INFORMED BUDGETEER:

@ End of 106th Congress Countdown @
Calendar Days to Sine Die: October 6
(From September 18)

Total Days	20
Less:	
Scheduled Non-Leg. Periods (0 days)	20
Fridays & Mondays before/after Non-Leg. Periods (0)	20
Remaining Saturdays & Sundays (4)	16
Mondays & Fridays in Leg. Periods (6) ; =	10

90 - 10?

- Since Congress returned from the August recess, it has attempted but failed to override Presidential vetoes of two tax cut proposals – the marriage penalty and death tax reform – that would have provided $118 billion in tax relief over the next five years. GOP Congressional leaders, realizing that they would be unable to enact significant tax relief in the 106th Congress, have now recommended that at least for FY 2001, 90 percent of the projected surplus should retire debt, with the remaining 10 percent available for spending or a few token tax reductions.

- The *Bulletin* has been inundated with questions about the 90-10 plan. In the hopes of allaying some concerns we will try to lay out the simplest of calculations to explain:

- The calculation begins with CBO's July estimate of the unified budget surplus for FY 2001, assuming that 2000 discretionary spending grows with inflation (a 2000 base level that we note includes spending for Y2K, Census, and other one-time items). This unified budget surplus estimate is $268 billion – comprised of between an on-budget surplus of $102 billion and an off-budget surplus (essentially social security) of $165 billion.

- The estimate must be adjusted for FY 2000 supplementals enacted in July and August. The net effect of the supplemental appropriations is that the unified budget surplus for FY 2001 increases to about $273 billion. This assumes that time has run out to reverse a provision in the supplemental that shifted the first payment in FY 2001 for Veterans and SSI benefits into FY 2000.

- The Social Security ($165 billion) and the Medicare HI surpluses ($32 billion) are then set aside. This $197 billion (or 72 percent) of the total surplus will not be spent or used for tax cuts, but will only go to retire debt held by the public.

- Next, the calculation assumes that some minor tax cuts (e.g. telephone excise tax repeal, FSC fix, small business tax relief and others) and some final end of session spending items (e.g. Medicare add-backs and discretionary spending over the budget resolution assumptions) will be enacted and, along with assorted interest expenses, will amount to no more than $27.5 billion.

- This means that in addition to the nearly $200 billion in debt reduction coming from the two trust funds described above, $48 billion of the estimated non-social security surplus in FY 2001 would be used to retire debt held by the public:

CBO's unified budget surplus, with supplemental	= $273 billion
Minus end of session tax and spending	= $28 billion
Total debt reduction	= $245 billion
Social Security and Medicare HI surpluses	= $197 billion
On-Budget surplus	= $48 billion

Voilà:

Debt reduction	$245 billion	
Unified Budget Surplus	$273 billion	= 90%

MAKE WAY FOR RECONCILIATION NUMBER TWO

- The Senate Finance Committee complied with the budget resolution instructions and reported a second reconciliation bill. Finance reported pension and savings taxrelief legislation which reduces revenues by $1.9 billion in 2001 and $27 billion over the period 2001-05.

- The rules for consideration are the same as for the first reconciliation bill: under the Budget Act, there are 20 hours available for debate on the bill. First degree amendments are debatable for 2 hours and 2nd degree amendments are debatable for one hour. All time limitations are equally divided.

- Because this is a reconciliation bill, the bill, any amendments thereto, and the conference report must conform to:

  - germaneness requirements (for amendments only);
  - prohibitions regarding Social Security; and,
  - the Byrd rule.

- The Byrd rule prohibits the inclusion of extraneous matter in reconciliation legislation. The Byrd rule allows offending provisions to be stricken from the underlying legislation, but Byrd rule points of order, like most Budget Act points of order, can be waived with 60 votes.

- The Retirement Security and Savings Act of 2000 was approved unanimously by the Finance Committee. The bill increases the amount individuals can save in an IRA from $2,000 to $5,000 by 2003. The bill increases maximum contribution limits for individuals over age 50 by 50 percent, and corrects part of the marriage penalty by increasing income limits for contributions to Roth IRAs for joint filers to twice the limit for single filers. The bill also allows tax-free withdrawals from IRAs for charitable purposes.

- The bill includes many provisions to expand pension coverage, including providing a new tax credit for small employer plan contributions and start up costs which will help offset the first three years of costs that small businesses incur when starting a new retirement plan.

- The bill includes provisions enhancing fairness for women, increasing portability for participants, and reducing regulatory burdens.

OMB REPORT CONFIRMS SEQUESTERS IN THE OFFING, BUT WHO CARES?

- As suggested in the *Bulletin* (September 5) welcoming budgeteers back from their summer vacations, OMB did follow up CBO's sequestration update report with its own, issued on September 8th. While OMB's assessment of the looming sequester situation is consistent with CBO's, OMB's report, unlike CBO's advisory report, is definitive for implementing the law.

- For the PAYGO scorecard, OMB estimates legislation enacted thus far, unless offset in the next month, reduces the surplus by $1.2 billion in 2001, which would trigger an across-the-board reduction of 0.5 percent of non-exempt direct spending programs, including Medicare.

- For discretionary spending, the OMB report notes that for FY2000, enacted levels for the crime, highways, and mass transit categories are within their respective caps. For all other discretionary spending, enacted levels exceed the caps for 2000, but the supplemental (P.L. 106-246) barred OMB from implementing the sequester that otherwise would have been required.

- For FY2001, OMB reiterates the common knowledge held by budgeteers all year long: the emerging levels of appropriations likely to be enacted will exceed the statutory caps that have remained on the books since they were set in 1997. The only question is–by how much? OMB's scenarios of Senate and House action to date suggest hypothetical sequesters of $75 to $80 billion in BA. This means that the stated appropriation levels would only be illusory and would require across-the-board reductions on the order of 10-15 percent below the advertised levels.

- Yet the consensus seems to be that the imminent negotiations with the Administration will only push appropriation levels higher. Therefore, some statutory remedy regarding the caps will be required so that the final levels agreed to by the Congress and the President don't evaporate in a sequester.

NEW CBO DEFENSE STUDY
RE-ESTIMATES SUSTAINING DEFENSE NEEDS

- On September 14, CBO Director Dan Crippen testified to the Senate Budget Committee on a study requested by Chairman Domenici. The Chairman's 1997 study request asked for CBO's analysis of the actual costs of the ongoing DoD defense plan. This study is the fifth in a succession of such CBO studies started in 1994. During this time, there has also been 14 GAO studies on this subject.

- The new CBO ("Budgeting for Defense: Maintaining Today's Forces") study looks at the type of forces in the Administration's current defense plan and estimates that supporting this force in a "steady state" condition – that is maintaining it in the same condition it is in today – would cost $340 billion per year on average, in "constant" 2000 dollars. See the table below for details:

FY2000 Appropriations for National Defense and CBO's Estimate of a Sustaining Defense Budget
($ in Billions, BA)

	FY 2000 Appropriation	Sustaining Level[A]	Percent difference
Department of Defense			
Military personnel	74	82	11%
Operation & maintenance	102	107	5%
Procurement	53	90	70%
Research & development	38	40	5%
Military construction	5	5	- -
Family Housing	4	4	- -
Subtotal	276	327	18%
Other Agencies	13	13	- -
Total	289	340	18%

SOURCE: CBO; Note: The figures in the table include both discretionary and mandatory funding. Details may not add to totals due to rounding. [A]The sustaining budget estimate is CBO's calculation of the annual funding required to maintain U.S. military forces at their current size; to modernize their weapons and equipment at a rate that is consistent with expected service lives and with maintaining a technological advantage over potential adversaries; and to maintain current funding for readiness. It is a steady-sate concept and not an estimate of the defense budget for any specific year.

- The study and Director Crippen's testimony raise a key question: rather than rushing to fill the funding gap with additional spending, there are additional options to consider. Those options include reassessing today's US national security strategy in response to the current world threat and recalibrating US forces to more appropriately address those threats. This is an exercise that many national security analysts strongly recommend. The budget to support such a reassessed strategy and defense force may be quite different. Perhaps the new President, whoever he may be, should take heed.

ECONOMICS

EUROPE CUTS MARGINAL TAX RATES

- While *Bulletin* readers were enjoying the summer holidays, some important fiscal decisions were being made in Europe. Both Germany and France announced they were cutting marginal income tax rates, including those for the highest income individuals.

- As part of its 50 billion mark multi-year tax cut package, Germany approved a further reduction in the top personal income tax rate. This rate will fall from the current 51 percent to 42 percent by 2005. It is interesting that traditionally high-tax Germany will now have a top marginal income tax rate largely on par with the US's (including the effects of the phase-out of deductions and exemptions for high income individuals).

- Not to be outdone, the French government subsequently announced a 120 billion franc multi-year tax cut, which included an across-the-board cut in marginal tax rates, including those for the highest income bracket. Such tax cuts were made possible by stronger than expected revenue inflows into the Ministry of Finance's coffers and the desire to give back some of this windfall to the individuals who generated it.

- Both nations said that marginal rate reductions for high income groups were needed to improve their competitive edge and revitalize their economies. Absent were any comments that rate reductions for the highest tax brackets are unfair or socially irresponsible. This is all the more notable since both countries are run by left leaning governments.

- In many ways, the launch of the euro likely encouraged such a shift in thinking. By making price differentials between nations more transparent, there is now a greater penalty for nations that have higher taxes and regulation. Thus there is more incentive to adopt growth enhancing fiscal policies.

- A footnote: The Financial Times reports that Hans Eichel, German finance minister, stated in a Bundestag budget debate last week that Germany's tax law was "not the most complicated in the world ... who has the most complicated tax system is clear: the U.S." The basis of his claim supposedly rests on work done by the International Fiscal Association in Holland. The *Bulletin* will check this out!

BUDGET QUIZ

Question: How are investments of federal funds in non-Treasury instruments treated in the budget?

Answer: In analyzing the budgetary effects of H.R. 4844, the Railroad Retirement and Survivors' Improvement Act of 2000, which passed the House on September 7, CBO stated the following:

> "Section 105 of H.R. 4844 would establish a new entity, the Railroad Retirement Investment Trust, which would be allowed to invest in non-Treasury securities, such as publicly traded stocks in private companies. By law, the fund's assets, which CBO estimates will total about $18.5 billion in December 2000, now consist solely of U.S. government securities...Similar restrictions apply to the investment policies of every major federal trust fund – Social Security, Medicare, Civil Service Retirement, Military Retirement, the Highway Trust Fund, and others. H.R. 4844 would make Railroad Retirement an exception to that rule.
>
> "...The current budgetary treatment of federal investments in non-

Treasury financial instruments is specified in the Office of Management and Budget (OMB) Circular A-11, which states that the purchases of such securities should be displayed as outlays and the sales of such securities and returns such as dividends and interest payments should be treated as offsetting receipts.”