A New, Progressive Economic Strategy for America

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Written over a series of weeks in April 2010, the following four pieces lay out a new economic strategy for America that creates broad-based prosperity and addresses the America's great economic challenges in the era of globalization. Dr. Robert J. Shapiro, the Chair of NDN's Globalization Initiative and former Under Secretary of Commerce for Economic Affair, describes an ambitious yet practical agenda for addressing the struggle of everyday Americans, getting the nation's fiscal house in order, reforming the tax code, and reclaiming American leadership and competitiveness in the global economy.

Shapiro's strategy is optimistic, in that it views the American economy as uniquely positioned for success in the age of globalization. However, if we lack the political will to implement Shapiro's necessary reforms and squander the opportunities presented us, we could find ourselves marveling at economic miracles around the world and left waiting for one of our own.

-Jake Berliner
Deputy Policy Director, NDN Globalization Initiative
May, 2011

A New, Progressive Economic Strategy, Part 1

Looking out onto the smoky, endless skyline of Seoul, Korea, I think about our two nations' similar economic paths, from abject underdevelopment to world-class modernization and wealth. In the 19th century, there was one place in the world that managed to move all the way up from low-income to high-income, and that was the United States. From 1870 to 1970, another society, Japan, managed the same achievement. Now, one other society will make the same great leap from 1960 to 2030 or so, and it will be Korea. If you doubt it, consider that since 1960, the real per capita income of Koreans has grown 37-fold, and the country's real GDP has expanded up 50-times. They've managed it in much the same way we did – making huge, sustained investments in education and infrastructure; sustaining a voracious work ethic animated by meaningful jobs open to anyone able to perform them; adopting astute policies that support native businesses but also expose them to foreign competition from more advanced rivals; and setting global ambitions for the nation's economy.

Yet, even these achievements by Korea in this period and by ourselves a while ago don't guarantee future success. Korean policymakers, businesses and workers certainly all face difficult challenges. But our interest here lies in our own, future path. President Obama and Congress, beset by a series of crises, have found themselves playing the role of a fire brigade. To his genuine credit, the President reached past the fires around him to drive basic health care reforms, a remarkable exercise of presidential will even if we're unsure of their real costs and benefits. Alas, the achievement represents only a modest piece of a larger economic strategy still waiting to be articulated and carried out, if we are to hope for a better economic future than the one being deeded to most Americans by the mistakes and dismal neglect of the preceding administration.

This is the first of four essays in which we will lay out a new economic strategy for the next decade. The last time such large ambitions were seriously attempted, they it came from conservatives led by Ronald Reagan, who also tried to surmount the emergencies of his time with broader reforms. Perhaps less than half of that attempt proved to be sound, and more than half clearly was not; but they all left long legacies. The big task for Mr. Obama and progressives today is to think and act as big as Reagan, and get at least three-quarters of it right this time.

Today, we will lay out the three basic parts of that task and begin to think through the first of them. These three economic challenges that demand basic reform are: 1) Restore real prospects for economic progress for average working Americans; 2) reclaim real, structural soundness for the government's finances in the face of the serious social challenges we will face over the next decade; and 3) secure America's leading role in the global economy.

The first part of this task is the most urgent politically, although not more so economically than the others. In fact, if we do not successfully address the second and third parts, the progress we make with the first will not be sustained. The essence of the first challenge is to ensure that average Americans can lead lives of economic progress and dignity. That aspiration, in turn, rests most fundamentally on restoring strong and dynamic job creation, so that everyone who wants to can not only find work, but also move up periodically to more demanding, better-paid jobs. A labor market that works this way – the kind we had in the 1950s, 1960s, and in the 1990s for a brief while – can deliver the basic elements of the American dream through meaningful work that provides real opportunities for rising incomes and upward mobility.

Every piece of this goal is in peril today. For a decade, job creation has slowed sharply, income gains for most people have stalled, and upward mobility has become the privilege limited to the top 20 percent of Americans. We all can see the growing gap that has opened up between the skills of most Americans and the demands of most new, well-paying jobs with futures. In one way or another, those jobs all now involve advanced technologies, which themselves also displace other jobs for millions of people. Finally, we can feel the pressures that squeeze so many jobs and wages, as businesses dealing with the intense competition created by globalization also face fast-rising costs, especially for health care, energy, and pensions.

These forces gripping American jobs and wages are all very complex, and there's no single magic bullet to vanquish them. So, we have to take them on piece by piece. For example, most new jobs come from relatively young businesses that are expanding quickly. We can ease some of the costs of creating those jobs by reducing the employer's payroll taxes on net, new employees and by assuming part of their health-care costs – approaches actually in place already in limited forms, in the new health care reforms and the latest jobs bill. Now, for some real innovation, let's also require that in exchange, these businesses become staging grounds for enhancing the skills of the new workers they hire. Half of what they save on payroll taxes and health care would go for onsite training or vouchers for ongoing outside instruction, especially in the information technologies that pervade most workplaces. For everybody else, new grants to community colleges could cover the cost of keeping their computer labs open and staffed on evenings and weekends, for anyone to come by and receive free training in those technologies.

These reforms, however, won't ease the cost pressures squeezing jobs and wages in most companies. So this plan also needs additional steps to reduce the fast-rising cost burdens on business from health care, energy and pensions. One sensible step that may seem radical by today's cramped standards would be to lighten those pension and health care burdens by (the radical part) expanding Social Security and Medicare. Start by raising the benefits of those who continue to work beyond ages 62, 65 and 70, which will directly reduce their employers' pension liabilities. Follow it up by the government assuming the obligations of many large companies for part of their retirees' health care. It might amount to federally-financed "medigap," a social provision which eventually progressives should want to extend to everyone.

It shouldn't surprise anyone that addressing the profound problems most Americans now face with jobs and wages won't be cheap. Next week, we will lay out the second part of our progressive economic strategy, on how best to restore sound financing for the national government. Progressives did that in the 1990s, with some help from conservatives, and they can do it again. This time, however, we also have to tackle the looming costs of two structural challenges to our future fiscal state, namely, health care for the retiring boomers and climate change. Then we will turn to America's ongoing leadership in the global economy, especially with regard to our strength as the source of innovation worldwide and our central place in the global financial system.

A New, Progressive Economic Strategy, Part 2: Spending Reforms

You don't have to be a Nobel economist to see that the United States needs a new economic plan if we hope to restore what once seemed part of the American birthright – ample job opportunities, strong and widespread income gains, and broad upward mobility. Last week, we sketched a package of initiatives to equip businesses and workers with the resources and incentives that such a strategy requires. This week, in part 2, we turn to a more general condition for sustained economic progress, a plan to control long-term deficits and national debt.

Bringing down the trillion dollar-plus annual deficits now projected for the next decade is straight-forward conceptually – you cut federal spending, raise taxes, and do both in ways that promote faster growth and so further increase revenues and further reduce spending. Moreover, serious steps to reduce these deficits should be a clear goal for progressives, so long as it's phased-in a few years from now when the economy is stronger. Once the economy recovers from the neglect and mistakes of the Bush administration and those who ran Wall Street, the current trajectory of massive deficits will push up interest rates and slow investment, incomes and growth. Tolerating these long-term deficits, then, would consign average Americans to another lost decade economically – and perhaps even worse, lay the toxic foundations for another crisis.

In practice, serious deficit reduction is always a difficult business, since who wants to pay higher taxes or accept fewer benefits? The challenge is to rethink and reconfigure federal spending and taxes, so we can channel spending and raise revenues in ways which reinforce job creation and income gains, and so help families and businesses prosper. This week, we focus on the spending reforms; next week, we will rethink taxes.

Progressives should approach this challenge in three ways. First, end not only earmarks but their larger and more permanent version, the major subsidy programs for influential industries. These subsidies arbitrarily tilt the economy towards companies with political clout and so reduce the jobs and wealth the economy is capable of producing. These industry entitlements range, for example, from much of the farm program which ends up raising food prices, and export promotion efforts that give selected exporters artificial advantages without affecting the overall trade deficit, to the below-market fees for mineral rights and other natural resources. Make a clean sweep of these ongoing taxpayer bailouts, and we could save between $100 billion and $150 billion per-year.

The second area involves the inescapable reforms of individual entitlements. Unlike industry entitlements, these programs serve clear and compelling social interests. As the boomers begin to retire, however, these programs in their current forms will become plainly unsustainable. Social Security reforms are the more manageable part, analytically and politically. The program's long-term deficit would melt away, for example, if Congress enacted three fairly modest adjustments: Shift the pension's annual cost-of-living adjustment to reflect the actual inflation recorded by the Bureau of Labor Statistics for the elderly people who receive it; link increases in the retirement age to increases in life expectancy for those age 65 and over; and tax all of the benefits of retirees with incomes above the national average. And all of these changes reflect the progressive values of fairness.

Fixing Medicare and Medicaid is much tougher. As this year's wrenching debate over health care reform demonstrated, nothing inspires greater public anxiety than changes in the arrangements which people consider matters of life and death. Yet, the current arrangements are also plainly unsustainable, especially as boomers enter the phase of their lives when heart diseases and cancers, the most common and expensive conditions to treat, become much more common. The general path is clear: We need reforms that go considerably beyond this year's changes to substantially slow the rates of increase for all health care costs.

By taking this broad approach, we can not only preserve Medicare but also produce large economic dividends. First, smaller annual increases in health care costs will reduce pressures on businesses to hold down wages. That's just what happened in the 1990s, when the shift to HMOs produced several years of much slower health care inflation, and average incomes grew more than 2 percent annually, after inflation. Moreover, slower health care costs also will help the overall economy. Since other advanced countries produce health care outcomes comparable to our own at less cost, our additional spending is flagrantly inefficient, stealing wealth and jobs from more economically-productive areas.

Happily, this year's health care debate aired a catalog of strategies to help contain these costs without compromising the quality of care; and the bill, as enacted, provides a credible beginning for a more extended process to control future increases. The insurance exchanges should reduce costs in the individual and small-group insurance market, and the investments in IT should help slow costs across the system. Both can be expanded and beefed up. The new law also begins to move the Medicare program from volume-based payments to reimbursements based on the value of the treatments. That can be substantially strengthened as well. This year's reforms also create a new advisory board to propose new ways to cut Medicare costs, with a process to fast-track the recommendations through Congress. Eventually we can apply this kind of arrangement to all of health care.

Finally, both parties will have to accept the most difficult changes advanced by the other. Democrats will have to live with taxing a share of the value of employer-provided coverage, along with serious malpractice reforms. And Republicans will have to accept a public option, in order to introduce real competition for insurers in areas where one or two of them comprise an effective monopoly or duopoly.

Looking out several years, these reforms for industry and individual entitlements should be able to pare several hundred billion dollars per-year from our structural national deficits. And if that's not enough, there's still a third area of large, potential savings in defense spending. For a start, eliminate any weapon system that the Pentagon says it doesn't need or want. These programs have become geographic entitlements, sustained to keep taxpayers dollars flowing to the districts of those who sit on the defense appropriations subcommittees. That's hardly a sufficient reason to weaken a broad plan with the promise of restoring economic opportunities and prosperity for average Americans.

A New, Progressive Economic Strategy, Part 3: Tax Reform

The most dispiriting feature of this year's economic debates, apart from their fierce partisanship, is the absence of a broad and encompassing view of what the American economy needs. In this series of essays, we're laying out a new, progressive strategy to advance the central goal of economic policy – namely, to ensure ample job opportunities, strong and widespread income gains, and upward mobility for most people. The previous two blog-essays described, first, a series of initiatives to equip businesses and workers with much of what they need to succeed economically, and second a new approach to contain the growth of federal spending so we can control long-term budget deficits. This week, in part 3, we turn to taxes. The challenge is to rethink and reconfigure the federal tax system, so we can raise the revenues we need in ways which reinforce job creation and income gains.

Progressives should approach this challenge in three ways, covering in turn corporate taxes, personal income taxes, and energy taxes. The first step involves ending the major corporate tax subsidies for influential industries, much as our spending initiative would end large, industry-specific spending subsidies. These corporate tax entitlements range from tax breaks crafted for oil, gas and wind energy producers, and special inventory rules for certain exporters (and not for U.S. firms producing the same products for the American market), to billions of dollars in privileged treatment for insurance companies, credit unions, and housing developers. Ending these and other corporate tax breaks could not only set back influence-peddling for a while and simplify the corporate tax code; it also would raise a boatload of new revenues. Half of those new revenues should go to deficit reduction, while the other half goes to lower a corporate tax rate that's currently one of the world's highest. To the modest degree that the lower corporate taxes in Europe and East Asia encourage American multinationals to shift more of their operations abroad, this approach should help create more conditions for domestic job creation. And we can amplify this effect with a measure described earlier in this series, sharp cuts in the payroll taxes of employers who expand their overall workforce and payrolls. In any case, ending tax subsidies for influential interests will make the entire economy more efficient, because companies that never qualified for special treatment would no longer have to compete at a disadvantage with tax-protected companies for capital and skilled workers.

Next, progressives should apply a similar and more sweeping approach to the personal income tax. The current, staggeringly complicated system is unsalvageable. Nearly 43 percent of all households pay no income taxes at all; and few of the 90 million households that do pay income tax can figure out their own liability. The responsiveness and accountability of a democracy can erode quickly when government is financed by a system that doesn't affect more than two-fifths of the people and isn't understood by the rest. The current income tax also is plainly unfair: Since different forms of income and spending are taxed differently, people with the same incomes, but earned or spent in different ways, bear very different tax burdens.

Progressives should make a clean sweep of this entire mess by creating a single personal exemption of \$100,000 to \$150,000 that would supplant all current personal deductions, from mortgage interest and child care expenses to capital gains and employer-provided health insurance. In one swoop, between 84 percent and 95 percent of all families would owe no income taxes, and the system would return to its origins, when it affected only the very well-to-do. The affluent also would claim the \$100,000 to \$150,000 exemption, plus an unlimited deduction for new retirement savings. But every other dollar would be taxed at 25 percent rate, regardless of whether the taxpayer earned or received it as salary, dividends, stock options, the “carried interest” of hedge and private equity fund managers, foreign royalties, or lottery winnings. This is progressive tax simplification with a vengeance.

Of course, a 25 percent tax on the income of only a small share of Americans will produce much lower revenues than the current system; and taking most people off the income tax could create powerful new pressures for more spending, if they know they won’t have to pay anything for it. So a new tax has to take the place of the income tax for most people; and the best candidate is an 8 percent to 10 percent value-added tax (VAT) that would cover everything people consume, except home purchases and rent, medical care, educational costs, and energy. Since the VAT would fall only on what people consume, not on what they save, it should have the same economic effect as the unlimited deduction for new retirement saving for higher-income people. Together, these provisions come close to eliminating taxes on new savings, enabling the country to finance more of its own investment and deficits without borrowing hundreds of billions of dollars a year from China, Japan, and Middle Eastern oil states. And the Earned Income Tax Credit can be scaled up to offset the cost of the VAT for lower-income families.

We exempt energy from the VAT, because energy is the focus of a third major tax reform, the enactment of a carbon-based tax to address climate change. Economists have long favored this approach over a cap-and-trade program, mainly because cap-and-trade creates more volatility in energy prices, which in turn harms the overall economy and weakens the incentives to develop new climate-friendly fuels and technologies. A direct, carbon-based tax, which will adjust the prices of different forms of energy in direct proportion to their harmful effects on the climate, makes more sense economically and environmentally. The last question for progressive tax reform is what we do with the $200 billion a year in new revenues which a serious commitment to address climate change would generate. Since the point of climate policy is not to make people poorer, but only to induce everyone to use less climate-damaging forms of energy – most notably, phasing down coal – the answer is to recycle the carbon-tax revenues through other, progressive tax cuts. One obvious candidate is payroll tax cuts, which would further reduce the costs for businesses of creating new jobs or raising the pay of existing jobs.

How much of these carbon-tax revenues could ultimately go to cutting payroll taxes, and how much might be reserved for deficit reduction, will depend on how successful we are in the other parts of this economic plan. If progressives can unwind special-interest spending and tax subsidies, contain health care costs, and put in place a broad VAT, the vast majority of carbon-tax revenues can go for tax cuts. Yet, the final results of all of these changes will also depend on how well we navigate the final issues for this plan, involving our role in the global economy. Those matters, including financial regulation, will be the focus of part four, next week.

A New, Progressive Economic Strategy, Part 4: The Global Economy

In a global economy, even the world's largest economy by a factor of three (that's us, compared to Japan and China) cannot by itself ensure job opportunities for everyone and healthy incomes gains for everyone who works hard and well. We may wish it were otherwise, but the United States and the forces of globalization now share control over America's economic path. The challenge is to work with those forces to benefit average Americans, and to exercise the global leadership required to ensure that other countries work with us to promote the growth and stability of the global system. This part of the progressive agenda has many elements, including efforts to advance open trade in ways that help average workers, steps to promote innovation and protect the rights of American innovators around the world, and responsible regulation of finance while promoting free flows of global capital.

In one way or another, just about every economic activity in America is touched by global forces, whether it's the operations of foreign companies, investors, innovators, consumers, or governments. We're still the world's largest economic actor by a long shot; but the global economy has grown too large, complex and fast-changing for even us to dominate, much less direct. Let's start with trade. Twenty years ago, 18 percent of all the goods and services produced in the world were traded across national borders – today, in a global economy two-thirds larger (adjusted for inflation), one-third of everything produced anywhere is traded – some $20 trillion worth per-year. Most of this rapid increase is tied to the explosive modernization of China and other large developing countries, and the fast-expanding consumption of their people.

America can generate good jobs and rising incomes for average families only by working with this historic expansion of worldwide trade. Progressives should be committed not only to equip American workers and companies with what they need to compete in a global trading system, but also to open markets here and around the world, especially in services and agriculture. The first commitment involves many of the initiatives described in earlier essays, including access to free IT training, health care reforms to reduce business costs, and tax reforms to make American companies more competitive.

In exchange, progressives should push to conclude the Doha trade round to open foreign markets in services, where U.S. companies excel, to negotiate fair, free trade status with burgeoning economies such as Korea and, in time, with Japan; and to hold China and other fast-growing emerging markets to their WTO promises to open their markets. In all of these cases, American firms and workers would gain, because our markets already are far more open than most others in the world. And there's no one else who can lead effectively here, since no other country has as much leverage with the holdouts in the EU and the developing world.

America's greatest exports are its new ideas, whether they're embodied in new software code, breakthrough pharmaceuticals and medical devices, new business services, genetically-enhanced foods, new forms of entertainment, or the latest-generation equipment. In fact, America's unique role in globalization is being the world's largest source of economic innovations and the testing grounds for adopting them on a large scale. To be sure, innovators come from every part of the globe; but for the last generation, American inventors, entrepreneurs and companies have dominated the development of most (not all) critical new technologies and new ways of doing business. And the effective application of new ideas is the principal source of most of the competitive edge American companies retain in many global markets.

To help keep all of this going, our new economic plan has to actively spur continuing economic innovation through tax reforms, a larger federal commitment to basic research, and by maintaining the healthy competitive pressures that spur innovation and their broad adoption. In this context, too, American workers need access to the skills required to use these innovations and perform effectively in workplaces dense with advanced technologies. These steps not only can help average families succeed as new ideas unfold; they also support America's place as the world's largest domestic market for innovations, which in turn will spur additional investments to develop their next generation.

A progressive economic program should include two initiatives in this area. First, since innovation is the essence of our competitive advantage in the world, we need a no-holds-barred campaign to cajole or coerce every other nation to respect the intellectual property rights of American innovators and companies. In addition, we need to reclaim the global leadership we exercised in the 1990s in addressing climate change by enacting measure to fix a strict and environmentally-appropriate price on carbon emissions, preferably with a carbon-based tax that recycles its revenues in other tax cuts. This would not only be part of America's responsibility for broad economic leadership, it also could spur to a dramatic degree American companies to develop new, climate-friendly fuels and technologies, and then broadly adopt them.

A progressive economic plan also has to take serious account of the global financial system. American companies are the world's largest foreign direct and portfolio investors, with operations and other investments spread across the developing and advanced world. The United States is also the world's largest single recipient of direct investments by foreign companies and portfolio investments by foreign funds and governments. So, we have an enormous stake in a healthy and stable financial system, here and around the world. And in the wake of the recent meltdowns, the central issue here is how best to regulate finance, here and around the world.

Based on the recent crisis, the basic terms of regulation seem clear. First, require that all financial institutions hold more capital, relative to their investments, and adjust those stricter capital requirements for the riskiness of a bank or fund's portfolio. That should help end their risky practice of making huge wagers, for example in asset derivative or interest rate futures, using almost entirely borrowed funds. Second, make sure that every transaction in finance, involving any kind of instrument, occurs on a public exchange or through a publicly-chartered clearinghouse. That can ensure that every trade or purchase is transparent and subject to the same disclosure and soundness rules. Third, end self-dealing compensation practices that just encourage the most risky wagers, for example by paying out bonuses long before anyone knows whether the transaction will actually work out. And none of these sensible changes would impede the free flow of investment and money – in fact, they should enhance America's premier position in the global capital system.

The good news here is that the regulatory plans passed by the House and being considered this week in the Senate both contain versions of these three basic changes. The bad news is that they're all weaker than needed – so, it's up to progressives to strengthen them.

That leaves the sticky matter of "Too Big to Fail," or what to do about funds or banks whose failure could trigger another broad crisis. We have two alternatives: Break them up, so no bank or fund can jeopardize the stability of the entire financial system. In its' favor, there is little evidence of real economic benefits derived from the huge size of the institutions that dominated the sector before the crisis, much less the even greater size of the behemoths that dominate it now. Many conservatives like this approach, from Alan Greenspan to Mervyn King (he runs the Bank of England), because it avoids the alternative, which would be a new process to take over the investment activities of any large player at the first sign of trouble. Either way, the plan should reject out-of-hand the current, reckless GOP position: No prophylactic break-ups, no new process to take them over when they're in trouble, and no future bailouts. That would be a formula for a global depression the next time that big finance implodes.

There's more to consider as well for a progressive plan to help Americans make the best of globalization, from sensible immigration reforms to measures to help recognize asset bubbles before they get out of hand. In one way or another, we will return to those issues later, along with some others. For now, we conclude this four-part series hopeful that somewhere out there, in Washington or beyond, there is a growing recognition that now is the time for progressives to rethink our national economic approach and reconfigure the economic agenda.