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Three Lessons from the Recent Budget Reconciliation Debate

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The budget reconciliation process that began a year ago has produced a $39 billion spending reconciliation law and a $70 billion tax reconciliation law. Together, these reforms will merely reduce the six-year growth rate of entitlement spending from 41 percent to 40 percent while extending many of the current tax laws. The immense difficulty in passing these modest reforms bodes ill for lawmakers who wish to address the impending explosion in Social Security, Medicare, and Medicaid spending that will otherwise necessitate the largest tax increases in American history. Because the perilous fiscal future demands much larger reforms, lawmakers should heed three lessons from the most recent budget reconciliation debate.

- The most recent reconciliation bill showed that small reconciliation bills face as much as political opposition as large ones.
- Baseline budgeting allows for the misperception that merely trimming the growth rate of entitlements will reduce nominal spending.
- Temporary tax cuts allow simple extensions to be misperceived as deep, additional tax cuts.

Lesson #1: Small spending reforms are just as hard to enact as large ones. The reconciliation bill's $39 billion in savings is only one-eighth the savings of the three reconciliation bills of the 1990s, which saved an average of $308 billion each. Yet this legislation received much more than one-eighth as much opposition from congressional spenders and the media and therefore took much more than one-eighth as much effort to enact.

For example, even though the only antipoverty spending reform merely lowered the annual growth rate of Medicaid spending from 7.8 percent to 7.6 percent, one newspaper headline stated that "Bush Wins Deep Cuts in Benefit Spending." *The New Republic*, after inaccurately summarizing the legislation, concluded that it "single[d] out the poor for punishment." A *New York Times* editorial slammed the proposal as "abominable," "outrageous," "madness," "mean-spirited," "ideological," "mayhem," "notorious," "slashing," and—pot meet kettle—"over-the-top." Opposition lawmakers were only slightly more charitable in their characterizations of the bill.

Small reconciliation savings have proven no easier to enact than large savings. Big-government advocates attack spending restraint with all of their might regardless of whether the savings are $40 billion or $400 billion. Most voters are vulnerable to this "sky is falling" rhetoric because they are too busy working and raising families to analyze the specific program implications of the large numbers reported in the news. If all spending reconciliation bills will be savaged as

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"record cuts" regardless of size, and if most voters will not have the information to dismiss this rhetoric automatically, lawmakers may as well write reconciliation spending bills that are large enough to rein in federal spending effectively.

Lesson #2: Baseline budgeting sabotages spending reform. The budget reconciliation law merely trimmed the growth rate of a couple of entitlement programs' budgets that have been rising steeply for years, yet the public perception was that lawmakers had slashed program budgets that had been stagnant for years. This misperception is the direct result of baseline budgeting rules.

Baseline budgeting, currently governed by the 1974 Congressional Budget Act, is the largest procedural impediment to reining in entitlement spending. It puts persistent annual entitlement spending increases on autopilot and makes restraining entitlement spending nearly impossible for two reasons:

First, Congress does not vote on the annual entitlement spending increases, and because reporters focus on congressional action rather than inaction, these increases go unreported and the public never finds out how fast entitlement spending is increasing.

Second, because the entitlement baseline assumes permanent spending increases of approximately 6 percent, any legislation to slow the rate of growth is mischaracterized as a "cut."

Consequently, lawmakers have created the worst possible spending scenario: The automatic 6 percent annual spending increases go unnoticed by the public, while any attempt to slow this rapid growth is considered a cut and receives disproportionate media attention because it requires a separate congressional vote. Not surprisingly, reforms slowing the five-year Medicaid growth rate from 7.8 percent to 7.6 percent were intensely criticized by a public that believed that stagnant program budgets were being slashed. Eliminating baseline budgeting would eliminate the statutory bias in favor of spending increases.

Lesson #3: The tax baseline assumes tax increases. While the spending baseline assumes automatic spending increases, the tax baseline assumes the expiration of the 2001 and 2003 tax cuts, as well as several other tax cuts, and that the alternative minimum tax will not be fixed. Lawmakers wishing to keep current tax laws in place must repeatedly pass new tax legislation to extend the current policies, creating—again, because reporters focus on congressional action—the perception of *new* tax cuts. During this period of budget deficits, these repeated tax "cuts" lead the public to believe taxes have been cut deeper than they actually were, which may dampen their enthusiasm for real tax rate reductions in the future.

While the current spending baseline is a relic of the 1974 Congressional Budget Act, the tax baseline is the product of recent Congresses that chose to pass temporary tax cuts because (1) only temporary tax cuts can be enacted under the filibuster-proof reconciliation process; (2) temporary tax cuts show a smaller long-term revenue loss than permanent tax cuts; and (3) some lawmakers prefer to create the perception of "cutting taxes every year."

Lawmakers should make permanent the 2001 and 2003 tax cuts, the fix to the alternative minimum tax, and all other temporary tax cuts to the extent that they promote economic growth without needlessly complicating the tax code. Additionally, implementing dynamic scoring of tax cuts would show that permanent tax rate reductions would not reduce federal revenues as much as some people fear. Without such reforms to fix the tax baseline, there is a risk of "tax cut fatigue" and the worry that future lawmakers may stop extending these tax cuts.

Conclusion. Congress has created baselines for entitlement spending and tax rates that automatically increase spending and taxes unless Congress acts. The spending baseline allowed the most recent reconciliation bill—which allows entitlement spending to expand by over 6 percent annually and keeps most tax rates at current levels—to be mischaracterized as "slashing social spending" to provide "new tax cuts for the rich." Congress can remove major political impediments to reconciliation reforms by reforming these baselines. Finally, lawmakers should understand that shrinking their spending reform proposals will not mute the opposition from big-government advocates, so they may as well make the reforms count.

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