THE REPUBLICAN STUDY COMMITTEE
BUDGET & SPENDING TASK FORCE
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President Requests Supplemental Appropriations for Hurricane Sandy

On Friday, December 7, the Obama administration sent a letter to Congress requesting disaster relief funding for response, recovery, and mitigation efforts related to Hurricane Sandy. The request totals $60.4 billion, including $12.97 billion in mitigation projects to "reduce the risk from future disasters." Of that $60.4 billion, $5.4 billion will be designated as "disaster relief," reaching the $11.8 billion cap on "disaster relief" spending in FY 2013 set by formula established in the Budget Control Act ($6.4 billion in "disaster relief funding was appropriated earlier this year in the Continuing Appropriations Resolution, 2013). The remaining $55.0 billion will be designated as emergency spending and will not be subject to any cap. **The administration has proposed no offset for this new federal spending.**

By the Numbers:		Spending Designations	
President's Aid Request	$60.4 billion	Disaster Relief Spending	$5.4 billion
Proposed Offsets	**$0.0 billion**	Emergency Spending	$55.0 billion

Several aspects of the request may be of note to RSC Members:

- CBO Score: CBO projects that only $21.7 billion of the request would be spent through FY 2014, leaving $38.7 billion, or 64% of the total funds, to be spent in FY 2015 and beyond, nearly 22 months from today.
- Disaster Relief Funding: The request asks for $11.5 billion for FEMA's Disaster Relief Fund.
- Mitigation Projects: The request asks for ~$13 billion in funding to mitigate future disasters, including projects by the Corps of Engineers and EPA to address the threat of extreme weather events and climate change.
- Climate Change: The request includes language related to climate change in multiple line items.
- National Flood Insurance Program: The request asks for an increase in the program's borrowing authority of $9.7 billion, a 47% increase.
- Duplicative Programs: The request asks for $17 billion to the Community Development Fund, $500 million for Social Services Block Grants, and $1 million for the Legal Services Corporation, all programs the RSC Sunset Caucus or Repeal Task Force have previously targeted for elimination.
- Miscellaneous Items: $9 million to replace vehicles, $24.1 million to plant trees, and $32 million for Amtrak.

For details on all requested funding, see the RSC Policy Brief: The President's Hurricane Sandy Disaster Aid Request.

Negotiators Exchange New Offers to Resolve the "Fiscal Cliff"

On Tuesday, December 11, the administration and House Republican leadership exchanged new offers to resolve the impending "fiscal cliff." Moving from its initial demand of $1.6 trillion in tax revenue two weeks ago, the administration now reportedly demands $1.4 trillion in new revenues. The administration's demand continues to include new stimulus spending and permanent authority for the President to raise the debt ceiling unilaterally. There are also reports that an offer to commit to move on corporate tax reform in 2013 was also included. House Republican leadership responded with its own counter-offer, which reportedly did not differ substantially from their prior offer of $800 billion in new revenues paired with $900 billion in mandatory and $300 billion in discretionary savings, among other provisions.

Quote of the Week: *"Our people in an overwhelming way supported the re-election of this president and there ought to be a quid pro quo . . . After the election of Jimmy Carter, [the mayor] went to Washington, D.C. and came home with some bacon. That's what you do."*

--Detroit Councilwoman JoAnn Watson, December 4th, 2012

CBO Issues Report on Unemployment Benefit Spending

The Congressional Budget Office recently issued a report, Unemployment Insurance in the Wake of the Recent Recession, on overall unemployment benefit spending over the last five years. Over that period, the federal government spent roughly $520 billion on unemployment insurance, including $94 billion in FY 2012 alone. There are currently three federal unemployment insurance programs: regular unemployment insurance, emergency unemployment compensation, and extended benefits. The newest of the programs, the Emergency Unemployment Compensation Program (EUC), which in its current form provides up to 47 weeks of extended unemployment benefits, was created in July 2008 and will expire in its current form at the end of this month. In its report, CBO examined four options for extending some type of expanded unemployment assistance. The most expensive, an extension of EUC in its current form for one year, would cost $30 billion. CBO acknowledged that unemployment insurance can "provide incentives for UI recipients to remain unemployed longer than they otherwise would."

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THE WALL STREET JOURNAL.

Taxes are Much Higher Than You Think
By: Edward C. Prescott and Lee Ohanian

President Obama argues that the election gave him a mandate to raise taxes on high earners, and the White House indicates that he won't compromise on this issue as the so-called fiscal cliff approaches.
But tax rates are already high—much higher than is commonly understood—and increasing them will likely further depress the economy, especially by affecting the number of hours Americans work.

Taking into account all taxes on earnings and consumer spending—including federal, state and local income taxes, Social Security and Medicare payroll taxes, excise taxes, and state and local sales taxes—Edward Prescott has shown (especially in the Quarterly Review of the Federal Reserve Bank of Minneapolis, 2004) that the U.S. average marginal effective tax rate is around 40%. This means that if the average worker earns $100 from additional output, he will be able to consume only an additional $60.
Research by others (including Lee Ohanian, Andrea Raffo and Richard Rogerson in the Journal of Monetary Economics, 2008, and Edward Prescott in the American Economic Review, 2002) indicates that raising tax rates further will significantly reduce U.S. economic activity and by implication will increase tax revenues only a little.

High tax rates—on both labor income and consumption—reduce the incentive to work by making consumption more expensive relative to leisure, for example. The incentive to produce goods for the market is particularly depressed when tax revenue is returned to households either as government transfers or transfers-in-kind—such as public schooling, police and fire protection, food stamps, and health care—that substitute for private consumption.

In the 1950s, when European tax rates were low, many Western Europeans, including the French and the Germans, worked more hours per capita than did Americans. Over time, tax rates that affect earnings and consumption rose substantially in much of Western Europe. Over the decades, these have accounted for much of the nearly 30% decline in work hours in several European countries—to 1,000 hours per adult per year today from around 1,400 in the 1950s.

Changes in tax rates are also important in accounting for the increase in the number of hours worked in the Netherlands in the late 1980s, following the enactment of lower marginal income-tax rates.

In Japan, the tax rate on earnings and consumption is about the same as it is in the U.S., and the average Japanese worker in 2007 (the last nonrecession year) worked 1,363 hours—or about the same as the 1,336 worked by the average American.
All this has major implications for the U.S. Consider California, which just enacted higher rates of income and sales tax. The top California income-tax rate will be 13.3%, and the top sales-tax rate in some areas may rise as high as 10%. Combine these state taxes with a top combined federal rate of 44%, plus federal excise taxes, and the combined marginal tax rate for the highest California earners is likely to be around 60%—as high as in France, Germany and Italy.

Higher labor-income and consumption taxes also have consequences for entrepreneurship and risk-taking. A key factor driving U.S. economic growth has been the remarkable impact of entrepreneurs such as Bill Gates of Microsoft, Steve Jobs of Apple, Fred Smith of FedEx and others who took substantial risk to implement new ideas, directly and indirectly creating new economic sectors and millions of new jobs.

Entrepreneurship is much lower in Europe, suggesting that high tax rates and poorly designed regulation discourage new business creation. The Economist reports that between 1976 and 2007 only one continental European startup, Norway's Renewable Energy Corporation, achieved a level of success comparable to that of Microsoft, Apple and other U.S. giants making the Financial Times Index of the world's 500 largest companies.
U.S. growth is currently weak, and overall output is 13.5% lower than what it would be had we continued on the pre-2008 trend.

The economy now faces two serious risks: the risk of higher marginal tax rates that will depress the number of hours of work, and the risk of continuing policies such as Dodd-Frank, bailouts, and subsidies to specific industries and technologies that depress productivity growth by protecting inefficient producers and restricting the flow of resources to the most productive users.
If these two risks are realized, the U.S. will face a much more serious problem than a 2013 recession. It will face a permanent and growing decline in relative living standards.

These risks loom as the level of U.S. economic activity gradually moves closer to that of the 1930s, when for a decade during the Great Depression output per working-age person declined by nearly 25% relative to trend. The last two quarters of GDP growth—1.3% and 2.7%—have been below trend, which means the U.S. economy is continuing to sink relative to its historical trend.

We have lost more than three years of growth since 2007, and our underachievement will continue unless pro-productivity policies are adopted and marginal tax rates are stabilized or lowered to prevent a decrease in work effort across the board. That means lifting crushing regulatory burdens such as those imposed by Dodd-Frank, and it means reforming immigration policies so that we can substantially increase our base of entrepreneurs by attracting the best and brightest creators from other countries.

Economic growth requires new ideas and new businesses, which in turn require a large group of talented young workers who are willing to take on the considerable risk of starting a business. This requires undoing the impediments that stand in the way of creating new economic activity—and increasing the after-tax returns to succeeding.