111th Congress
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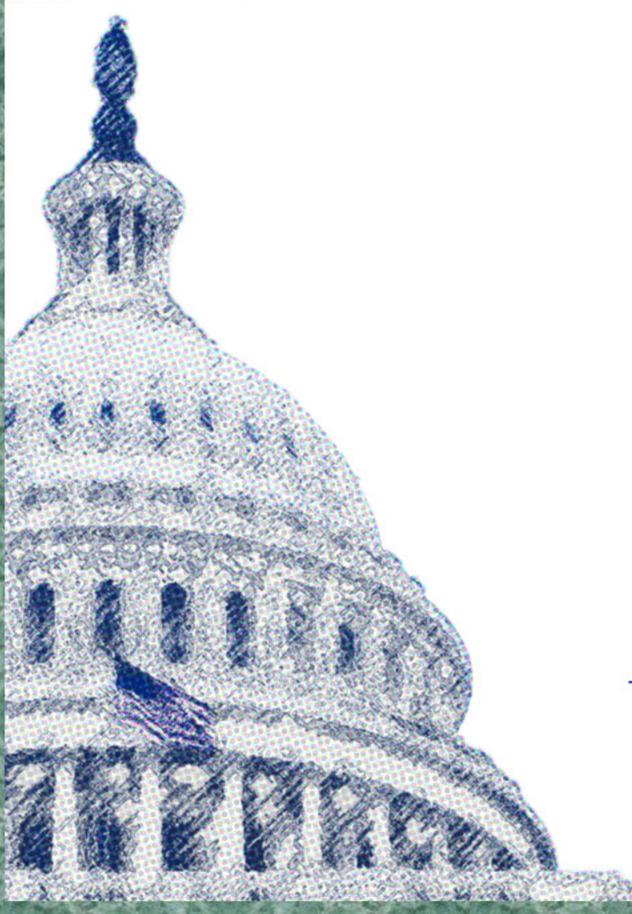
Independence Day Recess Packet



Prepared by the
U.S. Senate Budget Committee
Republican Staff
June 26, 2009

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June 26, 2009

Dear Republican Colleague:

As we wrap up our legislative business to return home for the Independence Day recess, it is important that we carry home information about the majority party's plan to reform the nation's health care system, especially the plan's impact on the country's fiscal outlook.

A preliminary analysis of the Democrats' still-incomplete health care reform bill by the Congressional Budget Office (CBO) shows that it increases spending by at least $1.3 trillion over the next ten years, with untold costs in the long-term. CBO's report showed that, after netting out revenue increases, the draft bill will result in a $1 trillion net increase to the federal budget deficit during 2010-2019. Even with a staggering price tag, it would leave millions still uninsured, while threatening the health insurance coverage that millions of Americans already have in place.

This is not fiscally responsible leadership. Even as the President announced that he is backing the enactment of Pay-As-You-Go (Pay-Go) rules into law, Democrats continue to drive up spending without the necessary offsets. The President's budget passed by the Democratic Congress dramatically explodes the size of government going forward and the trillions of new spending are not offset by any real spending cuts. Instead, taxes will be raised and the rest will be borrowed from future generations.

This prediction is not baseless. The same Democratic Congress – which has waved the Pay-Go banner in the past and now wants Pay-Go to become law – has exploited loopholes to sweep $883 billion of Pay-Go violations under the rug over the past several years. The Administration's statutory Pay-Go proposal would continue to exempt declared emergency spending from Pay-Go rules; would only apply to tax cuts or new mandatory spending; does nothing to control discretionary spending growth; and does nothing to reduce the trillions in public debt that will result from the President's budget.

This packet includes information about the cost of health care reform as well as the facts on Pay-Go. Our economy is at a crossroads and it is time to practice fiscal restraint, not simply talk about it while enacting more and more spending measures that we cannot afford.

Please contact my staff at 202-224-6011 if you need any additional information.

Sincerely

Judd

Judd Gregg

CBO Preliminary Analysis of the HELP Health Reform Bill

Summary

- **Cost Estimate:** In a June 15th letter to Senator Kennedy, CBO provided a preliminary analysis of certain provisions in Title I of the Affordable Health Choices Act.
  - **Net Deficit Increase: $1.0 trillion from 2010-2019.** New spending in the draft proposal is estimated to amount to nearly **$1.3 trillion**, partially offset by an estimated **$260 billion** in new tax revenues and **$40 billion** in reduced Medicaid outlays.
    - **New Spending:** Subsidies for individuals to purchase health insurance (up to 500% of federal poverty level– $110,000 for a family of four in 2009) and small businesses are estimated to cost **$1.3 trillion** over the next 10 years. However, this amount does not reflect the fully phased-in cost of the proposal, as these provisions would not be fully implemented until 5 years from now. The 10-year cost of the proposal when it is fully phased in could amount to **$2.3 trillion**.

      CBO estimates that spending for Medicaid and CHIP will decline by **$38 billion** over 10 years due to reductions in enrollment. CBO assumes states would reverse policies and no longer keep people eligible for those programs if they can receive subsidies and obtain insurance through gateways.
    - **New Tax Revenue**: CBO estimated that the Act would generate nearly **$260 billion** in new tax revenue, resulting from higher wages paid to employees who obtain coverage through a gateway rather than their employer. CBO assumes that employers would continue to provide the same level of total compensation to employees. Accordingly, taxable wage compensation would replace non-taxable health insurance compensation.
  - **Sources of Coverage:** The CBO estimates that if this bill were to be enacted, **15 million** fewer people would have employer-sponsored health insurance compared to what would happen under current law. This reflects several flows:
    - **Coverage Shift:** About **10 million** people would choose to obtain coverage through gateways rather than their employer because the subsidy they would receive under the legislation makes insurance from a gateway cheaper.
    - Another **10 million** people would have no option but to obtain coverage through gateways because their employers would not be offering insurance coverage.
    - About **5 million** people would choose to obtain employer-provided coverage (rather than insurance through a gateway).
  - For a more detailed summary, see The Budget Bulletin, Issue 5: June 19, 2009 - CBO & Health Reform, http://budget.senate.gov/republican/analysis/BB-Latest.pdf.

- **Key elements CBO did not estimate:** There are several features of the draft proposal that CBO has not yet estimated:
    - **Medicaid Expansion** - CBO did not estimate any budgetary effect from expanding Medicaid eligibility up to 150% of the federal poverty level; the draft bill assumes Medicaid eligibility will expand, but does not actually include language that would change the Medicaid law to produce the assumed result.
    - **Employer Mandate-** The CBO preliminary estimate did not include an estimate of the employer mandate as this section of the bill remains blank.
    - **Government-Run Plan-** The CBO preliminary estimate did not include an estimate of the government-run plan as this section of the bill remains blank.

- **Additional elements of Title I <u>not</u> included in the CBO preliminary analysis include provisions that:**
    - Require insurers to offer dependent coverage for children of policyholders who are less than 27 years of age.
    - Delegate authority to a Medical Advisory Council to establish minimum requirements for covered health benefits and to determine the level of coverage that individuals would need to obtain in order to qualify as having insurance.
    - Require insurers to maintain a minimum level of medical claims paid relative to premium revenues (otherwise known as a "medical loss ratio") or to repay certain amounts to policyholders; the HHS Secretary would have the authority to set the minimum medical loss ratio.
    - Apply "risk adjustment" (a process that involves shifting payments from plans with low-risk enrollees to plans with high-risk enrollees) to all health insurance policies sold in the individual and group insurance markets.
    - Allow employers to buy health coverage through the gateways.
    - Require health insurance plans participating in the new gateways to adopt measures that are intended to simplify financial and administrative transactions in the health sector (such as claims processing).

CBO Preliminary Analysis of Kennedy/Dodd Bill

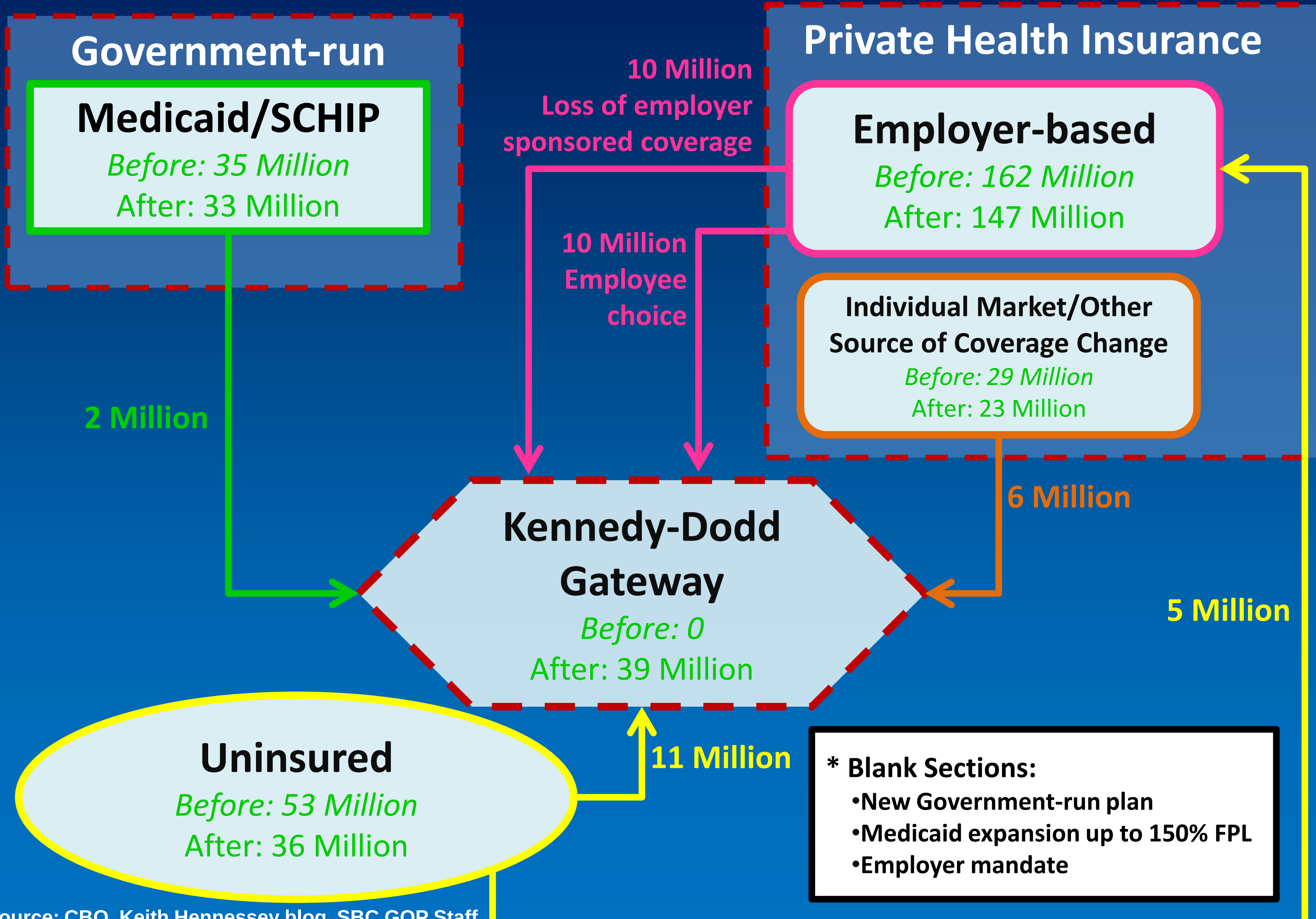
- **$1.3 trillion in new spending from 2010-2019** due mostly to subsidies for individuals to purchase health insurance (up to 500% of federal poverty level– over $110,000 for a family of four in 2009).

- **$1.0 trillion net increase to the federal budget deficit from 2010-2019** when factoring in **$260 billion** in new tax revenues and almost **$40 billion** in reduced Medicaid outlays.

- This amount represents a partial cost of the proposal, as these provisions are not fully implemented until 5 years from now. New spending under the proposal, fully phased in over ten years, **could amount to $2.3 trillion**.

- When fully implemented, about 39 million individuals would obtain coverage through the new insurance exchanges. At the same time, **the number of people who would have had coverage through an employer would decline by about 15 million** (or roughly 10 percent), and coverage from other sources would fall by about 8 million, so **the net decrease in the number of people uninsured would be about 16 million or 17 million**.

Coverage Shift Post- Kennedy/Dodd (2017)*



Source: CBO, Keith Hennessey blog, SBC GOP Staff

Statutory PAYGO: A Distraction from the U.S. Fiscal Crisis

- On June 9th, the Administration submitted to Congress a proposal to enact the "Statutory Pay-As-You-Go Act of 2009."
- This proposal seeks to re-establish PAYGO requirements in statute. Statutory PAYGO had been established in 1990, but expired in 2002.
- In principle, the PAYGO rule requires that any changes to revenues or direct spending that increase the deficit must be offset with commensurate revenue increases or spending decreases.
- In 2007, the Senate revised yet again its PAYGO point of order (some version of which has been in place since 1993), and the House instituted for the first time ever its own PAYGO point of order. However, neither of these rules include the enforcement mechanism of sequestration (which requires statutory authority), which would subject non-exempt direct spending accounts to a cut by a uniform percentage to mitigate the effects of PAYGO legislation that increased the deficit.

The Myth of the 1990's

- The most oft-cited justification for enacting the statutory PAYGO rule is the deficit reduction that occurred in the 1990's, when PAYGO was previously in force. Therefore, the argument typically follows that PAYGO reduces deficits. This ignores other essential features of the federal budget process during that period, such as statutory limits on discretionary spending, which the Administration has not proposed to re-enact in tandem with its statutory PAYGO proposal.
  - Real deficit reduction in the 1990's, and eventual surpluses, largely came as a result of major cuts to discretionary programs, reductions in mandatory spending that were not used to pay for something else, and a surge in tax revenues.
  - Owing to the perceived peace dividend, defense spending was cut by $95 billion in real terms between 1991 and 2000. Defense funding did not get back to 1991 levels until 2004.
  - Tax revenues surged as a result of the high economic growth and the stock bubble of the mid to late 1990s. From 1991 to 2000, individual and corporate tax receipts increased in excess of post-war averages, growing at an average annual rate of 8.1% and 8.5%, respectively. Tax revenues reached over 20% of GDP in 1998 for the first time since 1945.
- At no point from 1991-2002 did Congress and the president ever permit a sequestration under PAYGO to occur. Rather, Congress and the president enacted laws that either required certain legislation increasing deficits not go on the PAYGO scorecard or turned off a required sequestration altogether.

PAYGO in Name Only

- Since 2007 when the House and Senate adopted their version of their respective PAYGO point of order, Congress and the president have enacted 8 bills that have increased the deficit by $883 billion. All were passed either in violation of PAYGO rules, or were declared emergency spending and were therefore not subject to the PAYGO rules (see attached table).
- The statutory PAYGO proposal by the Administration would similarly exempt new spending or tax cuts that are designated as an emergency.
- Democrats frequently point to the enactment of the 2001 tax cuts (EGTRRA) as a glaring violation of the PAYGO principle, which the administration suggests would be avoided with a renewed PAYGO statute. However, 47 out of 50 Democrats in the Senate voted for a large tax cut substitute amendment

that would have violated the PAYGO principle as well, and added just as much to the national debt as EGTRRA did.

<u>Statutory PAYGO Misses the Point</u>

- The Administration's proposal only applies to new mandatory spending or tax cuts. If it was serious about controlling the growth in spending, it would commit to adhering to the low discretionary growth promises beyond 2010 made in the President's Budget by proposing statutory out-year discretionary spending caps.
- Under President Obama's budget, debt held by the public will rise to $17 trillion by 2019, nearly 82% of GDP. Assuming the President sticks to the out-year levels of discretionary spending in his budget (which is doubtful), at its best statutory PAYGO will do nothing to reduce the deficit or the debt. We should not be satisfied with a proposal for "fiscal responsibility" that leaves us with overwhelming deficits and out-of-control growth in debt.
- Too many members are given too much credit for fiscal responsibility because they support PAYGO. Members need to say no to short term spending that is supposedly "offset" six, seven, or eight or more years from now. Members need to say no to new entitlement programs that potentially increase the government's long term liabilities. Members need to say no to new "emergency" spending that is not really for an emergency. Members need to say yes to spending reductions for deficit reduction, not to pay for something else.

Democrats' "Pay-Go" = 8 bills that increased the deficit $883 billion over 10 years

Pay-Go violations	10-yr impact	Comments
Tax Increase Prevention Act of 2007	$50.6 bil	H.R. 3996 – **enacted** Bill to patch the AMT for 2007 reduced revenues and was not offset.
Foreclosure Prevention Act of 2008	$20.8 bil	H.R. 3221 – **enacted** Bill increased non-emergency direct spending by $37.5 bil and increased revenues by $16.8 bil over ten years. (See next section for emergency spending increase.)
Heroes Earnings Assistance & Relief Tax Act of 2008	$572 mil	H.R. 6081 – **enacted** Bill reduced on-budget revenues by $98 million and increased on-budget spending by $474 million over ten years.
Revenue losses related to minimum wage increase	$50 mil	H.R. 2206, 2007 Emergency Supplemental – **enacted** The supplemental included an increase in the minimum wage, as well as tax relief meant to mitigate the impact on businesses. The tax relief in the bill was not fully offset. (See next section for emergency spending increase.)
Subtotal – Pay-Go violations	**$72 bil**	

Emergency declarations	10-yr impact	Comments
2009 Stimulus bill	$498.8 bil	H.R. 1 – American Recovery and Reinvestment Act of 2009 – **enacted** Bill increased mandatory spending by $286.9 billion and reduced revenues by $211.8 billion. Was declared an "emergency," which made the measure exempt from paygo enforcement.
Stimulus rebate checks	$125.5 bil	H.R. 5140 – Economic Stimulus Act of 2008 - **enacted** Bill increased outlays by $41.9 billion and reduced revenues by $83.5 billion. Was declared an "emergency," which made the measure exempt from paygo enforcement.
EESA – Division C – AMT and extenders	$98.6 bil	H.R. 1424 – Emergency Economic Stabilization Act of 2008 – **enacted** Division C patched the AMT for 2008, extended many other expiring tax provisions, and provided special tax benefits for areas affected by disasters, reducing revenues by $99.5 billion. Was attached to the financial rescue bill and was declared an "emergency."
EESA – Division C – Mental Health Parity	$3.9 bil	H.R. 1424 – Emergency Economic Stabilization Act of 2008 – **enacted** Division C legislated the Paul Wellstone/Pete Domenici Mental Health Parity and Addiction Equity Act of 2008. Reduced revenues by $3.2 billion and increased spending by $700 million. Was attached to the financial rescue bill and was declared an "emergency."
EESA – Division C – County payments	$3.3 bil	H.R. 1424 – Emergency Economic Stabilization Act of 2008 – **enacted** Division C extended county payments and PILT. Reduced revenues by $229 million and increased spending by $3.1 billion. Was attached to the financial rescue bill and was declared an "emergency."
EESA – Division C – refundable child credit	$3.1 bil	H.R. 1424 – Emergency Economic Stabilization Act of 2008 – **enacted** Division C increased the refundability income threshold for the child tax credit, increasing spending by $3.1 billion. Was attached to the financial rescue bill and was declared an "emergency."
Veterans educational assistance	$62.8 bil	H.R. 2642 - 2008 Supplemental Appropriations Act – **enacted** Bill expanded veterans educational benefits. Increased spending by $62.8 billion with no offsets. Was declared an "emergency," which made the measure exempt from pay-go enforcement.
Unemployment insurance extension	$8.2 bil	H.R. 2642 - 2008 Supplemental Appropriations Act – **enacted** Bill extended UI benefits for 13 weeks. Increased spending by $11.5 billion and increased revenues by $3.3 billion for a net deficit increase of $8.2 billion. Was declared an "emergency," which made the measure exempt from pay-go enforcement.
Foreclosure Prevention Act of 2008	$4.2 bil	H.R. 3221 - **enacted** Bill included spending for CDBG block grants, housing counseling, and veterans housing benefits, declared "emergency," therefore exempt from pay-go enforcement.
Mandatory spending for MILC	$2.4 bil	H.R. 2206 - 2007 Emergency Supplemental – **enacted** The supplemental included mandatory spending and a baseline adjustment for the mandatory MILC program. It was declared an "emergency."
Subtotal – emergency declarations	**$811 bil**	

CBO Analysis of The Long-Term Budget Outlook

Summary

- "The current recession has little effect on long-term projections of noninterest spending and revenues. But CBO estimates that in fiscal years 2009 and 2010, the federal government will record its largest budget deficits as a share of GDP since shortly after World War II. …. Higher debt results in permanently higher spending to pay interest on that debt (unless the debt is later paid off). Federal interest payments already amount to more than 1 percent of GDP; unless current law changes, that share would rise to 2.5 percent by 2020."

- **Raising taxes isn't the answer**: "If outlays grew as projected and revenues did not rise at a corresponding rate, annual deficits would climb and federal debt would grow significantly. Large budget deficits would reduce national saving, leading to more borrowing from abroad and less domestic investment, which in turn would depress income growth in the United States. Over time, the accumulation of debt would seriously harm the economy. Alternatively, if spending grew as projected and taxes were raised in tandem, tax rates would have to reach levels never seen in the United States. High tax rates would slow the growth of the economy, making the spending burden harder to bear."

- "The choice facing policymakers is not whether to address rising deficits and debt but when and how to do so. Debt is projected to soon grow to unsustainable levels even under the extended-baseline scenario [which adheres closely to current law], which assumes that spending on programs other than Medicare, Medicaid, and Social Security will decline substantially (relative to GDP) over the next 10 years and that revenues will increase as a percentage of GDP over the long term from their average historical levels. Under the alternative fiscal scenario [which assumes policy changes that are widely expected to occur and that policymakers have regularly made in the past], debt is projected to soar almost immediately."

- Under the extended-baseline scenario, CBO sees federal spending increasing to 43.7% of GDP (11.9% of which is net interest) by 2080. Under the alternative fiscal scenario, federal spending amounts to 64.7% of GDP (30.3% of which is net interest) in 2080. While illustrative, this is not especially predictive.

- "The longer that policy action on the budget is put off, the more costly and difficult it will be to resolve the long-term budgetary imbalance."

- **The new outlook is similar to CBO's 2007 long-term outlook**. "Even in 2007, CBO projected that federal debt would quickly accelerate to unsustainable levels under the alternative fiscal scenario, reaching 100 percent of GDP in 2030. Because of the greater short-term accumulation of debt and higher projected spending that CBO now foresees, debt under this scenario is estimated to reach 100 percent of GDP in 2023."

- **Impact of monetizing the debt:** "Although an unexpected increase in inflation would let the government repay its debt in cheaper dollars for a short time, financial markets would not be fooled for long, and investors would demand higher interest rates going forward. If the government continued to print money to reduce the value of the debt, the policy would eventually lead to hyperinflation (as occurred in Germany in the 1920s, Hungary in the 1940s, Argentina in the 1980s, Yugoslavia in the 1990s, and Zimbabwe today)."

- **Long-term impact on GNP:** "Under the extended-baseline scenario [the more optimistic scenario], federal debt would rise substantially after the 2020s. According to the textbook growth model, the debt projected under that scenario would reduce the capital stock by about 5 percent in 2035 and shrink real GNP by about 2 percent, compared with what they would be if debt remained roughly at its 2008 share of GNP (by keeping the spending and revenue shares of GNP at roughly their 2008 levels). By 2080, federal debt would approach 300 percent of GNP, and the capital stock would be reduced by nearly 40 percent and real GNP by almost 20 percent. …. In actuality, the economic effects of rapidly growing debt would probably be much more disorderly as investors' confidence in the nation's fiscal solvency began to erode."

Entitlement Spending

- CBO projects that **health care spending** will grow from 17% of GDP today to 31% in 2035 and 46% in 2080. This scenario assumes a decline in the rate of growth in health care spending, from approximately 2% above the growth in GDP to .8% above the growth in GDP.

- More specifically, CBO projects that **Medicare spending** will be 3% of GDP in 2009, 8% in 2035 and 15% in 2050. These projections assume that the Medicare trust fund remains solvent, despite the fact that it is currently projected (by the CMS actuary) to run out of funds in 2016. CBO projects that **Medicaid spending** will be 3% of GDP in 2009 (federal and state share) and will grow to 5% in 2035 and 7% in 2080. **Social Security** is projected by CBO to consume 5% of GDP this year growing to 6% of GDP in 2035 and remain at about that level for the succeeding decades.

- Taken together, Medicare, Medicaid and Social Security are projected to consume approximately 45% of noninterest federal outlays this year. As a percentage of GDP, these three programs will grow from 10% this year to 16% in 2035 and 23% in 2080. The growth in these programs is due to the aging of the population and the rapid growth in per capita health care costs. Over the next 25 years, aging is the more important factor, accounting for around 64% of the projected growth in spending. Over the longer term, 56% of growth is attributable to health care costs over the entire 75-year projection period.