

WebMemo



Published by The Heritage Foundation

No. 1947
June 5, 2008

War Funding Bill: PAYGO Awry, Surtaxing Toward GI Benefits

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The Congress is readying legislation to fund the wars in Iraq and Afghanistan, and threatening to load up the bill with unrelated related programs and initiatives. The “war supplemental” the House passed on May 15 failed to include funding for the war, but it did include an artificial timeline for troop withdrawal, codification of deployment schedules, billions of dollars in unrelated domestic spending, and the blocking of important cost-saving new Medicaid regulations.

The no-funds war funding bill also included money for a misplaced, flawed, but potentially meritorious set of enhancements to the Montgomery GI Bill which provides veterans’ education benefits. In a nod to faux fiscal discipline, the House bill would fund the \$52 billion cost of these enhancements by declaring war on small businesses and investors in the form of a harmful but nevertheless revealing new income tax surtax. The surtax would be harmful to job creation and wage growth; it is revealing of how ready some Members of Congress are to pursue redistributive tax policies while returning to their tax and spend ways of yesterday.

Reforms to Veterans’ Education Benefits. Currently, veterans receive education benefits such as tuition assistance under the 1984-vintage Montgomery GI Bill, which traces its roots back to legislation enacted during World War II. After so many years, some updating and reforms are surely in order. For example, the legislation would, sensibly, allow education benefits to be transferred to spouses or dependent children. It also makes sense

to expand the education package offered to veterans as part of a reform to their overall compensation package. The Congressional Budget Office warns these reforms will likely make it more difficult for the armed services to retain good personnel without incurring significant extra costs, but these issues can be addressed through further refinements to the reforms.

Budgeting is about setting priorities. The United States needs a well-motivated, well-trained, well-equipped, experienced military to face the threats of the 21st century. By encouraging high-quality recruits and the retention of skilled professionals, an improved education program for veterans is surely consistent with maintaining such a force. Devoting resources to this purpose should be a priority. It certainly ranks as a higher priority than much of what passes for needed spending.

A Threadbare Mantle of Fiscal Responsibility. Another priority in budgeting is maintaining firm fiscal discipline. Fiscal discipline should mean maintaining a tight rein on spending so that any budget deficit remaining is manageable and sustainable. A tight rein on spending also means that tax burdens need not increase further, which would work to weaken the U.S. economy.

This paper, in its entirety, can be found at:
www.heritage.org/Research/Budget/wm1947.cfm

Produced by the Thomas A. Roe Institute
for Economic Policy Studies

Published by The Heritage Foundation
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Washington, DC 20002-4999
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This Congress came into office claiming the mantle of fiscal responsibility. Yet time and again it has tried to boost spending beyond the monumental \$2.8 trillion on track for 2008. So far in 2008 the Congress has already cobbled together a bloated, nearly \$300 billion farm bill, even though farm income is at an all-time high and looks to rise significantly from here. It is also working on an ill-advised bailout for the housing sector. The budget resolutions passed by the House and Senate call for significant increases in regular spending. And now Congress wants to hike spending further on domestic programs via the war funding bill, including this expansion of education benefits for veterans. Steadily expanding federal spending does not demonstrate fiscal discipline.

PAYGO Redefined to Avoid Spending Cuts.

The Congress has adopted PAYGO (pay-as-you-go) rules among its potentially effective devices for enforcing fiscal discipline. PAYGO rules are supposed to mean that increasing spending on veterans' benefits, for example, should be combined with some combination of reduced spending in other areas and higher taxes. Today, however, PAYGO rules are woefully misnamed. Much of the time, when Congress looks to raise spending it simply ignores PAYGO, turning PAYGO into go-and-spend. A good example is the recent bipartisan farm bill that blew past the PAYGO rules and is likely to pass over the President's veto as well.

When not waiving the rules to increase spending, Congress opts to transform PAYGO into tax-and-go, as in tax more and go spend. To fund the expansion of veterans' education benefits, the House decided to levy a new 0.5 percent income tax surtax on individuals with incomes over \$500,000 and married couples over \$1 million. As Congressman Mike Ross (D-AR), one of the leaders of the self-proclaimed fiscal conservative Blue Dog Democrats, argued, "I think those earning in excess of \$1 million per year will gladly pay this new patriot tax." (By the way, Mr. Ross voted for the PAYGO-waived \$300 billion farm bill, too.)

This proposed tax hike, and the helpful justification by Congressman Ross, demonstrates that many Members of Congress fail to appreciate the

extraordinarily high levels of tax already paid by upper-income taxpayers. According to data from the Tax Policy Center, the top 20 percent of income taxpayers pay almost three-fourths of the income tax burden.

This proposed tax also demonstrates a remarkable disregard for America's small businesses, most of which pay tax at individual rates and many of which would be subject to this higher rate. Small businesses create most of the net new jobs in America. They also create much of the dynamism in our economy. And perhaps most important of all, they represent the efforts of millions of Americans to pursue their dreams of getting ahead through their own initiative, hard work, and creativity. The owners of small businesses are many of Congressman Ross's glad taxpayers.

PAYGO Spending Cuts. In setting budget priorities, when Congress finds good cause to increase spending in one area, its first, second, and third priority in respect of fiscal discipline should be to find lesser spending priorities to cut. To offset the costs of the new veterans' benefits, surely Congress could find \$50 billion to cut out of the \$34 trillion CBO projects will be spent over the next 10 years.

Here's an idea: While increasing entitlement spending for veterans, how about cutting entitlement subsidies for rich farmers? The farm bill spends about \$50 billion through the direct payment program. If farm incomes were hurting, this could be a tough sell, but as the Economic Research Service notes, "In 2007, farm income was at a record level and ended the year very strong." Why are rich and prosperous farmers more deserving of subsidies than small businessmen and other taxpayers are deserving of keeping what they earn?

Medicare spending at \$391 billion in 2008 is crowding out other federal priorities, and the program is by universal accord unsustainable in its current form. The Administration proposed some minor changes to Medicare, yet because Medicare is so huge and growing even these small changes would save \$557 billion over the next 10 years. It is remarkable then that Congress could not find even one-tenth of these cuts acceptable to offset the cost of the new veterans' benefits.

At little risk of contradiction, it is fair to assert that every individual running for Congress runs against “waste, fraud, and abuse.” The Administration’s budget included a list of terminations and reductions for programs that are found to be ineffective or duplicative, and certainly qualifying as wasteful spending. In total, the proposed reductions and terminations would save some \$56 billion in 2009 alone. It is disgraceful that Congress couldn’t find even one-tenth of these reforms acceptable rather than resorting to tax hikes on small businesses.

Conclusion. The Senate is expected to pass its own version of a larded up war funding bill eventually. The good news is that the proposed income tax surtax is properly seen by enough Senators as a silly tax, and so the House proposed tax hike does little more than demonstrate the shallowness of their concern for true fiscal discipline and their readiness to hike taxes at the drop of a hat.

Comparing the nearly simultaneous experience of the bloated farm bill and the expansion of veterans’ benefits, a simple conclusion regarding PAYGO becomes obvious. As long as the bill is of manageable small size, such as the \$50 billion education enhancements for veterans, then PAYGO becomes tax-and-go. But for really big increases in spending, Congress just chooses to replace PAYGO with spend-and-go. Congress should do neither tax-and-go nor spend-and-go. It should instead go back to basic budgeting, set priorities in spending, and find cuts when new spending priorities arise. And, in the meantime, Congress should stop playing politics with national security and send the President a clean war funding bill.

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