Center on Budget and Policy Priorities

CBPP STATEMENT

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Contact:
Michelle Bazie, 202-408-1080, bazie@cbpp.org

820 First Street, NE, Suite 510
Washington, DC 20002
Tel: 202-408-1080
Fax: 202-408-1056
center@cbpp.org
www.cbpp.org

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STATEMENT BY ROBERT GREENSTEIN, EXECUTIVE DIRECTOR, ON THE PRESIDENT'S 2011 BUDGET PROPOSAL

The President's budget reflects both the short-term priority of boosting the economy and creating jobs and the longer-term priority of bringing deficits under control while meeting important national needs.

There is a strong case for more medium- and long-term deficit reduction than the budget contains. But the budget likely goes as far in this area as today's toxic political environment will allow, even if the President pushes forcefully for his policies. Indeed, many of his proposals that provide fiscal restraint, from closing unproductive tax loopholes to scaling back agricultural subsidies for wealthy farm operators, may prove to be beyond what a polarized Congress, facing continuous roadblocks and with one eye on the fall election, will produce this year.

Of particular note, the budget proposes to save $750 billion over 10 years through three significant steps on the tax side. First, it would narrow tax subsidies — which budget analysts call "tax expenditures" or "tax entitlements" because they essentially represent government spending that's delivered through the tax code, and that are now approaching $1 trillion a year in cost — such as for oil and gas companies, multi-national corporations that shift profits abroad to avoid paying their fair share of taxes here, and high-income households that receive much bigger subsidies than other Americans for the same tax-deductible expenditures. Second, it would reform financial institutions, such as by instituting a fee on large banks to cover the costs of bail-outs and discourage excessively risky behavior. Third, it would take other steps to reduce tax avoidance. Of this $750 billion in tax savings, the budget would allocate $284 billion for new tax cuts, primarily for middle- and lower-income families and for businesses, and save the rest for deficit reduction.

Enacting these and other proposals in the budget will be very difficult, given the penchant among some lawmakers to rail against deficits but vote against most measures to reduce them. Had the President proposed major *additional* budget cuts and revenue increases, not only would Congress almost certainly have rejected them, but the inevitable harsh attacks on them could have "poisoned the well" and made them even harder to achieve in the future if and when a more bipartisan atmosphere makes greater budgetary progress possible.

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Budget's Effect on Deficits and on Spending Growth

The budget would reduce deficits by $1.25 trillion over 10 years, compared to what they would be by continuing current policies. This does not count "savings" from eventual reductions in spending for operations in Iraq and Afghanistan, which are extremely difficult to measure.

This is a positive accomplishment. Yet deficits would still total $8.5 trillion over the next 10 years. Of this $8.5 trillion, $5.8 trillion would consist *not* of expenditures for any program, but of interest payments on the debt.

These high interest costs largely reflect the impact on the debt of policies that the President inherited — particularly the compounding budgetary effects over time of two very large tax cuts, a costly new drug benefit under Medicare, and the wars in Afghanistan and Iraq, none of which was paid for — as well as the mounting budgetary effects of ever-rising health care costs and the aging of the population. The costs of recent and proposed measures to rescue the economy have an impact as well, but a smaller one because these measures will end and, so, the costs will fade after a few years.

The Budget's Fiscal Policy Principles

In terms of fiscal policy, the budget gets three basic things right.

First, it sets an appropriate target — stabilizing the debt as a share of the economy after the economy has recovered, and achieving this goal by reducing the deficit to 3 percent of Gross Domestic Product and balancing the "primary budget" by 2015 — although the President and Congress will need to take substantial steps beyond those detailed in this budget to actually reach that goal. A growing number of fiscal policy experts from across the political spectrum agree that the essential fiscal policy goal is to keep the debt from rising faster than the economy (after the economy has recovered) and thereby prevent the cost of interest payments on the debt from exploding.

Second, it reaffirms the President's commitment to enacting comprehensive health care reform. This is the single most important step that policymakers can take this year to start addressing long-term deficits. Rising health care costs are, by far, the main driver of the long-term fiscal imbalance. The House and Senate health bills contain most of the reforms that health policy experts have identified as promising ways to slow health care cost growth over time. They also establish an array of research and demonstration projects to identify a new generation of cost-containment strategies and create mechanisms so promising strategies can be implemented without running the gauntlet of special-interest lobbying pressures on Capitol Hill.

Third, it would allow the Bush-era tax cuts for high-income Americans to expire on schedule at the end of the year. Extending these tax cuts, as some Members of Congress propose, would add $678 billion to the deficit over the next 10 years even before counting the associated interest costs, according to the budget, while doing little for the economy. When the Congressional Budget Office (CBO) recently examined a number of spending and tax options for boosting the weak economy and creating jobs in the years immediately ahead, it rated continuation of the Bush-era tax cuts for people with incomes over $250,000 *dead last*. See http://www.cbpp.org/cms/index.cfm?fa=view&id=3068.

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CBO's analysis and the work of other economists such as Mark Zandi of Moody's Economy.com suggest that putting resources now into well-designed tax and spending measures to boost the economy and create jobs, while keeping those measures temporary and letting the high-income tax cuts expire on schedule, would help the economy both in the short term (by boosting growth) and the long term (by keeping long-term deficits lower than they would otherwise be). This is essentially the course that the President's budget charts; it proposes $266 billion in temporary tax cuts and expenditure increases now to help ensure that the economy averts a double-dip recession and sustains a reasonable rate of economic and job growth, while saving 2½ times that much over the decade as a whole by letting the tax cuts for the wealthiest 2 percent of Americans lapse.

Some news outlets have reported that the budget proposes $100 billion in such temporary, economy-boosting measures. It does, in fact, propose $100 billion for a new "jobs initiative." But, it also proposes $166 billion in other efforts to boost the economy, largely by temporarily extending certain expiring provisions of last year's American Recovery and Reinvestment Act. They include $76 billion in temporary tax cuts — much of which would go for a one-year extension of the Making Work Pay tax credit — and $90 billion in temporary increases in mandatory programs, most of which would go to extend unemployment benefits and fiscal relief to state governments. The $266 billion total is much closer to what the weak economy requires. Zandi and other experts have called for additional measures of about $250 billion.

Domestic Spending Freeze Does Not Preclude High-Priority Investments

Contrary to fears expressed last week that the President's proposed freeze on total non-security discretionary funding would provide inadequate support for education, for vulnerable Americans, and the like, the budget actually does well in these areas. While capping overall domestic discretionary spending at a little below the 2010 level, it would *increase* funding in 2011 in high-priority discretionary areas such as education, clean energy, infrastructure, and basic research and development. At the same time, it would reduce or terminate funding for lower-priority programs, such as certain projects of the Army Corp of Engineers and NASA's current program to return astronauts to the moon.

For policymakers to achieve the savings from freezing this category of spending without impairing the government's ability to meet crucial national needs, however, Congress will need to follow the President's lead and reduce funds for low-priority discretionary programs to pay for increases in high-priority ones.

Policy Reforms to Promote Work, Productivity, and Savings

Finally, the budget includes several significant reforms and new investments to promote work, increase worker productivity, and boost national savings — all of which would benefit the economy over the long term — while also increasing opportunities for struggling families and individuals. Specifically, the budget would strengthen tax credits and programs that help low- and middle-income families with child care costs, which should enable more parents to work or to work more. It would substantially strengthen financial assistance so more students can afford college; a better-educated workforce is a more productive one. And it would help low- and middle-income families save for retirement. These measures would have multiple benefits: they would reduce the squeeze on family

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budgets, strengthen work effort, boost educational attainment, or increase national saving. Due to those and other proposals, Americans of modest means, many of whom are now facing major strains, would fare well under this budget.

Of particular note is the budget's large initiative to increase retirement saving among low- and middle-income families. The budget includes five related proposals here. It would: 1) provide for employers who do not sponsor a retirement plan to automatically enroll their employees in a direct-deposit IRA plan (while enabling employees to opt out); 2) make it easier for firms that *do* offer retirement plans to enroll their workers automatically (while, again, giving workers an opt-out option), an approach that, experience shows, sharply increases the use of retirement saving vehicles; 3) double the tax credit for start-up costs that small employers incur in setting up a retirement plan for their workers; 4) enlarge a tax credit, known as the saver's credit, under which the Treasury essentially matches retirement contribution (up to a limit) by low- and many middle-income households and thereby encourages them to save more for retirement; and 5) institute measures to improve the transparency and adequacy of 401(k) plans.

Taken together, these proposals should induce significant increases in retirement saving. Such an increase in saving would both help families in old age and strengthen U.S. long-term economic growth by increasing the pool of national savings that can be tapped for private investment in new plant and equipment.

These retirement savings initiatives will likely attract bipartisan support. But that does not mean they will be easy to enact. They will have to be paid for, presumably by closing some of the tax loopholes that the President's budget targets. If powerful lobbying pressures and campaign contributions convince lawmakers neither to close these loopholes nor find comparable savings elsewhere — as may well occur — the retirement saving initiative will fall by the wayside, and both ordinary families and the economy will fare less well.

Indeed, this trade-off reflects the larger dilemma that this budget — and fiscal policy in general — now face: whether policymakers can, in the months and years ahead, set priorities and make the needed hard choices. This budget represents a promising first step in that direction and will face tough challenges as a result. And it is only a first step; policymakers will need to take many more such steps in the not-too-distant future.

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