Fiscal policy after the mid-terms

The governance test

Modest, though not radical, budget goals are within the Republicans' reach
Nov 8th 2014 | WASHINGTON, DC | From the Economist print edition

A must-do list

Issue	Task ahead
Avoid government shutdown	Congress must renew funding by December 11th or else
Tax breaks	Expired last January, awaiting retroactive renewal
Budget	Senate, House should agree on one by April 15th 2015
Highway Trust Fund	Running low, must be reauthorised by May 2015
Debt ceiling	Must be lifted sometime between August and November 2015

Sources: Goldman Sachs, press reports

OF THE many reasons Congress is scorned, fiscal policy tops the list. Since Republicans took control of the House of Representatives in 2010 bitter battles with Senate Democrats and Barack Obama produced a near-default on the national debt, a white-knuckle fiscal cliff and a 16-day government shutdown. Now that Republicans also control the Senate, they have a chance to improve on that record.

Their first test comes quickly. Most of the federal government is operating on a temporary "continuing resolution" until December 11th. Without an extension, the government will shut down again. Given the beating their image took last time, Republican leaders are unlikely to want a repeat. They are more likely to seek a deal with Democrats, who control the Senate until the end of the year, to extend it at least until April, when Congress is supposed to pass a budget resolution.

That resolution lays out broad guidelines for how much the government may spend and tax. Congress hasn't passed one since 2010, largely because the Republican House and Democratic Senate have been ideologically too far apart. Once Republicans control both chambers, they can use the resolution to instruct key committees to rewrite the laws governing taxes and entitlements such as Obamacare and Medicare (health care for the elderly) through a process called reconciliation. Provided those changes reduce the budget deficit, a reconciliation bill could not be filibustered by the Democratic minority in the Senate because it only needs 51 votes, not the usual 60; though Mr Obama can still veto it.

Republicans will be tempted to use reconciliation to advance long-standing goals such as tax reform, the repeal of Obamacare and an overhaul of Medicare. Yet for practical reasons, they may not try. Mr Obama would veto such sweeping changes. Many Republican senators are running for re-election in Democratic-leaning states in 2016 and don't want to cast politically costly votes with nothing to show for it. “Nobody likes to do anything perceived as reducing Medicare spending,” says Judd Gregg, a former Republican senator who tried. As a result, Republican leaders may pursue more modest goals—such as repealing an unpopular tax on medical devices—which could attract a few Democratic votes and avoid Mr Obama's veto.

Republicans will also have to decide whether to keep in place the “sequester”, hard caps on discretionary spending such as defence, government operations and education (but excluding entitlements) that last to the end of 2021. The two parties agreed to raise the cap modestly last year, but that deal expires next September. Thereafter defence spending is projected to fall to 2.7% of GDP, the smallest since 1940, and other discretionary spending to 2.5%, the lowest since the 1950s. Republicans would like to raise the caps on defence spending, but that would need some Democratic votes in the Senate and Mr Obama's signature. They will get neither without raising the caps on domestic spending. The more likely result, then, is no change, at least until 2016.

Circumstances could push Mr Obama and the Republicans together on several fronts. Republicans could give the president “fast-track” authority to strike foreign trade deals. Highway construction and disability benefits are both financed by trust funds that are almost out of money; that could spur modest fixes to both. Mr Obama and Republicans also agree on the broad goals of corporate tax reform: a lower top rate and fewer loopholes.

Mr Obama and Republican leaders spoke of co-operation on trade and taxes the day after the election. But they do not trust each other. And Republicans are far from united. Mitch McConnell, the new Senate leader, could be stymied by a handful of conservatives led by Ted Cruz of Texas. They may insist that any budget bill must end Obamacare (though Mr Cruz has said he might settle for repealing bits of it), or refuse to raise the statutory debt limit, raising the spectre of arbitrary cuts to federal payments or default on the national debt. Republicans must avoid such calamities to prove they can govern. Otherwise, as their majority leader in the House, Kevin McCarthy, predicts, “There won't be a Republican president in 2016.”

From the print edition: United States