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the fiscal cliff resolution—one more missed opportunity to reform entitlements

Do you remember just a little over two months ago, when people were wondering whether it might be possible to design the "grand bargain" as part of the effort to avert a plunge over our infamous "fiscal cliff"? A lot has happened since then.

Recall that the concerns revolved around three looming events: the expiration of the Bush-era tax cuts; the impending reencounter with the debt limit; and the imposition of sequestration, the across-the-board spending cuts that were scheduled to take effect in early January. Many assumed that resolving these three events would involve, at the very least, a down payment on reducing the deficit that combined tax increases with spending cuts; some even entertained visions of entitlement reform as part of the solution. The actual result has been quite different—and also quite sobering: tax increases combined with spending increases!

The "Short-Term" Resolution

In an agreement between the Senate and White House reached New Year's Eve and supported by the House immediately after the New Year, Congress raised taxes by $600 billion over 10 years and called for a two-month delay in across-the-board sequestration cuts amounting to $109 billion in reduced spending for 2013.

The increased taxes will primarily be felt by the nation's wealthiest individuals. The highest marginal tax rate on the income tax increased from 35 percent to 39.6 percent for individuals earning more than $400,000 and couples earning more than $450,000. Itemized deductions were capped and exemptions phased out for individuals earning at least $250,000 and couples earning at least $300,000. Capital gains taxes and the tax on dividends increased from 15 percent to 20 percent for individuals earning more than $400,000 and couples earning more than $450,000. The top rate on the estate tax also increased from 35 percent to 40 percent, although the amount exempted from tax remained the same, at $5 million per individual.

The legislation also extended jobless benefits for one year for the long-term unemployed and extended the child tax credit, the earned income tax credit, and tax credit for tuition.

In addition, the payroll tax cut expired and returned to its previous rate of 6.2 percent.

The Debt Limit

Many believed the debt limit, which the nation had been projected to reach early in 2013, would be another triggering mechanism that would force the Congress to deal with the deficit, but like the other components of the fiscal cliff, it has proven thus far to be an illusory force for change. In what probably was a wise political decision, Republicans in the House decided not to try to force spending cuts in exchange for raising the debt ceiling; rather, they agreed to a short-term reprieve, increasing the debt ceiling to cover existing spending obligations until late May. The only proviso was that the Senate pass a spending resolution before that time, with a pay suspension kicking in for senators if a budget were not passed.

As others have noted, this proviso is more of a gesture than a real forcing action, because it is unconstitutional to change Congressional pay during an ongoing session. Thus, if the Senate were unable to pass a budget by May, its members would still receive their pay no later than the end of the Congressional session. Moreover, even if the Senate were to pass a budget—as the Senate's Democratic leadership has committed to do—and the House were also to pass its own budget, there is nothing in the proviso to compel the full Congress to come together to pass an agreed-upon budget.

Sequestration

The next "defining moment" in the budget negotiations will occur now, in early March, when sequestration spending cuts are scheduled to begin. The prevailing thinking this past fall was that the sheer mindlessness and bluntness of the spending reductions would force Congress to agree on a more thoughtful combination of reductions and/or tax increases in their place. However, the new conventional thinking in Washington seems to be that sequestration may not be so bad, in that it would at least reduce spending.

If sequestration were to go through, neither political party would likely be satisfied, but it seems less in keeping with the stated goals of Republicans than Democrats. Although it does produce real spending reductions, 50 percent of those reductions will come from reduced defense department spending (as opposed to the broader category of national security spending), and entitlements are basically exempt, other than a 2 percent reduction in payments to providers of services under Medicare. Given this reality and the call for more tax revenues by Democrats, sequestration seems more likely to be the default option than seemed possible six months ago.

What Will It Take to Get Entitlement Reform?

For those of us who look at the implications of continued growth in entitlement spending, the most recent public polls are very discouraging. A clear majority of Americans want deficit reduction, and they want it now rather than waiting until the economy gets stronger. The problem is that the areas of spending that they want targeted, other than defense, are not the areas that represent the majority of federal spending.

A recent joint survey by the Robert Wood Johnson Foundation, the Harvard School of Public Health, and the Kaiser Family Foundation shows little support for reducing spending on Medicare, Social Security, or education and not much support for reducing Medicaid spending, although there was less concern for Medicaid than the other areas (see Carey, M.A., "Americans Want Deficit Addressed Without Medicare Cuts, Poll Finds," Kaiser Health News, Jan. 24, 2013). Even a poll of conservative voters reported on the public policy blog of the American Enterprise Institute indicated little support for reforming Social Security or Medicare (Streeter, R., "Entitlement Reform's Popularity Among Conservatives," Feb. 13, 2013).

Unless or until voters can understand and accept how much entitlement spending will dominant total federal spending based on current forecasts, there is little reason to believe Congress might be willing to tackle such a philosophically and politically challenging idea as to reform the major entitlement programs—particularly Medicare. According to a Nov. 7, 2012, budget analysis by the Congressional Budget Office (CBO), the 40-year average for the percentage of gross domestic product (GDP) going toward federal spending is 21 percent, but we are currently above that share by almost two percentage points. By CBO estimates, if we continue along the projected trajectory for growth in entitlement spending, Social Security, Medicare, and Medicaid alone could account for about 16 percent of GDP by 2037 (see "The 2012 Long-Term Budget Outlook," CBO, June 2012). That would seem to provide a compelling reason to act—but apparently it is not. ●

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