Donald Trump faces economic challenges and opportunities as he builds a presidential administration. He’s faced with having to ensure a high and rising standard of living for all citizens and to ensure fiscal stability for the long run. And he has a chance to change inefficient government policies in ways that increase economic growth and well-being for all. Following are ten areas of economic policy that the new president must contend with.

Economic growth

Economic growth is critical. The new president will be challenged to implement policies that increase economic growth or at least not slow it down. Part of developing appropriate policies will depend on the answer to why growth has slowed.

Economists have debated whether we are in a long-term slump, in a slow period from which we will recover, or even not in a slow period at all. Robert Gordon has written that new technological innovations are unlikely to be as life-changing as earlier ones like pervasive electrification, indoor plumbing, automobile and air travel. Larry Summers claims that a world-wide shortage of demand has created a period unlikely to witness any significant growth (“secular stagnation”). Other economists are more optimistic about the changes brought on by advances in communication and computation that may profoundly change lives.1

Two factors contribute to economic growth: increases in the number of workers and increases in output per worker, which in turn comes from increased quantity and quality of capital and increased labor skill. America’s labor force has grown slightly in absolute terms during the last decade (0.5 percent per year) but is shrinking as a percentage of the population due to increased life spans and aging baby boomers.

In the longer term, policy can influence the effectiveness of the labor force by improving education to increase the quality and skill of employees. In the short term, the president can influence the size of the domestic labor force through incentives for people to work and by encouraging immigration (particularly high-skilled immigration). (I return to immigration later in this piece.)

In addition to increasing the labor force, economic growth also requires more productivity. John Cochrane, a senior fellow at SIEPR and the Hoover Institution, recently testified before Congress that a large number of regulations are reducing expected investment returns and deterring investment, thereby reducing productivity growth.

Raising economic growth by increasing and improving labor supply and increasing productivity could help with many of the other economic issues discussed in this brief — the federal budget, taxes, trade and immigration.

Federal budget

The U.S. budget deficit was 2.4 percent of GDP in 2015 (down from nearly 10 percent in 2009) and the debt held by the public is 75 percent of GDP (up from about 50 percent in 2009). While the debt has risen from about 34 percent of GDP just before the 2008 Great Recession to the

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1 For more information on these points, see the 2016 SIEPR Economic Summit presentations by Nick Bloom and Hal Varian, the SIEPR Associates talk by Erik Brynjolfsson and the SIEPR Policy Brief, Life in the Slow Lane by John Shoven.
current level, long-term interest rates have not risen, currently standing below 3 percent for a 30-year Treasury bond (and more importantly at less than 1 percent real).

However, the long-term forecast for budget deficits indicate that the debt-to-GDP ratio will increase sharply, largely because of increased spending for Medicare, Medicaid and Social Security. As a result, to have any meaningful change in federal spending, the increase in spending for these programs needs to be part of the conversation. Increased economic growth would be a silver bullet that could provide significant revenue to the federal government through gains in payroll tax revenues and general tax revenues. But counting on the level of growth necessary to offset the expected increases in spending — especially in the short run — is unrealistic.

The Social Security retirement fund is scheduled to run out of money in 2034 (and the Social Security Disability Insurance fund much sooner). Under current law, payments to all Social Security recipients would be cut about 25 percent so program payouts would match income. Congress could prevent such a drastic change in retiree income by changing the law to use general tax revenues for Social Security. At that point, it is likely that Congress would change other aspects of the program as well.

It is possible to delay the exhaustion date and reduce the cut with relatively simple gradual changes to Social Security benefits and taxes: implement a hybrid wage indexing system,2 gradually raise the retirement age, and increase revenues by raising the cap on earnings or raising the employer and employee contribution rates.

The increasing budget shares of Medicare and Medicaid are more difficult to control because people are living longer and individual care is costing more. Medicare’s budget is in two main parts — the part primarily funded by payroll taxes (Part A) and the portion funded by general revenues and beneficiary premiums (Parts B and D). Like Social Security, the portions funded by payroll taxes will either have to be cut when their current surplus runs out (projected in 2028) or Congress will have to change the law to increase the use of general revenues for Medicare.

Medicaid spending has also increased significantly. Any changes to the Affordable Care Act should consider how those changes would affect Medicare and Medicaid spending, especially per person.

Climate change

Probably the largest long-term challenge for the U.S. and global economy is climate change. There are at least three significant concerns: The degree of harm climate change will cause and when those harms will arise; what we can do to stop or slow the negative effects and the costs of such actions (including adaptation); and how to solve the global collective action problem by getting all or almost all countries to agree to cut carbon emissions.

The magnitude and timing of economic effects and the impacts of mitigation efforts are critical to understanding the policy options and their expected costs and benefits. Ideally, policymakers could optimize their responses based on those estimates and an appropriate discount rate. However, uncertainty and divergent preferences make consensus difficult.

Scientists have been working for a long time to understand the economic (and other) impacts of climate change. Marshall Burke, a SIEPR faculty fellow, showed in an earlier Policy Brief that past predictions might have underestimated the economic damage from climate change.

Scientists have been clear that carbon emissions have played a role in climate change and that significantly reducing carbon emissions globally could reduce the magnitude and economic impact of climate change. Reducing carbon emissions amidst uncertainty is like buying an insurance policy — we will spend money upfront in the form of higher costs for current consumption in exchange for reduced economic damage in the future.

The president-elect says he wants to reduce regulations across the economy, which may create an opportunity to exchange inefficient regulations and subsidies for a more efficient revenue-neutral carbon tax that could engender significant political support (except for opposition from carbon-intensive industries).

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Implementing a carbon tax that phases in over 10 years (to give people and companies time to plan capital purchases such as more fuel-efficient cars) would provide incentives to internalize the environmental cost of carbon use. To make such a tax more politically palatable to industry, it could be combined with a reduction of the Clean Power Plan (which is part of a legislated mandate — the Clean Air Act — and thus not easily cancelled administratively).

For example, a first step could be to use the carbon tax revenue to offset the first 1 percent of worker payroll tax for the first $30,000 of earnings (as the tax revenue increases, either the percentage or earnings level could increase, or the money could go to the Social Security trust fund). In addition to reducing the expected damage from carbon, a revenue-neutral carbon tax would increase the returns to working, especially for low-income workers and would help with economic growth. Even if the damage from carbon is overestimated, the efficiency cost of a revenue-neutral tax could be low because the revenue could be used to offset another tax with potentially more economically harmful effects. Finally, adopting a carbon tax would show the rest of the world that the U.S. is a leader in market-oriented solutions and is committed to playing its part to deal with a global challenge.

Affordable Care Act

Before the election, Donald Trump said he wanted to repeal and replace the Affordable Care Act (ACA). Soon after the election, he said he liked some parts of it, including the ability for children to stay on their parents’ plans until 26 years of age and preventing insurance companies from using pre-existing conditions to deny coverage. Any reforms, however, are likely to be difficult because there are now many people with a vested interest in maintaining at least some of the law’s provisions whereas others would profit from repeal. In addition, keeping some provisions while eliminating others risks unraveling the entire system, leading to higher prices and lower coverage.

Medicaid expansion and the subsidies for families with income below 400 percent of the poverty level have increased the number with insurance coverage by about 13 million between 2013 and 2015, according to SIEPR Senior Fellow Kate Bundorf. Of course, the increase in coverage comes at a cost.

The new health insurance exchanges established by the ACA provide a mechanism for consumers to shop for coverage and for insurance companies to provide comparable services. Unsubsidized prices on the exchanges are expected to increase next year. The increase in information and reduction in transaction costs make insurance markets more transparent. The resulting increase in competition, however, may be less enticing for insurance companies as it can reduce their profits. For the exchanges to work, enough insurance firms must compete in each area. An additional benefit of a well-functioning health care exchange is that people are more likely to feel comfortable leaving a job and not worrying as much about getting insurance on the individual market.

As SIEPR Director Mark Duggan points out, our current system of tax deductibility for employer-provided insurance creates two perverse incentives — overconsumption of insurance relative to goods purchased with after-tax dollars and a regressive system where high-income people get the largest subsidies. The ACA has a so-called Cadillac tax to limit the tax deductibility of high-end plans.

In a survey of more than 40 academic economists from top universities, the IGM Forum found that all agreed the ACA’s Cadillac tax would reduce costly distortions. Moving to a system where insurance is not tax deductible, or at least not deductible above a certain dollar limit, would reduce overconsumption and limit some of the regressivity.

In coming up with changes to the ACA, a Trump administration should account for the number of people who might lose health care coverage, the efficiency of the health care marketplace, and the inefficiencies from the tax treatment of health coverage. One key is to provide incentives for healthy people to participate in the marketplace to reduce overall prices (and to provide them with insurance for unexpected occurrences!). Any change should consider unintended consequences that would reduce participation in the health insurance marketplace by healthy people.

Taxes

President-elect Trump says he will change the tax system. Taxes are necessary to raise enough money to pay for government services. The 1986 Tax Reform Act eliminated many deductions and elements of
the tax code that were inefficient, but the intervening 30 years have led to significant increases in inefficient provisions.

The prescription to minimize the economic harm from taxes is to favor lower rates and a wider taxable base. Lowering rates provides more incentives to work or invest while widening the base reduces incentives to shuffle income between different characterizations and reduces tax harm.

Lowering rates is straightforward. Widening the base requires cutting deductions and exemptions. For example, even more than the health insurance deduction discussed above, the mortgage interest deduction distorts economic decisions between owning and renting and significantly favors higher income households. Reducing or limiting the mortgage interest deduction (perhaps phased in gradually) is an example of expanding the tax base that could lead to lower tax rates elsewhere.

Hefty corporate taxes are encouraging companies to locate jobs overseas and to retain money offshore to avoid taxes upon repatriation. While the government may lose some revenue, lower corporate rates should increase domestic jobs and therefore income tax receipts, as well as provide an incentive for firms to bring at least some of their foreign profits back to the U.S.

Income inequality, mobility, and low-income programs

Exit polls found that many working-class voters supported Donald Trump. One possible reason for their support is their frustration with the lack of real increase in their paychecks over the past 20 years, the lack of income mobility, and the growing disparity between the richest Americans and everyone else.

One of the most effective policies for helping low-income workers is the Earned Income Tax Credit (EITC). David Autor, an economist from MIT, and Harvard economist Greg Mankiw spoke about the benefits of the EITC at the 2016 SIEPR Economic Summit. The EITC gives additional financial support to those who work.

One of the reasons why economists like the EITC is that it provides incentive to work whereas traditional welfare programs, for example, provides a disincentive to work. As a result, EITC is probably a more efficient mechanism for redistribution of income.

Currently, the EITC provides supplemental income for working families (up to $5,572 for a family with two children, for example). One of the issues with any income supplement program is that as income rises above a certain level, the subsidy falls creating a higher effective tax rate (the lost benefits are what economists call the “implicit tax rate”).

The current implicit tax rate from the EITC phaseout is 21 percent — for each dollar earned above in the phase-out period, the subsidy drops by 21 cents. For example, expanding the EITC could reduce the implicit tax rate from 21 percent to 15.4 percent by keeping the same top level of subsidy and increasing the maximum earnings from $50,000 to $60,000. An increased EITC will increase the returns to work and supplemental income for those below $50,000 (and a decreased work incentive, but higher income for those between $50,000 and $60,000). In the short run, expanding the EITC will have some cost, but immediate benefits from additional work and likely long-term benefits from both working and higher incomes for these families with children will be important.

A boost to the minimum wage may be appropriate in some situations. But a large-scale increase in the national minimum wage is likely to harm some of the most vulnerable. A large increase would have different effects in San Francisco than in rural Pennsylvania — in the former, prices might go up, whereas in the latter, many fewer people would be hired because the ability to raise prices is lower.

Jeff Clemens, an economist at the University of California, San Diego, who was a visiting professor at SIEPR, wrote a Policy Brief explaining the unintended harm from a large minimum wage increase and how unemployment among high school dropouts would likely increase substantially.

Trade

Trade is an important source of economic welfare. Imports and exports each account for about 15 percent of U.S. GDP. The vast majority of economists believe that trade is an important component of increasing economic growth.

International trade is a subset of trade. Another subset is trade within the U.S. between states, where the lack of barriers to trade between states has generated huge benefits.
Similar benefits come from the long-term reductions in tariffs for international trade — we have better and cheaper cars, televisions and a host of other goods. At the same time, millions of Americans have jobs that exist to provide goods and services to people in other countries.

While overall trade provides a large net benefit, trade has harmed some people. Much of the harm is similar to the larger changes in employment due to advances in technology and mechanization. These larger changes account for about four times as many job losses as those caused by trade with China.

Artificial trade barriers to protect jobs costs more to the economy than the value of the jobs saved, but the costs are dispersed through the economy while the job saving is concentrated. A better solution would be to encourage trade and figure out ways to share the costs more widely, and minimize the costs by investing in programs so workers are flexible in responding to competition from trade.

Policies to ensure that workers across the country have the skills necessary for 21st century jobs have the potential to help with both of these issues.

**Immigration**

As discussed above, economic growth depends on growth in productivity and growth in labor supply. Immigration has been a significant factor in both parts of the economic growth equation. In the heart of Silicon Valley, a relatively large number of people are immigrants. Here, it is easy to see the impact on the labor force and on innovation — immigrants have built many businesses.

The current limit on H1-B visas frustrates individuals and companies from reaching their full potential and sends both to set up operations in other countries. As former SIEPR Distinguished Visitor Enrico Moretti shows, because we benefit from innovation, and innovation hubs depend on proximity, limiting the number of highly-skilled immigrants is against our interest. It is economically harmful to reduce the number of immigrants working here now and coming to work in the future.

Moving beyond the highly-skilled immigrants, additional less-skilled workers would also benefit our country. First, while there may be some competition for jobs, the “lump of labor” hypothesis has been disproven — an increased labor supply will increase economic growth and the total number of jobs. When the market pushes more efficient allocation of labor, there are large benefits. There are also large benefits when young immigrants move to the U.S. and contribute to the economy and to Social Security and Medicare funding.

Of course, we need to be safe and screen immigrants to prevent known terrorists from entering the U.S. We should be vigilant against all threats — from immigrants as well as our own citizens. But there are also benefits from having immigrants come to the U.S., making a decent living and returning some of what they earn to support their families across the borders. In addition to the economic benefits, having the U.S. and our market economy seen as a land of opportunity should have some spillover political benefits.

Setting up a system to encourage increased labor supply from immigrants across the board will benefit America in both the short and long run.

**Infrastructure**

Both Donald Trump and Hillary Clinton talked about spending more on infrastructure during the presidential campaign. Infrastructure spending can improve productivity, and the gains accrue to a wide range of people.

For many projects, the upfront costs are very high, but the marginal costs are low so it is efficient to have low or zero charges. When increasing infrastructure investments, it is important to make sure that these are good investments. Larry Summers and SIEPR’s Michael Boskin have both discussed spending on infrastructure projects. While they have different views of the appropriate magnitudes of public spending, they seem to agree on core principles.

First, any public infrastructure project should be subject to a cost-benefit analysis. It is critically important to ensure that total benefits exceed costs. For example, while universal broadband sounds like a great goal, laying fiber optic cable to very remote households at a cost of a hundred thousand dollars per household is likely to fail the cost-benefit test, especially as satellite provision is a reasonable substitute.

Second, where possible, ensure that payment is efficient. For example, user fees for expanded roads or airports would allow those who benefit from the project to bear the cost.
cost burden of the project. For some projects, like fixing potholes on city streets, direct user charges may not outweigh the transaction costs.

Third, since there are a wide variety of projects and a limited pool of money with which to pursue them, it will be critical to prioritize. Not only should the government compare the benefits of fiber deployment in Texas to the benefits from doing so in North Carolina, but from a bigger picture perspective, they need to compare investing more in fiber to the net social returns to improving highways. Setting up a rigorous cost-benefit framework and priority system given scarce resources is essential if the country will maximize the return from infrastructure investment.

Finally, it is important not to be misled by claims of jobs created in the building of infrastructure — such jobs are not only temporary, but they are a cost of the project. Any project would be more beneficial if it could be completed for less money. Jobs created by extra economic activity resulting from the project (lower transportation costs, etc.) and improved economic well-being (clean water, etc.) are the key benefits from infrastructure investments.

**Competition policy**

Typically, antitrust and regulatory policy becomes more aggressive in Democratic administrations and less interventionist when Republicans are in control. While this trend appears likely, Donald Trump’s campaign statements have caused some to question the conventional wisdom. For example, candidate Trump immediately announced his opposition to a proposed merger between AT&T and Time Warner. The campaign statement listed several objections to the transaction, none of which were based on general competition principles.

Businesses must have some degree of predictability if they are to invest. Any time a firm begins negotiations for a merger, they engage antitrust counsel to predict the likelihood of a challenge. Many transactions are abandoned because of potential antitrust scrutiny. Similarly, firms deciding on pricing strategies, product offerings or vertical relationships try to calculate the risk of regulatory intervention.

The Trump administration should articulate a clear and principled approach to competition policy. That will require choosing appointees for the competition agencies (DOJ and FTC) and independent regulatory agencies (FCC) who will quickly and clearly articulate their approaches to the business community so resources can be used to pursue opportunities that will not be challenged rather than wasting time on transactions that later need to be abandoned.

**Conclusion**

Keeping economic principles in mind when developing policy should help the Trump administration develop more efficient proposals that will help all Americans. Providing for incentives to work, broadening the tax base, putting mechanisms in place so people pay for the environmental harms caused by their actions, and ensuring safety-net health coverage provide significant opportunities for beneficial economic policy.