Taking a Balanced Approach: Four Revenue Options for Fixing Sequestration

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Policy Points:

- **Congress needs to replace sequestration with a balanced approach to deficit reduction that includes at least one dollar in new revenues for every dollar in smart, strategic spending cuts.**
- **Due to recent deficit reduction legislation and an improving national economy, Congress needs to find just $1.5 trillion in budget savings over the next decade in order to put the debt on a sustainable path relative to our economy.**
- **Sequestration is the wrong approach to finding these savings, since these spending cuts target the smallest portion of the federal budget – a portion that has already borne the brunt of previous deficit reduction.**
- **Instead, Congress should consider four revenue options that can raise almost $737 billion over the next decade, half of the savings required to hit the debt stabilization target.**
- **These revenue options include: (1) limiting the total savings from deductions and loopholes available to high-end taxpayers; (2) preventing offshore corporate tax avoidance; (3) limiting deductions for oil companies; and (4) eliminating the corporate deduction for expenses associated with moving business operations offshore.**

Introduction

In a series of votes this week, the United States Senate failed to repeal the $85.3 billion in automatic, across the board spending cuts known as "sequestration. As a result, these spending cuts will go into effect on March 1st—with likely devastating effects on North Carolina's families, state and local budgets, and fragile economic recovery. Over the next several rounds of federal budget negotiations, however, Congress still has the opportunity to address these cuts. In doing so, federal policy makers should pursue a balanced approach to deficit reduction that replaces the sequestration cuts with equal amounts of new revenue and smart spending cuts—for both 2013 and over the next decade.

This *Policy Point memo* makes the case that the cuts-only approach embodied in sequestration is both unnecessary given improvements in the short-term deficit over the past two years and counter-productive given that these cuts target a portion of the federal budget that is relatively small and is not a driver of the nation's long-term deficits.

Instead, Congress should replace sequestration with a specific set of four new revenue options, along with smart spending cuts to those programs that *are* the main driver for the long-term deficit. This balanced approach would eliminate special tax breaks for corporations and the most well off in order to

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avoid more cuts to important public investments in education, job training, and food safety that are currently targeted by sequestration and that benefit all North Carolinians.

The Federal Deficit Has Improved

Over the next decade, deep spending cuts like those included in sequestration are largely unnecessary, given the reality that the outlook for both the short-term and long-term federal deficit has actually improved considerably in the past two years. Due to the $2 trillion in deficit reduction contained in the Budget Control Act of 2011 and the $600 billion in revenues raised through American Taxpayer Protection Act, the nation's short-term deficits have dropped significantly—from more than $1 trillion and 7 percent of Gross Domestic Product (GDP) in 2012 to $845 billion and 5.3 percent of GDP in 2013. In even better news, the short-term deficit is expected to fall for the next two years to 3.7 percent of GDP in 2014 and 2.4 percent in 2015.[1] And while the deficit will begin to climb again after 2015, long-term deficits have also increasingly stabilized as health care costs have gone down. The Congressional Budget Office now projects that spending on Medicare and Medicaid—the nation's two major health care entitlement programs that together are the largest driver of long-term deficits—will be about $200 billion (or 15 percent) less in 2020 than projected only three years ago.[2] Although these programs will continue to drive increasing deficits over the long-term absent any additional reforms, four consecutive years of record slow growth in health care costs[3] is at least moving the long-term deficits in the right direction towards stabilization.

As a result of these savings, the nation is actually much closer to putting the nation's debt on a sustainable path than is often realized by policy makers. Since 2010, most mainstream economists have believed that the federal government needed to find about $4 trillion in deficit reduction over the next decade.[4] The good news is that after the two legislative packages referenced previously (the BCA and the ATPA), we need to find only about $1.5 trillion in additional savings in order to hit the original $4 trillion figure.[5] Given this lower deficit reduction, policy makers have more flexibility in choosing the right mix of spending cuts and new revenues.

Discretionary Spending is Not the Problem

The question facing policy makers is how best to achieve this much more manageable $1.5 trillion in deficit reduction—sequestration or more a balanced approach that includes revenues and smart spending cuts to those parts of the budget that are actually contributing to long-term deficits. Since 2011, Congress has focused its spending cuts largely on the smallest category of the federal budget—so-called "non-defense discretionary" spending. Comprising less than a quarter of the federal budget, this category includes non-entitlement domestic programs like food safety, job training, K-12 education, and research and development. As a result of the $2 trillion in cuts to these programs contained in the Budget Control Act, spending on these domestic discretionary programs is now at their lowest levels as a share of the national economy since the early 1950s—despite facing the demands of 21st century economy.[6] If allowed to go forward, sequestration would further reduce these domestic programs by an additional $1.2 trillion over the next 10 years, despite the fact that these programs are not the driver for our long-term budget deficits (the main drivers being health care entitlements). And according to a range of independent analyses, these cuts would significantly reduce critical services across North Carolina and damage the national economy - potentially leading to another recession.[7]

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Four Revenue Options for A Balanced Approach

Instead of seeking deficit reduction through deep cuts to the smallest area of the federal budget, Congress should replace sequestration with a balanced approach that includes one dollar of new revenues for every dollar of smart spending cuts in programs that are actually the main drivers of the long-term budget deficit. This involves finding enough new revenues to replace half of the $1.2 trillion in sequestration cuts (including the $85.3 billion for 2013) and provide half of the revenues necessary to hit the new debt stabilization target of $1.5 trillion over the next decade. This results in a total revenue goal of between $600 billion and $800 billion over the next decade.

To meet this goal, Congress can raise additional revenues by making sure that corporations and the wealthiest Americans pay their fair share in taxes rather than taking advantage of special and unfair tax breaks not available to most taxpayers. Reforming corporate and personal tax expenditures - an area of the budget that costs more than $1 trillion in foregone revenue every year and $10 trillion over ten years - is one of the best opportunities available to policymakers.[8] This cost surpasses every other major function of the budget, including Medicare, Social Security, and national defense, and is almost double the cost of domestic discretionary programs. As a result, tax expenditures represent a far better place to achieve balanced deficit savings than the domestic discretionary programs targeted by sequestration.

While many of these tax expenditures represent tax breaks are genuinely beneficial to working and middle class families[9] - which should be preserved - a significant portion constitute special tax loopholes, deductions, and credits available almost exclusively to corporations and the wealthiest Americans. Most economists believe such credits to be ineffective at promoting economic growth.[10] By closing these loopholes, Congress can raise sufficient revenue to protect important programs from unnecessary and counterproductive spending cuts like those involved in sequestration. Along with smart spending cuts, these new revenues can be used to contribute to a balanced approach to deficit reduction.

Specific revenue options include the following, which together total $737 billion over the next ten years, according to scoring by the Joint Tax Committee, just over half of the $1.5 trillion target for debt stabilization:

- **Limit the total amount wealthy individuals can benefit from deductions and exclusions to no more than 28 cents for every dollar** of these deductions and exclusions. According to the Center for Tax Justice, “deductions and exclusions provide subsidies for certain activities (like buying a home or giving to charity) through the tax system. But they subsidize these activities at higher rates for wealthy families than they do for middle-income families,” since wealthier families pay higher marginal tax rates.[11] In effect, the higher the marginal tax bracket, the greater the rate of savings on each dollar of deductions and exclusions. For example, a filer in the top 39.6 percent tax bracket saves almost 40 cents on every dollar of deductions, while someone in the 28 percent bracket saves only 28 cents on every dollar of deductions. This proposal would limit the savings to just 28 cents of every dollar of deductions, no matter how high the tax bracket. This would save $513 billion over the next decade.[12]

- **Prevent offshore corporate tax avoidance** through what The Center for Tax Justice calls a modest approach. This includes 13 proposals designed to crack down on the ability of corporations to shelter income earned overseas from U.S. taxes, the most critical of which involve (1) eliminating the deferral of foreign income from taxation until repatriation into the

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United States, and (2) reforming the foreign tax credit to ensure that American companies aren't using credits originally intended to offset the cost of foreign taxes to reduce their taxes on U.S. profits. Taken together, these 13 proposals will raise $221 billion over the next decade.[13]

- **Limit deductions for oil companies** by including oil form tar sands in the range of petroleum products subject to the taxes that fund the Oil Spill Liability Trust Fund. Despite no material difference between tar sands oil and other currently taxable types of oil, this type of oil is currently excluded from taxation, a loophole that this proposal will close, saving about $2 billion over ten years.[14]

- **Eliminate a tax break that encourages companies to ship domestic jobs overseas** by terminating the ability of companies to deduct the expenses associated with moving business operations offshore. This provision would raise about $1 billion over the next decade.[15]

Conclusion

Congress still has the opportunity to do the right thing on sequestration during upcoming negotiations over funding the federal government through the end of the current fiscal year. As this process continues, Congress should act to replace sequestration with a balanced approach to deficit reduction that includes one dollar in new revenues for every dollar in spending cuts. Doing so simply asks corporations and wealthy individuals to pay their fair share, and protects vital public investments in education, job training, and food safety.

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[1] Congressional Budget Office. (2013). The Budget and Economic Outlook: Fiscal Years 2013 to 2023.
[2] Ibid.
[3] Lowery, Anne. (2013). Slower Growth of Health Costs Eases Budget Deficit. The New York Times, February 11, 2013. Accessed at http://www.nytimes.com/2013/02/12/us/politics/sharp-slowdown-in-us-health-care-costs.html?_r=0
[4] Kogan, Richard. (2012). $2 Trillion in Deficit Savings Would Achieve Key Goal: Stabilizing the Debt Over the Next Decade. November 1, 2012. The Center on Budget and Policy Priorities. Washington, DC
[5] Congressional Budget Office. (2013). The Budget and Economic Outlook: Fiscal Years 2013 to 2023.
[6] Kogan, Richard. (2012). Congress Has Cut Discretionary Funding By $1.5 Trillion Over Ten Years: First Stage of Deficit Reduction Is in Law. November 8, 2012. The Center on Budget and Policy Priorities. Washington, DC.
[7] Fuller, Stephen. (2011). The Economic Impact of the Budget Control Act of 2011 on DOD & non-DOD Agencies
[8] Chuck Marr, Chye-Ching Huang, and Joel Friedman. (2013). Tax Expenditure Reform: An Essential Ingredient of Needed Deficit Reduction. The Center on Budget and Policy Priorities. Washington, DC
[9] These include credits like the EITC, Child Tax Credit, American Opportunity Credit, the home mortgage interest deduction, the charitable giving deduction, retirement savings deductions, and others.
[10] For a good review of this literature, see Peters, Alan and Fisher, Peter. (2004). "The Failures of Economic Development Incentives." Journal of the American Planning Association. Vol. 70, Number 1, Winter 2004. Chicago, IL: American Planning Association
[11] Center for Tax Justice. (2013). Working Paper on Tax Reform Options: End Tax Sheltering of Investment Income and Corporate Profits and Limit Tax Breaks for the Wealthy
[12] Ibid.
[13] Center for Tax Justice. (2013). Working Paper on Tax Reform Options: End Tax Sheltering of Investment Income and Corporate Profits and Limit Tax Breaks for the Wealthy
[14] LoGiurato, Btrett. (2013) .Senate Democrats Have Released Their Bill To Avoid The Sequester, And They're Bringing Back The Buffett Rule. Business Insider, February 14, 2013. Accessed online at http://www.businessinsider.com/senate-sequester-replacement-bill-plan-sequestration-2013-2#ixzz2MGzOkFb9
[15] Ibid.

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