# Budget Bulletin

Senate Budget Committee
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## INFORMED BUDGETEER

### TRANSPORTATION EQUITY ACT OF THE 21ST CENTURY (TEA21)

| TEA 21 Conference Resolution (1998-2003, Outlays in Billions) | | | |
|---|---|---|---|
| Category | Freeze | Add-ons | Total |
| Highways | 139.2 | +14.5 | 153.7 |
| Mass Transit | 27.7 | +3.0 | 30.7 |
| Total | 166.9 | +17.5 | 184.4 |
| Offsets required for Add-ons: | | +17.5 | |
| Itemized Offsets to Add-ons | | | |
| Veterans Tobacco (OMB Scoring) | | | -17.0 |
| Veterans Add-Backs (Mntgmry GI) | | | +1.6 |
| Veterans Net Savings | | | -15.4 |
| Student Loan Extension- 3 months | | | +0.1 |
| Reduce Social Services Block Grant | | | -2.4 |
| **Net Total Offsets** | | | -17.7 |

NOTE: SBC preliminary estimates; Freeze level includes all federal -aid highway funding subject to obligation limitations, NHTSA safety grants, motor carrier safety grants, NHTSA operations and research, and ARC highway funding.

- Last Friday, the House and Senate passed the conference report to ISTEA - now named the Transportation Equity Act of the 21st Century or TEA21 for short.

- For budgeteers following ISTEA events for well over the past year, the biggest development in the ISTEA conference was the establishment of a new firewall within the discretionary spending limits for highways and mass transit.

- This single firewall will allow for the spending all federal gas tax revenue, with a one year delay, by the Appropriations Committee. Here's how its works.

- The base firewall was established at a freeze amount closely equivalent to last year's Balanced Budget Agreement level for transportation programs. This firewall was increased by the amount of offsets in the final conference agreement (see table above).

- Including offsets, estimated total outlays for the TEA 21 are: for highways $153.7 billion and $30.7 billion for mass transit over the six year authorization period (1998-2003).

- Like the defense and crime firewalls, the Appropriations Committee does not have to fully fund the new firewall but they will be prohibited from moving these resources to other discretionary spending. In addition, the firewall will rise and fall over the next six years in conjunction with the estimates and actuals of revenues to the Highway Trust Fund.

### HOUSE BUDGET RESOLUTION IGNORES HIGHWAY BILL, 1999 CAPS

- The House Budget Committee completed its markup of the 1999 budget resolution last week. While much attention has focused on how many tax cuts would be assumed in the resolution, perhaps more scrutiny is warranted on how those cuts would be offset by reductions in discretionary spending.

- The following table shows how much less discretionary spending the House budget resolution assumes for most budget functions compared to the levels in the Senate-passed budget resolution. The Senate resolution comports with discretionary caps enacted as part of last year's Bipartisan Budget Agreement (BBA).

- Looking at 1999 alone, the House resolution the non-defense BA cap by $4.3 billion, even though House appropriators have already received assurances that the 1999 spending bills would be funded at the **existing** cap levels, and 302(b) allocations have already been issued to that effect.

| HOUSE MARK VS. SENATE- PASSED BUDGET Discretionary Spending, $ in Billions | | | |
|---|---|---|---|
| | | 1999 | Total |
| National Defense | BA | -0.00 | -0.000 |
| | OT | -- | -- |
| International Affairs | BA | -0.448 | -11.345 |
| | OT | -0.446 | -8.749 |
| Science, Space & Technology | BA | -0.353 | 0.974 |
| | OT | -0.102 | 0.794 |
| Energy | BA | -- | -3.680 |
| | OT | -- | -2.478 |
| Natural Resources and Environment | BA | -0.453 | -7.715 |
| | OT | -0.301 | -5.410 |
| Agriculture | BA | 0.179 | 1.159 |
| | OT | 0.033 | 1.089 |
| Commerce and Housing Credit | BA | 0.932 | -0.097 |
| | OT | 0.346 | 0.100 |
| Transportation | BA | -1.428 | -7.970 |
| | OT | -0.174 | -17.448 |
| Community & Regional Development | BA | 0.066 | -2.566 |
| | OT | -0.286 | -2.246 |
| Education, Training, Employment | BA | -1.107 | -6.037 |
| | OT | -0.211 | -6.988 |
| Health | BA | -1.306 | -14.276 |
| | OT | -1.148 | -12.227 |
| Medicare | BA | 0.102 | 0.460 |
| | OT | 0.038 | 0.448 |
| Income Security | BA | -- | 0.000 |
| | OT | -0.000 | -0.000 |
| Social Security | BA | 0.042 | 0.217 |
| | OT | 0.024 | 0.237 |
| Veterans Benefits | BA | -0.017 | 2.653 |
| | OT | -0.012 | 2.035 |
| Administration of Justice | BA | -0.776 | -8.313 |
| | OT | -0.590 | -4.774 |
| General Government | BA | 0.411 | 0.108 |
| | OT | 0.781 | -0.143 |
| Allowances | BA | -0.156 | 1.139 |
| | OT | 1.379 | 10.663 |
| Total Defense | BA | -0.000 | -0.000 |
| | OT | -- | -- |
| Total Non- Defense | BA | -4.312 | -55.289 |
| | OT | -0.669 | -45.098 |
| Total Discretionary | BA | -4.312 | -55.289 |
| | OT | -0.669 | -45.098 |

SOURCE: SBC preliminary comparisons

- This must mean that all the reductions will occur in the out-years. The House resolution assumes the caps will be reduced by $55.3 billion over the next five years, which is about a 5 percent reduction from the essentially frozen existing cap funding levels.

- To achieve these reductions, the House resolution focuses on a few budget functions. The largest reductions in BA would be made in health--$14.3 billion; international affairs--$11.3 billion; justice--$8.3 billion; natural resources and environment--$7.7 billion; and education--$6 billion. All, except health, are protected functions in the BBA.

- Special attention is deserving of assumptions made in the transportation function--the one other protected function in the BBA. The Senate-passed resolution assumed the BBA level, while allowing for the possibility of increasing spending along the lines of last week's Senate and House passed highway bill. (See discussion in first section of this week's *Bulletin.*) The House Budget Committee, however, purported to cut transportation outlays $17.4 billion below the BBA level **just one day before the conference committee on the transportation bill agreed to increase spending by $17.5 billion above the BBA** (accompanied by corresponding offsets). The $17.4 billion in cuts in the House resolution accounts for **more than one-third** of the $45.1 billion in outlay reductions the House assumes will be made over the 2000-2003 period

## PERSPECTIVES ON INCREASING TOBACCO TAXES

- The highest level of revenues <u>ever</u> in the history of the republic was 20.9 percent of GDP in 1944, at the height of financing World War II. Until this year, the post-war highest level of revenues was 19.7 percent of GDP in 1981, immediately preceding the historic Reagan tax cuts.

- The booming economy and sky-high stock market have helped send this year's level of revenues to 20.5 percent of GDP, guaranteeing that the federal government will post its first unified budget surplus in thirty years - somewhere around $60 billion.

- CBO's most recent forecast projects revenues at a level of 20.1 percent of GDP in 1999, then leveling off at about 19.5 percent of GDP thereafter. The surplus in 1999 is expected to be around $35 billion; the surplus in 2000 is expected to be around $10 billion.

- The Senate Commerce Committee tobacco legislation (S.1415) won't do much to change the outlook for the budget surplus, since the bill purports to be deficit-neutral. But it will increase the bite the government takes out of the economy by about 0.2 percent of GDP per year.

| LEVEL OF REVENUES<br>Percent of GDP | | |
|---|---|---|
| | Baseline Revenues | Revenues incl. S.1415 |
| 1999 | 20.1 | 20.3 |
| 2000 | 19.7 | 19.8 |
| 2001 | 19.5 | 19.6 |
| 2002 | 19.4 | 19.6 |
| 2003 | 19.3 | 19.4 |

- S.1415 contains a sizable tax increase - almost $65 billion over the next five years and $132 billion over the next ten years. Such a large tax increase is not without precedent, but what was the federal government's fiscal situation when Congress enacted such large tax increases in the past?

- Clearly, large tax increases were enacted when revenues as a percent of GDP were relatively low and deficits as a percent of GDP were high.

| SIGNIFICANT REVENUES RAISING LEGISLATION | | | |
|---|---|---|---|
| Legislation | Revenue raised | % of GDP Revenue | Deficit |
| Tax Equity Act of 1982 | $214 billion | 19.7% | 4.0% |
| Deficit Reduction Act 1984 | $102 billion | 17.5% | 4.9% |
| OBRA 1986 | $30 billion | 17.6% | 5.1% |
| OBRA 1987 | $70 billion | 18.6% | 3.3% |
| Revenue Reconciliation-1989 | $25 billion | 18.5% | 2.8% |
| Revenue Reconciliation-1990 | $137 billion | 18.2% | 3.9% |
| OBRA 1993 | $240 billion | 17.8% | 3.9% |
| S.1415- Tobacco Act | $52 billion | 20.5% | -0.7% |

## PERSPECTIVE ON RECENT REVENUE GROWTH

- It now appears that revenue growth will have topped 7 percent for the five years from FY1994-1998. This astounding performance owes much to the strength of the current economic expansion and strong capital gains receipts.

- However, what is notable is not the headline figure for revenue growth, but the fact that it has outstripped nominal GDP growth by more than 2 percent during this time. (Revenue growth was also strong during the 1970s and 1980s, but this was due to high inflation. Revenue growth was virtually the same as GDP growth over this period).

- Some may wonder if revenue growth can continue to exceed GDP growth indefinitely. This seems unlikely. Over time, one would expect revenue growth to roughly equal nominal GDP growth, lest taxes take up an ever increasing share of GDP.

- If one looks at the period from 1945-1998, nominal GDP growth and revenue growth have indeed been virtually equal. Since revenue growth has exceeded GDP growth for the last six years, it would be logical to expect a period where revenue growth lags nominal GDP growth going forward, although the exact timing of this shift is unclear.

| Revenue Growth Minus Nominal GDP Growth<br>(in percent) | |
|---|---|
| 1950s | 1.7 |
| 1960s | 2.3 |
| 1970s | -0.5 |
| 1980s | 0.1 |
| 1994-1998 | 2.9 |
| 1946-1998 | 0.2 |

## LONG-TERM FISCAL OUTLOOK

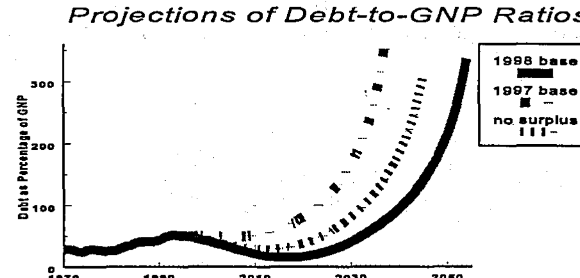
- CBO has just released its latest update of the long-term fiscal outlook. CBO concluded that the favorable events of the last year have served to delay an explosion in long-term deficits and debt by roughly 20 years. In March 1997, CBO predicted that debt would reach 100 percent of GDP by the mid 2020s. Now, they believe that this will not happen until the mid 2040s. However, it is important to note that these latest calculations assume that we remain in budget surplus through 2015.

- CBO believes that 25 percent of this year's long-term improvement is due to the Balanced Budget and Taxpayer Relief Act of 1997, while the remainder is due to economic and technical improvements.

- However, although we have had some improvement in the long-term outlook, the main conclusion of CBO's report is the same as last year -- we are presently on an unsustainable fiscal path, which will require significant entitlement reform to correct.

- CBO also presents another way of looking at the long-term fiscal imbalance. They estimate the amount that taxes would have to be raised permanently as a share of GDP in order to eliminate the imbalance. Presently, this would require that taxes to be raised immediately by 1.6 percent of GDP (or 8 percent more than total current federal tax revenues).

*Projections of Debt-to-GNP Ratios*




Source: Congressional Budget Office.
a/ The long-term projection that CBO made in March 1997.
b/ A projection that assumes that the budget is balanced from 2001 to 2008
c/ CBO's current long-term projection, March 1998.