COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET

BUDGET UPDATE
JANUARY 4, 2006

Stumbling to the Finish Line

Although being a budget watchdog generally requires a healthy dose of skepticism, recent months have provided reasons for cautious optimism. The sticker shock associated with the costs of responding to Hurricane Katrina on top of large structural deficits appears to have made the nation's fiscal health a higher priority for policymakers and the public.

After four years of tax cuts and spending increases enacted with little concern for their budgetary impact, talk of budget offsets has returned to the legislative process. Congress is on the verge of enacting greater spending cuts than the budget resolution required, while it deferred completing action on tax cuts before adjourning.

In addition to Congress nearing completion of the first deficit reduction reconciliation bill in eight years, various proposals have been put forward by members of Congress and others outside Congress for even greater savings. At the same time, the prospects of further tax cuts are in doubt as members who have supported tax cuts in the past question whether the federal government can continue to reduce revenue in light of our fiscal situation. Meanwhile, it now appears that the costs of responding to Hurricane Katrina will be less than the original estimates of $200 billion.

To be sure, there remains considerable pressure for additional tax cuts and increased spending, and the costs of tax cuts and spending increases on the legislative agenda when Congress returns next month exceed the modest deficit reduction efforts that have been made. The calls for austerity to pay for the costs of hurricane relief would have greater credibility if this principle were applied to other areas of the budget as well. But at least the inevitable political pressure for tax cuts and spending increases is being counterbalanced by a concern about the deficit. We are hopeful that the increased attention that the deficit has received in recent weeks represents a shift in the public discourse that will lead to serious deficit reduction efforts in the near future.

Proposals for a New Budget

As it became clear that the costs of responding to Hurricane Katrina would exacerbate the nation's already unhealthy fiscal condition, the Committee called on Congress to pass a new budget resolution to re-evaluate the country's fiscal priorities and exercise greater restraint in the rest of the budget. A new budget would have provided an opportunity for Congress to set out new priorities in a post-disaster environment, establish a plan to pay for these new costs, and re-examine previously adopted budget policies in light of the new fiscal realities.

House Budget Committee Chairman Jim Nussle announced plans to move an amended budget resolution for deeper spending reductions. Although he ultimately did not go forward with a formal amendment to the budget resolution, the discussion led to a plan that increased the amount of mandatory spending cuts in the spending reconciliation bill. The Committee applauds the efforts of Chairman Nussle and others to informally revise the budget to identify additional savings in mandatory spending programs. The same process should now be applied to the revenue side of the budget.

The Return of the Pay-As-You-Go Principle – More Punch Than Expected

The Committee has been a longstanding supporter of pay-as-you-go rules for legislation that would increase the deficit. While we applaud efforts to find offsets for the one-time costs of disaster relief in the Gulf Coast, it is far more important that Congress offset the costs of legislation that will have a permanent impact on the long-term budget outlook. The Senate debate on the spending reconciliation bill provided a concrete indication of progress in this area when the Senate voted 50-49 in favor of an amendment by Budget Committee Ranking Member Kent Conrad to reinstate the Senate pay-as-you-go rule. Although the amendment failed on a budget act point of order, the vote indicates that there may well be support to reinstate the paygo rule in the Senate as part of the budget resolution next year.[1]

As it turns out, even the existing Senate pay-as-you-go rule, which was widely considered by budget observers to be superfluous when it was adopted, has actually imposed some restraint on the legislative process, at least temporarily. The Senate's rule, enacted as part of the fiscal year 2004 budget resolution, establishes a point of order against any tax or entitlement spending legislation that would increase the deficit beyond the levels set forth in the budget resolution. When the only tax and entitlement spending changes assumed in the budget resolution were tax cuts and spending increases, this rule was redundant – it would only apply to legislation increasing the deficit by more than the total costs of all tax cuts and entitlement spending increases allowed by the budget

[1] The Conrad amendment was supported by all Democrats voting and six Republicans. In addition to the four Senate Republicans who voted for the paygo amendment to the budget resolution in 2004, (Senators McCain, Snowe, Chaffee, and Collins), the Conrad amendment was supported by Senator George Voinovich, who voted for a similar amendment to the budget resolution earlier this year, and Senator Tom Coburn, who had voted against previous paygo amendments. Senator Coburn's support for the Conrad paygo amendment was particularly notable because he is widely regarded as a leader among conservative budget hawks fighting to limit spending. His vote for paygo underscores that supporting paygo does not necessarily equate to opposing tax cuts, provided one is willing to cut spending by the same amount.

resolution. However, when the budget resolution contains both savings in mandatory spending programs as well as deficit increases for tax cuts or mandatory spending increases, the current paygo rule effectively requires that Congress approve the offsets called for in the budget resolution before the Senate can consider the full amount of deficit increasing legislation (be they tax cuts or mandatory spending increases) provided for in the budget resolution. Thus, the Senate paygo rule effectively limits the amount of tax cuts (or entitlement spending increases) that the Senate can consider to no more than $60 billion until the mandatory savings assumed in the budget resolution are passed by the House and Senate as part of a spending reconciliation conference report.

The joint explanatory statement accompanying the fiscal year 2006 budget resolution set forth a balance on the Senate paygo scorecard of $16.8 billion in fiscal year 2006 and $75.6 billion for fiscal years 2006 through 2010. These balances represent the net increase in the deficit from the tax and entitlement spending legislation assumed in the budget resolution, most notably the $105.7 billion in revenue reductions and $34.7 billion in mandatory savings called for in reconciliation. Congress has already adopted tax and spending legislation that used more than $15 billion of the paygo balance. These bills, including the energy bill, highway bill and legislation implementing the Central American Free Trade Agreement would reduce revenues by roughly $9 billion and increase mandatory spending by $6 billion. Consequently, there is only $60 billion currently available on the paygo scorecard for any tax or mandatory spending legislation considered by the Senate, including revenue reconciliation.

The full $70 billion cost of a revenue reconciliation bill provided for in the budget resolution as well as the other tax cuts assumed in the budget resolution would be allowed under the paygo rule if the savings from the spending reconciliation bill were added to the paygo scorecard. Although press reports have indicated that the Chairman of the Budget Committee would file an amended paygo scorecard upon adoption of a spending reconciliation conference report, the Senate rule states that savings from a reconciliation bill should not be counted for purposes of calculating the paygo scorecard.

The decision about whether or not to credit savings from the spending reconciliation bill to the paygo scorecard will determine if the bill will actually live up to its title of "Deficit Reduction Act." If the Chairman of the Budget Committee files an update to the paygo scorecard to incorporate the savings in the spending reconciliation bill and Senate parliamentarian agrees that the Budget Committee Chair has the authority to do so, those savings would not go to deficit reduction but would simply increase the size of the tax cuts or mandatory spending increases the Senate could consider under the existing pay-as-you-go rule. Not only would that allow the Senate to pass a tax cut reconciliation bill with a net cost of $70 billion, but it would allow the Senate to pass additional tax cuts (or entitlement spending increases) of up to $30 billion outside of reconciliation without violating the paygo rule. However, if the paygo scorecard is not adjusted, then the Senate could not consider a tax bill that would reduce revenues (and thereby increase the deficit) by more than $60 billion and could not consider any additional tax cuts or entitlement spending increases outside of reconciliation. The Committee recommends that the Senate not credit the paygo scorecard with the savings from spending reconciliation.

Update on Budgetary Impact of Hurricane Katrina

There was initially widespread speculation that responding to Hurricane Katrina would cost the federal government $200 billion or more; it now appears that the direct impact on the federal budget will be considerably lower. The total cost of the disaster supplemental appropriations, tax relief for taxpayers in the affected region, and other Katrina-related bills enacted to date is $101.5 billion (Table 1).

Several weeks after Congress approved two emergency supplemental appropriations bills totaling $62 billion, the President submitted an additional $17.3 billion funding request for Katrina-related relief and recovery efforts, but proposed that this request be funded by reallocating funds appropriated in the previous disaster supplementals. Congress approved most of the requested funding but increased spending above the amounts requested by the President for several accounts, bringing the total cost of the package to $29 billion. The increased funding added by Congress was offset by re-allocating a greater portion of previously appropriated funds, reducing some of the funding requested by the President, and an across-the-board cut in discretionary spending.

Spending from the FEMA Disaster Relief Fund has been slower than expected and the money remaining in the fund is expected to last through May of next year. The administration has indicated that it will be making another supplemental request early next year. FEMA has estimated that total flood insurance claims resulting from Hurricanes Katrina, Rita, and Wilma will exceed $23 billion, which may require additional borrowing authority for the National Flood Insurance Program beyond the $18.5 billion increase allowed under current law.

The budget resolution conference report set out criteria for emergency requirement based on the emergency definition developed by the Office of Management and Budget. Under these criteria, in order to be considered an emergency requirement the need must be: 1) necessary, essential or vital (not merely useful or beneficial); 2) sudden, quickly coming into being, and not developing over time; 3) an urgent, pressing and compelling need requiring immediate action; 4) unforeseen, unpredictable and unanticipated; and 5) not permanent, temporary in nature.

While initial Katrina-related expenditures clearly fit these criteria, it is much harder to justify the long-term costs of rebuilding the Gulf Coast as meeting them. The Committee believes that the additional funding for reconstruction and rebuilding should be included in the President's budget and considered as part of the regular budget and appropriations process instead of being passed as emergency spending exempt from budget discipline. It is also worth noting that these criteria clearly no longer apply to spending for military operations in Iraq and Afghanistan, which the Committee also believes should be considered as part of the regular budget process.

Table 1: Costs of Katrina-Related Legislation Approved to Date

	FY 2005	FY 2006	Total Cost
H.R. 3645 First Supplemental	$1.15 billion	$7.8 billion	$10.5 billion
H.R. 3673 Second Supplemental	$125 million	$21.8 billion	$51.8 billion
H.R. 3669 Flood Insurance Borrowing Authority		$2 billion	$2 billion
H.R. 3169 Pell Grant Relief Act		$2 million	$2 million
H.R. 3672 TANF Funding		$245 million	$289 million
H.R. 3768 Katrina Tax Relief		$3.3 billion	$6.1 billion
H.R. 3971 Hurricane Katrina Unemployment Relief			$394 million
H.R. 4133 Flood Insurance Further Enhanced Borrowing Authority		$14 billion	$15 billion
Katrina-Related Medicaid Provisions in Reconciliation Bill		$2.1 billion	$2.1 billion
Tax Benefits for the Gulf Opportunity Zone		$4.0 billion	$7.7 billion
Net New Spending in Third Supplemental (Not Including Offsets)		$2.8 billion	$5.6 billion
Total	**$1.3 billion**	**$58.0 billion**	**$101.5 billion**

Reconciliation Update

Congress is on the verge of completing action on a reconciliation bill reducing mandatory spending for the first time since the 1997 Balanced Budget Agreement. While some have argued that Congress should not have been considering reductions in entitlement programs at this time, the Committee strongly encouraged Congress to go forward with spending reconciliation legislation. The entitlement savings included in the spending reconciliation bills are but a mere drop in the bucket compared to the savings that will be necessary to address the nation's long term fiscal problems. The Committee does not take a position on the merits of the specific provisions in the reconciliation bill, but believes that those who object to individual provisions in the spending reconciliation should put forth alternative proposals for deficit reduction.

The Senate's reconciliation bill slightly exceeded the budget resolution's savings target but through a different mix in programmatic changes than the budget resolution assumed. Most notably, the Senate Finance Committee included several provisions reducing funding for Medicare payments to insurance companies approved in the prescription drug bill in order to reduce the amount of savings in Medicaid. The legislation reported by the Senate Agriculture Committee did not include the food stamp savings assumed in the budget resolution, achieving additional savings in farm programs instead. In addition, the Senate reconciliation bill contained numerous spending increases that were offset by greater spending cuts, including changes in the formula for physician payments under Medicare, extension of the Milk Income Loss Compensation program for dairy farmers, and student loan programs.

Although the House did not pass an amended budget resolution, the increased savings levels that were discussed as part of an amended budget resolution served as informal targets that Committees for the most part achieved. The most significant area of additional savings came from the House Ways and Means Committee, which reported legislation achieving $8 billion in savings, $7 billion more than the budget resolution required. Other areas of additional savings came from student loans and PBGC fees, agriculture and nutrition programs and Medicaid. The House bill contained some modest increases in spending, but far less than the Senate bill. The total savings in the package were reduced by nearly $4 billion before House passage as a result of dropping provisions regarding oil drilling and modifying reduction in food stamps and Medicaid.

Table 2: Senate Reconciliation Action by Committee

	Budget Resolution Instruction	**Spending Cuts**	**Spending Increases**	**Net Savings**
Agriculture	$3.0 billion	$4 .0billion	$998 million	$3.0 billion
Banking	$470 million	$570 million	None	$570 million
Commerce	$4.8 billion	$10 billion	$4.7 billion	$5.3billion
Energy	$2.4 billion	$2.5 billion	None	$2.5 billion
Environment and Public Works	$27 million	$30 million	None	$30 million
Finance	$10 billion	$28.5 billion	$19.2 billion	$9.3 billion
Health, Education, Labor and Pensions	$13.7 billion	$27.6 billion	$13 billion	$13.9 billion
Judiciary	$300 million	$578 million	$183 million	$395 million
Total	**$34.7 billion**	**$74.3 billion**	**$38.3 billion**	**$39.1 billion**

Table3: House Action on Reconciliation

	Budget Resolution Instruction	**Unofficial Revised Target**	**Savings in House Passed Legislation**
Agriculture	$3 billion	$4.3 billion	$3.5 billion
Education and the Workforce	$12.7 billion	$18.1 billion	$20.4 billion
Energy and Commerce	$14.7 billion	$16.4 billion	$16.6 billion
Financial Services	$470 million	$470 million	$470 million
Judiciary	$300 million	$300 million	$428 million
Resources	$2.4 billion	$3 billion	$286 million
Transportation and Infrastructure	$103 million	$150 million	$156 million
Ways and Means	$1 billion	$8 billion	$8.0 billion
Total	**$34.7 billion**	**$50.7 billion**	**$49.9 billion**

House and Senate conferees were ultimately able to agree on a package estimated to achieve $39.7 billion in savings. Although the total savings were closer to the Senate-passed bill, the fact that the final agreement contained $5 billion more in savings than called for in the budget resolution represented a significant accomplishment for House members who called for greater spending cuts.

The conference agreement moved toward the Senate bill somewhat in limiting the reductions in programs affecting low-income individuals by dropping food stamp savings, reducing the savings in child support and foster care programs and reducing the impact of the Medicaid changes on beneficiaries to approximately half as much as in the House bill. Conferees retained the savings from the House-bill in the SSI program as well as a scaled back version of the House-passed reauthorization of TANF welfare programs. The conference agreement contained repeal of the Byrd amendment, which sends proceeds from trade dumping subsidies to affected companies, but phased in repeal beginning in 2007, which reduced the savings to $300 million (compared to $3.2 billion in the House bill). The conference did not contain the provision from the Senate bill repealing the Medicare stabilization fund created in the prescription drug bill to encourage insurance companies to offer private Medicare Advantage plans, but adopted the Bush administration's proposal regarding risk adjustment for Medicare Advantage plans. The savings in the conference agreement from increasing PBGC premiums paid by businesses was lower than in either the House or Senate-passed bills. The conference agreement also accelerated the implementation of the Medicare Part B means tested premium that was included in the prescription drug bill. Although both the House and Senate narrowly approved the spending reconciliation conference report, final action was delayed when three relatively minor provisions of the conference agreement were stricken from the conference report in the Senate as a result of the Byrd rule. The House will need to vote to approve the conference report with these changes when it returns to session.

Table 4: Comparison of House and Senate Bills and Conference Agreement

	House	Senate	Conference Agreement
Medicaid savings	$14.4 billion	$10.4 billion	$11.0 billion
Medicaid spending	$2.5 billion	$6.1 billion	$6.3 billion
Net Medicaid Savings	$11.9 billion	$4.3 billion	$4.76 billion
Medicare savings	0	$18.1 billion	$15.1
Medicare spending	0	$13.1 billion	$8.7 billion
Net Medicare Savings	0	$5 billion	$6.4 billion
Spectrum auctions	$10 billion	$10 billion	$10 billion
Spending for converter boxes and other Spectrum relates spending	$1.5 billion	$4 billion	$2.6 billion
Net Spectrum Savings	$8.5 billion	$6 billion	$7.4 billion
PBGC fees	$6.2 billion	$6.6 billion	$3.6 billion
Student loan savings	$18.7 billion	$20.9 billion	$24.7 billion
Student loan spending	$4.2 billion	$11.2 billion	$12 billion
Net Student Loan Savings	$14.5 billion	$9.7 billion	$12.7 billion
Farm commodity programs	$1 billion	$2.7 billion	$1.7 billion
Agriculture conservations programs	$760 million	$1.1 billion	$934 million
Other agricultural programs	$1 billion	$227 million	$589 million
Milk Income Loss Compensation	0	$998 million	$998 million
Net Agriculture Savings	$2.8 billion	$3 billion	
Food Stamps	$647 million	0	0
ANWR	$2.5 billion	$2.5 billion	0
SSI	$732 million	0	$732 million
Child Support Enforcement	$4.9 billion	0	$1.5 billion
Foster Care Payments	$577 million	0	$343 million
Spending for TANF Reauthorization (Including Child Care)	$1.4 billion	0	$1.3 billion
LIHEAP Spending	$1 billion	0	$1 billion
Repeal Continued Dumping and Subsidy Offset (Byrd Act)	$3.2 billion	0	$300 million
Other Mandatory Savings	$270 million	$300 million	$270 million
Other User Fees	$784 million	$888 million	$959 million

Tax Cuts

The budget resolution also allows for tax cuts of $105.7 billion, including $70 billion under fast-track reconciliation procedures. The budget resolution conference report studiously avoided specifying what tax cuts were assumed in total beyond saying it could accommodate extension of expiring provisions of the tax cuts enacted in 2001 and 2003. Congress has already approved $7 billion in tax cuts (primarily the tax incentives in the energy bill), leaving $98.7 billion available for tax cuts under the budget resolution. Since reconciliation facilitates the ability of the Senate to pass tax cuts, tax writers are inclined to include provisions that will be harder to pass into reconciliation and leave popular provisions that are likely to receive enough votes to avoid a filibuster out of reconciliation. The decision about what tax cuts to include in reconciliation will largely depend on the judgment about what tax cuts could be enacted as part of the $28.7 billion remaining in the allocation for tax cuts outside of reconciliation.

The primary tax cuts under discussion as part of a tax reconciliation bill involve extensions of previously enacted provisions that are scheduled to expire over the next few years. These include the temporary "patch" preventing the Alternative Minimum Tax from affecting a substantial number of middle and upper middle class taxpayers, extension of the Research and Experimentation tax credit and other traditional "extenders", deduction of state sales taxes, and deduction for qualified educational expenses, which expire at the end of 2005, as well as extension of the "SAVR" tax credit, which expires at the end of 2006, increased expensing amounts for small businesses, which expires at the end of 2007, and the lower rate structure for capital gains and dividends, which expires at the end of 2008.

The Senate-passed revenue reconciliation legislation contains one year extensions of the AMT fix; Research and Experimentation Tax Credit; SAVR tax credit; small business expensing; as well as tax incentives for Gulf Coast reconstruction. This package also contains nearly $19 billion in offsets to reduce the total cost of the package to $57.8 billion. In order to get the package out of Committee, Chairman Grassley dropped the extension of the lower rate structure for capital gains and dividends.

The House passed a $56 billion tax reconciliation bill that extends the lower capital gains and dividends tax rates for two years (the most possible under reconciliation) along with extensions of other expiring tax cuts. Unlike the Senate, the House tax reconciliation bill did not include an extension of the AMT fix or tax incentives for hurricane relief. In addition, the House reconciliation bill did not include any of the revenue offsets that were in the Senate bill or any of the tax incentives for charitable contributions. However, the House passed a separate bill providing a one year extension of the AMT fix, with a cost of $31.2 billion. The House also passed a separate tax bill providing tax incentives for reconstruction of the Gulf Coast, with a cost of $7.1 billion.

This could potentially set up a House-Senate conference in which the total amount of tax cuts in play approaches $100 billion or more, creating an incentive for gimmicks and mischief to reach agreement on a conference agreement that fits within the $70 billion limit. The most obvious avenue for budgetary evasion would be to leave the AMT fix out of reconciliation and move it as a freestanding bill with the expectation that it would receive 60 votes to waive the budget act and allow tax cuts in excess of the budget resolution limits. The danger that the Senate will consider an AMT fix outside of reconciliation and possibly in excess of the budget resolution limits on tax cuts was underlined when Senate Republicans objected to a request by Finance Committee Ranking Member Max Baucus that the costs of the AMT fix be counted toward the $70 billion allocated to tax cut reconciliation and be included on the paygo scorecard. This position clearly preserves the Senate leadership's option to bring up a separate AMT fix bill after the Senate has already used up the tax cut allocation in the budget resolution with the expectation that the popularity of the AMT fix will be enough to obtain the votes necessary to waive the budget act. The Committee believes that if the Senate passes a freestanding AMT fix that the costs be included on the paygo scorecard and subtracted from the amount of room available for tax cuts under reconciliation.

Although the budget process limits the amount of tax cuts within the budget window to the levels set forth in the budget resolution, there are no limits on the costs of tax cut or spending legislation beyond the budget window. As a result, the most expensive parts of the President's budgetary agenda, extension of the income tax rate reductions, marriage penalty relief, child tax credit and other provisions expiring in 2010 will effectively be exempted from any budgetary restraints. The Committee has repeatedly encouraged Congress not to proceed with any tax cuts without including offsets so that they do not increase the deficit and has recommended that Congress evaluate all expiring tax cuts as part of a comprehensive review of tax and fiscal policy, instead of continuing to extend tax cuts financed by borrowing on an *ad hoc* basis.

Appropriations Update

Congress completed action the eleven appropriations bills before Christmas without resorting to an omnibus appropriations bill, although the defense appropriations bill had many of the qualities of an omnibus, attracting many unrelated items.

The primary budgetary issue looming over the appropriations process was the call for an across-the-board cut in discretionary spending, including spending in appropriations bills already enacted. Speaker of the House Dennis Hastert and Budget Committee Chairman Jim Nussle proposed an across-the-board cut of two percent in all discretionary spending. While proposals for across-the-board cuts in recent years have generally exempted defense and homeland security spending, Hastert and Nussle suggested that the reduction apply to all discretionary spending.

This proposal ran into considerable opposition over the size of the reduction as well as pressure to exempt spending for defense, veterans, homeland security, and education. (The opposition to applying the reduction to defense spending in particular was the primary reason that the House did not follow through with plans to take up an amendment to the budget resolution which included an across-the-board reduction.) Despite this opposition, the final defense appropriations conference report contained a 1% across the board cut in all discretionary programs except for veterans' health care, achieving savings of $8.5 billion. These savings were used to offset the costs of the additional funding for disaster assistance above the President's request as well as funding for avian flu preparedness.

The other major budgetary issue in the appropriations endgame was the fate of various proposals to provide emergency funding above the budget resolution spending limits. The Military Quality of Life appropriations bill contained $1.2 billion in contingent emergency funding to cover a shortfall in Veterans Affairs health care. Congress approved $3.7 billion emergency funding to prepare for a possible avian flu pandemic, $3.4 billion below President Bush's request for $7.1 billion in funding. Unlike the veterans' health care spending, the spending for avian flu preparedness was offset by the across-the-board cut. Senator Judd Gregg, who is chairman of the Appropriations Subcommittee on Homeland Security in addition to chairing the Budget Committee, proposed $1.1 billion in emergency spending for border control. This funding was initially included in the defense appropriations conference report, offset by proceeds from ANWR and spectrum auction, but was dropped from the conference report when the Senate rejected the ANWR provision.

Finally, there is the annual issue of the amount of timing shifts and other accounting gimmicks that will be used to make appropriations bills fit within the spending limits on paper. The House was able to pass all eleven appropriations bills and stay within the spending limits contained in the budget resolution with relatively few gimmicks, but many of the bills were passed with the expectation that funding would be increased in the Senate. Several of the appropriations bills approved by the Senate rely on timing shifts and other gimmicks to paper over increased spending. The Labor-HHS appropriations bill approved by the Senate contained nearly $3.7 billion in savings on paper by delaying SSI payments into the following fiscal year and other accounting maneuvers. Conferees rejected this maneuver, creating a funding squeeze which made it much more difficult for Congress to approve the Labor-HHS appropriations bill with the House initially voting to reject the conference report. The difficulty Congress had in clearing the Labor-HHS appropriations bill without the additional spending allowed by the timing shifts will create pressure to use these gimmicks next year.

The passage of the eleven regular appropriations bills does not mean that the appropriations process for fiscal year 2006 is over. The administration is expected to submit supplemental appropriations requests for Iraq and further disaster assistance. These supplementals could be used as a vehicle to restore some of the spending cuts contained in the regular appropriations bills. The most significant area for budget observers to watch is whether the Iraq supplemental is used to replenish defense accounts that were reduced through the across-the-board cut.

Conclusion

The increased interest in offsetting Katrina's costs and concern about the budget deficits by members of both parties has been heartening. Unfortunately, for all the pain and drama associated with passage of the spending reconciliation bill, the cumulative effect of legislation passed by Congress in 2005 was to increase the deficit considerably above current law. The spending cuts in reconciliation fell well short of offsetting the costs of the tax cuts that were moving on a parallel track, let alone the costs of Katrina. (Tables 5 and 6.)

In order to be meaningful, the concern about the deficit must go beyond just the goal of offsetting costs for Katrina to addressing the larger looming budget challenges. A serious effort to restore fiscal discipline will require both parties to make sacrifices and a realistic plan will require limits on defense and non-defense discretionary spending, structural reforms in entitlement programs, increased revenues and tough budget enforcement rules. Enacting modest savings in mandatory spending this year while holding off on additional tax cuts would be a good first step, but much harder work will be necessary.

Table 5: Impact of House Actions on the Deficit (Billions)

	2006	2007	2008	2009	2010	Five year
CBO August Baseline	**265**	**241**	**234**	**209**	**196**	**1,145**
Disaster relief and other non-defense emergency spending (net of offsets)	**57.4**	**21.1**	**8.9**	**4**	**1.4**	**92.7**
Defense	6.8	10.8	17.4	27.2	33.1	95.3
Non-defense discretionary	2.6	(12.1)	(23.9)	(32.3)	(40.7)	(106.3)
Iraq "Bridge Fund"	28.7	15.5	4.6	0.7	0.2	49.6
Subtotal, Discretionary	**38.1**	**14.2**	**(1.9)**	**(4.4)**	**(7.4)**	**38.6**
Spending cut reconciliation	(5.4)	3.8	(5.3)	(21)	(11.8)	(39.7)
Tax cut reconciliation	5.8	11.2	11.2	21.4	6.5	56.1
Net Impact of Reconciliation	**0.4**	**15**	**5.9**	**0.4**	**(5.3)**	**16.4**
Additional tax cuts	12.6	18.7	0	0	0	31.3
Debt service	2	6	9.5	10	11	38.5
Resulting Deficit	**376**	**316**	**255**	**219**	**196**	**1,363**

Table 6: Impact of Senate Actions on the Deficit (Billions)

	2006	2007	2008	2009	2010	Five year
CBO August Baseline	**265**	**241**	**234**	**209**	**196**	**1,145**
Disaster relief and other non-defense emergency spending (net of offsets)	**57.4**	**21.1**	**8.9**	**4**	**1.4**	**92.7**
Defense	6.8	10.8	17.4	27.2	33.1	95.3
Non-defense discretionary	2.6	(12.1)	(23.9)	(32.3)	(40.7)	(106.3)
Iraq "Bridge Fund"	28.7	15.5	4.6	0.7	0.2	49.6
Subtotal, Discretionary	**38.1**	**14.2**	**(1.9)**	**(4.4)**	**(7.4)**	**38.6**
Spending cut reconciliation	(5.4)	3.8	(5.3)	(21)	(11.8)	(39.7)
Tax cut reconciliation	11	36.7	5.6	6.7	1.9	61.8
Net Impact of Reconciliation	**5.5**	**40.4**	**0.3**	**(14.3)**	**(9.9)**	**22.1**
Debt service	2	6	9	10	9	36
Resulting Deficit	**368**	**323**	**250**	**204**	**189**	**1,334**