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BUDGET UPDATE
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The Congressional budget resolution increased the deficit relative to the CBO baseline by $200 billion from FY 2005 through FY 2010. Since passing the budget resolution, Congress has approved several bills that would increase spending above the limits in the resolution. Making matters worse, Congress is poised to take actions this fall that would result in further increases to the deficit beyond those already assumed in the budget resolution.

In this update, we examine the impact of Congressional actions on the deficit in two ways: 1) the increases in the deficit authorized by the budget resolution plus the increases in the deficit from legislation that increases the deficit further and 2) the increase in the deficit above the baseline as a result of legislation signed into law so far this year. The first approach provides a more complete picture of the impact of Congressional actions because it includes the costs of decisions that have already been made and are in the process of being implemented.

Impact of Legislation Enacted by Congress

Congress has approved four bills that will increase the deficit: the Iraq supplemental, the energy bill, the emergency supplemental appropriations for veteran's health care, and the highway bill. <u>These bills will add nearly $33 billion to the deficit next year, approximately 10% of the expected deficit for the current fiscal year. The cumulative effect of these four bills through the end of the decade would be to increase the deficit by nearly $95 billion, not counting increased debt service costs. When the debt service costs are counted, the total impact of these four bills on the deficit is more than $115 billion by the end of the decade.</u>

Table 1: Deficit Impact of Legislation Approved by Congress

	FY 2006	FY 2005-2010
Defense/tsunami supplemental	$30.8 billion	$82.6 billion
Veterans health care	$1.3 billion	$1.5 billion
Energy bill	$0.8 billion	$10.1 billion
Highway bill	?	$600 million (approximate)
Total cost of legislation	**$32.9 billion**	**$94.8 billion**
Debt Service	$2 billion	$20.4 billion
Total deficit impact	**$35 billion**	**$115.2 billion**

The numbers in the table are based on the CBO estimates of the increased outlays and revenue loss for the current fiscal year and the next five years. Although the defense/tsunami supplemental appropriated net new budget authority of $82.1 billion, CBO estimated that the total outlays flowing from the bill would be $82.8 billion ($200 million in spending would occur in 2011 and is not included in the table) because the bill included a rescission of budget authority that did not achieve any outlay savings.

The conference report on the energy bill contains tax breaks with a net cost of $7.9 billion over five years and increases in mandatory spending with a net cost of $2.2 billion over the next five years according to CBO. The supplemental spending for veteran's health care contained in the Interior appropriations conference report will result in a total of $1.5 billion in additional spending.

It is difficult to estimate the impact of the highway bill on the deficit for a variety of reasons, starting with the fact that CBO has just begun work on an estimate of the legislation. Absent a CBO estimate, it is difficult if not impossible to determine the outlays resulting from the bill over the next five years. It is the outlays flowing from the bill over the next five years and beyond, and not the contract authority and obligations limits in the bill, which will have a direct impact on the deficit. It is also difficult to determine what parts of transportation spending included in the CBO baseline should be compared to the costs of the bill.

For purposes of this update we will be conservative and assume that spending authorized up to the levels allowed in the budget resolution will not increase the deficit. The costs of the highway bill assumed in the budget resolution were included in the overall non-defense discretionary spending totals in the budget resolution, which were below the CBO baseline.

However, the conference report will result in higher spending than assumed in the budget resolution for two reasons. The bill provided for an additional $2.4 billion in spending from the trust fund and increased the spending limits for the transportation categories of the spending limits by that amount. The bill included new revenues to the trust fund to pay for the increased spending, but according to preliminary estimates by the Joint Committee on Taxation those offsets fell $386 million short of the $2.4 billion in additional spending. The net increase of $386 million in spending from the trust fund that was not offset by new revenues can fairly be described as an increase in the deficit.

In addition, the conference report contains an overlooked provision which allows Alaska to use all of the contract authority provided in the bill without being subject to the obligation limits. This provision effectively creates new mandatory highway spending for Alaska above the spending limits in the bill. No estimates are available about the cost of this provision, but exempting contract authority for Alaska from obligation limits will allow for increased spending of at least $200 million above the $284.5 billion reported cost of the bill. Finally, the conference report contained a rescission of $8.6 billion of unobligated funds that would take effect on September 30, 2009, the last day of the rescission. The timing of this rescission has caused some observers to question whether it will actually take effect. Without this rescission, the total cost of the bill would be more than $295 billion.

Impact of the Budget Resolution and Subsequent Legislative Actions

The net impact of legislation allowed by the allocations and reconciliation instructions in the budget resolution would increase the deficit by $200 billion from fiscal year 2005 through 2010. (CBO will be updating its baseline estimates in August and there will undoubtedly be improvements in the baseline numbers, but this will not affect the change in the deficit that will be the result of legislative actions.) The table below outlines the impact of the policies assumed in the budget resolution on the deficit.

Table 2: Deficit Impact of Policies Assumed in the Budget Resolution

	2005	2006	2007	2008	2009	2010	Total 2005-10
CBO Baseline Deficit	**365**	**298**	**268**	**246**	**219**	**210**	**1,606**
Tax Cuts	0.4	18	26	12	28	23	106
Defense Discretionary Spending	--	6	11	18	28	34	95
Iraq Supplemental[1]	32	62	24	8	3	2	133
Non-Defense Discretionary Spending	--	(4)	(18)	(30)	(40)	(48)	(139)
Total Mandatory Savings	0.2	(0.9)	(5)	(8)	(8)	(9)	(30)
Total Policy Change	33	81	38	0	11	0	164
Debt Service	0.3	3.1	7	8	9	10	36
Total Increase in Deficits	33	84	45	8	20	10	200
Resulting Deficit	**398**	**383**	**313**	**254**	**238**	**211**	**1,797**

[1] Including reserve for additional war supplemental in fiscal year 2006

Note: CBO estimates that $200 million of the outlays flowing from the defense/tsunami supplemental enacted in to law will occur in 2011, outside the budget window. The budget resolution conference report assumed enactment of a supplemental with a total cost of $81.9 billion, but did not specify the assumptions regarding when the outlays would occur. This makes it impossible to make a precise comparison between the spending levels assumed in the budget resolution and the deficit impact of the supplemental enacted into law during the budget window, but the total cost of the supplemental enacted into law will be $900 million more than assumed in the budget resolution. Numbers may not add due to rounding.

Congress has already enacted the fiscal year 2005 supplemental for Iraq, Afghanistan, and Tsunami relief assumed in the budget resolution. The budget resolution assumed enactment of a $81.9 billion supplemental for fiscal year 2005; the final supplemental appropriations bill signed into law has an estimated cost of $82.8 billion. The administration has not submitted another supplemental appropriations request for Iraq, but it is extremely likely that there will be a supplemental request at least equal to the $50 billion reserve assumed in the budget resolution.

Although the mix between defense and non-defense discretionary spending has changed in the appropriations bills passed by Congress from the assumptions in the budget resolution, the appropriations bills passed by the House have spent the entire allocation in the budget resolution, so the deficit impact of discretionary spending reflected in the chart is still accurate. The tax cuts and mandatory spending reductions included in the chart will be considered in the fall. It is reasonable to assume that Congress will enact tax cuts at least equal to the levels allowed in the budget resolution, especially since the budget provided that $70 billion of the tax cuts will be considered under reconciliation protections. In short, the increases in the deficit provided for in the budget resolution adopted by Congress have been enacted or are virtually certain to be implemented.

Congress has already exceeded the allocations or assumptions in the budget resolution four times. The first was the Iraq supplemental, which CBO estimates would result in outlays of $82.8 billion, $900 million more than the budget resolution assumed. The second was the supplemental funding for veteran's health care, which provided $1.5 billion in spending above the allocations in the budget resolution. The third was the energy bill, which increased mandatory spending over the next five years by $200 million more than the allocation in the budget resolution. Finally, the net costs of the highway bill exceeded the allocation in the budget resolution by approximately $600 million.

The budget resolution allocated $284 billion for the highway bill, with a mechanism allowing additional spending above the $284 billion allocation if it were offset by additional revenues to the highway trust fund. The conference report contains provisions providing slightly more than $2 billion in additional revenues to the trust fund, but as noted earlier, those offsets fell short of the $2.4 billion in additional spending. As a result, the net costs of the highway bill exceeded the adjusted allocation by $386 million over five years according to preliminary estimates. The provision exempting transportation projects in Alaska from the obligations limits in the bill would add another $200 million or more spending above the budget resolution allocation.

Table 3: Costs Above the Budget Resolution
(Over Budget Resolution Window of FY 2005 – FY 2010)

Iraq supplemental	$900 million
Veterans health care	$1.5 billion
Energy bill	$200 million
Highway bill	$600 million (approximate)
Total	$3.2 billion

Pending Legislation with Deficit Impact

There are three uncertainties going into the fall session of Congress that will determine how much Congress will have increased the deficit at the end of this year. First, will Congress actually enact the mandatory spending cuts assumed in the budget resolution? Second, will the appropriations bills signed into law stay within the limits in the budget resolution? Finally, and most significantly, will Congress enact tax cuts above the $100 billion allowed under the budget resolution?

The budget resolution assumed net savings of $30.5 billion in mandatory spending programs and contained reconciliation instructions to committees of jurisdiction to report legislation achieving savings of $34.7 billion (the resolution assumed a few modest increases in mandatory spending totaling $4.2 billion, for net savings of $30.5 billion). While reconciliation instructions essentially ensure that legislation achieving those savings will be reported and considered by the House and Senate, they do not guarantee that reconciliation legislation will make it through the entire legislative process and be signed into law. If reconciliation legislation becomes deadlocked in conference or otherwise fails to get final approval in the end of session rush, the net impact of Congressional actions on the deficit will be even greater.

The House passed all eleven appropriations bills prior to the Fourth of July recess and managed to stay within the spending limits contained in the budget resolution with relatively few gimmicks. However, several of the appropriations bills under consideration by the Senate rely on timing shifts and other gimmicks to paper over increased spending. The Labor-HHS appropriations bill reported by the Senate Appropriations Committee alone contains nearly $3.7 billion in savings on paper by delaying SSI payments into the following fiscal year and other accounting maneuvers. It is likely that several of the appropriations bills will be wrapped up into an omnibus appropriations bill. End-of-the-session omnibus appropriations bills are often a vehicle to stretch or break the budget resolution limits through gimmicks or outright waivers of spending limits.

There are several tax cuts in the queue that would exceed the allocations in the budget resolution or may move outside of the budget process. The budget allows $70 billion in tax cuts in a reconciliation bill and $36 billion outside of reconciliation. The energy bill used $7.9 billion of the allocation for tax cuts outside of reconciliation. The Chairmen of the Ways and Means and Finance Committees have not indicated which tax cuts will be included in a reconciliation bill, but there are three tax cuts with significant costs that are likely to be considered outside of the framework of the budget resolution – estate tax repeal/relief, AMT repeal/reform, and tax incentives for retirement savings. The Senate leadership may choose to use the remaining $28.1 billion allocated to tax cuts outside of reconciliation on other tax cuts with the expectation that these items could receive the 60 votes necessary to waive the budget act for tax cuts above the amounts allocated in the budget resolution.

Since a reconciliation bill cannot have costs outside the budget window, any legislation making permanent changes to the estate tax cannot be included in reconciliation. Making estate tax repeal permanent would increase the deficit by $9 billion from 2006-2010 but $289 billion over ten years. A compromise on estate tax repeal would have a lower ten year cost, but might have a larger cost in the first five years if the compromise includes a higher exemption and/or lower rates that would take effect before 2010. Since estate tax legislation will either require 60 votes to overcome a filibuster or be the result of a bipartisan compromise that will have overwhelming support, it could easily be considered outside of the budget process and get the 60 votes necessary to waive the budget act.

There is substantial bipartisan support for repeal of or substantial reforms to the Alternative Minimum Tax (AMT) that would have a significant revenue loss. Legislation repealing the AMT has been introduced by seven Members of the Finance Committee (and one Senator not on the Finance Committee), including the Senate Majority Leader and the Chairman and Ranking Democrat on the Finance Committee. Repeal of the AMT would cost $611 billion over the next ten years not counting debt service, and the costs would be considerably higher if the tax cuts enacted in 2001 are extended. In light of the bipartisan support for AMT repeal, this is definitely a candidate for consideration outside the budget process. Finally, given the proposals put forward by both parties providing tax incentives for retirement savings, it is easy to envision a retirement savings bill that could pass with sufficient bipartisan support to waive the budget act.

Conclusion

It now appears that Congress will pass and the President will sign legislation that will increase the deficit by more than the $200 billion assumed in the budget resolution. When the Office of Management and Budget released budget projections which showed an improvement in the deficit outlook, we expressed concerns that this good news would be used as an excuse to further relax fiscal discipline. The bills passed prior to the August recess and the outlook for legislative actions when Congress returns to session in September confirm that these fears are well-founded. The lower deficit projections should be used as an opportunity to take steps to reduce the deficit and move toward a balanced budget rather than an excuse to pass legislation that will add to the nation’s unpaid bills.