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HOW MIGHT FISCAL POLICY RESPOND TO THE RISE OF ARTIFICIAL INTELLIGENCE?

Karen Dynan
Douglas Elmendorf
Louise Sheiner

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ABSTRACT

Artificial intelligence will probably generate major changes in the US economy, although the nature, timing, and magnitude of those changes are highly uncertain. We analyze a set of long-term scenarios involving different combinations of faster productivity growth, greater income inequality, job displacement, and a higher capital share of income. For each scenario, we assess the implications for federal debt and potential policy responses related to faster economic growth, the distribution of income, support for workers who are laid off, and taxation and ownership of capital. Given the uncertainty surrounding AI's economic effects, policies that are robust to different scenarios would be especially valuable.

Karen Dynan
Harvard University
Department of Economics
and NBER
Kdynan@fas.harvard.edu

Douglas Elmendorf
Harvard University
Harvard Kennedy School
and NBER
Doug_Elmendorf@hks.harvard.edu

Louise Sheiner
The Brookings Institution
lsheiner@brookings.edu

The development and use of artificial intelligence (AI) are proceeding at a dramatic pace. Although its ultimate effects are highly uncertain, AI could raise productivity and national income substantially while significantly reshaping labor markets and the distribution of income. These possibilities have important implications for fiscal policy.

In this paper, we examine four illustrative scenarios for the macroeconomic effects of the rise of AI. The scenarios are not intended to be specific predictions, but rather illustrations of the types of effects that have garnered scholarly and popular attention in recent months. We do not attempt to assign probabilities to the different scenarios, which seems to us exceedingly difficult. Instead, we explore the effects of each scenario on the US federal budget in the absence of policy changes and consider what fiscal policy responses might be useful if that scenario unfolds. We conclude with a discussion of what responses might be appropriate now in light of the uncertainty about AI's future effects.

We do not deal with the immediate effects of AI or the potential effects of AI on the environment, social interactions, or national security. We also do not examine regulation of AI, nor do we discuss potential effects of AI on other countries or on international trade and financial flows. Many of the issues we discuss apply also to tax and spending policies of state and local governments in the United States and to tax and spending policies in other countries, but we do not pursue those extensions either.

The scenarios build on the latest projections from the Congressional Budget Office (CBO; 2026d) covering the next 30 years and on CBO's (2025) analysis of the sensitivity of their projections to changes in economic conditions. CBO's projections incorporate an increase in the annual growth rate of total factor productivity (TFP) in the nonfarm business (NFB) sector owing to AI of 0.1 percentage point over the coming decade (CBO 2026b, page 38); the agency has not publicly quantified its assumptions regarding AI for later years. Our scenarios represent additional effects of AI beyond those included in CBO's projections.

The scenarios are as follows and are summarized in Table 1:

- In the first scenario, AI is a rising tide that lifts all boats proportionally. Specifically, AI boosts average annual growth of TFP in the NFB sector over the next 30 years by 0.5 percentage points, from the average of 1.1 percent projected by CBO to 1.6 percent. The additional national income goes to capital owners and workers in proportion to their incomes in the absence of AI.

- In the second scenario, AI is again a rising tide, but it lifts only some boats. Specifically, TFP and GDP growth are higher as in the first scenario, while capital

and labor income are higher only for people in the top quintile of the distribution. The result is a sizable increase in income inequality.

Table 1: Four Illustrative Scenarios for the Rise of Artificial Intelligence

Scenario	Increase in Annual TFP Growth Rate	Reduction in Number of Workers	Distribution of Additional Income
Scenario #1 A rising tide lifts all boats proportionally	0.5 percentage points	None	Proportional to income in absence of AI
Scenario #2 Income inequality increases	0.5 percentage points	None	Proportional to capital and labor, but all to top quintile
Scenario #3 Jobs are lost and new jobs emerge	0.5 percentage points	2 percent	Proportional to capital and labor, but all to top quintile
Scenario #4 Capital wins amid major permanent job displacement	1 percentage point	6 percent	All to owners of capital in top quintile

- The third scenario adds significant job losses combined with the emergence of new jobs. AI has the same effects on TFP and income inequality as in the second scenario, but it also causes large numbers of workers to lose their jobs and have difficulty finding new ones even though new jobs emerge in the economy. As a result, the unemployment rate ends up 1 percentage point higher and the labor force participation rate 1 percentage point lower than otherwise would be the case. We assume that GDP follows the same path as in the second scenario, with the foregone labor input from additional unemployment and a smaller labor force made up through higher labor input from those who remain employed, perhaps reflecting additional hours worked or AI-driven improvements in human capital.

- In the fourth scenario, AI has more profound effects, with even faster economic growth, major permanent job displacement, and income gains going exclusively to capital rather than labor. TFP grows 1 percentage point per year faster than CBO projects, and job losses gradually raise the unemployment rate by 2 percentage points and reduce the labor force participation rate by 4 percentage points. We assume that the foregone labor input is made up through additional capital investment, so GDP growth rises by the increment to TFP growth.

The pace of disruption to labor markets would matter crucially for macroeconomic outcomes and appropriate policy responses. If the demand for workers with particular skills dropped sharply, many workers would lose their jobs and need to find new ones—but if the demand diminished gradually, some workers with those skills would retire, and new workers would enter other fields, so fewer workers would be laid off. In our third and fourth scenarios, job losses occur at a moderate pace as additional TFP emerges. Faster changes would be more disruptive and would increase public pressure for policy responses.

We recognize that the four scenarios we examine include only a subset of the possible effects of AI.

One alternative we do not explore is that AI might have only small effects on productivity, the labor market, and the income distribution. That outcome might arise because AI's spread is dampened by public resistance to its economic and social effects. Consistent with this possibility, Pew Research Center (2025) found that 50 percent of Americans were more concerned than excited about AI, with only 10 percent holding the opposite view. Or that outcome might arise because the positive effect of AI on productivity is offset by smaller boosts to productivity from other factors. Consistent with this possibility, Jones (2026) showed that output per person has grown at a fairly stable rate for 150 years despite the episodic introduction of significant new technologies. In either of these cases, the rise of AI would not present significant new issues for fiscal policymakers.

Another alternative we do not examine is that AI might raise productivity more sharply for workers outside the top quintile than within it, which would raise incomes for many people and reduce inequality. For example, Bloom et al. (2024) showed that AI reduces the skill premium if "it is more substitutable for high-skill workers than low-skill workers are for high-skill workers," and Cruces et al. (2026) explained that AI might narrow "effective productivity differences in task execution by relaxing cognitive constraints that are more binding for lower-education individuals." That outcome presumably would generate less public pressure for policy responses than the scenarios we highlight.

Finally, we do not analyze the most benign and optimistic alternative for labor markets, in which AI boosts productivity substantially without a large shift in the distribution of income, and many workers take advantage of their higher earnings by choosing more leisure. In that case, labor input would fall appreciably, but there probably would be little demand for changes in fiscal policy.

In the following sections, we take up the four scenarios in turn. For each scenario, we provide a rough estimate of the effect on the federal budget in the absence of significant changes in fiscal policy and then analyze some economic implications of the scenario and potential responses of fiscal policy—which would, in turn, affect budget outcomes. A final section of the paper draws out the implications of our analysis for fiscal policymaking today.

I. Illustrative Scenario #1—A Rising Tide Lifts All Boats Proportionally

In this scenario, the rise of AI boosts TFP growth in the NFB sector from the average of 1.1 percent in CBO's extended baseline projections for the next three decades to 1.6 percent, as shown in Table 2. The NFB sector is about 75 percent of the economy, so that increase in annual TFP growth would raise annual GDP growth directly by 0.38 percentage points. But faster TFP growth also leads to more capital investment and other economic adjustments, so the increase in gross domestic product (GDP) is ultimately about 5 percent after a decade, 10 percent after two decades, and 16 percent after three decades. Capital and labor incomes across the distribution are assumed to rise proportionally.

Table 2: Illustrative Scenario #1—A Rising Tide Lifts All Boats Proportionally

Scenario	Automatic Budget and Economic Effects After 30 Yrs	Potential Policy Responses Beyond Taking No Action
TFP growth +0.5 pp/yr	Debt reduced by 39 percent of GDP	Raise spending and cut taxes relative to current law and projection methodology to maintain closer historical relations to GDP
Additional income proportional to income in absence of AI	All incomes higher	

A. Direct Effects on the Federal Budget

To estimate the effects of faster TFP growth on the federal budget, we rely on CBO's latest long-term budget projections (2026d) and most recent analysis of alternative long-term scenarios (2025). Specifically, we apply to CBO's current extended baseline the percent change in GDP, percentage-point change in interest rates, and percent change in spending and revenues relative to GDP from CBO's earlier scenario analysis.[1] However, we treat discretionary spending differently than CBO does, as we explain below.

1. <u>The Base Case</u>

Faster economic growth affects the path of federal debt through four channels.

First, faster economic growth increases incomes and therefore federal revenue. Moreover, because the federal income tax system is progressive and has thresholds that are indexed not for GDP growth but for inflation (or are not indexed at all), increases in incomes raise effective tax rates. The result is that faster GDP growth increases revenue relative to GDP. However, this effect is quite small: CBO (2025) projected that an ongoing increase in TFP growth of 0.5 percentage point would raise revenue after three decades by just 0.14 percent of GDP.

Second, faster economic growth increases federal spending apart from interest payments, but by less than GDP increases, which lowers spending relative to GDP. In CBO's analysis, this effect stems from a combination of program rules and CBO's projection methodology, and the effect is large:

- Under current law, Social Security benefits of newly retiring workers are indexed to wages and therefore rise one-for-one with productivity growth, but benefits of already retired recipients are indexed to price growth and so do not respond to changes in GDP. Therefore, total Social Security spending rises by less than GDP.

- For Medicare, CBO assumes that faster GDP growth raises spending in the long run because spending per beneficiary is projected to increase with GDP per capita plus a specified amount of "additional cost growth." However, CBO holds such

[1] For example, if CBO's scenario analysis shows that a 0.5-percentage-point increase in TFP raises Social Security outlays relative to GDP by *x* percent after 20 years, we apply that same *x*-percent increase to CBO's extended baseline projection of Social Security outlays in 2046.

spending unchanged over the first ten years of its alternative scenarios, so total Medicare spending rises by less than GDP.

- For Medicaid and the Children's Health Insurance Program (CHIP), CBO makes similar assumptions about the effects of GDP growth on spending per beneficiary. But faster GDP growth also lowers the poverty rate, which reduces the number of people eligible for those programs. Thus, growth of spending on Medicaid and CHIP falls short of GDP growth to a slightly larger degree than spending for Medicare.

- For the subsidies in the marketplaces established under the Affordable Care Act and for other mandatory spending (which includes the Supplemental Nutrition Assistance Program [or SNAP], veterans' benefits, and other programs), CBO assumes that economic growth has no effect on outlays. Because faster GDP growth probably would reduce the number of people eligible for means-tested programs like SNAP and health-insurance subsidies, this assumption probably generates a small over-estimate of spending if TFP grew more rapidly.

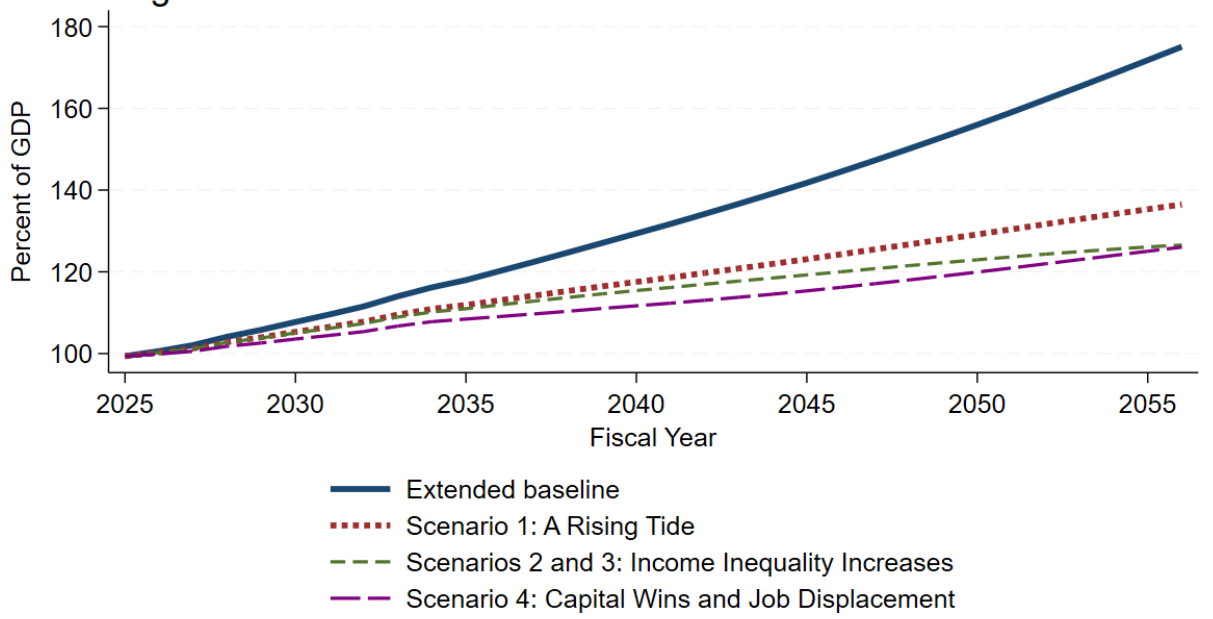
- In its analysis of alternative scenarios, CBO assumes that faster economic growth would have no effect on discretionary spending. However, we do not find the implication that discretionary spending will dwindle indefinitely relative to GDP to be a compelling depiction of current policies, especially given that, in practice, defense and nondefense discretionary outlays have shown no trend relative to GDP in recent decades (Dynan, Elmendorf, and Gullo 2026). Instead, we use the assumption CBO makes in its extended baseline projection that discretionary spending rises with inflation during the first ten years but in line with GDP thereafter (following a five-year transition period). As a result, faster GDP growth causes discretionary spending to diminish relative to GDP in our analysis but not as sharply as CBO assumes in its scenario analysis. If TFP grows 0.5 percentage points per year more rapidly than in CBO's extended baseline, discretionary spending falls from 6.1 percent of GDP in 2025 to 4.5 percent in 2056 under our approach rather than the 4.0 percent of GDP under CBO's approach.

Third, faster economic growth has no effect on the amount of existing federal debt, so the existing debt becomes smaller relative to GDP.

Fourth and finally, faster economic growth generally increases interest rates on newly issued Treasury securities. That rise in rates boosts both interest payments on new borrowing and interest payments on existing debt as it is rolled over. That increase in interest payments raises debt relative to GDP, which represents a partial offset to the first three effects we describe.

Taking these channels together, we estimate that 0.5 percentage points of additional annual TFP growth would lower the ratio of publicly held federal debt to GDP by 39 percentage points relative to the extended baseline at the end of three decades, as shown in Table 2. CBO's (2026d) extended baseline shows federal debt rising from 101 percent of GDP in 2026 to 175 percent in three decades, so this hypothesized increase in growth would offset roughly half of that projected rise, as can be seen by comparing the bold line and the thin solid line in Figure 1.

Figure 1: Federal Debt under Different Scenarios for the Rise of AI



Note: Federal debt held by the public relative to GDP. Based on CBO's (2026) extended baseline and authors' analysis.

2. Robustness Considerations

The estimated difference in debt relative to GDP of 39 percentage points stems overwhelmingly from the reduction in noninterest spending relative to GDP (30 percentage points), with much smaller contributions from the gain in revenue relative to GDP (2 percentage points) and the combined effects of higher GDP and higher interest rates on existing debt (7 percentage points).[2]

The dominant role of the reduction in noninterest spending relative to GDP reflects two factors highlighted in the previous section—payments to beneficiaries not keeping pace

[2] The calculated contribution of lower noninterest spending uses the higher interest rates under CBO's alternative TFP path; at the interest rates in the extended baseline, this contribution would be a bit higher.

with rising incomes of others in society under current law, and federal spending for national defense and many nondefense activities not keeping pace with rising spending on other goods and services under CBO's methodology.

Yet, those features of current law and CBO's projection methodology raise important questions about whether the projected fiscal improvement is consistent with what most people would view as a continuation of current policies. If federal outlays for transportation, education, veterans' healthcare, and other programs decline relative to outlays for private goods and services, will that outcome appear to most people like the perpetuation of the status quo or a deviation from it? If higher incomes mean that individuals in the bottom part of the income distribution no longer qualify for some government benefits, will that outcome appear to most people like a continuation of the existing safety net or as a weakening of the redistribution inherent in our social insurance programs? If incomes of retirees fall markedly relative to the incomes of workers, will that outcome appear to most people like the intended structure of the Social Security program or an inappropriate breach of the generational social contract? If income growth pushes people into higher tax brackets, will that outcome seem like an extension of current tax policy or a change in it?

As a practical matter, policymakers have generally acted to keep federal revenue and spending apart from the largest benefit programs roughly stable relative to GDP over long periods. Revenue shows no trend relative to GDP over the past six decades, while defense spending, nondefense discretionary spending, and spending for benefit programs excluding Social Security and the major health care programs show no trend relative to GDP for the past three, six, and six decades, respectively. Therefore, the improvement in budget outcomes that appears to result naturally from faster TFP growth may prove at least partly illusory if policymakers ultimately choose to maintain historical relationships between those budget categories and GDP. We return to these issues when we discuss possible policy responses.

Another important aspect of CBO's estimates of the budgetary effects of faster economic growth is the expected impact of faster growth on interest rates. CBO anticipates that interest rates would be higher by roughly the increment to TFP growth, but the actual impact could be different—both generally and in response to the rise in AI specifically. For example, faster growth spurred by AI might attract foreign capital, which would hold down interest rates, or an AI boom might spur ongoing investment in computer capacity and energy production, which would push up interest rates.

Suppose instead that interest rates did not change at all in this scenario. Then, debt would be lower than we show in Figure 1, by an amount that builds to 12 percent of GDP by the end of three decades.

B. Implications for National Saving

An increase in TFP growth would change optimal national saving as viewed by a Ramsey-style social planner, but the implications for federal saving are unclear.

With faster economic growth in prospect, a Ramsey-type planner might want current generations to share in some of the expected future gains, reducing saving to raise current consumption by more than the immediate increase in output. That motive would be stronger when the intertemporal elasticity of substitution in the social welfare function is smaller, because the planner would place more value on smoothing consumption gains across current and future generations. But if the elasticity is very large, the planner might instead reduce current consumption and raise saving to take advantage of the higher returns on investment that might prevail.

Faster economic growth would likely affect private saving as well. Households expecting faster income growth would tend to increase consumption by more than their immediate income gains. So would households that did not directly anticipate higher future income but owned stocks whose values rose immediately in anticipation of AI-driven growth. Higher interest rates, however, could push in the opposite direction, inducing households to save more. The effect on overall business saving is also unclear: Some firms might have higher profits and retain them, but others might deploy more of their profits to take advantage of AI-related opportunities.

The implication for federal saving would depend on how the change in actual private saving compared with the change in optimal national saving.[3] And even that comparison would not be enough: Whether actual saving was more or less than optimal saving *before* the arrival of AI would matter as well. Therefore, Ramsey-style analysis does not offer ready guidance for policymakers about whether the rise of AI would justify larger or smaller federal budget deficits.

[3] State and local governments operate under fiscal rules that keep their operating budgets close to balance and their borrowing roughly aligned with their capital investments, so they cannot make large, sustained changes in their saving.

The scenarios we examine in the rest of the paper would generate somewhat different changes in optimal national saving and actual private saving. But in none of the scenarios are the implications of a Ramsey-style analysis for federal budget deficits clear.

C. Potential Fiscal Policy Responses

Even in this relatively favorable scenario, policymakers would face important choices about whether to allow the outcomes implied by current law and CBO's projection methodology to occur. If so, federal benefits received by retirees would decline relative to the incomes of workers, federal taxes would rise relative to incomes, and federal spending on many programs would decline relative to private spending. Policymakers would need to decide whether to accept those outcomes or instead to adjust policies to maintain closer historical relationships between major budget categories and GDP, as listed in Table 2. The policy question is fundamentally whether faster economic growth should lead to a smaller government relative to GDP or instead support higher levels of public benefits and services alongside rising private incomes and spending.

Some people might consider certain relative declines in incomes to be reasonable on the view that government programs should provide a minimum amount of support and not necessarily enable beneficiaries' incomes to keep pace with average incomes; they might also observe that the rise of AI spurs equity-price increases that are good for many retirees. But other people might think instead that government policy should treat economic need as relative rather than absolute, and therefore that benefits should be bolstered.

Healthcare spending might draw particular attention because healthcare costs have historically risen faster than GDP and because increases in healthcare costs have often generated pressure for larger public subsidies. Long-term projections of such spending often depend on assumptions that spending will grow at a pace that is additional to the growth of GDP by a specified amount (for example, CBO 2026d). Thus, CBO's long-term projection with faster economic growth incorporates faster growth of federal spending on healthcare beyond the first decade, as noted above. But faster growth of healthcare spending also would push up individuals' premiums for Medicare Part B (which covers payments to physicians), and past increases in the cost of health insurance have tended to generate increases in public subsidies (Follette and Sheiner 2005).

Moving beyond government benefits, some people might view a decline relative to GDP in spending for discretionary programs as appropriate belt-tightening by the federal government. However, other people might worry that maintaining the effectiveness of programs such as transportation infrastructure, scientific research, education and training, and national defense would require discretionary spending to rise broadly in line

with the overall economy. In many cases, the cost of providing existing services rises as wages elsewhere in the economy increase, and demand for some services may rise as the population and economy grow (as discussed by Dynan, Elmendorf, and Gullo 2026).

In addition, some people might believe that the rise in taxes relative to incomes was acceptable on the grounds that people are richer than otherwise, so paying a larger share of incomes in taxes would still leave them better off. But other people would argue that the federal government should restrain the share of income it collects and adjust spending accordingly. Median personal income adjusted for inflation as measured by the consumer price index is now more than 50 percent higher than it was half a century ago, and public support for raising taxes or reducing benefits is quite limited, which suggests that rising incomes do not generally resolve fiscal challenges.

II. Illustrative Scenario #2—Income Inequality Increases

In this scenario, as in the first one, the rise of AI boosts average annual TFP growth over the next 30 years from the average of 1.1 percent projected by CBO to 1.6 percent. GDP again would be roughly 5 percent higher than otherwise at the end of the coming decade and 16 percent higher at the end of three decades. In this scenario, though, the increment to national income goes entirely to people in the top quintile of the distribution and not at all to those in the rest of the distribution, as shown in Table 3.

A. Direct Effects on the Federal Budget

By construction, this second scenario is simply the first scenario plus a shift of income upward in the distribution. Thus, the direct budgetary effects of this scenario equal the budgetary effects of the first scenario plus the effects of the income shift.

The upward shift of income would increase personal income tax revenue, because the tax is progressive, but decrease payroll tax revenue, because more labor earnings would be above the maximum amount to which Social Security taxes apply. The shift also would increase benefit payments because people with incomes in the lower part of the distribution would not experience the income gains they would in the first scenario.

CBO (2026a) estimated average federal tax rates that include personal income taxes, payroll taxes, corporate income taxes, and excise taxes, which together account for roughly 90 percent of federal revenue; estate and gift taxes and other sources of revenue are not included in CBO's estimates. CBO reported that the average federal tax rate in 2022 (the latest year included in the analysis) was 20.6 percent for all households together

and 25.9 percent for households in the highest quintile of the distribution. Therefore, in estimating the direct budgetary effect of this scenario, we apply the top-quintile average tax rate of 25.9 percent to the increment in GDP rather than the economy-wide average tax rate of 20.6 percent.

Table 3: Illustrative Scenario #2—Income Inequality Increases

Scenario	**Automatic Budget and Economic Effects After 30 Yrs**	**Potential Policy Responses Beyond Taking No Action (with new options in *italics*)**
TFP growth +0.5 pp/yr Additional income goes entirely to the top quintile	Debt reduced by 49 percent of GDP Higher incomes increased and other incomes unaffected	Raise spending and cut taxes relative to current law and projection methodology to maintain closer historical relations to GDP *Increase progressivity of the tax and transfer system* • *Expand means-tested benefits* • *Expand low-cost or no-cost public services for everyone*

Some of the people whose income gains in the first scenario would have made them ineligible for Medicaid and CHIP would not experience those gains in this scenario. As a result, the decrease in spending on Medicaid and CHIP relative to GDP would be smaller in this scenario than in the first scenario. Modeling benefit payments in detail is beyond the scope of this paper, so we simply assume that the reduction in spending on these programs relative to GDP is one-third smaller.[4]

Taking these elements together, we estimate that this scenario of faster growth with greater inequality would reduce the ratio of federal debt to GDP by 49 percentage points relative to the extended baseline after 30 years, as shown in Table 3 and by the dashed line

[4] The shift in the distribution of earnings also would affect Social Security benefits, but the impact would be very small within our 30-year window: Additional productivity growth cumulates slowly to higher earnings, and earnings levels change benefits only after people retire. We do not attempt to estimate this effect.

in Figure 1. That reduction is larger than the 39 percentage points of reduction in the first scenario of faster growth with no change in inequality.

B. Potential Fiscal Policy Responses

The policy issues raised by the first scenario would arise as well under this second scenario. Policymakers would need to decide whether to take no action and allow the changes in relative incomes, tax burdens, and spending that would occur under current law and projection methodology to take place, or instead to adjust policies to keep budget categories closer to their historical relationships with GDP, as listed in Table 3.

In addition, the shift of income upward in the distribution in this scenario would raise further questions about the desired degree of redistribution through the tax and transfer system. One view would be that the redistribution that would occur automatically through the existing tax and transfer system would be sufficient. Under that view, taxes and transfers are intended to reduce the inequality of market incomes to a chosen extent rather than to achieve any particular distribution of after-tax- and-transfer income.

An alternative view would be that the tax and transfer system should be made more progressive to boost the incomes of people outside the top quintile and limit the inequality of after-tax-and-transfer income. That position might reflect the declining marginal utility of income, concerns that individuals' well-being depends in part on relative consumption, and worries that greater income inequality hinders democracy by reducing social solidarity and giving some individuals the resources to exercise disproportionate political power.

The historical record offers examples of policy changes driven by each of these perspectives. Expansions of Medicaid and the Children's Health Insurance Program, new subsidies in health insurance marketplaces under the Affordable Care Act, and increases in refundable tax credits have all reduced inequality. But the large tax cuts enacted in 2017 and 2025, as well as the large benefit cuts enacted in 2025, went in the opposite direction.

If policymakers wanted to respond to this second scenario by increasing the progressivity of federal taxes and spending, they might return to some of the tax rules in place during the mid-2010s or earlier and use the resulting funds to enhance the wellbeing of people outside the top quintile of the income distribution, as shown in Table 3. One possible approach would be expanding means-tested benefits, for example by extending eligibility for health insurance subsidies or making housing assistance more broadly available to lower-income households. Another possible approach would be expanding low-cost or no-cost public services for everyone, such as expanding pre-school education, post-secondary job training, personal care for older people, or public transportation. The latter

approach might engender wider support from voters and less stigma for participants than increasing means-tested benefits because the services would be available to everyone (for example, Lasky-Fink and Linos 2026).

III. Illustrative Scenario #3—Jobs Are Lost and New Jobs Emerge

In this third scenario, as in the first and second scenarios, the rise of AI boosts average annual TFP growth over the next 30 years from CBO's projected average of 1.1 percent to 1.6 percent.

However, in this scenario, AI displaces large numbers of workers across occupations over time—first, perhaps, call-center workers, and then some types of lawyers, and so on. New jobs emerge, but workers who lose jobs struggle to find ones that match their skills, so some leave the labor force and others face prolonged unemployment. We assume that the labor force participation rate declines by 1 percentage point and the unemployment rate rises by 1 percentage point over the next decade relative to what they would do otherwise, as shown in Table 4.

We assume further that the foregone labor input is made up through additional labor input of some other sort (perhaps reflecting additional hours worked or AI-driven improvements in human capital), so both GDP and the labor share of income are the same in this scenario as in the first two scenarios. As in the second scenario, the income gains from higher GDP in this scenario go entirely to the top quintile of the distribution.

This scenario is somewhat analogous to the "China shock" of the 2000s but differs in two important ways. One difference is that the drop in labor demand is not as geographically concentrated as with the China shock because the occupations that are most affected will differ over time and because the affected occupations involve workers across the country. Another difference is that the AI shock in our parameterization is much bigger than the China shock, affecting 3 million people at any given time (2 percent of a labor force of roughly 170 million) and therefore many millions over the next few decades, compared with a China shock that spurred the loss of about 1.5 million to 2 million manufacturing jobs between 2000 and 2007 (Autor, Dorn, and Hanson 2025).

A. Direct Effects on the Federal Budget

Because GDP and the labor share of income are the same in this scenario as in the previous one, the path of federal debt would be roughly the same as well, and we do not estimate it separately. A more precise estimate would include the effect on means-tested

spending of foregone earnings by people who are unemployed or not in the labor force, but such precision is beyond the scope of this paper.

Table 4: Illustrative Scenario #3—Jobs Are Lost and New Jobs Emerge

Scenario	**Automatic Budget and Economic Effects After 30 Yrs**	**Potential Policy Responses Beyond Taking No Action (with new options in *italics*)**
TFP growth +0.5 pp/yr 1 pp higher unemployment and 1 pp lower labor force participation Additional income goes entirely to the top quintile	Debt reduced by 49 percent of GDP Higher incomes increased Workers who lose jobs face large obstacles both professionally and personally	Raise spending and cut taxes relative to current law and projection methodology to maintain closer historical relations to GDP Increase progressivity of the tax and transfer system • Expand means-tested benefits • Expand low-cost or no-cost public services for everyone *For people who lose jobs, provide more support and facilitate transitions* • *Expand unemployment insurance* • *Establish wage insurance* • *Expand worker training and employment services*

An alternative version of this scenario would have the foregone labor input owing to job losses *not* be offset by other labor input but instead show through to lower GDP than in the second scenario. In that case, debt would not decline as much relative to GDP.

B. Implications of Job Losses

Workers who lose jobs because of structural drops in labor demand face substantial obstacles both professionally and personally.

To begin, a large empirical literature has shown that workers who lose jobs often suffer earnings losses that persist for years; see, for example, the seminal paper by Jacobson, LaLonde, and Sullivan (1993), and the later estimates and literature review by Couch and Placzek (2010). More recently, Braxton and Taska (2023) assessed that, on average, nearly half of the earnings decline that follows job loss stems from technological change, because workers who do not have the skills needed to perform newly created jobs within their occupation often take lower-paying jobs in other occupations. And Mei and Rindels (2026) estimated that workers who lose jobs because of technological changes suffer larger long-term earnings declines than workers who lose jobs for other reasons.

As one example of this phenomenon, Feigenbaum and Gross (2024) found that a decade after the telephone system moved from operators to mechanical switches, operators tended to be in lower-paying occupations or to have stopped working altogether. As another example, Autor et al. (2025) found that locations especially exposed to manufactured imports from China in the 2000s generally experienced full rebounds in employment later, but that the rebounds occurred almost entirely because new people entered those labor markets and only to a very small degree because of reemployment of people who had lost their jobs.

Other research has shown that people who lose jobs can suffer from significant health problems as well. Sullivan and von Wachter (2009) estimated that male workers with high seniority who lose jobs have much higher mortality during the year following job loss than comparable workers who do not lose jobs and that this effect wanes over time but is visible for at least two decades. Kuhn, Lalive, and Zweimüller (2009) showed that job losses spurred by plant closures in Austria raised spending for antidepressants and increased men's hospitalizations for mental health problems, although the effects were small in economic terms, and overall healthcare spending was little changed. Pierce and Schott (2020) estimated that US counties that were more exposed to the China shock experienced larger increases in fatal drug overdoses. And Finkelstein, Notowidigdo, and Shi (2026) estimated that areas more exposed to the economic shifts spurred by the North American Free Trade Agreement (NAFTA) saw sustained increases in mortality over the following 15 years, especially among working-age men, and that exposure to the China shock had a similar effect.

As we noted above, the rolling AI shocks in this scenario would not be as geographically concentrated as the China shock but would instead tend to affect specific occupations across many places. This difference would lessen the likelihood of self-reinforcing downward regional spirals related to local public finances and business confidence, but it would not necessarily lessen the challenge of finding new jobs that fit workers' skills.

The difficulty of finding new jobs presumably would depend on the characteristics of people affected. Manning and Aguirre (2026) estimated the ability of people in different occupations to shift to new positions if their current ones were displaced by AI, and they examined the correlation of that ability with the estimated risk of job displacement. They concluded that adaptive capacity and AI exposure are positively correlated, but still that millions of workers who are highly exposed to AI would struggle to transition to new positions. Many of those workers now have clerical or administrative roles.

C. Potential Fiscal Policy Responses

The potential policy responses that we discussed for the first and second scenarios are relevant for this third scenario as well, as listed in Table 4. Policymakers might choose to take no action and allow the changes in relative incomes, tax burdens, and spending that would occur under current law and projection methodology to take place, or they might choose to raise spending and reduce taxes to more closely track their historical relationships with GDP. In addition, policymakers might or might not choose to address the rising inequality of market income by increasing the progressivity of federal taxes and spending.

Beyond those choices, policymakers also would need to decide whether to respond to the loss of jobs, higher unemployment, and lower labor force participation in this scenario.

In arguing for a policy response, Strauss (2025) wrote: "[T]he people most likely to be left behind [by automation] often did everything society asked of them in the old system, only to discover that their hard-won expertise has become yesterday's technology. We could treat their redundancy as collateral damage. Or we can try to shape the transition toward broad prosperity."

Arguments against a policy response could include the concerns that retraining efforts could be ineffective, that support for people who have lost jobs because of AI could be unfair to other people who do not have jobs that suit them, and that interventions on behalf of people who have lost jobs could reduce the incentive to acquire new skills and search for employment. We return to those issues shortly.

If policymakers decided to respond to the significant job losses in this scenario, they would face the further decision of how to do so. We consider in turn three possible approaches to assisting workers who lose their jobs—expanding unemployment insurance, establishing wage insurance, and expanding worker training and employment services. In each case, policymakers also would need to decide how to fund such assistance.

1. Expanding Unemployment Insurance

Unemployment insurance (UI) provides short-term cash benefits to alleviate some of the drop in income that occurs with job loss. Specifics differ across states and have varied over time, but a worker who is laid off generally receives benefits equal to about half of their former wage, up to a cap, for 26 weeks.

Unemployment insurance has some notable advantages in responding to job losses caused by AI (for example, see Gimbel 2025). The program already exists, so it could be expanded more easily than a new program of financial support could be established. And the program does not require determination of the reason that someone has lost a job, so it will apply naturally to AI-related disruption.

However, unemployment insurance also has significant limitations. One limitation is that some groups of workers are not covered by the program. Eligibility might be broadened, as occurred temporarily during the COVID recession, although defining and measuring unemployment for some of the groups currently excluded, such as workers in the gig economy or informal employment, is difficult. Another limitation is that the system needs modernization. Administrative systems could potentially be upgraded so that more people could be handled with fewer errors and less fraud than occurred during the COVID recession (JPMorganChase 2022).

Other limitations make the system less well suited to dealing with job losses resulting from AI. For example, workers whose occupations experience sharp drops in demand may take longer than six months to find new jobs, especially because they may need to acquire different skills or credentials and may need to explore different sectors of the economy. Benefit duration might be increased, but doing so would reduce the urgency of job search, training, and other transition activities; for example, Marinescu and Skandalis (2021) showed that unemployed workers' search efforts increase and reservation wages decrease as their unemployment insurance benefits near an end. This concern might argue for conditioning extended benefits on transition activities, which we discuss below.

A further limitation is that workers who receive unemployment insurance still experience a significant drop in income, especially if they had higher wages and their benefits are capped. Benefit amounts might be increased to address this concern; for example, Landais, Michaillat, and Saez (2018) showed that the optimal replacement rate is higher when jobs are scarce, as they would be in this scenario. Yet, doing so would, again, reduce the urgency of transition activities.

Lastly, for laid-off workers who become reemployed at lower wages, unemployment insurance does not provide any further support. If policymakers wanted to tackle that issue, they would need to consider wage insurance, which we turn to next.

If policymakers chose to expand unemployment insurance, they would need to decide how to fund that expansion. One possibility would be to increase the existing taxes that pay for unemployment benefits; alternatives include increasing taxes on all taxpayers or, in light of the increase in income inequality in this scenario, on higher-income taxpayers only.

2. Establishing Wage Insurance

Wage insurance is one element of the Trade Adjustment Assistance (TAA) program, which was established in 1962 and has been modified numerous times since then. The program has provided workers who lose jobs because of international trade with job training, extended unemployment insurance benefits for people who participate in training, and, for workers age 50 and over, wage insurance comprising up to two years of cash benefits equal to half of the difference between wages before being laid off and wages after reemployment (Hyman, Kovak, and Leive 2024). However, authorization for the program lapsed, and workers who lost jobs after June 30, 2022, are not eligible to receive benefits.

Wage insurance has multiple strengths for responding to job losses stemming from AI: It provides support beyond the short term, which enables people whose occupations have been hollowed out to be trained in different skills and to learn about different lines of work. It is paid after a laid-off worker takes a new job, so it encourages reemployment. And it can be restricted to a specified time and amount to avoid subsidizing low-wage employment permanently.

However, wage insurance also has weaknesses. One weakness is that wage insurance reduces workers' incentives to search for better-paying jobs and invest in their skills, which could lead to worse job matches and low wages in the long run. TAA addresses this issue to some degree by linking benefits to training, and empirical evidence suggests that the problem is not very great: Hyman, Kovak, and Leive (2024) estimated that eligibility for the wage-insurance part of TAA substantially increased short-run employment and earnings, and Hyman et al. (2021) found that eligible workers were more likely to be employed after losing their jobs than otherwise similar workers who were not eligible and that long-run earnings were not notably different.

Another weakness is that the structure of wage insurance violates some views of fairness: Some workers with given earnings today receive payments because they had higher earnings in the past, while workers with those same earnings today but lower earnings in

the past do not receive payments. This concern might be dealt with by funding wage insurance with taxes on employed workers in an explicit social-insurance model. Alternative ways to fund wage insurance include, as with expansions of unemployment insurance, increasing taxes on all taxpayers or on higher-income taxpayers only.

A further weakness is that restricting wage insurance to workers who lose jobs because of a specific cause, such as international trade under TAA, presents both administrative challenges and questions of fairness. The administrative challenges in distinguishing job loss caused by AI rather than some other force could be especially great, given the complex structure of the economy and AI's economy-spanning impact. And questions of fairness could be acute as people continue to lose jobs because of other technological changes and continued shifts in global trade.

Thus, even if the rise of AI was the primary motivation for policymakers to establish wage insurance, they might choose to make all laid-off workers eligible. Yet, such broad eligibility would increase budgetary cost and could have undesirable incentive effects in sectors or occupations that were thriving, so policymakers might instead choose an intermediate approach such as limiting wage insurance to workers who lose jobs because of significant structural factors but not ordinary job turnover. Evidence of such factors could include mass layoffs, declining employment in an occupation, or large earnings losses after reemployment.

3. Expanding Worker Training and Employment Services

For eligible beneficiaries, TAA has covered training costs for up to three years, and it also has provided case management services and allowances for job search and relocation. Overall, though, public spending on training and employment services in the United States is less than one-fifth of the average among advanced economies when measured relative to GDP (Organisation for Economic Co-operation and Development 2026).

Low spending may be the result of longstanding skepticism about how much training and employment services truly help laid-off workers succeed in the labor market. Katz et al. (2022) wrote that "US government-sponsored training and employment programs have a mixed record for youth, disadvantaged adults, and dislocated adult workers with limited cases of large persistent improvements in earnings" (page S250). And Holzer (2026) provided a comprehensive review of the research literature on training and concluded that there is "considerable variation in estimated returns across programs and groups" (page 621).

Yet, the right types of training programs and related services do seem to make a positive difference. Katz et al. (2022) reviewed the evidence on "sector-focused training programs that … combine up-front screening, occupational and soft-skills training, and wraparound services," finding that "the programs generate substantial and persistent earning gains" (page S249). Such programs focus on industries and occupations where local labor demand is strong, and Katz et al. found that the programs effectively help participants move into jobs with higher wages. As another example, Hyman (2022) estimated that receiving TAA's training and other support increases workers' wages, labor force participation, and earnings over the following decade, although the effect on annual earnings wanes by the end of that span. Hyman hypothesized that the effect of training tends to diminish over time because technological change continues to shift labor demand. As a further example, Delfino et al. (2026) studied Italian jobseekers and estimated that "effective reskilling policy requires two distinct levers: targeting—by matching workers to occupations that fit their identity—and information—by clearly signaling program quality and employment prospects" (page 3).

In sum, the design of training and employment services is crucial. Programs that are closely connected to employers' needs, that are short enough that workers can get to new jobs quickly and potentially retrain again in the future, and that are responsive to workers' preferences seem more likely to be effective than other programs. Liebenluft (2026) discussed additional lessons from past adjustment assistance programs that could inform future policy responses to AI-related disruption.

If policymakers chose to expand training and employment services, they would need to decide, as with wage insurance, whether to limit eligibility to workers who lose jobs because of AI or to broaden eligibility to include workers who lose jobs for other reasons. They would further need to decide how to fund such services; as with wage insurance, policymakers could tax employed workers in a social-insurance framework or could increase taxes on all taxpayers or on higher-income taxpayers only.

IV. Illustrative Scenario #4—Capital Wins Amid Major Permanent Job Displacement

Artificial intelligence has more profound effects in this fourth illustrative scenario, as shown in Table 5. TFP growth is 1 percentage point per year higher than in the absence of AI, which is twice the difference in the first three scenarios. Major permanent job displacement ultimately raises the unemployment rate by 2 percentage points and reduces the labor force participation rate by 4 percentage points, with those effects phasing in over three decades as productivity rises.

Table 5: Illustrative Scenario #4—Capital Wins Amid Major Permanent Job Displacement

Scenario	**Automatic Budget and Economic Effects After 30 Yrs**	**Potential Policy Responses Beyond Taking No Action (with new options in *italics*)**
TFP growth +1 pp/yr 2 pp higher unemployment and 4 pp lower labor force participation Additional income goes entirely to capital and to the top quintile	Debt reduced by 49 percent of GDP Higher incomes increased Workers who are permanently displaced face huge obstacles both professionally and personally	Raise spending and cut taxes relative to current law and projection methodology to maintain closer historical relations to GDP Increase progressivity of the tax and transfer system • Expand means-tested benefits • Expand low-cost or no-cost public services for everyone For people who lose jobs, provide more support and facilitate transitions • Expand unemployment insurance • Establish wage insurance • Expand worker training and employment services *Foster employment opportunities* • *Support private jobs* • *Provide public jobs* • *Encourage earlier retirements and shorter workweeks* *Institute Universal Basic Income (UBI)* *Tax capital at higher rates* *Establish some public ownership of businesses* • *Create a sovereign wealth fund* • *Place equity in individual accounts*

We assume that the foregone labor input is made up through additional capital investment, so GDP growth is boosted by the increment to TFP growth. Relative to what it would have been in the absence of AI, GDP will be roughly 9 percent higher after a decade, 21 percent higher after two decades, and 35 percent higher after three decades.

However, in this scenario, all of the increase in income accrues to capital owners in the top quintile of the distribution. For people who keep their jobs, living standards are unchanged except that government services increase—although by less than GDP given the assumptions we discussed earlier. For people who lose their jobs, living standards presumably fall.

The increase in the income share of capital owners in the top quintile of the distribution means an increase in the income share of people who generally have high saving rates (for example, see Dynan, Skinner, and Zeldes 2004). That outcome increases the risk that demand for goods and services would fall short of potential supply on an ongoing basis and not only during recessions. Under those circumstances, fiscal policy (and monetary policy) would face additional challenges, but we do not pursue those issues here.

A. Direct Effects on the Federal Budget

The increment to TFP growth in this scenario is twice that in the second scenario, and the distribution of all income gains to the top quintile in this scenario matches our assumption for the second scenario. Therefore, our starting point for estimating the effects of this scenario on the federal budget is to double the effects from the second scenario.

However, this scenario includes a further effect: The additional income arising from faster growth goes entirely to capital and thus is taxed at the capital tax rate, rather than being shared between labor and capital and being taxed at a mixture of the labor and capital tax rates. Because the tax rate on capital is lower than the tax rate on labor, this difference in the distribution of income means that debt declines by less relative to GDP than it would otherwise.[5] To model this effect, we take the following steps:

- We begin with CBO's (2026c) estimates of marginal tax rates during the coming decade for new investments that earn returns that just cover the opportunity cost of funding those investments. CBO reports that those tax rates will be around

[5] The displacement of workers and assumed offset from capital investment means that some income will be shifted from labor to capital and therefore will be taxed at a different rate. However, the effect of this shift on revenue might be small—for example, if displaced workers are disproportionately low-wage, their average federal income tax rate might be close to, or even below, the capital income tax rate. We do not try to account for this effect.

6 percent for nonresidential equipment and (after the next few years) around 21 percent for nonresidential structures. We use 10 percent as a rough weighted average.

- However, some of the returns to AI will come from existing assets and some from profits in excess of opportunity costs, and those income sources face higher tax rates than in CBO's figures. We assume that the effective capital gains tax rate is 9 percent—one-third of the 25.9 percent average tax rate for households in the top quintile of the distribution that we noted above, as a rough adjustment for the effects of deferral until realization and stepped-up basis at inheritance. The corporate tax rate for all but the smallest businesses is 21 percent. Putting those pieces together yields a total tax rate for the top quintile on capital income from existing assets and supernormal returns of 28 percent (1-[1-.09]*[1-.21]).

- Then we assume that half of the capital income to be generated by AI will come from new investments that earn returns equal to opportunity costs and half will come from existing assets and supernormal returns. The result is an average tax rate on this income in the top quintile of the distribution of 19 percent. We make one further adjustment for potential tax evasion by reducing that assumed tax rate from 19 percent to 15 percent.

- Our assumed tax rate on capital of 15 percent is 42 percent lower than the overall average tax rate of 25.9 percent that we noted above, so we reduce the amount of additional tax from the growth in national income by 42 percent.

Taking these considerations together, we estimate that the rise in AI in this scenario would reduce federal debt by 49 percent of GDP in three decades, as shown in Table 5 and by the dotted line in Figure 1. Although this scenario envisions an increment to economic growth that is twice the increment envisioned in the second scenario, the reduction in federal debt after three decades is the same here. The reason is that the income derived from the additional economic growth goes to capital alone rather than to capital and labor, so the income faces a substantially lower tax rate.

An alternative version of this scenario would have the additional income go to both capital and labor for people in the top quintile of the distribution. In that case, the additional income would be taxed at the 25.9 percent average tax rate for households in the top quintile that we noted above. Federal debt would be reduced by 94 percent of GDP after three decades and would be smaller relative to GDP than it is today.

B. Implications of Job Displacement and Shift in Income to Capital

The most important implications of this fourth scenario are the major job displacement and the stark shift in income shares from labor to capital. We take up those issues in turn.

1. Major Job Displacement

When people who want to work cannot find suitable jobs, the harm they experience is not just a loss of income but also a loss of purpose and social contact.

For example, Pope Leo XIV (2026) wrote: "[F]inancial assistance to the poor may at times be necessary in emergencies, but it cannot become the sole response, since the goal is to enable each person to live with dignity through his or her own work. … Work remains a fundamental dimension of the human experience, for not only is it a means of sustenance, but it is also a context for expression, relationships and contributing to the community. Therefore, the problems related to work extend beyond the income necessary for family survival" (paragraphs 149 and 154).

As another example, Ramamurti (2025) reported answers to a survey of 12,000 Americans who were asked: "Imagine a future where robots can do almost any job better and cheaper than humans. In this scenario, most people would not have traditional jobs. Do you think this would be: 'Mostly a good thing – people could pursue what matters to them' or 'Mostly a bad thing – people need jobs to have purpose and dignity'?" Among the respondents, 67 percent chose "mostly a bad thing," 21 percent chose "mostly a good thing," and 13 percent said they were not sure. The shares were similar for subgroups of respondents based on age, gender, race, and education.

And as a further example, Hussam et al. (2022) conducted an experiment on work in the admittedly unusual context of a refugee camp in Myanmar. They estimated that employment raised psychosocial wellbeing more than cash alone and that two-thirds of employed people were willing to forgo cash payments to keep working temporarily for free.

The importance of work in people's conception of a good life comes through as well in views of government policy.

Ramamurti (2025) presented answers to this follow-up question in the same survey: "Imagine robots and AI do almost all paid work, so there are very few human jobs but plenty of goods and services. What's the best way to make sure people have income?" Among respondents, 39 percent chose "a guaranteed public service/job program paying wages to anyone who wants one," 31 percent chose "a universal monthly cash payment to every adult (UBI)," 6 percent chose "no general cash or service assistance from the

government," and 24 percent said they were not sure. These shares varied by subgroup, with the preference for a "public service/job program" rather than a "universal payment" more pronounced among younger people.

Yet, belief in the significance of work seems to apply much more strongly to people viewed as being of working age than to people viewed as being of retirement age. Hetschko, Knabe, and Schöb (2011) showed that people in Germany who have been unemployed for a long time report a large improvement in life satisfaction when they retire, whereas employed people report stable satisfaction when they retire. The authors attributed this difference to unemployed people feeling that retirement brings their lives into alignment with social norms.

Attitudes toward Social Security and Medicare illustrate these points. Benefits from the programs are broadly viewed not as "welfare," but rather as payments that workers have earned through their work and to which all workers contribute; moreover, these benefits go primarily to retirees. That status as social insurance intended to support dignified retirements gives Social Security and Medicare political protection that other federal benefit programs do not have.

A crucial question for this fourth scenario of the rise of AI is whether social attitudes might change if job displacement becomes widespread. Yglesias (2025) wrote: "[Working] is our social and cultural norm regardless of economic necessity. … But as we head into an artificial intelligence future, I think we're all going to need to develop a better understanding of that English gentleman mindset, where you're not working but you're also not just a layabout and it's still considered a dignified, proper way of life." If attitudes do change in that way, support for different sorts of government policy might change as well.

2. Stark Shift in Income Shares from Labor to Capital

Compared with their traditional positions, the capital and labor shares of income nearly reverse in this fourth scenario. Some analysts have said that the capital share might rise even higher (for example, Trammell and Patel 2025), while others have explained that even if the economy reached "nearly complete automation" of production, the capital share might stabilize well below 100 percent (Aghion, Jones, and Jones 2019, page 274).

Regardless of the precise outcome, various observers have noted the possibility of a surge in the capital share of income and called for a reconsideration of economic policy. For example, Vinod Khosla (2026), who cofounded Sun Microsystems, wrote: "AI will transform economies and need a rethink of capitalism & equity. Labor portion of economy (vs capital) will decline sharply. Should we eliminate preferential treatment of capital gains tax and

equalize to ordinary income?" Dario Amodei (2026), who leads Anthropic, said that he could "make a pragmatic argument to the world's billionaires that it's in their interest to support a good version of [progressive taxation]: if they don't support a good version, they'll inevitably get a bad version designed by a mob." And Larry Fink, chief executive of BlackRock, wrote: "History suggests that transformative technologies create enormous value—and much of that value accrues to the companies that build and deploy them, and to the investors who own them. There's a real risk artificial intelligence could widen wealth inequality if ownership does not broaden alongside it" (Pitcher 2026).

C. Potential Fiscal Policy Responses

The potential policy responses that we discussed for the first, second, and third scenarios are relevant for this fourth scenario as well and are listed in Table 5. Policymakers might choose to adjust existing tax and spending programs to maintain closer historical relations to GDP, to make further changes to address rising inequality, and to provide more support and facilitate transitions for people who lose jobs and cannot find new ones quickly.[6] Moreover, the drop in employment would probably generate a significant loss of employer-sponsored health insurance, which would increase pressure on policymakers to expand access to public insurance.

Beyond those choices, policymakers also would need to decide whether to respond to the major permanent job displacement and the stark shift in income shares from labor to capital that occur in this scenario. We consider four potential approaches for addressing those additional challenges—fostering employment opportunities, instituting a Universal Basic Income (UBI) program, taxing capital at higher rates, and establishing some public ownership of businesses.

1. Foster Employment Opportunities

If policymakers chose to respond to a permanent shortfall of jobs, they could support private jobs, provide public jobs, or free up jobs for people without them by encouraging workers to retire earlier and work shorter weeks.[7] We take up these possibilities in turn.

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[6] In considering whether to adjust existing programs, policymakers might be especially attentive to Social Security. People who ended up without work for several years or more would receive fewer earnings credits and thus smaller Social Security benefits unless adjustments were made to the benefit formula.

[7] The public sector might also play a useful role in the training of junior workers. Junior positions can be effectively apprenticeships, in which workers receive training that prepares them for senior positions later while also providing immediate value to their employers. Because workers often move between employers, training has a positive externality, so uncoordinated decisions about the numbers of junior positions will lead to under-provision for society overall. Under-provision may be minimal when junior workers provide

Private-sector employment might be supported by significantly expanding programs for worker training and job matching, as we discussed above. Private-sector employment also might be subsidized directly.

Acemoglu, Manera, and Restrepo (2020) and Acemoglu, Autor, and Johnson (2026) showed that the tax code favors investment in capital relative to employment. That balance could be shifted if, for example, the government eliminated payroll taxes, which would cut the cost of employing workers or of being self-employed by roughly 15 percent. Such a change could be refined in various ways, such as by restricting the elimination of tax to earnings below a chosen threshold. However, large cuts in payroll taxes and a corresponding increase in the use of general revenue to fund Social Security and Medicare would undermine the earned-benefit nature of those programs.[8]

In addition, policy options for subsidizing employment are not limited to reducing existing tax rates to zero. For example, Weinzierl (2025) raised the possibility of "large negative tax rates" (page 2) to encourage work.

Another potential approach would be to provide jobs in the public sector. The survey results reported above suggest that this approach might receive broad support, and there is a precedent: Between 1931 and 1940, the unemployment rate exceeded 14 percent each year, and the Civilian Conservation Corps and Works Projects Administration each employed about 3 million people out of a labor force of about 50 million.

To make a notable difference under the circumstances of this fourth scenario, public-sector jobs would need to be scalable without large amounts of training or capital investment, to provide a sense of purpose to the workers who take the jobs, and not to crowd out many private-sector jobs producing the same output.

Traditional public works would not satisfy those criteria because construction depends much more on skilled labor and equipment today than it did in the 1930s. Personal care for older people and children might satisfy the criteria, though: Different types of care draw on different skills, and some types require few specific skills; required capital investment is not extensive; care is valuable to the people who receive it and thus could be meaningful to those who give it; and in coming decades, many people will probably want eldercare and

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significant immediate services, but it could become much larger if AI supplants many of those immediate services. In that case, the government might encourage or subsidize coordination among private employers.

[8] To maintain benefit levels, workers' earnings records would need to be credited for their work even if payroll taxes were not collected on those earnings.

be unable to afford it, so public provision could complement private provision rather than substitute for it. On the last point, we expect that AI-enabled machines will provide an increasing amount of personal care; however, given the rising need for care in an aging population and the difficulty of automating all of the physical and emotional aspects of care, we expect that the desire for human care will remain high.

A further potential approach to addressing a permanent job shortfall would be to open jobs for people who want them by encouraging people with jobs to retire earlier and work shorter weeks and encouraging firms to offer these options. This approach would represent a marked shift in policy, which has been encouraging later retirements to manage the budget challenge of an aging population. However, this scenario posits an ongoing weakness in labor demand that differs sharply from typical experience, and appropriate policy might differ as well. Indeed, when labor demand was persistently inadequate during the 1930s, one of the motivations for establishing Social Security was to coax older workers to leave the labor force and free up jobs for younger workers (DeWitt 1999).

Thus, in this fourth scenario for AI, policymakers might lower the age for receiving full Social Security benefits (which has been increased from 65 to 67 over the past few decades) and the age for receiving Medicare benefits (which has been unchanged at 65). Policymakers also might seek a restructuring of jobs to enable people on the cusp of retirement to reduce work hours gradually rather than through hard stops, and they might seek methods to help retirees find greater meaning and social interactions in their lives.

The effectiveness of such changes would depend in part on the degree to which policy changes would induce behavioral changes. The effectiveness would depend also on the extent to which the people who retired earlier or worked shorter weeks were holding jobs that could be done by workers being displaced by AI. And the success of such changes at meeting a social need would depend on the extent to which people who retired earlier or worked shorter weeks enjoyed the additional personal time more than did people who were unable to find jobs in the absence of the policy changes.

2. Institute a Universal Basic Income (UBI) Program

In its simplest form, a UBI program would provide each person with a regular cash payment of a specified amount regardless of their employment status or personal characteristics. UBI proposals are often framed as replacing some or all existing government benefit programs, although specific proposals differ considerably and often incorporate age restrictions, phaseouts of payments as incomes rise, and other features.

Kearney and Mogstad (2019) explained that support for UBI has come from people concerned about different economic challenges, including the increase in income inequality, the complexity of existing benefit programs, and the risk that technological change will eliminate many jobs. Yet, other people have argued that UBI is not the best response to those challenges.

Economists' analysis of UBI has focused on three issues (for valuable reviews of relevant research, see Hoynes and Rothstein 2019, Kearney and Mogstad 2019, and Luduvice 2024). One issue is the budgetary cost of a UBI program, which would be huge. Consider, for example, annual payments of $15,000, which would be slightly below the poverty line for a single person and less than two-thirds of the average Social Security retirement benefit. The total annual cost of such payments would exceed $5 trillion, which nearly equals total federal spending today apart from defense and interest on the debt.

A second issue is the effect on the well-being of lower-income people of substituting UBI for existing benefits. Hoynes and Rothstein concluded that UBI would "direct much larger shares of transfers to childless, nonelderly, nondisabled households than existing programs, and much more to middle-income rather than poor households." Thus, a UBI program would require a reduction in payments to current beneficiaries, a very large increase in total spending, or both.

A third issue that has received significant attention is the impact of UBI on labor supply. Marinescu (2018), Jones and Marinescu (2022), Vivalt et al. (2026), and other researchers estimated that other unconditional transfers have had modest to moderate impacts on work effort, but Kearney and Mogstad argued that most of the transfers being studied occurred years ago or are small in dollar amount, and so their applicability to a significant UBI program launched today is unclear. In addition, researchers such as Conesa, Li, and Li (2023), Daruich and Fernández (2024), and Luduvice (2024) have analyzed the effects of UBI on labor supply and other variables in dynamic general-equilibrium contexts and have reached a range of conclusions. That said, in a scenario with permanently insufficient labor demand, reductions in labor supply may not concern policymakers much.

3. Tax Capital at Higher Rates

In this illustrative fourth scenario for the rise of AI, capital income surges, and income inequality rises. Therefore, raising the tax rate on capital would make a substantial difference in the trajectory of government debt, provide substantial funding for spending increases or cuts in other taxes, or enable a combination of those effects. Moreover, raising the tax rate on capital would enhance the relative consumption and political power of people outside the top strata of income, as we discussed earlier.

However, raising the tax rate on capital would diminish saving, investment, and economic growth relative to what they would be otherwise. In addition, the global mobility of capital means that, without coordination by policymakers around the world, raising the tax rate would have smaller positive effects on government revenue and larger negative effects on economic growth than in a closed economy.

A large research literature has analyzed different approaches to taxing capital and the consequences of those approaches. We cannot effectively distill that literature in the small space available here. Instead, we simply highlight some of the key alternatives that policymakers might consider.

One potential approach to taxing capital at higher rates would be to increase tax rates within the existing structure of taxation. For example, Liscow (2026) recently argued that "current taxes already reach most of the rich's economic income, which includes unrealized capital gains … Even for the top 0.1 percent, about 60 percent is taxed, adjusted for inflation." He advocated raising the top marginal income tax rate to its pre-2017 level, pushing the corporate tax rate back up to its historical level, and ending the step-up basis rule for inheritances, emphasizing that "none of this would require defending untested constitutional theories or imposing complex asset valuation systems."

Another potential approach would be to tax the ownership of wealth. The constitutionality of that approach at the federal level is unclear, but proposals for state-level wealth taxes have received increasing attention. Saez and Zucman (2026) recently backed the proposed tax in California of 5 percent of billionaires' wealth over five years. They drew on estimates by Boll, Saez, and Zucman (2026) that billionaires in California paid 0.2 percent of their wealth in individual income tax per year from 2023 through 2025 and that a permanent wealth tax could raise substantial revenue for the state even accounting for expected outmigration of some taxpayers.

A further potential approach would be to tax consumption, perhaps through a value-added tax with an exclusion for moderate amounts of consumption so that the tax primarily affected owners of significant amounts of capital. Korinek and Lockwood (2026) predicted that the rise of AI will push the capital share of income close to 100 percent and therefore that consumption taxation will be used to an increasing degree. Consumption taxes might be especially appealing to policymakers if they decide to increase the taxation of capital after extraordinary returns to capital have occurred but largely before those returns are spent.

The rise of AI has also spurred proposals for a different but related approach of taxing AI or digital activities broadly. The goal of such proposals appears to be not to increase the tax on capital per se but rather to tax a sector that may represent a significant share of future economic activity—and, for some advocates, a sector that should be slowed in its advance so that society has time to adjust. Different variants of such a tax have been suggested, including a "compute tax," a tax on data from digital firms, and a tax on AI use (for example, see Bindley 2026, Korinek and Lockwood 2025, and Stevenson 2025).

4. Establish Some Public Ownership of Businesses

By taxing corporate profits and individual incomes (including the incomes of unincorporated businesses), the federal government receives a fraction of the income accruing to business owners. Thus, the government holds an implicit ownership position in businesses. Raising the tax rate on capital would increase the fraction of business income received by the federal government and thereby increase the government's implicit ownership position.

Nonetheless, establishing some explicit public ownership of businesses could be different from raising the tax rate on capital in multiple ways.

First, the fraction of business income received by the public through public ownership would be more robust to shifts in political sentiment. Tax rates can be lowered or raised through legislation backed by the president and narrow majorities in Congress, whereas giving up or acquiring ownership stakes would face larger political and legal obstacles. That difference might be especially important in this scenario because capital owners who received a much larger share of national income would presumably gain even more political power. For example, Trammell and Patel (2025) argued that "once the masses lose … economic power, due to AI, the political power will follow … and only redistributing capital itself will keep the means of production (and 'real power') themselves widely distributed."

Second, people might view business income received through ownership as earned income rather than redistributed income. For example, Smith (2026) wrote: "Taxes naturally seem adversarial … Government ownership stakes, on the other hand, seem like an *alignment of interests*. Although the math isn't much different, the optics could convey more of a message of 'We're all in this together'—a very Rooseveltian idea. And … the slogan that everyone in America deserves a stake in the AI that their nation created could have some real populist appeal."

Third, the opportunities for avoiding payment of income to business owners are much more limited than the opportunities for avoiding payment of taxes. For example, many businesses use tax provisions related to intellectual property, types of business entities, and global locations of income and costs to reduce their tax liabilities, and businesses in the digital sector may be especially well-positioned to take advantage of some of those provisions. But the point of those efforts to reduce tax liabilities is to increase payments to equity owners. Therefore, explicit public ownership could result in greater tax revenue than seemingly comparable tax rates on business profits.

At the same time, explicit public ownership of businesses would present a host of questions and challenges regarding how that ownership would be arranged and managed. To explore these questions, we consider in turn two possible approaches to public ownership—creating a sovereign wealth fund that holds ownership stakes, or placing ownership stakes into individual accounts.

If the government created a sovereign wealth fund, the key decisions for policymakers would include the following:

- How would the fund's acquisition of equity shares be financed? If financed through the issuance of federal debt, then the government would be placing a leveraged bet on the return to business capital, analogous to what the Japanese government has done in the past few decades (Chien, Du, and Lustig 2025). If financed instead through additional taxes, then the nature of that taxation could be key; for example, Bearer-Friend and Polcz (2025) proposed that generative AI firms make one-time tax payments in the form of their equity, while Garman (2026) proposed that all firms make payments as a fraction of their capital liabilities. Taxing only generative AI firms would present the daunting challenge of defining what constitutes an AI firm or, perhaps, of calculating the fraction of a firm's profits that derive from AI.

- Would the fund invest in private placements as well as public shares? If substantial portions of the additional income from AI are capitalized into share prices before companies issue shares publicly, then gaining access to some of that value might require venture-type investments in companies while they are privately held. Trammell and Patel (2025) stated that "the fraction of corporate capital held by private firms has … risen steeply in recent decades in the US, from 8% in 2000 to 19% today," and that "a lot of AI wealth is being generated in private markets." However, if a sovereign wealth fund made venture-type investments, that would be complex to administer and could lead to prominent losses as well as gains.

- What sorts of companies would the fund invest in? If it invested in large, domestic businesses alone, then some advantages of further diversification would be foregone. If it invested in foreign businesses as well, then the ethos of "we're all in this together" would be diminished. And if it invested in small businesses as well, then the complexity of administering the fund would be higher.

- Would the fund be an active investor or a passive investor? Policymakers who favored an explicit agenda of industrial policy or sought influence to advance other social goals might prefer the fund to be an active investor. But policymakers who opposed ad hoc government interventions in the economy, feared self-dealing by government officials, or wanted to maximize the fund's financial return might prefer the fund to be a passive investor. That latter group of policymakers presumably would worry that even if a fund was established initially as a passive investor, the guardrails implemented for that approach might erode over time.

- How would the activities of the fund be included in the federal budget? If expected equity returns were included in budget projections without any adjustment for risk, then the budget outlook might appear to be more favorable than it truly was. That distortion might lead policymakers to make decisions about taxes and spending they would regret if realized returns fell short of expectations.

An alternative approach to establishing some public ownership of businesses would be to place ownership stakes into individual accounts. Those accounts could allow for very limited control by individuals or very expansive control by individuals, with many possibilities in between. The structure that policymakers chose would make an enormous difference in the impact of the accounts.

For accounts with very limited control by individuals, consider the possibility of notional claims on a sovereign wealth fund. Policymakers might decide, for example, that each person would receive a certain number of claims at birth or upon entering adulthood, would be barred from trading or pledging those claims in any way, and would need to annuitize the claims through the government when reaching a designated older age. Accounts of that sort would leave investment decisions to the government (which would help people who were not accustomed to making significant investment decisions themselves), minimize administrative costs, ensure that people saved for retirement, and facilitate annuitization. However, people might not feel a sense of ownership of the sort we discussed above, and they would not be able to make their own investment decisions.

For accounts with very expansive control by individuals, consider the possibility of supplementary IRAs with marketable assets. Policymakers might decide, for example, that

each person would receive shares of a Wilshire 5000 index fund upon entering adulthood and could sell those shares at any point they chose, though perhaps with a penalty for withdrawal from the accounts before a designated older age. Accounts of that sort would give people full ownership of wealth, with the flexibility to determine the amount and composition of their investments. But the flexibility would also expose people to the considerable risk of making bad financial decisions.

Intermediate structures are possible as well. For example, notional claims on a sovereign wealth fund might be redeemable with the government not only at a designated older age but also in response to specified life events. Or supplementary accounts with marketable assets might have strong restrictions on withdrawals and a limited number of investment options. The tradeoffs between these arrangements have strong echoes of the late-1990s discussions about potential reforms to Social Security (for example, see Elmendorf, Liebman, and Wilcox 2002).

V. Conclusion: Implications for Policymakers Today

The rise of artificial intelligence will probably generate significant changes in the economy and society, although the nature, extent, and timing of those changes are not known today. The changes could include much faster productivity growth, notably greater inequality of labor earnings, substantial job churn, and major permanent job displacement with income gains going entirely to capital. Some of these changes might be viewed as continuations at faster paces of phenomena experienced over the past few decades. But the more disruptive possibilities, such as an ongoing economy-wide shortfall of jobs or a dramatic shift in income toward capital, would be fundamentally new developments.

Given current laws and the methodology used in budget projections, faster economic growth stemming from AI would improve the budget outlook of the federal government. Faster growth would be projected to slightly reduce the burden of existing debt, raise revenue a bit relative to GDP, and lower spending markedly as a share of GDP. However, the projected improvement in the budget outlook might be at least partly illusory because policymakers have acted recurringly over time to keep revenue, discretionary spending, and spending for a collection of benefit programs roughly stable relative to GDP. And even taking the projected improvement in the budget outlook at face value, federal debt would continue to rise significantly relative to GDP in the scenarios we analyzed.

Moreover, rising inequality, greater job churn, and especially large-scale permanent job displacement and a rapidly growing capital share of income would generate substantial economic, social, and political strains. The existing tax and transfer system would provide

some automatic responses to such changes, but many people might view those responses as inadequate. Therefore, we expect that policymakers would face considerable pressure to ensure that gains from AI would be shared broadly across society, in terms of both incomes and opportunities for meaningful work. Policy responses probably would have substantial fiscal implications themselves.

We have catalogued a wide range of possible fiscal policy responses to the rise of AI, as summarized in Table 6. Possible responses include increasing the progressivity of taxes and spending, expanding support and transition assistance for laid-off workers, fostering employment opportunities, instituting universal basic income, taxing capital at higher rates, and establishing some public ownership of businesses.

The ideal policy responses would probably depend on the nature of the changes due to AI, as we have discussed. Indeed, combinations of policies might be appropriate. For example, Marinescu (2025) advocated a two-part policy strategy with TAA-like adjustment assistance to address job loss and UBI funded by a tax on the digital economy to address income shifts. Sperling (2026) urged both initiatives for job creation and financial support for people who are working or making other contributions to society. And Korinek and Lockwood (2026) proposed a UBI program financed by consumption taxes.

However, the changes that AI will bring to the economy and society are not yet known. Predictions have been hazarded recently by a number of analysts—including Acemoglu, Autor, and Johnson (2026), Amodei (2026), Imas (2026), Jones (2026), Karger et al. (2026), and Trammell and Patel (2025)—but immense uncertainty remains.

Thus, a key question for fiscal policymakers today is how to act given that the consequences of AI are potentially enormous but deeply uncertain.

One possible approach for policymakers would be to wait until the effects of AI become clearer before making significant policy changes. An important advantage of that approach is that policy changes could then be targeted at any specific effects that concern the public.

But that “wait and see” approach has an important disadvantage as well, which is that substantial problems can develop before policy changes are implemented. Understanding of economic changes often comes slowly, because collecting and analyzing data takes time, and adjustments to policy often occur slowly after understanding is achieved, because policymakers need to agree on policy actions. With the “China shock,” for example, much of the policy discussion occurred only after many of the shock’s economic and social consequences had become deeply entrenched.

Table 6: Potential Fiscal Policy Responses to the Rise of Artificial Intelligence

Elements of Illustrative Scenarios	Potential Policy Responses Beyond Taking No Action
TFP grows more rapidly Additional income goes entirely to the top quintile Jobs are lost and new jobs emerge Higher unemployment and lower labor force participation Additional income goes entirely to capital	Raise spending and cut taxes relative to current law and projection methodology to maintain closer historical relations to GDP Increase progressivity of the tax and transfer system • Expand means-tested benefits • Expand low-cost or no-cost public services for everyone For people who lose jobs, provide more support and facilitate transitions • Expand unemployment insurance • Establish wage insurance • Expand worker training and employment services Foster employment opportunities • Support private jobs • Provide public jobs • Encourage earlier retirements and shorter workweeks Institute Universal Basic Income (UBI) Tax capital at higher rates Establish some public ownership of businesses • Create a sovereign wealth fund • Place equity in individual accounts

In our fourth scenario, this disadvantage could be especially great. If income gains from AI accrue primarily to capital owners at the top of the income distribution, waiting to observe that outcome definitively might foreclose some policy options altogether as vested interests become stronger.

An alternative possible approach for policymakers, then, would be to adopt policies now that could be useful in multiple potential scenarios for the rise of AI and could insure against the most disruptive potential effects. For example, policymakers might choose to institute a modernized form of TAA on a limited scale or to begin modest public purchases of equities through a sovereign wealth fund. Then, if the more challenging scenarios for AI materialize, those policies could be scaled up or accelerated more readily than if they had not been launched at all. Moreover, the concerns of many Americans about the potential effects of AI might be assuaged to some degree if certain policy responses were initiated now.

A variant of this approach would be to establish automatic triggers for certain policies to come into force. For example, policymakers might legislate that a form of TAA would be instituted if unemployment persisted above a preset threshold or that public purchases of equities would begin if the capital share of income rose above a preset level.

Whether such "insurance" approaches would be appropriate depends in part on the economic, social, and budgetary costs of adopting such policies if the more challenging scenarios do not occur or the triggers do not operate in the anticipated manner. Evaluation of such costs is beyond the scope of this paper, but the costs might not be large. Technological change and shifts in international trade will continue to generate job loss and occupational displacement, so stronger systems for aiding workers' transitions to new jobs might be viewed by policymakers as valuable even apart from AI. Similarly, modest public purchases of equities financed by additional government borrowing would expose the government to greater financial risk, but the risk would be limited as long as equity purchases remained small in scale, the government would have a larger expected financial return, and budget projections could be adjusted for the risk being incurred.

Historically, major economic transformations have often led to important innovations in fiscal institutions, and the rise of AI may ultimately prove to be another such moment. How our society chooses to address the changes associated with AI may become one of the central questions of our time.

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