Senate Budget Committee Republican Staff
BUDGET BULLETIN
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INFORMED BUDGETEER

SUPPLEMENTAL CAVEATS

- Rumors a few weeks ago of an imminent supplemental request in the $3 billion range for operations in Iraq grew to the expectation of a $60-$70 million request on the eve of the President's address to the nation. Now we know the President will transmit a request for an eye-popping $87 billion for Iraq in the near future. Account-level details on the request and a CBO estimate are not yet available, but some observations apply and are worth noting at this time.

- Several news organizations are incorrectly reporting this request's impact on the 2004 deficit by simply adding the total request to the latest deficit estimates from CBO and OMB. This is misleading for several reasons. First, CBO's deficit estimate of $480 billion for 2004 **already assumes all appropriations enacted in 2003 are inflated into 2004**, and beyond. Because the CBO baseline deficit figure for 2004 already reflects a reoccurrence of a $79 billion supplemental (as adjusted for inflation, close to the anticipated request of $87 billion) in 2004, CBO's latest deficit estimates need not be adjusted to reflect the President's request.

- Second, remember that the $87 billion supplemental request is budget authority, not outlays, and thus will not likely increase the deficit by that full amount in 2004. How much it affects the deficit will depend upon what activities Congress provides appropriations for and how fast the agencies spend them.

- A final note – OMB's Mid-Session deficit estimate of $475 billion for 2004 (which, remember, reflects the President's policies as of July and is not a baseline) **did not anticipate additional funding for Iraq**, as several press accounts have noted by adding various estimates of the 2004 outlay effects of the President's $87 billion supplemental to get to a new, imputed "Administration" estimate of, say, $525 billion. They then suggest that the deficit under the President's request could be less than that because of the impact of other policies included in the President's request that have not yet been enacted. But such policies are few, small, and essentially a wash, so they pose little risk to the accuracy of such ad hoc estimation. Only mandatory spending (not requested by the President) that could be enacted during the rest of this session (or next year) poses a risk of further increasing such adjusted OMB deficit estimates.

PICKING AND CHOOSING PELL GRANT DATA

- With the Labor-HHS appropriations bill on the Senate floor (which includes funds for Department of Education programs), opportunists have charged that the Administration is damaging federal student financial aid by undermining the Pell Grant program. Some have accused the President of cutting Pell Grants, while others have faulted the Administration for revising factors used to calculate a student's financial need.

- The facts in the table below powerfully disprove the first assertion. From the 2001 level to the President's 2004 request, appropriations for Pell Grants have increased by nearly $4 billion. By any metric one chooses -- be it appropriated amount, program cost, recipients, or maximum grant -- the numbers have been on a healthy upward trajectory since 2001. (It should be noted that the President's 2004 request included the assumption that the maximum grant would remain $4,000. This was because Congress had yet to pass the 2003 appropriation, which increased the maximum to $4,050. When the President submitted his budget, the request reflected maintaining current law, which was a $4,000 maximum grant.)

PELL GRANTS

		Approps. Level Enacted ($ billions)	Program Level Implemented ($ billions)	Maximum Award	# of Pell Recipients (millions)
2001	Actual	8.8	9.9	$3,750	4.3
2002	Request	9.8	9.6	$3,850	4.0
	Actual	11.3	11.6	$4,000	4.8
2003	Request	10.9	11.5	$4,000	4.9
	Actual	11.4	12.5	$4,050	5.1
2004	Request	12.7	11.9	$4,000	5.1
	Senate Reported	12.2	12.1	$4,050	5.1

Source: Senate Budget Committee Republican Staff, Dept. of Education

- The second fallacy deals with eligibility for Pell Grants, which is based on a detailed formula set in law that evaluates a postsecondary student's financial need. The formula calculates each student's cost of attendance (COA) and his or her expected family contribution (EFC). The difference between the COA and EFC is considered the student's financial need. After adjusting for any other financial aid the student is to receive, financial need translates into a Pell award somewhere between zero and the maximum Pell grant (currently $4,050).

- By law, the Secretary of Education must post revisions annually to some of the tables that are used in calculating students' financial need. One of these tables sets out the allowance factor for state and other taxes, which has not been adjusted for a decade. When the EFC is computed, families are given an allowance (an offset) for state and other taxes paid. This is to rightly recognize that a family in a high tax state has less ability to pay for a student's postsecondary education than a family in a low tax state, all else being equal. For the first time since award year 1994-1995, the Secretary of Education has followed the law and used Treasury data to adjust the state tax allowance tables, and in response there has been an outcry.

- So why is updating the data for the first time in a decade a problem? In 1994, the most recent available file from Treasury was from tax year 1988, and since then taxes in virtually every state have fallen. This means families' were getting a windfall benefit. The formula overestimated some families' need as their taxes fell and net income rose, and they received Pell Grants that they would <u>not</u> have been eligible for if the data had been updated as required. With the recently (and finally) updated table, the lower taxes are reflected in the formula, thereby increasing a family's EFC, which decreases financial need and, in some cases, decreases the amount of a student's Pell Grant.

- All else being equal, some students may receive smaller Pell Grants as a result of this change, but does that outcome lead to the conclusion that updating the table was the wrong thing to do? Certainly not; it is the law that answers that question. Section 478(g) of the Higher Education Act states that: "For each award year after 1992-1993, the Secretary shall publish in the Federal Register a revised table of State and other tax allowances for the purpose of sections 475(c)(2), 475(q)(3), 476(b)(2), and 477(b)(2). The Secretary shall develop such revised table after review of the Department of the Treasury's Statistics of Income file and determination of the percentage of income that each State's taxes represent."

- So what can we learn from the actual statute? First, the Secretary <u>shall</u> publish a revised tax allowance table in each award year after 1992-1993. We are clearly past the date of the 1992-1993 award year, so the Secretary must publish a <u>revised</u> table. For the last decade, the revised table has not actually been revised; it has been a reproduction of the previous year's table.

- Disregarding the law for a decade is not justification for continuing to ignore it. This year, the Department of Education is finally correcting this long-standing error, as is its obligation. Not to update the table would allow people to obtain Pell Grants who should not be eligible. Despite these inconvenient facts, the Senate today adopted (50-48) the Corzine amendment (to the Labor-HHS appropriations bill), which would prohibit the Dept. of Education from implementing this change. No budget point of order applied because the amendment used a gimmick of delayed obligations to offset the cost of the amendment. Perhaps the conferees on the bill will decide to follow the law instead.

WHAT'S IN A NAME?
BOND. LAME BOND.

- The current transportation authorization bill for highways and transit programs, TEA-21, expires on September 30, 2003. At this point it is safe to say that the planned six-year reauthorization of these programs will not even have been considered in committee, much less be enacted, by that date. So efforts over the next two weeks will concentrate on a short-term (say, 5-month?) extension, allowing authorizers to grapple with their key problem: How to feed the appetite for accelerating growth in transportation spending with a revenue funding stream that is not expected to grow as rapidly?

- What are the components of this funding puzzle? For the last 20 years, highways and transit programs have shared the gasoline taxes deposited in the Highway Trust Fund. Currently, the mass transit account of the fund receives 2.86 cents of the 18.4-cent federal excise tax on gasoline (or 15.5 %, worth about $4.7 billion in 2003).

- Since TEA-21 was enacted in 1998, the surge in excise taxes that accompanied the once-booming economy fueled large increases in transportation spending. Recently, however, the growth in revenues slowed as a result of the sluggish economy. Absent a consensus for raising the gas tax to increase the amount of <u>real</u> resources available for transportation spending, proponents of continued rapid growth in highway spending have toyed with novel and controversial approaches – such as bonding authority – for making it appear as if there is more money coming into the highway account. (More precisely, some want to redirect nearly all gas taxes away from transit into highway programs and leave transit on its own to borrow funds through various new bonds.)

- In light of these murky options floated by congressional committees and industry groups, the Chairman of the Senate Budget Committee asked both CBO and the Treasury to evaluate various hypothetical proposals compared to the tried-and-true process of appropriating funds for spending programs.

- CBO's response, issued in June, examined three versions of the rumored proposals. Under one option, Congress would authorize the creation of a new government-sponsored enterprise, the Transportation Financing Corporation (TFC), which would issue tax-credit bonds. CBO concluded that investors would view repayment of TFC bonds as more risky than the repayment of the Treasury debt that would have to be issued to fund increased spending, meaning that it would cost about 2 percent more to provide a certain program level under the TFC approach than it would through appropriations. For example, a $5 billion per year transit program (or any program) would cost $100 million more under this bond proposal than under the usual process.

- Another option would require the Treasury to issue special tax-credit "transit bonds," using the funds raised for spending on transit projects. Unlike Treasury debt, the transit bonds would provide tax credits instead of cash interest. CBO concluded that this proposal "would be an unusual, and potentially more expensive, form of Treasury borrowing to finance government spending, equivalent to adding to the deficit to pay for transit programs."

- Under the last option, Congress would authorize either the Department of Transportation or Treasury to issue a special type of Treasury bond paying cash interest, similar to a conventional Treasury bond, with the borrowed amounts spent on transit projects. CBO concluded that this proposal would result in additional spending to be financed by government borrowing, except that, due to administrative costs and reduced liquidity, this proposal could be more costly than conventional Treasury financing.

- The Treasury Department's July analysis reached similar, but more emphatic, conclusions: the "Department opposes these proposals in the strongest possible terms. . . .[and i]f legislation including these or similar proposals were to be presented to the President, [the Treasury Secretary] would recommend that he veto the legislation." Treasury points out that not only would such special purpose borrowing (for <u>any</u> reason) be more costly than traditional (unitary) Treasury borrowing, but that "even small changes in market participants' perceptions of Treasury financing principles would" trigger additional interest costs of $3 billion annually, and "<u>the American taxpayer would be worse off</u>." (Emphasis in original.)

- The response of some proponents has been that such proposals are quite acceptable since CBO reported that <u>only</u> a 2-percent add on would result. Translation: it is OK if taxpayers pay 2 percent more than they would under the regular, more transparent approach to spending as long as the more complicated, more expensive approach fools enough people into making it easier to increase spending on certain activities. Fortunately, these two analyses seem to have taken some of the wind out of the sails of such proposals.

WASTE, FRAUD, & ABUSE REPORTS: OVERDUE

- Section 301 of the 2004 Budget Resolution instructs most authorizing committees in both the House and Senate to identify changes in law for mandatory spending programs under their jurisdictions that will achieve savings through the elimination of waste, fraud, and abuse. The goal set for each committee is to identify 1 percent in savings for each dollar they spend. The Chairman of the Senate Budget Committee sent letters in May to affected Senate committees setting out specific guidelines. The budget resolution required committees to report back with recommendations by September 2, for use in developing future budget resolutions. In the Senate, the Committees on Foreign Affairs, Finance, and Governmental Affairs are the only ones that have thus far submitted their findings of waste, fraud, and abuse in programs within their jurisdictions.

- The project focuses on mandatory spending programs since mandatory spending makes up 60 percent (excluding net interest) of all federal spending. Mandatory programs are not automatically subject to the annual congressional review that applies to appropriated discretionary programs. Regular assessment of these programs is essential in making sure taxpayer dollars are being used wisely. The Budget Committee strongly encourages each committee who has not yet done so to comply with this oversight requirement of the 2004 Budget Resolution.