

United States Senate

WASHINGTON, DC 20510-4704

COMMITTEES:
APPROPRIATIONS
BUDGET
HEALTH, EDUCATION, LABOR,
AND PENSIONS
RULES AND ADMINISTRATION
VETERANS' AFFAIRS

January 24, 2013

Dear Colleagues,

Although we are just a few weeks out from the year-end bipartisan deal to avert the last fiscal cliff and Congress faces a number of budget deadlines that could make the next few months challenging, I am confident that we can work together to deliver the balanced and bipartisan budget deal the American people expect and deserve. And I am hopeful that the constant crises and brinksmanship can finally come to an end, allowing us to the regular budget order and pass a Senate budget resolution that works for middle class families and the economy.

As incoming chairman of the Senate Budget Committee, I thought it would be helpful to work with Committee staff to put together a memo laying out the state of play as we enter this critical period and begin working in the Budget Committee to write a budget resolution. Hopefully the information below will help us all be as clear as possible as we explain to our constituents and our colleagues why we are fighting for budget solutions that are balanced, fair, work for middle class families, and help build a foundation for long-term economic growth.

As you all know, we are not starting from scratch in the 113th Congress. This memo first lays out the bipartisan work we've already done over the last two years to reduce our deficit and debt by at least \$2.4 trillion. Critically, it shows that the vast majority of the savings we've already agreed to and passed into law have come from spending cuts.

Since this is an area in which bipartisan groups have done a lot of work to lay out some clear goals that have been accepted by members from both sides of the aisle, the memo shows how the deficit reduction work of the past two years stacks up against the Simpson-Bowles and Gang of Six plans. And as you will see, it makes it very clear that in order to achieve the balanced approach that these groups recommend, the next steps we take need to include equal amounts of responsible spending cuts and new revenue from the wealthiest Americans.

The memo then lays out in detail the three cliffs we still have ahead of us. It explains what the impact of sequestration's across-the-board cuts would be if they aren't replaced in a balanced way, as well as the need to avoid a government shutdown at the end of March. It shows how devastating it would be if Republicans continue using the debt limit as a political pawn, and it highlights the clear need to allow the federal government to pay the bills it has already accrued.

Finally, this memo identifies the most significant conclusion that can be drawn from the facts as they stand today: We need to fight to make sure any budget deal we make is balanced, fair for the middle class, and calls on the wealthiest Americans to pay their fair share. It lays out just a

few of the tax giveaways for corporations and the wealthiest Americans that should be on the table, and it identifies ways to make sure middle class families and seniors get the fair deal they deserve.

I hope this memo is helpful as we work together to write a budget resolution and tackle our budget challenges in a balanced and bipartisan way. I am happy to discuss any of these issues further or make my staff available for additional analysis.

Sincerely,

A handwritten signature in blue ink that reads "Patty Murray". The signature is written in a cursive style with a large initial "P" and a long, sweeping underline.

Senator Patty Murray (D-WA)
Incoming Chairman, Senate Budget Committee

Memorandum

To: Senate Colleagues

From: Senator Patty Murray (D-WA) and Senate Budget Committee majority staff

Re: Where we stand heading toward upcoming budget cliffs and beginning work on a Senate budget resolution

Date: January 24, 2012

Part I: Two Years of Bipartisan Deficit Reduction: \$2.4 Trillion, Mostly Spending Cuts

Over the last two years, Congress worked together with the Administration to pass legislation reducing deficits by at least \$2.4 trillion.¹ These first steps took us a significant way toward our deficit reduction goals. It is very important to note, however, that the vast majority of the savings in these new laws come from spending cuts. And only in the last month have we been able to bring in any new revenue by raising taxes on the wealthiest Americans.

2011: Spending cuts alone, Republicans refuse to include revenue

The bipartisan deals we made in 2011 have cut discretionary spending by almost \$1.5 trillion for fiscal years 2013 through 2022 (\$1.7 trillion including interest savings).² These savings were achieved in two ways, first through a series of Continuing Resolutions (CRs) that cut spending by about \$550 billion over ten years, and then through enactment of the Budget Control Act (BCA), which established spending caps – saving an additional \$900 billion over ten years. *The result of these cuts is that discretionary spending will fall to its lowest level as a share of the economy in over half a century.*

Aside from establishing the ten years of discretionary caps and sequestration to enforce those cuts, the BCA also contained a separate sequester mechanism to backstop the work of the Joint Select Committee (JSC). Because Republicans refused to put a penny of new revenue on the table and prevented the JSC from reaching a balanced and bipartisan deal, the painful across-the-board cuts to defense and domestic spending will begin in March unless Congress and the Administration reach agreement on a balanced replacement.³

2012: The year-end deal to extend middle class tax cuts, raise revenue from the wealthiest Americans

Although it should not have taken until the last minute to get done, the bipartisan American Taxpayer Relief Act of 2012 (ATRA) delivered on the promise we made to our constituents to permanently extend middle class income tax cuts and bring in new revenue from the wealthiest Americans.⁴

¹ Up to \$3.6 trillion including the across-the-board cuts scheduled to occur under sequestration

² Relative to the CBO's August 2010 baseline, which is used because it is the last baseline of record prior to the implementation of a series of discretionary spending cuts.

³ The BCA sequester was initially scheduled to go in effect at the beginning of 2013, but was delayed for two months by the ATRA.

⁴ The ATRA was signed into law by President Obama on January 2, 2013.

This year-end deal is expected to reduce deficits by more than \$600 billion over the next ten years (or more than \$700 billion with interest savings),⁵ with the bulk of that revenue – approximately \$400 billion – generated by allowing the top income tax rate to rise from 35% to 39.6% on household income over \$450,000 (see **Table 1**).

ATRA also permanently indexed the Alternative Minimum Tax (AMT) exemption amount to inflation; extended through 2017 the expansions of various refundable credits first enacted in 2009; and extended through 2013 other expiring tax provisions, including the Research and Experimentation credit. It provided some much-needed support for workers still fighting to get back on the job by extending for one year emergency unemployment insurance benefits. Finally, ATRA also increased Medicare physician payments (i.e., the “doc fix”), and replaced the first two months of the BCA sequester with an equal mix of spending cuts and revenue increases, with the spending cuts split evenly between defense and nondefense.

Table 1. Breakdown of Revenue from High-Income Households in the ATRA of 2012

<i>(\$billions)</i>	2013-2022
Increase top rate on ordinary income to 39.6% and top rate on capital gains/dividends to 20%	446
Reinstate Personal Exemption Phase-out and Pease itemized deduction limit for high-income households	152
Estate tax changes	19
Total	617

Sources: CBO, JCT, SBC Staff.

Note: Compared to a current policy baseline.

If Congress doesn't replace the automatic, across-the-board cuts scheduled to occur under sequestration in a balanced way, the ratio of spending cuts to revenue increases would be 4:1, with roughly 80% of the savings coming from funding that primarily benefits the middle class and most vulnerable families, versus a 20% contribution from revenue coming from high-income taxpayers (see **Table 2**).

⁵ Relative to a current policy baseline that extends certain expiring tax policies. The President's Fiscal Commission (“Simpson-Bowles”), the Bipartisan Policy Center's Debt Reduction Task Force (“Rivlin-Domenici”), the President, and the House Budget Committee all used versions of a current policy baseline. Under conventional scoring rules and a *current law* baseline, however, which assume expiring policies lapse as scheduled, CBO estimated ATRA will increase deficits by about \$4 trillion over ten years (or about \$4.6 trillion, including the additional debt service costs associated with the bill).

Table 2. Deficit Reduction during the 112th Congress

<i>(\$billions, 2013-2022)</i>	Spending	Revenue	Total (ex Interest)	Interest	Total
Excluding savings from BCA Sequester					
BCA, 2011 CRs (ex BCA sequester)	1,464	-	1,464	240	1,704
ATRA	-	617	617	96	713
Total	1,464	617	2,081	336	2,417
Percent of total	70%	30%			
Including savings from BCA Sequester					
BCA Sequester	984	-	984	216	1,200
Total	2,449	617	3,065	552	3,617
Percent of Total	80%	20%			

Sources: Congressional Budget Office (CBO), Joint Committee on Taxation (JCT), SBC Staff.

Note: for discretionary, the table compares current spending path, following adoption of 2011 CRs and BCA caps on spending to CBO's August 2010 baseline.

Savings from BCA sequester include both discretionary and mandatory, although the vast majority of such savings is scheduled to come from further cuts in discretionary funding.

Part II: How do these first deficit reduction steps stack up against other bipartisan efforts? They have much less revenue!

As we continue working to tackle our budget challenges and build on recent efforts, it is valuable to look to the work of bipartisan groups over the last several years as frameworks for what a balanced, bipartisan, and comprehensive deal could look like.

These bipartisan frameworks include significant new revenue and have far more balance between spending cuts and revenue increases than the deficit reduction measures we've enacted to date.

For instance, the President's Fiscal Commission and the Senate's Gang of Six each proposed roughly \$4.8 trillion in deficit reduction over the 2012-2021 period,⁶ with over \$2 trillion coming in the form of new revenue. Excluding the interest savings of roughly \$800 billion, the two bipartisan efforts proposed a roughly 1:1 ratio of spending and revenue savings (see Table 3).

Further, measured over the same ten-year window used to estimate the effects of the ATRA legislation (2013-2022), the two bipartisan efforts each provide for revenue of between \$2.4 trillion and \$2.5 trillion, or roughly four times the amount of new revenue to be generated by the year-end deal.

⁶ Under a current policy baseline for revenue. Note that for discretionary spending, the plans measured savings relative to CBO March 2011. If adjusted to measure savings relative to August 2010, the ratio between spending and revenue savings – excluding debt service – remains roughly 1:1 (although reflecting slightly more spending).

Table 3. Deficit Reduction under Bipartisan “Simpson-Bowles” and “Gang of Six” Plans

<i>\$billions</i> 2012-21	“Simpson-Bowles”				Senate “Gang of Six”			
	Spending	Revenue	Interest	Total	Spending	Revenue	Interest	Total
Savings	1,967	2,064	796	4,827	1,924	2,064	783	4,771
Ratio	49%	51%			48%	52%		

Sources: The Moment of Truth Project, Senate Gang of Six, Office of Management and Budget, and SBC staff.
 Notes: Estimates relative to a current policy baseline, not a “plausible” baseline as was originally used by both groups. The difference is to increase the amount of the adjustment for revenue between the two baselines by \$866 billion (for 2012-21). Numbers do not include savings related to Social Security changes. Finally, the table measures savings for discretionary spending relative to CBO March 2011 (vs August 2010 in Table 2).

Part III: The upcoming cliffs

- **March 1—BCA Sequestration**
- **March 27—Government funding/potential shutdown/little sequestration**
- **May 19th—The Debt Limit**

Over the next three months we face three significant budget deadlines and it is important to distinguish between each of these events and the action they require from Congress. While discussions over how to avoid a government shutdown and replace the BCA sequester to reflect a better balance between spending cuts and revenue are appropriate, it is absolutely irresponsible for members of Congress to use the debt limit for political purposes and even entertain the possibility of allowing the federal government to default on its obligations.

Cliff #1: BCA Sequestration. Although it was intended as a trigger to push both sides toward compromise, the Republicans’ insistence on protecting the rich from paying their fair share of taxes has made sequestration a very real possibility.

The BCA directs that the \$1.2 trillion in automatic, across the board spending cuts be:

- (1) reduced by the amount of interest savings (equal to 18% of the total, or \$216 billion),
- (2) spread evenly over 9 years (\$984 billion divided by 9, or \$109.3 billion a year), and
- (3) split evenly between defense and nondefense (\$54.7 billion for each category).

ATRA did two important things regarding the BCA sequester scheduled for 2013:

- (1) delayed implementation of the cuts by two months (from January 2nd until March 1st), and
- (2) paid for the \$24 billion cost of that delay with an equal mix of spending cuts and new revenue.

Prior to Congress lowering the amount of the 2013 sequester (from \$109 billion to \$85 billion), OMB calculated the across-the-board cut for non-exempt programs in its report to Congress pursuant to the “Sequestration Transparency Act of 2012” in September 2012. However, with the replacement of \$24 billion of the previously scheduled savings, those percentages will now be lower (see **Table 4**).

For instance, for nondefense discretionary, the percentage reduction should fall to approximately 5.1%. For nondefense mandatory (other than for Medicare), the percentage reduction should fall to 5.3%. Finally, for defense discretionary, the percentage reduction should fall to approximately 7.3%.⁷

Table 4. Sequester Percentages for Key Categories

%	Original OMB Estimate Before ATRA	Revised Estimate Following ATRA
Nondefense Discretionary	8.2%	5.1%
Medicare	2.0%	2.0%
Other (non-Medicare Nondefense Mandatory)	7.6%	5.3%
Defense Discretionary	9.4%	7.3%
Defense Mandatory	10.0%	7.8%

Sources: OMB, Center on Budget and Policy Priorities.

Note: In addition to Medicare, there are certain other health programs not shown above that also are capped at 2%.

Although ATRA reduced the overall level of funding to be sequestered, the delay means that a smaller portion of the year’s funding is available to absorb the cut. Consequently, the impact of the cuts will generally not be less dramatic despite the fact that each account will be reduced by a lesser amount. In fact, on an annualized basis, in most cases, there is little difference.

Note that the BCA exempts a number of programs from sequestration. In total, there are approximately 155 exempt accounts and programs (out of a total of about 1,200 accounts). Most exemptions are for programs that are categorized as nondefense mandatory (including several of the largest programs). These programs include those administered by the Department of Veterans Affairs, several retirement and disability accounts, and low-income programs.

Most discretionary funding *is* subject to sequestration with a few notable exceptions. Discretionary funding for veterans programs, including veterans’ health care, is fully exempt as is Pell grant funding. The President also was provided and has used the option for 2013 to exempt military personnel funding. That exemption means that other non-personnel defense accounts must be reduced by more to make up the difference from exempting military personnel funding.

For mandatory spending, the BCA includes several “special rules” to limit the amount of any cut. For instance, Medicare cuts to providers are capped at 2%. The 2% limitation also applies to some activities within Health Resources and Services Administration and Indian Health Services.

⁷ The revised percentages are calculated using the data provided in the “OMB Report Pursuant to the Sequestration Transparency Act of 2012” (P.L. 112-155), on tables 2 and 3, updated to reflect the new sequester total of \$85 billion.

Student loans are impacted by the sequester through a special rule to raise origination fees by the percent of sequester cuts. For example, a 6% sequester cut would increase student loan origination fees to 1.06%. The effective increase would occur during academic year 2013-2014 (fiscal year 2013).

Finally, examples of mandatory programs that are neither exempt from the sequester nor subject to a “special rule” that limits the size of the cut include: programs that support farm prices, vocational rehabilitation, mineral leasing payments, and the Social Services Block Grant.

While sequestration would be painful, it would be worse to replace these cuts in a way that hurts the middle class and most vulnerable families even more and doesn't call on the wealthy to pay their fair share.

Cliff #2: 2013 Appropriations – Funding of Government Operations. The 2013 CR is set to expire on March 27th, and unless Congress acts by this date to approve appropriations for the funding of government operations, the government will shut down. Any deal would also need to adjust or include revised funding levels to adhere to the limits for security and non-security categories enacted as part of ATRA, or risk triggering additional automatic cuts.

Should Congress fail to come to agreement on either full-year funding or another CR for 2013 by March 27, 2013, the government will shut down, many federal employees will be furloughed, and government operations that seniors and families depend on will be cut off or reduced.

A government shutdown could have a devastating impact on our still-recovering economy and cut off access to Social Security for new filers, loans for small business owners and families trying to buy a home, food-safety inspections, and so many other programs and services that families and seniors across the country count on.

The BCA's “little sequester”

The BCA limited overall 2013 funding to \$1.047 trillion by capping defense funding at \$546 billion and nondefense funding at \$501 billion. The law required that a firewall between defense and nondefense funding be established for 2013 and all years through 2021 if the JSC did not reach an agreement.⁸ Exceeding the limit in either category would trigger automatic across-the-board cuts in that category.

While the CR rate kept overall funding at \$1.047 trillion, it increased defense funding by \$10.9 billion while lowering nondefense funding by the same amount relative to the limits in place. If not for action as part of the ATRA, the increase in defense funding would have resulted automatically in defense cuts of \$10.9 billion. These cuts, sometimes referred to as the “little sequester” or “cap sequester,” are separate from and in addition to the larger, more commonly understood BCA sequester.

⁸ A firewall imposes a separate cap on specified categories of spending in addition to the aggregate cap.

Adjusted limits under ATRA

ATRA switched the 2013 firewalls from defense/nondefense to security/non-security. In addition, it reduced the overall 2013 level for all discretionary spending by \$4 billion. As a result, the CR's security funding level exceeds the limit for the security category by \$7 billion. When Congress provides permanent funding for 2013, it will need to align the levels for appropriations within the security category with the limit enacted in ATRA. Otherwise, a sequester will be triggered and automatic cuts will go into place

Cliff #3: The Debt Limit. The amount of debt the federal government is allowed to maintain is capped in law by the debt limit, which currently stands at \$16.4 trillion. The debt limit was technically reached on December 31, 2012, but the Treasury has used authorities (i.e., "extraordinary measures") outside of its typical cash management practices to remain within the current limit.

Even with this effort, Treasury indicates the debt limit will be reached between mid-February and early March, depending in part on the timing of receipts flowing into and payments leaving the Treasury. To meet all of the obligations of the federal government, Congress will have to increase the debt limit.

Keep in mind: Raising the debt limit only allows us to pay the bills that the government has already accrued—it does not authorize or appropriate any new spending.

Failing to raise the debt ceiling is **NOT** equivalent to a government shutdown. The Treasury has clearly stated that "the government would default on its legal obligations – an event *unprecedented* in American history."

Allowing a government default would have a far-reaching impact on Americans, including causing market turmoil that would threaten the savings and investments of families; delaying refunds of income taxes and payments to our seniors, veterans, military members, small business owners, and others⁹; and throwing millions of workers out of their jobs.

In fact, economists generally see even the threat of default as extremely reckless, and there is a strong possibility that a prolonged debate could have very negative consequences for the economy and the budget. It has been suggested that the extended 2011 debt ceiling discussion hurt confidence and cut job growth by about half during the 3-4 month-long debate—and an actual default might spark a financial crisis and would force immediate spending cuts many times larger than those faced in last year's fiscal cliff.

⁹ Treasury estimates that it makes approximately 80 million separate payments per month. Failing to address the debt limit puts all of these payments at risk.

Further, at some point, ratings agencies will almost certainly downgrade US credit if the ceiling is not raised.¹⁰ For instance, *Fitch Ratings*, has written that “...failing to raise the debt ceiling in a timely manner is not consistent with being triple-A.” A lower credit rating could create the equivalent of a tax increase on every American, in the form of higher interest rates on American families’ mortgages, car loans, and credit cards. *Fitch Ratings* also recently said that they believed that “the debt ceiling is an ineffective and potentially dangerous mechanism for enforcing fiscal discipline.”

The debt limit has historically been raised through a vote of Congress, which has occurred under Presidents from both parties, usually with little to no controversy. As has always been the case, there should never be any doubt that the U.S. is going to pay the bills we’ve already accrued.

House Republicans took an encouraging step in the right direction this week when they passed legislation to suspend the debt limit through May without demanding spending cuts. But this short-term increase perpetuates the cycle of uncertainty that has already impacted American families and businesses.

Now that it should be clear that House Republicans don’t seem to be willing to allow a default to actually take place, we should pass a long-term solution to give the markets and the economy certainty and prevent this issue from being used as a political pawn.¹¹

Part IV: It is clear that the next steps need to be balanced, protect the middle class and most vulnerable, and include revenue from those who can afford it most

Examining the deficit reduction Congress has undertaken over the past two years and holding it up to the bipartisan plans that both sides agree are balanced frameworks, a few conclusions become very clear.

Revenue Must be Included in Any Deal. Tackling our budget challenges requires both responsible spending cuts and additional revenue from those who can afford it most.

We simply cannot solve this problem on the spending side alone – the magnitude of the required cuts is so large that they would be unworkable, unfair, and inconsistent with the budget values and priorities of the vast majority of Americans. And while the recent agreement took important steps toward calling on the wealthiest Americans to pay their fair share, more needs to be done.

It would be tremendously unfair and unbalanced to ask further sacrifice from the middle class and most vulnerable families, while the wealthiest Americans and biggest corporations continue to benefit disproportionately from the countless preferences embedded in the tax code.

¹⁰ In fact, Standards and Poor’s already downgraded the US credit rating from AAA to AA+ in August 2011 as a result of the last debt ceiling crisis. In addition, while both Fitch Ratings and Moody’s have maintained the AAA rating for the US, both have downgraded their outlook to negative in the past two years.

¹¹ The House passed H.R. 325 on January 23rd. The bill temporarily suspends the limitation on borrowing by the Department of the Treasury through May 18, 2013. In addition, on May 19th, the bill automatically raises the current statutory limit of \$16.4 trillion to cover the amount of borrowing above that level that occurred during the period of the suspension.

The recent agreement did little to address the skewed distribution of the benefits conferred to high-income households by tax expenditures. The top 1% of taxpayers receives nearly 25% of the benefit from these provisions. In total, tax expenditures were estimated to cost the Treasury \$1.2 trillion in forgone revenue in 2011. That is nearly equivalent to what we spent on *all* discretionary programs in 2011.

Republicans know that our tax code is riddled with giveaways for the wealthiest Americans and biggest corporations. Speaker Boehner admitted as much late last year when he proposed to raise \$800 billion for deficit reduction by closing “special-interest loopholes and deductions.”

The Speaker is correct – we spend billions on tax breaks for oil and gas companies. Tens of billions of dollars more is lost to abusive tax shelters and offshore tax havens. Corporate jet owners still get a \$3 billion tax break. We could raise hundreds of billions of dollars by making sure the rich no longer benefit disproportionately from deductions and other tax preferences. We could save \$9 billion by making sure individuals can’t exploit loopholes to avoid paying employment taxes. And the list goes on.

The alternative to raising additional revenue is spending cuts so large that they would be devastating to middle class families who have already sacrificed so much.

We must ask ourselves, is it worth preserving the tax break for corporate jets at the expense of cutting Pell grants that help Americans gain employment and opportunity? Or keeping the giveaways for the oil and gas companies while cutting worker training programs that help small business owners hire the skilled workers they need? Those are the tradeoffs we need to consider as we fight for our values and priorities.

We should also keep in mind that the year-end deal is projected to result in a ten-year revenue average of 18.5% of GDP (reaching 19.1% of GDP in 2022)¹². We know from historical experience that revenue at that level will not be sufficient to balance the budget—the last five times the budget was in balance, revenues ranged between 19.5 and 20.6% of GDP—especially as more and more baby-boomers enter their retirement years.

We should protect critical investments in our workers and communities. It is also important for everyone to understand that the majority of deficit reduction over the past two years came through cuts to discretionary spending. Moreover, those cuts have been disproportionately applied to nondefense funding. Relative to 2010, defense funding under the 2013 CR is essentially frozen at the 2010 level while nondefense funding has been cut by more than 9 percent below the 2010 level. So we need to make sure that as we work to tackle our budget challenges, we aren’t cutting the long-term investments in our workers, our businesses, and our communities that will help our economy continue to recover and grow from the middle out.

¹² Working from CBO’s August 2012 baseline. This number may change with the release of CBO’s January 2013 baseline.

So while we have already cut so much from discretionary funding and should find savings in other ways before we cut more, should Republicans insist on additional cuts to this small slice of the overall budget, defense should contribute at least as much as nondefense. This equal sharing of the burden of discretionary spending reductions has been a key element of every bipartisan deficit reduction proposal, including Simpson-Bowles.

The middle class and most vulnerable families have already sacrificed enough. Tackling our budget challenges shouldn't come at the expense of the middle class and most vulnerable families who have already sacrificed so much in this tough economy, and it doesn't have to. It is important to continue the principle outlined in the Fiscal Commission that called for protecting the truly disadvantaged and ensuring "our nation has a robust, affordable, fair, and sustainable safety net." To meet this objective, "benefits should be focused on those who need them the most."

Proposals that achieve savings through draconian cuts to the Supplemental Nutrition Assistance Program (SNAP), formerly known as Food Stamps, and other critical safety net programs fail to reflect this key bipartisan and American principle.