

Real World Economics - Fall 2008 Lecture Series

Issues, Choices and Tradeoffs in Election 2008

*Sept. 15: Macro Issues—The Recession,
Taxes, Deficits and Social Security*

Obama and McCain: The Key Macro Issues

Macroeconomic issues are interwoven

- Taxes
- Federal budget deficit
- Social Security
- Recession / credit crunch / housing finance crisis
- Trade

Tax Issues

- Tax rates
- Alternative Minimum Tax
- Bush tax change sunsets
- Fundamental system change, i.e. flat tax or VAT
- “Tax reform”

McCain - Taxes

- Individual income tax rates unchanged
- Corporate income tax reduced from 35% to 25%.
- “Phase out” AMT

McCain tax continued.

- Faster expensing of equipment
- Greater R&D tax credit
- Ban any taxes on Internet or cell phones
- *End deductibility of health insurance premiums**

Obama - Taxes

- “Making work pay” tax credit \$500/\$1000
- Increase in tax rates for high income (over \$250,000) taxpayers
- Increase education and child care credits
- Eliminate taxes for seniors under \$50,000
- *Estate tax reverts to pre-2001 provisions in 2010**

Joel Slemrod's* assessment

Panel at Humphrey Institute,
September 4, 2008

* Paul W. McCracken Collegiate Professor. Professor of Business Economics and Public Policy. Professor of Economics, University of Michigan

Big-Picture Similarities

- Both would retain most of the Bush tax cuts.
- Both would make the Research and Experimentation Credit permanent (but different).
- Both would limit, but do not repeal, the Alternative Minimum Tax.



Big-Picture Differences

- McCain would collect considerably less in tax, about \$100 billion per year less.
- McCain emphasizes business tax cuts.
- Obama would raise more revenues from high-income people by returning to Clinton-era rates for those making more than \$250,000 per year.
- Obama would collect less from middle-income people, through a series of targeted tax cuts that are reminiscent of Clinton-era policies.

Big-Picture Lessons

- There is no sign of fundamental tax reform.
- There are mixed signs about whether Congress will wean itself from using the income tax as a delivery mechanism for scores of subsidy and reward programs. McCain seems more likely to address this.

Big-Picture Lessons (cont'd.)

- There is no sign that policy will address the long-term fiscal imbalance between the promises in Social Security and, especially, Medicare and our (un)willingness to tax ourselves to pay for it.

Ed's Real World assessment

- Differences in proposals are less important than rhetoric suggests.
- Tax Policy Center (Urban / Brookings) estimate of \$5.4 trillion deficit increase for Obama & \$7.4 trillion for McCain, 2009-2018, ceteris paribus probably accurate but ...
- Opportunity for reform lost again.

Deficit Issues

- What specific spending to cut?
- Raise taxes as alternative to borrowing (abroad)?
- Political feasibility / international credibility of proposals?

Obama - Deficit Plan

- Reinststate PAYGO Rules
- Reverse Bush Tax Cuts for the Wealthy
- Cut Pork Barrel Spending
- Make Government Spending More Accountable and Efficient
- End Wasteful Government Spending

Obama deficit continued ...

- Make the Tax System More Fair and Efficient
- End Tax Haven Abuse
- Close Special Interest Corporate Loopholes

McCain - Deficit Plan

- *“Reasonable economic growth.*
- *Comprehensive spending controls.*
- *Bi-partisanship in budget efforts.”*
- One-year freeze on non-military discretionary spending.
- End earmarked appropriations.

Real World assessment

- BOMFOG from both candidates
- Failure to take deficit reduction seriously in past now compounds difficulty at present and for years to come
- American public has not yet reached a consensus that deficits matter.

Social Security Issues

- Baby Boom funding shortfall?
- Medicare funding problems?
- Fundamental change to model, i.e. personal accounts?

McCain - Social Security

“Reform Social Security: John McCain will fight to save the future of Social Security, and he believes that we may meet our obligations to the retirees of today and the future without raising taxes. John McCain supports supplementing the current Social Security system with personal accounts – but not as a substitute for addressing benefit promises that cannot be kept. John McCain will reach across the aisle to address these challenges, but if the Democrats do not act, he will. No problem is in more need of honesty than the looming financial challenges of entitlement programs. Americans have the right to know the truth and John McCain will not leave office without fixing the problems that threatens our future prosperity and power.”

Obama - Social Security

“Obama is committed to ensuring Social Security is solvent and viable for the American people, now and in the future. Obama will be honest with the American people about the long-term solvency of Social Security and the ways we can address the shortfall. He will work with members of Congress from both parties to strengthen Social Security and prevent privatization while protecting middle-class families from tax increases or benefit cuts. As part of a bipartisan plan that would be phased in over many years, he would ask those making over \$250,000 to contribute a bit more to Social Security to keep it sound.”

Real World assessment

- Both as unspecific as possible – probably good
- Points to McCain for saying (at least temporarily!) that everything is on the table
- Points to Obama for willingness to whisper higher taxes
- Make your own subjective judgments ...

Trade Issues

- Seek multilateral (WTO-Doha) agreements?
- Seek bilateral (NAFTA) deals?
- Withdraw from / modify existing agreements?
- Modify domestic policies that distort trade?

Obama - Trade

“Barack Obama will fight for a trade policy that opens up foreign markets to support good American jobs. He will use trade agreements to spread good labor and environmental standards around the world and stand firm against agreements like the Central American Free Trade Agreement (CAFTA) that fail to live up to those important benchmarks. Obama will also pressure the World Trade Organization to enforce trade agreements and stop countries from continuing unfair government subsidies to foreign exporters and non-tariff barriers on U.S. exports. Obama will fight for stronger protections for U.S. intellectual property, and – in the case of China in particular – an end to an artificially devalued currency that puts U.S. companies at a perpetual disadvantage.”

McCain - Trade

“John McCain believes that globalization is an opportunity for American workers today and in the future. Ninety-five percent of the world's customers lie outside our borders, and we need to be at the table when the rules for access to those markets are written. To do so, the U.S. should engage in multilateral, regional and bilateral efforts to reduce barriers to trade, level the global playing field and build effective enforcement of global trading rules.”

Real World assessment

- Most economists would agree much more with McCain than Obama on trade.
- General public probably agrees more with Obama than McCain.
- Neither would rock the boat on existing agreements under normal circumstances.

- Restrictions on trade and immigration always are popular in times of economic crisis.
- Great Depression shows the dangers of trade demagoguery in a shrinking economy.

General Observations

- Neither candidate gets particularly high grades from economists
- Either candidate probably better than choices we faced in past or might have gotten this year.
- Prudent citizens will weigh many factors when deciding how to vote.

- As in 1932, real issues will be substantially different on Inauguration Day than what were thought to be during campaign.
- Choose candidates based on your overall evaluation of their experience, prudence and character, not on their campaign briefing documents.
- Events are in the saddle, and what the new president will be able to do about growing economic problems is limited.

Good Luck!

We live in interesting times.
Learn from them!

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