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A Responsible Budget Resolution in Three Easy Pieces

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Recent gains in spending are weighing down the federal budget and presenting a challenge to the House Members writing the FY 2007 budget resolution. Unless lawmakers confront runaway spending, within a decade just balancing the budget will require a $7,000-per-household tax increase. To avoid that end, a responsible budget resolution should freeze discretionary spending through 2011, get moving on entitlement reform, and extend the 2001 and 2003 tax cuts. Without a serious resolution, the House will be in a poor position to negotiate with the free-spending Senate, which has already passed a budget resolution that bursts the President's spending limits.

1. Freeze Non-Defense Discretionary Spending through 2011. Budgets are about setting priorities. National defense and homeland security are the federal government's highest priorities, but lawmakers have boosted non-defense discretionary spending by 49 percent since 2001. Clearly, growth in this category can afford to level off for a few years. Last year's near-freeze on non-defense discretionary spending was a strong start, and Congress should build upon it.

Those who consider a multi-year freeze politically untenable need only examine the budgets of the 1990s. From 1991 to 1998, all discretionary outlays (including those for defense) grew by just 0.5 percent annually, on average.[1]

There is bipartisan support for such restraint. President Bush's budget request would slightly reduce non-defense discretionary spending through 2011. He has also proposed statutory caps that would limit the growth of total discretionary spending to about 2.2 percent per year through 2011.[2] Last year, the House Democrats' Blue Dog Coalition went even further and proposed capping growth of total discretionary spending at 2.1 percent per year.[3]

Freezing non-defense discretionary spending does not mean freezing every program. High-priority programs should receive spending increases, offset by reductions in lower-priority programs. To say that offsets cannot be found is to say that every federal program is justified, successful, and operates at equal efficiency. This is not the case.

The $27 billion spent annually on special-interest pork-barrel projects, such as grants for "therapeutic horseback riding" and the Baseball Hall of Fame, is low-hanging fruit. Just like millions of families do with their own budgets, Congress and the President must set priorities and balance high-priority increases with low-priority spending cuts.[4]

Next, lawmakers should eliminate wasteful and outdated programs such as the Advanced Technology Program, a plum example of corporate welfare.

This paper, in its entirety, can be found at:
www.heritage.org/research/budget/wm1020.cfm

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Defense spending could yield some savings, as well. While the troops must have all the resources they need to fulfill their missions and the services must be able to continue their ongoing transformation efforts, Congress should clean up wasteful spending at the Defense Department and seek out efficiency gains in national security.

2. Reform Entitlement Spending. Over the next decade, Medicare spending will grow by 9 percent annually, Medicaid spending by 8 percent annually, and Social Security spending by 6 percent annually. Altogether, nominal entitlement spending will nearly double.[5] This unsustainable growth threatens to crowd out all other spending and force massive tax increases. Last year's budget reconciliation slowed the annual growth rate of entitlement spending over the next decade from 6.08 percent to 6.04 percent. Much more must be done.

Congress should build on the modest progress in last year's reconciliation bill by including reconciliation instructions that at least match the $308 billion in average five-year savings achieved by the three reconciliations laws of the 1990s. The Republican Study Committee has already put forward a plan to cut $358 billion over five years, which is close to the amount proposed in the 1994 Contract with America.[6] Congress can find entitlement savings across the budget:

- Cap farm subsidies at $250,000 per farm. This would correct the strange distribution formula that currently sends more than two-thirds of farm subsidies to just 10 percent of subsidy recipients.

Table 1 WM 1020

RSC Reconciliation Proposal Is Near 1990s Average

Year/Proposal	Five-Year Entitlement Spending Savings
1990	$447 billion
1993	$244 billion
1997	$232 billion
2005	$40 billion
2006 RSC Proposal	**$358 billion**

All amounts inflation-adjusted for 2005 dollars.

Source: Congressional Research Service.

- Cap federal Medicaid growth at 5 percent per year. Congress could transform the program into block grants to states, giving states more flexibility to tailor their programs to local needs while still being held to federal performance standards, as under the 1996 welfare reforms.
- Bring means-testing to the unaffordable Medicare drug entitlement, which currently faces a 75-year budget hole of $8.1 trillion—more than twice Social Security's unfunded liabilities ($3.7 trillion).
- Convert more antipoverty programs from expensive, inefficient handouts that trap families in poverty into time-limited benefits that encourage movement towards self-sufficiency, like the reformed welfare system.
- Attack waste, fraud, and abuse, such as the $40 billion in annual program overpayments.[7]

1. Office of Management and Budget, *Historical Tables, Budget of the United States Government, Fiscal Year 2007* (Washington, D.C.: U.S. Government Printing Office, 2006), p. 133, at *www.whitehouse.gov/omb/budget/fy2007/pdf/hist.pdf.*
2. Office of Management and Budget, Analytical Perspectives, *Budget of the United States Government, Fiscal Year 2007* (Washington, D.C.: U.S. Government Printing Office, 2006),p. 213, at *www.whitehouse.gov/omb/budget/fy2007/pdf/spec.pdf.*
3. The Blue Dog proposals are summarized in Brian M. Riedl, "The Blue Dog Democrats' Budget Process Proposal: An Emerging Bipartisan Consensus," Heritage Foundation *WebMemo* No. 670, February 18, 2005, at *www.heritage.org/Research/Budget/wm670.cfm.*
4. For specific spending-cut recommendations, see Brian M. Riedl, "How to Get Federal Spending Under Control," Heritage Foundation *Backgrounder* No. 1733, March 10, 2004, at *www.heritage.org/Research/Budget/bg1733.cfm.*
5. Congressional Budget Office, "The Budget and Economic Outlook: Fiscal Years 2007 to 2016," January 2006, p. 52, at *www.cbo.gov/showdoc.cfm?index=7027&sequence=0.*
6. The RSC Budget is available at *www.house.gov/pence/rsc/doc/RSC_2007_BUDGET.doc.*

3. Extend the 2001 and 2003 Tax Cuts. In the 11 quarters before the 2003 tax cuts came into effect, real annual economic growth averaged 1.1 percent. In the 11 quarters since the tax cuts, the economy has expanded 3.9 percent annually—more than triple the previous rate. Business investment declined for 10 consecutive quarters before the 2003 tax cuts. It has expanded over all 11 quarters since. Employment numbers were stagnant before the 2003 tax cuts. Five million new jobs have been created since 2003.[8] These are not coincidences. Lower tax rates increased incentives to work, save, and invest, all of which increased productivity and helped the economy expand.

This strong economic growth is also replenishing tax revenues. Between 2004 and 2006, tax revenues are projected to rise by an unprecedented $420 billion. This 22 percent jump will be the largest two-year revenue surge since 1976-78, when soaring inflation and bracket creep steeply increased tax revenues. While current tax revenues, at 17.6 percent of GDP, remain slightly below the postwar average of 17.9 percent of GDP, the Congressional Budget Office estimates that, even with all tax cuts extended, revenues will reach 17.7 percent of GDP by 2016.[9] Clearly, low tax revenues are not the main cause of the present fiscal imbalance.

Yet uncertainty about whether the tax cuts will expire makes it difficult for entrepreneurs to plan future investments. Letting the tax cuts expire would harm businesses, families, and the economy, and history shows that any new revenues would likely be allocated to new spending and not deficit reduction. Unless Congress extends the tax cuts, between now and January 1, 2011,

- Tax rates will rise substantially in every tax bracket, some by 450 basis points;

Table 1 WM 1020

Economic Growth More Than Tripled After the 2003 Tax Cuts

Time Period	Average Annual Growth (Real): GDP	Average Annual Growth (Real): Business Investment
11 Quarters Before the 2003 Tax Cut	1.1%	-5.6%
11 Quarters After the 2003 Tax Cut	3.9%	8.7%

Note: The tax cuts took effect in the second quarter of 2003. Business investment is non-residential fixed private investment.

Source: Heritage Foundation calculations using Bureau of Economic Analysis data.

- Low-income taxpayers will see the 10-percent tax bracket disappear and will have to pay taxes at the 15-percent rate;
- Married taxpayers will see the marriage penalty return;
- Parents will lose 50 percent of their child tax credits;
- Taxes on dividends will increase beginning on January 1, 2009;
- Taxes on capital gains will increase, also beginning on January 1, 2009; and
- Federal death taxes will come back to life in 2011, after fading down to nothing in 2010.[10]

Each of these tax hikes would take place within the budget resolution's five-year window. Lawmakers should encourage economic growth and curtail economic disruption by making these successful tax cuts permanent.

7. For these and other recommendations, see Brian M. Riedl, "The Five-Step Solution: Cutting the Budget Deficit in Half by 2009 While Extending the Tax Cuts and Rebuilding Iraq and Afghanistan," Heritage Foundation *Backgrounder* No. 1833, March 16, 2005, at *www.heritage.org/Research/Budget/bg1833.cfm.*
8. Data calculated by The Heritage Foundation using Department of Commerce Bureau of Economic Analysis Data at *www.bea.gov/bea/dn/dpga.csv* .
9. Congressional Budget Office, "The Budget and Economic Outlook: Fiscal Years 2007 to 2016," January 2006, at *www.cbo.gov/showdoc.cfm?index=7027&sequence=0*. This projections takes the CBO revenue baseline adds their revenue estimates of reforming the Alternative Minimum Tax and extending all tax cuts.
10. See William W. Beach and Rea S. Hederman, Jr., "Make the Bush Tax Cuts Permanent," Heritage Foundation Webmemo No. 956, January 5, 2006, at http://www.heritage.org/Research/Taxes/wm956.cfm.

Conclusion. The current trend in federal spending is unsustainable. Within 20 years, Social Security, Medicare, and Medicaid are projected to crowd out every federal program except defense—which would be crowded out by 2045.[11] The longer lawmakers duck their responsibility to confront out-of-control spending, the more painful the remedy will be. Freezing non-defense discretionary spending and reining in runaway entitlements will help America keep taxes low and thereby avoid the kind of economic stagnation that now plagues Western Europe. Extending the tax cuts will help keep the American economy the envy of the world.

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11. Brian M. Riedl, "Entitlement-Driven Long-Term Budget Substantially Worse Than Previously Projected," Heritage Foundation *Backgrounder* No. 1897, November 30, 2005, located at *www.heritage.org/Research/Budget/bg1897.cfm*.