Inforum Economic Outlook

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University of Maryland
December 12, 2013
The Newest Generation of LIFT: IDLIFT2

- Interindustry structure and information derived from BEA benchmark 2002 IO and 1998-2010 annual IO tables.
- Time series of REAL IO Tables from 1998.
- Industry and commodity definitions harmonized with BEA NAICS IO and industry data.
- Consistent industry definitions for investment, employment and value added.
- Industry data integrated and reconciled to latest version of NIPA in real and nominal terms.
- Built partly with generous support of Center for Medicare and Medicaid Services (CMS).
Employment: More of the Same

Employment year-on-year percentage growth

Source: Bureau of Labor Statistics
U.S. Economy in 3 Graphs: The GDP Gap

Real GDP – CBO Potential (% of Potential)

Lowest since 1982
Civilian labor force participation rate (%)

Lowest since 1978
U.S. in 3 Graphs: Inflation and Interest Rates

Effective Federal Funds Rate

Core Consumer Inflation

Lowest since loans invented
The Good News

- Deleveraging easing, especially for non-financial businesses.
- Private business sitting on lots of cash. Non-financials wait for firmer expansion of demand.
- Pent-Up demand for housing, rising home prices.
- Energy production increases.
- In 2014-15 exports accelerate again.
- Moderation of sequester. For the moment, political winds improved.
- Fiscal Stimulus? Infrastructure deserves a big new spend.
## Outlook Overview

### Real (Inflation-Adjusted) Quantities, Average Annual Growth Rates, Percent

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<th>00-11</th>
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<td><strong>Demand</strong></td>
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<td>Gross domestic product</td>
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<td>GDP deflator</td>
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<td>1.4</td>
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<td>1.9</td>
<td>2.1</td>
<td>2.2</td>
<td>2.6</td>
<td>2.4</td>
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### Prices

- GDP deflator
- Consumption deflator
### Outlook Overview

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<tr>
<th>Supply (Percent Growth)</th>
<th>00-11</th>
<th>11-12</th>
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<tr>
<td>Population</td>
<td>0.9</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
<td>0.9</td>
<td>0.9</td>
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<td>Labor force</td>
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<td>0.9</td>
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<td>0.8</td>
<td>0.9</td>
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<tr>
<td>Employment</td>
<td>-0.1</td>
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<td>1.4</td>
<td>1.7</td>
<td>1.5</td>
<td>1.2</td>
<td>1.0</td>
<td>1.0</td>
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<tr>
<td>Labor productivity</td>
<td>1.8</td>
<td>0.9</td>
<td>0.3</td>
<td>0.5</td>
<td>0.9</td>
<td>1.3</td>
<td>1.5</td>
<td>1.3</td>
<td>1.3</td>
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<tr>
<td>Potential GDP (Real)</td>
<td>2.6</td>
<td>1.7</td>
<td>1.8</td>
<td>1.9</td>
<td>2.1</td>
<td>2.3</td>
<td>2.4</td>
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<tr>
<td>Unemployment Rate (%)</td>
<td>8.9</td>
<td>8.1</td>
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<td>6.3</td>
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### Interest Rates

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<tr>
<td>Treasury Bills, 3-month</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>0.5</td>
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<td>3.5</td>
<td>3.8</td>
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<tr>
<td>Yield, 10 yr. Treasury bond</td>
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### Nominal Quantities, Billions of Dollars

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<tr>
<td>Current account (% of GDP)</td>
<td>-2.9</td>
<td>-2.7</td>
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<td>-2.9</td>
<td>-3.1</td>
<td>-3.4</td>
<td>-3.1</td>
<td>-1.5</td>
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<td>Federal net borrowing (% of GDP)</td>
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<td>-7.5</td>
<td>-5.8</td>
<td>-4.9</td>
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<td>-3.6</td>
<td>-1.8</td>
<td>-2.1</td>
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</table>
Is monetary policy effective?

Money multiplier (m2/mbase) and velocity (gdp/m2)
Is quantitative easing blowing bubbles?

Shiller P/E Ratio and Long Term Interest Rates

The Perils of Tapering

- Most dangerous potential effects in emerging markets.
- Presumably, “tapering” means a gradual adjustment to bond prices. What is the chance of that? (refinance)
- Mortgage rates will rise, but pent-up demand should keep housing buoyant.
- Fed will be prepared to reverse drawdown of QE if growth falters.
- Fed stresses the importance of “communication,” but a lack of “understanding” on the part of market commentators, the media, and congresspersons complicates their task.
Is Fiscal Policy More Effective?

Real Total Fed + S&L Spending After Recessions

Quarters After Recession Trough

1982q4  1991q1  2001q4  2009q2
GDP Recovery After Recessions

Quarters After Recession Trough

1982q4  1991q1  2001q4  2009q2
Employment Recovery after Recessions

Quarters After Recession Trough

- 1982q4
- 1991q1
- 2001q4
- 2009q2

Graph showing employment recovery over different recessions with markers for specific quarters.
Good Short Term Policy Options

Monetary
- Provide clear guidance on QE taper and Fed rate.
- If needed, extraordinary policy still available: Create temporarily high inflation to aid deleveraging. Price level targeting, GDP targeting.

Fiscal
- More fiscal stimulus to fill AD hole: Bond yields remain low, education and infrastructure provide “bang for the buck.”
- Stimulus combined with deal on raising revenue with tax reform and reducing future entitlements would be most effective.

Structural
- Tax reform (eliminate loopholes, reduce rates).
- Relax regulations and other restrictions.
- New labor market measures (job matching, increase mobility).
Household Net Worth  
(Multiple of GDP)

Source: Federal Reserve Board
Household Debt Service
Percent of Household Disposable Income

Source: Federal Reserve Board
Europe will grow again, slowly

Annual percent change in GDP (2005 dollars)

<table>
<thead>
<tr>
<th>Country</th>
<th>2010</th>
<th>00-10</th>
<th>10-11</th>
<th>11-12</th>
<th>12-13</th>
<th>13-14</th>
<th>14-15</th>
<th>15-16</th>
<th>16-17</th>
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<td>3.9</td>
<td>3.1</td>
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<td>Mexico</td>
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<td>North America</td>
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Sources: Inforum, OECD Economic Outlook, Consensus Forecasts, Blue Chip Economic Indicators, IMF WEO
U.S. remains very competitive
Unit labor costs 1995 = 100

Source: OECD
Health Care Expenditures Have Grown Slowly Since 2007

![Graph showing annual growth of national health expenditure and gross domestic product from 1960 to 2011. The graph indicates a steady increase in health expenditure growth until 2007, followed by a decline.](image-url)
## Both Excess Inflation and Excess Expenditure are Down

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<tr>
<td><strong>Annual Percent Change</strong></td>
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<tr>
<td>Gross Domestic Product (GDP)</td>
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<td>National Health Expenditures</td>
<td>8.9</td>
<td>9.8</td>
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<td>3.6</td>
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<td>NHE as percent of GDP</td>
<td>2.4</td>
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<td>Real Health Care Expenditure</td>
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### Decomposition of "Excess Cost" of Health Care

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<td>Excess Health Care Cost</td>
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<tr>
<td>Excess Health Care Inflation</td>
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<tr>
<td>Excess Real Expenditure</td>
<td>1.2</td>
<td>1.1</td>
<td>1.4</td>
<td>-0.6</td>
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Why? Have We Bent the Curve?

- Recession (loss of income and job-base insurance)
- Significant increase in cost-sharing
- Generic prescriptions
- Structural changes in private market (ACA and non-ACA)
- Medicare/Medicaid Changes (independent of ACA)
- Medicare/Medicaid Changes (because of ACA)
- Coming ACA: Provider MFP Fix
ACA Penalizes Hospital Readmissions

Monthly Medicare 30-Day, All-Condition Hospital Readmission Rate
January 2007 - August 2013

Source: Centers for Medicare and Medicaid Services, Offices of Enterprise Management.
My Platform:

If you have an insurance plan, and you like it, that has to stop.

Economics of insurance reform is a Classic Insider-Outsider game.
ObamaCare: Did Something Go Wrong?

The Uninsured Population - As a Share of the Nonelderly Population and by Poverty Levels, 2012

- Medicaid/Other Public, 20.8%
- Employer-Sponsored, 55.7%
- Uninsured, 17.7%
- Private Non-Group, 5.8%

- >400% FPL: 10%
- 251-400% FPL: 14%
- 100-250% FPL: 37%
- <100% FPL: 38%

47.3 M Uninsured

266.9 M Nonelderly
**Tax subsidies for health are unfair and boost (wasteful?) expenditures**

<table>
<thead>
<tr>
<th>Insurance Person</th>
<th>Employer Provided</th>
<th>Individual</th>
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<td>A</td>
<td>B</td>
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<tr>
<td>Premium Cost</td>
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<td>12000</td>
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<tr>
<td>(including employers)</td>
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<td></td>
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<tr>
<td>Income</td>
<td>150,000</td>
<td>50,000</td>
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<tr>
<td>Tax bracket</td>
<td>30%</td>
<td>15%</td>
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<td>Tax subsidy</td>
<td>3600</td>
<td>1800</td>
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<tr>
<td>Net cost</td>
<td>8400</td>
<td>10200</td>
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What would “alternative” reform look like?

- Separate employment from health insurance and defragment market by removing tax bias for employer-provided insurance.*
- Promote more market-orientated and “patient-centered” approaches (national exchanges, FSA, etc.)
- Increase cost-sharing (even more). Higher-deductible plans.
- Allow premiums to vary based on health “status,” age, gender, etc. Federal determination of income and health based premium supports.
- Increase information and transparency.
- Transition Medicaid recipients into the market exchanges.
- Break monopoly certification rules and rationalize tort system.

* Note: Tax deductibility of employer provided health premiums is quite possibly the stupidest law of the land.
Further Reading

On health care cost trends:

Trends in Health Care cost Growth and the ACA
http://www.whitehouse.gov/sites/default/files/docs/healthcostreport_final_noembargo_v2.pdf


On alternative programs:

“Best of Both Worlds: Uniting Universal Coverage and Personal Choice in Health Care,
http://www.aei.org/policy/health/healthcare-reform/

The American Health Care System: Principles For Successful Reform,

Uwe Reinhardt:
Long Term Issues

- Potential GDP: How much hysteresis from the Great Recession? Can we reach “full” employment?
- Hysteresis - Intercept Change
- Secular Stagnation – Chronic Operation Below Potential (Summers)
- Technological Stagnation - Slope Change (Gordon)
- Factors:
  - Federal Debt – Do high rates slow growth?
  - Increasingly Unequal Income Distribution
  - Entrepreneurial Crisis
  - Political Dysfunction – Rent seeking and Olsonian Decline (great upheaval can reset society)
Potential GDP and GDP 2000-2030

Billions of 2005 dollars

Potential GDP, Dec. 2007

Potential GDP, Dec 2013

Current GDP forecast
GDP Gaps: Did we permanently lose 6% of income?

For further discussion see: Aggregate Supply in the United States: Recent Developments and Implications for the Conduct of Monetary Policy, Reifschneider, et. al. (FRB)
Debt Check! Federal Net and Gross Debt

Source: U.S. Treasury Department and Inforum Calculations
...do not cover future obligations.

Perspective: This is 6.6% of Notional PV of GDP, 2013-2087
Entitlement Reform: Social Security

- Increase cap on payroll taxes.
- Change COLA to better reflect inflation.
- Increase retirement age.
- Cover new S&L workers.
- Reduce benefits for richest, strengthen safety nets for poorest. (What is meant by “means-testing”?)
- Little sentiment for privatization of SS accounts.
- Politically implausible
- Since most boomers have insignificant savings, do these entitlement cuts make sense?
Tax Reform: How can we tax labor and capital less and consumption more?

- Reduce/Eliminate tax expenditures, especially:
  1. Convert health care premium income exclusion to tax credit (voucher). (~$160 billion in FY2010)
  2. Phase out mortgage interest deduction (~$110 bill in 2010).
- Use proceeds to lower and flatten rates.
- Lower Corporate tax rates (phase out eventually)
- Unify rates across earned, dividends, capital.
- Best time ever for Higher energy taxes/Carbon tax!
- National Sales (RD) or Value Added Tax.
Do we Have an Entrepreneurship Crisis?

Net Business Creation (thousands)

Private sector establishment births and deaths, seasonally adjusted. Total private. Levels in thousands. BLS.
Most “net” new jobs created from new firms.

Source: Davis, Faberman and Haltiwanger (2010)
U.S. Income Distribution became skewed in the last thirty years.

Cumulative Growth in Before Tax Income (2010 dollars)

- 1st Quintile
- Second-Fourth Quintiles
- 81st to 99th
- Top 1 Percent

Source: CBO
Especially in Education

Fraction of students completing college by income quartile and birth year

And in health status and life expectancy

Increase in Life Expectancy, and Increase in Difference in Life Expectancy by Economic Status


a. Socioeconomic groups are defined using county-level indicators of education, occupation, unemployment, wealth, income, and housing conditions.
**Does Income Inequality Discourage Growth?**

Stiglitz, Deaton, Solow, Saez, Podesta

It appears that both Inequality and Immobility are rising.

Potential Mechanisms:
- Lower consumer spending
- Leads to credit bubbles and crisis
- Underinvestment in education and health
- Government capture: Rent-seeking behavior
- Reduce risk-taking and entrepreneurs

Further reading: Journal of Economic Perspectives—Vol 27, No. 3—Summer 2013
Robert Gordon Stagnation Thesis


- Recent innovation (ICT) does not stack up well vis-à-vis mid-20th century innovations, especially electricity, internal combustion engine, running water, indoor toilets, communications, entertainment, chemicals, petroleum.

- Headwinds will subtract from MFP growth: demography, education, inequality, globalization, energy/environment, and the overhang of consumer and government debt.
Marxian Optimism

Marx was first to place technology at center of economics growth -- just when the situation seems darkest for capitalism, technology bails it out.

Technologies coming down the pike:
- Cheaper, environmental friendly energy (NG)
- Self-driving cars
- Additive (3D printers) manufacturing)
- Robotics
- Big data
- Genetically modified crops and animals
- Translation technologies
Longer term forecast (to 2040):

- Potential GDP growth $\sim 2.4\%$
- Forecast assumes gradual rebalancing of private, government and external accounts.
- Weaker dollar, rapid technological growth in manufacturing, and rising savings rate changes economic structure toward exports and away from consumption.
- Nonetheless, government services and transfers will expand. Health care spending (with/without reform) will dominant future of government spending and domestic production growth.
- All roads lead to tax reform. To pay for entitlements, education and infrastructure, government revenues will have to rise. How this is accomplished is important.
Long term potential growth is almost 2.4%

Difference in logs, 5-year moving average
Current account deficit: soft landing

Billions of dollars

Current account
Net income
Net trade
Net Transfers
Federal expenditures, revenues and deficit

Percent of GDP

Expenditure
Revenue
Deficit

rev_gdp
exp_gdp
def_gdp
Federal Debt as percent of GDP
Inforum Economic Outlook

Thank you!