

THE CONCORD COALITION



Budget Update

March 20, 2007

Senate Budget Committee Adopts Fiscal Year 2008 Budget Resolution

I. Introduction

The Senate Budget Committee (SBC), voting 12-11 along party lines March 15, approved a Democratic-drafted FY 2008 budget resolution that aims to produce a \$132 billion surplus by FY 2012.

“While no single budget resolution can solve all of our budget challenges, this plan will begin to put the nation back on a more sound fiscal path,” Committee Chairman Kent Conrad (D-ND) said in opening the two-day Budget Committee markup of his five-year fiscal blueprint.

Senator Judd Gregg (R-NH), ranking Republican on the Committee, countered that the Democrats’ plan contains “no attempt to address the long-term problems we face.”

There is some validity in each point. The SBC plan appears to be a holding action, designed to improve the fiscal outlook by forcing deficit neutral choices among competing priorities. This process has been missing from recent budgets and restoring it would be an important step towards a more responsible fiscal path. However, more needs to be done. Restoring a “pay-as-you-go” rule (paygo) — and making the tough choices to enforce it — would stop digging the hole deeper but it would not fill the hole that has already been dug. Nothing in the SBC plan would restrain the projected spending growth of federal health care and retirement programs — primarily Medicare, Social Security and Medicaid — that are the main source of the nation’s unsustainable long-term fiscal outlook.

II. Highlights of the Senate Budget Committee’s Budget Resolution

Deficit path

Chairman Conrad’s \$2.9 trillion budget plan for FY 2008 shows four years of steadily declining deficits, from \$249 billion in FY 2008 down to \$14 billion in FY 2011. It then projects a surplus of \$132 billion in FY 2012, the last year of the plan’s five-year window. As a percentage of Gross Domestic Product (GDP), spending and debt would decline over the five-year period while revenues would increase.

Table 1 Outlays, revenues, deficits and debt as a percentage of GDP

	2008	2009	2010	2011	2012	2008-2012
Outlays	20.5	20.3	19.6	19.4	18.8	19.7
Revenues	18.7	18.8	18.8	19.3	19.5	19.1
Deficit/surplus	-1.7	-1.4	-0.6	-0.1	0.8	-0.6
Debt held by public	37.1	36.9	36.1	34.7	32.5	
Gross debt	66.6	67.1	67.1	66.4	65	

In comparison with the President’s budget, as scored by the Congressional Budget Office (CBO), the SBC budget would average higher spending over the five-year period (19.7 percent of GDP vs.19.4 percent) and higher revenues (19.1 percent of GDP vs.18.5 percent). By 2012, revenues would be a full percentage point of GDP higher under the SBC plan than in the President’s budget (19.5 percent vs. 18.5 percent). Spending would not diverge by as much. Under the SBC plan, spending in 2012 would be 18.8 percent of GDP and in the President’s budget spending would be 18.6 percent of GDP.

Paygo — the defining feature

The defining feature of the SBC plan is renewal of a paygo rule for all entitlement expansions and tax cuts. This rule, which was in effect from 1990 through 2002, would require that entitlement expansions or tax cuts, including extension of expiring tax provisions, be offset with spending cuts or revenue increases. In keeping with this rule, the SBC plan assumes no entitlement expansions or tax cuts that are not offset.

The practical effect of adhering to paygo in the budget plan is that several politically popular items, such as expansion of the State Children’s Health Insurance Program (SCHIP), reauthorization of the farm program, relief from the Alternative Minimum Tax (AMT) and extension of the 2001 and 2003 tax cuts are consigned to reserve funds pending deficit neutral legislation from the appropriate committees of jurisdiction.

In all, the SBC plan includes 22 deficit neutral reserve funds. These are essentially spending and tax initiatives flying standby on the budget resolution — if there is no room, they don’t get a seat. As the sheer number of these reserve funds demonstrates, it is vital to the plan’s success that paygo be applied across the board. If one exception is allowed, advocates of all the other reserve fund programs and tax cuts will demand to be released from the deficit neutral offset requirement.

One downside to the paygo assumption in the SBC plan is that it produces an improbable deficit path because it assumes a revenue surge as tax cuts and AMT relief expire. It seems more likely that any offsets found to balance these expiring provisions would be implemented in a way that smoothed out the flow of revenues (or spending cuts) over a period of years. It is also possible, of course, that even in the absence of offsets some of the expiring tax provisions or reserve fund entitlement expansions would command sufficient support to overcome the 60-vote paygo point of order against them. Such exemptions would add to projected deficits or subtract from the projected 2012 surplus. Nevertheless, the paygo requirement would subject all such deficit

increasing initiatives to appropriate scrutiny. It would force an explicit trade-off between spending, taxes and debt, which is exactly what the budget process should do.

Discretionary spending

The SBC plan includes a FY 2008 discretionary spending cap of \$947 billion in new budget authority — \$18 billion higher than requested by President Bush. It is too soon to tell whether this number will be adopted by the full Senate, or whether the House will urge a different number, but it seems likely that a discretionary spending level this far above the President's request would provoke veto threats from the White House on subsequent appropriation bills.

The plan adopts President Bush's defense spending proposal including \$295 billion to fund Iraq and Afghanistan military operations from FY 2007 through FY 2009. Of that, \$145 billion is for FY 2008 war costs.

Both Conrad and Gregg have said that the President's war funding level is unrealistically low, with only \$50 billion projected for FY 2009 and nothing after that. However, neither side attempted to increase that number during the Committee markup.

The SBC plan rejects the domestic discretionary spending levels recommended by the President. Instead, it assumes higher amounts for programs such as low income heating assistance, homeland security, education, Community Development Block Grants, Amtrak, community policing, and health care. Filling in the details of these funding levels would be up to the Appropriations Committee later this year.

Discretionary outlays would be \$150 billion higher over five years than in the President's budget, as scored by CBO. Both budgets, however, assume a fairly tight rein on discretionary spending. The President's budget assumes a virtual freeze. The SBC plan allows modest increases. Under either budget, discretionary spending would decline as a percentage of GDP, from 7.8 percent in 2006 to 7.1 percent in the SBC plan and 6.9 percent in the President's budget.

Mandatory spending

In keeping with the paygo rule, the SBC budget resolution does not assume expansions of mandatory spending programs unless they are paid for. For example, the plan includes an extra \$15 billion for SCHIP but assumes that this will be paid for with savings from Medicare. It also includes an additional \$35 billion for SCHIP in a deficit neutral reserve fund. However, that money would only become available if the Senate Finance Committee finds offsets needed to pay for the increase.

Noticeably absent from the plan are any of the entitlement savings contained in the President's budget. In fact, the plan contains no reconciliation instructions requiring the appropriate committees to produce savings from entitlement programs. Sen. John Cornyn (R-TX) offered an amendment during the Budget Committee markup to add reconciliation instructions to come up with another \$33.8 billion in entitlement savings, but it was defeated on a party-line vote. Some

of the President's recommendations may reappear later in the process as proposed offsets if the paygo rule is ultimately adopted. The trade-off, however, is that savings used for offsets will not be available for deficit reduction.

During the Committee markup, Chairman Conrad agreed with comments from several Republicans that entitlement spending must be addressed. He said, however, that the way to do that is through a bipartisan process, not necessarily through the budget resolution. "It can't be done in a budget [resolution] that will pass with votes from only one side of the aisle and it's clear that that's going to be the case with this budget," Conrad said before the straight party-line vote in favor of his proposal.

Conrad and Gregg announced earlier this month they had agreed to co-sponsor legislation creating a bipartisan 16-person commission, made up mostly of congressional Members and headed by Treasury Secretary Henry Paulson. The group would make recommendations about entitlement reform and its proposals would be allowed to come directly to the floor of Congress for debate on a fast-track basis.

Revenues

The most contentious point during the Committee markup, and likely on the coming floor debate, is whether the plan relies on tax increases to achieve balance in 2012. Chairman Conrad contends that the SBC plan achieves a surplus in 2012 without raising taxes. Republicans have argued that, in fact, the plan would result in a large tax increase. The difference is in how one interprets the revenue baseline. Conrad's plan does not contain a tax increase above current law; however, current law assumes that taxes will go up.

All of the 2001 and 2003 tax cuts are scheduled to expire on Dec. 31, 2010. That date is within the five-year window covered by the budget resolution. In addition, current law provides no further AMT relief. The SBC plan neither calls for nor blocks the extension of those tax cuts. Instead, the plan includes future tax relief (including AMT relief) in one of the deficit neutral reserve funds. Under paygo, the revenue loss of all future tax cuts and extensions would have to be fully offset by new revenues raised elsewhere or by entitlement program savings. Failing that, any tax cut proposal or tax cut extension would have to win a super-majority of 60 votes to waive the offset requirement.

While the rule is sound, there is no question that coming up with the necessary offsets would be a daunting challenge. Extending all expiring tax cuts and providing continuing AMT relief over the next five years would necessitate offsets of roughly \$900 billion. Conrad has cited three potential sources of revenue offsets that would not "raise taxes"; 1) closing the "tax gap" in uncollected but owed taxes; 2) closing offshore tax havens and shutting down shelters; and 3) tax code simplification.

Republicans on the Budget Committee, including ranking Finance Committee member Chuck Grassley (R-IA), have argued that these initiatives, while worth doing, would not produce anywhere near enough revenue to cover the expiring tax cuts or fund new spending locked in the

reserve funds. Treasury Secretary Paulson has also cautioned that, “On this particular issue, [tax gap] I think we ... owe it to the American people to take some of the mystery out of this, because I don't think it does anybody a service to let the American people think there's a big pot of gold there and that we can tap into that gold to fund all sorts of things without there being a big cost to that.”¹

It may, or may not, be that offsets can be found for expiring tax cuts. The point of subjecting them to paygo, however, is to require a consideration of priorities. Circumstances have changed dramatically since many of the tax cuts were enacted. The surplus years have been replaced by deficits and the budget faces new demands for the war on terrorism and homeland security. Moreover, policymakers have not taken action to prepare for the costs of the baby boomers' retirement and health care costs that will begin to place a strain on the budget in the next few years. A logical response to the dramatically changed budgetary conditions would be to reassess whether all of the tax cuts enacted in the past fit the changing circumstances of the future. Paygo would not compel a particular answer, but it would compel the question.

Budget enforcement

When Congress enacted President Bush's proposed tax cuts in 2001, it did so using the budget resolution's reconciliation process — a fast-track procedure that is not subject to filibuster and therefore requires only a simple majority for passage, not a 60-vote super majority.

Many Democrats were critical of the approach, claiming that reconciliation was never intended to make it easier to pass deficit-raising legislation — only to ease the path for politically difficult deficit reduction plans that include tax increases or spending cuts. The SBC plan acts on this concern by limiting the use of reconciliation to deficit reduction legislation.

The SBC plan would also require that all designated emergency spending bills would be subject to an emergency designation point of order that could only be waived with 60 votes in the Senate. The language is designed to prevent non-emergency measures from passing as emergency legislation to skirt established spending caps.

A further point of order in the Senate would be established against any legislation that would cause a net deficit increase of more than \$5 billion in any of four 10-year periods beginning in FY 2018 through FY 2057. To facilitate this rule, the CBO would be directed to prepare long-term estimates of each bill, joint resolution, amendments thereto and conference reports.

III. Concord Coalition perspective

The SBC plan contains several positive attributes supported by The Concord Coalition. Specifically it would:

- **Establish budget balance (or surplus) as its fiscal policy goal.** This is the most appropriate goal given the known fiscal challenges that loom with the baby boomers' retirement years (beginning in 2008). It is encouraging that both the Senate Budget

¹ Testimony before the Senate Finance Committee, February 6, 2007.

Committee and the Bush Administration are now on record in support of a balanced budget by 2012 — although their plans for achieving that goal are still far apart.

- **Adopt paygo rules for entitlement expansions and tax cuts.** These simple rules played a crucial role in bringing the deficit under control in the 1990's. Renewing them is the most important thing Congress can do in the short-term to prevent the long-term outlook from getting worse.
- **Reject the administration's practice of assuming permanent extension of certain expiring tax cuts in the baseline.** The decision whether to remove the legislated sunsets for the tax cuts is a policy decision. It should be made through the legislative process, not by budget scorekeepers.
- **Reject reconciliation protections for legislation that would increase the deficit.** The procedural protections for reconciliation legislation are intended to help Congress take actions that are responsible but politically difficult, not irresponsible but politically popular.

There are, however, aspects of the plan that are disappointing. Specifically, it does not:

- **Budget for likely war costs.** Like the President's budget, the SBC plan assumes just \$50 billion for the cost of military operations in Iraq and Afghanistan in 2009 and nothing in 2010 through 2012. Democrats have correctly noted in the past that this is an unrealistic assumption.
- **Provide a spending reconciliation bill to achieve savings in entitlement programs.** The explosion in health care and retirement benefits looms on the horizon is the single biggest threat to our nation's fiscal health. Including entitlement savings as a regular part of the annual budget process is an important step in addressing our long-term challenges. The President proposed some reforms in his budget, particularly with regard to Medicare, that merit inclusion in the congressional budget resolution. A more comprehensive approach to long-term fiscal policy may have to await the kind of bipartisan process supported by Senators Conrad and Gregg. That is no reason, however, to avoid incremental steps that make sense on their own and that can achieve substantial savings.

Figure 1:

**Deficit (-) and Surplus (+) Projections:
FY 2008 Budgets**

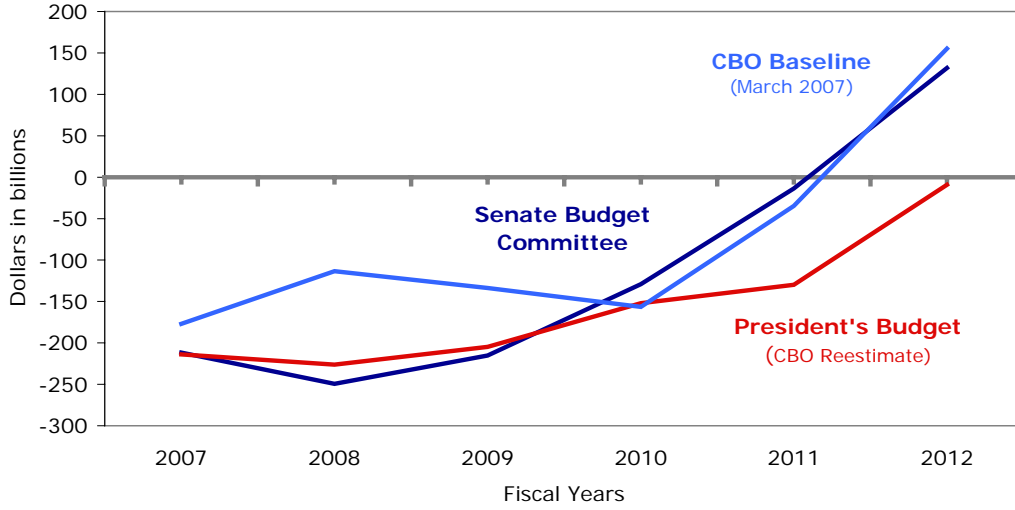


Figure 2:

Total Receipts and Outlays

