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United States policy overview

Dr Joseph Minarik

Dr Joseph Minarik is Senior Vice President and Director of Research at the US Committee for Economic Development (CED). He was the chief economist of the Office of Management and Budget for the eight years of the Clinton Administration. Prior to his service in the Clinton Administration, Dr Minarik worked closely with Senator Bill Bradley on his efforts to reform the federal income tax, which culminated in the Tax Reform Act of 1986, writing Making Tax Choices in 1985; and served as Chief Economist to the House Budget Committee in 1991–92 and 2001–05, and staff director of the Joint Economic Committee in 1989–90. Recently, he served on the Bipartisan Policy Center's Debt Reduction Task Force and the National Academy of Science's Our Fiscal Future project, two national efforts to reduce the federal budget deficit.

The beat of a different drum

The United States has always marched to the beat of a different drummer. In 2018, the US economy, and economic policy, did so with a flourish.

In the closing instants of 2017, the US Congress passed a sizable tax cut, almost precisely 180 degrees out of phase from what all of the macroeconomic stabilisation text books would prescribe. A different drummer, indeed.

That fiscal fizz was felt throughout the US economy. The real Gross Domestic Product (GDP) perked up from a 2.2 per cent growth pace in 2017 (and in the first quarter of 2018) to 4.2 per cent in the second quarter, and 3.4 per cent in the third.

These latest growth figures are beyond the economy's current potential growth rate (about 2.0 per cent for the next five years, according to the nonpartisan Congressional Budget Office, or CBO).

A buoyant job market

Accordingly, the job market has been going gangbusters – which remains a mystery of sorts. From an already satisfyingly low rate of 4.5 to 4.0 per cent in 2017, unemployment fell to the high threes for most of 2018.

After the discouraged exodus from the labour force during the financial crisis, where have these workers come from? Adult civilian labour force participation, which was as high as 67.3 per cent in January of 2000 and still 66.4 per cent in January of 2007, plunged to 62.9 per cent in January of 2017, and has barely budged to 63.1 per cent in December of 2018.

And another mystery: The US popular press is full of stories about the dawning of an age of robots that will take over a broader and broader range of jobs. The future of work is a hot topic. And yet, measured US productivity growth remains puzzlingly slow.

Some argue that the US national accounts mis-measure output, on the low side. And yet, the missing income from the national accounts certainly does not show itself in consumption (or on tax returns). Perhaps all of this missing income is realised in leisure-time enjoyment or quality of life. But if so, the puzzle is why we are all not happier. Or perhaps we are, but somehow do not notice it.

Meanwhile, employers who are facing this tighter job market have begun increasing wages, if very gradually. Yet so far, inflation rates remain low. Has competition in an economy that compares prices in nanoseconds in cyberspace become so intense that inflation will remain dormant? And yet…

Trade uncertainty

Economic policy is, to some, problematic. In 2017, the US withdrew from the Trans Pacific Partnership, just as the nation needed every friend to mount an attack on questionable trade practices by China. And the US Administration began heated argument with the nation's two leading trade partners and neighbours, Canada and Mexico.

The dispute with China remains in the shouting stage, while the renegotiated North American Free Trade Agreement (the original was undeniably in need of revision, having been written before the general availability of the Internet) remains stalled in a balky US Congress. US trade volumes fluctuated more than normal in 2018, as some flows have increased to beat anticipated competitive tariff increases and then ebbed thereafter.

A wild ride on the stock market

Some might think that trade uncertainty is the cause of the wild oscillations in the US stock markets at the end of 2018. Others would cite instead slowly rising interest rates as the culprit.

A full decade of crisis-restrained low interest rates is finally coming to an end, leaving many observers seemingly disoriented as the numbers have shifted for the first time in so long. Rates remain extremely low from an historical perspective, which might suggest that the Federal Reserve's critics are over-reacting.

The Fed itself would argue that maintaining low interest rates over long periods of time would create distortions in the financial structures of business firms, twist incentives, and lead to financial bubbles. Monetary authorities also quite naturally prefer that rates are high enough that they can be cut to bolster any future economic downturn. But others fear that the economic downturn may be already upon us, witness the stock market slide, and that increasing interest rates too soon may make that downturn unnecessarily worse.

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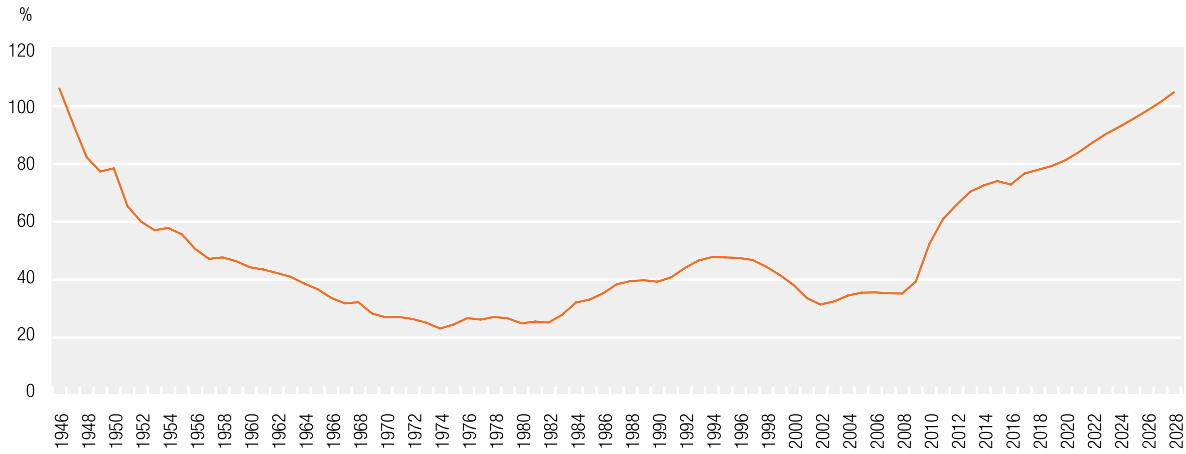
FIGURE 1
US ratio of debt held by the public to GDP



Source: US Congressional Budget Office. The Budget and Economic Outlook: 2018 to 2028

December 2018 brought intense focus on those minute-by-minute gyrations of the stock market, with frequently articulated fears that the downsides might portend or even cause an early recession. But more-quiet concern about the more distant future may be even more important.

A troubling budget outlook

President Trump has declared that he will not cut the US Medicare and Social Security programs, which arguably are the leading causes of a highly troubling federal budget outlook. There we return to the December 2017 tax cut, which by one year's evidence seems to have had the predicted effect of worsening the budget deficit picture.

Factoring in that tax cut and a number of likely fiscal developments (most but not all of which, including extending legally expiring tax cuts, worsen the baseline outlook), leads the CBO to project a public debt outlook (see Figure 1) that in 10 years would virtually match the highest US debt burden in history from 1946, at the end of World War II.

Obviously, the 2028 economy and budget are likely to prove not at all the match for the post-World War II US environment for economic growth and budget savings. In 1945, for example, the US federal government spent almost 37 per cent of the US GDP on defense; by 1948, it was 3.5 per cent, contributing an enormous reduction in public spending. In 2018, defense spending is estimated at only 3.2 per cent, rendering a 33-per-cent-of-GDP reduction rather difficult.

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Likewise, among other changes in the potential for economic growth, in 1946 the troops were marching home to join the labour force, whereas in 2028 the oversized baby-boom generation will still be wobbling off toward retirement.

President Trump has been quoted (from private setting by unattributed sources) as when presented with this budget outlook, having acknowledged the issue, but to have added, "Yeah, but I won't be here." Such reports may not be credible, but they do convey well the reality of the US economic and budget outlook at the end of 2018.