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CBPP STATEMENT

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Obama's Budget: More Investment With More Deficit Reduction

Statement of Robert Greenstein On the President's Fiscal Year 2017 Budget

President Obama's new budget shows that we can address key unmet national needs and substantially reduce deficits at the same time. The budget proposes major initiatives to increase economic opportunity, reduce poverty, and boost investment in infrastructure and other activities important to raising productivity and long-term growth. It also would reduce deficits by $2.9 trillion over the coming decade, which would hold deficits below 3 percent of gross domestic product (GDP) during this period and keep the debt-to-GDP ratio stable for 25 years, the Office of Management and Budget (OMB) estimates. In addition, it would shore up Medicare's Hospital Insurance trust fund.

To be sure, policymakers won't enact most of the President's initiatives this year; indeed, in a step that breaks with decades of tradition and reflects today's corrosive partisanship in Washington, Republican congressional leaders aren't inviting the OMB Director to discuss the budget at congressional hearings. But because the President and Congress agreed last year on total funding levels for defense and non-defense appropriations in fiscal year 2017 — and the President's budget adheres to those levels — a number of its proposals outside of taxes and entitlement programs likely will receive consideration in the appropriations process.

More fundamentally, the Obama budget is designed to chart a path for the nation's future and, as such, it puts key ideas and proposals on the table for debate this year and in the years ahead. In that sense, it's somewhat akin to what various presidential candidates are doing and what Speaker Ryan has urged congressional Republicans to do.

But the analogy between the Obama budget and tax-and-spending proposals of many presidential candidates stops there. In key respects, Obama's proposals and those of various candidates couldn't be more different. While, as noted, Obama's budget would reduce deficits by $2.9 trillion over the coming decade, the proposals of numerous candidates would *add* trillions to deficits, mainly through massive tax cuts. In addition, many of the candidates' proposals are vague and lack detail, making them difficult to evaluate.

Fiscal Effects

The budget proposes $2.9 trillion in deficit reduction over the decade from fiscal years 2017 to 2026, not counting savings related to funding for Overseas Contingency Operations (e.g., for the Middle East conflicts). The savings would limit deficits to no more than 2.8 percent of GDP throughout the decade and stabilize the debt as a share of GDP over this period and beyond. The debt would equal a projected 76.5 percent of GDP in 2016 and stand at 75.3 percent of GDP in 2026, OMB estimates.

Policymakers would likely need to enact more deficit reduction in coming decades to address the nation's long-term fiscal challenges. But the Obama budget would represent important progress on this front, and preventing the debt-to-GDP ratio from rising over the next quarter-century would be a significant accomplishment.

Some critics undoubtedly will castigate the budget for focusing its deficit reduction efforts on the revenue side. But we should keep several facts in mind. First, its $2.9 trillion in deficit reduction for 2017-2026 would come *on top of* the $4 trillion to $5 trillion in deficit reduction that policymakers have already achieved since 2010, and those savings came heavily on the spending side. With the new Obama proposals, *total* deficit reduction over this period would fall roughly 50-50 between spending and revenues, OMB estimates. Also, part of the proposed Obama revenue increases would effectively "pay for" the large year-end tax bill that policymakers enacted in December *without* offsetting its cost.

Under the budget, federal spending would average 22.3 percent of GDP over the coming decade, which isn't far above the 21.6 percent average of the Reagan years. Moreover, a significantly larger share of Americans is elderly now and receiving Social Security and Medicare than in the Reagan years. In addition, we've experienced more than a quarter-century of health care cost growth since the Reagan years, which has boosted the cost of federal health insurance programs, most notably Medicare.

Opportunity and Poverty

This budget marks a major effort to increase opportunity — especially among children and youth — and reduce poverty. It includes a large and impressive array of proposals, several of which have at least some bipartisan support or reflect bipartisan principles, and they deserve careful consideration rather than blind rejection.

Specifically, the budget features initiatives to substantially expand access to high-quality child care and preschool education for many children, especially from families with modest incomes. It includes $10 billion over ten years to expand the home visiting program, an evidence-based program that's proven successful in helping low-income parents be better parents and thereby improve their children's life chances. It would commit $11 billion over the decade with the goal of eliminating homelessness among families with children.

The budget proposes $12 billion over the decade to provide low-income children with supplemental food benefits in summer months when school is out and children lack access to free or reduced-price school meals. That's another evidence-based initiative; demonstration projects that were rigorously evaluated found this supplemental nutrition assistance reduced food insecurity among low-income children in the summer and improved their diets. The budget also includes a long-overdue funding boost for the Temporary Assistance for Needy Families block grant, which has been frozen for 20 years without any adjustment for inflation and, thus, has eroded substantially in value.

The budget would strengthen the Earned Income Tax Credit for workers not raising children — the one group of workers that the federal tax code still taxes into, or deeper into, poverty. House Speaker Paul Ryan has proposed a nearly identical measure.

And the budget proposes $2 billion to test various innovative state and local approaches to aiding desperately poor families who face a downward spiral into severe economic crisis. These pilot projects would test approaches to stabilizing these families, getting their parents back on their feet, and protecting their children. Among their targets are families that, recent research has shown, live on as little as $2 per person per day in cash income or even less.

Increasing Economic Growth and Productivity

The budget aims to boost long-term economic growth by investing more in early childhood education, computer-science education, and other such areas, as well as by enhancing the skills and employability of disadvantaged youth, expanding the use of apprenticeships, improving college affordability, and other measures. A better trained and more adaptable work force will yield more productive workers, boosting the economy and job growth.

The budget also contains a well-designed, $300 billion-plus investment in infrastructure, largely financed through a new oil fee, that would help address widely recognized deficiencies in the nation's transportation system. A faster, safer, and cleaner transportation system will mean more efficient travel and transport, benefiting individuals and businesses alike. The proposal also would use 15 percent of the oil fee revenues to provide assistance to low- and moderate-income families facing higher costs from the transition to cleaner energy.

The budget's tax measures also should promote economic efficiency and productivity. By reforming, curbing, or eliminating various tax credits, deductions, and other preferences (known collectively as "tax expenditures") that misallocate resources by favoring tax-advantaged investments that may be economically inefficient, these proposals should benefit the economy over time. By scaling back scores of dubious tax breaks, the budget would raise nearly $1 trillion over the decade and promote more productive and efficient investment.

Finally, the budget provides additional funding after 2017 for non-defense appropriations, which support a wide range of priorities that include productivity-enhancing investments in education, basic research, and infrastructure. That would build on last year's bipartisan agreement, which provided relief from the Budget Control Act's sequestration cuts in 2016 and 2017, by sticking with the agreed-upon funding levels for 2017 and proposing sequestration relief in the years that follow. That relief would, for instance, help accommodate the President's proposal to double funding for clean energy research over the next five years.

The budget would more than offset the costs of sequestration relief through extensive deficit-reduction measures, as noted above. Absent this sequestration relief, spending on appropriated non-defense programs will fall in 2018 and succeeding years to its lowest levels on record as a percent of GDP, with data going back to 1962.

Bolstering Medicare

The budget would bolster Medicare in several ways. It would reduce Medicare's projected spending, raise its revenues, and dedicate Medicare taxes appropriately. This would extend the solvency of Medicare's Hospital Insurance trust fund for more than 15 years.

On the spending side, the budget proposes Medicare reforms that would save more than $400 billion over ten years, primarily from reforms related to medical providers, insurance companies, and the prices that

Medicare pays for prescription drugs. On the revenue side, it would close a loophole to bolster Medicare's finances. Under current law, people making less than $250,000 a year (less than $200,000 for a single tax filer) pay 2.9 percent of their wages and salaries into Medicare's trust fund. People who make more than that pay a 3.8 percent tax on their wages and salaries over the thresholds, as well as on investment income they receive (such as capital gains, dividends, and interest income). But certain investment income from their businesses that's passed through to individuals escapes the tax. The budget closes this loophole by applying the 3.8 percent tax to the pass-through investment income of people making over $250,000 — including from partnerships, limited liability companies, and S corporations.

The number of affected business owners would be small because roughly 97 percent of small business owners have incomes below the $200,000 and $250,000 thresholds. Most business owners, including sole proprietors, pay Medicare taxes on their income just as workers do. That some pass-through income escapes this tax, however, is not only inequitable but also creates incentives for wealthy owners and investment fund managers to re-characterize their income, or re-arrange their business operations, to avoid the tax.

Along with reforming the 3.8 percent net investment tax, the budget would address long-standing efforts by owners of certain pass-through enterprises to avoid payroll taxes by arranging their affairs to understate their salaries and wages. The Government Accountability Office and the Treasury Department's Inspector General for Tax Administration have highlighted this problem.

All told, these revenue proposals would raise $272 billion over the next decade, nearly all of which would go to Medicare's Hospital Insurance trust fund. Finally, in a related matter, the budget would address an anomaly under which the revenues from applying the 3.8 percent Medicare tax to investment income over $250,000 now go to the budget's general revenue fund rather than to Medicare's trust fund; under the Obama budget, all revenue from the 3.8 percent tax would go to the trust fund.

Conclusion

Rather than ignore this budget, policymakers would be wise to examine it closely. It charts a prudent, thoughtful path forward. It balances its further investment in both human and physical capital against the need to put the nation's finances on a sustainable path. Moreover, it includes a welcome focus on the most disadvantaged, offering proposals to increase opportunity and reduce poverty. Even if one disagrees with various specific proposals, the principles upon which this budget is based should serve to help guide future debates.

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