

# KICKING THE CAN: THE U.S. CONGRESS, THE BUSH ADMINISTRATION AND THE 2008 BUDGET

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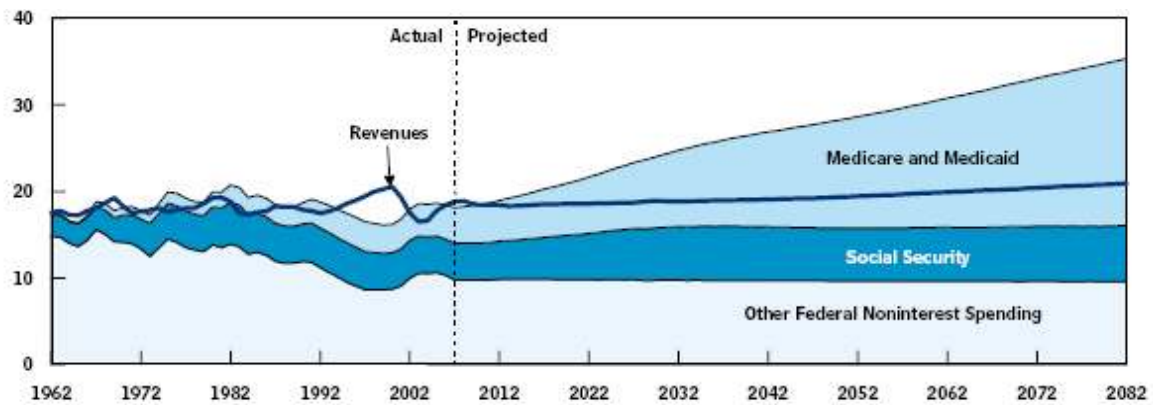
*We were wise indeed, could we discern truly the signs of our own time; and by knowledge of its wants and advantages, wisely adjust our own position in it.* Thomas Carlyle

## ABSTRACT

*In December 2008, the U.S. Department of the Treasury issued its annual report on the health of the federal budget. The report details the U.S. government's long-term financial outlook, including the biggest fiscal challenge, i.e., the unsustainable growth in entitlement programs. Later the same month, U.S. federal budget legislation for FY 2008 was completed, with passage of an approximately \$555 billion omnibus appropriations bill for largely non-defense spending (\$70 billion was included for the wars in Iraq and Afghanistan). There was considerable conflict between the Democratic Congress and the Bush Administration over funding for these two wars. Except for the Mexican War (1846-48), the U.S. has always raised taxes to pay for war, lest deficit and debt get out of hand. This article examines the FY 2008 budget and issues related to its passage, and the longer-term issue of U.S. government fiscal sustainability. It argues that Congress did little to address this problem, rejecting the few initiatives proposed by the Bush Administration. The budget views of the presidential candidates suggest that U.S. fiscal sustainability will remain in jeopardy.*

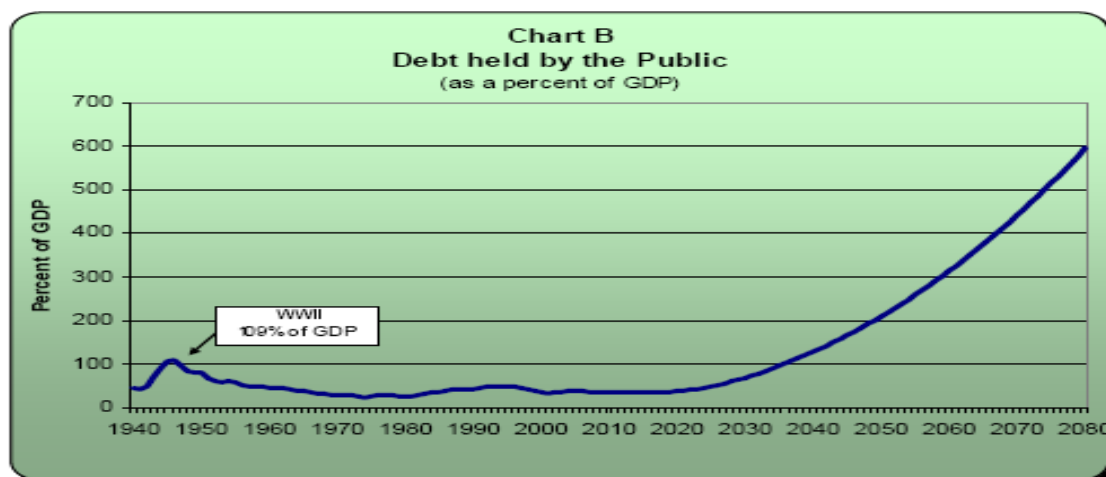
## INTRODUCTION: FISCAL UNSUSTAINABILITY

In December of 2007, the Congressional Budget Office (CBO) issued its biennial report on the long-term budget outlook. The first sentence concludes that “under any plausible scenario, the federal budget is on an unsustainable path—that is, federal debt will grow much faster than the economy over the long run.”<sup>1</sup> The second sentence targets the spending piece of the problem, i.e., “rising costs for health care and the aging of the U. S. population.”<sup>2</sup> The report includes the chart shown below illustrating those trends.



Also in December, the Department of the Treasury issued its annual report on the health of the federal budget. The press release describing this report says that it “details the U.S. government’s short-term and long-term financial outlook, including the government’s biggest fiscal challenge—the unsustainable growth in entitlement programs.”<sup>3</sup>

This report was accompanied by a “citizen’s guide,” designed to help ordinary Americans understand “how the Federal Government is managing taxpayer dollars.”<sup>4</sup> One of the “Facts and Figures” provided at the end of the guide tells us that debt held by the public and accrued interest had increased to \$5.1 trillion by 2007.<sup>5</sup> (A chart showing the future of the debt held by the public taken from that report is shown below). Further, we are told, “nearly half of the U.S. public debt is held by foreign countries, so a substantial portion of government interest payments go [sic] abroad.”<sup>6</sup>



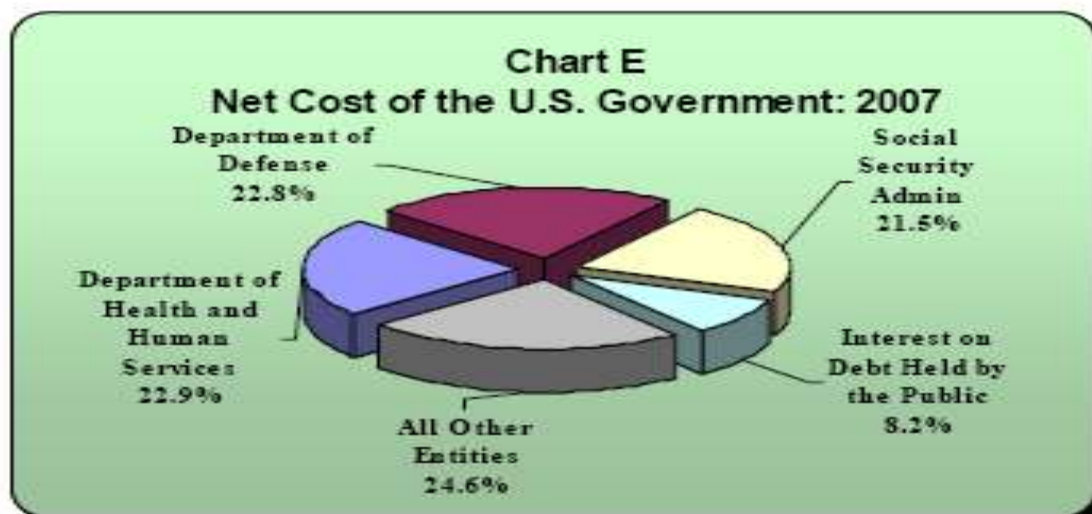
In February of 2008, the Wall Street Journal noted the impact of the “spiraling costs of government health and retirement programs,” suggesting that “[t]he next president . . . could find the U.S. government so deeply in hock that it would face losing its Triple-A credit rating, something that has never happened since Moody’s Investor Service began grading U.S. securities in 1917.”<sup>7</sup> This happened to Japan in 1999, and, according to

Moody's Vice President Steven Hess, it "could happen in the United States if these programs aren't reformed."<sup>8</sup>

## THE 2008 BUDGET

Budget legislation for FY 2008 was completed in late December, with passage of a large (approximately \$555 billion) omnibus non-defense (well, sort of--\$70 billion is for the wars in Iraq and Afghanistan) appropriations bill, two and a half months *after* FY 2008 began. There was considerable conflict between the Democratic Congress and the Bush Administration over funding for the wars in Afghanistan and Iraq, which was (temporarily) resolved. All of the war funding will go *straight to the debt*, as has all previous spending for these two wars. Except for the Mexican War (1846-48), we have always *raised* taxes to pay for war, lest deficits and debt get out of hand.<sup>9</sup>

The Global War on Terror (GWOT) is being prosecuted while taxes are being consistently cut. CBO told Congress in October that spending for U.S. operations in Iraq and Afghanistan and other activities related to the war on terrorism (including war-related VA benefits) totaled \$604 billion to date and that a total of between \$1.2 and \$1.7 trillion may be spent for these wars by 2017.<sup>10</sup> In looking at more than two hundred years of US history, Robert Hormats found a central theme: "[S]ound national finances have proved to be indispensable to the country's military strength. Without the former, it is difficult over an extended period of time to sustain the latter."<sup>11</sup>



There was also conflict and delay over the non-defense portion of annual spending, the majority of the omnibus bill. The administration declared victory on this front, restraining non-defense discretionary spending to levels slightly below what is needed to keep pace with inflation. This fiscal Sturm und Drang was focused almost entirely on the one quarter of the budget you see in the chart above, titled "All Other Entities," also taken from the Treasury's 2007 financial report.

## (EAR)MARKING TIME

There was a significant amount of transparency associated with earmarking this year. The Office of Management and Budget (OMB) hosts a data base allowing citizens to learn who is earmarking what, at <http://earmarks.omb.gov/>. According to OMB, Congress approved 11,700 earmarks in FY2008 appropriations legislation, totaling \$16.9 billion.<sup>12</sup> A third of all funding for earmarks is included within the defense appropriations bill.<sup>13</sup> The FY 2008 earmark total may actually be an 11 percent reduction in dollar value from previous years.<sup>14</sup> One House member was embarrassed when his \$129,000 earmark for “The Home of the Perfect Christmas Tree” in Mitchell County, N.C. was removed as a result of opposition from so-called “fiscal conservatives” in the House.<sup>15</sup> Pork has now been named and placed, but at one percent, it remains puny in terms of total spending.<sup>16</sup>

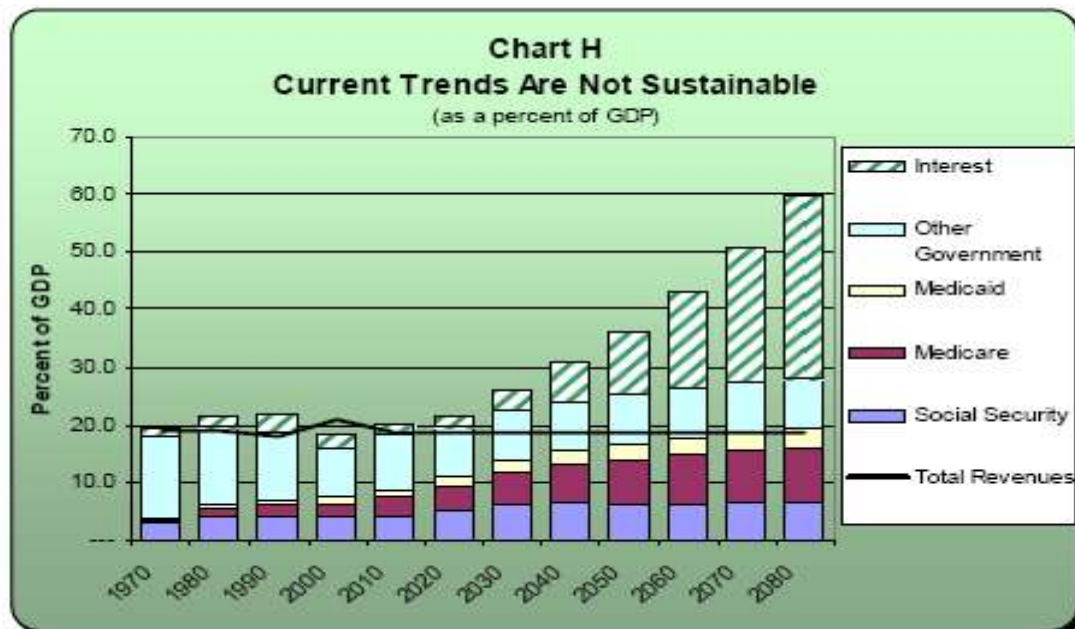
The Bush Administration began the budget year by noting that “the number of earmarks peaked in 2005.”<sup>17</sup> To be clear, in 2005, the Republicans controlled both the White House and Congress. After chastising Congress for excessive earmarking in his final State of the Union Speech, President Bush issued an executive order telling agencies that they “should not commit, obligate, or expend funds on the basis of earmarks included in any non-statutory source.”<sup>18</sup> The Romans of Washington will fiddle furiously over these dollars and it is certain to attract the attention of the media.<sup>19</sup> Republican senators promptly established a “fiscal reform working group” to address earmarks.<sup>20</sup> In February they deployed an earmark reform website, with a banner reading “Stop the Earmarks, Fix Washington.”<sup>21</sup> A campaign was launched by FreedomWorks, National Taxpayers Union, Citizens Against Government Waste and the Club of Rome to give an open Republican seat on the House Appropriations Committee to earmark opponent Congressman Jeff Flake.<sup>22</sup> This effort, according to the Conservatives with Attitude blog, was to show “how serious the new minority party is about controlling spending and reform.”<sup>23</sup> Exactly right.

Some Republican House members urged their fellow Republicans to “just say no” to earmarks, on the assumption that if they do this, Democrats will be shamed into abstaining as well. Says Congressman Flake, “if Republicans said we’re just not going to earmark this year, there is absolutely no way that the Democrats could do so.”<sup>24</sup> Representative Joe L. Barton, Republican of Texas, countered that “House Republicans should not engage in “unilateral disarmament.”<sup>25</sup> Such fiscally conservative groups as the American Conservative Union, the National Taxpayers Union and Taxpayers for Common Sense urged the administration to reject the FY 2008 earmarks, which, they argued, “would strike a blow for fiscal responsibility.”<sup>26</sup> This “blow”, which was not struck, would have removed 1/15<sup>th</sup> of the amount budgeted by Congress for FY 2008 just for interest on the debt.

Meanwhile, Medicare and Medicaid will continue to burn through federal revenues at a record pace over the next decade. CBO projects that spending for these two federal healthcare programs will grow at an average annual rate of 8.0 and 7.2 percent respectively; the comparable projected rate of growth for the economy over this period is 4.6 percent.<sup>27</sup>

Earmark reform is change for chumps, as such funding is a very small part of discretionary spending accounts, which, in turn, are a small and declining share of total

federal spending. It is shown as “Other Government” in the chart you see below, from the Treasury’s 2007 financial report. Advocates for its reform are budget drunks, looking for their car keys where the light is good, within appropriations bills, rather than where they were lost, in those dark and dangerous policy regions called entitlement reform and tax increases.



## ENTITLEMENT REFORM

What was done in this budget to address the fundamental problems we face, and have been facing for some time, i.e., the unsustainability of the federal budget driven by entitlement spending? The answer, it appears, is nothing important. The Bush Administration began the budget year by proposing a series of funding warnings, points of order and reporting requirements. These are measures intended to tell us all, once again, that we are in deep trouble because of entitlement spending commitments. But they are all signals, rather than solutions.

However, the administration actually proposed some substantive reform of Social Security. It proposed changing the benefit calculation formula (termed “progressive indexing” by the administration), which would have decreased future benefits for upper income recipients and increased them for lower wage workers.<sup>28</sup>

The administration also proposed some savings from Medicare that would come from certain high income beneficiaries. Here is their delicate language describing this proposal: “To help improve Medicare’s long-term sustainability, the Budget proposes to broaden the application of reduced subsidies for certain higher-income beneficiaries.”<sup>29</sup>

Congress ignored progressive indexing for Social Security, preferring the status quo, which meant \$615 billion in new money for Social Security for FY 2008. It did worse than nothing as re the primary driver of federal spending, i.e., Medicare and Medicaid. Flinching at the prospect of more practitioners dropping Medicare patients, Congress delayed a 10 percent cut in payment to Medicare physician providers scheduled for January 1; instead, those providers will get a 0.5 percent *increase* for six months. Congress also refused the administration's proposal to increase premiums and co-payments for military retirees under 65 years of age to align them with general health insurance plans. That proposal would have saved over \$19.3 billion over six years.<sup>30</sup>

By failing to complete the re-authorization of the farm program, Congress declined a chance to reduce agricultural entitlements. It did attempt to enact legislation that would have *increased* spending for the State Children's Health Insurance Program (SCHIP), a relatively small federal health care entitlement. That legislation, it should be noted, would have been paid for by a tax on cigarettes, but it did not pass.

## TAXES

The tax developed to offset the cost of an expanded SCHIP was there because of PAYGO (Pay As You Go). PAYGO means that new entitlement spending must be offset ("paid for") by cuts in other entitlements or tax increases, and new tax cuts must be offset by tax increases elsewhere or cuts in entitlements. The House also put new taxes in place when it passed its version of another temporary fix for the Alternative Minimum Tax (AMT). Those new taxes—the offset required by PAYGO—would have come from tax increases on private equity executives, hedge fund managers, and others. However, the Senate refused to accept these tax increases and the administration said it would veto *any* AMT bill that included revenue-raising offsets. The House yielded to the Senate and the administration on this and the Treasury will forego the \$50 billion in revenues that would have come in via those offsets.

The passage of the AMT patch was the only tax legislation of consequence to pass in FY 2008. Congress did nothing to simplify a numbingly complex tax code. The tax code is laced with specific provisions set to expire at various points in the future. A January report by the Joint Committee on Taxation took 21 pages to list such provisions expiring between 2007 and 2020.<sup>31</sup> Depending upon how many additional forms taxpayers must fill out in addition to Form 1040, the estimated average preparation time for tax returns was between eight and 27 hours.<sup>32</sup>

## THE BUDGET PROCESS

The deficit for FY 2008 will come in at about \$219 billion.<sup>33</sup> To accommodate this latest installment, Congress increased the debt limit during the budget year, setting it at \$9.8 trillion. The debt limit has been increased *five* times in the last six years, from \$6.4 trillion to its current cap.<sup>34</sup> Undeterred, the budget resolution adopted by Congress in May looked into the future, imagined a *surplus* of \$132 billion in 2012, and then

identified the manner in which it would dissipate these funds, e.g., extensions of income tax cuts, extending breaks on the estate tax and making SCHIP more generous.<sup>35</sup> The ranking Republican on the Senate Budget Committee referred to the budget resolution in the Senate as “a budget from the Land of Oz.”<sup>36</sup>

This budget resolution, timid in its goals for FY 2008 and hallucinatory in its expectations for the future, was not passed on time. (This poor show, however, is better than the previous year’s effort, when Congress did not complete the budget resolution at all). On other budget process metrics, Congress also did poorly. It failed to complete action on appropriations bills by the beginning of the fiscal year, using four continuing resolutions (CRs) to get this part of the budget job done. And this is the budget year *before* the congressional and presidential elections; it is proving just as difficult in 2008.

However, it is not unusual for Congress to miss the deadline for completing appropriations and use CRs as a procedural bridge until they finish. In 2006 Congress did not complete *any* of its appropriations bills by year’s end, and had to complete that business in February of 2007, before taking up this year’s budget. In both 2005 and 2007 they rolled nine spending bills into an omnibus. This year’s omnibus combined 11 spending bills plus supplemental spending for the GWOT. Congress has needed at least three CRs every year since President Bush took office to complete appropriations.<sup>37</sup>

Both the House and the Senate adopted rules providing for the return of PAYGO to address the deficit, as noted above, trumpeting their potential for fiscal discipline. Before her party took control of Congress, Speaker Pelosi announced that the Democrats were committed to “‘Pay As You Go’ budgeting - no more deficit spending.”<sup>38</sup> Democrats on the House Budget Committee claimed that “[S]trict adherence to the new pay-as-you-go rule is helping pull the budget out of the deficit ditch,” releasing a list of prestigious endorsements of its adherence to PAYGO principles.<sup>39</sup> The Committee for a Responsible Federal Budget cited PAYGO as the “central principle of the budget resolution” for FY 2008.<sup>40</sup>

As noted above, Congress “waived” goodbye to the PAYGO rules for the AMT patch as a consequence of resistance from the Senate and the administration. This was the most high profile of the PAYGO flare-ups, but not the only one. When CBO scored the farm bill reported out of the House Agriculture Committee, it noted that PAYGO savings of \$3.5 billion over the 2008-2012 period and \$4.8 billion over the 2008-2017 period came “primarily by shifting the timing of certain crop insurance program expenses beyond 2017 and by speeding up certain collections from farmers expected after 2017.”<sup>41</sup> House Republicans noted gimmicks in other bills, such as steep “funding cliffs” and shifts in corporate taxes from one fiscal year to another, budgetary gymnastics designed to allow nominal but unrealistic compliance with PAYGO.<sup>42</sup> The Committee for a Responsible Federal Budget acknowledged “a significant and disappointing amount of gaming of the PAYGO principle,” citing such budgetary hazards as “disingenuous sunsets.”<sup>43</sup>

This is not your father’s PAYGO. The PAYGO rules for the 110<sup>th</sup> Congress represent a diluted version of the PAYGO legislation that had been in place between 1990 and 2002.<sup>44</sup> Now in the form of congressional rules rather than statutory law, PAYGO principles are more easily subverted. More to the point, PAYGO does nothing to reduce the growth in spending for existing entitlements, nor does it restore revenues previously cut. It is, in short, a prophylactic, designed to prevent Congress from exacerbating the

currently unsustainable situation. Where it would have made a difference for the deficit in FY 2008—the AMT, SCHIP, and the re-authorization of the farm bill—it was either irrelevant or ineffective. The budget wonkery surrounding PAYGO implementation displaces serious discussion of entitlement and revenue reform.

## FISCAL STIMULUS

As Congress began its second session in late January, the economy was faltering--unemployment was up, the Dow Jones Industrial Average was down--a downturn triggered at least in part by subprime mortgages gone bad. This is a rainy day for which we have not saved. Yet the administration and Congress pledged a fix, and put it in. Balancing the economy trumps balancing the budget.<sup>45</sup> “Timely, targeted and temporary” tax cuts and spending increases, blessed by both parties and both the executive and legislative branches of government, were enacted for this purpose. The deficit for FY 2008 will be increased accordingly, by an additional \$168 billion.<sup>46</sup> The Washington Post observed that “The agreement on a stimulus package represented the first time since divided government returned to Washington a year ago that the two ends of Pennsylvania Avenue sheathed their swords and came together on a major initiative without any bloodletting first.”<sup>47</sup> To paraphrase Tacitus, Democrats and Republicans have made a deficit and called it peace. Public borrowing becomes balm for private borrowing gone bad. If we had a surplus now, this would be an easy call, but we have not had this option since 2001. Because we have a deficit, and growing debt, stimulating the economy is a problem.

## HOPE FOR CHANGE?

Presidents can lead budget reform, and a new president is in the offing. Democratic candidates for president campaign as agents of hope and change. What they hope to change as regards the structural deficit is obscure. They evince little political appetite for cuts to entitlement programs or tax increases. Senators Obama and Clinton voted in favor of the budget from Oz last May. On the hustings, former senator John Edwards and Senator Obama speak *sotto voce* about increasing the payroll tax for high earners; otherwise they join Senator Clinton in competing to see who will more effectively extend already problematic healthcare programs.<sup>48</sup> Succor from Uncle Sam is promised, but these campaign shopping lists show no price tags.

## OR MORE (OR LESS) OF THE SAME?

On the Republican side, Senator McCain draws attention to the problem of digging further into a fiscal hole in his comments on the need for a fiscal stimulus. Senator McCain is one of the few Republicans who voted against the large Bush-led tax cuts in 2001 and 2003, though he now thinks they should be made permanent. In warning against current spending practices, he frequently draws attention to earmarking, which



he has consistently battled, implying that a simple solution is at hand. He does, however, note “an unsustainable budget pathway,” referring to Social Security, Medicaid and Medicare obligations,” deferring a solution to necessary but not sufficiently specific means, i.e., “comprehensive bipartisan reform.”<sup>49</sup>

Former Governor Romney sent a mixed message in an envelope ostentatiously stamped “conservative.” He noted the need to reform entitlements, and agreed with McCain that the solution must be bipartisan.<sup>50</sup> He touted his business expertise as a tool for controlling spending and presented a shopworn list of targets: “[W]e can control earmarks. We can control pork. We can put a cap on discretionary spending.”<sup>51</sup> His presidential campaign website included a chart showing “The Domestic Discretionary Spending Binge.” He also called for a measure--congressional rules requiring a three-fifths majority to pass any law that would raise taxes--that would make it more difficult for Congress to use revenues as part of the solution to the structural deficit.

There was some contradiction between the universal health care plan for Massachusetts that Romney led as governor-- which implies a significant role for government and which is generating a need for more funding-- and his arguments for a market solution to health care.<sup>52</sup> “Conservative principles,” he argued, “have the answers for health care.”<sup>53</sup> These principles gave rise to calls for deregulating state health markets, making all health insurance expenses tax deductible, reforming medical liability systems and improving the quality and transparency of health care delivery systems. His plan was based upon “private insurance, not government insurance. No government-managed health care and no increase in taxes.”<sup>54</sup> However, the quasi-governmental system he installed in Massachusetts, similar in structure to what Senator Clinton proposes, will need additional taxes to work. No longer governor, Romney abjured those revenues, claiming that we can fight and win the health care battle with one hand tied behind our back. He, however, left the fight, dropping out of the race in early February.

Former Arkansas governor Mike Huckabee says that he “will work with the private sector, Congress, health care providers, and other concerned parties to lead a complete overhaul of our health care system.”<sup>55</sup> How Mr. Huckabee would effect his health care reforms was not spelled out on his website. He would also address federal spending with the line item veto, a budget reform perennial. The most recent version, available to President Clinton between 1996 and 1998, was used exclusively to reduce discretionary spending by trivial amounts. Judged unconstitutional in *Clinton v. City of New York*, it would require an amendment to the constitution to restore it.

Mr. Huckabee told us in some detail how he would change the tax code, i.e., by replacing the existing system with the “fair tax.” Said the former governor, “[w]e’ll all be taxed on what we decide to buy, not what we happen to earn. We won’t be taxed on what we choose to save or the interest those savings earn. The tax will apply only to new goods, so we can reduce our taxes further by buying a used car or computer.”<sup>56</sup> However, there is no good reason to believe that the projected tax rate of 23 percent is accurate or sufficient to replace current revenues.<sup>57</sup> (But, of course, the former governor reminds us, “I didn’t major in math, I majored in miracles.”)<sup>58</sup> Mr. Huckabee also dropped out of the race.

Former Senator Fred Thompson put an important entitlement reform on the table by suggesting that initial Social Security benefits be indexed to price inflation rather than

wage growth.<sup>59</sup> That is not unlike the proposal that the Bush Administration proposed at the beginning of the budget year, to no avail. This initiative would have contributed significantly to solving the problem of Social Security insolvency. Thompson dropped out of the race in late January.

## SUMMARY

The deficits we have constructed for ourselves are centered, on the spending side, on the largest entitlement programs, i.e., Medicare, Medicaid and Social Security, and on the revenue side on the large tax cuts passed in 2001 and 2003. The spending increases are scheduled by law and propelled by demographics and human behavior to become much bigger. Most of the tax cuts expire in 2010, but may be changed by Congress before then.

The sooner that taxes and serious health care reform (and later, Social Security reform) return to the agenda of Congress, and to the talking points of presidential candidates, the sooner we can begin to change course. These proposals may not appeal to network news anchors, YouTubers or budget bloggers, but they are central to eliminating the deficit and paying down some debt.

If your favorite presidential or congressional candidate discusses the budget in terms of reducing waste and trimming pork, you should know that they are not yet serious. If they venture into entitlement reform--which they should--listen carefully. To update President Kennedy, ask them, and yourself, not what your budget can do for you; ask them, and yourself, what you can do for your budget. That most likely means getting less and paying more.

Elected officials in Congress and the White House made the federal budget less sustainable this year. PAYGO is a corral for horses already out of the barn, and earmark reform is a sideshow. It was another year of punting on the big money and porking on the little money. A single page in the Treasury report inadvertently sums up this achievement: "This page is intentionally blank..."

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