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TWO KEY TESTS FOR HOUSE AND SENATE ACTION ON CONGRESSIONAL BUDGET RESOLUTION

by Chuck Marr

As Congress prepares a budget resolution for fiscal year 2010, it should apply two key tests to any proposed change in the plans approved by the House and Senate Budget Committees:

- Would the proposal support economic recovery in the near term?
- Would it reduce budget deficits over the long term?

The President's budget proposal would begin addressing both the economy's immediate needs and the nation's long-term budget problems. It would add nearly $1 trillion less in total deficits over the next decade than we would incur by continuing current tax and spending policies. But early signs are mixed on whether the changes Congress makes as it prepares its budget plan will strengthen or undercut efforts against the recession and long-term deficits.

Weak Economy, Rising Long-Term Deficits Require Action

The nation faces a dual challenge:

- **Severe cyclical contraction.** Real GDP declined at a 6.3 percent rate during the fourth quarter of 2008; the unemployment rate reached 8.1 percent in February and could climb into double digits. The Congressional Budget Office now expects this to be the most severe recession since World War II.
- **Unsustainable long-term fiscal path.** In stark contrast to the Bush Administration, which inherited a surplus and a rapidly shrinking public debt, the current Administration inherited a dire fiscal situation, with the recession compounding the underlying long-term fiscal pressures resulting from rapidly rising health care costs, the aging of the population, past tax cuts, and war costs. If we continue current policies — e.g., extend the Bush tax cuts and other expiring tax breaks, continue to enact relief from the Alternative Minimum Tax and prevent scheduled cuts in Medicare physician fees from taking effect, and fund our troops overseas even as we phase down operations in Iraq and Afghanistan — the nation is on a path to amass $10 trillion in cumulative deficits over the next decade, during which time the deficit will not fall below 5 percent of GDP.

Policymakers, therefore, face two separate tasks:

- **Counteracting the immediate downward economic pressure.** The recently enacted economic recovery package will boost infrastructure spending and consumption in order to increase overall demand in the economy. In addition, the Treasury and Federal Reserve are working to stabilize financial markets and the banking system.

- **Improving the long-term fiscal situation.** At this juncture, policymakers should adopt measures that will impose fiscal restraint over the long term and take effect once the economy starts to recover. Policymakers certainly should avoid policies that worsen the long-term fiscal outlook.

President's Budget Recognizes Dual Challenge

The President's budget proposes specific measures to help address both aspects of this dual challenge:

- **Fighting the recession.** The Obama budget incorporates the recently enacted economic recovery act and, importantly, does not undercut that legislation through measures that would reduce demand, such as cuts in spending for discretionary (i.e., non-entitlement) programs in 2010. The budget also includes $250 billion in additional funds to help stabilize the financial markets.

- **Beginning to confront the long-term fiscal challenge.** The budget includes spending and tax proposals that, while only a first step, indicate a willingness to make the kinds of difficult fiscal choices that will be needed. For example:

  - ✓ **Slowing cost growth in Medicare.** The budget includes measures such as reducing the sizeable overpayments currently made to private insurance companies participating in Medicare, lowering Medicare payments for home health services to better reflect actual costs, and reducing Medicare payments to hospitals with high rates of patients readmitted less than 30 days after discharge. In addition, the budget includes a longstanding Republican proposal to increase the premiums that affluent Medicare beneficiaries pay for prescription drug coverage.

  - ✓ **Limiting deductions for high-income filers.** The budget limits the rate at which families making over $250,000 can take itemized deductions to 28 percent, or a little less than double the rate for deductions taken by middle-income households. This measure, which would help to finance health care reform, bears some similarity to a more far-reaching proposal advanced by the Bush-appointed Tax Reform Panel in 2005 to limit the tax rate for deducting home mortgage interest to 15 percent for all filers.

  - ✓ **Paying for the Making Work Pay tax credit**. The budget extends this middle-class tax cut and pays for it with revenues generated by the Administration's cap-and-trade climate change proposal. On the other hand, the President's budget extends the middle-class tax

cuts from the Bush years *without* paying for them, although at least it recognizes that the nation cannot afford to continue the Bush tax-cut windfalls for households at the top of the income spectrum.

In sum, the President's budget takes modest but important first steps toward fiscal responsibility. Over the 2010-2019 period, it would trim the deficit by almost $1 trillion compared to a continuation of current policies.

Now It's Congress's Turn

Congress now faces this dual fiscal policy test as it crafts its budget plan. In considering proposed changes to the budget resolutions approved by the House and Senate Budget Committees, policymakers should consider their impact both on the current recession and on the nation's long-term fiscal future.

As the debate opens, early signs are mixed:

- **Cutting discretionary funding for 2010?** Perhaps confusing the short-term priority of bolstering the economy with the long-term need to reduce deficits, some in Congress have proposed cutting discretionary spending for 2010 below the levels proposed in the House and Senate plans (which are already below the level proposed in the President's budget). Such cuts would undercut the very fiscal stimulus that Congress just enacted and that the economy badly needs, as the sharply rising unemployment rate demonstrates.

- **Taking options off the table?** Senator John Thune (R-SD) recently offered an amendment (to unrelated legislation) forbidding Congress to enact legislation that would reduce charitable contributions. This was a seeming attempt to short-circuit the President's proposed limit on itemized deductions, which would reduce charitable contributions by less than 2 percent. While the Senate (narrowly) rejected the amendment, both houses will likely face similar efforts in the coming days. Given the fiscal challenge the country faces, all options must remain on the table.

- **Cut the estate tax even more?** In 2001, with a large surplus and a disappearing national debt, Congress enacted a massive cut that included a phaseout of the estate tax, under which the exemption level has risen to date from $2 million to $7 million. It is hard to believe that policymakers would have endorsed such radical changes in the estate tax if today's fiscal outlook had prevailed at the time. Nevertheless, some in Congress, lacking support for permanent repeal of the tax, are now proposing further shrinkage of the tax, which affects the estates of only the wealthiest one-quarter of 1 percent of people who die. Such a measure would clearly fail both of the tests outlined above: it would not help address the current downturn, and it would harm the long-term budget outlook.