COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET

Memo to: Board and Members
From: Susan Tanaka and Carol Wait
Date: March 25, 1999

Subject: The Congressional Budget Resolution
"It were not best that we should all think alike; it is a difference of opinion that makes horse-races"*

The House and Senate are expected to vote this week on nearly identical versions of the Concurrent Resolution on the Budget for FY 2000.

The House and Senate will either bounce the budget back and forth until a single version passes both bodies or they will conference right after the Easter recess. In any event, Congress is expected to adopt the budget resolution before the statutory April 15 deadline.

Stripped of complicated accounting, this year's budget debate could be described as positioning for the "big horse race in the sky" coming up in November 2000.

Relative to the economy—even to total Federal receipts and outlays—the differences between the President and the likely congressional budget resolution are not large. We have seen much bigger rounding errors in 10-year budget projections. But the approaches define nearly classic differences between Republicans and Democrats.

The Republican congressional resolutions would spend less, tax less and reduce the debt more than the President's budget proposes. Many Republicans concede, however, that the commitment to keep discretionary spending consistent with the caps enacted as part of the 1997 Balanced Budget Act will be difficult, if not downright impossible.

The President's budget would earmark a greater share of economic output to pay for federal programs. Explicitly, it would earmark larger shares of future economic output and general revenues to pay for the big individual entitlements, Social Security and Medicare.

* Mark Twain, *Pudd'nhead Wilson,* 1894.

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The President's budget successfully took a major chunk of projected surpluses off the table by articulating the connection between reduction in publicly held debt and the feasibility of future Social Security and Medicare commitments. Republicans upped the ante by taking100% of projected Social Security surpluses off the table. That decision put a tight constraint on both tax cuts and non-Social Security spending in the House- and Senate-reported budgets. The House and Senate versions being virtually identical, those constraints will be reflected in the final version of the congressional budget resolution.

Comparing the President's Budget with the House and Senate Resolutions
FY 2000 Budget Proposals

	1999	**2000**				**2004**			
	CBO	CBO Est.		Cong. Resolution		CBO Est.		Cong. Resolution	
	Estimate	Baseline	Pres. Req.	Senate	House	Baseline	Pres. Req.	Senate	House
Discretionary									
Defense	274	286	284	276	276	316	314	314	314
Non-Defense	300	317	321	295	295	360	329	289	288
Unallocated		-32				-79	10		
Subtotal	574	572	605	571	571	598	654	604	603
Mandatory									
Social Security	387	404	422	404	404	487	510	487	487
Medicare	192	206	204	206	206	266	264	266	266
Medicaid	108	117		117	117	160		160	160
All Other	213	220	343	220	220	265	437	265	268
Subtotal	901	947	969	947	946	1,177	1,211	1,177	1,180
Net Interest	229	218	219	218	218	170	189	177	177
Total Outlays	1,704	1,736	1,793	1,736	1,735	1,945	2,053	1,957	1,959
Total Revenues	1,815	1,870	1,874	1,870	1,877	2,184	2,182	2,135	2,134
Surpluses	111	134	80	135	141	239	128	178	175
On-budget	-16	-5	-126	3	*	68	-146	7	*
Off-budget	127	138	206	138	141	171	274	171	175
Debt held by the public	3,628	3,525	3,565	3,510	3,502	2,796	3,188	2,926	2,919

* Less than $500 million.

House, Senate, and President's Budgets—Three Major Differences

- **Complexity and transparency:** The President's budget proposes complicated accounting and policy measures to earmark greater shares of future general revenues for Social Security and Medicare. None affect future benefit costs at all.[1]

  The congressional resolutions take a simpler approach. They fence off 100 percent of Social Security surpluses. That would reduce publicly held by larger amounts than the Administration's budget proposes. It would do more in real economic terms to make future Social Security and Medicare benefits affordable. The Senate version includes "reserve funds", but neither version of the congressional budget earmarks additional resources for those programs in the absence of Medicare reform.

- **Spending:** The President's budget would save less and spends more than Republican plans. Spending would be 4% higher over 5 years and 6% higher over the next decade. The biggest differences are in discretionary programs. (See charts on the next page.) The President wants nearly 9% ($26 billion) more for non-defense discretionary spending next year, and 18% (over $110 billion) more for total discretionary outlays in 2009. The congressional resolutions would keep discretionary spending within existing caps through FY 2002, and permit modest growth (under 3 percent per year) through 2004. Thereafter, both congressional budgets essentially freeze discretionary spending through 2009.

- **Taxes**: Excluding Universal Savings Accounts (USAs), the President's budget contains a net tax increase. Including USAs, the President's budget reduces net revenues $42 billion over ten years ($3 billion in the first five years). Republican plans would cut taxes (net of any revenue raisers) $770-780 billion in tax cuts over 10 years.

Similarities

- **No real Social Security or Medicare reforms.** The President and congressional leaders agree on the need for major reform, but neither the President's budget nor congressional proposals would cut benefits or raise taxes. These are essential steps to reconciling the level of future benefit promises with anticipated revenues. Each side wants the other to go first. Meanwhile, reform stalls and the clock ticks away.

  Congressional leaders argue correctly that using all Social Security surpluses to reduce publicly-held debt puts government in a stronger position to pay promised benefits to future retirees and to meet other high priority public service needs. Republicans want cover from the President, else they will not embrace such reforms for fear they will be accused of using Social Security and Medicare to pay for tax cuts.

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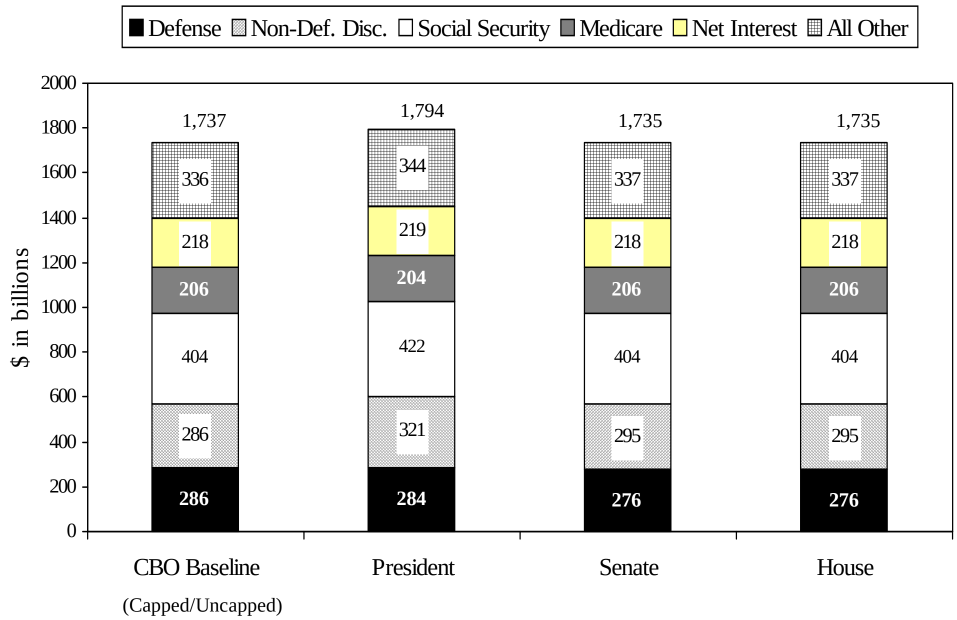
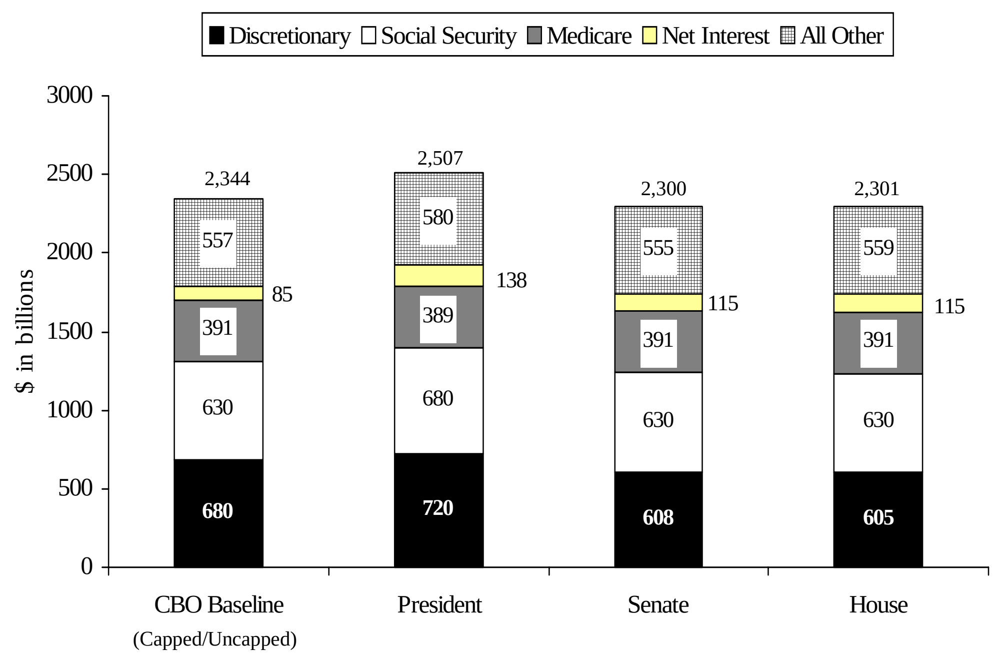
[1] Our explanation of these proposals is available from our office.

Projected Spending in FY 2000



Projected Spending in FY 2009

$ in billions



Similarities (continued)

Transfers to Social Security and Medicare (proposed in the President's budget) would extend trust fund solvency. But they do not provide any new resources or otherwise affect the economic burden these programs will pose in the future. Beneficial economic effects stem from debt reduction, which would happen if Congress and the President do nothing this year, not from the proposed transfers. Transfers would increase the amount of non-marketable U.S. Treasuries held by the trust funds, and explicitly shift the burden for retiring that additional debt to income taxes or other non-payroll tax revenues.

- **Offsets:** The House and Senate budgets make reference to many of the offsets proposed in the President's Budget, as examples of savings that could be used to keep spending within the totals (and the discretionary caps) in the resolution. Both versions of the budget resolution contain year-by-year, function-by-function spending totals, which illustrate savings the Budget Committees believe could offset significant increases for defense and education. But congressional budgets reject out of hand the two largest offsets contained in the President's budget—tobacco tax increases; and recoupment of part of the proceeds from the settlement between States and tobacco producers.

A Fourth Alternative: The Blue Dog Democrats' Budget

The Blue Dog Democrats plan would take 90 percent of unified budget surpluses off the table. That includes 100 percent of projected Social Security surpluses and half of on-budget surpluses.

- The Blue Dog budget would divide the remaining on-budget surpluses evenly between tax cuts and spending increases ($42 billion over 5 years for each).

- Relative to the House majority plan, the Blue Dog budget would increase spending for dense, agriculture (crop insurance and discretionary programs); education and training, discretionary health programs, and discretionary veterans programs.

The Bottom Line

Debt reduction equals fiscal responsibility. The congressional resolutions propose to run larger unified budget surpluses and buy down more publicly held debt than the President's budget. Given upcoming demographic changes and the lack of progress on substantive Social Security and Medicare reform, the most important measure of fiscal responsibility and prudence this year is who would buy back more debt held by the public and do the most to reduce total government liabilities.

Changes in Debt Held by the Public
($ billions)

	Baseline	President	Senate	House	Blue Dogs
Debt held by the public:					
1999	3,628	3,628	3,628	3,628	3,628
2004	2,756	3,188	2,926	2,919	2,791
2009	1,168	2,324	1,861	1,856	n/a
Reduction: 1999-2004	-872	-440	-702	-709	-837
Reduction: 1999-2009	-2,460	-1,304	-1,767	-1,772	n/a

Governments save by running surpluses and retiring publicly held debt. Debt reduction increases net national savings almost dollar for dollar. Increased saving is imperative for increased investment. Increased investment is critical to higher economic growth and continuing improvements in average living standards. The bigger the economic pie, the easier it will be to meet the needs of all groups in the population when the baby boom generation retires

Debt retirement reduces future interest costs. The Congressional Budget Office (CBO) March baseline projects a $2.4 trillion reduction in debt held by public from 1998 to 2009. Over the 1999-2009 period, federal interest costs would decline by 2.3 percent of GDP—from 2.9 percent of GDP to 0.6 percent. (Currently, 1 percent of GDP is about $90 billion.)

- Our Board's first choice policy would be to use <u>all</u> budget surpluses (Social Security plus projected on-budget surpluses beginning in 2001) to retire debt—the CBO baseline assumption.

- Neither the President nor Congress will adopt that policy. Thus interest costs in all versions of the budget exceed the baseline. Absent real reforms in Medicare, Medicaid and Social Security, eventually other functions of government will have to be cut deeply, taxes will have to go up substantially, or government will return to deficit financing much sooner than this year's budget debate suggests.

- Republican budgets would use 100 percent of Social Security surpluses to retire debt. By 2004, debt held by the public would 8 percent lower than under the President's budget and nearly 20 percent lower than the President proposes for 2009.

- But Republican plans would result in debt held by the public 6 percent higher than the baseline in 2004 and nearly 60 percent higher in 2009. The President's budget would reduce publicly-held debt $400 billion (16 percent) less than the baseline estimate for 2004. In 2009, debt held by the public under the President's plan would be 150 percent (nearly $1.2 trillion) higher than the baseline.

- The House Blue Dog Democrats' budget would reduce publicly-held debt more than any of the other plans. Debt held by the public in 2004 would be on 1 percent higher than the projected baseline level.

"Dangerous" spending increases and tax cuts

Despite large and growing surplus projections, current laws and policies will be unsustainable once the baby boom generation retires. In fact, the crunch may come before that time because projected surpluses may not materialize.

Even if they do, over the next decade, before the baby boom retires, CBO projects that Medicare, Medicaid and Social Security will combine to add 3 percent of GDP to government spending while revenues will grow with the economy. By 2009, those "big three" programs will subsume more than half of all government outlays.

- Congressional Republican's assert that the President's proposed new spending is unaffordable.

- The Administration charges the tax cuts in the congressional budget resolution are irresponsible.

We can make either argument. We cannot make a case that new/increased spending is more or less irresponsible than tax cuts or vice versa.

- The Administration, many Congressional Democrats, and a number of editorial page writers argue that years of deficit reduction left the country with many pressing needs. They defend the gimmickry endemic to the Social Security proposals in the President's Budget as necessary to head off irresponsible tax cuts.

- Republicans counter that they must get some of the projected surpluses out of Washington before the money gets spent, increasing the size of government and the bills future taxpayers will be forced to pay.

In fact, consumption oriented tax cuts *and* increased spending both would widen the gap between current law spending and revenues in future years. But today's political leaders clearly have limited tolerance for policies designed to meet future needs. Given large projected surpluses, this generation of politicians wants to do something for this generation of voters. In general, Republicans want to cut taxes and Democrats want to increase spending; but they are likely to compromise and do some of both. The greatest danger continues to be a compromise that embraces big spending *and* big tax cuts.

Medicare

The CBO actually concludes that President's budget would spend less for Medicare than the congressional resolutions—annually and over five and ten years. That is because the Administration proposes some changes to provider payments to offset some new initiatives—and does not show the cost of pharmaceutical benefits in the budget. Neither the House- nor the Senate-reported resolution assumes any Medicare reductions.

Administration officials criticize Republicans for failing to address Medicare. They make much of the fact that the President's budget would use some projected surpluses to extend the solvency of the Medicare Trust Fund. They do not emphasize that the President's budget uses Social Security surpluses for that purpose.

CBO, the General Accounting Office, and our Committee all have testified that the "transfers" the President's budget uses to extend the life of the Social Security and Medicare trust funds would have no economic impact. They increase the amount of non-marketable U. S. government securities held by the trust funds. The transfers make explicit the expectation that non-payroll tax receipts will be needed to fulfill current promises to future beneficiaries, i.e., the "transfers" have no connection to payroll tax receipts. None of this would make Social Security or Medicare more affordable for future taxpayers. The proposal would not increase the future stream of total revenues to government; nor would it reduce the flow of benefits payments.

A majority of the 16-member National Bipartisan Commission on the Future of Medicare endorsed a Medicare reform proposal developed by Commission Chairman, Senator John Breaux. The plan would convert Medicare from a fee-for-service indemnity plan into a program to subsidize health insurance premiums. Fee-for-service coverage would be one of the available options under the new program. Beneficiaries would use the subsidies to purchase insurance. All participating insurance plans would have to provide a standard core benefit package. Plans could offer additional benefits. Beneficiaries would pay any additional costs. Beneficiary contributions would reflect incomes.

The President criticized the Breax plan, but has yet to offer his own substantive alternatives. Congressional resolutions refer to the Breaux plan, but assumes no costs or savings associated with enactment of Medicare reform legislation. The resolution does include contingency funds for Medicare reform. But the President and Congressional Democrats point out that the contingency funds total far less than the President's proposed transfers to Medicare. Finally, Administration officials complain that the amounts set aside in the congressional budget for Medicare reform are fenced off—that money cannot be used simply to provide new benefits or extend trust fund solvency.

Social Security

Putting aside the USA accounts and government investment in private equities, there is no substantive difference between budgets with regard to Social Security benefits. Nor is there any difference with regard to receipts earmarked to meet benefit commitments. There remains a large gap between dedicated revenues and promised benefits for both Social Security and Medicare. None of the entries in this year's budget debate addresses that gap.

Of course, one cannot cavalierly put aside the President's two major Social Security proposals.

- Many Republicans like the idea of individual accounts; but almost all oppose the USA design, which is a new entitlement and an add-on, rather than a replacement for all or part of traditional Social Security. But Republicans are flirting with proposals that also would augment, rather than replace current Social Security benefits. Some of these proposals would guarantee minimum benefit levels equal to existing Social Security promises. That guarantee goes beyond the current law entitlement and nobody has specified how it would be funded.

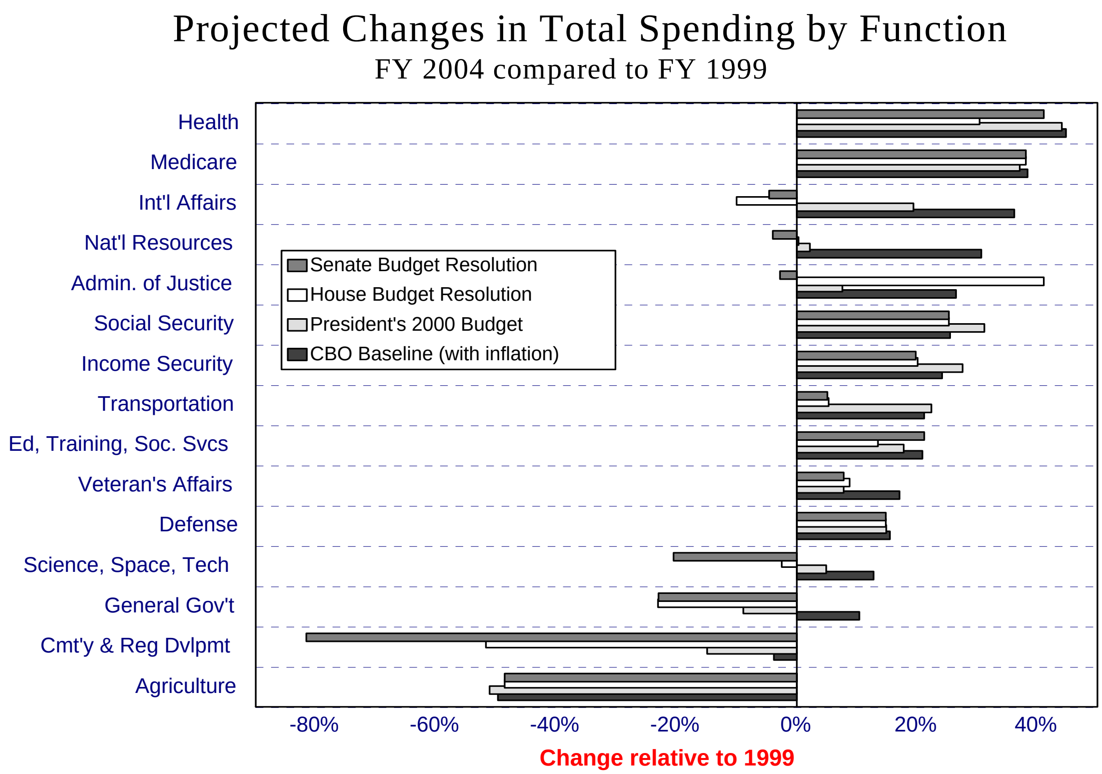
- Federal Reserve Chairman Alan Greenspan strengthened Republican opposition to investment of trust fund assets in the stock market with his adamant objections to the proposals. (Republican opposition to that idea probably did not require much buttressing.)

It would appear that Social Security reform is a dead issue for this Congress. The best anyone can hope is that Congress and the President really will agree to buy down substantial amounts of debt—and thus buy a little breathing space during this period of delay.

A Closer Look at Discretionary Spending

The chart on the next page illustrates function-by-function differences between the House, Senate, and President's budgets with respect to discretionary spending. The big reduction in Community and Regional Development is due to the huge so-called "emergency" bill enacted at the end of last year.

Current law includes no "firewalls" between defense and non-defense discretionary after next year. The congressional budget will propose to create one. Congressional Republicans candidly admit that the discretionary numbers are by far the toughest element in their budget resolution.



CBO amounts inflate discretionary spending from 1999 levels. they do not reflect $79 billion in reductions that would be required in 2004 to get to levels implied by discretionary caps, which limit spending through 2002. President's budget amounts reflect CBO's re-estimates.

Budget Process Reforms

The most significant process reforms in the congressional versions of the budget would make it much harder to pass so-called “emergency” legislation that exempts spending from the discretionary caps and paygo rules. The first would tighten fiscal discipline. The second would relax discipline by “clarifying” (that is, suspending explicitly) paygo rules when government has an on-budget surplus.

The Budget Committees are charged under the Congressional Budget Act with determining spending, revenue and deficit levels for purposes of budget enforcement. The Senate Budget Committee consistently has held that paygo rules do not apply when government has an on-budget surplus. The eventual congressional resolution would re-write the BEA, if necessary, to ensure that everyone interprets budget enforcement rules that way. Suspending paygo in times of surplus is likely to have the same impact as suspending paygo in times of deficits. Net national savings will decrease because the surplus probably will be used for consumption-oriented tax cuts or spending increases. These policies would already be included in budget resolution revenue and spending levels. The “clarification” would protect substantive legislation meeting those resolution targets from paygo requirements.