Backgrounder

Published by The Heritage Foundation

No. 1842
April 6, 2005

A Responsible Way to Reconcile the House and Senate Budget Resolutions

Brian M. Riedl, William W. Beach, Nina Owcharenko, Ben Lieberman, and David C. John

House and Senate conferees are reconciling their respective versions of the 2006 budget resolution. The overall differences amount to only 0.42 percent: The Senate version (S. Con. Res. 18) would spend \$13.858 trillion over the next five years, and the House version (H. Con. Res. 95) would spend \$13.800 trillion. Yet behind these small differences lie diverse approaches to dealing with runaway spending, budget deficits, high taxes, and the coming retirement of the baby boomers.

If nothing is done, the nation faces \$400 billion budget deficits each year for the next decade, followed by stratospheric Medicare and Social Security costs. These costs will eventually require either doubling income taxes or eliminating the entire discretionary budget—including spending on defense, education, health research, and veterans' health care. This paper recommends ways for House and Senate conferees to settle on a responsible budget resolution that best limits runaway spending.

Comparing the Budgets

Table 1 summarizes the House and Senate budget resolutions. The Senate budget would allow more discretionary spending than the House version. Both versions call for the first mandatory spending reconciliation package since 1997, but the House budget would save substantially more money. The Senate version provides the most tax relief.

Although both resolutions represent progress over past budgets, neither the House version nor the Sen-

Talking Points

- While the House and Senate budget resolutions represent progress over past budgets, neither resolution substantially slows the growth of government. The Senate version would spend \$13.858 trillion over the next five years, and the House version would spend \$13.800 trillion. Both plans allow mandatory spending to expand by approximately 36 percent over the next five years—an average of 7 percent annually.
- Despite similarities, these budgets differ in their willingness to rein in spending. The House budget shaves much more off the mandatory spending baseline, while the Senate budget provides greater tax relief.
- The best budget plan would expand pro-growth tax relief and begin to rein in spending by grabbing the "low-hanging fruit" in areas such as Medicaid and farm subsidies. Such actions could lay the groundwork for larger reforms next year.

This paper, in its entirety, can be found at:
www.heritage.org/research/budget/bg1842.cfm

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

Published by The Heritage Foundation
214 Massachusetts Avenue, NE
Washington, DC 20002–4999
(202) 546-4400 • heritage.org

ate version substantially slows the growth of government. Both plans allow mandatory spending (including net interest) to expand by approximately 36 percent over the next five years—an average of 7 percent annually. Neither budget resolution calls for eliminating even one government program, and neither resolution is likely to lead to significant reductions in corporate welfare or pork-barrel spending. The Senate budget does not address the hundreds of billions of dollars lost annually in waste, fraud, and abuse; the House proposes modest reforms.

The House budget resolution would save $68.6 billion in mandatory spending over five years, while the Senate version would save $17.0 billion. The Senate budget resolution allows $848.8 billion in discretionary budget authority in 2006, versus $843 billion in the House budget resolution.

The best combination of these budgets would slow discretionary spending, reform runaway entitlements, and provide pro-growth tax relief.

Table 1 B 1842

Summary of House and Senate Budgets

Summary

	House	Senate
2006 Discretionary Budget Authority	$843.0	$848.8
2006-2010 Mandatory Savings	$68.6	$17.0
2006-2010 Tax Cuts–Total	$106.0	$128.5
2006-2010 Tax Cuts–Reconciled	$45.0	$128.5

Mandatory Spending Reconciliation Instructions by Committee

Senate	2006	2006-2010
Agriculture, Nutrition, and Forestry	0.171	2.814
Banking, Housing, and Urban Affairs	0.030	0.270
Commerce, Science, Transportation	0.008	2.576
Energy and Natural Resources	0.033	2.658
Environment and Public Works	0.014	0.112
Health, Education, Labor, and Pensions	2.204	8.576
Total	**$2.460**	**$17.006**

House of Representatives	2006	2006-2010
Agriculture	0.797	5.278
Education and Workforce	2.097	21.410
Energy and Commerce	0.630	20.002
Financial Services	0.030	0.270
Judiciary	0.123	0.603
Resources	0.096	1.413
Transportation and Infrastructure	0.012	0.103
Veterans Affairs	0.155	0.798
Ways and Means	3.907	18.680
Total	**$7.847**	**$68.557**

Note: All amounts are in billions of dollars.

Sources: H.Con.Res. 95, 109th Cong., 1st Sess., at *www.house.gov/budget/fy06legtextar031105.pdf* (April 4, 2005), and S.Con.Res. 18, 109th Cong., 1st Sess., at *www.senate.gov/~budget/republican/major_documents/sc18.pdf* (April 4, 2005).

Recommendation #1: Congress should limit discretionary spending to $843 billion.

Consistent with President George W. Bush's budget (as scored by the Congressional Budget Office), the House voted for $843 billion in non-emergency discretionary budget authority for 2006. This represents a 2.5 percent increase over 2005.

The Senate added $5.8 billion to this amount, intended for Pell Grants and K–12 education, to arrive at $848.8 billion. Much of this increase was offset by an equal reduction in new tax cuts.

Discretionary spending has leaped 45 percent since 2001. Although national security priorities justified many of the defense increases, non-defense discretionary spending has increased 36 percent over that span. Clearly, these bloated budgets can afford to level off for a few years.

The House budget would modestly increase defense spending and slightly reduce non-defense discretionary spending, for an overall 2.5 percent increase. Those who consider 2.5 percent growth too small need only examine the 1991–1998 period, during which total discretionary outlays grew by an average of just 0.5 percent annually and the $269 billion budget deficit was completely eliminated.[1] The endorsement by the House Democrats' Blue Dog Coalition gives the President's and House's discretionary spending totals bipartisan support.[2]

Thus, the conferees should reject the Senate's addition of $5.8 billion in discretionary spending. The education budget—the Senate's preferred des-

1. Office of Management and Budget, *Historical Tables, Budget of the United States Government, Fiscal Year 2006* (Washington, D.C.: U.S. Government Printing Office, 2005), p. 125, at *www.whitehouse.gov/omb/budget/fy2006/pdf/hist.pdf* (March 11, 2005).

tination for this additional spending—has already doubled since 2001, from $35.2 billion to $70.5 billion. (See Table 2.) If lawmakers want another massive education increase, they can offset it by reducing lower-priority programs. To say that offsets cannot be found is to assume that every federal program is justified, is successful, and operates with maximum efficiency.

Recommendation #2: Congress should find at least $15 billion in Medicaid savings.

The House voted to instruct the Energy and Commerce Committee to save $20 billion over the next five years. Most of these savings are expected to come from Medicaid, with some additional savings from spectrum fees.

The Senate voted down the Senate Budget Committee's call for $15 billion in Senate Finance Committee savings, nearly all of which was expected to come from Medicaid.

The House Energy and Commerce Committee and the Senate Finance Committee should consider adopting the President's modest recommendations for Medicaid savings.[3] Two key recommendations for consideration are:

- **Reducing financing gimmicks.** Some state officials employ a variety of tactics to leverage federal matching funds, including overpaying government providers and imposing excessive fees. Some officials divert federal Medicaid payments to non-Medicaid purposes. These and other tactics are clearly inappropriate.[4] The Bush Administration merely seeks to stop such activities.
- **Tightening enforcement rules for asset transfers.** With clever estate planning, individuals can shelter their assets and still qualify for long-term care services financed by the taxpayers under Medicaid without delay or penalty. The Bush Administration has proposed closing the existing loopholes in order to preserve Medicaid for those who truly need it.[5]

Preferably, Congress should go far beyond the President's modest proposals. Lawmakers should work to improve Medicaid's overall quality and delivery of care. This would include working with state officials to create consumer-based structural reforms in the program, as well as mainstreaming low-income Americans into the private health care system that serves most Americans. This could be done with refundable health care tax credits and by bringing consumer-directed and innovative care management to the populations that depend on Medicaid.[6]

Recommendation #3: Congress should require at least $5.3 billion in agriculture savings.

The House followed President Bush's calls for farm subsidy reforms by voting to save $5.3 billion from the House Agriculture Committee's entitlement baseline through 2010.

2. 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*.
3. Office of Management and Budget, *Budget of the United States Government, Fiscal Year 2006*, pp. 143–144, at *www.whitehouse.gov/omb/budget/fy2006/budget.html* (April 4, 2005).
4. See U.S. General Accounting Office, *Medicaid: Improved Federal Oversight of State Financing Schemes Is Needed*, GAO–04–228, February 2004; George Reeb, Assistant Inspector General, Centers for Medicare and Medicaid Audits, Office of Inspector General, U.S. Department of Health and Human Services, "Inter-governmental Transfers: Violation of the Federal–State Partnership or Legitimate State Tools," testimony before the Committee on Energy and Commerce, U.S. House of Representatives, March 18, 2004, at *energycommerce.house.gov/108/Hearings/03182004hearing1232/Reeb1892.htm* (April 4, 2005); and James Frogue, "Medicaid's Perverse Incentives," American Legislative Exchange Council, *The State Factor*, July 2004, at *www.alec.org/meSWFiles/pdf/0420.pdf* (April 4, 2005).
5. For a more in-depth look at the issues facing Medicaid and long-term care, see Center for Long-Term Care Financing, "The Realist's Guide to Medicaid and Long Term Care," September 7, 2004, at *www.centerltc.org/realistsguide.pdf* (April 4, 2005).
6. For further discussion, see Nina Owcharenko, "Congress Should Get Serious About Medicaid," Heritage Foundation *WebMemo* No. 705, March 30, 2005, at *www.heritage.org/Research/HealthCare/wm705.cfm*.

Table 2 B 1842

Spending Is Increasing Across Government

Spending Category	Total Outlays 2001	Total Outlays 2005	2001-2005 Increase Amount	2001-2005 Increase Percentage	2001-2005 Increase Average Annual
National Defense	$304,882	$465,871	$160,989	53%	11.2%
Social Security	432,958	519,686	86,728	20%	4.7%
Medicare	217,384	295,432	78,048	36%	8.0%
Income Security Programs	152,640	211,929	59,289	39%	8.6%
Medicaid	129,374	188,497	59,123	46%	9.9%
Education	35,203	70,520	35,317	100%	19.0%
Health Research and Regulation	42,896	69,035	26,139	61%	12.6%
Veterans Benefits	45,039	68,161	23,122	51%	10.9%
International Affairs	16,493	31,961	15,468	94%	18.0%
Federal Retirement and Disability	80,972	94,312	13,340	16%	3.9%
Justice Administration	30,205	40,657	10,452	35%	7.7%
Community and Regional Development	11,773	20,141	8,368	71%	14.4%
Unemployment Benefits	30,242	38,066	$7,824	26%	5.9%
Natural Resources and Environment	25,623	30,960	$5,337	21%	4.8%
Housing and Commerce	5,739	10,653	$4,914	86%	16.7%
Other Spending	142,454	210,551	68,097	48%	10.3%
Undistributed Offsetting Receipts	-47,011	-64,976	-17,965	-38%	-8.4%
Net Interest	206,167	177,948	-28,219	-14%	-3.6%
Total Spending	**1,863,033**	**2,479,404**	**$616,371**	**33%**	**7.4%**

Note: All amounts in millions of dollars. National defense and international affairs totals exclude additional 2005 supplemental spending.

Source: Heritage Foundation calculations based on Office of Management and Budget, *Historical Tables, Budget of the United States Government, Fiscal Year 2006* (Washington, D.C.: U.S. Government Printing Office, 2005), pp. 53-70, Table 3.2, at *www.whitehouse.gov/omb/budget/fy2006/pdf/hist.pdf* (March 11, 2005).

The Senate budget calls for savings of $2.8 billion.

The federal government spends nearly $30 billion per year on agriculture. The House budget resolution, which would reduce farm subsidies by a modest $1 billion annually, is the least that Congress can do to reform America's largest corporate welfare program. Congress could achieve most of these savings by implementing President Bush's request to reduce the maximum farm subsidy from $360,000 per farm to $250,000 and by closing current loopholes that allow some farms to collect millions annually.

If lawmakers really want farm subsidies to help struggling farmers, just $4 billion per year would guarantee every full-time farmer in America a minimum income of 185 percent of the federal poverty level ($35,798 for a family of four in 2005).[7] Instead, two-thirds of all farm subsidies are distributed to the wealthiest 10 percent of farmers. The U.S. Department of Agriculture reports that farmers of "large" and "very large" farms—the types that receive the bulk of the subsidies—report an average household income of more than $135,000.[8]

It gets worse: 78 farms received over $1 million in subsidies in 2002. The $110 million received by Riceland Foods was more than Washington gave to every farmer in 12 states combined. Not to be outdone, a dozen *Fortune* 500 companies—including John Hancock Mutual Life Insurance, Westvaco, Chevron, and Caterpillar—have pocketed farm subsidies as much as 510 times the amount received by the median farmer. Farm subsidy checks are also sent to celebrity "hobby farmers," such as David Rockefeller, Ted Turner, Scottie Pippen, and former Enron CEO Ken Lay.[9]

There is no justification for taxing waitresses and welders to fund *Fortune* 500 companies and large agribusinesses. Conferees should accept the House version, with savings of $5.3 billion over five years.

Recommendation #4: Congress should find $18 billion in PBGC savings.

The House voted to instruct the Education and the Workforce Committee to save $21.4 billion over five years. Most of these savings would likely come from accepting the President's recommendation to increase Pension Benefit Guaranty Corporation (PBGC) premiums.

The Senate voted to instruct the Health, Education, Labor, and Pensions Committee to save $8.6 billion from their entitlement baseline, with $5.3 billion expected to come from new PBGC premiums.

The PBGC insures workers' defined benefit pension plans, protecting their pensions if their employers go bankrupt. A defined benefit pension plan pays a monthly amount based on the worker's annual salary, adjusted by the length of a worker's employment. These plans cover about 34 million Americans—about 16 percent of the workforce.

A rising number of defined benefit pension plans either have failed or are severely underfunded. The PBGC ended fiscal year (FY) 2004 with a $23.3 billion deficit, the largest in its 30-year history. To make matters worse, pension plans underfunded by a total of almost $96 billion could fail in the near

7. Linda Ghelfi, Craig Gundersen, James Johnson, Kathy Kassel, Betsey Kuhn, Ashok Mishrok, Mitchell Morehart, Susan Offutt, Laura Tiehen, and Leslie Whitener, "A Safety Net for Farm Households," U.S. Department of Agriculture, Economic Research Service, *Agriculture Outlook* No. 268, January–February 2000, pp. 19–24, at *www.ers.usda.gov/publications/agoutlook/jan2000/ao268.pdf* (March 11, 2005). The authors estimated a cost of $7.8 billion when including everyone who reports any farm income, including "hobby farmers" who have other full-time jobs. Giving subsidies only to full-time farmers—defined as lower sales, higher sales, and large family farms, as well as a fraction of limited-resource farms that are also full-time—would cost approximately $4 billion. The eligibility threshold for several federal income-assistance programs, like Women, Infants, and Children (WIC), is 185 percent of the federal poverty level.

8. Ashok K. Mishra, Hisham S. El-Osta, Mitchell J. Morehart, James D. Johnson, and Jeffrey W. Hopkins, "Income, Wealth, and Economic Well-Being of Farm Households," U.S. Department of Agriculture, Economic Research Service, *Agricultural Economic Report* No. 812, July 2002, p. 52, at *www.ers.usda.gov/publications/aer812* (March 11, 2005).

9. Brian M. Riedl, "Another Year at the Federal Trough: Farm Subsidies for the Rich, Famous, and Elected Jumped Again in 2002," Heritage Foundation *Backgrounder* No. 1763, May 24, 2004, at *www.heritage.org/Research/Budget/bg1763.cfm*.

future and be taken over by the agency. Overall, defined benefit pension plans have promised $450 billion more in benefits than they have in assets.

Most of the PBGC's annual income, which is used to reduce the agency's deficit, comes from a $19 per worker annual insurance premium paid by covered pension plans. The Bush Administration proposes to raise premiums by $11 (equal to the amount of wage growth in the past 14 years) to $30 per worker and to index the premium to the annual growth in wages. This raise would take effect in FY 2006 and would be the first increase since 1991. Underfunded plans would also pay an annual risk-based premium that reflects the gap between benefit promises and funding targets. The PBGC board would set the amount based on the risk of plan failure and the need to improve the agency's finances.

While the increased premiums will provide additional revenue to the agency, substantial reform of pension plan funding rules would also improve its finances. The current rules are extremely complex, and plans are judged as if the employer will always be making contributions, regardless of the risk of failure. For example, Bethlehem Steel's pension plan was judged to be 84 percent funded even though it had only 45 percent of the assets needed to pay promised benefits. The PBGC was left to cover the $4.3 billion shortfall.

The revised funding rules would both provide a more accurate picture of plan funding and require companies to meet their obligations. They would also prevent a company from expanding benefit promises while its plan is severely underfunded. Combined with the additional premiums, the new funding rules would sharply reduce the need for a major taxpayer bailout of the PBGC.

Recommendation #5: Congress should open ANWR for oil production, likely generating $2.5 billion in revenue.

The House budget has no provisions for oil exploration and drilling in the Arctic National Wildlife Refuge (ANWR), but the House has repeatedly passed energy legislation containing such provisions.

The Senate voted to instruct the Energy and Natural Resources Committee to find $2.6 billion in entitlement savings in its baseline. Opening ANWR for oil production would likely produce $2.5 billion in revenue from leasing that would count toward these savings. In effect, the Senate budget assumes oil-leasing revenues from ANWR.

Majorities in both the House and the Senate recognize the importance of making use of available domestic energy supplies by opening a small portion of ANWR to exploration and drilling. ANWR is the largest single source of untapped American oil, and extracting significant amounts of oil could be accomplished with minimal environmental impact. The House should adopt the Senate ANWR provisions and include the ANWR drilling revenues in the budget.

Recommendation #6: Congress should save $18.7 billion by cutting waste, fraud, and abuse.

The House budget resolution instructs the Ways and Means Committee to save $18.7 billion over the next five years. Many of these savings would likely be accomplished by reducing the massive overpayments in the earned income tax credit (EITC) program.

The Senate budget does not include a similar provision.

The easiest way to trim runaway federal spending is to cut waste, fraud, and abuse. In the 1980s, the Grace Commission focused lawmakers' attention on the vast amount of waste littered throughout government, such as the Department of Defense's infamous $640 toilet seat and $436 hammer. Over the past two decades, layers of waste have once again built up as Congress has largely abandoned its constitutional duty of overseeing the executive branch.

Congress has an opportunity to make government more efficient and cost-effective. The House provision would eliminate an average of $3.7 billion in annual waste from entitlement programs overseen by the Ways and Means Committee. The committee should have no difficulty finding waste to cut:

- EITC overpayments cost **$9 billion** annually.
- Medicare overpayments top **$12 billion** annually.
- Medicare pays up to **eight times** what other agencies pay for the same drugs and medical

supplies (which also raises co-payments for Medicare beneficiaries).

- Medicare contractors owe the federal government **$7 billion**.[10]

Recommendation #7: Congress should authorize a minimum of $106 billion—and preferably $128.5 billion—in tax cuts.

The House budget allows for $106 billion in tax cuts over the next five years and provides reconciliation instructions for $45 billion. While the Ways and Means Committee may choose which taxes to cut, lawmakers are considering:

- An annual adjustment of the income threshold for the alternative minimum tax (AMT);
- The President's proposed tax cuts for energy production and for charitable giving; and
- Extending assorted expiring tax provisions, such as the research and development tax credit and the state sales tax deduction.

The Senate voted to allow and reconcile $128.5 billion in tax cuts over five years. More specifically, in a non-binding vote, the Senate expressed a preference for cutting taxes by $133 billion and raising taxes by $5.4 billion by closing unspecified corporate tax loopholes. While the Senate Finance Committee enjoys the same flexibility as the House Ways and Means Committee, Senators are said to be considering:

- Extending the dividend, capital gains, and small-business expensing tax cuts through 2010;
- Repealing the 1993 tax increase on Social Security benefits;
- Permanent repeal of the death tax;
- Incorporating the President's proposed energy tax cuts; and
- Extending many of the same expiring tax provisions as in the House budget.

Congress should focus on tax policies that encourage tax reform that results in a better tax system. Specifically, lawmakers should once again update the income threshold for the AMT rules to prevent what would otherwise be a major tax increase for millions of Americans. The Senate's extensions of the 2004 dividend and capital gains tax rate cuts are also good tax policy. Likewise, extending business expensing will help economic growth and reduce the clutter of bad tax law.

Lawmakers should avoid further complicating the tax code with new tax cuts for energy companies and incentives for enhanced charitable giving, as worthy as those policy goals may be. Complicating the code at the very time that the President's Advisory Panel on Federal Tax Reform is attempting to simplify it is not good tax policy.

Directly subsidizing state tax collections through the "new" deduction for state sales taxes is also bad tax policy. If anything, a reformed tax code needs to reduce drastically or eliminate subsidies, not expand them.

Overall, the most pro-growth tax policies would make permanent the tax cuts for dividends and capital gains and the expensing of benefits for small-business owners. In addition, the budget should include sufficient funds for the President's expansion of tax-free savings accounts and for alternative minimum tax relief. While helpful, the Senate's recommended repeal of the 1993 tax increase on Social Security benefits should take place only after more pro-growth tax policies have been enacted.

Recommendation #8: Congress should revisit the Blue Dog Coalition's useful budget proposals.

Most budget process reforms written into the budget resolutions are not debated in conference committee. This is because the budget resolution does not produce binding laws, so its available budget process reforms are limited to rules changes. The House and Senate generally set these rules for themselves within their own versions of

10. 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*, and "How Congress Can Achieve Savings of 1 Percent by Targeting Waste, Fraud, and Abuse," Heritage Foundation *Backgrounder* No. 1681, August 28, 2003, at *www.heritage.org/Research/Budget/bg1681.cfm*.

the budget resolutions, and the rules do not require negotiations with the other body. Still, the Senate budget includes some strong new enforcement provisions, such as:

- New three-year discretionary spending caps, enforced by a point of order;
- A point of order against legislation costing more than $5 billion in any decade between 2015 and 2055; and
- A point of order against placing new unfunded mandates on states.

The Senate also extends its pay-as-you-go (PAYGO) rule and its point of order against increasing advanced appropriations. All points of order will require 60 votes to override. Regrettably, the Senate defeated a rule that would have closed loopholes currently allowing lawmakers to skirt budget caps by labeling regular spending as "emergencies."

Not to be outdone, the House agreed to a new majority-enforced point of order against appropriations bills that exceed their 302(b) spending ceiling. While this rule excludes conference reports, in which much of the overspending occurs, this reform is a good first step toward helping the House to enforce its own budget. The House budget addresses the "emergency" loophole by requiring that emergency legislation be accompanied by a written statement explaining how this spending fits specified emergency criteria.

The House Budget Committee had an opportunity to bring better accountability and transparency to the budget process when the House Democrats' Blue Dog Coalition offered an amendment that, among other things, would impose tight caps on discretionary spending, require written justification for each earmark, strengthen congressional oversight, and create a rainy-day fund for emergencies. Regrettably, the committee defeated this amendment by an 18–18 vote.

Conclusion

Bringing the budget under control requires a long-term commitment to reform, including some painful trade-offs. Although neither the House nor the Senate budget resolution includes deep spending cuts, it is important that lawmakers begin the reform process. Grabbing the "low-hanging fruit" this year with commonsense reforms in areas such as farm subsidies and Medicaid can help to lay the groundwork for the increasingly difficult decisions that lawmakers will face in future budgets.

—Brian M. Riedl is Grover M. Hermann Fellow in Federal Budgetary Affairs in the Thomas A. Roe Institute for Economic Policy Studies, William W. Beach is John M. Olin Fellow in Economics and Director of the Center for Data Analysis, Nina Owcharenko is Senior Policy Analyst for Health Care in the Center for Health Policy Studies, Ben Lieberman is Senior Policy Analyst in Energy and the Environment in the Thomas A. Roe Institute for Economic Policy Studies, and David C. John is Research Fellow in Social Security and Financial Institutions in the Thomas A. Roe Institute for Economic Policy Studies at The Heritage Foundation.