THE AMERICAN ECONOMY IN A NEW ERA



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EXECUTIVE SUMMARY

Advancing Economic Participation in the AI Era: A Private- and Public-Sector Agenda

by Glenn Hubbard and Luke Pardue

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Introduction

Advances in artificial intelligence (AI) are poised to reshape the US economy at an unprecedented scale and speed. While the rise of AI is likely to raise aggregate income and wealth in the long term, the gains are likely to be unevenly distributed, and the path to this end state will involve a disruptive transition. In this paper, Glenn Hubbard and Luke Pardue argue that a failure to consider the disruptive impacts during this transition period can lead to a populist pushback, putting the long-term economic gains at risk. They outline an approach for the private and public sectors to wisely manage both the transition period and the long run as the economy is reshaped by AI.

Because the nature and extent of AI disruption remain uncertain, Hubbard and Pardue frame this response as a risk-management problem, requiring proactive steps that are flexible to different ways economic activity may shift. Policymakers should respond in three ways: modernize the country's social insurance landscape, improve workforce training programs, and update the tax structure. Business leaders have a crucial role to play in this transition as well: acting as stewards of their workforce and the communities in which they operate, including by incorporating AI tools in ways that complement human work and investing in workforce training programs, will build public support for the market economy and serve firms' long-term interests.

Principles to Guide Private and Public Action

Growth in AI capabilities and adoption—and the disruptive impact of these forces—will be fast and uneven. AI's disruption has already begun and will continue to unfold as the technology's capabilities and adoption grow, with disparate and unpredictable consequences for workers in different occupations and industries. In light of this uncertainty, the private- and public-sector responses should both evolve and embrace risk management. Responses should be flexible to allow different paths for model capabilities and business adoption to unfold. To be sure, many of the reforms the authors suggest would be prudent to undertake even if AI results in much smaller economic shifts than many predict, making them sensible risk-management opportunities.

Widespread participation in the economy is critical to a flourishing society. The authors do not aspire to a future in which AI replaces all human work, and they argue that the private- and public-sector responses to these developments should prioritize active participation in the economy among working-age adults. Participating in the economy means gaining economically valuable skills and having the opportunity to work at reasonable earnings. Work not only generates earnings but is also a source of identity and purpose. Employment has been associated with higher overall well-being, and economic disconnection generates large personal and social costs.

Building public institutions that can manage the structural transition is crucial. The AI revolution is occurring at a time when trust in the country's major institutions is at a historic low: in 2025, just 28 percent of Americans expressed "a great deal" or "quite a lot" of trust in US institutions, compared to 49 percent in 1979. Globalization and past technological advances have further eroded the public's confidence that the economy can deliver widely shared benefits. Navigating this challenge will require leveraging time-tested institutions, such as America's community college system. However, the inability to help dislocated workers remain connected to the economy amid prior episodes of automation and globalization should be motivation to experiment with new approaches as well.

Long-run outcomes must be distinguished from transition outcomes. When business leaders and policymakers focus too heavily on long-run, steady-state outcomes, they risk ignoring that the economic transition will likely be disruptive for some workers. If individuals do not believe advances in AI will benefit them, they may take steps to slow the diffusion of the technology. The political realignment resulting from the economic disruptions that followed China's entrance into the global trading system is an illustrative example of this phenomenon: declines in manufacturing employment were small relative to aggregate job churn in that period, and affected areas began to regain employment after 2010, but the economic shock many communities experienced during this period generated a sharp political reaction against free trade. Strategies to prepare and reconnect people to the economy during periods of structural change are crucial to maintaining the economic openness that drives economic growth.

Recommended Private-Sector Actions in the Short and Long Run

In the long term, AI's impact on employment and wages within an occupation will depend on two factors: whether the technology automates tasks in that role without creating new ones that rely on human expertise (the "labor-reinstating" effect) and whether productivity-enhancing technology increases demand for a sector's output (the "income elasticity"). As a result, four types of disruption could emerge: (1) AI automates enough tasks to reduce labor demand for certain jobs; (2) AI reshapes the work done within a role but keeps "humans in the loop"; (3) economic value flows to "bottleneck jobs" that AI cannot replace, such as those with inherently social aspects; and (4) AI drives the creation of new jobs that do not currently exist.

Hubbard and Pardue make the point that how these disruptive forces play out—that is, the extent to which AI tools eliminate occupations, reshape roles, or drive the creation of new work—is in part a result of how firms choose to adopt AI. Given the political economy concerns described above, it is in firms' long-term interest to act as stewards of their workforce and the communities in which they operate. In the near term, this means business leaders should aim to incorporate AI in a way that complements human tasks rather than replacing entire occupations.

Over time, as firms incorporate these tools and as AI capabilities improve, the tasks human workers will be relied on to perform will shift, resulting in reshaped jobs and new work. Firms should make continual investments in their workforce to ensure their skills and expertise keep up with the requirements of these roles. Firms tend to underinvest in training, however, due to the risk that upskilled workers will leave. Industry-level and public-private partnerships can address this challenge by lowering the cost that any single firm faces.

Public-Sector Responses to Smooth the Transition

Because the labor market risks posed by AI are too large for individual parties to bear, Hubbard and Pardue call for a modernized social insurance program designed to both mitigate income loss and reconnect workers to productive economic activity during long-term structural change.

Previous efforts to assist displaced workers have largely been disappointing. Congress passed the Trade Adjustment Assistance (TAA) program in the 1960s to help workers adapt to trade-induced economic disruptions, but the evidence of the effectiveness of TAA is sparse, and the program was far too targeted to have a large impact. The country's broader public workforce development system is largely governed by the Workforce Innovation and Opportunity Act (WIOA). Historical outcomes for dislocated workers participating in WIOA are mixed and dependent on the type of training workers take part in.

The largely disappointing track record in this area is in part because the country spends a relatively small amount on workforce development compared to other developed economies: 0.02 percent of GDP in 2023 compared to the OECD average of 0.11 percent. Furthermore, existing programs struggle to connect workers in need of their services with meaningful training opportunities: training providers that states deem eligible for WIOA funds are often not aligned with states' own projections of in-demand occupations, and limited information is offered to participants about provider training quality.

This historical record for assisting workers experiencing disruption shows that current tools are not prepared for the scope and speed at which AI may reshape the labor market. Hubbard and Pardue propose a new policy agenda that builds on previous successes.

Wage insurance: Wage insurance programs replace a portion of a worker's wages if they accept a lower-paying position following displacement. Evidence from small-scale historical experiments shows they can speed reemployment, particularly for high-earning older workers who see lower returns from participating in retraining. Because evidence suggests AI substitutes well for high-skill (and high-pay) jobs, this policy lever is particularly well suited to facilitating older workers' reconnection to employment during the AI disruption.

Personal Reemployment Accounts (PRAs): For younger workers, the social insurance system should be reimagined to provide broader access to temporary income support and assistance in developing new skills. Hubbard and Pardue propose Personal Reemployment Accounts that provide flexible funds for workers to use on training services, career counseling, transportation, or childcare, alongside a reemployment bonus, incentivizing workforce participation while preserving individual choice.

PRAs should be paired with reforms to the existing workforce development system. First, state workforce development boards should regularly update their lists of eligible training providers to remove programs that do not consistently produce positive outcomes for participants. Second, job centers should provide stronger outcome data to participants, as unemployed workers are more likely to enter a program if they believe their participation will translate into employment opportunities.

Because this disruption is both ongoing and uncertain, Hubbard and Pardue call for closer ties between training providers and employers. They recommend expanding grants for customized job training programs, which provide public funding for employer-led training efforts. Finally, Congress should increase resources to community colleges, which play a large role in ensuring workers across the country have economically valuable skills throughout their careers.

Tax Policy in the AI Economy

AI advances will drive two longer-run challenges. First, while AI-driven productivity gains may raise national income, such gains may largely accrue to capital, which is taxed at a rate lower than labor income is. Disruptions that reduce labor's share of income will work to exacerbate both deficits and concerns over high profits in technology firms. Second, the public investments the authors call for may come at a time in which the government's capacity to respond is already strained. Even under optimistic projections in which AI raises productivity growth between 0.5 and 1 percentage point per year over the next thirty years, federal debt is projected to rise from 100 percent of GDP today to between 126 and 136 percent of GDP by 2055.

Hubbard and Pardue argue that as labor income erodes and capital income drives consumption, the government should shift away from an income tax and toward taxing consumption. Such a tax system can be implemented in the US through a combination of a wage tax and a business cash-flow tax at the same rate. A cash-flow tax taxes a firm's revenue, minus all its expenses including investment. That is, it would allow businesses to expense investment immediately, boosting investment. It is also much simpler than a corporate income tax, which requires complex depreciation schedules. Finally, a cash-flow tax has the desirable property that taxes would fall on excess profits—returns above the riskless rate—including firms earning rents from AI.

Congress can move toward a pure cash-flow structure by completing the shift to full expensing (allowing immediate expensing of all investment costs) and removing the deduction for interest payments.

Hubbard and Pardue propose pairing this cash-flow tax with a progressive wage tax, featuring a wage subsidy at the bottom that would generate the same pro-work incentives as today's Earned Income Tax Credit.

With an eye toward increases in inequality during rapid technological advances, the authors also recommend reforming the estate tax by replacing the stepped-up basis at death, which effectively wipes away a significant portion of capital gains that go untaxed, with a carryover basis.

The Importance of Processes

The authors end by pointing out that this disruption is arriving at a time when state capacity is relatively low by historical standards. The public response to the COVID-19 pandemic exposed both the limits of public capacity, particularly within the labor market, and the potential for effective responses in a crisis. One lesson from the pandemic is that process matters. Hubbard and Pardue propose the creation of an AI Economic Engagement Task Force, which would coordinate the policy response in a way that cuts across agencies, including the Departments of Labor, Education, and Treasury. Such a task force would also include members from US statistical agencies to guide the coordination of public and private data and facilitate new data collection. In addition to the public response to COVID, policymakers can look to historical efforts to boost individuals' connection to the market economy amid structural economic transitions, including the Committee for Economic Development following World War II in America and the Marshall Plan in Europe.

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Glenn Hubbard is dean emeritus of Columbia Business School. He is also the Russell L. Carson Professor of Finance and Economics. Hubbard received his B.A. and B.S. degrees summa cum laude from the University of Central Florida, where he received the National Society of Professional Engineers Award. He has been a visiting professor at Harvard University and the University of Chicago. Additionally, he is a visiting scholar at the American Enterprise Institute in Washington. He holds A.M. and Ph.D. degrees in economics from Harvard University, where he received fellowships from the National Science Foundation and the Alfred P. Sloan Foundation. In addition to writing more than 100 scholarly articles in economics and finance, Glenn is the author of three popular textbooks, as well as co-author of *The Aid Trap: Hard Truths About Ending Poverty*, *Balance: The Economics of Great Powers From Ancient Rome to Modern America*, and *Healthy, Wealthy, and Wise: Five Steps to a Better Health Care System*. In government, Hubbard served as deputy assistant secretary for tax policy at the United States Treasury Department from 1991 to 1993. From February 2001 until March 2003, he was chairman of the U.S. Council of Economic Advisers under President George W. Bush. While serving as CEA chairman, he also chaired the economic policy committee of the OECD. In the corporate sector, he is chairman of the Board of MetLife and sits on the board of BlackRock Fixed Income Funds. Hubbard is co-chair of the Committee on Capital Markets Regulation; he is a past chair of the Economic Club of New York and a past co-chair of the Study Group on Corporate Boards.

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Luke Pardue is Policy Director at the Aspen Institute's Economic Strategy Group (AESG). He obtained his PhD in economics from the University of Maryland and, before joining AESG, worked as an economist at Gusto, a small business payroll platform. Before Gusto, Luke held research positions at the US Census Bureau and Federal Reserve Board. His research focuses on finding policies and practices that help businesses, workers, and families thrive. His work and commentary have been featured in outlets including *The New York Times*, *The Washington Post* and *The Wall Street Journal*. Luke currently lives in Washington, DC.

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