Memo to:	Board and Members
From:	Carol Wait and Susan Tanaka
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Subject: Budget Issue Update
The Balanced Budget Agreement of 1997
Graying of America Project
Upcoming Exercises

<u>The Balanced Budget Agreement of 1997</u>

The President and House and Senate Leaders are to be congratulated for reaching bipartisan agreement to balance the budget by 2002. The norm of budget balance served the country well for nearly 200 years. It is difficult to overstate the importance of restoring that norm to all debates about Federal Fiscal policy.

There has been a great deal of hyperbole around this budget agreement. Proponents make too much of it and opponents exaggerate its shortcomings.

Congresses and Presidents reached bipartisan balanced budget agreements in 1982, 1985, 1987 and 1990. None balanced the budget. The success of budget agreements rests on enforcement: what Congress and the President agree to enforce and how they agree to enforce it.

To balance the budget—given Budget Resolution revenue estimates and historical experience—the agreement must reduce outlays to 19 percent of GDP by 2002—lower than any year since 1974.

Important budget enforcement mechanisms were enacted in 1985, 1987, and 1990. They were extended in 1993. This agreement should build on that foundation.

Revenue Provisions in the Budget Resolution

Net tax cuts no greater than $85 billion over 5 years [$83.1 billion taking into account the assumptions of the President's Earned Income Tax Credit (EITC), Civil Service Retirement System (CSRS) and Federal Employees Retirement System (FERS) reforms]; and no more than $250 billion over ten years.

This level of tax cuts, "provide enough room for broad based capital gains tax reductions, significant estate tax reform, a $500 per child tax credit and expansion of IRAs."

Includes $35 billion specifically for tax cuts consistent with the objectives of the President's HOPE and tuition tax deduction proposals.

House and Senate Leaders commit to "seek to include other Proposals form the President's 1998 budget" [e.g., the welfare-to-work tax credit, capital gains relief for home sales, enterprise zone and enterprise community proposals, brownfields, foreign sales corporation (FSC) treatment of software, and tax incentives intended to spur economic growth in the District of Columbia].

Leaders also will seek to include various pending congressional tax proposals.

Tax cuts shall not explode in the out-years.

EITC or other programs primarily for lower-income individuals, nor Superfund taxes, "shall not be used to offset the costs of the tax cuts. [But nothing about Superfund taxes not being used to pay for spending for other purposes.]

Spending Highlights

New Defense budget authority can grow from $266 billion to $290 billion by 2002; but defense outlays remain essentially flat through 2000 and increase only $5 billion over the period. That pattern would support increased spending for procurement; but increases in O&M almost certainly would require reductions in end strength, else the outlay caps would be breached. There are separate caps for defense ([firewalls] in 1998 and 1999, enforced by 60 vote point of order in the Senate.

International Affairs spending is modestly above the freeze baseline each year, as are outlays for Environment and Natural Resources, Commerce and Housing Credit, Community and Regional Development, Health and Income Security are above a freeze in most years.

Transportation, Education and Training and Administration of Justice are the big winners.

- ⇒ Transportation is above a freeze and the President's Budget, but below the fully inflated current services baseline.
- ⇒ Education is above the freeze, above the fully inflated current services baseline, but lower than the President's request.
- ⇒ Justice is more than 5% above a freeze every year, but below the fully inflated current services base and below the President's request.

Medicaid and Medicare—Restraint on growth in these two programs comprises the lion's share of savings in mandatory savings in this agreement.

$13.6 billion Medicaid savings over five years compared to current laws and policies.

- ⇒ Net savings assume a higher match for the District of Columbia and inflation adjustments for Puerto Rico and other territories, and $1.5 billion to ease the impact of increasing premiums for Part-B, i.e., insurance to pay doctor bills, office charges, home health care, etc., on low-income beneficiaries.
- ⇒ The $13.6 billion savings does not reflect new children's coverage. Protections for legal immigrants under welfare reform, or extension of veterans' Medicaid income protections assumed in the agreement.
- ⇒ Savings primarily from reduced disproportionate share payments. Assumes more flexibility for States, including repeal of the Boren amendment, converting current managed care and home/community-based care waivers to State Plan Amendment, and eliminating unnecessary administration requirements.

Medicare savings total $115 billion over five years.

- ⇒ Supposed to extend the solvency of Part A Trust Fund for 10 years.
- ⇒ Give beneficiaries more choice, e.g., includes provider sponsored organizations and preferred provider organizations. These provisions are similar to the reforms sponsored by Senators Gregg, Wyden and others.
- ⇒ Maintain Part B premiums at 25% of program costs, and phase in over seven years premiums for home health.
- ⇒ Establish prospective payment system for home health, skilled nursing home facilities, and outpatient departments.
- ⇒ New benefits including, expanded mammography coverage, colorectal screenings, diabetes self-management, higher payments for preventive vaccinations. Increase spending $ billion over five years, and $20 billion over ten years, to limit copayments for outpatient services unless Congress and Administration agree on more cost-effective means to accomplish this goal.

Two Reconciliation Bills

- ⇒ Spending Reductions to be submitted to the Budget Committees by June 20, 1997.
- ⇒ Revenue Reductions to be submitted to the Budget Committees by June 27, 1997.
- ⇒ First [Spending Reconciliation] bill to include debt limit extension through 12/15/97.

Additional Budget Enforcement

This is not the first bipartisan agreement between a President and a Congress to balance the budget. We've been there and done that in 1982, 1985, 1987, and 1990. We learned from those experiences: enforcement is the key to actual outcomes; nominal dollar expenditure caps backed up by sequestration can ensure actual outcomes consistent with the promises such agreements make. To deliver on the promise of this agreement, Congress and the Administration must extend discretionary and enact entitlement caps backed up by sequestration.

Should spending exceed the levels included in this agreement, Congress and the President should be required to respond—either by passing a law to increase the caps, or by making adjustments to eligibility and benefits rules to keep spending within the limits in the law—or sequestration should be triggered to eliminate the overage.

Entitlement caps should be adjusted to reflect changes in economic conditions and numbers of beneficiaries. This will permit the automatic stabilizers in the budget work. Entitlement caps should not be adjusted to reflect so-called "technical changes", i.e., adjustments required because initial estimates of new policies were overly optimistic.

The Committee is working with a bipartisan group in the house toward incorporating House of Representative rules in a reconciliation bill this year.

We are meeting with the Centrist Coalition. We hope and expect they will agree to push this in the future.

Comparisons
CBO Base/President/Balanced Budget Agreement
Revenues, Outlays and Deficits
($ in millions—totals may not add due to rounding)

Revenues	1997	1998	1999	2000	2001	2002	% of GDP 2002	Five-Year Total
CBO Base	1555	1607	1672	1742	1816	1893	19.1	8730
President*		1598	1669	1741	1814	1895	19.2	8717
Pres w/trigger**		1598	1669	1739	1817	1918	19.4	8741
BBA***		1602	1664	1728	1805	1890	19.1	8689
Outlays								
CBO Base	1622	1685	1776	1869	1937	2036	20.6	9303
President*		1699	1766	1831	1864	1919	19.4	9079
Pres w/trigger**		1699	1766	1831	1850	1873	18.9	9019
BBA***		1692	1754	1811	1859	1889	19.1	9005
Deficits								
CBO Base	-67	-78	-104	-127	-121	-143		-573
President*		-101	-97	-90	-50	-24		-362
Pres w/trigger**		-101	-97	-92	-33	45		-278
BBA***		-90	-90	-83	-54	1		-316

* President's Budget re-estimated by CBO using the CBO March Baseline, but increasing revenues and reducing debt service costs—taking into account the new CBO estimates table

** w/trigger "Alternative Proposals" to balance the budget based on CBO economic assumptions and technical estimates.

*** The Balanced Budget Agreement of 1997

The table below illustrates how the discretionary spending caps in the 1990 and 1993 budget agreements worked:

⇒ Discretionary outlays were permitted to rise $33 billion between 1990 and 1991, largely to pay for Desert Storm. The caps were not due truly to bite until 1993; then the 1993 agreement provided permitted another growth spurt.. And in the period 1990-1996, defense cuts helped to accommodate non-defense increases.

⇒ Domestic Discretionary spending was allowed to rise again between 1993 and 1995

⇒ In 1995 and 1996, discretionary spending was really tight. Non-defense discretionary spending will go back up again a bunch next year, due largely to s spending spree before the elections last fall.

	1990	1991	1992	1993	1994	1995	1996	1997
Defense	300	320	303	292	282	274	267	268
Non-Def Disc	200	214	232	248	262	272	268	280
Total	500	533	535	541	544	546	533	547

⇒ The table at page 8 illustrates how much more restrained appropriations will have to be to keep discretionary spending within the caps contained in the Budget Resolution. Non-defense discretionary spending would go up $15 billion by 2000, then go down about $11 billion by 2002.

⇒ For 1998 and 1999, the Budget Resolution proposes a separate defense cap, which would keep Defense spending at $267--$268 billion. Thereafter, defense spending would be allowed to rise about $2 billion per year through 2002—but there would be no separate “fire wall” for defense.

⇒ Nothing in the agreement would keep Congress and the President from further reducing defense in 2000 and thereafter to pay for higher domestic spending.

⇒ But the Appropriators are the only part of the budget that would be subject to on-going enforcement under the agreement. Paygo would restrain new entitlement and revenue legislation; but current entitlement and revenue laws could produce much higher spending than the projections underlying this agreement.

⇒ Total entitlement spending has doubled as a percent of GDP over the last thirty years. The reciprocal of that growth has been shrinkage in discretionary spending. Total discretionary spending has declined from 12.7% to 7.1% of GDP. Defense is down to 3.6% from 9.3% of GDP. If this Budget Agreement does not include real, effective, enforceable entitlement caps, we will continue to witness the incredible disappearing discretionary spending in the Federal budget.

Graying of America Project

The report on the first phase of the project goes to press almost simultaneously with this update. Contact our office if you want a copy(ies). The short version of that report "Building a Better America" is available from our office now. That report, with errata, is only $2 per copy. We hope schools, business groups and others will avail themselves of this opportunity to distribute this document to students, members and others at a very reasonable cost.

In June, the Committee will host a retreat to begin discussion of the options to address the issues raised in the first phase of the Graying project.

This project has taken longer than we anticipated, at every step; but we and out co-sponsors agree it is worth the time; because we actually have achieved agreement on facts surrounding these issues. That agreement represents a very broad consensus –from AARP to NAM and ACLI and the Governors' Association.

As we move on to consider options, it is not necessary to reach agreement *on what should be done*. This project will make a major contribution indeed, if we can only reach agreement on what *can be done* to solve the problems we face as a result of changing demographics.

Exercise in Hard Choices

The Committee will host out first Exercise in Hard Choices this year at De Anza Community College, in Cupertino CA on Saturday June 23. Representative Anna Eshoo will be at the meeting.

The Exercise this year will focus on the longer term issues raised in the Graying of America Project.

Both Administration spokesmen and Congressional leaders acknowledge that fact. They say it was necessary to separate balancing the budget from reforming elderly entitlements. They say, once the balanced budget agreement is enacted, their next task must be to solve the generational deficit problem. This Exercise, therefore, will permit our participants to choose among the options Congress and the President have considered this year to balance the budget by 2002—and it will provide insights into the kinds of options they will have to consider to address our larger, longer-term problems.

Expenditures by Major Category
($ in millions—totals may not add due to rounding)

	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002	5-year totals
Discretionary						
Defense	267	267	269	271	273	1346
Domestic	286	293	295	294	288	1456
Total	553	559	564	564	561	2802
Mandatory						
Social Security	381	400	420	441	464	2104
Medicare	200	209	226	232	248	1115
Medicaid	105	112	121	129	138	605
Other	205	222	233	250	242	1151
Subtotal	890	943	999	1052	1091	4975
Net Interest	249	252	248	242	237	1227
Total Outlays	1692	1754	1811	1858	1889	9004

Percent of GDP

	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002
Defense	3.3	3.1	3.0	2.9	2.8
Non-Def Discretionary	3.5	3.4	3.3	3.1	2.9
Total Discretionary	6.8	6.5	6.3	6.0	5.7
Social Security	4.7	4.7	4.7	4.7	4.7
Medicare	2.4	2.4	2.5	2.5	2.5
Medicaid	1.3	1.3	1.3	1.4	1.4
Other Mandatory	2.5	2.6	2.6	2.7	2.4
Subtotal Mandatory	10.9	11.0	11.1	11.1	11.0
Net Interest	3.0	2.9	2.8	2.6	2.4
Total Mandatory	13.9	13.9	13.8	13.7	13.4
Total Outlays	20.7	20.4	20.1	19.7	19.1