Center on Budget and Policy Priorities
820 First Street, NE, #510
Washington, DC 20002
http://www.cbpp.org

The Concord Coalition
1011 Arlington Blvd, # 300
Arlington, VA 22209
http://www.concordcoalition.org

CED
2000 L St., NW # 700
Washington, DC 20036
http://www.ced.org

The Committee for a Responsible Federal Budget
1630 Connecticut Ave, NW, 7th floor
Washington, DC 20009
http://www.crfb.org

Centrists.Org
236 Massachusetts Ave, NE, Suite 205
Washington DC, 20002
http://www.centrists.org

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Contact: Henry Griggs, 202-408-1080, griggs@cbpp.org
Morgan Broman, 202-296-5860, morgan.broman@ced.org
Tristan Cohen, 703-894-6222, communications@concordcoalition.org
Jerry Irvine, 202-986-2700, irvine@newamerica.net
Ed Lorenzen, 202-546-4090, edlorenzen@centrists.org

JOINT STATEMENT ON THE NEED FOR PAY-AS-YOU-GO DISCIPLINE

The five organizations joining in this statement have warned that large, chronic budget deficits pose a threat to the economic health of our nation. For that reason, we are increasingly alarmed at the apparent willingness of lawmakers to propose new initiatives, without offsets, that would increase deficits in both the short and long term. At a time when fiscal policies should be focused on reducing deficits in recognition of the enormous strains that the retirement of the baby-boom generation will soon place on federal resources, failure to offset new initiatives on a pay-as-you-go basis would send a dangerous signal that fiscal discipline in Washington has all but disappeared. At the very least, lawmakers need to stop digging the hole deeper.

Our organizations have maintained consistently that the President and the Congress should reestablish the pay-as-you-go rule — applying to all tax cuts and all mandatory spending increases — to require lawmakers to consider the tradeoffs inherent in the enactment of costly new legislation. In light of great fiscal challenges facing the nation in the long term, this pay-as-you-go principle should take into account the impact of legislation on revenues and spending in years beyond the current budget window. While adherence to such a rule would not itself improve the fiscal outlook under current policies, the establishment of a rule making it harder to enact legislation further worsening the nation's fiscal problems would represent an important step forward in the struggle to restore fiscal responsibility. And even in the absence of a formal pay-as-you-go rule, policymakers need to discipline themselves not to pass costly legislation without offsetting the full costs.

The mindset in Washington today, unfortunately, seems to be the opposite. Various lawmakers from both parties are now considering or promoting new tax breaks that would substantially increase federal deficits and debt. In fact, these tax cuts would go far beyond violation of the principle of pay-as-you-go. They even would violate the budget resolution adopted by the Congress earlier this spring, which itself increases the deficit by $168 billion over the next five years. The total costs of these tax cuts would far exceed the $106 billion in tax cuts assumed in the budget resolution.

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Serious bipartisan efforts are now underway to: 1) repeal permanently the estate tax or to reach an estate tax "compromise" that would reduce revenues and increase deficits and debt nearly as much as full repeal; 2) repeal the individual alternative minimum tax (AMT); and 3) expand or establish tax breaks related to retirement. Proponents of these various tax cuts generally have *not* proposed to offset their costs and seem generally to believe offsets are not necessary. Enacting these tax cuts without offsets, however, could add $1 trillion to $2 trillion in deficits and debt over the next 10 years, and add much larger amounts to deficits and debt in future decades when the full effect of these revenue reductions would be felt.

Such efforts, in the face of already unsustainable deficits, illustrate the unrealistic and growing gap between what Americans are being promised in federal programs and what they are being asked to pay for those programs. Such efforts also demonstrate why it is more important than ever to reestablish — in law and in spirit — the principle that any tax cut or spending increase should not increase the deficit.

Some of the proposed new initiatives seek to address legitimate policy concerns, and some changes in tax policy may warrant consideration. But in this environment of already excessive red ink, *no* tax cuts or entitlement increases — whether new measures or extensions or expansions of existing measures, including the entire package of tax cuts enacted in 2001 and 2003 and the Medicare prescription drug benefit — should be enacted without offsets ensuring that they do not increase short- or long-term deficits and debt. We are particularly concerned about legislation that appears to have little cost over the next five to 10 years but would substantially increase deficits outside of the budget window. And we are concerned that lawmakers may focus on the seemingly modest cost of individual proposals without fully appreciating the substantial cumulative impact of all proposals together. It is not responsible to continue to promote legislation that is supposed to improve the lot of the American people without considering the corrosive effects that the cumulative deficits and debt added by such legislation would have on current and future citizens.

Background

The Congressional Budget Office projects deficits totaling $1.2 trillion over the next five years under current policies. If the tax cuts enacted in 2001 and 2003 are allowed to expire in 2010, as scheduled under current law, modest surpluses would be achieved starting in 2012. But, according to CBO, if the President's policies (including extension of the tax cuts) are enacted, there would be deficits in every year through 2015 (with a deficit of $256 billion in that year), and deficits would total $2.6 trillion in 2006 through 2015. Even those figures are too optimistic, because they assume no new funding for Iraq and Afghanistan in any future year.

In the longer run, the deficit situation will become considerably worse as larger numbers of baby boomers retire and per-person health care costs continue to grow rapidly. CBO warned in 2003 that over the long term "current fiscal policy [is] unsustainable." The Government Accountability Office has issued similar warnings.

The Congressional budget resolution adopted in April would increase the deficit, relative to CBO's current policy projections, by $168 billion over five years, not an auspicious start. In addition, influential lawmakers now seem willing to promote large new initiatives that are not fully reflected in the budget resolution, are not offset, and would increase deficits and debt further. Some of these proposals would have a particularly deleterious effect on the long-term budget outlook.

For instance, a number of lawmakers are promoting permanent repeal of the estate tax (under current law, the tax is repealed in 2010, but reinstated in 2011, using the 2001 parameters) or changes in the tax that would cost nearly as much as repeal. According to the Joint Committee on Taxation (JCT), making repeal permanent would cost $290 billion in 2006 through 2015, and $72 billion in 2015 alone. This 10-year estimate understates the long-term cost of making repeal permanent, however, since that policy would not begin to take effect until 2011. The revenue loss in the first 10 years in which the full effect of repeal would be felt — 2012 through 2021 — would be far higher, about $745 billion. When the associated $225 billion in higher interest payments on the debt are taken into account, the total cost in the first 10 years of making the estate tax permanent would be nearly $1 trillion.

Furthermore, seven members of the Finance Committee (and one Senator not on the Finance Committee), including the Senate Majority Leader and the Chairman and Ranking Democrat on the Finance Committee, have introduced legislation that would repeal the individual alternative minimum tax (AMT). According to CBO, repealing the AMT would reduce revenues by $611 billion over 10 years, assuming that the 2001 and 2003 tax cuts are allowed to expire in 2010. If those tax cuts are extended, the revenue loss from repealing the AMT rises to $954 billion over 10 years. Including the associated interest costs, the total increase in deficits and debt would be $1.2 trillion.

The House Ways and Means Committee is expected to consider new retirement-related tax cuts as part of Social Security legislation. It is not yet clear what tax cuts may be included. The goal of increasing saving for retirement is certainly laudable, but many proposed tax cuts in this area are structured so that they would cost little in the short run but have large long-term costs. For instance, an Administration proposal to establish "Retirement Savings Accounts" would cost little over the next 10 years but eventually could cost as much as $90 billion a decade. Any tax cuts included in Social Security legislation should be offset both over ten years and over the longer term.

Finally, some lawmakers appear to be interested in expanding the Medicare prescription drug plan, enacted in 2003. There are many ways to structure changes, but all would be costly, and any expansion should be offset so as not to increase the deficit further either in the short or long run.

None of these measures are fully reflected in the President's budget or the Congressional budget resolution. We would note that the President did not propose any change in the AMT in his budget; instead, he asked his Advisory Panel on Federal Tax Reform to include AMT reform in the proposals it will report later this summer. He stated that the panel's proposals must be revenue neutral (after taking into account the cost of making the 2001 and 2003 tax cuts permanent). The President — to his credit — thus is on record in support of fully offsetting the costs of AMT reform through changes elsewhere in the tax code.

The President's budget did propose to make estate tax repeal permanent and to establish Retirement Savings Accounts. But since little of the cost of those proposals would occur before 2011 and his budget extends only through 2010, the full cost of those proposals is not reflected in his budget.

The Congressional budget resolution did not comply with the pay-as-you-go principle. Yet even that resolution could not accommodate all of the tax cuts described here. The resolution assumes total tax cuts will not exceed $106 billion over five years. Repeal of the AMT itself would reduce revenues by $337 billion in 2006 through 2010. (Estate tax repeal and Retirement Savings Accounts could be accommodated in the budget resolution but only because they have little cost in 2006 through 2010; their big costs come after that.)

There are many national needs that could potentially be addressed through tax cuts or entitlement increases. Lawmakers can disagree about whether the specific tax cuts discussed here would help meet those needs. But lawmakers should agree that there is an overriding imperative to bring unsustainable deficits under control. On our current path, we are in danger of ever-expanding deficits and declining growth in our national output and living standards

As a first, critical step toward meeting this imperative, policymakers should agree not to take any actions that make the deficit outlook worse. They should immediately reestablish and abide by the principle that — no matter how worthy the goal of the proposed policy — any tax cut or entitlement increase (including the extension of expiring tax cuts or expansion of existing entitlement benefits) must be offset in order to avoid digging the fiscal hole any deeper.

To be clear, budget process alone cannot reverse these trends. No matter how tightly budget laws are drawn, they will not work without the political will to make hard choices. However, budget rules such as pay-as-you-go establish hurdles that make it more difficult to enact fiscally irresponsible policies. Restoring the pay-as-you-go principle would, at a minimum, force Congress to weigh the short-term political attractions of new proposals against the long-term fiscal consequences. Given where deficits now stand and the known fiscal challenges that lie ahead, it is policymakers' responsibility to do this. They owe future generations no less.