Congressman Joe Pitts

Sixteenth Congressional District of Pennsylvania

Memorandum on the Fiscal Cliff

TO: Citizens of the 16th Congressional District of Pennsylvania
FROM: Congressman Joe Pitts
DATE: December 14, 2012
RE: The Fiscal Cliff

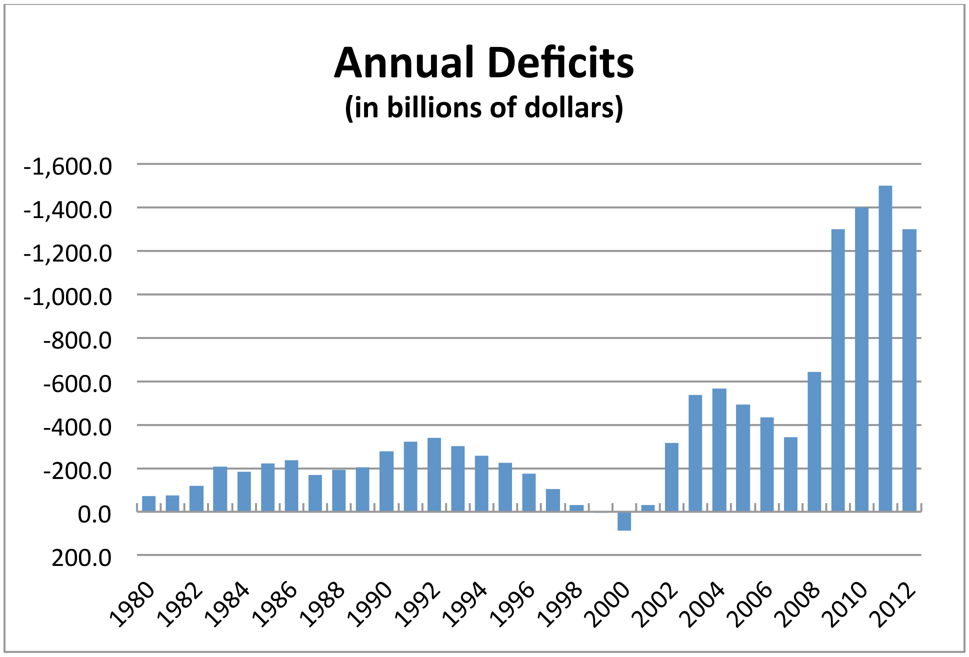
If you listen to the news at all, you have been hearing a lot lately about the "fiscal cliff," the "sequester," and arguments over how much rich people should pay in taxes. I've been listening to a lot of opinions lately about what we should do. Interest groups like Americans for Tax Reform and MoveOn.Org have been urging people to call me to oppose or support certain policies.

Lost in all of this debate, and even lost from most news coverage, is the real issue: our government's ballooning debt. It is because of the debt that we have a "fiscal cliff." It is because of the debt that we have sequestration. It is because of the debt that we are debating higher tax rates for some Americans.

Since most media haven't done a very good job of explaining this, I hope you'll read the next couple of pages and draw your own conclusions.

The Fiscal Cliff

"Cliff" is legislative jargon for an important deadline. It is an image taken from bar graphs that portray a sudden drop in funding, revenue, or some other important measurement. In this case, a number of important taxing and spending policies expire at the end of this year. Congress has several important decisions to make, and has (unfortunately) postponed making them until now, because of the election. Finding agreement will be difficult because an increasing number of congressmen are tired of kicking the can down the road. We are $16 trillion in debt already and borrowing more than $1 trillion more each year. This is not sustainable. (See chart next page.)



How We Got Here

Congress has balanced its budget only four times since Neil Armstrong walked on the moon. Our government debt has grown at a faster and faster rate since the Johnson Administration. It is far past the point of simply being irresponsible. Our debt is endangering our national prosperity and endangering critically important programs like Medicare that millions of Americans rely upon for their well-being.

The looming "sequestration" is only the latest in a long string of efforts to rein in spending, which includes the 1985 Graham-Rudman-Hollings Balanced Budget Act, the 1995 government shutdown, and last year's "supercommittee" negotiations.

When President Obama took office in 2009, he quickly became the first president to borrow more than a trillion dollars in one year. Having campaigned on a promise to cut the deficit in half, he appointed a bipartisan commission on debt reduction, led by Erskine Bowles and Alan Simpson—Bill Clinton's former chief of staff, and a retired Republican Senator. The commission issued a report on December 1, 2010, but without the wide majority needed to make its plan "official." Its recommendations have not been acted on by the President or by Congress.

Frustrated by the lack of action on the debt, several House conservatives refused to vote for an increase in the debt limit last year unless it was combined with a plan to balance the budget over time. Because Congress couldn't agree on a way to do this, a plan was devised to create a joint House-Senate "supercommittee" that would work out a compromise by a set deadline. With that commitment embedded in the legislation, enough votes were gained to raise the debt limit. In the event that the supercommittee failed, the bill required automatic across-the-board cuts in federal spending equivalent to $2 trillion over ten years.

Despite a valiant attempt by Pennsylvania Senator Pat Toomey to broker a compromise, the supercommittee failed in its job. The supercommittee reported on December 23, 2011: "After months of hard work and intense deliberations, we have come to the conclusion today that it will not be possible to make any bipartisan agreement available to the public before the committee's deadline." This failure triggered the across-the-board cuts (or "sequestration" of funds) that will happen at the end of this year if no new agreement is reached.

If the House, the Senate, and the President are unable to come to a new agreement, several taxes will go up and programs will see their funding cut virtuously across the board. On top of that, several temporary programs and tax rules will coincidentally expire at the same time.

Tax Increases

The Bush Tax Cuts. In 2001, President Bush fulfilled a campaign pledge by reducing taxes for every taxpayer. This included reductions in marginal rates, a new 10 percent rate for the lowest-income taxpayers, an increase in the child tax credit, larger contribution limits for 401(k)s and IRAs, and several other changes that lowered people's tax burdens. For complicated procedural reasons these changes were only made to last ten years. The retirement contribution limits were eventually made permanent and the other provisions were briefly extended. Now, however, they will expire on December 31, raising taxes on all Americans in multiple ways. Unless Congress acts to prevent it, that is.

Rich People. Republicans and Democrats both want to maintain the lower taxes rates for most Americans. President Obama and most Democrats, however, want to let them increase for wealthier Americans. Republicans argue that a great many of these "wealthy Americans" are actually struggling businesses that could be forced to lay off workers to pay the higher taxes. We argue that now is not a good time to raise taxes on anyone.

The Alternative Minimum Tax. The AMT was created in the 1960s to ensure that a small number of rich Americans couldn't avoid paying taxes. It was not indexed for inflation, however, and affects more and more people every year. Each year, Congress temporarily changes the law to keep this tax from affecting the middle class. However, Congress has irresponsibly avoided permanently fixing the problem because that would have the effect of making our long-term budget calculations look (accurately) worse.

The Payroll Tax "Holiday." The amount you contribute from your paycheck to Social Security was reduced as part of the controversial 2009 "Stimulus" bill. This temporary reduction expires at the end of this year. Congress could extend it, but probably won't.

"Obamacare" Taxes. Most Americans are unaware that the President's healthcare law ("Obamacare") included several big tax increases. In fact, the law creates or increases more than 20 taxes. On January 1, 2013 there will be a new $20 billion tax on medical devices (increasing their cost for patients), a new $2,500 limit on the Flexible Spending Accounts millions of Americans use to help manage their healthcare spending, a $123 billion tax increase on investment income, a reduction in the amount of medical expenses you can deduct on your taxes, and a new 3.8 percent tax on investment income for high earners (essentially raising the capital gains tax). These are just a few of the tax increases, already in law and about to take effect.

Spending Cuts

The automatic, more or less across-the-board "sequestration" spending cuts that were put in gear by the Supercommittee's failure take effect on January 2, 2013 unless Congress is able to come to a new agreement. Federal spending comes in two categories: "mandatory" or "entitlement" spending (like Medicare, Medicaid, and Social Security) and "discretionary" spending (like transportation, foreign aid, and national parks). While defense spending is not technically "mandatory," it is important enough that most people do not consider it to be truly "discretionary."

Entitlements. Most entitlement spending was protected from sequestration. However, about $200 billion would be cut from Medicare (over ten years) by reducing payments to healthcare providers. This would likely make it harder for seniors to find doctors willing to treat them.

Defense. $800 billion would be cut from defense programs (over ten years). The Secretary of Defense has been outspoken about the serious ways in which this could affect national security.

Discretionary Spending. Another $700 billion would be cut from non-defense discretionary spending, reducing funds for all sorts of government programs ranging from cancer research to education.

Additional Items

There are some other items that are part of the "fiscal cliff," most notably the end of extended unemployment compensation benefits and a cut in compensation for doctors who treat Medicare patients.

Unemployment Benefits. Congress has extended unemployment benefits several times over the last few years, because of the bad economy. These extra benefits will expire on December 31.

Medicare Doctors. In 1997, Congress attempted to put Medicare spending on a sustainable trajectory by defining limits to its growth in law. Those limits soon proved to be unrealistic in the absence of real Medicare modernization. However, Congress has (irresponsibly) avoided fixing the problem because (just like the Alternative Minimum Tax) that would have the effect of making our long-term budget calculations look (accurately) worse.

What Needs to be Done

Fundamentally, the "fiscal cliff" is a deadline Congress set for itself to address its own spending problems because it didn't want to have to do it before the election. For several years now, our government has been borrowing about 40 cents out of every dollar it spends. The consequences of this will be severe if we don't get our house in order quickly.

If the government were a typical American household earning $65,000 a year, then they would have spent over $108,000, putting more than $43,000 on their credit card this year alone. All told, that family would have $493,000 in credit card debt.

President Obama campaigned on raising taxes and won. He has made the case that wealthy Americans must pay more in taxes. Republicans are concerned about the economic effects of this for our weak economy, but are willing to compromise by raising revenue by limiting or closing tax loopholes while not actually increasing tax rates. Most of this revenue would come from wealthier Americans.

No amount of tax increases, however, will fix our debt situation. Even if we were to go "over the cliff" and let all of the Bush-era tax cuts expire, let all of the Obamacare taxes take effect, and let all the sequestration cuts take effect, our national debt would still climb higher.

As the Congressional Research Service says: "Under a current policy baseline, where expiring tax cuts, the alternative minimum tax patch, and the Medicare 'doc fix' are assumed to be extended, deficits are unsustainably large even after enactment" of all the other provisions of the sequestration law."

Even if all $2 trillion covered by the sequestration law were allowed to take effect, that would only reduce our debt ten years from now by $1.1 trillion. It now stands at $16.3 trillion.

As dramatic as the "fiscal cliff" seems, it is a small matter compared to our real fiscal problems. There simply is no way to solve our debt crisis without modernizing and protecting Medicare and other "entitlement" programs. If you would like to read more about my views on how to do that, please read my Memorandum on the Government's Debt at pitts.house.gov/issues.

Our fiscal problems are tremendous challenge for America. It is not surprising that elected officials have shied away from making the difficult decisions necessary to fix the situation. America, however, is worth fighting for and our prosperity is worth protecting. I stand ready to work with anyone in either party who is willing to stop kicking the can down the road and put our government on an actual, realistic, and binding budget.