COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET

To: Members of the Board and Interested Parties
From: Maya MacGuineas, President, the Committee for a Responsible and
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Re: Budget Update

The President's budget projects a gradually reduced deficit over the next five years, from the $412 billion deficit in fiscal year 2004 (3.6% of GDP) to $207 billion in 2010 (1.3% of GDP). This decline mirrors the decline in the deficit projected under current law as the near-term budget outlook improves modestly. In fact, the President's policies would actually increase the deficit over the five-year window. Furthermore, the budget relies on unrealistic assumptions and gimmicks to limit the size of the proposed deficit.

Table 1 shows the impact of the President's policies on the deficit. Two items jump out from the chart. First, after declining gradually from 2005 through 2010, the deficit starts growing again in 2011. Second, the costs of the tax cuts jump from $125 billion in the first five years to more than $1.4 trillion from 2011 through 2016 in order to accommodate permanent extension of the 2001 and 2003 tax cuts.

The President's budget calls for permanent extension of the rate reductions, marriage penalty relief, child tax credit, estate tax repeal, and the capital gains and dividend tax cut enacted in 2001 and 2003. These extensions would cost $1.228 trillion over ten years. The capital gains and dividend tax cut is the only one of these provisions that would expire within the next five years (2008). The budget also proposes extension of other expiring tax cuts, including the research and experimentation tax credit and welfare to work tax

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credit. The President once again proposed tax-free savings accounts, Retirement Savings Accounts (RSAs), and Lifetime Savings Accounts (LSAs), which have a modest positive impact on the budget over the next five years but large costs after 2010 (more on that later). The budget includes a variety of other tax cuts including health care tax credits, tax preferences for charitable giving and affordable housing construction, and several pension changes.

Table 1

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2006-2010	2006-2015
Tax Cuts*	0	3	13	23	43	43	184	289	300	315	329	125	1543
Mandatory Savings **	-3	-3	-12	-13	-11	-12	-12	-12	-11	-9	-9	-51	-103
Defense Discretionary	31	34	22	20	28	34	37	38	39	40	42	139	336
Non-defense Discretionary	1	-2	-17	-30	-39	-46	-51	-54	-56	-58	-60	-134	-412
Debt service	0	2	4	5	6	8	13	25	41	57	76	25	237
Total Change in Deficit	30	34	10	4	28	28	173	287	313	346	378	104	1601
Proposed deficit	394	332	278	250	246	229	268	230	244	247	256	1336	2581
* Includes costs of refundable tax credits													
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Mandatory spending

In a notable and positive departure from recent practice, where entitlement programs have not received much scrutiny in the budget process, the President proposed significant savings in mandatory spending programs. CBO estimated that the net impact of the President's mandatory spending policies (excluding outlay effects of tax credits) would result in savings of $65 billion over five years and $106 billion over ten years.

The most significant mandatory spending policy in the President's budget is proposed changes to achieve savings in Medicaid and the State Children's Health Insurance Program (SCHIP) as well as some proposals to increase federal funding. The budget also includes proposals to increase funding for Medicaid and SCHIP. CBO estimates that the net impact of the President's proposals for Medicaid and SCHIP would result in savings of $7.6 billion over five years and $27 billion over ten years, considerably less than the savings of $12 billion over five years and $45 billion over 10 years estimated by the Administration. This is in part due to the fact that CBO was not able to estimate the costs of several of the Administration's Medicaid proposals because the Administration did not provide sufficient details about those proposals.

Other major mandatory savings in the President's budget include farm programs ($7 billion over five years and $16 billion over ten years) and increased fees for the Pension Benefit Guarantee Corporation and veterans benefits ($2.5 billion over five years and $4.3 billion over ten years). CBO estimated that the President's proposed changes in student loans would achieve savings of $3 billion over five years but would increase spending by $4 billion over ten years.

Discretionary spending

The President's budget relies on large, unspecified saving in discretionary spending after FY2006 to achieve deficit reduction targets. Although the specific reductions in discretionary spending programs for FY 2006 have received the most attention, the President's budget assumes much more substantial, unspecified savings in non-defense discretionary spending in the following four years. CBO estimates that total non-defense discretionary outlays (including homeland security) would decline from $474 billion in 2006 to $465 billion in 2010, but the President's budget does not provide any details on how those savings would be achieved. The domestic spending cuts in the President's budget do not reduce the deficit, but simply offset most (but not all) of the costs for the President's priorities of increased defense spending and new tax cuts.

What is missing

Costs of operations in Afghanistan and Iraq after 2005 The budget incorporates the costs of the supplemental appropriations for operations in Afghanistan and Iraq that the Administration has said it will submit for 2005. This is a welcome improvement from previous budgets, which failed to include any costs for continuing military operations. However, the budget does not include a request for continuing funding in 2006 through the regular appropriations process. Furthermore, the budget does not include any costs for overseas military operations and reconstruction efforts after 2005.

Alternative Minimum Tax The budget fails to include any costs for extending the temporary patch in the Alternative Minimum Tax (AMT) enacted in 2003 and extended for one year in 2004. According to CBO, extending the AMT relief enacted in 2003 would add $218 billion to the deficit over the next five years -- $56 billion in 2009 alone. A full fix of the AMT -- to prevent the alternative tax from negating promised tax cuts and becoming the de-facto tax calculation for the upper-middle class -- would cost substantially more than that. The task of finding a fix for the AMT will be left to the President's Tax Reform Commission, complicating the already difficult task facing that commission.

Social Security President Bush has made Social Security reform the centerpiece of his domestic agenda this year, but did not include any costs for Social Security reform or even parameters for what he would consider acceptable short-term costs. The Administration has released the outlines of a proposal for individual accounts that allow workers to divert 4% of the 12.4 payroll tax into individual accounts beginning in 2009. The Administration has estimated that this would increase the deficit by $750 billion over five years and the costs have been estimated to be as much as $4.5 trillion over twenty years. To his credit, the President has put Social Security reform on the agenda and recently, has emphasized that individual accounts will not solve the problems facing Social Security and that tough choices to reduce benefits or increase revenues will be necessary. He has gone so far as to discuss the types of tough choices he would consider in a variety of forums, including the State of the Union (in sharp contrast to the usual practice of listing all the goodies the President is proposing), but has not put forward any specific changes to achieve savings. Even if benefit reductions and revenue increases are added to the President's proposed individual accounts, it is unlikely that these changes will have much impact on the costs over the next ten years since most of the savings would take years to materialize, particularly on the benefit side since workers over 55 are exempted from any benefit changes.

Budget enforcement in the President's budget

Although process alone will never be able to solve the nation's fiscal problems, budget mechanisms can bring greater accountability to the budget process and help provide Members of Congress with the political cover to make the tough choices that will be necessary to reduce the deficit. The President's budget includes several budget process reforms that would impose a measure of fiscal discipline on the budget process. However, the discipline would only apply to the spending side of the budget, exempting changes on the revenue side, both undermining the effectiveness of the budget mechanisms and making them more difficult to sell politically.

The President's budget calls for reinstating budget enforcement mechanisms of discretionary spending limits and PAYGO rules. Unfortunately, the President continues to propose that tax legislation be exempt from these rules**.** The only commonsense way to restore fiscal discipline is to apply budget rules to all legislation that would increase the deficit.

The President's budget calls for discretionary spending limits for the next five years at the levels proposed in the budget, which assume a freeze in non-defense, non-homeland security discretionary spending. Previous experience has demonstrated that discretionary spending limits can be a useful tool for fiscal discipline if they are set at reasonable levels but can actually work against fiscal discipline if they are set at unrealistic levels.

The discretionary spending limits enacted in 1990 and extended in 1993 were quite successful in restraining discretionary spending. By contrast, the much more restrictive spending caps enacted as part of the 1997 budget agreement proved to be unrealistic and were effectively ignored, leaving no credible restraint on discretionary spending in place.

The President's budget also contains a seemingly arcane proposal to include extension of the expiring tax cuts in the baseline, which could have significant implications for budget enforcement. If the extension of the expiring tax cuts were included in the baseline, legislation making those tax cuts permanent would not be scored as increasing the deficit and therefore would not be subject to pay-as-you-go or other budget enforcement rules. The sunset provisions were added to the tax cuts enacted in 2001 and 2003 in order to make the total costs of the tax cut fit within the budget limits demanded by moderate Republicans in the Senate. Changing the budget rules to allow these tax cuts to be permanently extended without being subjected to budget limits would effectively undo those compromises.

The President's budget contains several other budget process reform proposals that the Committee has long supported, including points of order against legislation that would increase the unfunded obligations of entitlement programs, making the budget resolution a joint resolution signed by the President, a stricter definition of emergency spending, and granting the President line-item veto authority.

Many of these proposals were included in the President's budget last year. Several of these proposals were debated and voted on when the House of Representatives considered budget process legislation last June, but none of them received a majority. The Senate did not take action on separate budget process legislation.

House Budget Committee Action

The Committee Mark put forward by Chairman Nussle generally followed the outlines of the President's budget with minor changes. The budget calls for a deficit of $376 billion in 2006 declining to $203 billion in 2010. It would allow for tax cuts of $105.7 billion and calls for mandatory savings of $67 billion. The budget provides for two reconciliation bills, one cutting taxes to be considered in June and a second to reduce mandatory spending programs to be considered in September.

Tax cuts

The budget provides for total tax cuts of $105.7 billion over five years. According to materials provided by the Committee, the tax cut number in the budget is intended to accommodate all expiring tax provisions of the 2001 and 2003 tax cuts ($42 billion), which included tax cuts on capital gains and dividends, section 179, and estate tax repeal. It also accommodates certain expiring provisions such as individual AMT relief and the research and experimentation credit. It could also accommodate extension of the capital gains and dividend tax cut.

The budget contains reconciliation instructions for tax cuts of $45 billion of those tax cuts. The Chairman's mark does not specify which tax cuts would be included in the tax cut reconciliation bill. There is speculation that the reconciliation protections would be used to move more controversial tax cuts, such as extension of the capital gains and dividend tax cuts, with more popular tax cuts such as the AMT fix and permanent extension of middle-class tax cuts moving separately.

Mandatory spending reductions

The budget contains a reduction in mandatory spending programs of $7.6 billion in 2006 and $67.0 billion over five years. These are net numbers, representing unspecified increases and decreases. The total amount of mandatory spending cuts in the Chairman's mark is similar to the mandatory savings proposed in the President's budget, once the President's major mandatory spending initiatives are removed, which CBO estimated to be approximately $65 billion. The mandatory savings are placed in Function 920 (Allowances) instead of being distributed among the budget functions, which makes it difficult to determine which programs the Committee envisions being reduced under the reconciliation instructions.

The reconciliation instructions in the Chairman's mark provide some indication of where the mandatory spending savings will be achieved. Table 2 on the following page reflects the reconciliation instructions in the Chairman's mark by committee:

Table 2
(All numbers in $billions)

	2006	2006-2010
Committee on Agriculture	-797	-5,278
Committee on Education and the Workforce	-2,097	-21,410
Committee on Energy and Commerce	-630	-20,002
Committee on Financial Services	-30	-270
Committee on the Judiciary	-123	-603
Committee on Resources	-96	-1,413
Committee on Transportation and Infrastructure	-12	-103
Committee on Veterans Affairs	-155	-798
Committee on Ways and Means	-3,907	-18,680
Total	-7,847	-68,557

The Agriculture Committee could achieve the required savings from changes in farm programs and food stamps. The savings from programs within the Education and Workforce Committee jurisdiction could come from student loan programs or the President's proposed changes to the Pension Benefit Guarantee Corporation.

The bulk of the savings within the Energy and Commerce Committee would come from Medicaid since Chairman Nussle stated that Medicare would not be changed. If the Energy and Commerce Committee adopted the President's proposals regarding spectrum and Power Marketing Administration it would need to achieve savings of approximately $15 billion from Medicaid, roughly twice the $7.4 billion in savings CBO estimated the President's policies would achieve.

The $798 billion in savings that the Veterans Affairs Committee was instructed to achieve is substantially lower than the $4.3 billion in savings contained in the President's budget from charging fees to higher income veterans with non-service connected disabilities and increasing prescription drug co-payments.

It is unclear how the Ways and Means Committee would achieve savings of $18.7 billion since the Chairman stated that Medicare will not be affected and Social Security is off-budget. Other major programs within the jurisdiction of the Ways and Means Committee include the EITC, Trade Adjustment Assistance, Unemployment Compensation, the TANF (welfare) and child care block grants, and Supplemental Security Income.

Discretionary spending

The budget generally follows the President's overall funding levels for domestic discretionary program. Total discretionary spending for 2006 would be $843 billion – a 2.1% increase over 2005. After 2006 the budget calls for modest increases for homeland security programs and essentially freezing all other domestic discretionary programs through 2010. This would result in savings of $216 billion below the CBO baseline over five years. Put another way, domestic discretionary spending over the next five years would be $216 billion lower than necessary to keep pace with inflation.

The Chairman's mark provides essentially the President's level of defense funding for 2006 through 2010, including the costs of the $81.9 billion Iraq supplemental the President requested. It also contains $50 billion for ongoing military operations for 2006 which was not included in the President's budget, but does not include any costs for military operations after 2006.

Turning reconciliation upside down and backwards

The budget resolution includes reconciliation instructions to the Ways and Means Committee to report legislation cutting taxes by $45 billion, thereby granting reconciliation protections to legislation cutting taxes (and increasing the deficit) by $45 billion. Reconciliation protects legislation from a filibuster in the Senate, and ensures that such legislation would need 51 instead of 60 votes to pass. The reconciliation process was intended to make it easier to pass legislation making tough choices to cut spending or raise taxes to reduce the deficit.

When the budget went into surplus, Congress began to use reconciliation protections to make it easier to cut taxes and make projected budgets worse. Reconciliation is intended to help Congress take actions that are responsible but politically difficult, not politically popular actions that are fiscally irresponsible. This was a bad precedent to set in a period of surpluses, and is even worse now that the budget is back into deficit.

Making matters worse, the reconciliation instructions call for the tax cut reconciliation to be reported by June 24th, but do not require the Committees to report legislation achieving the mandatory savings until September 16th. If the mandatory savings are not going to produce any deficit reduction, but will simply offset the costs of tax cuts, Congress should at a minimum be expected to eat its spinach by passing the spending cuts before getting to the dessert of tax cuts. That approach was taken in implementing the 1997 Balanced Budget Agreement, the previous time that Congress considered both a spending cut and tax cut reconciliation bill. The timing of the reconciliation bills increases the likelihood that the tax cuts called for in the resolution are enacted into law while the mandatory savings are not achieved.

Budget Committee Mark up

The budget committee mark-up followed the normal script for budget resolutions, with Democrats offering a variety of amendments to restore spending to priority functions offset by increased revenues and the amendments being defeated along party lines. There was one brief shining moment where the debate departed from the script and an amendment making some modest but positive improvements in the budget process briefly had enough bipartisan support to pass. The amendment, offered by Blue Dog leader Jim Cooper, would have repealed the Gephardt rule which allows the House to avoid a separate vote on increasing the debt limit, require a roll call vote on all legislation with costs in excess of $50 million, require CBO scoring of conference reports and require all bills to have a budget act compliance statement prepared by the Budget committee before coming to the floor for a vote. Several of these items were in the budget process package put forward by the conservative Republican Study Committee, and four members of the RSC initially voted in favor of the amendment before one member changed his vote to defeat the amendment on an 18-18 tie. Nonetheless, this brief and unexpected outbreak of bipartisanship in the Budget Committee markup provides some hope for the prospects of at least modest improvements in the budget process.

Senate Budget Committee Action

The Committee Mark put forward by Chairman Gregg also followed the outlines of the President's budget, but scaled back some of the spending reductions in response to pressure from Senators. The budget calls for a deficit of $362 billion in 2006 declining to $208 billion in 2010. It would allow for tax cuts of $71 billion and calls for mandatory savings of $38 billion. The budget provides for two reconciliation bills, one cutting taxes to be considered in June and a second to reduce mandatory spending programs to be considered in September.

Tax cuts

The budget provides for total tax cuts of $71 billion over five years. According to materials provided by the Committee, the tax cut number in the budget is intended to accommodate extension of major expiring tax provisions such as the capital gains and dividend tax cut and small business expensing.

The budget contains reconciliation instructions for tax cuts of $70 billion of those tax cuts. The Chairman's mark does not specify which tax cuts would be included in the tax cut reconciliation bill. Unlike the House, the Senate is likely to include all tax cut extensions in the reconciliation tax bill. Any other tax legislation considered by the Senate outside of reconciliation would have to be virtually revenue neutral, with just a $1 billion cushion of remaining room for tax cuts.

Mandatory spending reductions

The budget contains a reduction in mandatory spending programs of $38 billion over five years. The total amount of mandatory spending cuts in the budget is considerably lower than the $65 billion in savings contained in the President's budget. The budget calls for lower savings than the President's budget in agriculture, student loans, and PBGC fees, among other areas, and does not include any savings in veterans programs. The Committee indicated that the resolution assumes increases in mandatory spending for an energy bill, higher education reauthorization and welfare reauthorization within the net savings of $38 billion. The budget contains reconciliation instructions to achieve savings of $4.3 billion in 2006 and $32 billion over five years.

The reconciliation instructions in the Chairman's mark provide some indication of where the mandatory spending savings will be achieved. Table 3 reflects the reconciliation instructions in the Chairman's mark by committee:

Table 3
(All numbers in $billions)

	2006-2010
Agriculture Committee	-2.8
Banking Committee	-0.3
Commerce Committee	-2.6
Energy Committee	-2.7
Environment and Public Works Committee	-0.1
Finance Committee	-15
HELP Committee	-103
Total (numbers do not add up because of rounding)	-32

The Agriculture Committee could achieve the required savings from changes in farm programs, food stamps, and child nutrition programs. The savings from the Health Education, Labor and Pensions (HELP) Committee would come from student loans and increased PBGC fees, which the Committee assumes will be smaller than the President's budget. Virtually all of the savings within the Finance Committee's jurisdiction would come from Medicaid.

Discretionary spending

The budget generally follows the President's overall funding levels for domestic discretionary program, but allows for slightly higher spending over the five years. Total discretionary spending for 2006 would be $843.4 billion. After 2006 the budget calls for modest increases for homeland security programs and essentially freezing all other domestic discretionary programs through 2010. This would result in savings of $207 billion below the CBO baseline over five years. Put another way, domestic discretionary spending over the next five years would be $207 billion lower than necessary to keep pace with inflation.

The budget fully funds the President's level of defense funding for 2006 through 2010, including the costs of the $81.9 billion Iraq supplemental the President requested. It also contains a reserve fund of $50 billion for ongoing military operations for 2006 which was not included in the President's budget. It does not include any costs for military operations after 2006.

Budget enforcement

The budget includes several budget enforcement provisions which would apply to the set. It establishes discretionary spending limits at the levels contained in the resolution for 2006 through 2008. The budget ostensibly reinstates PAYGO rules in the Senate for taxes as well as spending, but provides that all tax cuts assumed in the budget resolution would be exempt. Both the discretionary spending limits and PAYGO exemption would apply to subsequent budget resolutions. The budget would also establish a new 60 vote point of order against legislation that would increase mandatory spending by $5 billion or more in any of the four 10-year periods from 2015 through 2055. This point of order would not apply to tax cuts that would substantially increase the deficit in future years

Budget window

The President's budget as well as the House and Senate budget resolutions use a five-year budget window. The five year budget window fails to display the costs of making the tax cuts permanent as well as the increased costs of the Medicare prescription drug benefit that will again cause rising deficits just as the baby boomers begin to join the entitlement rolls in large numbers after 2010. The Congressional Budget Office re-estimate of the President's budget shows the deficit beginning to creep upward just after the five-year budget window. The deficit would bottom out at $229 billion in 2010 before jumping to $268 billion in 2011 and remaining above $230 billion through 2015.

In addition, the five-year budget window omits the effects of some of the proposals in the President's budget. For example, the proposed Retirement Savings Accounts and Lifetime Savings Accounts would shift substantial amounts of revenue from future decades into the next five years, allowing the proposal to raise nearly $17 billion in revenue in the five-year budget window, but then digging a deeper hole in future budgets. According to the Joint Committee on Taxation, the RSA proposal in the President's budget would increase revenues by $14.5 billion over the five-year budget window, but will cost more than $17 billion from 2011-2015. This revenue loss would continue to grow substantially after 2015.

House and Senate consideration of the budget

The primary drama surrounding the House consideration of the budget resolution is the demands by conservative Republicans for a provision that would require a separate vote to waive the budget act. Reportedly more than twenty Republicans have threatened to vote against the rule to consider the budget resolution if this provision is not adopted.

Their initial proposal called for a 3/5 vote for budget act waivers, but has been revised to waivers to be approved by a simple majority. This would still be a substantial improvement over the current practice in which the rule for consideration of legislation routinely waives all points of order, increasingly without even indicating which points of order are being waived. Requiring a separate vote to waive the budget act would put some teeth in the budget act and would establish a measure of accountability by requiring members to acknowledge budget act violations and go on record waiving the rules.

The House leadership opposes this proposal because it would provide a list of "budget busting" votes that could be used against members. In addition, any budget process rules by definition limit the flexibility of the leadership to bring legislation to the floor. The leadership is working with the conservatives to try to find an accommodation. A similar deadlock last year led to the consideration of budget process reform legislation in June.

There will be a Democratic alternative offered by Budget Committee Ranking Member John Spratt. The Democratic alternative is expected to restore the mandatory spending reductions in the President's budget, fully fund the President's defense request, and set funding for non-defense discretionary spending at roughly the CBO baseline levels. On taxes, the budget is expected to provide no room for net tax cuts and require all tax cuts including extension of expiring tax provisions to be offset. The Democratic budget will be able to show a balanced budget in 2012 by assuming that all of the tax cuts will expire after 2010.

The Senate debate will be highlighted by votes on amendments to reinstate PAYGO for all legislation which would increase the deficit, strike the reconciliation protections for tax cuts and amendments to eliminate or reduce the mandatory spending reductions. All of these amendments have a chance of receiving a majority.

The Senate passed an amendment reinstating PAYGO last year, leading to a deadlock in conference. Despite the change in the Senate composition since last year, there still is a reasonable chance that a PAYGO amendment would pass again this year. Senator George Voinovich has stated his support for "classic PAYGO" after voting against the PAYGO amendment last year.

Another key vote for fiscal discipline and integrity of the budget process will come on an amendment to strike the reconciliation instructions for the tax cuts. The amendment would not change the overall revenue numbers in the resolution, thereby still leaving room for tax cuts, but would require those tax cuts to be considered under the regular legislative process instead of moving through the reconciliation process.

The Senate is also likely to consider a series of amendments striking or reducing the various reconciliation instructions for reductions in mandatory spending programs. There is also likely to be an amendment striking all of the reconciliation instructions for mandatory spending. A similar amendment passed the Senate in 2003 when the budget reported by the Budget Committee contained instructions for mandatory savings.

Conclusion

The emphasis on reducing the deficit is a welcome change from the "deficits don't matter" rhetoric of recent years. The fact that deficits will be declining over the next five years is an improvement from the rising deficits over the last five years, though the goal of reducing the deficit by half falls far short of what is needed. The Committee has always maintained that budget balance over the business cycle should be the goal. Given the upcoming retirement of the Baby Boom, that should be the minimum for which the country strives.

That said, the proposals that have been put forward fail to set out a credible plan to reduce the deficit. The budget proposed by the President and the budget resolutions reported by the House and Senate Budget Committees would actually increase the deficits above current law. For their part, Congressional Democrats reject all of the spending reductions proposed by the President and rely on the unrealistic assumption that all the tax cuts, including the middle-class tax cuts that Democrats have supported, will be allowed to expire after 2010.

In order for a deficit reduction plan to be credible and politically sustainable, all parts of the budget – taxes, entitlements, defense, and domestic programs, must be on the table and the burden of deficit reduction should be distributed fairly. It does not appear that goal will be achieved this year.