Insight

Highs and Lows in Fiscal Policy in 2014

GORDON GRAY | DECEMBER 18, 2014

In terms of fiscal policy, 2014 was not a banner year. Very few positive steps were taken to fundamentally improve the nation's budget and tax challenges, though unlike some recent years, there was little *new* policy to further harm the nation's economic health, such as an inefficient stimulus, the Affordable Care Act (ACA), or a new slate of tax increases. Despite the lack of major activity, some progress was made in some areas, and some ground was lost in others. Hopefully, with the benefit of hindsight, 2014 will be seen as a year when some important groundwork was laid on good fiscal policy, while 2014's missteps get obscured by time.

Highs

1.New Congress

Without question, the most positive development in 2014 happened in November, when the nation handed the Senate back to Republicans. Since 2011, the House of Representatives has been passing budgets, drafting comprehensive tax reforms, and sending over 40 jobs bills to the Senate only to see them ignored. The 114th Congress should prove to be different, and we should expect to see bicameral efforts to enact pro-growth policies to accelerate a languid economy.

2.Tax Reform Act of 2014

Comprehensive tax reform remains the one of the most elusive federal policy goals. In revenue neutral context, bringing rates down means eliminating tax preferences that have important constituencies – and eliminating a sufficient number of them to really affect marginal rates typically means uniting those constituencies in opposition. The outgoing chairman of the House Ways and Means Committee should be commended for braving this opposition. The Camp tax reform bill is not perfect, but it would serve as an important element of pro-growth fiscal policy.

3.FY2015 House Budget

For 4 years in a row, the House of Representatives has demonstrated a willingness to carry-out the most basic responsibility of governance: pass a budget. Budgets represent priorities, and lay out a framework for addressing fiscal issues beyond the single-year increments of appropriations acts. In undertaking this effort, House members open themselves up to scrutiny for the hard choices that budgeting entails, hard choices that the Senate largely defers. The House is to be especially commended for undertaking the budget exercise this year, setting out a pathway to balance, despite the fact that the Ryan-Murray budget agreement allowed for a fallback mechanism if no FY2015 budget was passed.

4.Permanent Expensing

The last official act conducted by the U.S. Senate was to pass a retroactive extension of dozens of tax provisions to cover tax year 2014 – which ends in a couple of weeks. These temporary and retroactive measures are increasingly common, and lend more uncertainty to the tax code at a time when the economy could use less. The House of Representatives tried to take a differenent approach, taking up individual measures, debating them and where worthy, passing them as permanent elements of the tax code. Few measures are more worthy of this treatment than business expensing. Part of the tax extenders package is a provision that allows businesses to immediately deduct 50 percent of qualified business investment. One study found that a permanent 50 percent expensing policy would grow the economy GDP by over 1 percent and create over 200,000 jobs. The House of Representatives voted to make this provision permanent, only to see the measure die in the Senate.

5.The Bipartisan Budget Act of 2013

In December of 2013, the House and Senate agreed to spending levels over the next two fiscal years, putting in place some needed stability in the nation's budget outlook. The Bipartisan Budget Act of 2013 is a reflection of the achievable: it is incremental and the product of a deeply divided government. For those concerned with the fiscal trajectory of the nation, there is more to like than dislike. The Act provided relief for bad policy – the sequester – in exchange for better policy in the form of mandatory savings. The Act reduced the deficit and forestalled some of the draconian cuts falling on the nation's military during a time of increasing geopolitical angst. The Act also set out guidelines to minimize the chance of a government shutdown.

Lows

1.Anti-Inversion

With the House of Representatives in Republican hands since 2011, the administration has seen its ability to pass highly partisan legislation of dubious, if not outright damaging economic value, through a single-party Congress evaporate. Instead, the administration has increasingly tried to flex its muscles through unilateral regulatory actions. There is perhaps no worse example of this new approach to fiscal policy-making than the anti-inversion rules put forward by the Treasury Department earlier this fall. The measures penalize U.S. employers, and do so without addressing the fundamental reason for such tax-based decision making: the lousy U.S. tax code. The administration has failed to engage the Congress on tax reform, while pursuing policy that put high quality U.S. jobs at risk – upwards of 42,000.

2.President's Budget

The president's FY2015 budget continued a tradition of disappointment. By the numbers, the president's budget notches a trifecta, combining a $1.8 trillion tax increase, a $2.5 trillion spending increase, and highest level of debt since 1950. Moreover, the president's budget relied on rosy economic costs that magically paired higher economic growth with lower interest rates.

3.Safety Net Still Going Broke

In July, the Medicare Trustees issued their annual report detailing the financial state of America's entitlement programs. The report echoed past conclusions: Medicare and Social Security are still going bankrupt. The report concluded that at its current pace, Medicare will be bankrupt in 2030 (four years later than last year's projection) and Social Security will go bankrupt in 2033. Sooner still is the bankruptcy of the Social Security Disability Insurance trust fund. Two years from now, in 2016, the DI trust fund is projected to be exhausted.

Upon the fund's exhaustion, program recipients would only receive 80 percent of benefit payments. According to the Congressional Budget Office (CBO), 9.3 million disabled workers are projected to be receiving an average monthly DI benefit of $1,216 in 2016. If the DI trust fund is depleted, benefit payments are only authorized to meet program receipts, which would reduce the average payment by $243.2 down to $972.8, a 20 percent cut. Yet the administration remains on the sidelines as these programs face financial challenges.

4.Veto Threat

Among the odder developments in 2014 fiscal policy was the White House's veto threat against a bipartisan, bicameral agreement of expiring tax policies. Chairman Dave Camp and Majority Leader Reid had agreed on a number of pro-growth policies that, if made permanent, would boost important investments and add more certainty to a shaky tax code. Many of these policies are permanent in the president's own budget, but the administration instead approached the compromise with characteristic reflexive populism, complaining at the last minute that the package did not contain certain provisions for individuals. The result of this veto threat? A short term extension that contains neither the permanent provisions negotiated by Congress, nor the individual provisions desired by the White House.

5.Off-shoring Baucus

One of the most ill-timed personnel moves by the current administration was the nomination of Senator, and then- Chairman of the Senate Finance Committee, Max Baucus to be ambassador to China. At a time when many observers are concerned with the flight of U.S. companies overseas for tax reasons, it was with some irony that the administration literally off-shored Senator Baucus when he was engaging in good-faith discussion with Chairman Dave Camp on tax reform. When the president plucked him out of this process, much of the steam behind tax reform evaporated. What we are left with is a broken tax code.