Peterson Institute for International Economics

Unpacking the consequences of the new US tax and budget legislation

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[00:00:15.05] - Kimberly Clausing

Hello everyone. Thanks for joining us today for this event on unpacking the consequences of the new tax and budget legislation. I'm Kimberly Clausing, and I'm going to be moderating our conversation today and contributing to it. So let me start with a self-introduction. I'm an economist a non-resident senior fellow at the Peterson Institute. I'm also a professor of tax law and policy at the UCLA School of Law. And during the first part of the Biden administration, I headed the Office of Tax Analysis at the U.S. Treasury. Let me introduce my co-panelists and then set the stage a little bit, and then we will be going through remarks in roughly the order that I'm introducing them, and then we will have plenty of time for conversation among ourselves and questions and answers. So first we'll hear from Jason Furman. He is He is also a nonresident senior fellow at the Peterson Institute. He is also a professor of practice jointly at the Harvard Kennedy School and the Department of Economics at Harvard. During the Obama administration, Furman served 8 years as a top economic advisor to the president, including a time as the 28th chair of the Council of Economic Advisers during Obama's second term.

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Next, we will hear from Joshua Rauh. He is the Orman Family Professor of Finance at the Stanford Graduate School of Business and a senior fellow at the Hoover Institution. He formerly He served as the chief economist at the Council of Economic Advisers during the first Trump administration from 2019 to 2020. And then we will hear from Maury Obstfeld. He is the C. Fred Bergsten Senior Fellow at the Peterson Institute and the Class of 1958 Professor of Economics Emeritus at UC Berkeley. Among his many achievements, Maury Obstfeld has served as the chief economist at the International Monetary Fund and as a member of the U.S. President's Council of Economic Advisers, also during the Obama administration. So before we get started with our individual remarks, allow me to set the stage with just a few preliminaries about the bill. This bill is often colloquially referred to as the One Big Beautiful Bill Act. And I think we can certainly agree with elements of that description. It was one bill, and we— that was a strategy

that I think worked well for the president and the Republicans in Congress to do this as one. In one fell swoop. It is certainly big legislation with far-reaching implications for our tax code.

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Whether it is beautiful is a harder question. In my view, not so much. And many tax policy experts have found things to critique here, although there are some good elements of the bill as well. Nonetheless, it certainly has huge consequences for fiscal balances, for the tax system, for fairness and who pays taxes, and very interesting interesting interactions with other elements of the president's policies, including trade policy, which is something at the core of what we're working on here at Peterson. So let me just start out with a couple, um, big picture elements of what the bill does, uh, so that everybody is on the same page, and then we'll dive into the individual remarks. At the core of the bill are provisions that make the Tax Cuts and Jobs Act temporary provisions permanent. The fiscal cost of doing that is about $3.7 trillion. $1.2 trillion. If you compare that to the fiscal cost of the bill as a whole, you'll see that the remainder of the bill is roughly deficit neutral. So one way of thinking about this bill is that the primary deficit impact was just to extend things that were otherwise going to expire.

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Those things included individual provisions that cut taxes for many households and also included the pass-through business provisions and the estate provisions. There were also new tax cuts included in this legislation, including many that the president campaigned on, uh, that we can discuss later as well. And if you add in some other new tax cuts, you get about $400 billion in additional tax cuts that affect individuals, as well as another almost $1 trillion in business tax cuts, which are either reversals of built-in business tax raisers that were otherwise occurring due to the Tax Cuts and Jobs Act provisions, or some new business tax cuts as well. There were some deficit-reducing elements of the bill as well. Prominently among those was reduced Inflation Reduction Act green tax credits with a net reduction in subsidies for clean energy of about $500 billion. There were also big spending cuts to Medicaid and SNAP, some of which only kick in with a delay that, that save about $1 trillion. So when you add it all up, the net fiscal cost of the bill is about $3.4 trillion according according to the CBO and the JCT who track these things. It will also generate an additional $700 billion or so in interest costs.

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So we're looking at about $4 trillion in additional deficits. Some of these provisions are temporary. If those were fully extended, as has often been the case in the past, then the deficit would be much larger at about $5.5 trillion of additional deficit. So that's kind of the big picture of

what the bill does. Now we're going to turn to our panelists for more perspectives on the bill, starting with, with Jason.

[00:05:40.04] - Jason Furman

Great. Well, it's great to be with all of you. And I was also going to begin by agreeing that it was one, agreeing that it was big, and saying that beautiful is something that is debated. On the big part, there is a fiscal element to all of this, and then there's structural policy in three major areas. On the fiscal side, in January, the Congressional Budget Office projected the debt was going to continue rising as a share of GDP, rising to 118% of GDP by the end of the decade. When you look at that forecast, it in my mind optimistically assumes that the 10-year interest rate is going to fall back down to something like 3.8%. Assumes a pace of immigration well above what we have right now. Although it is possible that AI means that productivity will be a little bit higher than they assumed. But all in, arguably, that was an optimistic forecast. After the one big beautiful bill is done, even factoring in continued tariff revenue, We are on course to have debt that is higher than that. Um, how much higher depends on whether certain provisions, um, get extended, what interest rates are, what productivity is.

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But at this point, debt is on an upward path as a share of GDP for the indefinite future, with the only question mark, um, being how much. Moreover, on the policy side, there are now several risks, almost all of which are towards higher debt, not towards lower debt. One risk which Kim had is a set of tax cuts expire. Moreover, the SALT threshold also has a more generous threshold which itself expires. Take all of that together and it's about $100 billion a year to make all of that permanent. The second fiscal risk is that a lot of people, as they were passing this law, said that they would not let the full Medicaid provisions go into effect. Several of the people who voted for the law said their vote was effectively contingent on these provisions being undone at some future date. There's some scope for undoing them potentially through executive action. And of course, they can be undone legislatively. How much fiscal risk is there in that? Maybe even another $100 billion a year. And then finally, we have a set outside of the bill, a set of tariffs that are of disputed legal status, and courts will be making decisions on them that don't reflect the will of, um, the Congress are not enshrined in law.

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And from a fiscal perspective, also, those tariffs are more likely to go down than up at some point. So in some sense, they also are a fiscal risk that we've chosen to make so much of our financing dependent on something that Congress, um, never signed off on. So at this point, um,

not only is the debt rising as a share of GDP But the policy risks are that it could rise more quickly. The economic risks, I think, are also that it could rise more quickly. There is an upside for AI, but there is the downside for interest rates and the vicious cycle of debt driving up interest rates, interest rates driving up debt, and that process working itself out. The second thing I would say is what is remarkable is yesterday I was looking back at an article from 2001 that somebody sent me.. And so much of the fiscal debate then was about Social Security and the looming problems, um, in Social Security. Social Security, according to the last trustee's report, is going insolvent in 2033. After this law, um, that insolvency date is going to move forward, um, likely to 2032. Um, in that sense, it's sort of breathtaking that Washington put all this time and effort into every single structural issue that we have other than the one that actually has a deadline and that becomes harder and harder to address the closer you get to it.

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In fact, if you look at the cost of this bill relative to current law, it's about 1.5% of GDP. That is as large as the present value of the shortfall in Social Security plus Medicare hospital insurance combined. This wasn't some small technical thing. In some sense, we legislated and locked in something to the fiscal gap as large as the whole imbalance we have in Social Security and Medicare hospital insurance. Let me briefly say a few things about the structural aspects of the bill. Ignoring the tax rates, what was made permanent on the individual side was broadly quite sensible. It has a higher standard deduction. It simplifies taxes. It does good things with the child tax credit. That all could have been done on a revenue-neutral basis. The entire cost of this law was— almost the entire cost of this law was in terms of reducing the tax rates. And, you know, Josh has estimates of that, others have other estimates, but there's no estimate that's been published by any group that shows that that would offset more than 20% of its cost. And many of the estimates, including the Congressional Budget Office or the Dynamic Score, would add to the cost of the bill, not subtract to it, when you take into account things like it driving up up interest rates.

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The rates are unaffordable on the business side. Kim can go into more detail. I happen to think expensing was a thought— was a good thing to have done. It actually costs relatively little on a present value basis. A lot of the cost in the 10-year window is just pulling forward costs we would have had. It's unfortunate though that we didn't do it without restructuring other aspects of the tax code that should have gone together with it. For example, disallowing interest deductions, which would be the standard thing that I think almost any economist would say you should do. So unfortunately, it was sort of hastily ad hoc tacked onto something that didn't deal with the other aspects. The Medicaid changes will, according to the Congressional Budget

Office, result in 12 million people losing their health insurance. And will be, in some sense, um, if I were making the recommendation, the last place I would go with deficit reduction. It's one thing to say we're going to cut Medicaid, but we're also cutting Medicare, Social Security, and raising taxes, and everyone needs to chip in to make the budget work. Um, to my mind, it's another thing altogether to say the only people that we're imposing substantial sacrifices on is this population, um, together with regulatory changes and the expiration of the premium tax credit, the uninsured rate will undo about 3/4 of the improvement after the Affordable Care Act.

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It's a very, very substantial health policy. And then finally, on energy, it repeals much of what President Biden did on clean energy. I don't think what President Biden did was the first best thing that could have been done. To repeal or replace it would have been completely fine with me. There are a few things there where it's repealing basically subsidies for American manufacturing, which I think again has relatively little to do with climate change. But some of those tax credits did have relatively high bang for the buck. And most analyses I've seen show that the cost of them far exceeded the social cost of carbon. And so now they're leaving us in a place where, we took away the way we were dealing with climate change and didn't add any new one into it. So in summary, I agree the bill is big. It locks in a fiscal course. It puts lots of upward risk on that fiscal course. It ignored the biggest looming fiscal issue we have. In fact, it made it worse, not better, and asked for sacrifice from all the wrong people.. But other than that, it was beautiful.

[00:14:52.25] - Kimberly Clausing

Thanks, Jason. While we're going to Josh, let me remind the audience or tell the audience that if you have questions, there'll be time for them at the end, and you can start putting them in the Q&A whenever you see fit. Josh, you're up next.

[00:15:05.00] - Joshua D. Rauh

Thanks very much, Kim and Jason. Really a pleasure to have this opportunity to join the panel today. And indeed, as they say, you know, beauty is in the eye of the beholder. I think there's a little more beauty in this bill maybe than some of my other fellow panelists here. Maury, also great to be on the panel with you. But let me start by saying that I think actually Jason and I share a number of takes on this bill and on the general fiscal situation. You know, some of the things that Jason said that very much resonated with me are, number one, I'm generally very concerned about our nation's fiscal trajectory and our debt trajectory. I am also concerned about the question as to whether some of the provisions that are in the bill, the OBBA, will potentially

be undone, such as the Medicaid cost-saving provisions, whether those could potentially be undone. And then we, of course, would not see those, see those cost savings. Generally concerned about things like the salt cap, which for economists who, like myself and I think like Jason and most economists who prefer lower rates and a broader base, that salt cap at $40,000 through through 2030 came in higher after a lot of wrangling, higher than I think those of us who like a system with lower rates and a broader base would like to see.

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And there's a real question about what's going to happen in the future with that, given the various political dynamics. And I'm also very concerned about the fact that nothing has been done on Social Security or Medicare in this bill, despite the deadlines and despite, as Jason, I think, very precisely said, that it becomes harder and harder to address as those dates draw closer. And, you know, in general, I also very much praise the business provisions of the bill. I think those are really the beautiful, some of the most beautiful provisions of the bill. And I praise those because I also favor us moving more in the direction of a cash flow tax. So I'd like to see even broader expensing of capital. I think it was also good that we began to introduce for structures some expensing for qualified production facilities. And of course, I'd also like to see more interest limitations. I think Congress did the right thing by returning the measure, the base to EBITDA, a measure that includes capital expenses as opposed to one that does not, earnings before interest and taxes, without the DA. The reason being that I think if you don't have capital expensing or you don't have interest limitations based on EBITDA, you end up biasing the code against companies that have shorter capital lifetimes.

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So anyway, so I think there's a lot there that we agree on there. I think, you know, some of the places where I think we may part ways in how we view it and where I may find some provisions of the bill better than Jason and also may not be as worried about some of the costs, the CBO, the scored costs of the bill, have to do with a few things. And for that, I'm going to share a few slides, if that's okay. So let me put those up. So, so first of all, so this graph shows for rolling 10-year windows, the fiscal picture before the One Big Budget Bill Act and the CBO projections afterwards. And the real action that I see in this graph is kind of in the middle. We see revenue that is somewhat lower during the first two decades of the 2000s than we had during the Clinton years of the mid-1990s. But what we see more strongly is the rise in non-interest outlays. That our non-interest outlays are rising at a very rapid and unsustainable pace. And so I think that's the first observation, the graph. And the second is that the One Big Beautiful Bill Act doesn't really materially change this picture.

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Now, when you see what it does with spending, the spending cuts there are really fairly minor. What's going on with this drop here on the right-hand side of the graph, that's just related to the expiration of a lot of the COVID-era error provisions and the cuts in the OBBBA, which are really slowdowns in the rate of spending growth on Medicaid, primarily and also the Medicaid work requirements. Those are a pretty, have a pretty small effect. They're material, but they're still relatively small, amounting to 0.3 or 0.4% of GDP. Now, what about the revenue? Okay, so this graph shows the scored revenue changes under OBBA versus no OBBA under the CBO. So from the CBO's estimated budgetary effects of the law. And you see here, there is a divergence that comes in between these two amounting to around 1% of GDP of revenue again. So I'm going to make two points about this. Number one is the issue is more largely in the spending category than in the revenue category. I think this graph shows that. And secondly, my view about the CBO's scoring and the JCT scoring of the act is that it overstates the costs.

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And that's based on a couple of things. So it's based on actually a couple of some papers that I've written recently, primarily one of them on the business side about firm investment and the user cost of capital with John Hartley and Kevin Hassett. And that, that paper looks at Tax Cut and Jobs Act variation across BEA asset classes. It uses the standard Auerbach and Hassett and Cummins-Hassett and Hubbard specifications. And using the TCGA variation, it finds elasticities of investment with respect to the user cost that would be in the range of -1.8 to -3.5 versus the CBO's -0.7. So it's not that I think the CBO is doing anything partisan or doing anything structurally wrong, although I will say the— what is structurally motivating the literature are the Auerbach and Hassett specifications of the investment rate as opposed to the investment level. But that being said, I think the real issue is about the parameterization. And then also on the individual side, the evidence that I've published about the experience of California, which raised top marginal tax rates from 10.3% to 13.3% in 2012, it's now 14.4%. That's a 30% increase in the top bracket marginal tax rate.

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And what I find there is an elasticity of taxable income of 2.6 to 3.0 for top bracket taxpayers who stay in the state. So, you know, one of the challenges of using states to understand things that might be relevant for federal policy is taxpayers are a lot more mobile across states than they are leaving the United States. But that elasticity is just based on top bracket taxpayers who who stay, I would argue it's a clean experiment. So my belief is that the parameterizations that are used in the JCT and CBO scoring are too low. And I want to also emphasize this not only through GDP, but also through avoidance and evasion, which we know from a fairly extensive

literature might make up a fairly large part of behavior, of estimated behavioral responses. And, you know, one of the calls I want to make actually coming out of this whole debate about the big beautiful bill is I think the scoring, it would have been much easier to resolve some of these issues had there been somewhat more transparency in the JCT and the CBO models. And in fact, I've called and will continue calling until it's done or maybe until, you know, I can't do any more calling in my life, lifetime, for the source codes to be made public for the JCT and CBO scoring.

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I think that would be preferable to having different kind of pop-up labs like the Yale Budget Lab or the Penn Wharton Group, which I think are doing, you know, they all do great work, but it, you know, trying to replicate something that actually we could sort of all get closer to agreement on if it were made transparent, if it were made public, the source codes were made public.

[00:24:51.14] - Kimberly Clausing

Josh, not to interrupt too much, but just letting you know you're at 9 and a half minutes because I know you're—

[00:24:56.03] - Joshua D. Rauh

Okay, well, then I'm just going to skip. I'm going to skip to the end. So bottom line, I think, you know, under Behavioral responses will be consistent with recent studies. I think the revenue impacts of the bill tax cuts will be considerably smaller than the CBO JCT projections. That's due to both effects in both conventional and dynamic scores. I don't claim it's going to be— the cost is going to be zero. I think there's about $800 billion cost in the child tax credit, for example, which does not have big growth effects. I don't think it's zero. I do think these are pro-growth tax cuts which do increase long-run GDP. I am very concerned about the debt situation, about the interest cost burden, which I've, which I've written, although I do also think that Congress should still be taking measures if possible to increase long-run GDP if they have small fiscal costs. Exactly how much fiscal costs? Would like CBO and JCT to fully publish their models. And finally, you know, just want to end with echoing, I think, the very big problem, which is that Congress should be very concerned about the debt and the interest cost burden.

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Separately, I've calculated 2035 interest payments as a share of non-Social Security revenue at 30%, currently at around 24%. So I would say that we should be very concerned about that, but shouldn't try to fix it with tax increases. So thanks, and sorry for running over.

[00:26:13.22] - Kimberly Clausing

No problem. Thank you. So I'm going to go next and hopefully leave enough time for Maury as well. So let me just share my screen. I've got a few slides up here as well. Okay. So looking at the bill through the classic tax policy priorities, the first 3 I think are very familiar to public finance economists. We think about the revenue impact, the efficiency, and the fairness issues or progressivity of the bill. I think tax administration is also important. Can you administer the law? How well does it work in terms of compliance and enforcement burden. And then I'm going to add a fifth criteria, the sort of international collective action problems. So when thinking about this bill, I agree with Jason and Josh that the revenue shortfall is very concerning. And I just wanted to mention that I think that this affects normal, regular households and taxpayers in some really important ways. In addition to affecting the macro picture, the macro picture, of course, is interest rates will be higher than they would ordinarily be, and that can harm investment even you're trying to encourage investment through things like expensing, if interest rates are going up at the same time, you're undoing some of that benefit, which is why outfits like CBO and Penn Wharton and Budget Lab have all found that dynamic estimates of the cost of this bill can exceed the static ones because of these negative effects on interest rates.

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But interest rates affect households too, right? It makes the cost of their debt-financed purchases higher. It means that more of their tax goes to interest payments than to other government goods and services. And one way of thinking about that is to say, okay, we sort of told people that we were going to cut government spending by cutting Medicaid and SNAP, and we saved $1.1 trillion on that. But that savings, $700 billion of it is being offset by higher interest costs because of the debt finance. So if you think about what the taxpayer is getting, it's kind of harming the most vulnerable among us without necessarily actually reducing the deficit because of all this debt it sit financed interest. But I think one of the big issues is the absence of fiscal space. And what if there is another recession? What if there's a war? What if there is a pandemic? You want to have some fiscal space to respond to things. And if the government's already maxing out the credit card, that's harder. On the efficiency front, I am, you know, like Josh and Jason, I think we can point to positive things from expensing.

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I think one useful thing we might discuss in the Q&A is, is how to pair that with other tax policy reforms. I think in terms of interest deductibility, this legislation actually goes in the opposite direction of restraining that and loosening the restraints on, on interest deductibility. So as, as

much as it may be efficient to encourage more investment in R&D, I think there are other things in the bill that kind of harm efficiency, including the, the new Trump tax policy priorities, many of which create new sources of of horizontal inequity in the tax code, but also extending the pass-through deduction. And, you know, dealing with some of the other negatives associated with, with this bill, I think, make it unclear that the bill on net enhanced efficiency. In terms of tax administration, I think there are a lot of things here that are complicated and difficult to administer. I would just make a plug for rethinking the cuts to the IRS, which have already lost 25% of their staff just since the Trump administration, second Trump administration started. So this is going to create a lot of difficulty in terms of administering the tax code.

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But I'd like to spend the balance of my time talking about the fairness implications and the international collective action problems. So in 2024, in the summer of 2024, I did some analysis of the the Trump economic plan, combining the extensions of the Tax Cuts and Jobs Act, which you see in the blue bars here, with the effects of tariffs. And here I'm looking at the biggest Trump campaign proposals, which was a 20% across the board plus 60% on China. And that gets you the red bars of, of income effects. And what you see is the combination, which is in the gray bars, is highly regressive in the sense that only the very richest households benefit on net from this agenda because their tax cuts outweigh the tax increases that are coming from the tariffs. Whereas for the 80% in the bottom of the distribution and even the top quintile, it's unclear that they on net benefit. Now, this was done prior to the election of President Trump, and his policies have evolved. The Tax Cuts and Jobs Act extensions have been accompanied by new things, including cutting cuts to the safety net at the bottom, but also some new tax cuts.

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And the tariff proposals have also evolved. So if you look at how this picture has evolved, the Budget Lab has, has done some analysis that's— that finds actually a very similar picture to what we found ahead of the, the administration, but includes a lot of subtleties that we weren't able to model, including the actual tariff increase that we see at present. So this was done you know, about a month ago, but also the spending cuts. And so you see the spending cuts are particularly hurting those in the bottom 3 deciles, whereas the tax increases are dominant for those in the middle relative to the tariff tax increases relative to the tax cuts from Tax Cuts and Jobs Act. And it's only those in the top decile who are really on net benefiting from this agenda, that black circles that you're seeing are showing you the net of the OBB legislation and the tariff increases as of the time of that writing, which was about a month ago. So that distribution picture, I think, is concerning in part because it really goes against the sort of populist narrative of this administration. But it also, more importantly, you know, is taking a society that is already

suffering from polarization and the sense that people are being left behind and sort of compounding that problem by lavishing better tax treatment for those at the top, including this big expansion of the SALT deduction that was referred to earlier, which is going to generate, you know, thousands of dollars of tax benefit for a lot of well-off households while asking for the sacrifice at the bottom.

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So that's one concern that I have with this legislation. Another concern is backing away from international collective action problems. So Jason already mentioned, I believe, that the Inflation Reduction Act tax credits are certainly not perfect, and I am completely on board with that. I've done some analysis myself that suggests that you could, you know, replace half of them with a modest carbon fee and dramatically improve the emissions trajectory. But even as they were, they did pass cost-benefit analyses when you compare it to the social cost of carbon, and they did result in a lot of emissions reduction. So the emissions reduction only got us about halfway to our Paris commitments, but it was an important emissions reduction alongside regulatory improvements in the power sector and in the auto sector. Now we're in a scenario now where if you compare the trajectory prior to the Trump administration, that's the blue dotted line, to the one at present with regulatory rollback and with repeal of the Inflation Reduction Act credits, which is the red dashed line where we're not going to see anywhere near the emissions reductions we would have seen. And when we look at the extra energy use coming from AI, this picture is actually probably a little bit optimistic.

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So I think backing away from our commitments on climate is problematic. I would just point out with my final slide here that this isn't the only area where we've backed away from international collective action. In 2021, the vast majority of the world representing about 95% of the world economy, those governments agreed to implement a minimum corporate tax of 15% on multinational companies. Now, 55 jurisdictions, all those that are in kind of light blue on this map, have implemented that agreement. But this legislation, while not as bad as it could have been in that regard, because at first it included this sort of revenge tax, to sort of target the countries that were implementing the agreement fully. But this legislation does sort of step away from US commitments on international tax cooperation as well, in part because there was an agreement with the G7 or the remainder of the G7 prior to this legislation to, to create a sort of a parallel system for the United States where US multinational companies would be treated treated differently from those in the rest of the world. This, alongside with trade cooperation, public health, international aid, and even security commitments, are all areas where the United States is stepping away from world leadership.

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And I think one really interesting question for the future is whether the other countries can continue their efforts. I've got one suggestion in a, in a working paper that's just posted on Peterson about how the rest of the world might move forward on climate., but that's going to be needed in, in a lot of other areas as well. So I'm going to turn next to Maury, and then we will have time for questions and answers after that. Great.

[00:36:22.20] - Maurice Obstfeld

Thank you, Kim. It's a pleasure to be here on this panel with this, this group and to follow up with a more of a global perspective focusing on U.S. government borrowing The, let me see if I can get this to advance. Okay, here we go. As Kim pointed out at the outset, the bill adds considerably to prior deficits. Reconciliation was carried out under a baseline that I think somewhat deceptively assumed that the TCJA tax cuts had been put in place to be permanent tax cuts. If you, if you take that fiction seriously, then you get the picture on the left, which is a CBO-generated picture of of the effect on the deficit and changes in outlays and revenues, not including interest. And you can, you can see that one, one feature of the bill is that the, the tax cuts are front-loaded relative to the spending increases, the spending decreases, the spending decreases come much later. And I think this is a very politically motivated feature of the bill that really goes against any sensible public policy consideration. But if you, if you go with the baseline that was in place in January 2025, which is the current law baseline, things look, look much worse.

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And this is essentially where, where Kim's $4.1 trillion, increase in debt over a 10-year window comes from. So this is really, really big relative to what CBO was already forecasting, which was worrisome in, um, uh, uh, the, uh, the, uh, uh, run-up to the Trump administration. Now, uh, one factor that will come into play in what the overall deficits turn out to be is tariff revenue. Um, Kim and I are working on a paper on this right now, and just to show one, um, exercise we do, um, we look at various, uh, preference specifications to see what could be raised at different tariff rates. We seem to be settling on something that is around 18% on average. And at that rate, in this exercise, you might get slightly north of $300 billion, uh, dollars in revenue a year. Now, this is a very optimistic forecast because it doesn't take into effect macro effects, which are likely to be negative, and also tax offsets elsewhere in the system, which are definitely going to be negative. So even if you're pretty optimistic on tariff revenue, which as Kim pointed out is a very

regressive way of raising money, it really takes us back to the 19th century, which I think is part of the design here.

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You just leave a big hole in the deficit, which still has to be filled. Um, these are also provisions that are, that are probably going to be very hard to unwind by future administrations, given that, um, they're, they're really necessary to prevent the deficit from blowing up completely. Now, this implies a lot of Treasury issuance, and, um, global markets are going to need to absorb a lot of profit. This graph shows that in, uh, uh, 2011 or so, um, about half of outstanding Treasuries were owned by foreign countries. Now the number is closer to 32 or 33%. Foreigners will still have to absorb a lot of Treasuries. The bulk will have to be absorbed domestically. And this raises a question, um, how do we absorb those domestically given our low, uh, private sector saving rate? Uh, it could be that investment suffers. It could be that we, uh, borrow a lot abroad in order to be able to buy these treasuries. And in the latter case, you have to wonder how the Trump administration's go balancing overall US foreign trade is even, even possible. The degree to which foreign investors continue buying Treasuries will affect the sustainability of this trajectory because the foreign, foreigners are the marginal lenders here and their demand is going to depend on currency risk and by implication, inflation risk.

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The dollar's continuing liquidity and its role as a world currency. The US willingness to maintain open capital markets and support the dollar ecosystem. Kim mentioned the revenge tax, which was a very worrisome development in terms of the US commitment to open financial markets, even if it didn't ultimately come to pass. Um, fears of dollar weaponization by the administration, which I think have been heightened by other coercive actions, uh, concerns about financial stability in an environment where financial deregulation is being pushed harder and where a major push in realm of stablecoins and crypto is underway with unknown implications. And there were strains in all of these areas. I think the, the ongoing attacks on the Fed will make investors wary about increasing their dollar positions, their Treasury positions. And we may see more fireworks this week when the Fed doesn't cut interest rates. And as Jason introduced, and I I think the other panelists agree. We're facing upcoming crises in Social Security and Medicare, which will be very destabilizing for markets when they start to approach even closer without concerted action by the Congress. Dollar flight could raise borrowing rates in a vicious circle. And in fact, we did have periods in the past, such as the 1970s, when the dollar's international position eroded, and the recovery from that was only gradual.

[00:43:43.23]

And you can see that erosion in the gray line here showing international reserves, uh, held in dollars, uh, as a percent of total reserves. Uh, the funding environment is deteriorating generally. Um, studies of Treasury yields show that the convenience yield and on treasuries and the longer-term term premium advantage are declining as the covariance in the return on stocks and bonds rises, as it has in some recent episodes, it becomes more expensive to issue long-term Treasuries. And in a more inflationary environment, which would come about through kneecapping the Fed, that is more likely. The same is true of positive shocks between U.S. capital outflows and global shocks, such as we saw back in April Uh, a number of studies show that the convenience yield on longer-term Treasuries has been falling. And, uh, uh, studies also show that a big factor here is increasing supplies of Treasury assets, which have been driving up borrowing costs for the Treasury. Um, uh, the Treasury could move to more short-term issuance. To lower fiscal costs, but that would lead to greater rollover risk. Uh, one factor that Ken Rogoff emphasizes that I think is not discussed enough is, uh, the seniorage come that comes from the more than a trillion dollars in cash held abroad.

[00:45:40.03]

Uh, at current short-term interest rates, that's worth about $40 billion a year. That's not nothing. And it's put in danger by the push for stablecoins, which will transfer that seniorage to private stablecoin issuers away from the government. And finally, there's a huge risk of higher interest rates globally. Uh, we see, uh, a move toward, uh, relaxing budgetary rules in Europe and higher defense spending. Uh, uh, there may be more stimulus coming out of China. And if indeed AI does increase productivity, remember that will also tend to increase interest rates. So with that, I'll stop.

[00:46:28.16] - Kimberly Clausing

Thanks so much to all the panelists. There's a bunch of questions in the queue, but there's an area that I'd like to get to too, and I see Jason has flagged something as well. So let me, put out the first question and then we'll turn to Jason. Unless Jason, do you have something that's immediate that's responsive?

[00:46:47.26] - Jason Furman

I was going to comment a little bit on what some of the previous people had said, but I don't know whether we have time for that or not.

[00:46:54.17] - Kimberly Clausing

Okay, so let's, let me open with a question to you and then you can both use that to answer and then counter. I noticed one question in the queue, but also one thing I had wondered about hearing the exchange between you and Josh is about industrial policy, but I'm going to make this broader and talk more generally about investment as well, right? Because if we think about encouraging investment and growth in the US economy, I think that's something that almost everybody would agree is a good thing. We want investment and we want growth. But we've got a lot of confounding things going on at once. We've got a war on immigrants that is making our, not just labor shortages more likely, but also affecting the environment for foreign students. We've got less research funding. We've got changes in fundamentals, how the central Bank is being treated. And then of course we have the, the trade war itself, which is, you know, generating higher costs for anyone who has imported intermediate goods and fewer markets for those who would export to countries that are retaliating. And then of course there's the distinction between what's going on with the interest rate due to all this deficit and debts and the expensing goals, right?

[00:48:06.14]

So this president is supposedly about encouraging manufacturing, encouraging investment, encouraging growth. Both. But on the one hand, there's some tax policy things that are pushing in that direction. And on the other hand, there's this, you know, collection of other things that are moving in the other direction. So I guess for both you and Josh, how will we even know if the, you know, investment and R&D provisions are working in this environment? And then I think also, to the extent that you have a second to address it, like, maybe you could expand a little bit on the role of interest limitations here too, which I know have been moving in the opposite direction of what your prior work has suggested. So So let's start with Jason and then maybe go to Josh and then we'll see what else we can get through.

[00:48:47.04] - Jason Furman

Yeah. So, you know, as with everything, the aggregate macro data won't tell us because it'll have 100 causes. So we'll need to wait for a paper by my colleague Gabriel Treter-Reisch and others where they find like 2 firms that got slightly different treatment in their R&D and one of them expanded and one of them didn't and try to infer from that. More broadly though, I think the thrust of your question or the question is investment is not just about tax rates. Investment is about a predictable business environment. Investment is about having, you know, people that can give you higher return to that investment. It's about, you know, innovation with government funding, universities, all of that. And right now we're getting a number of those pieces wrong. Even when it comes to something like regulation in the energy sector. Yes, there's been deregulation of some types of energy production, but there has been increased regulation of

other types of energy production, of wind and solar, for example. So even there, um, there are ways in which I think this administration is properly described as increasing regulation in some areas, decreasing it, um, in others. And then finally, interest rates matter a lot, and anyone who listened to Moore should ask themselves whether you would make your budget plans for the country over the next decade, assuming that long-term interest rates are going to fall by 60 basis points.

[00:50:14.02]

That is what we are counting on with all the budget numbers everyone showed you. And that might happen, but that's certain— I wouldn't bet the country on a 60 basis point fall in interest rates when all of that is happening. In addition to investment, labor supply matters a lot. A bunch of our labor supply comes from immigrants. In fact, our labor force would be shrinking, not growing, were it not for immigrants. We're going to have less of that. And then there is the incentives of individual income taxes. Here, Josh has done, I think, some very good research that has moved my priors up and made me think people are more responsive to taxes, especially high-income people, than I'd previously believed. That actually is bad news for the fiscal outlook with the currently policy environment, not good news. Though, um, because it means that CBO's— it doesn't help the scoring of the OBBA. I think Josh was wrong about that. The reason it doesn't help that scoring is because if Josh is correct that people are really responsive to taxes, then CBO's baseline should have been worse because it should have had people cut back on work a lot when taxes cut rates went down, and then a larger delta.

[00:51:29.14]

But you end up in exactly the same place because tax rates aren't changing. Changing. Where are labor tax rates changing? It's through tariffs. Much of tariffs is effectively a tax rate on labor. You can't buy as much with your labor earnings as you used to be able to. And so your dynamic score of the tariffs would be much, much worse if Josh's elasticities are correct. And so that's a substantial downside risk to the fiscal trajectory. The very final thing I'd say is just, I think showing there's a small net change in spending, that's because there's big offsetting changes. We increased things like defense and immigration. Medicaid is being cut by about 15%. So very large change for that one program. But yes, as a whole, spending is largely unchanged because other areas of spending are increased.

[00:52:22.12] - Kimberly Clausing

Let's go to Josh next, and then I have a question for Maury that comes from the Q&A.

[00:52:26.18] - Joshua D. Rauh

Okay, great. Well, I mean, I guess I'll just say, you know, until I see a well-identified empirical study demonstrating the impacts of tariffs on labor, you know, that one can put up against the empirical studies that are out there and that I've worked on that estimate the impacts of income taxes on taxable income, I'm not quite convinced. At least the tariffs are going to have a worse impact on growth and taxable income than income taxes. I'm just going based on the empirical literature, but maybe—

[00:53:04.29] - Jason Furman

No, no, but that wasn't my argument, Josh. I was saying income tax rates stayed the same here.

[00:53:09.05] - Joshua D. Rauh

Yeah.

[00:53:09.13] - Jason Furman

So there's no sort of dynamic benefit to that. Whatever CBS minus in the baseline is a plus.

[00:53:15.02] - Joshua D. Rauh

No, I understand that.

[00:53:15.19] - Jason Furman

I was referring to your higher effective income tax rates rates this year than we had a year ago because tariffs have gone up.

[00:53:21.26] - Joshua D. Rauh

I was going to get to that. I was going to get to that. Okay. Well, first, I wanted to answer your point that you said tariffs are a tax rate on labor and that therefore, yeah, I mean, I'm speaking about the Delta. I generally agree that because people are so responsive to tax rates, our tax rates continue to be too high and need to be lowered. And so it is bad news for our fiscal trajectory if people are very responsive to high taxes because taxes are very high. I want to agree with you about the point you made about assuming that rates will drop by 60 basis points and all these fiscal projections are made based on that. You know, I've done some sensitivity analyses around that and show that you don't have to have interest rates be much higher for the, you know, interest payments to basically take over, you know, revenue, majority of

revenues very quickly. And on interest limitations, just quickly, I also want more interest limitations and, you know, the bill directionally in that sense didn't go in the right direction. However, I do think there's an issue with the way that it was implemented.

[00:54:23.15]

Until it's zero, it's better for it to be based on something like EBITDA than on EBIT. How do we see what's going on? Well, we need to look at micro studies where you can look at, for example, in our work across different BEA asset classes, there's always macro things you have to tease out. And then finally, just one quick point about progressivity. I think we always have to start out those progressivity discussions by pointing out that the US tax and transfer system is highly progressive. If you look at the CBO's numbers, the highest quintile is contributing $120,000 per household, lowest quintile is receiving $30,000 per household. The bill makes it slightly less progressive. It lowers resources for the lowest quintile by 2.6%. It raises resources for the highest quintile by 1.9%. But the question's always got to be in the context of where we're starting from. So, throw that in.

[00:55:16.14] - Kimberly Clausing

Okay. So I'll resist the urge to comment on that because I want to turn to Maury and some of these macro questions about the bill as well. If we go to the second question in the queue, it's reminiscent of the experience in the '90s, which I think many of us really admired some of the policy choices that happened in the '90s. '90s where fiscal responsibility enabled a kind of a grand bargain with the Fed where interest rates were low, but the deficit was being cut and we ended up in a surplus by the end of the decade and some really good macro outcomes that decade. So one question is, can we learn anything from that that would apply to now, or is this environment just too different? And then a related question in the queue that I'm going to also throw to Maury so he can do whatever combination of this that he would like is it comes from, I assume, Hank Aaron at Brookings or someone with a very similar name that said that some are surprised that tariffs have not affected inflation, but perhaps the value of the dollar depreciating has also not boosted inflation.

[00:56:25.26]

Perhaps there are other reasons, other things going on with inflation. What do you think will happen with the macro picture and inflation? So take whichever combination of those that you like, and then we'll see if we have any more time after that, but that might run us out.

[00:56:41.25] - Maurice Obstfeld

Okay, I'm going to try not to use up all the remaining time, but, and answer, you know, as much as I can. You know, on the policy package in the '90s, I mean, it was a, looks like a golden age now. And, you know, we finished the '90s with a budget surpluses and debt-to-GDP ratio even lower than when Ronald Reagan left office. So pretty impressive, low inflation, high growth. Of course, we had the internet and now we are hoping that AI will be similar, but I think we're in a much more dysfunctional political environment. I think if you were serious about about reducing the trade deficit, which is a prime goal of the, the President's tariff policy. You would adopt a combination of fiscal restraint and monetary ease. And that's the, the package the questioner mentions, which would, which would lower interest rates, bring the dollar down more, and bring about adjustment in, in the trade balance. But that's not what we're seeing. What we're seeing is a, uh, combination of fiscal largesse and, um, banging on the Fed to lower interest rates. And, um, uh, that's a, a, uh, recipe for not adjusting the trade deficit as efficiently and for getting a lot of inflation.

[00:58:23.08]

And it's, it's just actually reminiscent of the you know, the package that Nixon introduced in 1971 when he went off gold. Basically, he had tariffs. He did have dollar depreciation, but he also had a lot of pressure on the Fed to ease. He had wage price controls, he had tax cuts. And what we got was the inflation of the 1970s. So I think if you look at that bad precedent, um, that's more likely where we're, we're headed. Um, that being said, you know, we haven't seen at the macro level pass-through from tariffs or much so far from the dollar's depreciation. Um, uh, more micro studies, uh, that have been done by the Fed do show that, um, at the micro level we're starting to see tariff pass-through, but we've had a lot of other macro factors, for example, lower energy prices, lower rental prices that have been pushing in the other direction. So, you know, we don't really know the counterfactual here, but I do think that eventually the tariffs will feed through and I think the depreciation will feed through. If you're a foreign firm selling into the United States, and we have to remember here that most of them, invoice in dollars.

[00:59:49.25]

So unlike for the case of countries that, import goods invoiced in dollars, when their currencies depreciate, prices rise immediately. In the US, when the dollar depreciates, that doesn't happen immediately. But for those firms, their profits measured in their own currencies go down when the dollar depreciates. And so eventually they're going to raise prices. One of the facts that is, that I think, I think is not acknowledged sufficiently is that, uh, and I guess I'm sorry, I have used up the remaining time, is that with the dollar so much weaker, financial conditions are really, really loose. You can't just look at the interest rate that the Fed sets, but you have to look at the

stock market, look at the dollar. We're already in an environment of loose financial conditions, I think that more than justifies what the Fed is likely to do this week.

[01:00:47.13] - Kimberly Clausing

Thanks so much. Um, so let me just close with one observation and then thank the panelists. Um, I think the observation is that with respect to investment and the effects of tariffs and the entire, uh, very interesting economic environment that we're in, we have a lot of experiments that are happening simultaneously. We're going to need some of the the best, you know, research in the world to really pick apart the causality here, which I think is going to be very difficult and interesting and should be fodder for a lot of great research at Peterson and elsewhere in the time ahead. A huge thank you to Jason and Josh and Maury and Peterson for putting this together. I think this has been a really useful conversation. I'm sure it's raised a lot more questions than it's answered, but hopefully we will continue working on that in the time ahead. And thanks to the audience for attending. Standing. Thanks everyone.

[01:01:39.09] - Joshua D. Rauh

Thank you.