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[Home](#) > [New Budget ... Old Policies](#)

New Budget ... Old Policies

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On February 7, when President Obama came to address the Chamber, he broke the ice by remarking that maybe he should have brought over a fruitcake when he first moved into the neighborhood to get things off on a better foot. While it was a nice way to begin, everyone was anxiously waiting to see if the change in rhetoric would lead to a change in action. A week later, on Valentine's Day, the first hint of an answer arrived in the form of the Greenbook, the administration's budget proposals, and it certainly wasn't the fruitcake the business community was expecting.

Economic Outlook

According to the Greenbook and accompanying documents, the administration's budget projects a federal deficit in 2011 of \$1.6 trillion, or 10.9% of GDP. Over a 10-year period, the deficit would hit a low of \$607 billion in 2015. And by 2021, it would once again climb back up to \$774 billion. As a share of GDP, the deficit would hit a low of 2.9% in 2018 before rising to 3.1% at the end of the forecast horizon. The debt is projected to expand by \$3.8 trillion in the next five years and by \$7.2 trillion in the next 10 years. As a result, the debt to GDP ratio would rise from about 72% in 2011 to over 77% by 2021. In 2008, by contrast, the debt to GDP ratio was 40.3%.

What is even more disturbing is the realization that even this modest budget was achievable by assuming an unrealistically rosy economic scenario and calling for more than \$1.5 trillion in tax increases on corporations, successful small businesses, and individuals. Quite simply, the administration's budget not only fails to balance the budget but fails even to get it moving in the right direction. It fails even to stabilize the debt ratio—let alone reduce it. Also, it takes in about 20% of GDP in taxes, and it fails to get spending below 22.3% of GDP in any year. Under this budget proposal, both revenues and outlays remain well above historic norms—meaning bigger, less efficient, and more intrusive federal government.

In addition to its rosy economic scenarios, this budget breaks with several long-standing budgeting conventions in the development of its baseline. Whereas the Congressional Budget Office (CBO) constructs a baseline using current laws and services to provide a

reference point of what could be expected with no legislative changes (a what if we did nothing scenario), this Greenbook provides no such reference and offers only an “adjusted baseline,” which assumes passage of specific administration proposals. The Greenbook baseline thus assumes the continuation and indexation of 2011 exemption levels for the AMT, extension of the 2001 and 2003 tax rates for lower and middle class taxpayers, and the extension of the estate tax at 2009 levels (\$3.5 million per spouse exemption and 45% rate). By changing conventions and including certain pet programs in the baseline, the administration avoids both scrutiny and the need to “pay for” such programs with spending cuts or revenue increases.

Tax Hikes

This budget calls for about \$1.5 trillion in tax increases on corporations, successful small businesses, and higher income individuals. A significant amount of these increases—over \$400 billion over 10 years—are recycled from prior years’ budgets. These hikes include \$129 billion in changes to the international tax regime, such as curtailing deferral and changes to the foreign tax credit regime, which threaten the ability of American worldwide companies to compete in a global economy.

In addition to international tax changes, the Greenbook once again proposes repeal or changes to long-standing accounting methods, resulting in over \$60 billion in tax increases over 10 years. It proposes repeal of the last-in, first-out (LIFO) accounting method, proposes repeal of the lower-of-cost-or-market (LCM) accounting method, and changes the tax treatment of punitive damages. These changes run counter to decades of tax law.

The Greenbook doesn’t stop there. It imposes \$21 billion of new compliance burdens on businesses and changes the tax treatment of “carried interest” to raise another \$15 billion. The Greenbook proposes a \$30 billion tax hike in the form of a bank tax, ostensibly to pay for the TARP program, which banks have already paid back with interest. All that will be achieved by this bank tax is to further limit access to capital and hamper the ability of American financial institutions to compete in a global economy.

The budget also suggests the imposition of \$46 billion of punitive energy taxes, which result in increased energy costs and decreased energy security. These proposed energy tax increases repeal incentives, such as the deduction for domestic production activities, that are widely available to other industries. So it’s not closing “loopholes”; it’s singling out energy producers for punitive tax treatment. Also back again are \$14 billion of new taxes on life insurance companies.

The Greenbook doesn’t stop with general business tax hikes; it contains over a trillion dollars of proposed tax increases on individuals (those making over \$200,000 or \$250,000 married filing jointly) and successful small businesses beginning at the end of 2012. These include \$700 billion over 10 years in higher taxes generated by raising marginal rates, increasing investment taxes (and don’t forget the 3.8% Medicare tax on investment income from the health care bill that kicks in at the end of 2012), and limiting the ability of taxpayers to use certain deductions under PEP and Pease provisions. Another \$321 billion in tax hikes come from the reinstatement of the limit on itemized deductions, which limits the benefit of such things as the mortgage interest deduction, the deduction for charitable contributions, and the deduction for state and local sales tax.

What’s Missing?

While this budget is full of proposed tax increases, it offers little in the way of incentives to encourage businesses to grow and create jobs. In contrast to the trillions of new and permanent taxes business can expect to face, they see only \$116 billion over 10 years of tax incentives, \$106 billion of which is composed of making the R&D tax credit permanent, a credit that we renew almost annually anyway.

Further, despite repeated calls by both parties and the president to repeal the onerous 1099 reporting requirements, the Greenbook doesn't fully execute this plan. It leaves in place the 1099 reporting requirements for services and rental property payments, proposing just partial repeal of those provisions relating to reporting requirements for property.

While this budget includes much to criticize, perhaps the biggest criticism is what is missing. Despite numerous conversations between the White House, the business community, academics, and the Hill, as well as a specific mention in the president's State of the Union address, the Greenbook makes no mention of tax reform. Moreover, many of the tax proposals included in this budget, if enacted, would make it harder to achieve true fundamental tax reform.

So what is the bottom line for this budget? For those still wondering if the shift in the administration's rhetoric is real, this budget suggests otherwise. The words may be softer, but the proposals clearly call for more spending, higher taxes, and bigger government. The more things seem to change, the more they stay the same.

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