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Fiscal Commission Report: Too Much Taxes, Not Enough Spending Cuts

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The National Commission on Fiscal Responsibility and Reform deserves credit for taking on the large structural deficits that risk eventual economic calamity.¹ Over the next decade, runaway spending is set to double the national debt, which would risk higher interest rates, slower growth, and steeply higher tax rates. Unfortunately, however, the commission's report involves a tax-heavy solution to a spending problem.

Spending Is the Problem. Expanding spending—not declining revenues—drives America's long-term deficits. Even if all tax cuts are extended, revenues will soon slightly exceed their historical average of 18 percent of the economy. Federal spending—rising from its historical average of 20 percent of the economy to a projected 26 percent by the end of the decade—is the moving variable.²

Nearly all of this new spending will come from Social Security, Medicare, Medicaid, and net interest on the debt, the combined nominal cost of which will rise from \$1.6 trillion to \$3.6 trillion over this decade. Over the long term, the Congressional Budget Office (CBO) projects that nearly all new debt will result from these four spending categories.³

The Highest Tax Burden in American History. Because spending is driving long-term deficits, a reasonable solution would focus overwhelmingly on this growing spending. One aim would be to limit government spending to the amount Washington has historically taxed—18 percent of GDP. A compromise could balance the budget at 19 percent of GDP, the midpoint between historical tax reve-

nues (18 percent) and spending (20 percent). Instead, the commission aims to eventually balance the budget at 21 percent of GDP, which would represent the highest tax level in American history. And it would take until 2035 to balance the budget.

Most disturbingly, the proposal also includes a tax hike trigger that would automatically raise taxes if Congress does not enact what they call tax reform. Such a device would inject too much uncertainty into the economy, just like the uncertainty about tax rates next year is affecting markets now. Moreover tax reform—e.g., the tax hike—is supposed to come first out of the pipeline in 2013. Spending, not revenues, is the problem, and we've been down this road before: immediate tax hikes accompanied by promises of spending cuts in the future. This is unacceptable.

Building a Better Baseline. The commission report could be interpreted as much heavier on spending restraint than tax hikes. This effect is overstated, because the commission measures all tax and spending changes against a baseline that already assumes nearly \$2 trillion in tax increases from letting parts of the 2001 and 2003 tax cuts expire and from no longer renewing many other annual tax cuts.

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<http://report.heritage.org/wm3071>

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The proper way to measure the commission's proposals are against a current-policy baseline that assumes today's spending and tax policies continue. That current-policy baseline assumes that:

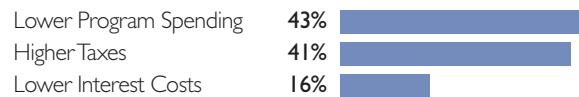
- Congress would extend the 2001 and 2003 tax cuts, continue adjusting the Alternative Minimum Tax (AMT) threshold for inflation, and continue regular tax extenders (adjusted for inflation);
- The Medicare "doc fix" will be enacted annually, preventing a cut in physicians' payments;
- Spending on Iraq and Afghanistan will grow at the Congressional Budget Office's "fast draw-down" scenario; and
- Other discretionary spending will expand at the rate of the economy.

The commission baseline uses some of these adjustments (such as the AMT patch and Medicare doc fix) but not others (such as many of the tax extenders).⁴

Huge Tax Hikes, Modest Entitlement Savings. Measured against the baseline, the commission would reduce deficits by \$8 trillion between 2011 and 2020. Revenues would rise by \$3.3 trillion, program spending would fall \$3.5 trillion, and \$1.3 trillion would be saved in net interest costs. So despite nearly all long-term deficits arising from soaring spending, the commission report nearly splits the difference between tax hikes and spending reductions in the first decade (see Table 1 and Chart 1).

Digging deeper, the commission would reduce Social Security and health spending (the cause of nearly all long-term deficits) by just \$442 billion in the first decade—a 2 percent reduction from the projected \$20.2 trillion spending level. The growth

Fiscal Commission Deficit Reduction, 2011–2020



Sources: Current-policy budget baseline based on Congressional Budget Office data. See Brian Riedl, "The Three Biggest Myths About Tax Cuts and the Budget Deficit," Heritage Foundation *Backgrounder* No. 2423, June 21, 2010, at <http://www.heritage.org/Research/Reports/2010/06/The-Three-Biggest-Myths-About-Tax-Cuts-and-the-Budget-Deficit> (December 2, 2010); National Commission on Fiscal Responsibility and Reform, "The Moment of Truth," December 2010, at <http://www.fiscalcommission.gov/news/moment-truth-report-national-commission-fiscal-responsibility-and-reform> (December 2, 2010).

Chart 1 • WM 3071 heritage.org

rate of these programs would merely dip from 6.5 percent to 6.2 percent annually. Other mandatory spending, which has grown immensely over the past decade, would still spend 95 percent of its baseline level over the next decade.

The only real significant spending reductions would come in discretionary spending. And here the commissioners are sorely misguided in their approach to cutting defense spending, which is already under-funded. Measured against a generous baseline that assumes that discretionary spending grows as fast as the economy, the commission would save \$2.8 trillion over the decade. Global war on terrorism spending would be nearly phased out (as currently scheduled), and other discretionary spending would be nearly frozen at current levels. After a decade in which discretionary spending expanded 79 percent faster than inflation, this freeze represents a positive but modest first step. At the same time, lawmakers should be careful to fund national defense at a level that preserves national security and to focus savings in soaring domestic programs.⁵

1. National Commission on Fiscal Responsibility and Reform, "The Moment of Truth," December 2010, at <http://www.fiscalcommission.gov/news/moment-truth-report-national-commission-fiscal-responsibility-and-reform> (December 2, 2010).
2. Based on a current-policy budget baseline. See Brian M. Riedl, "The Three Biggest Myths About Tax Cuts and the Budget Deficit," Heritage Foundation *Backgrounder* No. 2423, June 21, 2010, at <http://www.heritage.org/Research/Reports/2010/06/The-Three-Biggest-Myths-About-Tax-Cuts-and-the-Budget-Deficit>.
3. Congressional Budget Office, "The Long-Term Budget Outlook," June 2010, at <http://www.cbo.gov/ftpdocs/115xx/doc11579/06-30-LTBO.pdf> and supplemental data at <http://www.cbo.gov/ftpdocs/115xx/doc11579/LTBO-2010data.xls> (December 2, 2010).
4. This baseline, which is based on Congressional Budget Office, can be found in the appendix of Riedl, "The Three Biggest Myths About Tax Cuts and the Budget Deficit."

The Fiscal Commission v. the Current-Policy Budget Baseline

Current-Policy Baseline	Actual			2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2011–2020
	2008	2009	2010											
Total Revenues	2,524	2,105	2,143	2,351	2,576	2,814	3,121	3,279	3,492	3,693	3,887	4,076	4,261	33,550
Total Outlays	2,983	3,518	3,485	3,736	3,655	3,811	4,102	4,416	4,799	5,097	5,384	5,764	6,131	46,896
Social Security	612	678	701	726	753	789	831	878	931	989	1,052	1,119	1,191	9,259
Health Care	602	693	738	801	791	850	949	1,048	1,173	1,251	1,316	1,427	1,524	11,130
Other Mandatory	382	722	487	573	476	450	448	450	476	474	470	495	507	4,819
Discretionary	1,134	1,238	1,358	1,408	1,367	1,371	1,411	1,462	1,529	1,589	1,652	1,726	1,800	15,315
Net Interest	253	187	202	227	268	351	463	578	691	795	895	997	1,109	6,373
Deficit	-459	-1,413	-1,342	-1,385	-1,080	-998	-981	-1,137	-1,308	-1,404	-1,497	-1,687	-1,870	-13,346
Debt Held by the Public	5,803	7,545	9,031	10,331	11,529	12,634	13,705	14,928	16,321	17,818	19,413	21,201	23,178	
Commission Plan	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2011–2020
Total Revenues			2,143	2,511	2,722	3,045	3,387	3,603	3,844	4,077	4,303	4,541	4,774	36,806
Total Outlays			3,485	3,703	3,671	3,691	3,842	4,024	4,276	4,450	4,597	4,839	5,052	42,144
Social Security			701	726	752	786	826	870	921	975	1,035	1,100	1,167	9,159
Health Care			738	799	795	828	917	1,013	1,133	1,208	1,261	1,367	1,461	10,782
Other Mandatory			487	573	475	441	433	429	449	443	435	456	463	4,596
Discretionary			1,358	1,379	1,385	1,297	1,237	1,200	1,195	1,195	1,197	1,210	1,222	12,518
Net Interest			202	226	264	338	429	511	579	628	670	705	739	5,089
Deficit			-1,342	-1,192	-949	-646	-455	-421	-432	-372	-294	-298	-279	-5,338
Debt Held by the Public			9,031	10,133	11,200	11,952	12,497	13,004	13,522	13,987	14,380	14,779	15,164	
Difference	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2011–2020
Total Revenues			0	160	146	231	266	324	352	384	416	465	513	3,256
Total Outlays			0	-33	16	-120	-260	-392	-523	-647	-787	-925	-1,079	-4,752
Social Security			0	0	-1	-3	-5	-8	-10	-14	-17	-19	-24	-100
Health Care			0	-2	4	-22	-32	-35	-40	-43	-55	-60	-63	-348
Other Mandatory			0	0	-1	-9	-15	-21	-27	-31	-35	-39	-44	-223
Discretionary			0	-29	18	-74	-174	-262	-334	-394	-455	-516	-578	-2,797
Net Interest			0	-1	-4	-13	-34	-67	-112	-167	-225	-292	-370	-1,284
Deficit			0	-193	-131	-352	-526	-716	-876	-1,032	-1,203	-1,389	-1,591	-8,008
Debt Held by the Public			0	-198	-329	-682	-1,208	-1,924	-2,799	-3,831	-5,033	-6,422	-8,014	

Sources: Current-policy budget baseline based on Congressional Budget Office data. See Brian Riedl, "The Three Biggest Myths About Tax Cuts and the Budget Deficit," Heritage Foundation *Backgrounder* No. 2423, June 21, 2010, at <http://www.heritage.org/Research/Reports/2010/06/The-Three-Biggest-Myths-About-Tax-Cuts-and-the-Budget-Deficit> (December 2, 2010); National Commission on Fiscal Responsibility and Reform, "The Moment of Truth," December 2010, at <http://www.fiscalcommission.gov/news/moment-truth-report-national-commission-fiscal-responsibility-and-reform> (December 2, 2010).

Table 1 • WM 3071  heritage.org

More Work Needed. Overall, the fiscal commission would raise taxes by \$3.3 trillion over the decade. Yet it recommends only minor tweaks to a broken health care system, fails to repeal Obamacare, and focuses Social Security reform too far on

the tax side. Discretionary spending is the only source of significant first-decade spending restraint.

Surely larger entitlement savings are expected in future decades, yet much more can be done sooner. Lawmakers examining the commission report

- See James Jay Carafano, "Top 10 Reasons to NOT Put Defense Spending 'On the Table,'" The Foundry, December 1, 2010, at <http://blog.heritage.org/2010/12/01/top-10-reasons-to-not-put-defense-spending-on-the-table>.

should demand stronger entitlement reform—particularly in health care, with a plan by Representative Paul Ryan (R-WI) and economist Alice Rivlin as the model⁶—and not settle for a plan that leaves the highest sustained tax burden in American history.

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6. Congressional Budget Office, “Preliminary Analysis of Rivlin-Ryan Health Care Proposal,” November 17, 2010, at http://www.cbo.gov/ftpdocs/119xx/doc11966/11-17-Rivlin-Ryan_Preliminary_Analysis.pdf (December 2, 2010).