

# Somethin's Gotta Give.....

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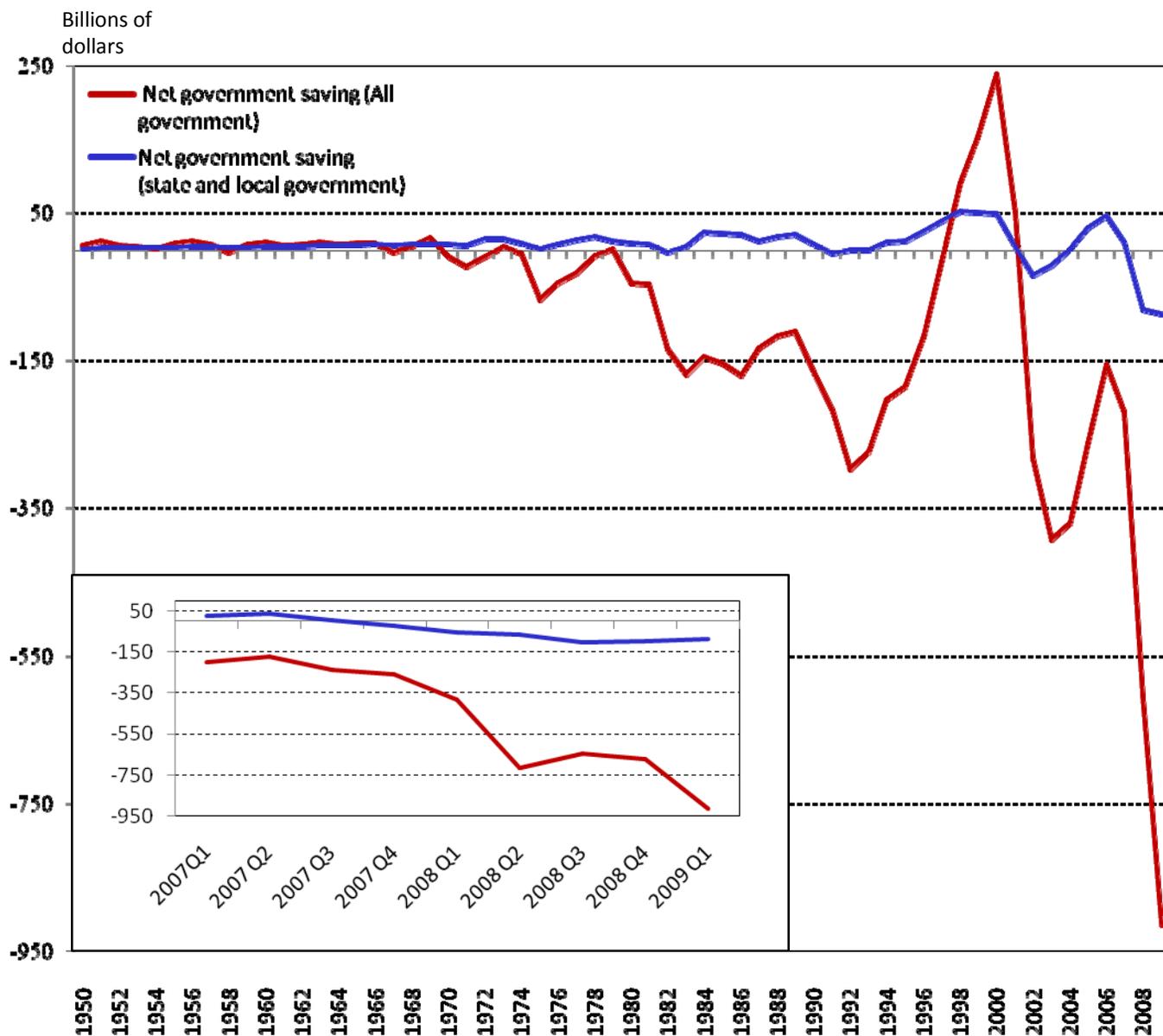
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Note: the views offered in my presentation are mine only. They do not necessarily belong to those of the Federal Reserve Bank of Boston, the Board of Governors of the Federal Reserve System, or the people at my table last night.

## How to treat a headache... shiatsu back massage



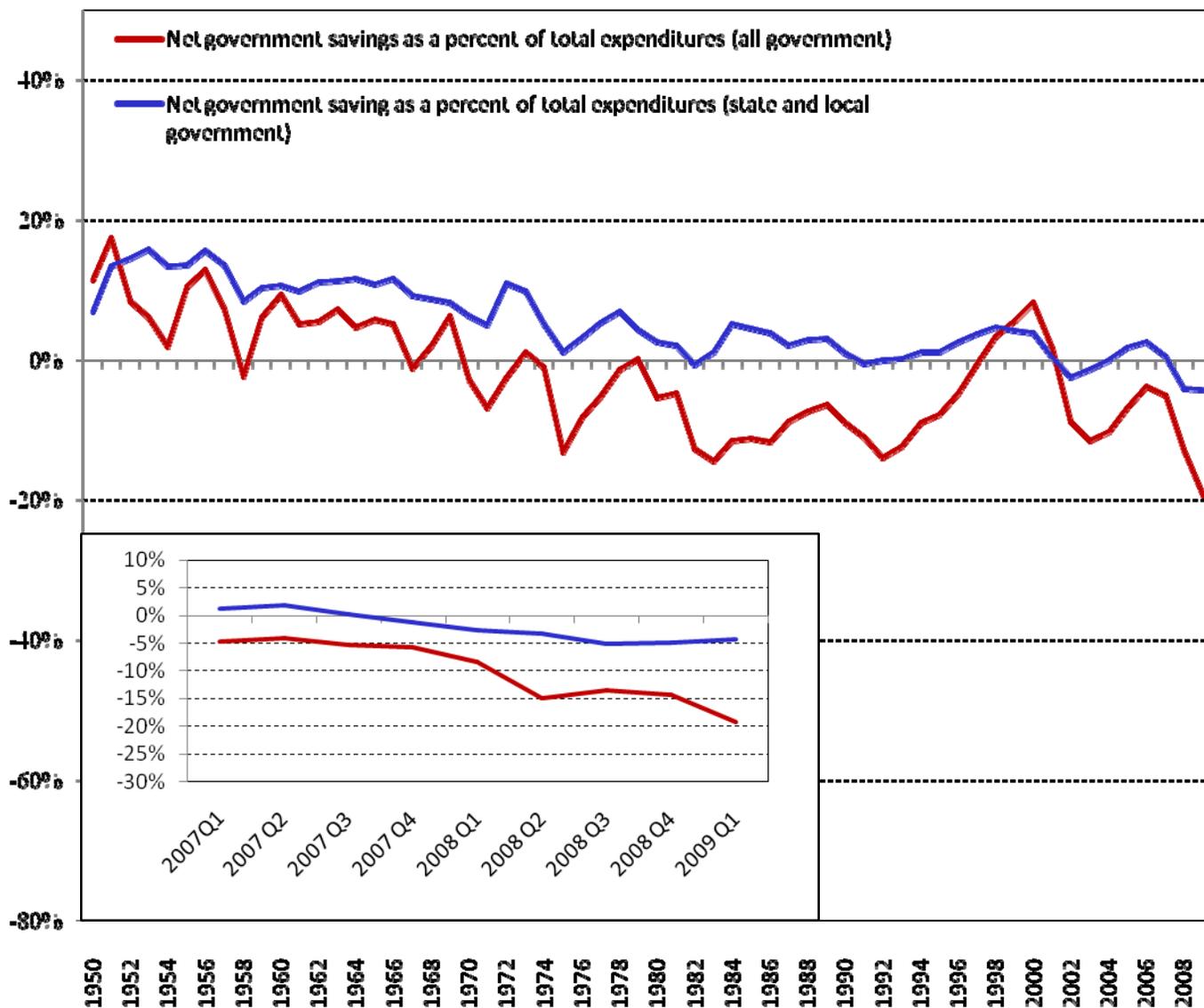
## Net Government Saving



Source: Bureau of Economic Analysis, National Income and Product Accounts tables

Note: The net savings entry for 2009 represents savings through the first quarter of the year at an annual rate.

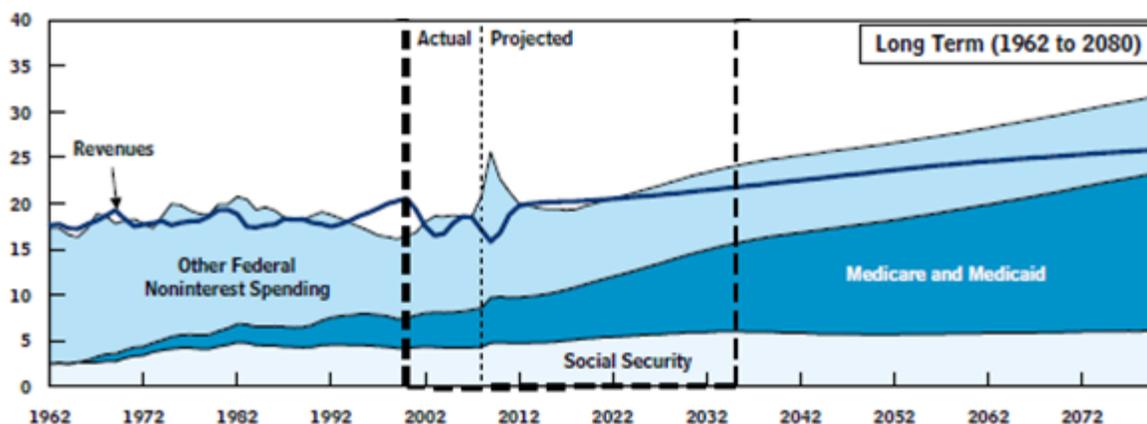
## Net Government Saving as a Percent of Total Government Expenditures



Source: Bureau of Economic Analysis, National Income and Product Accounts tables

Note: The net savings entry for 2009 represents savings through the first quarter of the year at an annual rate.

## Federal Revenues and Noninterest Spending, by Category, Under CBO's - Extended-Baseline Scenario (% of GDP)

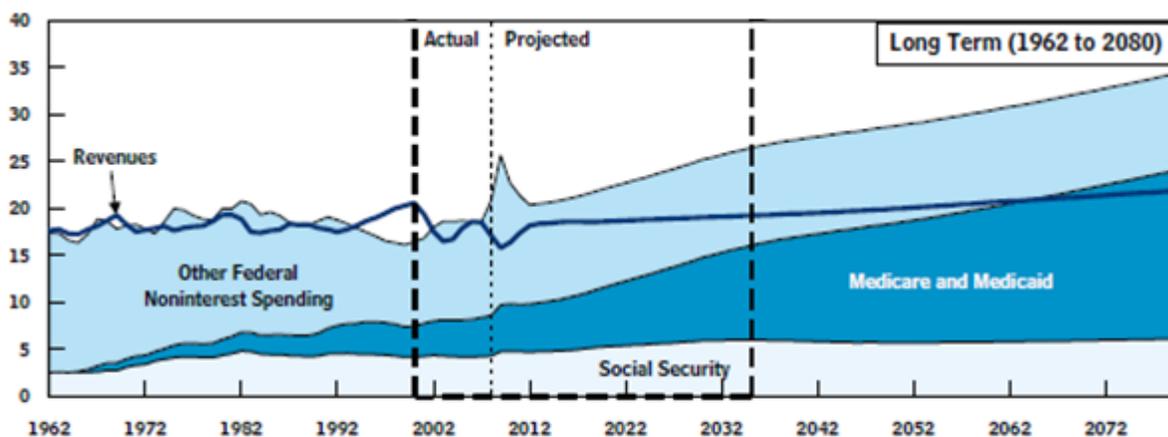


Source: Congressional Budget Office.

Notes: Spending in this figure excludes interest payments on the debt; hence, the gap between federal revenues and noninterest spending shown here does not equal the projected surplus or deficit.

The extended-baseline scenario adheres closely to current law, following CBO's 10-year baseline budget projections from 2009 to 2019 and then extending the baseline concept for the rest of the projection period.

## Federal Revenues and Noninterest Spending, by Category, Under CBO's - Alternative Fiscal Scenario (% of GDP)



Source: Congressional Budget Office.

Notes: Spending in this figure excludes interest payments on the debt; hence, the gap between federal revenues and noninterest spending shown here does not equal the projected surplus or deficit.

The alternative fiscal scenario deviates from CBO's baseline projections, beginning in 2010, by incorporating some changes in policy that are widely expected to occur and that policymakers have regularly made in the past.

## Assumptions About Federal Spending and Revenue Sources Underlying CBO's Long-Term Budget Scenarios

	Extended-Baseline Scenario	Alternative Fiscal Scenario
<b>Assumptions About Spending</b>		
Medicare	As scheduled under current law	Physician payment rates grow with the Medicare economic index (rather than at the lower growth rates scheduled under the sustainable growth rate mechanism)
Medicaid	As scheduled under current law	As scheduled under current law
Social Security	As scheduled under current law	As scheduled under current law
Other Spending Excluding Interest <sup>a</sup>	As projected in CBO's 10-year baseline through 2019, remaining thereafter at the projected 2019 level as a share of GDP	As projected in CBO's baseline through 2011, remaining thereafter at the projected 2009 level, minus stimulus and related spending, as a share of GDP
<b>Assumptions About Revenue Sources</b>		
Individual Income Taxes	As scheduled under current law	Tax provisions in JGTRRA and EGTRRA are extended and AMT parameters are indexed for inflation after 2009
Corporate Income Taxes	As scheduled under current law	As scheduled under current law
Payroll Taxes	As scheduled under current law	As scheduled under current law
Excise Taxes and Estate and Gift Taxes	As scheduled under current law	Constant as a share of GDP over the long term
Other Revenues	As scheduled under current law through 2019, remaining constant as a share of GDP thereafter	As scheduled under current law through 2019, remaining constant as a share of GDP thereafter

Source: Congressional Budget Office.

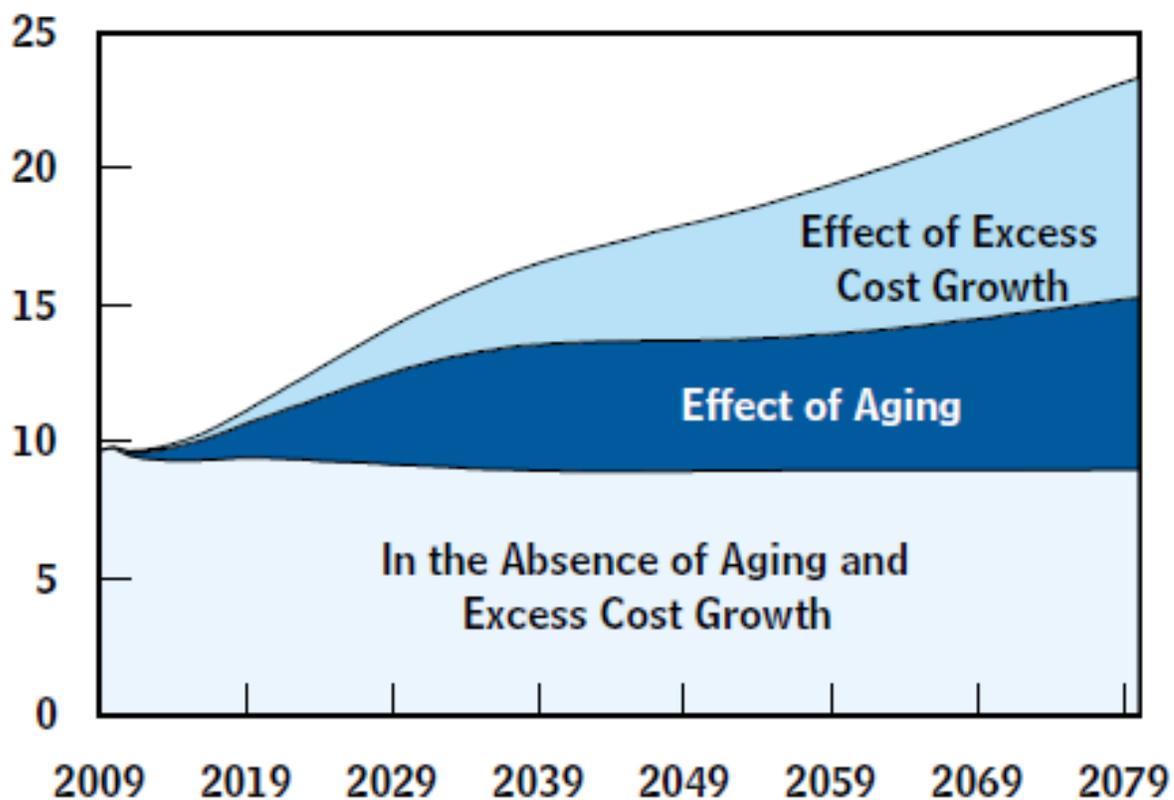
Notes: The extended-baseline scenario adheres closely to current law, following CBO's 10-year baseline budget projections from 2009 to 2019 and then extending the baseline concept for the rest of the projection period. The alternative fiscal scenario deviates from CBO's baseline projections, beginning in 2010, by incorporating some changes in policy that are widely expected to occur and that policy-makers have regularly made in the past.

GDP = gross domestic product; JGTRRA = Jobs and Growth Tax Relief Reconciliation Act of 2003; EGTRRA = Economic Growth and Tax Relief Reconciliation Act of 2001; AMT = alternative minimum tax.

- a. Federal spending on the refundable portions of the earned income tax credit and the child tax credit is not held constant as a percentage of GDP but instead is modeled with the revenue portion of the scenarios.

## Factors Explaining Future Federal Spending on Medicare, Medicaid, and Social Security

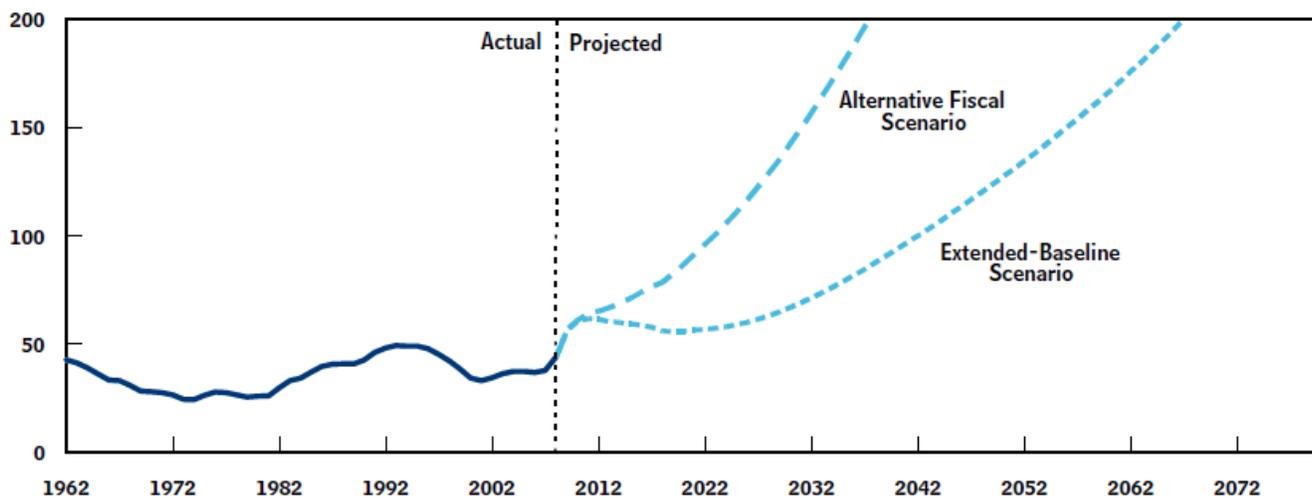
Percentage of GDP



Source: Congressional Budget Office

## Federal Debt Held by the Public Under CBO's Long-Term Budget Scenarios

(Percentage of gross domestic product)



Source: Congressional Budget Office.

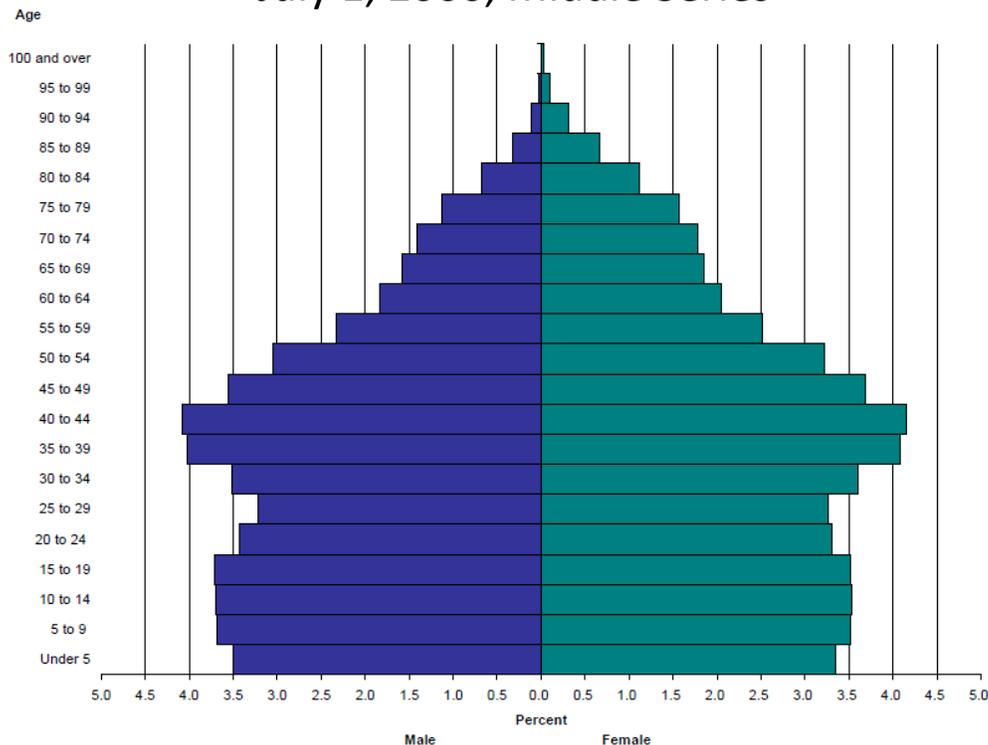
Note: The extended-baseline scenario adheres closely to current law, following CBO's 10-year baseline budget projections from 2009 to 2019 and then extending the baseline concept for the rest of the projection period. The alternative fiscal scenario deviates from CBO's baseline projections, beginning in 2010, by incorporating some changes in policy that are widely expected to occur and that policy-makers have regularly made in the past.

## Age Distribution of US Population (in thousands), 2000-2050

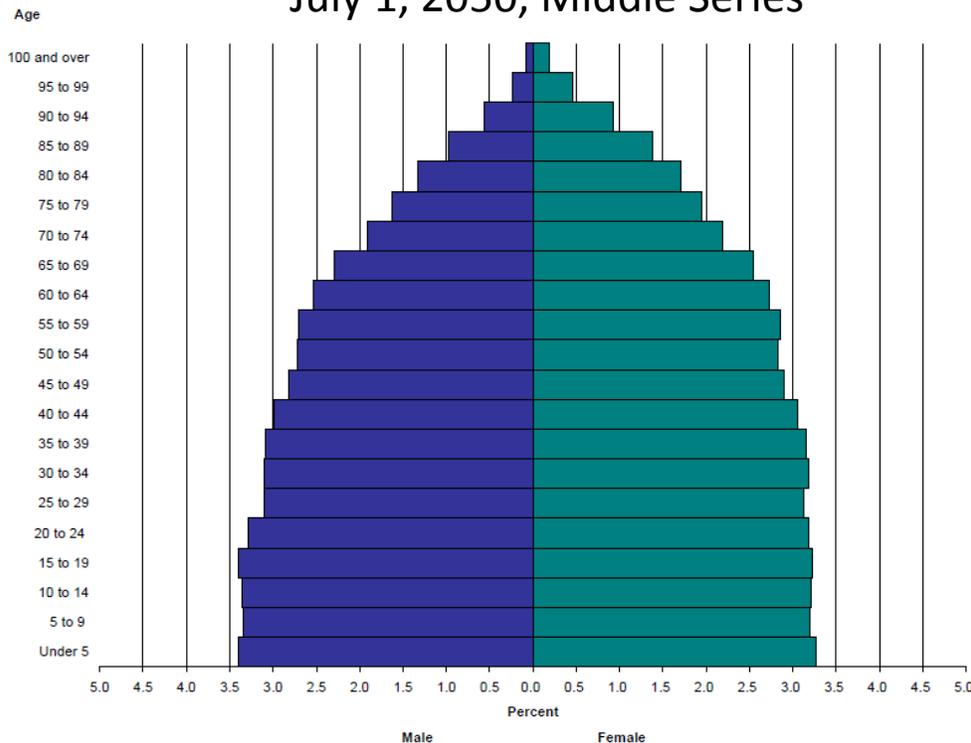
Year	5-19 years	20-44 years	45-64 years	65-84 years	85 and over
2000	61,331	104,075	62,440	30,794	4,267
2010	61,810	104,444	81,012	34,120	6,123
2020	65,955	108,632	83,653	47,363	7,269
2030	70,832	114,747	82,280	61,850	9,603
2040	75,326	121,659	88,611	64,640	15,409
2050	81,067	130,897	93,104	65,844	20,861
<i>Average Annual Growth</i>					
2000-2010	0.16%	0.07%	5.95%	2.16%	8.70%
2010-2020	1.34%	0.80%	0.65%	7.76%	3.74%
2020-2030	1.48%	1.13%	-0.33%	6.12%	6.42%
2030-2040	1.27%	1.20%	1.54%	0.90%	12.09%
2040-2050	1.52%	1.52%	1.01%	0.37%	7.08%

Source: U.S. Census Bureau, 2004, "U.S. Interim Projections by Age, Sex, Race, and Hispanic Origin"

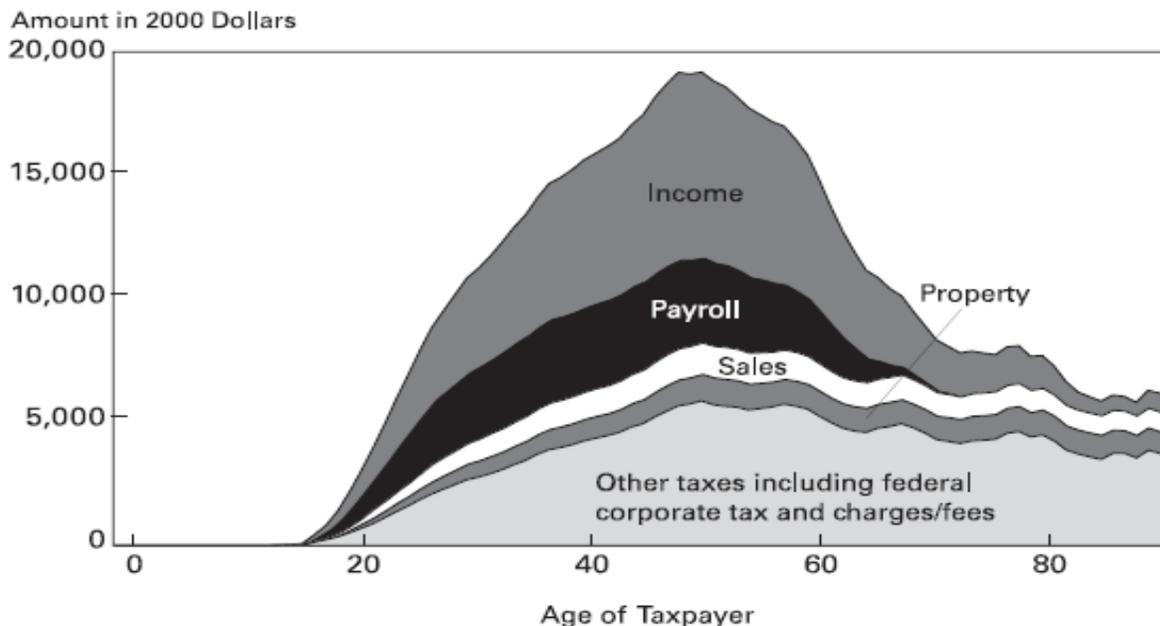
## Projected Resident Population of the United States as of July 1, 2000, Middle Series



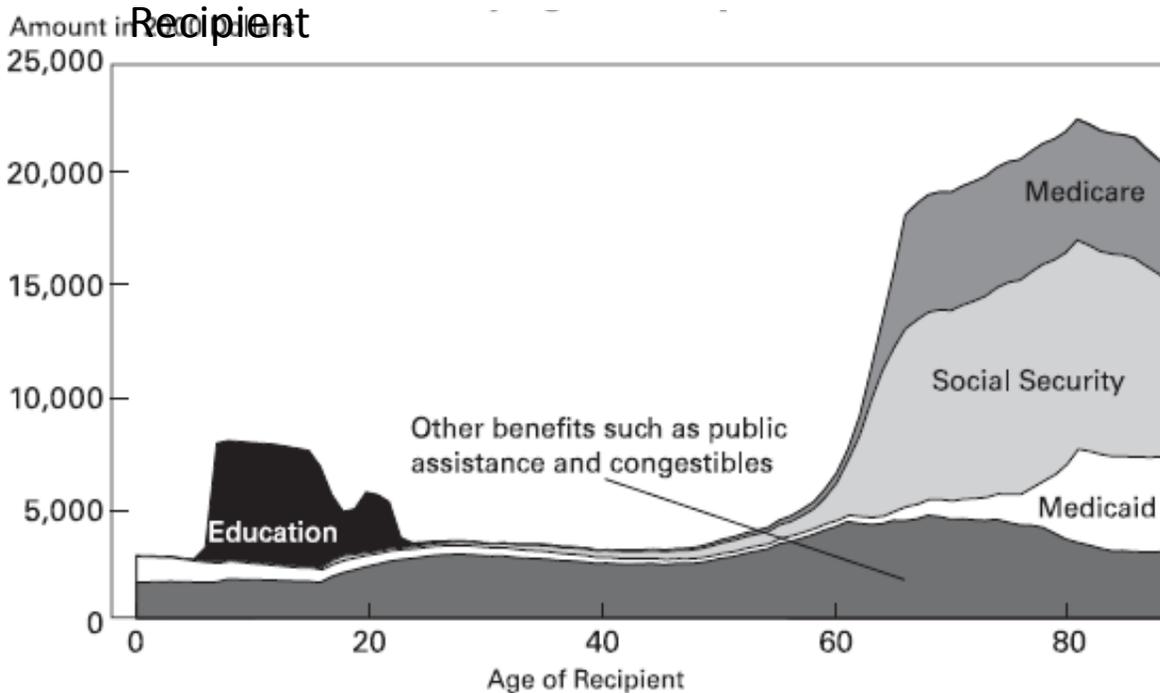
## Projected Resident Population of the United States as of July 1, 2050, Middle Series



## Federal and State/Local Taxes by Age of Taxpayer



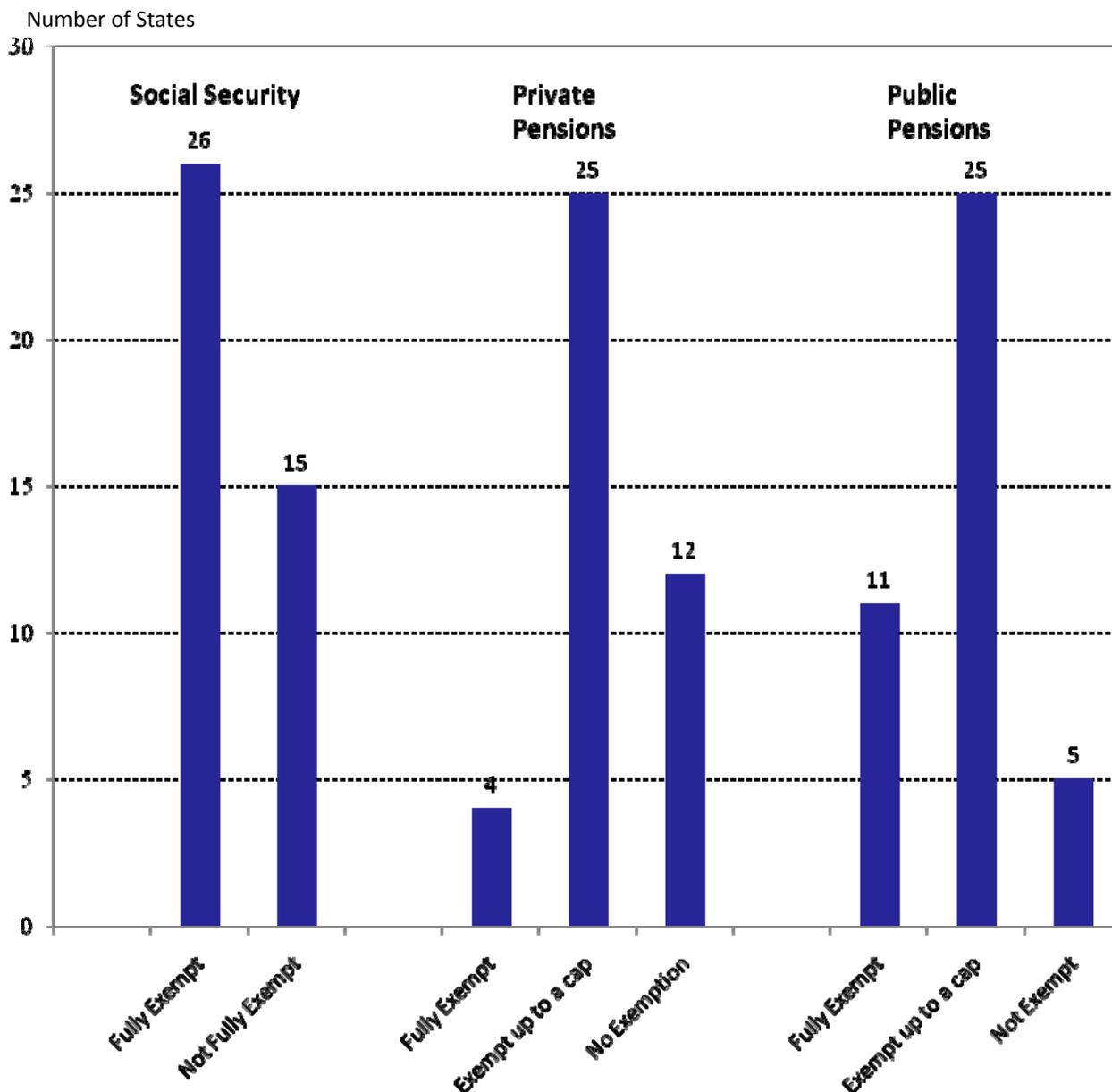
## Federal and State/Local Benefits by Age of Recipient



Source: Ronald D. Lee and Ryan D. Edwards (2001). "The Fiscal Impact of Population Change". In Jane Sneddon Little and Robert K. Triest, eds., *Seismic Shifts: the Economic Impact of Population Change*. Federal Reserve Bank of Boston Conference Series No. 46, pp. 220-237.

Figures based on data from the U.S. Bureau of the Census, March Current Population Surveys of 1994 and 1995, inflated to 2000 levels.

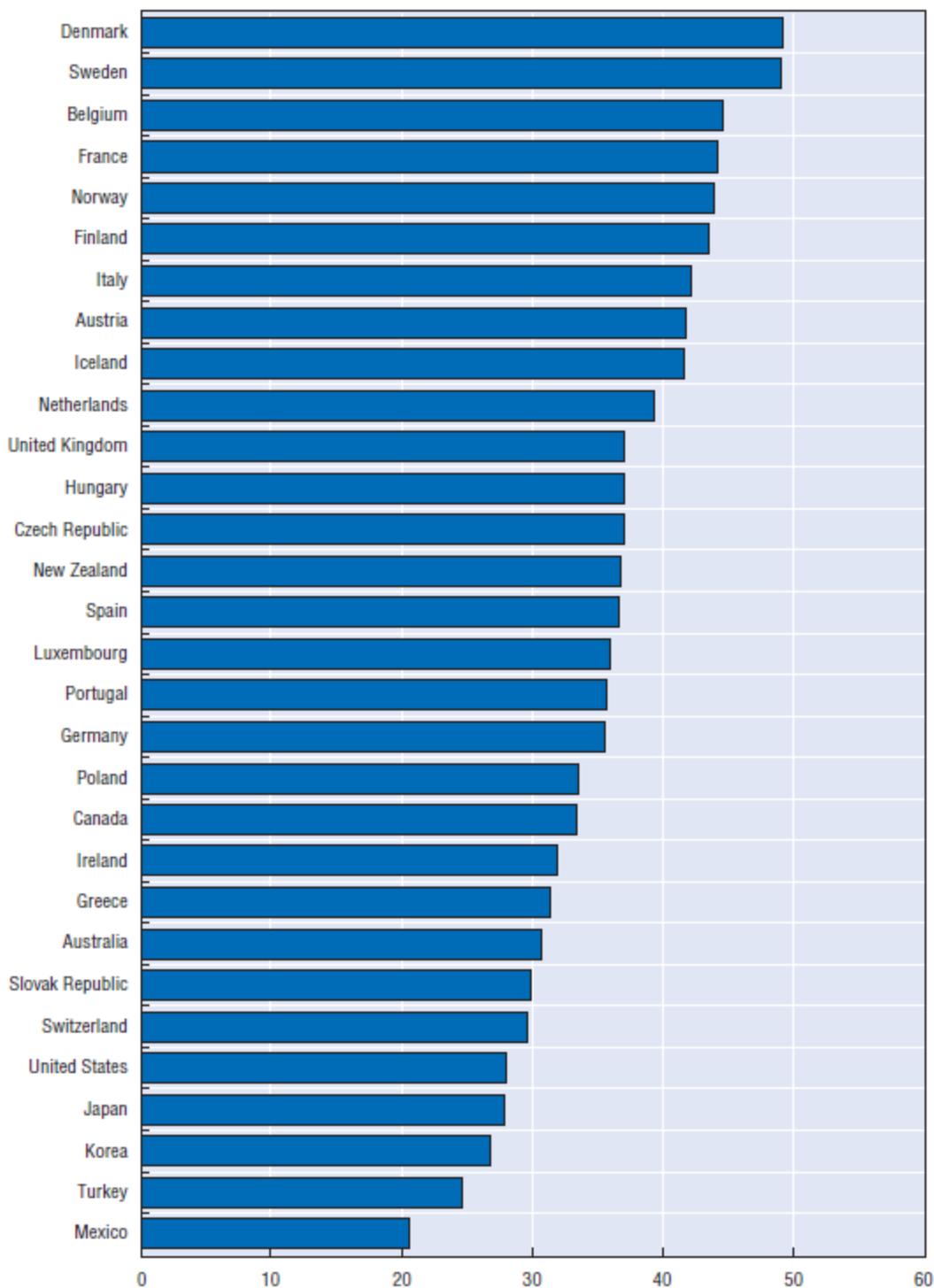
## State Income Tax Treatment of Social Security Benefits and Pension Income, 2008



Source: David Baer, "State Handbook of Economic, Demographic & Fiscal Indicators," AARP Public Policy Institute, 2008.

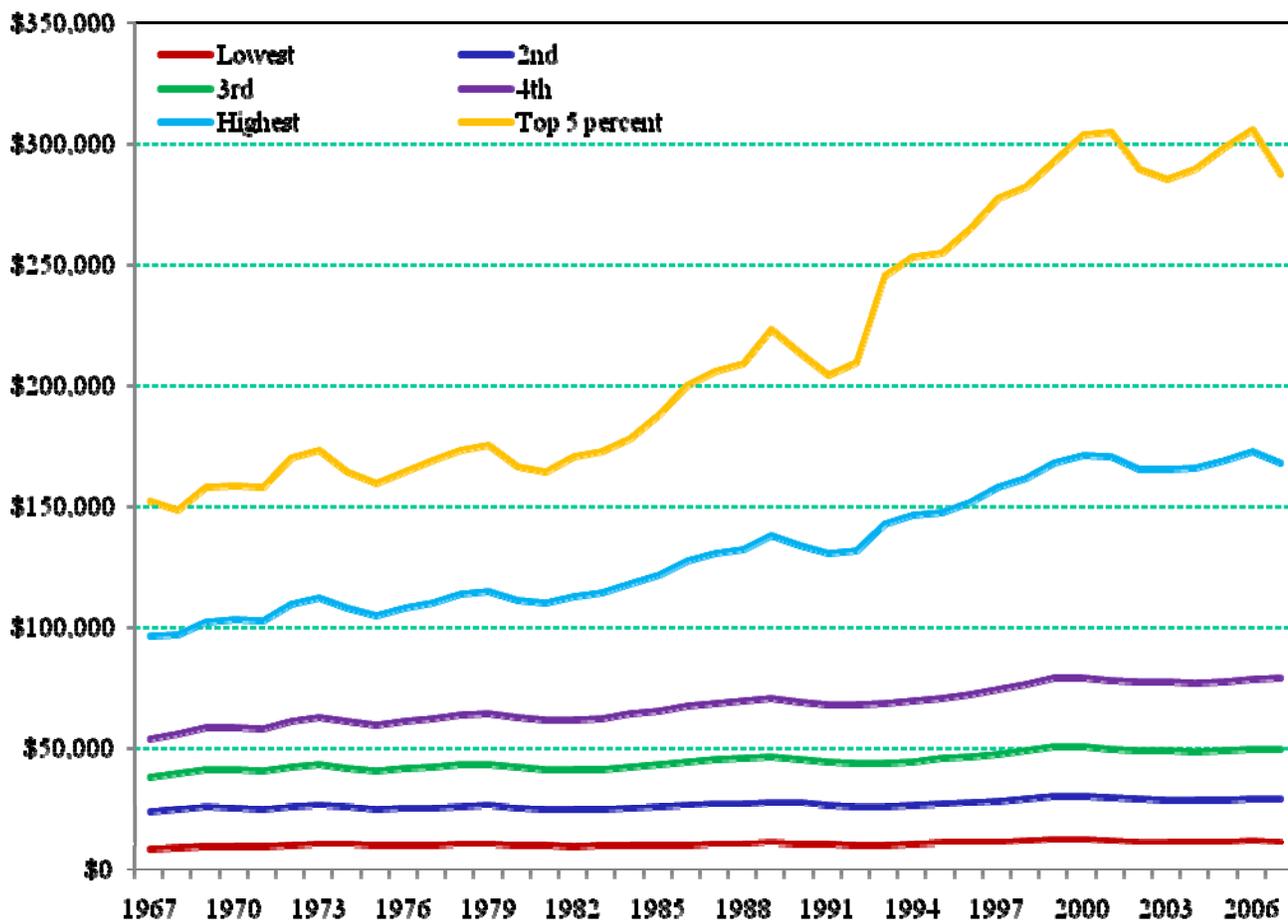
Note: Multiple states are excluded because they have no, or limited, personal income tax

## Total Tax Ratio as Percentage of GDP, 2006 (Countries have been ranked by their total tax to GDP ratios)



Source: OECD, *Revenue Statistics 1965-2007, 2008 Edition*

## Growth in Income Inequality, Average Real Household Income by Quintile and for Top Five Percent, 1967-2007



Source: U.S. Bureau of the Census, Current Population Survey, Annual Social and Economic Supplements

# CONCLUSIONS

- **Governments at all levels are running record deficits**
- **The resulting increase in public debt will compound stress at all levels of government, created primarily by rising health care costs, aging of population, and difficult-to-avoid future investments in public infrastructure**
- **We cannot escape sharply higher taxes or dramatic cuts in government spending at all levels of government, acceleration of inflation, or high interest rates. All will crimp economic growth.**
- **As a result, absent some wealth-generating technological breakthrough, our standard of living will fall, or at best improve more slowly.**
- **Given rise in inequality in recent decades, such a scenario will seriously alienate “average American” absent sharper redistribution.**
- **We will need to rethink tax preferences for elderly.**
- **We must allocate our resources more efficiently to minimize economic pain.**