

The Obama Budget, 2019, and the Impending Fiscal Nuclear Winter

By Kenneth J. Kies

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You have read this story before.

More than likely, you have read it so often that, while the conclusion holds the same fascination as a roadside car wreck, you have become just as detached as if you were driving past.

Trust me when I say this time the story is different.

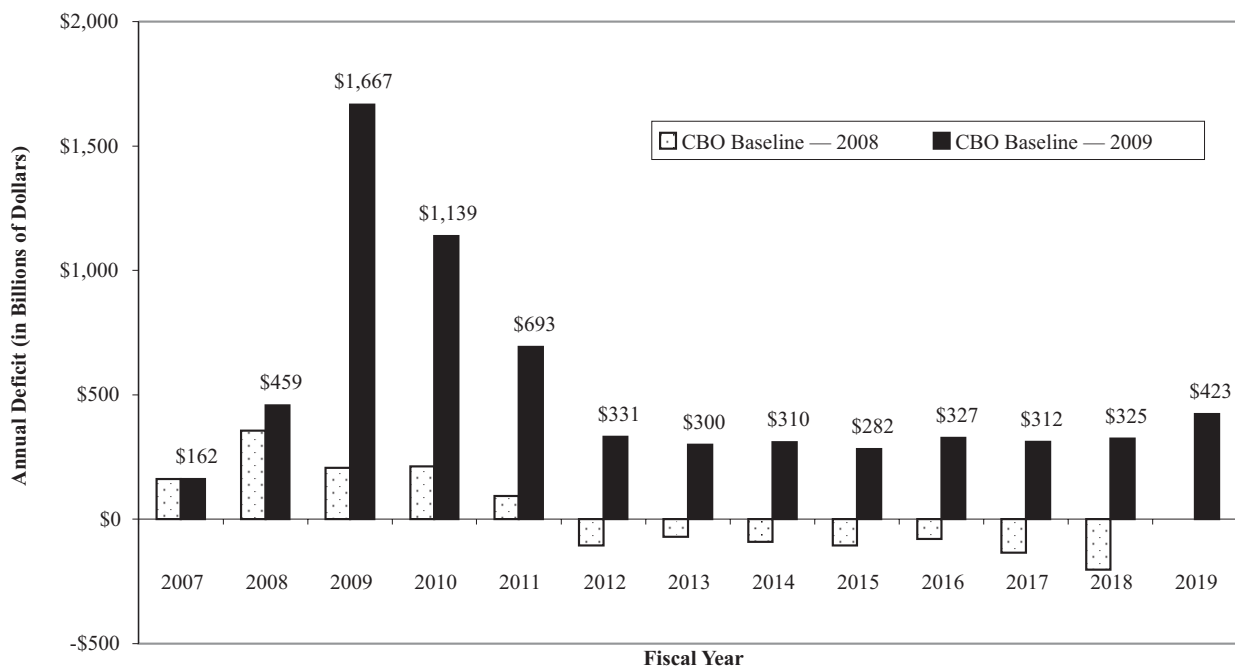
In the past the story has been this: Growing demands from Medicare, Medicaid, and Social Security will drive up federal spending to untenable levels within decades. This thesis could have been printed in any publication any time for the past 20 years.

In that time, policymakers have approached the problem from the perspective that if the United States could just act soon enough, it could avoid making drastic changes in tax or spending policies. Instead, they could slow the rate of spending, modestly raise revenues, or gradually save enough in advance to offset the burgeoning costs.

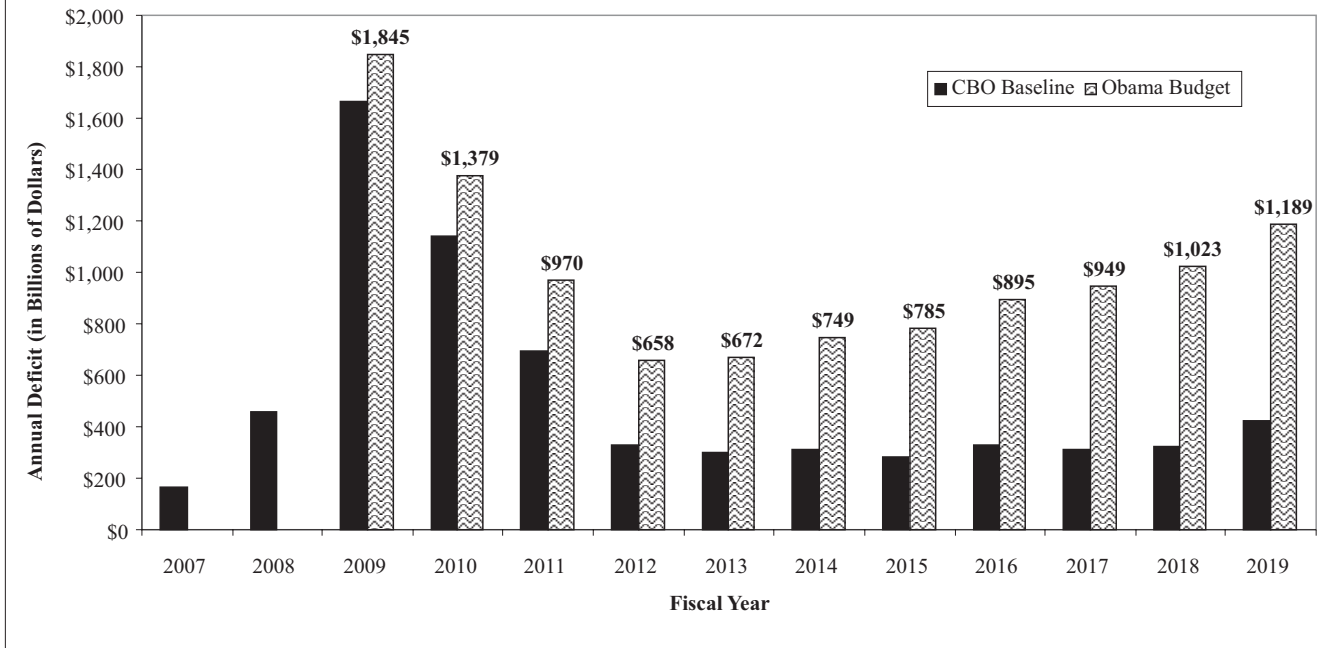
Those approaches will no longer work in light of the world's current economic meltdown and the havoc it has wreaked on the U.S. federal budget. From March 2008 to March 2009, annual deficits projected by the Congressional Budget Office from 2008 through 2018 increased by \$6 trillion. (See Figure 1.)

First, federal receipts have fallen through the floor — income taxes in 2009 will raise roughly \$550 billion less than previously expected. Second, expenditures have skyrocketed: In fiscal year 2009 alone, the government is projected to spend \$838 billion more than was expected just 12 months ago. And, third, deficits caused by this huge mismatch in policy can no longer be mitigated with cash surpluses generated by the payroll tax.

**Figure 1. Federal Budget Outlook
2008 vs. 2009**



**Figure 2. Federal Budget Outlook
Obama vs. Baseline**



Regarding the third point, for years there has been an academic debate over whether the real crisis for Social Security will come when the program stops running a cash surplus or when its trust fund runs dry. This February — when the Office of Management and Budget announced that Social Security will run an \$8 billion cash deficit in 2009 — that debate stopped being academic. In fact, rather than generating more than \$200 billion in surpluses over the next decade — as had been expected in January 2008 — Social Security benefits will exceed Social Security payroll taxes by \$240 billion over the next 10 years. Income taxes on Social Security benefits will continue to flood the Social Security Trust Fund, but the message is clear that the gravy train is coming to an end.

So, we are not driving past a roadside wreck. We are in a multicar pileup, with flames licking close and occupants still trapped inside. And every plan being debated will only make things worse. The budget proposed by President Obama would add another \$4.8 trillion in annual budget deficits over the next decade. (See Figure 2.) Under Democratic alternatives, the picture would be \$600 billion to \$700 billion better than under the president’s proposal. Even the House Republican plan — titled “The Path to American Prosperity” — would increase deficits relative to the budget baseline by \$1.5 trillion over the next decade and leave the nation with an annual budget deficit of \$580 billion by 2019.

There is a temptation to think that the current fiscal crisis will work out; the nation has survived every other crisis it has faced, why not this one?

As you know, the federal government will borrow from the public roughly \$2 trillion during fiscal 2009 to fund its expenses, including roughly \$170 billion in interest payments on existing debt. That is true whether

Congress follows the budget proposed by Obama or the path laid out in budget resolutions approved last month by the House and Senate.

At 13.1 percent of GDP, the deficit for 2009 will be the highest in the nation’s history other than during World War II. By comparison, in 1942, 1943, 1944, and 1945, the deficit as a percent of GDP was 14.2 percent, 30.3 percent, 22.7 percent, and 21.5 percent, respectively.

Looking back to those deficits — and the economic boom that followed — it might be easy to conclude that the fiscal crisis will simply work out.

Here is the difference. Starting in 1946, shedding the war effort’s mammoth costs allowed the nation to shake off the vestiges of its agrarian past and emerge as an industrial powerhouse. With Americans trained on the value of savings by the Depression and the war, this behemoth economy had the fuel capital needed to create a period of expansion unseen before in history.

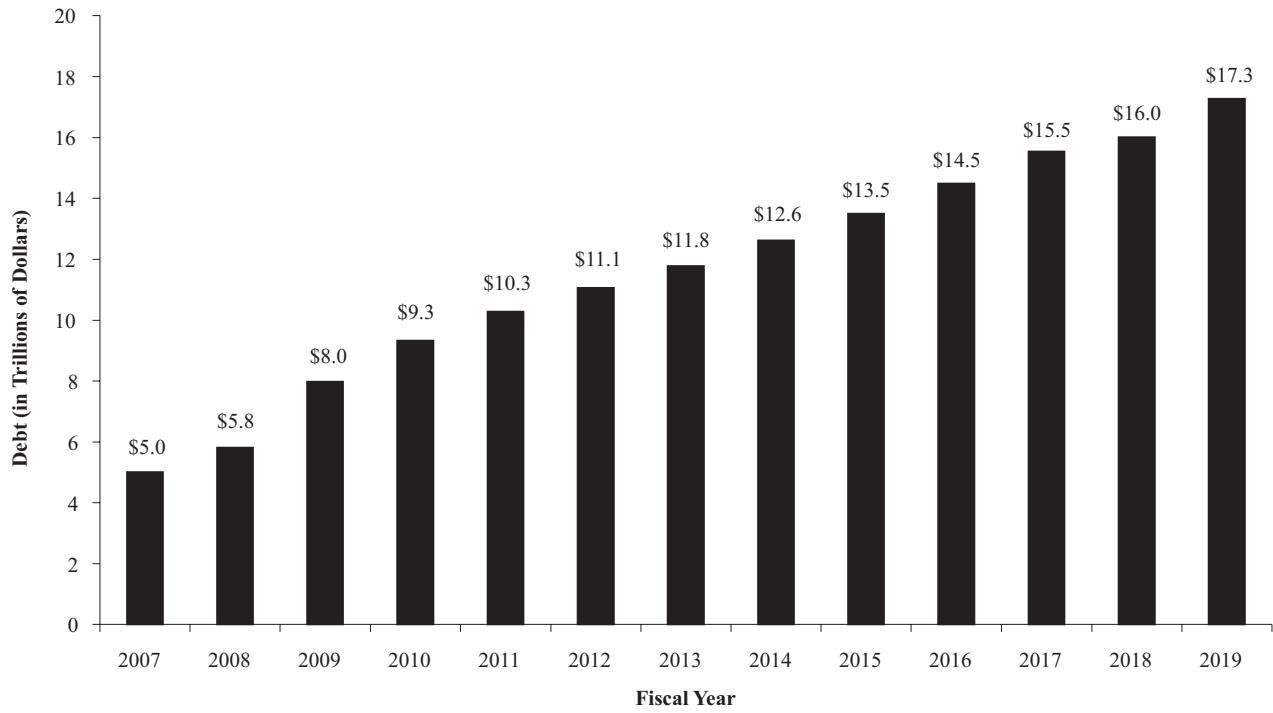
Today, the nation is in the middle of a global economic recession. There is the very real prospect that trillions invested in ailing businesses by the government will never be recouped. And a large percentage of the nation’s workforce is ready to retire.

Those differing circumstances are borne out by the numbers.

By 1947 — just two years after a four-year string of record-breaking deficits — the government ran a 1.7 percent of GDP annual budget surplus. And from 1947 through 1977, the federal government reduced the federal debt as a percent of GDP by an average of 4 percent per year.

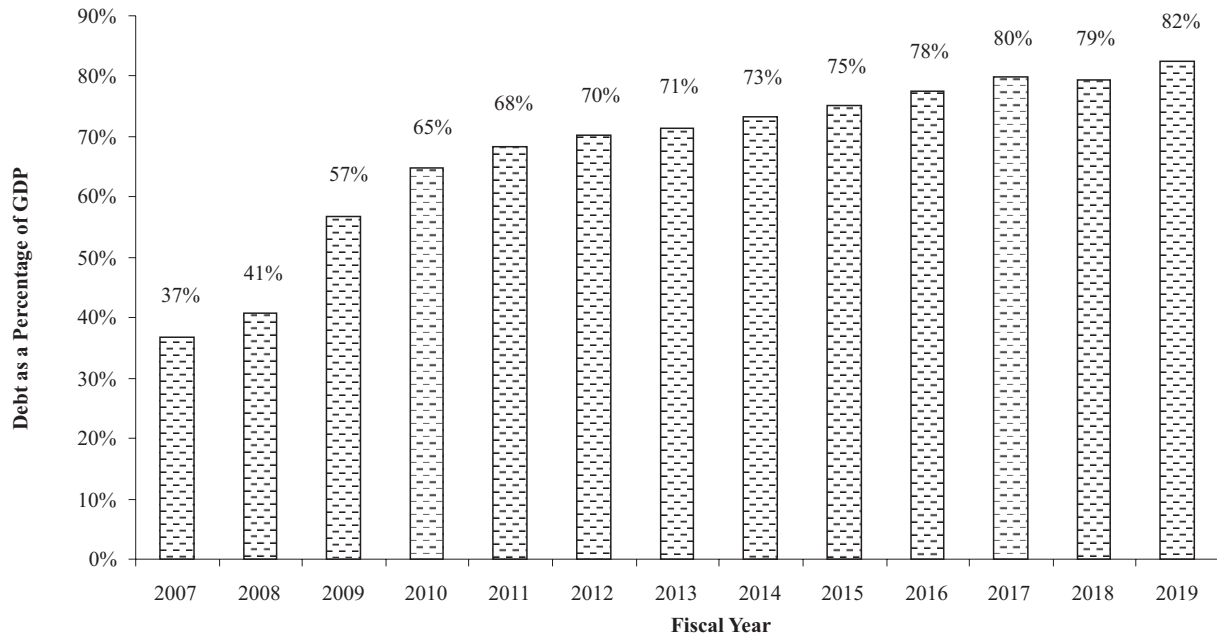
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Figure 3. Publicly-Held Debt — Obama Budget



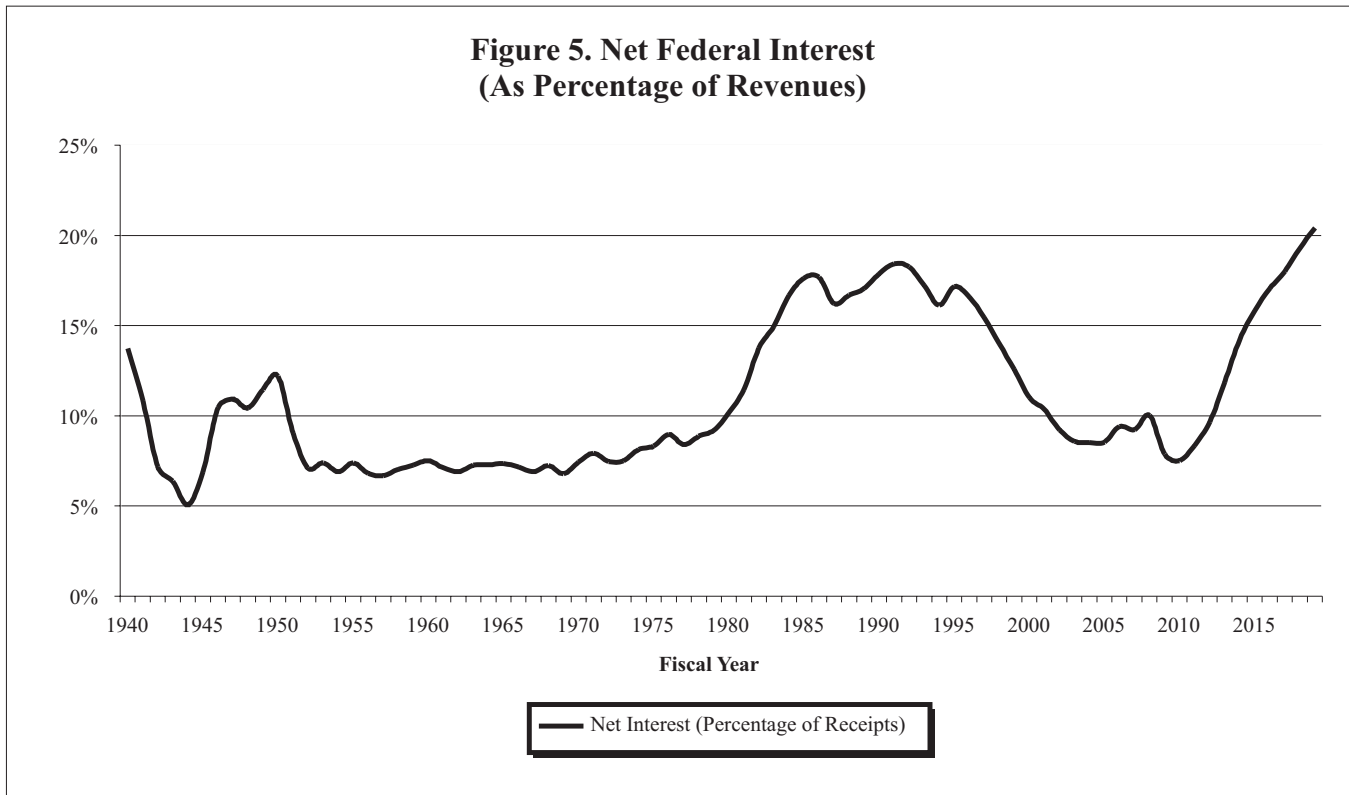
Source: Congressional Budget Office.

Figure 4. Publicly-Held Debt (As Percentage of GDP) — Obama Budget



Source: Congressional Budget Office.

**Figure 5. Net Federal Interest
(As Percentage of Revenues)**



By comparison, from 2010 through 2019, under the budget proposed by Obama, the spike in deficits will subside, but to levels that are historically high, averaging 5.6 percent. As a result, the federal government will increase its debt as a percent of GDP by an average of 4 percent per year.

For decades the government has borrowed to make ends meet. It has borrowed from the public and from foreign governments. It has borrowed from the trust funds it created and to which it forced Americans to contribute.

But never in peacetime has the nation borrowed so much.

By 2019, debt will rise to \$17.3 trillion, or 82 percent of GDP. (See figures 3 and 4.) As a result, federal interest payments on publicly held debt will rise from \$170 billion in 2009 to \$806 billion by 2019, or about 15.7 percent of the federal budget. The nation has never, even during World War II, spent that much of its budget on interest payments.

Measured as a percentage of revenues, the amount of interest that will be paid by the government is even more staggering. By 2019, federal interest payments to the public will be equal to 20.4 percent of receipts. (See Figure 5.) The current record is 18.4 percent, set in 1995.

In other words, the United States will be spending staggering sums of money paying interest on the debt for government services that, for the most part, have already been consumed. Even worse, the government will have to borrow every single penny of those interest payments on that debt.

This is akin to using a credit card to make payments on an interest-only loan. Or in this case, borrowing — in

just one year — another \$2,700 for every man, woman, and child in the United States to make the interest payments on existing debt.

Finally, there will be a temptation to shrug off this commentary as partisanship.

But all those projections come from the CBO, a non-partisan congressional agency headed by a director chosen by the Democratic controlled Congress.

The projections have not been altered or cherry-picked. If anything, the budget outcomes could easily be worse if the economy recovers more slowly than predicted by the CBO or if interest rates rise. Those projections also exclude the cost of Obama's healthcare proposal, which if history is any precedent, is likely to cost more than expected.

As a result, the only conclusion — and a nonpartisan one at that — is that we cannot follow this path. The only time the nation ventured so deeply into debt was in 1946, which was for a one-time effort that ended with the conclusion of the war.

There is no end in sight for the spending increases envisioned under current budget plans. While spending will fall from the 28.5 percent of GDP spike in 2009, it will never settle to its postwar average of 19.6 percent. Instead, spending will grow steadily from 22.7 percent of GDP in 2012 to 24.5 percent of GDP by 2019.

It is possible to address these concerns. Obama could forgo the \$3 trillion in tax provisions proposed by his budget. That would increase projected revenues by \$2.5 trillion, the portion of his tax provisions that actually cut taxes, and reduce spending on the "refundable" portion of his provisions by another \$500 billion. Obama also

might postpone his effort to increase healthcare spending. That could save anywhere from \$600 billion to \$1.5 trillion.

But given the to-do made recently by the administration about finding \$100 million in spending to cut — or 0.0025 percent of the federal budget for fiscal 2009 — it appears likely that it will not seek to curb its spending appetites, but rather try to increase revenues.

The revenue base, including corporate and individual income taxes and payroll taxes, cannot handle an increase to 25 percent of GDP, which would be needed to address the looming deficits. Americans reasonably would find the tax rates needed to raise that amount of money through an income tax to be unacceptable. As a result, the administration is more likely to seek an alternative, less visible revenue stream. We should not be surprised to see Obama's tax reform commission emerge on December 4, 2009, with a plan crowned by a VAT or its economic equivalent.

Tax Leveraged Stimulus for the Equipment Leasing Industry

By Charles T. Terry

Charles T. Terry is a professor of law at the University of Illinois College of Law. The author wishes to thank the University of Illinois College of Law, and the Equipment Leasing Association, for granting him access to their research resources and materials. The author particularly wishes to thank Linda M. Beale, Associate Professor of Law, Wayne State University Law School, for her comprehensive and thoughtful comments; Ji Kim, now of Vedder Price, for assistance in developing the initial principles of Capital Equipment Expensing; and finally, Judy Nolen for her excellent proofreading services.

A. Introduction

In 2002 I first developed a theory of normative capital cost recovery for a realization-based income tax.¹ In a later article published in 2006, I attempted to show how capital cost recovery could be used practically by individual equipment owners, in the form of a capital equipment expensing (CEE) deduction.² After the Equipment

¹See Charles T. Terry, "Normative Capital Cost Recovery for a Realization-Based Income Tax," 5 *Fla. Tax Rev.* 467 (2002) (hereinafter referred to as Terry, *Normative Capital Cost Recovery*). "This article assumes that normative capital cost recovery principles for a realization-based income tax (RBIT) may be determined by extrapolating from a deep analysis of the three fundamental capital formation, capital recovery, and realization principles, that define that tax base. This article does not treat these principles merely as practical deviations from a Haig-Simons accretion-measured income tax (AMIT), but as the normative structural and accounting features of a unique and functionally discrete tax base. Rather attempting to adjust or correct or adjust the U.S. RBIT in order to emulate or replicate the financial or economic characteristics of an AMIT, this article shows how a particular application of RBIT principles — capital cost recovery for short-lived and relatively completely wasting assets — can be structured consistent with all three normative principles of a realization-based income tax."

See discussion *infra* note 21 for an explanation of the term "normative capital cost recovery," as applied in this article.

²See Terry, "Capital Equipment Expensing: Incremental Tax Reform for a Transition Realization-Based Income Tax," 7 *Fla. Tax Rev.* 240 (2006) (hereinafter referred to as Terry, *Capital Equipment Expensing*). The 2002 "article actually discussed cost recovery theory and policy with respect to 'short-lived and completely wasting assets.'" Terry, *supra* note 1, at 472. At that time, I did not want to be viewed as specifically discussing the particular characteristics of IRC section 179; although it was, and still is, the closest real world framework for comparatively discussing the issues addressed in that article.

The focus of this article is on the functional [rather than legal] structure of section 179 within the U.S. income tax base as of Jan. 1, 2005, and the tax policy implications of that structure, rather than on the specific provisions of section 179.