Introduction

By Melissa S. Kearney and Amy Ganz

A national debate about the strength and fairness of American capitalism is taking place against a backdrop of vast levels of income and wealth inequality, growing pessimism about the state of economic opportunity and mobility, increased market concentration in many sectors, and a precarious fiscal situation. Restoring the promise of America's capitalist system will require policies that enable more Americans to succeed in our market-based economy. Designing effective policies requires an accurate diagnosis of what is ailing American capitalism in order to effectively strengthen it. This volume brings to bear perspectives from leading subject matter experts on critical issues.

This book is organized around three broad economic challenges facing the United States. Section I addresses the widespread concern that increasing market concentration in many sectors is stifling competition and undermining a more dynamic economy. Section II explores the federal government's unsustainable deficit and debt position and the associated concern that such trajectories imperil the long-run stability and security of the American economy. Section III considers a range of current policy ideas—including a federal wealth tax, "Medicare for All," and universal basic income—that would dramatically change our economic institutions and policies in order to achieve greater progressivity through taxes and government spending.

Part I: Market Concentration

Competition in product and labor markets allows for the efficient allocation of resources and is the foundation of the market economy. Competition drives innovation, lowers prices, and increases output. Yet, there is reason to worry that competition in the U.S. product and labor markets is dwindling. Fewer new firms are entering some markets; aggregate measures of firm concentration are rising; and mergers and acquisitions have increased. These trends coincide with a falling labor share of income and rising profits among market-leading firms, stoking concern among many observers about increasing firm monopoly power over consumer prices and monopsony power over employee wages.

However, there is not consensus among scholars as to what the trends in market concentration are, let alone what they imply for consumer and worker welfare. A recent academic paper shows that concentration in local markets has actually

declined, even as aggregate measures have increased.[1] Furthermore, to the extent that some industries have experienced increased concentration and a decline in the labor share of profits, it is not clear that the trends reflect anticompetitive forces or an erosion of labor institutions. For instance, a recent paper presents evidence that the decline in the labor share is consistent with a rise of "superstar firms." In this framework, changes in the economic environment that advantages the most productive firms in an industry lead to an increase in product market concentration and a fall in labor share. Competing explanations for recent trends in market concentration have very different policy implications.[2]

This volume features two chapters on the state of market concentration and competition in the United States, and potential policy responses to these trends. Nancy Rose, the Charles P. Kindleberger Professor of Applied Economics and Head of the Department of Economics at the Massachusetts Institute of Technology, encourages caution in interpreting aggregate trends in market concentration as signifying meaningful reductions in competition. Her memo highlights substantial measurement challenges that call into question the interpretation of these measured trends.

Despite Rose's skepticism that the documented increases in market concentration actually reflect reduced market competition, her assessment of the relevant economic and legal landscape lead her to suggest reforms that would promote greater market competition and enhance antitrust enforcement from the Department of Justice and other federal agencies.

Economist Thomas Philippon, Professor of Finance at the Stern School of Business at New York University, takes a more aggressive stance on the issue of whether market concentration is impeding competition. He argues that although increasing market concentration is not always harmful to the economy, rising concentration since the early 2000s has produced market inefficiencies and reduced investment and productivity growth. He also attributes much of the increase in market concentration since the early 2000s to weak antitrust enforcement and new barriers to entry.

In response, Philippon proposes regulatory reform at the federal and state level that would promote greater competition, including more vigorous antitrust enforcement and occupational licensing reform. Philippon also considers the state of digital competition, an area that has garnered much interest and concern in recent months. There, he encourages strengthening regulations that would promote consumer welfare by increasing platform interoperability and data portability.

---

1 Rossi-Hansberg, E., Sarte, P. D., & Trachter, N. (2019). *Diverging Trends in National and Local Concentration*. (Working Paper No. 18-15R). Federal Reserve Bank of Richmond. Retrieved from https://www.princeton.edu/~erossi/DTNLC.pdf

2 Autor, D., Dorn, D., Katz, L. F., Patterson, C., & Van Reenen, J. (2019). *The Fall of the Labor Share and the Rise of Superstar Firms.* Retrieved from https://economics.mit.edu/files/12979

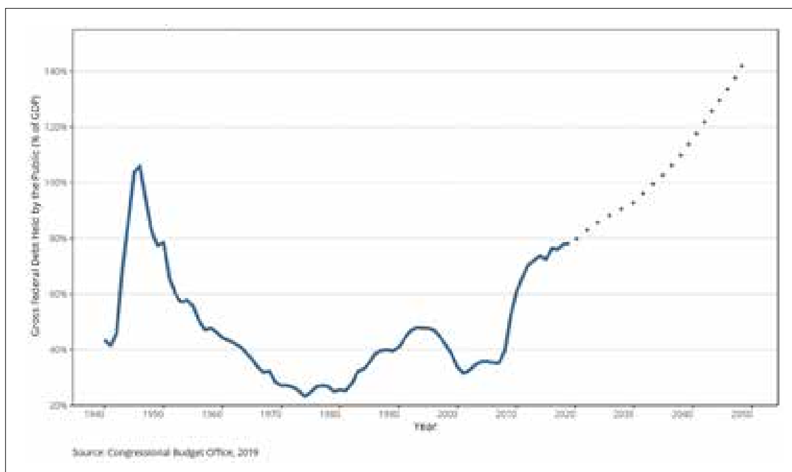
Part II. Rising Federal Debt and Slowing Economic Productivity

2.1 U.S. Fiscal Debt

According to recent estimates from the Congressional Budget Office, the U.S. debt as a share of the economy is on track to surpass its previous World War II high of 106% of Gross Domestic Product (GDP) as soon as 2037 and climb to 144% by 2049 (see Figure 1). The projected surge in long-term debt is driven by a combination of increased entitlement spending on an aging population and interest payments on the national debt. Government spending as a share of GDP is on track to increase from 20.7% today to 28.2% by 2049. In contrast, revenues under current law are expected to remain relatively flat, increasing from only 16.5% to 19.5% of GDP over the next 30 years.[3]

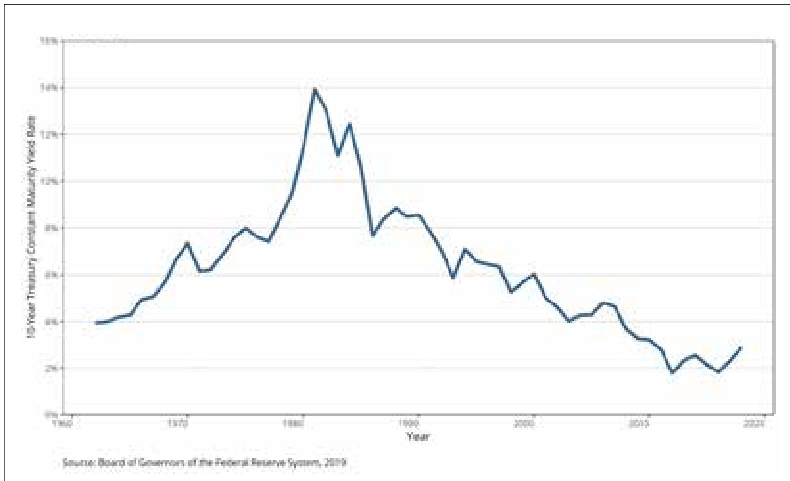
Prior beliefs about fiscal constraints are being challenged by historically low interest rates and unprecedented levels of government debt. Current projections show that the United States' debt and deficit trajectory will continue to rise indefinitely as a share of the economy absent policy change. Yet, long-term interest rates on government debt remains historically low (Figure 2). Moreover, many mainstream, macroeconomic models imply interest rates are expected to remain well below historical levels for the foreseeable future.

Figure 1. Debt Trajectory



3 Congressional Budget Office (2019). *The 2019 Long-Term Budget Outlook.* Retrieved from https://www.cbo.gov/publication/55331

Figure 2. Long-Term Interest Rates Have Been Persistently Low



To what extent should policymakers be concerned about stabilizing the fiscal trajectory now as opposed to waiting until later? In his chapter, William Gale, the Arjay and Frances Miller Chair in Federal Economic Policy at the Brookings Institution, argues that the federal fiscal outlook is unsustainable even if interest rates remain below the growth rate for the next 30 years. He argues that short-term policy responses should focus on investments that are tax-financed rather than debt-financed, and that, most importantly, policymakers should enact a debt reduction plan that is gradually implemented over the medium to long term. He also considers the merit of enacting various fiscal targets, such as a benchmark of debt-to-GDP or interest payments as a share of the economy.

2.2 Technological Innovation

Any proposal for new government spending or changes to the tax code will raise important questions about what is *fiscally feasible* in light of the federal government's debt and deficit trajectory. Of course, not all spending proposals will have the same long-run impact on the budget, dollar-for-dollar, since some expenditures will enhance economic growth and eventually create more government revenue.

Long-run economic growth is driven by productivity gains and, in particular, technological innovation. Government investments in technological innovation have played a significant role in America's economic prosperity. But, will America remain at the forefront of technological advancement, especially in light of the massive government investments in new technology in China and other East Asian countries?

In his chapter, MIT economist John Van Reenen argues that the private sector alone does not invest in developing new technologies at a socially optimal level. Further, he argues that large, positive economic spillovers exist from government-sponsored basic research and private-sector technological innovation, which justify far greater public investment in such activities. Van Reenen considers the merits of a U.S. industrial policy that would be comprised of tax credits, direct subsidies, and human capital investments, all of which have been shown to produce net positive research and development activity in the public and private sectors.

Part III. Increasing Government Redistribution in Response to Income Inequality and Declining Economic Mobility

3.1 Rising Income Inequality and Declining Economic Mobility

Trends showing widening income inequality, stagnant median income growth, and declining economic mobility suggest economic opportunity is declining and economic outcomes are disappointing for many Americans. The average household in the bottom 20% experienced annual income gains of 0.8% per year between 1979 and 2015, while average incomes in the top 1% grew by 3.4% per year over the same period.[4] Figure 3 illustrates overall income growth by household income quintile since 1979. After taxes and transfers, income growth for the average household in the bottom quintile from 1979 to 2015 approached 80% (1.6% per year), with about half of that growth composed of means-tested transfers (i.e., Medicaid, Children's Health Insurance Program (CHIP), Supplemental Nutrition Assistance Program (SNAP), Supplemental Security Income (SSI)). Meanwhile, those in the middle 60% of the distribution saw income gains of 45% to 51% (1% to 1.2% per year), post taxes and transfers. The distribution of post-transfer income growth by quintile is illustrated in Figure 4.

While income inequality has increased over time, intergenerational mobility—the share of adults who eventually earn more than their parents—has decreased. Data reveals that today's generation of adults are less likely to have surpassed their parents' level of income than the generation before them. Figure 5 shows that the share of children who surpass their parents' earnings as adults has declined sharply over the past few decades. Only 50% of individuals born in the 1980s earn more than their parents did at their age, as compared to more than 90% of adults born in the 1940s.[5]

4 Congressional Budget Office (2018). *The Distribution of Annual Income, 2015*. Retrieved from https://www.cbo.gov/system/files/2018-11/54646-Distribution_of_Household_Income_2015_0.pdf

5 Chetty, R., Grusky, D., Hell, M., Hendren, N., Manduca, R., & Narang, J. (2017). *The Fading American Dream: Trends in Absolute Income Mobility Since 1940.* (Working Paper No. 22910). National Bureau of Economic Research. Retrieved from https://doi.org/10.3386/w22910

Figure 3. Change in Average Pre- and Post-Tax and Transfer Income by Quintile from 1979–2015: Total Percentage Income Change, Before Taxes and Transfers

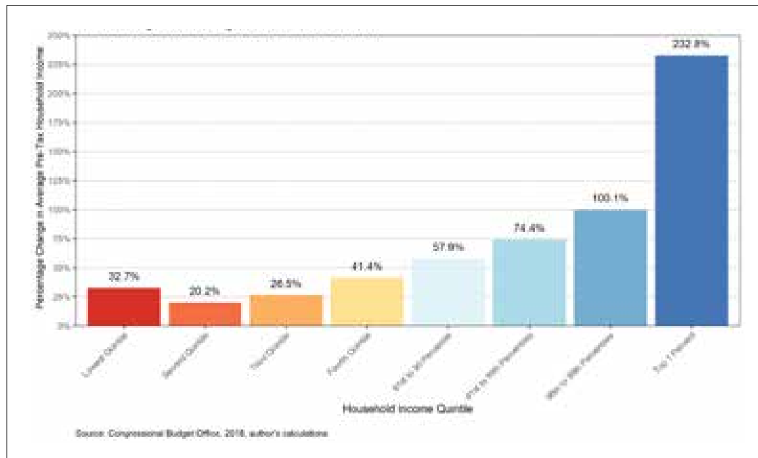
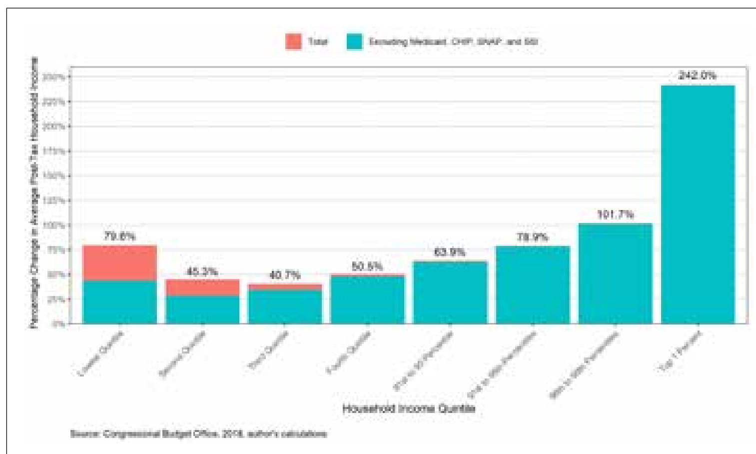


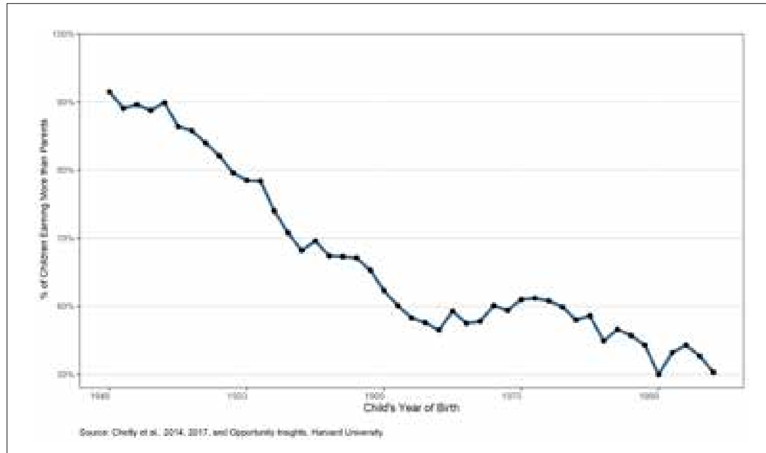
Figure 4. Change in Average Post-Tax Income by Quintile from 1979–2015: Total Percentage Income Change, After Taxes and Transfers



Low rates of economic mobility result from *both* lower economic growth and increasing income inequality. Had economic growth maintained the levels the United States experienced in the mid-20th century—and assuming no changes to the current distribution of growth—62% of individuals born in 1980 would earn more than their parents did. In contrast, assuming current growth rates but allowing

income to be distributed as it was in the 1940s, 80% of children would exceed their parents' income level.[6]

Figure 5. Absolute Economic Mobility Has Declined



3.2 Policy Responses

Many Americans report favoring bold policy proposals to reduce income inequality and foster greater economic mobility. A number of leaders are calling for a dramatic expansion of government programs and benefits to deliver more widespread economic security. Proposals for *universal* benefits, including for childcare, health care, post-secondary education, and even basic income, abound in today's policy debates, each of which would expand the scope and reach of the social safety net higher up in the income distribution.

In his chapter, Craig Garthwaite, the Herman R. Smith Research Professor in Hospital and Health Service at the Kellogg School of Management, describes the economic trade-offs of expanding the government's role in financing and regulating health care through a single-payer system such as Medicare for All. Such a policy would expand access and potentially reduce the costs of health care for beneficiaries. Garthwaite highlights the trade-offs and downstream consequences of such a significant structural change to the U.S. health-care system, including potential changes in the quality and quantity of medical services supplied and the willingness of drug innovators to invest in the research and development (R&D) of new products. Garthwaite also highlights several alternative policy approaches that could promote the dual goals of increasing access to and affordability of health care.

---

6 Chetty et al., 2017.

Another policy idea that has enjoyed renewed popularity in recent years is the idea of a government Universal Basic Income (UBI) guarantee. Aspen Economic Strategy Group (AESG) members Melissa Kearney and Magne Mogstad argue that any substantial UBI program would be extremely expensive—potentially costing up to $3 trillion per year, or roughly three-quarters of the *entire* U.S. federal government budget—and yet would do little to address the underlying challenges driving increased income inequality and decreased economic mobility. They argue that a UBI would spend a great deal of public resources providing income assistance to individuals who don't need it. Furthermore, they argue, a UBI could exacerbate the very challenges the policy is intended to address by discouraging work and diverting resources away from existing benefit programs that promote human capital development and economic mobility.

Recent polling data show that a large majority of registered voters believe the tax system favors the wealthy (73%) and upper-income individuals should pay more in taxes (63%).[7] At the time of this writing, two presidential candidates and numerous lawmakers in Congress have responded by putting forward proposals that would raise dramatically more tax revenues from the wealthiest Americans, including by taxing wealth directly.

This volume features two chapters written by leading tax experts on the issues of wealth taxation and income tax reform. Alan Viard of the American Enterprise Institute focuses his analysis on the wealth tax proposals put forward by presidential candidates Senator Elizabeth Warren (D-Massachusetts) and Senator Bernie Sanders (I-Vermont). Viard argues that a wealth tax would likely reduce national saving and investment, although the latter impact would likely be ameliorated somewhat by an increase in capital inflows from abroad. He also highlights that although the proposed wealth tax rates appear to be low, they are equivalent to high-rate income taxes. Finally, he cautions that a wealth tax would potentially encounter a number of compliance and administration hurdles, and its revenues would likely erode if Congress were to add additional exemptions for certain asset classes, such as real estate.

Lily Batchelder, the Robert C. Kopple Family Professor of Law, and David Kamin, Professor of Law, both of NYU School of Law, analyze the benefits and drawbacks of four different but potentially complementary approaches to increasing the progressivity of the tax code and raising drastically more revenue from the wealthiest Americans. These approaches include a dramatic increase in the progressivity of taxes on labor and other ordinary income; a tax on accrued gains of the wealthy at ordinary income tax rates; a wealth tax on high-net-worth individuals; and a financial transactions tax. They also identify incremental approaches that could be taken to

7 Politico. (2019). *National Tracking Poll #190202* [Poll]. Retrieved from https://morningconsult.com/wp-content/uploads/2019/02/190202_crosstabs_POLITICO_RVs_v1_AP.pdf

raise more revenue from the wealthy without making substantial changes to existing tax structures, including the reversal of several provisions in the 2017 tax law, taxing accrued gains at death at higher rates, and reducing the exemption threshold and increasing the rate of estate taxes, among other approaches.

Conclusion

Government in a market-based, liberal democracy should seek to foster healthy market competition, promote economic opportunity, and address inequities in the market distribution of outcomes in ways that are consistent with our democratic ideals and values. This volume represents an effort to bring the best evidence to bear on some of the greatest economic challenges facing American capitalism today and on potential policy responses to those challenges.