Rebuilding the Global Economy
A series outlining policy priorities and solutions

MEMORANDUM ON

STRENGTHENING THE US ECONOMY TO FOSTER REBUILDING AND RECOVERY

To: Chair of the Council of Economic Advisers
From: Karen Dynan
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Background: Global economic activity plunged earlier in 2020 due to the fallout from the COVID-19 pandemic. While most countries have experienced some recovery, the pace at which activity is picking up has slowed and many experts believe that it could be years before conditions fully normalize. Given the immense macroeconomic and human costs associated with the situation and the political instability it generates, it is imperative that the US government does what it can to support a robust recovery in this country and abroad. The United States should also embrace the opportunity to address challenges that were holding back economic growth—at the national level, the global level, and the individual household level—even before the pandemic.

With these goals in mind, this memo lays out four key priorities for US economic policy. Some are explicitly linked to US engagement with other countries; others are focused on strengthening the US economy in ways that can foster US leadership of recovery and rebuilding around the world. The priorities do not include reducing federal budget deficits relative to those projected under current laws. Given historically low interest rates, the accumulation of federal debt is not one of the country's biggest economic challenges; instead, it is sufficient that any increase in discretionary or ongoing federal spending be accompanied by increases in federal revenue.

In keeping with the traditional and appropriate role of the Council of Economic Advisers (CEA), these recommendations are based on sound economics rather than political considerations. The CEA can be an important resource to this administration if it engages with leading economists from around the world to learn about successful policies in other countries and brings the best evidence and expert analysis to bear on policy challenges.

PRIORITY 1: Strengthen automatic fiscal stabilizers

Market participants expect that interest rates on government debt in many countries will be close to zero for years, if not decades, to come. Accordingly, central banks in the United States, Europe, Japan, and elsewhere will have substantially less ability to spur economic activity by cutting interest rates than they have had in the past few decades. Although nontraditional forms of monetary policy can fill some of that gap in recession-fighting capacity, fiscal policy will need to play a much larger role now and for the foreseeable future. In the United States and many other countries, fiscal stimulus during periods of economic weakness has been too small, too short-lived, and too susceptible to short-term political wrangling. The failure to pass an extension of the CARES Act in the last three months demonstrates this viscerally. Therefore, automatic fiscal stabilizers should be significantly expanded.

US leadership in forging international consensus on the importance of fiscal stabilizers and in adopting stronger stabilizers is crucial. Part of that leadership in the United States would be adopting tax and spending rules that are explicitly linked to economic conditions. For example, indexing payroll tax rates to state-level unemployment rates would be both feasible and effective. The United States would benefit directly from other governments' improving their automatic stabilizers. Consider the economic benefits to the US and the world economies if automatic stabilizers rather than premature austerity had guided fiscal policy in Japan between 1998 and 2000 and in Germany between 2010 and 2012. Global growth would have been stronger, and it would have been more balanced than what actually occurred, with US households being the consumers of last resort.

PRIORITY 2: Bring US taxation of multinational companies more in line with that of other advanced economies

Despite significant changes in US business tax rules in 2017, the United States' current tax treatment of business income remains out of line with the treatment in many other advanced economies, does not collect enough revenue to support needed government spending, and does not foster efficiency and fairness. For a number of years, many economists have advocated a combination of expensing of investment costs and eliminating the deductibility of interest expenses; that combination would treat different kinds of investments more equally and reduce financial risk. Adopting that combination would also enable an increase in the US corporate tax rate, which would bring it more in line with rates of other countries and raise needed revenue. Moreover, concerted international efforts to reduce companies' ability to shift profits to lower-taxed locations would both reduce distortions to efficiency and increase government revenue.

PRIORITY 3: Increase US infrastructure investment

Infrastructure investment in the United States now represents a smaller percentage of GDP than in most years of the past half century, and the quality of US infrastructure is declining relative to that of other countries. This stinting of investment is short-sighted from the perspective of US output and income, and it discourages foreign investment and trade in the United States. With interest rates at historically low levels, the case for a significant increase in infrastructure spending is compelling. It will be important, however, to focus additional spending on projects that yield significant returns (no "bridges to nowhere") and to fund maintenance and repair of existing capital rather than focusing solely on flashy new projects. Also, who builds US infrastructure is less important than getting what is needed built and getting value from the dollars the United States spends. Accordingly, the United States should allow competitive bidding for construction, installation, and maintenance of non-security-sensitive parts of US infrastructure; the United States should also insist that foreign governments allow the same opportunity for US firms.

PRIORITY 4: Strengthen US social programs

The consequences of the pandemic for employment, income, and well-being of American families have highlighted preexisting weaknesses in US economic and social systems. Enabling lower- and middle-income American families to thrive in the postpandemic world is necessary in moral terms and also for achieving greater social and political stability. Such stability will make the United States a more desirable partner and a more effective leader for other nations. Appropriate changes include providing more comprehensive health insurance, making other benefits more portable, increasing protections for workers, and giving children in lower-income families a better chance to succeed economically.

ACTIONABLE TO-DO LIST:

- Engage with leading economists from around the world to learn about successful policies in other countries and bring the best evidence and expert analysis to bear on US policy challenges.
- Expand automatic fiscal stabilizers and make them more effective by legislating triggers for starting and stopping that are explicitly linked to economic conditions.
- Adopt specific changes to bring the US corporate tax rate more in line with the rates of other countries and raise needed revenue.
- Increase infrastructure spending, focusing on projects that yield significant returns, including maintenance and repair of existing public capital.
- Provide more comprehensive health insurance, make other benefits more portable, increase protections for American workers, and fund programs that will give children in lower-income American families a better chance to succeed economically.