

POLICY BRIEF

**RECOMMENDATIONS
FOR THE NEW
ADMINISTRATION**

Policies to Promote Economic Growth in the United States

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This brief is part of a series of policy recommendations for the administration of President Joe Biden. Focusing on a range of important issues facing the country, the briefs are intended to provide decision-makers with relevant and effective ideas for addressing domestic and foreign policy priorities. View the entire series at www.bakerinstitute.org/recommendations-2021.

INTRODUCTION

The question of whether the United States is likely to continue on the robust growth path of earlier years or whether economic growth is likely to decelerate or even enter an extended period of “secular stagnation” is of critical importance to future living standards. In this policy brief, we examine: (1) the role of technology in promoting productivity growth, (2) the relationship between labor markets and economic growth, including the importance of human capital accumulation and the role of immigration; and (3) the effects of fiscal policy, including both expenditure and tax reform, on the prospects for growth.¹

ADVANCES IN TECHNOLOGY AND ECONOMIC GROWTH

The effects of advances in technology on economic growth are highly controversial, with a huge chasm between the views of the “techno-optimists” and the “techno-pessimists.” The techno-pessimists argue that recent technological advances, such as artificial intelligence (AI) and information

communication technologies, are not as transformative as earlier revolutionary general purpose technologies—such as the steam engine, electricity, and the internal combustion engine—so that the slowdown in productivity growth experienced over the past 50 years is likely to continue. By comparison, the “techno-optimists” argue that recent and future productivity and growth-enhancing developments in AI, robotics, and digitally connected sensors will, after a lag of undetermined length, spark a new era of technology-induced increases in productivity that will lead to significantly faster economic growth. Indeed, this view has led to concerns that such increases in productivity will eventually be so dramatic and will occur so rapidly that they will significantly increase unemployment over time, leading to often-discussed concerns about the “future of work” and prospects for significant and persistent unemployment.

The evidence thus far can be broadly interpreted in two ways. On the one hand, the largely tepid growth in productivity despite significant technological advances over most of the last 50 years is consistent with the techno-pessimist story. On the other hand, the argument that significant



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amounts of time may be required before technological advances are translated into productivity gains, but such gains could eventually be significant (Hubbard, forthcoming) strikes us as quite plausible. Moreover, the fact that recent significant technological advances have not been rapidly translated into large productivity gains suggests that problems with increasing unemployment will develop slowly. This in turn increases the likelihood that, over time, technological advances will, as they have with technological advances in the past, lead not only to productivity growth and increases in aggregate wealth and living standards but also to increases in employment attributable to the creation of many complementary and new jobs, many of which will be robot-assisted and some of which may not yet even be envisioned—results that will mitigate employment concerns, especially if the transition is lengthy and gradual. Moreover, declines in the size of the labor force due to aging of the population (and perhaps to reduced immigration) should also help limit the problems associated with technology-induced job losses.

Our view is that this debate about the implications of technological advances for economic growth suggests two broad directions for public policy. First, the United States should promote future productivity growth by facilitating increased innovation, including in AI, robotics, and digital sensors. Expanded government support for research and development (R&D), especially basic research, is appropriate. In particular, recent declines in real federal R&D spending are extremely troubling, as are recent proposals to further cut such spending. In addition, the provision in the recently enacted Tax Cuts and Jobs Act (TCJA) that will require five-year amortization of R&D expenses—rather than the long-standing treatment of immediate expensing—seems singularly misguided. (The maintenance of the incremental R&D credit is also appropriate, given the positive externalities associated with such investment.)

Second, we can limit technology-induced job losses by significantly augmenting existing policies for retraining, ongoing education, increasing mobility, and income support during the transition between jobs—consistent with the often-expressed theoretical arguments that changes that improve aggregate welfare but cause individual losses should be accompanied by compensation for those losses. The United States currently provides such assistance for trade-related job losses under the Trade Adjustment Assistance (TAA) program, but the TAA program is minuscule in comparison to the losses suffered. It should be expanded and better designed, applying more generally to job displacement including that associated with technological advances, and provide funds for lifelong learning and training programs and workforce development.

LABOR AND ECONOMIC GROWTH

Increasing labor productivity is clearly of critical importance to maintaining economic growth. Cunha (forthcoming) argues that the key to improving the skills of the labor force, especially at the lower end of the income distribution, is to promote college readiness among children who grow up in low-income households and to improve the matches between college-ready, low-income students and colleges; he stresses that college readiness requires investments in children at a very early age, coupled with parental education. This implies that resources in the United States should be focused on both education designed to enhance cognitive skills and the development of socioemotional skills at early (preschool) ages for low-income children—rather than the enactment of expensive non-means-tested proposals for tuition-free college at two-year colleges and all public universities. Providing college-ready low-income students with better guidance regarding opportunities at more selective institutions, especially information about the application process and available financial aid, would also generate large returns.

Another way to expand the labor force is through immigration. For example, Borjas (forthcoming) argues that admitting high-skill immigrants is the policy most likely to increase economic growth, especially if such immigrants have positive external effects on the productivity of native workers. We would add two caveats or extensions. First, the children of immigrants have relatively higher rates of upward income mobility, which suggests that a policy focusing on admitting high-skill immigrants may exclude some individuals who would ultimately be highly productive members of society. Second, some anecdotal immigrant success stories suggest that the externalities generated by immigrants may be quite large in some cases. For example, more than 40% of Fortune 500 companies in 2017 were founded or cofounded by an immigrant or the child of an immigrant, with an immigrant share of 57% for the top thirty-five companies in that group. This suggests strongly that cutbacks in immigration at a time of concern about future economic growth prospects are counterproductive.

FISCAL POLICY AND ECONOMIC GROWTH

Finally, tax and expenditure policy can have significant effects on economic growth. For example, as stressed by Feldstein (forthcoming), an important issue limiting growth prospects in the United States is the unsustainable nature of current fiscal policy—although the present environment of extremely low interest rates and inflation has reduced the urgency of addressing this issue in comparison to previous years. Feldstein makes a persuasive case for raising revenues by reducing tax expenditures and enacting a carbon tax, as well as reducing entitlement spending to control deficits and increases in the national debt. In Diamond and Zodrow (forthcoming), we argue that implementing a carbon tax, even neglecting its considerable benefits in terms of reducing carbon emissions and other pollutants, would either have small negative effects on economic growth or actually increase growth, and would not necessarily have

a regressive impact on the distribution of income, depending on how the revenues from the tax are used.

Additional tax reforms, especially for the taxation of business income, would also be conducive to growth. For example, we would complete the movement to a cash-flow tax with expensing at the business level that was partially enacted under the TCJA, including eliminating all deductions for interest expenses. With full expensing, the corporate income tax rate could be raised somewhat—to around 25%—although concerns about both the mobility of firm-specific capital that generates economic rents and income shifting should preclude further increases. The provisions limiting tax avoidance under the TCJA should also be enhanced.

In summary, continued robust economic growth in the United States will, among many other things, require policies that encourage rapid technological innovation and increases in productivity, encourage increases in the stock of human capital, promote investment while reducing debt, and maximize economic efficiency, including minimizing the distortions caused by the tax system. The discussions in Diamond and Zodrow (forthcoming) provide an insightful and provocative roadmap for achieving these critical objectives.

ENDNOTES

1. For wide-ranging discussions of these issues, see John W. Diamond and George R. Zodrow, *Prospects for Economic Growth in the United States*, Cambridge University Press, forthcoming, 2021. The volume will include all papers cited in this policy brief: Glenn Hubbard, “The \$64,000 Question: Living in the Age of Technological Possibility or Showing Possibility’s Age?”; Flávio Cunha, “Human Capital and Long-Run Economic Growth”; George Borjas, “Immigration and Economic Growth”; and Martin Feldstein, “The Future of Economic Growth in the United States.”

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