# INFORMED BUDGETEER

## CBO MONTHLY UPDATE

**OUTLAYS THROUGH MAY**
($ in Billions)

| Major Category | October - May FY 1998 | FY 1999 | % change |
|---|---|---|---|
| Defense-Military | 169.5 | 171.8 | 1.4 |
| Social Security benefits | 246.6 | 254.1 | 3.0 |
| Medicare | 142.2 | 138.7 | -2.4 |
| Medicaid | 67.0 | 70.6 | 5.5 |
| Net Interest- Public Debt | 167.8 | 158.2 | -5.7 |
| Other | 312.1 | 343.8 | 10.1 |
| Total | 1,105.2 | 1,136.2 | 2.9 |

SOURCE: Monthly Budget review, CBO; June 5, 1999

- From the CBO June Monthly Budget Review:

  "In compliance with the Congressional budget resolution for 2000, CBO will update its economic and budget forecast on July 1. Although CBO has not yet completed its new estimate of the 1999 surplus, current trends suggest that the surplus is likely to be slightly higher than the current projection of $111 billion. Specifically, the continued slow pace of Medicare spending, along with slightly lower than anticipated outlays in a number of other areas, suggest that total outlays for 1999 may fall a bit short of CBO's current estimate of $1,704 billion. In addition, the economy's rate of growth for the rest of the year is expected to be higher than CBO previously forecast, leading to a small increase in projected revenues for the fiscal year."

## SOME CLUES TO THE REVENUE SURPRISE MYSTERY

- Richard Kasten, David Weiner and G. Thomas Woodward of CBO's Tax Analysis Division presented a paper at the spring National Tax Association conference titled "What Made Receipts Boom and When Will They Go Bust?" The paper will be published in the fall 1999 National Tax Journal and is still subject to revision.

- Between 1994 and 1998, federal revenues relative to GDP rose 2.1 percentage points, from 18.4 % of GDP to 20.5%. Virtually all of the increase was due to surging individual income taxes, which increased from 7.9% of GDP to 9.9% of GDP over the same time period. This very high level of taxes as a percent of GDP was the result of five years of revenue growth exceeding GDP growth.

- Why did revenues grow so much faster than the overall economy over the past several years? A table from the forthcoming paper shows that about half of the excess growth was due to taxable incomes growing faster that GDP (both taxable personal income and AGI) and the other half was due to a significant increase in the effective tax rate on taxable income.

- The table compares actual tax liability at the end of the 1994-1997 time frame to a "naive" estimate of what that tax liability would have been had the ratio of income tax liabilities to GDP remained at its 1994 level. The difference between the two is further decomposed to illustrate what was behind the revenue boom.

- Taxable personal income grew faster than GDP, accounting for about 15% of the boom. Taxable personal income can grow faster than GDP if, for example, non-taxable compensation (health benefits and other fringes) grew more slowly than taxable compensation or if indirect business taxes (i.e., excise and customs duties) grew more slowly than GDP.

- Adjusted gross income (AGI) grew faster than taxable personal income, accounting for about 40% of the excess revenue. Within this category, capital gains realizations grew substantially faster than GDP over the time period, accounting for about 30% of the revenue surprise.

- The income to which tax rates are actually applied grows at a different rate than AGI because of itemized deductions. Itemized deductions grew slower than AGI over the 1994-1997 period, accounting for about 1% of the boom.

- The remainder, or about half, of the difference is due to a higher effective tax rate. Real bracket creep (higher real incomes being taxed at higher rates), growth of highly taxed sources of income (such as income from partnerships and S corporations), and a further skewing of income growth at higher levels are the reasons behind a higher effective tax rate.

**Sources of Growth: Ratio of Income Tax Liability to GDP**
1994-1997

| | $ billions | % of change |
|---|---|---|
| Actual tax liability | 736.9 | |
| Naive estimate of liability | 623.6 | |
| **Difference** | **113.3** | **100%** |
| **Growth: taxable personal income in excess of GDP** | **16.9** | **15%** |
| **Growth: AGI in excess of taxable personal income** | **45.4** | **40%** |
| Capital Gains | 34.2 | |
| IRA, 401(k), pension, social security | 4.7 | |
| Other components of AGI | 6.5 | |
| **Growth: deductions slower than AGI** | **1.4** | **1%** |
| **Higher effective tax rate** | **49.7** | **44%** |
| Effect of overall real growth | 19.6 | |
| Growth of highly-taxed income | 7.1 | |
| Changing income distribution | 23.0 | |

## A DELUGE OF DIRECT SPENDING AND POINTS OF ORDER

- After four days of debate on May 24, the Senate passed S. 1059, the FY 2000 Department of Defense Authorization bill. During the course of the debate, the Senate adopted 107 amendments, 101 of them on the last day -- all of them by voice vote.

- Among these were several amendments that added direct spending to the bill. These could be grouped into three categories: military pension actions, GI Education benefits and other veterans benefits, and other. The costs of these voice-voted amendments were substantial. A summary description of them and their ten-year (2000-2009) costs is in the table below.

- These costs do not include about five other amendments that CBO has not yet had time to score; thus, the estimate of $15.6 billion in direct spending over 10 years is probably conservative.

- Unfortunately, this $15.6 billion is not offset by savings or receipts credited to the Armed Services Committee, which handles the defense authorization bill. That makes this spending subject to a 60-vote point of order, specifically under section 302(f) of the Budget Act: the Armed Services Committee would exceed its allocation for direct spending.

- That also means that when each of these amendments was considered, they were subject to a point of order. However, because of the political popularity of these provisions no Senator raised any objection.

- As this *Bulletin* goes to press, the House is acting on its version of the Department of Defense Authorization bill, and these and other defense issues will soon go to a House-Senate Conference Committee. Should a conference report to the Senate include any of these direct spending items not offset, the whole conference report would be subject to a 60-vote point of order. In this situation, the point of order would lie not against a politically popular individual benefit in the form of an amendment, but against the entire conference report.

| DOD AUTHORIZATION BILL<br>$ in Millions | |
|---|---|
| | 10-year cost |
| **Pension Benefits** | |
| Military Pension Increase | 233 |
| Survivor Benefits Extension | 63 |
| Survivor Benefits Coverage | 4 |
| **Subtotal** | **300** |
| **GI Education Benefits & Veterans Benefits** | |
| Increased Assistance | 1,048 |
| Member Contribution Changes | 1,952 |
| Accelerated Payments | 161 |
| Entitlement of Children | 9,835 |
| Other Benefits | 84 |
| Illnesses of "Atomic" Veterans | 1,456 |
| **Subtotal** | **14,536** |
| **Other benefits** | |
| Double Dipping for Military Retirees | 738 |
| DoD Civilian Pensions | 35 |
| Italian Ski Resort Compensation | 24 |
| **Subtotal** | **797** |
| **Total** | **15,633** |

## BUDGET PROCESS REFORM IN THE HOUSE

- In February Representatives Nussle and Cardin introduced the Comprehensive Budget Process Reform Act of 1999 (H.R. 853). The House may consider the legislation in the near future. The bill's seven titles are described below.

- *Title I: Budget with Force of Law.* This title calls for a joint budget resolution (rather than the present concurrent resolution) which would require the signature of the President. It also contains a fall-back procedure generating a concurrent resolution in the event that the President vetoes the joint budget resolution.

- *Title II: Reserve Fund for Emergencies.* This title repeals the current provisions in the Balanced Budget and Emergency Deficit Control Act with respect to emergency spending and creates a new mechanism by which a reserve fund for emergencies (equal to the average of previous 5 fiscal years) is established.

- The Budget Committees would then decide if a particular item of emergency spending warrants an adjustment from the reserve. Procedures are also included if emergency spending will exceed the amount set aside in the reserve. This reserve will become effective only upon the enactment of legislation which changes or extends the existing discretionary spending caps.

- *Title III: Enforcement of Budgetary Decisions.* This title makes changes to the Budget Act and to House Rules to tighten enforcement in the House and to require committees of the House to include "budget compliance statements" in their reports and to justify the need for waivers of the Budget Act. The title also amends the Budget Act to require that CBO prepare cost estimates for conference reports.

- *Title IV: Accountability for Federal Spending.* Subtitle A of this title provides a point of order in the House and Senate against legislation which provides direct spending for a new program for a period exceeding 10 years.

- It also amends House Rules to prohibit consideration of legislation creating indefinite (exceeding 10 years) authorizations for discretionary programs and to facilitate the offering of amendments which would subject new direct spending to annual appropriations.

- For both the House and Senate, it also creates a savings lockbox by which authorizing committees can generate direct spending savings which will be credited towards the discretionary caps and not counted towards pay-as-you-go.

- Subtitle B of this title amends House Rules to require authorizing committees to create a timetable for reviewing/reauthorizing legislation at least once every ten years and to include in their activity reports a summary and justification of the budgetary effects of legislation reported by the committee.

- Subtitle C of this title permanently requires CBO to prepare 10-year cost estimates and repeals the Gephardt rule in the House regarding legislation affecting the statutory limit on the debt.

- *Title V: Budgeting for Unfunded Liabilities and other Long-Term Obligations.* Subtitle A of this title proposes a study and implement of an alternative budgetary treatment of federal insurance programs. Currently these programs are budgeted on a cash basis. This proposal suggests moving to a risk-assumed cost basis similar to how loan programs under Credit Reform are treated. Subtitle B requires the President's budget and CBO to report on long-term (75 years) budgetary trends.

- *Title VI: Baseline, Byrd Rule, and Lockbox.* Subtitle A of this title requires additional comparisons in both the President's and Congress' budgets to show the percentage change in spending between the current year spending and the fiscal year for which the budget is submitted (and the next four years).

- Subtitle B would amend the Senate's Byrd Rule (a prohibition against extraneous items in reconciliation bills) to eliminate the application of the rule to conference reports. (*Bulletin* observation: this is reform?)

- Subtitle C would create a "spending accountability lock-box ledger" such that enacted savings (i.e. funds within the discretionary caps) which are not spent in the appropriations process and are specifically designated as "savings" would result in adjustments to allocations and reduce the discretionary spending caps.

- Subtitle D provides for an automatic continuing resolution at the previous year's level in the event that any of the regular appropriations bills are not enacted prior to the beginning of the new fiscal year.

- *Title VII: Budgeting in an Era of Surpluses.* This title amends the statutory pay-as-you-go rules such that sequestration will take place only to the extent that increased spending exceeds the on-budget surplus.