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COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET

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**BUDGET UPDATE**

April 6, 2007

**Congress Faces Tough Choices and Will Need to Show Discipline  
In the Face of Pressure to Bust the Budget**

Now that the House and Senate have passed their budget resolutions, they will begin the process of trying to resolve outstanding difference in conference. The two resolutions are quite similar to each other, though they are substantially different from what the President has proposed. It appears likely that the differences will be able to be worked out in conference and the budget passed in a timely manner.

The House and the Senate should be applauded for sticking to pay-as-you-go, even in the face of extreme pressure to make exceptions for popular programs. However, the heavy lifting on pay-go—finding offsets for the proposed higher levels of spending, fixing the AMT, and extending some of the tax cuts—still lies ahead. A glaring shortcoming of both budgets is that neither makes any headway on the important and inevitable task of entitlement reform and the long-term budget challenges. If one were to combine the pay-go principles central to the two Congressional budgets with the types of entitlement reforms in the President's proposed budget, there would be real progress towards fiscally responsible budgeting.

**Getting to Balance**

All three budgets deserve credit for being structured to reach balance within the budget window of five years. That said, the House's budget is the only of the three that is projected to achieve balance by 2012. The budget that the Senate reported out of Committee would have reached balance in its original form. But an amendment sponsored by Senator Baucus to use the entire \$132 billion surplus projected for 2012 to extend select tax breaks and finance spending on SCHIP was adopted. Because interest costs of the motion were not offset, the budget has a \$5 million deficit in 2012. The widespread support for the Baucus amendment, which passed 97-to-1, and thus the willingness to spend away surpluses before they have even materialized, is troubling. We congratulate House and Senate budget leaders for their resolve so far, and urge them to hold fast to the pay-go principle.

The president's budget was structured to reach balance in 2012 under the Office of Management and Budget's assumptions, but when the Congressional Budget Office released its own analysis, it showed the budget with a \$31 billion deficit in 2012.

Even though two of the three plans fall short of achieving the fiscal goal of budget balance, it is encouraging that they set such a goal and tried to reach it. Moreover, these differences are not very large given the inevitable uncertainties in economic and technical assumptions. Each of the budgets deserves credit for making budget balance a central priority. Each would deserve more credit if they achieved that goal without gimmicks, vagueness, or omissions, of which none are completely free. Setting a fiscal goal is a useful and necessary step in getting the budget back on track and making the necessary and sometimes painful trade-offs that responsible budget demands.

We would generally suggest that the broad fiscal goal should be balance over the business cycle—running deficits when the economy slows and surpluses as it heats up. If this were our current course, we would already be firmly in the midst of annual budget surpluses given the strength of the economy. Furthermore, given the impending retirement of the baby boomers, it would be wise to increase national saving in advance of that large generation's shift from workers to retirees. One way to do this would be to run larger surpluses than we otherwise would in normal times.

By these standards, while the goal of reaching balance by 2012 is certainly better than no goal at all and is a vast improvement over where we were a few years ago, it is not as aggressive as we would hope for. Given the relative timidity of the goal of balance by 2012, we would at least hope for highly realistic budgets to do so. Certainly, making the deficit worse in the short run—as all three budgets would do—should be considered unacceptable.

**Comparison Table (Dollars in Billions)**

	Senate Resolution		House Resolution		President's Budget		Current Law	
	2008	2012	2008	2012	2008	2012	2008	2012
<b>Total Revenues</b>	2,678	3,235	2,720	3,405	2,679	3,174	2,720	3,405
<b>Discretionary</b>	1,133	1,082	1,142	1,100	1,123	1,041	1,046	1,112
<b>Mandatory</b>	1,794	2,158	1,791	2,152	1,782	2,164	1,787	2,138
<b>Total Spending</b>	2,927	3,240	2,933	3,252	2,905	3,205	2,833	3,250
<b>Surplus</b>	-249	-5	-213	153	-226	-31	-113	155

### **Three Cheers for Sticking to Pay-go**

The Committee for a Responsible Federal Budget (CRFB) strongly applauds both the House and Senates Budget Committees for reinstating and adhering to pay-as-you-go. It took a tremendous amount of resolve to comply with the pay-go principle—which requires that all new entitlement spending and/or tax cuts be offset in order to keep the budget deficit from growing—in the face of pressures to pay for popular programs like SCHIP and the farm bill through deficit spending.

CRFB has a long-standing record of support for pay-go due to the belief that, along with spending caps, it is a critical first step towards rebalancing the budget. We recently issued a joint release with the Center on Budget and Policy Priorities, the Committee on Economic Development, and the Concord Coalition urging legislators not to make any exceptions to this important budgeting principle.<sup>1</sup>

While both the Senate and House's proposed budgets stick to the pay-go principle, the difficult task of finding offsets for the budget policy choices, has not yet been addressed. It is perfectly appropriate for budget resolutions not to contain the details of the actual budgets. The details are regularly left up to the relevant committees. The reserve funds that are used in the budget are a legitimate approach, which have been used in the past, to create placeholders for offsets.

But the budgets make it clear that their priorities include specific increases in spending for SCHIP, farm subsidies, education, housing, and Filipino veterans of World War II, as well as tax cuts for the middle class and AMT relief. No details are provided concerning how these changes would be paid for. The asymmetric level of detail makes it appropriate to give credit for sticking to the principle of pay-go but keeps us from being overly congratulatory until the details have been provided. It is premature to take credit for a budget that increases spending, cuts taxes and is fiscally responsible, until the necessary tough choices to make the numbers add up are clearly identified.

As the budget negotiations proceed, pressure to make special exceptions for pay-go will mount. There are signs that resolve may already be crumbling. For one there appears to be sufficient support to pass a fix for the AMT that is not fully offset by increases in other taxes or reductions in spending. We would strongly advise against this. The Committee urges that no exceptions be made to pay-go as the budget process unfolds. Opening the door for one exception will open the floodgates for many. Given that the pay-go principle is the fiscally responsible glue that holds this budget together, retreating from the principle would be a huge blow for responsible budgeting.

Additionally, the widespread support for the Baucus amendment in the Senate, which ignores the strictures of pay-go, is troubling. In spending a projected budget surplus before it even materializes, Baucus is making the same mistake that the President and Congress made in 2001. If the economy enters into a recession, or if the promised offsets are not found, or if an unforeseen emergency draws down our national resources, then there will be no surplus in 2012. And if any of these scenarios occur, then the Baucus amendment will have greatly exacerbated our nation's fiscal difficulties.

Given these uncertainties, pre-committing the money so far in advance is not a prudent course of action. Instead, we should wait until we are closer to the time when those dollars would be spent to make sure the projections are accurate. If there are budget surpluses, using them to extend some or all of the tax cuts would be perfectly appropriate (as would using them to help finance entitlement reform) but that decision should be postponed until we are more certain the surpluses will be real.

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<sup>1</sup> (<http://crfb.org/documents/4CspaygostatmentMarch2007.doc>)

We do not believe pay-go is perfect. The differential treatment of taxes and spending is problematic and should be addressed. Furthermore, compliance with pay-go oftentimes leads to claims of fiscal responsibility that are exaggerated. Pay-go, in and of itself, does nothing to improve the budget picture. But without it, it is much easier for legislators to make the fiscal situation dramatically worse, as we have seen in recent years. With all the current pressure for tax cuts and new spending to meet pent-up demand, sticking to pay-go is critical for keeping the budget picture from deteriorating further. The commitment of the House and Senate's Budget Committees to this principle should be strongly commended.

## **Taxes**

Opponents of the budget resolutions have characterized the budgets as raising taxes. Yes, large tax increases are part of current law, but no, they are not due to the budget resolutions. The increases were created as part of the original tax cuts when they were passed in 2001 and 2003 as a result of how those tax cuts were crafted. Because the proponents of the tax cuts opted to make them appear smaller (and make passage easier) by relying on reconciliation, which requires expiration after the budget window period, their expiration has been built into current law for years.

Both the House and Senate resolutions assume that the 2001 and 2003 tax cuts will expire at the end of 2010. They rely on the higher revenues levels to reach balance while simultaneously expressing the intention to make at least some of the tax cuts permanent. With pay-go in place, extending the tax cuts will require offsetting the costs. This could be done either by increasing other taxes or cutting spending. Rather than fighting over ownership of the tax increase, we wish Congress would focus on the real issue: what trade-offs they support. If we are going to make the tax cuts permanent, which ones? And if we are going to offset the costs—as we should—what other taxes will be increased or what spending decreased? Budgets are supposed to force trade-offs but no one, as of yet, is willing to confront that tension.

We have criticized the administration for proposing a revenue-neutral fix for the Alternative Minimum Tax while providing no details about for what it would look like. The House and Senate budgets do the same thing. The Senate's approach in particular, which would cost money in the short-run and recoup the loss over a longer period of time, risks digging the deficit hole deeper without ever making up the difference. However, the commitment of Congress to pay-go rules for both mandatory spending and taxes makes its promise slightly more meaningful than that of the White House. Work by the House Ways and Means Committee to develop a comprehensive reform for the AMT buttresses the argument that the House's budget will include legitimate offsets for AMT relief. We nonetheless, continue to worry about the risk of the AMT busting the budget due to widespread and bipartisan support for cutting the tax. CRFB strongly encourages Congress not to make an exception to pay-go even for this popular tax cut.

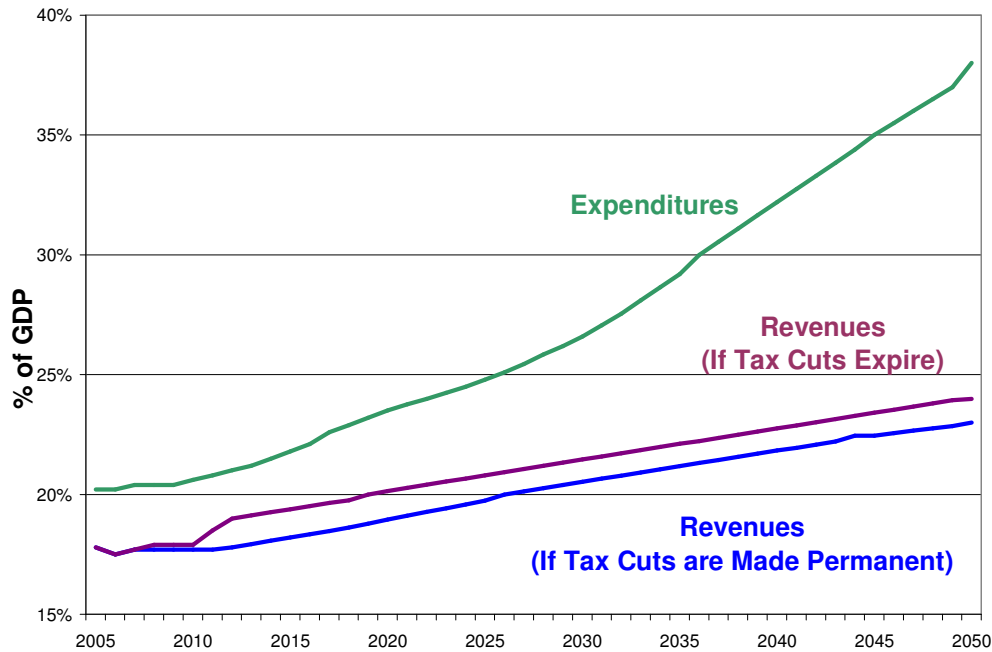
## **Tax Gap Exuberance**

CRFB also continues to worry about "tax gap exuberance." While none of the budgets explicitly use tax gap savings to fund proposals, this is the clear intention. A better, more responsible course of action would be to wait for any savings from improved collection and enforcement to materialize before the revenues are considered in the budgeting process.

## Major Shortcoming

By far the most disappointing area of both budgets is their failure to address or improve the nation's long-term budget challenges. The single largest fiscal problem facing the country is the long-term budget imbalance we will face due to promises in our major retirement and healthcare entitlement programs. (See chart below.) The budget is on an unsustainable path. Failing to act will make the policy changes we ultimately have to adopt far more painful. We have punted on this issue year after year, and with the first of the baby boomers beginning to collect Social Security next year, continuing to ignore this looming crisis is simply unacceptable.

### Long-Term Spending and Revenue Projections



The White House offered a number of promising proposals in its budget that could serve as an excellent starting point for discussions.<sup>2</sup> It was courageous of them to include these proposals and we wish the majority party had followed suit by offering their own ideas on entitlement reform. While we will not go into details of assessing the budgets that were offered as alternatives to the budget resolutions, it should be noted that Congressman Ryan's alternative contained significant entitlement savings, for which he should be congratulated.

We continue to strongly support the proposal by Senators Conrad and Gregg for a budget working group to bring together policy makers to confront these issues. Senator Conrad wanted to avoid politicizing entitlement reform by suggesting reforms in the budget, so there needs to be another venue in which this issue can be addressed. The bipartisan atmosphere of a Members working group would be an ideal forum.

<sup>2</sup> See CRFB Budget Update February 6, 2007 <http://crfb.org/documents/BudgetUpdateFeb2007-Preliminary.doc>.

## **The Supplemental, Sigh**

We have watched the discussions on the emergency supplemental spending bill to fund operations in Iraq with dismay. Yes, it was probably predictable, but that makes it no less regrettable. The Committee has no position on the war. We have no position on a troop withdrawal timetable. But we strongly believe that emergency spending bills should not be larded up with costly, non-emergency items.

What we have seen dumped in the supplemental represents the worst in budgeting. We have warned repeatedly that abuse of the supplemental process has led to a shadow budget, undermining the very purpose of budgeting. We hope that starting to budget for the war in the normal budget process will help improve this ongoing abuse. We recommend jettisoning the outlandish unrelated spending in the supplemental.

## **Slightly Positive Signs for the Future**

We are slightly more optimistic than we have been in a number of years that we could be nearing a turning point on the budget. The budgets we have seen so far from the White House and Congress are improvements over what we have seen in the past few years. Divided government is likely to slow actions that would otherwise worsen the budget situation. For the most part it will be difficult to pass new tax cuts or large new spending initiatives without one party or the other blocking these changes (although the AMT and the extension of the middle-class tax cuts may have sufficient bipartisan support to pass without offsets.) It would be in the best interests of both parties to tackle entitlement reform now while different parties control Congress and the White House, so that both sides can share responsibility for the inevitable difficult choices.

The budget negotiations we are about to witness, in particular the negotiations on how to fill the reserve funds, will undoubtedly prove contentious. We hope that this debate does not worsen relations on the Hill and between the White House and Congress—we desperately need Members to improve relationships across the aisle. Moreover, we hope that the final compromise is not brokered through a weakening of the resolve for fiscally responsible budget choices. The best scenario would be a budget that sticks to pay-go and the beginning of serious efforts on entitlement reform. It may well be premature, but we remain cautiously optimistic that whether through a commission, a Members working group, or individual Members showing leadership, the beginnings of crucial long-term budget reform plans could start to emerge in the coming year.

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CRFB recently held its Annual Budget Roundtable and Dinner, which featured a panel on the 1990 Andrews Air Force Base Budget Summit with Richard Darman, William H. Gray, Bill Frenzel and Leon Panetta. To see a summary and video, please see [http://www.newamerica.net/events/2007/crfb\\_conference](http://www.newamerica.net/events/2007/crfb_conference).