Committee for a Responsible Federal Budget

We Need Offsets, Not Omissions
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The House of Representatives has just passed two pieces of legislation that could significantly increase the nation's federal debt. The American Jobs and Closing Tax Loopholes Act, as originally considered, was projected to cost $188 billion and add $134 billion to the deficit. The new, scaled back and split up version approved by the House will cost $113 billion and add $54 billion to the deficit. This is on top of an emergency supplemental war spending bill passed by the Senate yesterday at a cost of $60 billion—none of which is paid for.

In both cases, Congress has shown a fiscally dangerous failure to offset their costs. Emergency designations and PAYGO loopholes aside, given the daunting mountain of debt the country faces, we must offset the costs for these bills. Abiding by this principle is the least we can do in stopping a dangerous fiscal situation from getting worse.

Fig 1. Costs of Extenders and Emergency Supplemental (2010-2020)

American Jobs and Closing Tax Loopholes Act	Original Bill	House-Passed Bill
Extend Unemployment Benefits	$47 billion	$40 billion
Extend Medicaid Payments to States	$24 billion	n/a
Extend COBRA Health Subsidies	$8 billion	n/a
Doc Fix	$63 billion	$23 billion
Build America/Other Infrastructure Bonds	$8 billion	$8 billion
One Year Tax Extenders Package	$32 billion	$32 billion
Other Spending	$8 billion	$10 billion
Gross Cost of Bill	**$190 billion**	**$113 billion**
Tax Carried Interest as Regular Income	-$19 billion	-$18 billion
Barrel Oil Spill Liability Tax	-$11 billion	-$11 billion
Other Offsets	-$26 billion	-$28 billion
Net Cost of Bill	**$134 billion**	**$54 billion**
War Supplemental Bill	**Senate**	**House**
Operations in Iraq and Afghanistan	**$34 billion**	**$33 billion**
Other Disaster Aid	**$5 billion**	**n/a**
Department of Veterans Affairs	**$13 billion**	**$13 billion**
Other Spending	**$9 billion**	**$38 billion**
Total	**$60 billion**	**$84 billion**

Rather than finding offsets, though, the House has instead scaled back the legislation – leaving other provisions for another day. This is not an acceptable alternative, if the plan is to deficit-finance omitted provisions in the future. The substantial, bipartisan resistance to the original version of the legislation should signal to policymakers the need to offset the costs of such proposals. Deeming a provision as "emergency" spending in order to circumvent PAYGO or labeling a bill as a "jobs" measure will do nothing to ease the fears of voters and the markets over our mounting debt.

The Extenders Bill

The extenders bill, which contains a number of safety net provisions and temporary tax extensions, was scaled back from its original version due to concerns about deficit spending. It was also split into two pieces of legislation – one dealing mainly with tax extenders and unemployment benefits, and the other providing a 19-month extension of the doc fix. The original bill had also included funding for extending COBRA health subsidies (originally $8 billion) and Medicaid payments to states (originally $24 billion), though these were dropped from the House version.

The House bills would cost $113 billion over the next decade or so, and include only $60 billion of offsets. These offsets would come from counting 75 percent of carried interest earnings as ordinary income for tax purposes (thus taxing them at a higher rate), increasing the tax on oil used for the oil spill liability fund (which is illegitimately being counted both as an offset for this bill and a way to pay for oil spills – it cannot do both), as well as other revenue changes.

Technically, the amount not being offset does not need to be paid for under statutory PAYGO. Some provisions in the bill, such as the extension of unemployment benefits ($40 billion), are designated as emergency spending and thus exempt from PAYGO rules. The "doc fix," ($23 billion) meanwhile, is considered to be a "current policy adjustment."

While the "emergency" provisions may be important, they are hardly emergencies in the sense that they are not a surprise to anyone. Policymakers have known for a long time that unemployment benefits (and COBRA benefits, in the original version) would need to be extended – programs like these have undergone several rounds of temporary extensions already. Politicians have had plenty of time to think through potential offsets.

There is an argument that in order to effectively stimulate the economy, provisions such as these should not be accompanied by immediate tax increases or spending cuts. This case can be made on economic grounds by those who believe the economy needs more stimulus, or political grounds, by those who are unwilling to make the hard choices that should go with additional spending and tax cuts.

But there is no reason the costs should not be offset over the longer run, say over five years or so. In fact, demonstrating to the markets that we will pay back our borrowing once the economy recovers would quite likely have the effect of strengthening, rather than weakening, the stimulative effects of the bill.

The House also passed a patch to the doc fix—however one that has been significantly scaled down. In the past two weeks, the five year $88.5 billion doc fix was pared back to a three year plan at a cost of $65 billion and finally to a 19-month fix costing $23 billion.

Though this has been significantly scaled back, that does not excuse failing to pay for it. It was a mistake to avoid permanent reform of the flawed physician payments formula when the country undertook comprehensive health care reform, and we should not exacerbate that error by deficit-financing continued fixes—which we will need to do again less than two years from now. In the past, we have paid for many of the temporary fixes. Absent a permanent fix, we should update physician payments on a temporary and fully-offset basis.

That this bill adds so much to the deficit is unacceptable. We appreciate any and all efforts to reduce the level of borrowing. But simply shortening the length which these policies are extended will not do the trick, if the goal is to extend them again. Temporary policies should be that—temporary—and emergency measures should not be used as a back door effort to make them permanent. If the real intention is to extend these policies for a longer time, though; the focus should be on offsetting the costs. Otherwise Congress will have to return once again to deal with the same slated expirations in the future.

The Supplemental Spending Bill

The supplemental war spending bill passed by the Senate includes $33.5 billion for ongoing operations in Iraq and Afghanistan as well as some unrelated items, such as $13 billion for the Department of Veterans Affairs. While the Senate has passed their version of the supplemental, lawmakers in the House postponed their markup of an $84 billion version of the bill that included unrelated items such as $23 billion to prevent teacher layoffs. The spending in this bill is discretionary, and therefore not subject to PAYGO. And because it is considered an emergency supplemental, it is also not bound by the same rules as spending included in last year's budget resolution.

We should not allow spending in the supplemental to add to the debt. Moreover, in supplemental bills Congress should only include spending on policies which are truly necessary, unanticipated, and cannot wait until the next appropriations process.

On the left, some, such as Reps. David Obey (D-WI) and Barney Frank (D-MA) have supported paying for the costs of the wars in Iraq and Afghanistan through a "war tax". This is one option. On the right, Senators Tom Coburn (R-OK) and John McCain (R-AZ) proposed paying for war costs through spending cuts. Some of their ideas included cutting the budgets of members of Congress ($100 million), disposing of unneeded and unused government property ($15 billion), collecting unpaid taxes from federal employees ($3 billion), and eliminating bonuses for poor-performing government contractors ($8 billion over ten years). Either strategy would be acceptable, and Congress should consider both choices (and others) seriously.

Principles: Getting Specific on Pay-fors

Literally thousands of potential offsets exist for both the extenders bill and the war supplemental. Which ones are chosen is a political matter – but the debate must be over *how*, not *if*. Congress should be praised for paying for the one-year tax extenders in the bill with revenue offsets. That same approach must be applied to the rest of the provisions, however. Here are a few ideas they might explore:

- **Offset the doc fix by strengthening the IPAB Commission.**

The "doc fix" would patch scheduled cuts to Medicare physician payments. This patch has gotten costlier with each passing year. One option to ensure these fixes don't add to the debt is to charge the newly-formed Independent Payment Advisory Board (the "Medicare Commission") with identifying and enacted the necessary level of offsets. To ensure such cuts are achievable, IPAB's authority could be expanded to include control over Disproportionate Share Hospital (DSH) payments, Medicare cost sharing rules, spending in Medicaid and the new health exchange subsidies, and perhaps over current tax subsidies for health care.

- **Offset war spending by reforming weapon systems or reducing Pentagon spending.**

Congress is planning to spend some $34 billion on ongoing operations in Iraq and Afghanistan, even as the rest of the Pentagon's budget has seemed to grow unchecked. Secretary of Defense Robert Gates has pledged to spearhead an effort to scrub $10 billion from Pentagon overhead costs, which would be a start. Looking at reforming weapons system – for example replacing the Joint Strike Fighter Program with F-16s and F/A-18s – could generate additional savings.

- **Offset Medicaid and COBRA benefits by advancing the start date of the health insurance excise tax.**

In the original version of the extenders bill, extending Medicaid payments to states and COBRA health subsidies had a $32 billion price tag. Although these provisions were dropped from the House version of the bill, it does not mean they will not appear again in the future. If they do, we believe they could be offset by moving up the start date of the health insurance excise tax, which is scheduled to begin in 2018 under the recently-passed health reform bill. Using this tax to claw-back a small part of the current tax-subsidy on high-cost health insurance plans could generate more than enough money pay for the extension of these safety net programs. We estimate advancing the start date to 2014 would raise at least $100 billion. Alternatively or additionally, Congress could also include a plan whereby states would have to repay their extra Medicaid funds over time.

- **Offset unemployment benefits with a two-year freeze on federal pay increases.**

Lawmakers are currently extending unemployment benefits because unemployment rates remain extremely high from the recession. But even as wages have fallen in most of the economy, federal workers have continued to see their salaries rise faster than inflation. A one-year wage freeze would save roughly $30 billion over ten years, suggesting that a two-year freeze would more than cover the cost of extending unemployment benefits in either the House or Senate version of the bill.

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The difficulty in attracting enough votes for the tax extenders measure underscores the growing unease among lawmakers of adding to the debt at a time when other countries are paying dearly for their lack of fiscal probity. They are right to be concerned. Voters increasingly understand that we need to stop digging our debt hole deeper. Perhaps this episode will serve as a wake-up call to congressional leaders. Hopefully when Congress returns to finish work on the tax extenders and supplemental, lawmakers will seriously explore paying for their full costs.

We understand that the economy is still fragile and the war still ongoing, making many of these costs necessary in lawmaker's eyes. However, part of fostering a strong economic recovery and attending to the highest national priorities is making the tough choices necessary to avoid running up dangerous levels of debt. If the debt grows too high, in the long run we will not have the economic strength necessary to create jobs, nor will we have the fiscal flexibility necessary to respond to future emergencies, either at home or abroad.