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Update on the Budget Deficit and Tax Reform -- Summary

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Donald Marron is director of the Urban-Brookings Tax Policy Center based at the Urban Institute. His research focuses on tax reform and America's long-run fiscal challenges. Alice Rivlin is a visiting professor at the Public Policy Institute of Georgetown University and a senior fellow in the Economic Studies Program at the Brookings Institution. She was the founding director of the Congressional Budget Office and served as vice-chair of the Federal Reserve. Rivlin discuss the budget deficit and the importance of stabilizing the growth of our debt over time so that it doesn't grow faster than our economy. Rivlin notes that the economic recovery underway is threatened today more by political forces than by economic forces. Marron details the so-called fiscal cliff deal, which resolved many outstanding issues surrounding the tax code and brought much needed certainty into the tax picture.

Key observations include:

- The economy is growing and is on track to recovery. But it is threatened by political forces and the failure of the political system to come to grips with fundamental economic problems, including the prospective long-run increase in the federal debt.
- A federal debt of roughly 30 percent of GDP is sustainable. We wouldn't want to go much lower than that -- it wouldn't make sense to try to pay the debt down to zero. The current debt to GDP ratio is roughly 73 percent.
- The political focus should not be on balancing the budget, but rather on reaching a point where the

federal debt is sustainable, i.e., where the U.S. economy can grow faster than the debt.

- The costs of entitlement programs -- Medicare, Medicaid, and Social Security -- are growing faster than the economy.
- The bipartisan commissions focused on the U.S. debt problem came up with very similar recommendations: reduce the rate of growth of entitlements, freeze discretionary spending -- domestic and defense -- and reform the tax system to generate more revenue and promote growth.
- The future of the entire U.S. tax code was uncertain at the end of last year. The fiscal cliff deal resolved many of those uncertainties, some of which have been subject to debate for more than a decade.
- Tax cuts for high-income individuals were allowed to expire, and their taxes were raised through a number of provisions, including to support the Health Care Reform Act. Those tax increases will bring in nearly \$700 billion in additional revenue over the next 10 years.
- While President Obama had to compromise, there is no question that the tax code is more progressive than it had been.
- The vast majority of challenges in the tax code are not loopholes, but are consciously chosen social and economic policies. For example, tax subsidies for mortgage interest, retirement savings, the treatment of depreciation, and the use of alternative energy reflect broad based social policies.
- The fiscal cliff presented opportunities for overall tax reform and a grand bargain on the budget, but both opportunities were missed. We have lost the catalyst for tax reform and the tax code remains too complicated, with negative implications for economic growth.