly private capital.

Numerous legislators and policy experts have suggested that the creation of a National Infrastructure Bank (NIB) would attract private investment for public purposes while ensuring that projects are funded on the basis of economic and social benefit, not political gain. Despite differences of detail, many proposals employ the same basic elements. The NIB would be a financially self-sustaining government-owned corporation established to provide a market-oriented service. A modest amount of public seed capital would secure substantial private capital. An analytical staff would provide policy entrepreneurship identifying unique opportunities to leverage private capital for public needs. Once such possibilities are identified, bank executives could convene the necessary parties and work to broker agreements among them. This approach would encourage creativity in solving infrastructure needs. And by insulating the selection of projects from the political process, it would better align infrastructure investments with real social and economic needs.⁵¹

Conclusion: Structural Difficulties and Strategic Directions

Infrastructure does not typically garner headlines—until a bridge collapses or a dam bursts. It is, however, the foundation of a healthy economy and society. And it is an issue that leaders at every level of our federal system, including the president, will have no choice but to address, hopefully sooner rather than later. The need is great and growing. If the expert estimates are correct, between now and 2020, [we should be investing](#) roughly \$150 billion annually in transportation and port projects, water and sewage systems, the energy grid, and much else besides.

In the current political and fiscal environment, this will not be easy. Raising general revenues by \$150 billion each year for infrastructure is politically out of the question. There are four structural obstacles. First, citizens are being asked to pay now for investments that will yield a return over a lengthy period. But when household budgets are squeezed, patience to wait for future returns on spending is limited. Second, different regions have different needs: some rural and small-town voters often must drive long distances to work and shop and are highly resistant to gas tax increases. Third, it is hard to explain why tax dollars should travel to Washington, only to be returned to the states and localities. Why not just cut out the middleman? And finally, a basic difference between the federal government and other jurisdictions—Washington’s ability to borrow readily for public purposes—is diluted in times when the people disapprove of budget deficits, whatever the purpose.

These difficulties suggest that presidential candidates should consider two very different responses. First, public pressure may support a presidential proposal to reallocate

responsibilities within our system of federalism. States and localities may be more willing to tax themselves for projects if they can expect to reap the benefits directly, rather than shoring up broad national objectives. This is especially relevant today, as governments closer to the people enjoy higher levels of trust than the federal government.

Second, it may be time for a new partnership between the public and private sectors. Individual investors and large investment pools are flush with cash seeking a reasonable return at a bearable level of risk. [Mobilizing private dollars](#) for public purposes should be an easier sell than is commandeering those dollars through our system of taxation.

The devil, as always, is in the details. But the bottom line is this: an efficient modern economy cannot be sustained without public goods that the market, left to its own devices, will under-supply. As always, governments face the challenge of mobilizing public support for these goods. The art of legislation is finding the path of least resistance to reach these essential public goals. And legislators will be more motivated to seek that path when they enjoy sustained leadership and support from the executive branch. Working with governors, mayors, and the private sector, the next president must break the logjam and create a new model of infrastructure finance for the 21st century.

¹ Michael G. Krukones, *Promises and Performance* (Lanham, MD: University Press of America, 1984).

² Ron Haskins and Isabel Sawhill, *Creating an Opportunity Society* (Washington: Brookings Institution Press, 2009), 70-71.

³ It might be said that environmental improvements should be included in the GDP and therefore as a contribution to economic growth. But it is not easy to put a dollar value other than considering the costs of improvements and not the value of benefits.

⁴ GNP equals GDP minus income that flows abroad. It is therefore a better measure of the standard of living of U. S. residents.

⁵ Michael Graetz, *100 Million Unnecessary Tax Returns: A Simple, Fair, and Competitive Tax Plan for the United States* (New Haven: Yale University Press, 2007).

⁶ John Dawson and John Seater, "Federal Regulation and Aggregate Economic Growth," *Journal of Economic Growth*, forthcoming. A summary of the article's findings can be found in John Bailey, "Federal Regulations Have Made You 75 Percent Poorer," accessed July 9, 2015, <https://reason.com/archives/2013/06/21/federal-regulations-have-made-you-75-per>.

⁷ For current law projections, see Congressional Budget Office, "The 2015 Long-Term Budget Outlook" (Washington: 2015). For current policy projections, see Alan J. Auerbach and William G. Gale, "The Fiscal Problem: Gone Today, Here Tomorrow" (Washington: Brookings, 2015).

⁸ For further analysis of tax expenditure reform options, see Daniel Baneman et al., "Options to Limit the Benefit of Tax Expenditures for High-Income Households" (Washington: The Tax Policy Center, 2011).

⁹ Yale University law professor Michael Graetz also has proposed a VAT, but he would use the revenues gained to cut the income tax substantially—raising the exemption to about \$100,000 and taxing income above that level at a flat 25 percent—and to halve the corporate tax rate. See: Michael J. Graetz, "100 Million Unnecessary Returns: A Fresh Start for the U.S. Tax System," *Yale Law Journal* 112 (2004): 263–313.

¹⁰ For more discussion, see: William G. Gale and Benjamin H. Harris, "Proposal 10: Creating an American Value-Added Tax" (Washington: The Hamilton Project, 2013); Eric Toder and Joseph Rosenberg, "Effects of Imposing a Value-Added Tax to Replace Payroll Taxes or Corporate Taxes" (Washington: The Tax Policy Center, 2010).

¹¹ For more information, see: Rob Portman and Charles Schumer, "Senate Finance Committee International Tax Reform Working Group: Final Report" (Washington: U.S. Senate Finance Committee, 2015).

¹² Alan Auerbach and Joel Slemrod, "The Economic Effects of the Tax Reform Act of 1986." *Journal of Economic Literature* 35 (1997): 589-632.

¹³ Unless otherwise noted, all 10-year budget projections for Fiscal Years 2015-2025 are taken from the March 2015 Congressional Budget Office (CBO) baseline. U.S. Congressional Budget Office, "Updated Budget Projections: 2015 to 2025" (Washington: 2015), <https://www.cbo.gov/sites/default/files/cbofiles/attachments/49973-UpdatedBudgetProjections.pdf>. Budget projections through 2040 are taken from CBO, "The 2015 Long-Term Budget Outlook" (Washington: 2015).

¹⁴ CBO, "The 2015 Long-Term Budget Outlook," Summary Figure 1, 7.

¹⁵ Ibid, Figure 6-1, p.75.

¹⁶ CBO, "The 2015 Long-Term Budget Outlook," 28.

¹⁷ CBO, "The Budget and Economic Outlook: 2015 to 2025," Figure 4-3, 102.

¹⁸ Employees of firms that offer insurance to their workers can enroll in exchange plans with tax subsidies rather than their employer's plan if the premium costs for the worker-only policy they are offered exceed 7 percent of their income. However, if the premium for a worker-only policy is below this threshold but the premium for a family policy exceeds this level the family is precluded from accessing subsidized coverage through the exchange unlike the situation facing workers whose employer offers no insurance.

¹⁹ Currently, 19 states have not expanded Medicaid eligibility under the ACA. Many of these states limit eligibility to certain categories (only adults with children) and those with incomes well below the FPL. Specifically, as of April 2015, 21 states offered no Medicaid coverage to childless adults, 13 states offered parents of dependent children Medicaid only if their incomes fell below 50 percent of the FPL and 4 offered such parents Medicaid coverage if their incomes fell between 50 and 100 percent of the FPL. In Alabama and Texas eligibility was restricted to parents with incomes at or below 18 percent of the FPL. Under federal law, all children in families with incomes below the FPL and assets below constricted thresholds are eligible for coverage. Kaiser Family Foundation, "Where Are States Today? Medicaid and CHIP Eligibility Levels for Adults, Children, and Pregnant Women" (Menlo Park, CA: April 2015), <http://kff.org/medicaid/fact-sheet/where-are-states-today-medicare-and-chip/>.

²⁰ If it objects to the IPAB proposals, Congress can either approve an alternative package with comparable savings or vote to reject the IPAB package. In the latter case, Congress would probably be faced with over riding a presidential veto.

²¹ Congressional Budget Office, "Budgetary and Economic Effects of Repealing the Affordable Care Act," (Washington: June 2015), 10-11.

²² The ACA reduced the annual payment updates for most institutional providers by the 10 year average increase in multifactor productivity (about 1.1 percentage points) and increased the HI payroll tax by 0.9 percentage point on those with earnings in excess of \$200,000 (\$250,000 for joint returns).

²³ For sources of these and a number of other figures used in this paper, see Office of the Under Secretary of Defense (Comptroller), "Fiscal Year 2016 Budget Request" (Washington: Department of Defense, February 2015).

²⁴ A word of clarification: A subtitle of one of my recent books on defense spending was phrased, "Maintaining Military Preeminence While Cutting the Defense Budget." However, since that book was written, the defense budget has in fact been further cut; I no longer support additional cuts. On the flip side, I signed a letter written by a number of national security specialists calling for a return to DoD funding levels as they were projected just after the 2011 Budget Control Act was signed, assuming no sequestration or similar curbs on Pentagon spending. While I believe that such funding levels would be reasonable, this paper attempts to achieve strong national security at slightly lower levels than that letter advocated, partly through a number of additional efficiencies and reductions that could not be included in such a consensus document.

²⁵ Office of Management and Budget, "Historical Tables: Budget of the U.S. Government, Fiscal Year 2016" (Washington: Government Printing Office, 2015).

²⁶ International Institute for Strategic Studies, *The Military Balance 2015* (Oxfordshire, England: Routledge, 2015).

²⁷ Congressional Budget Office, "Long-Term Implications of the 2015 Future Years Defense Program" (Washington: November 2014), 1-3.

²⁸ Some of these appear in Michael O'Hanlon, *Healing the Wounded Giant* (Washington: Brookings Institution Press, 2013).

²⁹ See, for instance, Alex J. Pollock of the American Enterprise Institute (May 31, 2013) <https://www.aei.org/publication/what-to-do-with-fannie-and-freddie/>, John Griffith of The Center for American Progress (September 6, 2012) <https://www.americanprogress.org/issues/housing/report/2012/09/06/367367-things-you-need-to-know-about-fannie-mae-and-freddie-mac/>, and The Corker-Warner bill (June 25, 2013) http://www.warner.senate.gov/public/index.cfm/pressreleases?ContentRecord_id=da03f027-9876-485e-82d6-78fe5f8485f6.

³⁰ Brainard, Lael, "Dodd-Frank at Five: Assessing Progress on Too Big to Fail", *Board of Governors of the Federal Reserve System*, July 9, 2015, <http://www.federalreserve.gov/newsevents/speech/brainard20150709a.htm>; see also: Avraham, Dafna, Patricia Selvaggi, and James Vickery, "A Structural View of U.S. Bank Holding Companies" (New York: The Federal Reserve Bank of New York, July 2012), <http://www.newyorkfed.org/research/epr/12v18n2/1207avra.pdf>.

³¹ Readers should take these graduation statistics with a grain of salt; see long version of this paper and the following for more:

<http://www.npr.org/sections/ed/2015/06/09/412939852/high-school-graduation-rates-the-good-the-bad-and-the-ambiguous>

<http://www.npr.org/sections/ed/2015/06/12/411751159/the-story-behind-the-record-high-graduation-rate>

³² Karl Alexander, Doris Entwisle, and Linda Olson, *The Long Shadow* (New York: Russell Sage Foundation, 2014).

³³ For a review of studies, see the Department of Health and Human Service's "Home Visiting Evidence of Effectiveness" website: <http://homvee.acf.hhs.gov/models.aspx>

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- ³⁴ Matthew Crellin, Darrell Aaron, David Mabe, and Courtney Wilk, "Catalyst for Competition: Performance-Based Funding in Higher Education: A case study of three states" (Boston: New England Board of Higher Education, 2011).
- ³⁵ For more on these "skin in the game" proposals, see Micheal Stratford, 2015. *Risk Sharing, Yes. But How?*, <https://www.insidehighered.com/news/2015/05/21/bipartisan-agreement-risk-sharing-concept-only>
- ³⁶ For more details, see Isabel V. Sawhill, *Generation Unbound* (Washington: Brookings Institution Press, 2014).
- ³⁷ I estimate that the growth of single parent families since 1970 has increased the child poverty rate by 25 percent; Sawhill, *Generation Unbound*.
- ³⁸ Sawhill, *Generation Unbound*, ch. 3.
- ³⁹ Ron Haskins, "The Family Is Here to Stay—or Not," *Future of Children* 25, no. 2 (2015): 129–53.
- ⁴⁰ Claudia Copeland, Linda Levine, and William J. Mallett, "The Role of Public Works Infrastructure in Economic Recovery" (Washington: Congressional Research Service: 2011), 3.
- ⁴¹ Sherle R. Schwenninger, "A Capital Budget for Public Investment" (Washington: New America Foundation, 2007), 61.
- ⁴² Congressional Budget Office, "Public Spending on Transportation and Water Infrastructure, 1956 to 2014" (Washington: Congressional Budget Office: 2015), 2.
- ⁴³ Copeland, Levine, Mallett, 1-2.
- ⁴⁴ Klaus Schwab and Xavier Sala-i-Martin, "The Global Competitiveness Report 2014-2015" (New York: World Economic Forum, 2014), 378-379.
- ⁴⁵ Jonathan D. Miller, "Infrastructure 2009: Pivot Point" (Washington and London: The Urban Land Institute and Ernst & Young, 2009), iv.
- ⁴⁶ While most of the federal gas tax accumulates in the Highway Account of the trust fund, the remainder is distributed to the Mass Transit Account and supports public transit systems.
- ⁴⁷ U.S. Government and Accounting Office, "Federal-Aid Highways," GAO-04-802, 2004, 5.
- ⁴⁸ A recent poll found that a majority of voters would support a gasoline tax increase if it was targeted to roadway maintenance. See: Keith Laing, "Poll: Voters Would Support 10-cent Gas Tax Hike," *The Hill*, April 29, 2015, <http://thehill.com/policy/transportation/240527-poll-voters-would-support-10-cent-gas-tax-hike>.
- ⁴⁹ William A. Galston and Korin Davis, "Setting Priorities, Meeting Needs: The Case for a national Infrastructure Bank" (Washington: The Brookings Institution, December 2013), 7-8.
- ⁵⁰ *Ibid.*, 8-10.
- ⁵¹ *Ibid.*, 18-19.