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KEY ISSUES AND THREATS IN THE HOUSE BUDGET PROCESS DEBATE

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The House is expected to consider major budget process legislation in June. The legislation that will come to the House floor (H.R. 3973), which the House Budget Committee reported in March, would reinstitute pay-as-you-go rules for entitlement programs but exempt tax cuts from those rules. The legislation also would establish five-year caps on discretionary programs. These caps would likely force substantial reductions in domestic discretionary programs in the years ahead.

The Budget Committee's bill could be expanded. Other measures could be added in the House Rules Committee, which has jurisdiction over some aspects of the budget process. In addition, a number of amendments could be offered on the House floor.

The additional proposals may be drawn from one or more of three measures: 1) a measure known as the "Family Budget Protection Act" (H.R. 3800), which was introduced by Reps. Jeb Hensarling, Paul Ryan, Chris Chocola, and Christopher Cox and more than 100 co-sponsors, most of whom are conservative Republican members; 2) a bill (H.R. 3925) introduced by Rep. Mark Kirk (R-Ill.) that is co-sponsored by about 20 mostly moderate House Republicans but contains many of the same provisions as the Family Budget Protection Act; and 3) a proposal transmitted to Congress by the Bush Administration on April 2.

This analysis focuses on several especially troubling provisions contained in the House Budget Committee bill or in one or more of the other three measures. This paper is not intended to be a comprehensive analysis of the other three proposals or to suggest that there are no provisions in those proposals that may have merit. This analysis considers three areas:

- The adverse consequences of the House Budget Committee's pay-as-you-go proposal;
- The proposed discretionary caps and several other provisions affecting discretionary programs that could be offered; and
- A proposal to establish caps on entitlement programs.

1. Pay-As-You-Go Rules

The House Budget Committee bill includes a proposal, backed by the Administration and also reflected in the Administration's budget process bill, to reimpose the pay-as-you-go rules on entitlement programs but to exempt tax cuts from these rules. Under the pay-as-you-go rules established on a bipartisan basis in 1990 with the support of the first President Bush, both entitlement increases and tax cuts had to be paid for. Entitlement increases and tax cuts were treated the same — both had to be offset, and their costs could be offset *either* through reducing other entitlements or raising more tax revenue.

The House Budget Committee bill would reimpose this discipline on entitlement expansions only. Tax cuts would not have to be paid for. In addition, entitlement improvements could be paid for *only* by cutting other entitlements. Measures to close abusive tax shelters or other tax avoidance schemes and use the savings to finance improvements in an entitlement benefit, such as a veterans benefit or a program to shrink the ranks of the uninsured or reduce poverty, would not be allowed. Savings on the tax side of the ledger would be off limits for pay-as-you-go purposes.

This proposal, which ignores calls from Federal Reserve Chairman Alan Greenspan and a host of budget watchdog groups to apply the pay-as-you-go rules to *both* tax cuts and entitlement increases, would have a number of deleterious effects. It would leave the door open to unlimited, costly tax cuts that could raise deficits to still higher levels. The proposal also poses other problems:

- *It could tilt budget and tax policy toward affluent individuals and against low- and middle-income families*. The bulk of the federal benefits that low- or moderate-income families receive are provided through entitlement programs, such as Medicare, Medicaid, veterans programs, student loans, and the like. In contrast, the bulk of the government subsidies that flow to high-income individuals and corporations tend to come through the tax code. A rule that requires entitlement expansions but not tax cuts to be paid for is likely to tilt the policy "playing field" toward the well-off.

- *The proposal would distort important policy debates*. Policymakers wishing to examine options to reduce the ranks of the uninsured, for example, would be faced with an uneven "playing field." Proposals to reduce the ranks of the uninsured by broadening Medicaid coverage or expanding the State Children's Health Insurance Program (SCHIP) would have to be paid for. But proposals to write tax breaks related to health insurance into the tax code would *not* have to be paid for. A number of health insurance tax breaks that have been proposed in the past few years would be worth the most to people in the highest tax brackets and would most heavily subsidize high-income individuals who already have health insurance. The pay-as-you-go rules approved by the House Budget Committee would confer a very large advantage on tax-cut-based approaches to health insurance (other than refundable tax credits) over program-based approaches, regardless of the relative efficiency and effectiveness of the tax-based options.[1]

- *The Budget Committee's pay-as-you-go rule would likely prove to be a failure in curbing deficits*, since it would sanction the enactment of more tax cuts by failing to impose any fiscal discipline to restrain such action. The tax code is packed with tax breaks that favor particular activities, which Alan Greenspan has referred to as "tax entitlements" and which cost many hundreds of billions of dollars a

[1] The House Budget Committee bill treats the refundable portion of refundable tax credits as entitlement increases, and so requires them to be paid for. It makes an exemption to this rule only for the continuation of refundable tax credits enacted in the 2001 or 2003 tax-cut bills.

year. Moreover, if pay-as-you-go rules are imposed on program entitlements but not on these tax entitlements, tax lawyers and lobbyists are likely to design various entitlement expansions so they can be delivered through the tax code. Such an approach may result in even larger increases in deficits, since targeted tax breaks often are less efficient and more costly than comparable program expansions.

2. Issues Related to Discretionary Programs

The Budget Committee's Discretionary Caps

The caps in the House Budget Committee bill are designed to lock in the cuts in domestic discretionary programs outside homeland security that are featured in this year's budget resolution. The Budget Committee bill was crafted so that the new caps would be set at the discretionary spending levels contained in the version of the budget resolution that emerged from conference. The conference report on the budget resolution, which the House recently approved, calls for $77 billion in funding cuts over the next five years in domestic discretionary programs outside homeland security. (Cuts are defined here as reductions below the Congressional Budget Office baseline — i.e., below the fiscal year 2004 funding levels, adjusted for inflation.) While the discretionary funding levels contained in budget resolutions for years after the initial fiscal year that a budget resolution covers usually are not taken very seriously, the proposed caps would change that, because they would lock in these shrunken funding levels.

- Under the conference report on the budget resolution, the cuts in domestic discretionary programs outside homeland security would reach $19 billion in 2009 under the budget resolution conference report. Overall funding for domestic discretionary programs, measured as a share of the economy, would drop by 2009 to its lowest level since 1963.

- Every area of domestic discretionary funding would be cut over the next five years except for space and science, education and training, and veterans health care and services. For example, in 2009, funding for environment and natural resources programs would be cut $2.2 billion below the 2004 level adjusted for inflation.

- By 2009, the cuts in domestic discretionary programs outside homeland security would be nearly *six times deeper*, when measured as a share of the economy, than the domestic discretionary cuts instituted under the discretionary spending caps imposed in 1990 and 1993.

- Moreover, the cuts in domestic discretionary programs would likely turn out to be significantly deeper than this. The proposed caps would cover *total* discretionary spending, including defense spending. The domestic reductions just discussed would be required if the funding levels for defense, international affairs, and homeland security over the next five years adhere to the levels assumed in the budget resolution conference report. The defense levels contained in the conference report, however, are far below the levels in the Administration's budget, and a Congressional Budget Office analysis has found that the defense levels contained in the Administration's budget are themselves well below the projected costs of implementing the Administration's own multi-year defense plan (known as the "Future-Year Defense Plan"). If these caps are enacted now but the cost of defense spending (other than emergency spending) turns out to be higher in coming years than the levels assumed in this year's budget resolution — as is likely to be the case — then domestic programs will have to be cut by even larger amounts than the amounts cited here for Congress to comply with the caps.

The caps that the House Budget Committee bill would establish stand in sharp contrast to the discretionary caps imposed in 1990 and 1993. Not only would the new caps require much deeper cuts, but unlike the caps enacted in the 1990s, they would *not* be part of a balanced deficit-reduction package that puts every part of the budget on the table — including taxes — and calls for shared sacrifice.

Indeed, the conference report on the budget resolution fails to reduce budget deficits at all. Instead, it would *increase* deficits above the levels at which deficits otherwise would stand, primarily because of the tax cuts contained in the budget.

Possible Amendments that Could Place Discretionary Programs at Still Greater Risk

Two other provisions that may be offered as amendments, which are included in both the Hensarling and Kirk bills, could pose further threats to domestic discretionary programs. These measures could lead to still deeper reductions in these programs.

- One such provision would supplement the discretionary cap with a *"sub cap" applied to nondefense programs*. But there would be no "sub cap" for defense programs. This would mean that funds could be shifted from domestic to defense programs but *not* from defense to domestic programs. This could make the cuts in domestic programs even deeper than described above.

- The other such provision would *lower the budget "baseline" for discretionary programs* by setting the baseline at the previous year's funding level *without any adjustment for inflation*. The baseline for discretionary programs has traditionally reflected an adjustment for inflation, in recognition of the fact that the cost of purchasing goods or providing services generally rises with inflation.

  Under this proposal, baseline levels through 2014 would equal the 2004 appropriation levels, with no allowance for inflation in the intervening years. If program funding remained at the 2004 funding levels for ten straight years despite inflation, the levels of service that discretionary programs provide would have to be cut substantially.

  This change in the baseline rules could lead to larger reductions over time in discretionary programs, since funding levels that merely keep pace with inflation would be branded as increased spending. Another result could be bigger tax cuts. The deficit forecasts that CBO issues each year are based on the official budget baseline. Under this proposal, the deficit forecasts would be based on a baseline that assumed that all discretionary programs — including defense programs and education — would be frozen for ten consecutive years. Such an assumption almost certainly would be unrealistic; it would understate overall levels of discretionary spending. In fact, only once in the last four decades has total discretionary spending been frozen for as many as *five* years, and that was after the collapse of the Soviet Union, when defense spending declined. Due to the unrealistic assumption that discretionary spending would be frozen for ten straight years, the budget forecasts would be too rosy, showing budget deficits to be significantly *smaller* than they actually would be. These rosy budget forecasts could then be used to argue that it is safe to enact still more tax cuts. In 2001, forecasts that turned out to be too rosy paved the way for fiscal profligacy; under this proposal, history could repeat itself.

3. The "Entitlement Cap" Proposal

The Hensarling and Kirk bills also contain nearly identical "entitlement cap" provisions. These provisions are not included in the Budget Committee bill or the Administration's bill. These provisions would require extremely large cuts in entitlements outside Social Security that would total *$1.8 trillion* over the next ten years. (The $1.8 trillion figure is based on Congressional Budget Office projections of entitlement costs, inflation, and caseload growth.)

Under these provisions, a cap would be set each year on the total amount of entitlement spending allowed. If the cap for a fiscal year would otherwise be exceeded, automatic cuts (or "sequestration") in certain specified entitlement programs would ensue.

The formula for setting the entitlement caps, which is identical in the two Republican budget process bills, includes no allowance for increases in health care costs, other than costs related to increases in caseloads. Yet health care costs per beneficiary rise significantly each year in Medicare, Medicaid, and the private sector alike. Indeed, health care costs have been rising as fast or faster in the private sector than in Medicare and Medicaid, demonstrating that these cost pressures stem not from deficiencies in Medicare and Medicaid's basic structures but primarily from the nature and operations of the U.S. health care system itself, such as the rapid advances in medical technology that are producing new treatments and medications that improve health and prolong life, but at a substantial cost.

The formula that would be used to set each year's entitlement caps would include no adjustment for these increases in health care costs. It also would fail to reflect the cost of the Medicare prescription drug bill. These omissions result in caps well below the projected cost of entitlement programs under current law. Aggravating these problems, interest payments on the debt would be considered an entitlement; whenever interest costs increased — because the Federal Reserve raised interest rates or, for example, because a new tax cut was enacted that increased deficits and thus raised the level of the debt on which interest payments are made — the entitlement caps would be exceeded by a larger margin, and entitlement programs would have to be slashed more deeply.

Primarily for these reasons, the entitlement caps that these bills would write into law would be approximately $1.8 trillion below the amounts that entitlement programs are projected to cost over the next ten years under current law. The result would be $1.8 trillion in required cutbacks. (For a more detailed budget explanation of why, using CBO assumptions, the required cuts total $1.8 trillion, see "Entitlement Cap Proposal Would Require Cuts of $1.8 Trillion Over the Next Ten Years," Center on Budget and Policy Priorities, March 16, 2004.)

If the $1.8 trillion in cuts were achieved by reducing all entitlements (other than Social Security, which would be outside the caps) by the same percentage, the cuts would total:

- nearly $800 billion over ten years in Medicare,
- nearly $400 billion in Medicaid,
- $69 billion in unemployment compensation,
- $53 billion in veterans benefits,
- $23 billion in the school lunch and other child nutrition programs, and
- $11 billion in student loans, to name a few program areas.

Entitlement Cuts Over 10 Years Under H.R. 3800 and H.R. 3925, If All Entitlements Are Cut Proportionately
(in billions of dollars)

Medicare	-797
Medicaid	-392
Federal civilian retirement and disability	-117
Unemployment Compensation	-69
Military retirement and disability	-67
Supplemental Security Income	-63
Earned Income Tax and Child Tax Credits	-54
Veterans' benefits	-53
Food Stamps	-43
TANF, child care, child support enforcement	-37
Child Nutrition	-23
Commodity Credit Corporation	-21
Other federal retirement and disability	-14
TRICARE for Life	-13
Foster Care and Adoption Assistance	-13
Student loans	-11
Universal Service Fund	-10
State Children's Health Insurance	-8
Social services	-7
Other miscellaneous	-23
TOTAL	**-1,834**

Some of these programs could be cut less deeply. For that to occur, however, other entitlements would have to be cut *more* deeply. These massive entitlement cuts would be required even if deficits turned out to be substantially lower than had been forecast, perhaps because of unusually robust economic growth or because Congress decided to raise revenues to cover the rising costs of programs such as Medicare. (Note: The only difference between the entitlement-cap provisions in the Hensarling and Kirk bills relates to how Medicare would be affected if automatic entitlement cuts were triggered because Congress failed to make the entitlement cuts necessary to keep entitlement spending below the caps. Otherwise, the entitlement cap provisions of the two bills are identical. For additional discussion of how the automatic entitlement cuts would work under the Hensarling bill, see the entitlement cap analysis referenced above.)

Conclusion

The proposals outlined here share some basic themes. These proposals would largely or entirely shield tax cuts from fiscal discipline while aiming heavy artillery at the domestic budget. The proposals are unbalanced; they reject any notion of shared sacrifice. They appear to be designed to advance an agenda of leaving the floodgates open for unlimited tax cuts while starting to shrink the budgets of federal programs substantially. This approach differs fundamentally from earlier budget agreements, which were aimed at reducing deficits.