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MEMORANDUM

MEMO: December 1, 2022
TO: Congressional Leaders
FROM: Ben Ritz and Nick Buffie, PPI's Center for Funding America's Future
RE: Priorities for End-of-the-Year Budget Negotiations

After the Georgia runoff election, lawmakers will begin a mad sprint to resolve the unfinished business of the 117th Congress. These priorities will likely include a bipartisan reform of the Electoral Count Act to safeguard our democracy from domestic threats and a renewal of the National Defense Authorization Act to protect us from threats abroad. But the biggest unresolved issues are primarily fiscal: Congress must pass new appropriations by December 16 to prevent a partial government shutdown. Lawmakers must also decide before the end of the year whether to renew a number of tax provisions that expire in 2022.

Throughout this process, it is essential that lawmakers prioritize the fight against inflation above all else. Consumer prices have risen by nearly 8% over the past year and families are feeling the squeeze as wages can't keep up with the soaring cost of living. Nearly four in five voters said they had experienced hardship from inflation, and a plurality ranked it as their top concern in midterm exit polls.

Although restoring price stability is primarily the job of the Federal Reserve, actions taken by Congress can help or hinder the Fed's efforts. Independent estimates from experts at the Federal Reserve Bank of San Francisco, Brookings, and Johns Hopkins have all concluded that deficit-increasing policies adopted by Congress and the administration over the last two years have increased inflation by roughly three percentage points.

The borrowing binge cannot continue. Congress should not cut taxes or increase spending over the next year or in future years without concurrently offsetting the costs over the same time period. Lawmakers should instead work on a bipartisan basis to address the following priorities in a fiscally responsible way:

PROVIDE ADEQUATE APPROPRIATIONS FOR NORMAL GOVERNMENT OPERATIONS AND NEW PUBLIC INVESTMENTS

To avoid a government shutdown, Congress must pass a new omnibus appropriations bill to fund the government for the remainder of fiscal year 2023, or a continuing resolution extending FY2022 levels before the end of this year. The House omnibus bill would increase appropriations over last year's levels by 9% (roughly consistent with total economic growth), while the Senate omnibus bill would increase appropriations by 10.3%.

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When discretionary spending was at historically low levels as a share of gross domestic product (GDP) over the past decade, PPI was a vocal champion for increasing it. But those days have ended. Freezing or slightly reducing discretionary spending relative to GDP is one of the easiest things Congress can do to start reducing its contribution to inflation. At the very least, any increase in aggregate discretionary spending levels above the rate of inflation should be offset.

However, there are some narrow needs for which Congress should increase appropriations in real terms. The CHIPS and Science Act, passed earlier this year, authorized a dramatic expansion of federal support for research and development but did not actually appropriate the money needed to fund it. As we have long argued, federal support for research and development is one of the most important public investments our government makes because it lays the foundation for technological innovations that power economic growth. Congress should fully fund the programs authorized by CHIPS and direct as much of that money as possible into basic research specifically, because this is the category of federal R&D least likely to be financed by the private sector but the most likely to have the highest return on investment over time.

Congress must also ensure that the funding for the Internal Revenue Service (IRS) enacted through budget reconciliation earlier this year goes towards enforcement activities aimed at reducing the "tax gap" (the difference between taxes owed and taxes actually paid). Republicans have tried to undermine this effort to crack down on wealthy tax cheats by introducing legislation to rescind part of the funding boost already appropriated. Although that measure is likely a non-starter for Democrats, Republicans may attempt to achieve the same outcome by cutting baseline IRS funding in the normal appropriations process to offset at least part of the additional resources. Such a move would force the IRS to redistribute resources away from the new enforcement activities just to cover activities it previously engaged in. Lawmakers should hold the line and reject this effort that would amount to a deficit-increasing tax cut exclusively for tax cheats.

SUPPORT THE FIGHT FOR DEMOCRACY IN UKRAINE

The Biden administration has requested $37.7 billion to aid Ukraine in its effort to repel the Russian incursion. This includes $21.7 billion of defense spending to provide weapons, military aid, and intelligence support to the Ukrainians; $9.9 billion of direct support to the government of Ukraine; $1.5 billion of economic stabilization funds meant to upgrade physical infrastructure, support Ukrainian civil society organizations, etc.; and $1.1 billion to repair Ukraine's energy infrastructure, as the invasion has left many Ukrainians without power. The $37.7 billion figure also includes money not going directly to Ukraine, such as $300 million to expand global food supply (which has decreased during the war). Of all the spending being considered in the lame duck, this assistance is likely to be the least inflationary because it doesn't subsidize domestic

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consumption. Members of both political parties should support Ukraine as it looks to defend itself and the western world from Russian aggression.

RESTORE SOME EXPANSION OF THE CHILD TAX CREDIT

For couples earning $150,000 or less, the American Rescue Plan (ARP) Act increased the child tax credit (CTC) to $3,600 per child under 6 and $3,000 per child ages 6-17 in 2021. The ARP reforms pulled 2.1 million children out of poverty, helping push the 2021 child poverty rate to a record-low 5.2%. However, CTC benefits fell substantially at the beginning of this year, especially for low-income families.

Under the current CTC structure, from 2022 to 2025, parents with income tax liabilities and household incomes under $400,000 can reduce their tax payments by $2,000 per child. Families who don't owe any taxes — who tend to be low-income — receive a refund check equivalent to the lesser of either $1,500 per child or 15% of wages above $2,500. In 2026, the CTC will decline to $1,000 per child for families with income tax liabilities; for families without liabilities, the maximum refund will be capped at 15% of wages above $3,000.

Aside from the tax increases in 2022 and 2026, the problems with the CTC are numerous: Benefits per child are smaller for low-income families than for high-income families; 17-year-olds are ineligible for the credit; and unlike virtually all other provisions of the tax code, the CTC does not rise with inflation. The ARP resolved most of these problems (all but the lack of an inflation adjustment), but did so only for tax year 2021.

Although a full restoration of the ARP CTC is not practical, there are many options for Congress to expand the CTC for families in need. By making families without tax liabilities eligible for a larger share of the maximum credit, lawmakers could boost the incomes of the poorest households. Lawmakers could also extend the CTC to 17-year-olds or index the CTC to grow with inflation. Had the maximum CTC risen in line with inflation since 2018, it would be $2,300 per child in 2023.

If the benefit increase is targeted to low-income families, it need not be especially costly. The new outlays from a partially expanded CTC could be offset by raising the top marginal tax rate by less than two percentage points or by curtailing other tax credits that disproportionately benefit high-income families.

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RESTORE IMMEDIATE EXPENSING FOR R&D INVESTMENTS

Starting this year, American businesses are no longer allowed to deduct their annual research and development (R&D) expenses on their tax returns. Rather, their R&D expenses will be deducted gradually over five years. This change, known as "amortization," was meant to offset a small portion of the enormous corporate tax cuts included in the 2017 Trump tax bill. Eliminating amortization would reduce federal revenues by $155 billion over 10 years.

The problem with amortization is that it discourages private R&D investment, thus lowering the probability that businesses will make productivity-enhancing investments. The U.S. would join only Australia as an outlier among advanced economies that do not allow immediate deduction of R&D investments. The U.S. corporate income tax code also doesn't require amortization for most other costs, such as expenditures on employee training or benefits, making this a curiously backwards tax treatment for the most socially beneficial business investments.

A better approach would be to restore the immediate expensing of R&D investments while taxing corporate profits (rather than corporate investments) at a higher rate. Lawmakers could offset the cost of eliminating amortization by raising the corporate tax rate less than 1.5 percentage points.

IMPROVE RETIREMENT SECURITY WITHOUT COSTLY BUDGET GIMMICKS

In March 2022, the U.S. House of Representatives passed the Securing a Strong Retirement Act of 2022 (also known as "Secure 2.0"). A similar bill (known as the "EARN Act") has been introduced in the Senate by Sen. Ron Wyden (D-Ore.) and is currently under consideration by the Finance Committee.

These bills would change retirement policy in a number of ways. Secure 2.0 and the EARN acts would increase the maximum annual "catch-up" contributions which workers 50 and older can make to their retirement plans from $6,500 to $10,000; they would grant tax credits to small businesses providing retirement plans to their workers; they would make more part-time workers eligible for employer-sponsored retirement plans; they would remove early-withdrawal financial penalties for victims of domestic abuse, individuals fleeing natural disasters, and people with terminal illnesses or long-term care costs; and they would increase the age at which individuals are required to take minimal distributions from their retirement accounts by three years (from 72 to 75). The last provision would be phased in gradually, with the age for required minimum distributions (RMDs) rising to 73 in 2022, 74 in 2029, and 75 in 2032.

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There are arguments to be made for many of these reforms. However, they are paid for largely through a series of budget gimmicks. The Secure 2.0 and EARN acts include two notable expansions to Roth retirement accounts: They would allow employers to make matching contributions to such accounts; and they would require that employee catch-up contributions be made to Roth accounts rather than to traditional 401(k)s. These provisions would increase revenues over the short term while decreasing revenues over the long term because they would increase taxes on retirement contributions while cutting taxes on withdrawals in future years. According to the Joint Committee on Taxation, this revenue-shifting constitutes the bills' entire funding over the first decade. The Committee for a Responsible Federal Budget has noted that "the second-decade cost [of the EARN Act] would very likely exceed $100 billion, possibly significantly so."

While many parts of the Secure 2.0 and EARN acts have some merit, the budget gimmicks do not. Congress should either find legitimate offsets or delay consideration of this bill until they can.

Congress is also debating a measure to repeal Social Security's Windfall Elimination Provision (WEP) and Government Pension Offset (GPO) provisions. These provisions are an imperfect way of preventing public-sector workers from receiving Social Security benefits that are disproportionate to their Social Security contributions. While these rules are in clear need of reform, there are better options than outright repeal. Simply eliminating the WEP and the GPO would disproportionately benefit high-income households, worsen inflation, and make Social Security insolvent one year earlier. Any changes to these provisions should be considered in the context of comprehensive improvements to Social Security that strengthen the program's finances and avoid disproportionately benefiting higher-income households.

PASS ENERGY PERMITTING REFORM TO BOOST ENERGY SUPPLY AND COMBAT CLIMATE CHANGE

After six years of flatlining, household energy prices rose 32% between October 2020 and October 2022. This increase has disproportionately harmed low-income households, who spend a higher share of their income on energy costs than middle- or high-income households. The $1.2 trillion of domestic investments Congress approved in the bipartisan infrastructure law, the CHIPS and Science Act, and the recent reconciliation bill have the potential to solve this problem by transforming our infrastructure and unleashing a clean energy revolution. To maximize the bang for each taxpayer buck, it is necessary for this money to be spent in an efficient way.

Unfortunately, these investments are at risk of being strangled by red tape. As PPI has previously noted, "unnecessary and duplicative government reviews and nuisance lawsuits have pushed

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average time for permitting [energy projects] to 4.3 years for transmission [projects], 3.5 years for pipelines, and 2.7 years for renewable energy generation projects." The first step to streamlining the permitting process and increasing energy supply would be to pass the Energy Independence and Security Act (EISA) as part of a year-end omnibus bill or a renewal of the National Defense Authorization Act.

The EISA would change federal permitting processes in numerous ways, most notably by setting one- or two-year targets (depending on the scale of the project and the number of government agencies involved) for finishing environmental reviews; requiring the president to set a list of 25 high-priority infrastructure projects that would receive priority permitting, and update that list every six months; requiring that project approvals be challenged within at most 150 days of the project's public announcement; approving the Mountain Valley Pipeline, a natural gas pipeline which would run through Virginia and West Virginia; and creating "dispute resolution procedures for resolving project disagreements without delays."

Congress should also include provisions from the Streamlining Interstate Transmission of Electricity Act, which would organize and consolidate the currently convoluted permitting processes for many transmission projects. By making it easy to build energy infrastructure, especially clean energy infrastructure, Congress can increase energy supply, lower prices, and combat climate change all at once.

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