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Informed Budgeteer

TO EXTEND, OR NOT TO EXTEND....

- The outgoing Clinton Administration issued its last baseline projections in mid-January. The publication outlined OMB's projected surplus using assumptions defined by the Budget Act, but then proceeded to qualify why the "real" projected baseline surplus should be smaller. Though the Clinton Administration is gone, some in Congress have picked up the "smaller surplus" baton.

- One reason that the "real" surplus is smaller, according to the Clinton Administration and some in Congress, is because the baseline assumes that provisions that expire under current law are not extended.

- They contend that because it is likely that expiring provisions will be extended, the failure to include them as if extended in the baseline overestimates the available surplus. The Clinton Administration went so far as to say: "A more prudent approach would be to include these expiring provisions as part of the baseline *before considering future policy changes* (emphasis added)."

- The *Bulletin* knows that savvy budgeteers can see through this attempt to confuse the fiscal policy debate. An extension of an expiring provision has always been a policy question, not a baseline question (but for a few exceptions as defined by the Budget Enforcement Act). Just because something is <u>likely</u> to happen does not warrant its automatic inclusion in the baseline.

- The baseline is the starting point from which we measure our policy actions. For example, let's just say a budget resolution is written to incorporate a $1.6 trillion tax reduction over the next ten years. If the taxwriting committees wish to extend expiring tax relief provisions, the cost of those extensions must fit within the $1.6 trillion number.

- If expiring provisions were included in the baseline as if extended, it would reduce the ability of committees of jurisdiction to exercise appropriate oversight and choice regarding those provisions.

- Equally as important when considering whether to extend or not to extend an expiring provision - - particularly a tax provision - - should be in the context of other tax laws changes that may be considered.

....AND MUCH ADO ABOUT POPULATION

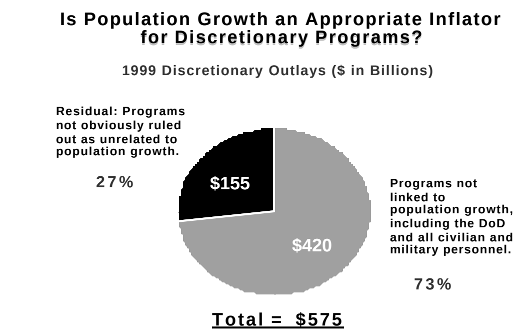
- Just as some have recently suggested that expiring tax and other mandatory provisions that are sometimes extended should be included in Congress' baseline starting point, some also suggest that the current statutory approach for inflating the discretionary baseline is inadequate (see Section 258(c)(5) of the Balanced Budget and Emergency Deficit Control Act of 1985, as revised).

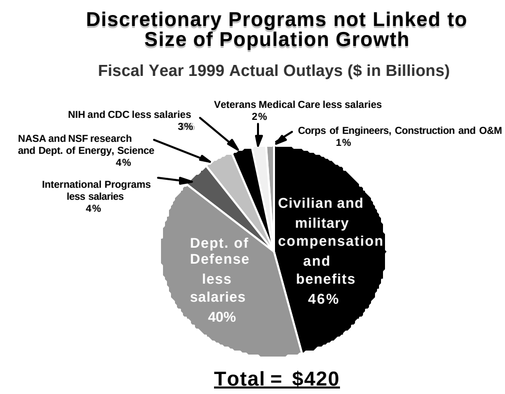
- They contend that the current approach (essentially used by CBO since the enactment of the Budget Act in 1974, without the cloud of this recently emerging criticism) results in an understatement of the likely path of discretionary spending. They maintain that a more appropriate approach to projecting a discretionary baseline would account for not only inflation, but also population growth.

- There are two good arguments against making the discretionary (the word "discretion" doesn't appear there by accident) baseline a per capita yardstick. The first is that doing so would undermine what a baseline for discretionary programs is supposed to represent: that is, a neutral measuring stick of present policy against which competing proposals regarding future policy can be compared.

- A discretionary baseline, adjusted for inflation, is appropriately neutral because it ensures that the purchasing power represented by future years' baseline levels is the same as the current year, without biasing toward any particular policy outcomes. As such, the discretionary baseline can be a starting point from which the Budget Committees build a budget resolution.

- The second, and perhaps more empirical, argument against incorporating population growth effects into the baseline inflators is that at least 73% of discretionary programs are in no way linked to population growth, as illustrated by the following two pie charts.





- Of the 73% of discretionary programs that are not linked to population growth, the largest percentage (46%) is for civilian and military compensation and benefits. The discretionary baseline, as stated in law, currently inflates these expenditures by the Employment Cost Index (ECI), which is the index that largely governs future increases in federal compensation. Historically, the annual number of and level of compensation of federal employees has in no way tracked the annual change in the U.S. population.

- After salaries for federal employees, the next largest component of discretionary programs that are not linked to population growth is spending for the Department of Defense; such defense programs represented 40% of the $420 billion not linked to population. (Salaries for DoD, as well as salaries in the other programs on the chart have been subtracted out of the totals for those programs to avoid double counting.) Again, the level of defense spending is more a function of external threats and national security policies than population.

- Similarly, proponents of making the baseline a per capita measure have not mustered the slightest effort to argue how population is linked to levels of spending for: NASA (outer space is outer space), scientific and medical research (there are always unanswered questions and uncured diseases), international programs (the number of nations on earth keeps increasing), and water projects (rivers and coastlines remain fixed).

- *The Bulletin* reasons that the percentage of discretionary programs not linked to population growth is ***at least*** 73% because the link between population growth and some of the discretionary programs in the other 27% may also be debatable. Examples of such discretionary expenditures include the monies devoted to the Coast Guard and NOAA.

- If one is simply trying to increase the level of discretionary spending, linking the growth in the discretionary baseline to an indicator that is not related to the programs in that baseline is unreasonable. At least be willing to call a spade a spade. An increase in discretionary spending may not be a meritless goal, but to do so by building additional discretionary dollars into the baseline illogically is not an honest means to reach that goal.

SPECTRUM ESTIMATES SURGE

- Two weeks ago, the *Bulletin* explained a just-completed spectrum auction that generated nearly $17 billion in high bids. The amount from that one auction eclipses the cumulative total receipts from all spectrum auctions held over 1994-2000.
- Given this, curious budgeteers would do well to wonder: what does this mean for projections of receipts that could arise from spectrum auctions that the FCC will conduct as long as it has such authority (which expires at the end of 2007)?

- In its baseline projections that it just released, CBO dramatically increased its estimate of spectrum auction receipts by $10 billion (or 55%) over its previous baseline – for a total of $28 billion over the 2002-2011 period. In a "box" devoted to this topic in its Budget Outlook report, CBO notes that that the "prices being paid for spectrum licenses have skyrocketed over the last year."

- Specifically, CBO remarks on the "market enthusiasm for 3G [third generation – simultaneous voice and high-speed data wireless communications] services," applications. Such services are the likely applications for which bidders will use much of the spectrum to auctioned by the FCC over the next six years.

- CBO cites both the "robust" FCC auction completed in January as well as auctions held in European countries over the past year, the latter which "yielded unit prices that were, on average, about four times higher than the amounts previously paid for similar" U.S. licenses.

- While the latest baseline provides CBO's best estimate (i.e., it has as much of a chance of being too high as too low), CBO tempers its current assessment of future spectrum auctions by noting the uncertainty that especially pertains to them: new, unencumbered frequencies available for auction are hard to come by, incumbent users resist change, and spectrum values have been volatile for a variety of reasons.

- CBO's own estimating experience testifies to this volatility. In 1997, when the Balanced Budget Act required the FCC to conduct the auctions that we anticipate over the next six years, even most of those who authored the legislation scoffed that CBO's estimate at that time of $25 billion over 1998-2011 was "pie in the sky." After enactment, CBO's subsequent baselines suggested a diminished likelihood that the original estimates would be realized.

- Now, as we are three and a half years closer to the time of actually conducting the contemplated auctions, CBO's latest baseline indicates that current conditions are likely to make the original cost estimate appear, if anything, conservative.

STREAMLINING SALES TAX FOR THE 21ST CENTURY

- In a response to the rapid growth of electronic commerce and concerns from the business community, 29 state governments created the Streamlined Sales Tax Project. The primary goal is to overhaul the existing sales and use tax system and implement a new, simplified system that accommodates interstate commerce and is adoptable to electronic commerce. As the system exists today, it is a patchwork of 7,500 individual taxing jurisdictions across the United States, each with its own rules, paperwork and procedures. Forty-five states and the District of Columbia have sales taxes of some kind.

- The Project, created in March 2000, has completed its work, known as the Uniform Act and Uniform Agreement and has forwarded it to the National Governors' Association and National Conference of State Legislatures for consideration and to the states to begin the legislative process.

- The proposal includes uniform definitions and tax rates, a vendor registration system, and minimal vendor audits. In addition, it provides the necessary authority for a state to enter into the agreement and sets the specific elements which must be enacted by the individual state before they participate.

- The Project is hopeful their recommendations will alleviate a number of the barriers interstate vendors deal with everyday. These barriers include multiple tax rates, varying laws on product definitions, extensive taxreturn requirements, and costly and time-consuming annual audits. As a result, the tax collection burdens imposed upon vendors with either be eliminated or eased to a great extent. Observers expect state legislatures across the country will debate and discuss the Project's recommendations this year.

QUOTE OF NOTE: CUTTING TO THE CHASE

L Senator Domenici and GAO Comptroller General David Walker made the following observations at the close of the February 6 Budget Committee hearing:

Sen. Domenici: I think your answers to Senator Phil Gramm clearly put before us that whether we have a $900 billion tax cut or a $1.6 trillion taxcut over the next decade, it is clearly going to have little or no effect on what you told us about the tremendous shortfalls looming for Social Security and Medicare 20, 30, and 40 years from now. Is that correct?

Walker: That is correct. You are still going to have a problem, especially in the Medicaid and Medicare area, huge problem.

CALENDAR

Senate Budget Committee Hearing Schedule

Unless otherwise noted, all hearings will be held in Dirksen 608 at 10:00 a.m. Additional hearings and witnesses may be scheduled.

February 12: The Future Defense Budget; Witnesses: Dr. Andrew F. Krepinevich, Executive Director, Center for Strategic and Budgetary Assessments; Adm. Bill Owens, former Vice Chairman of the Joint Chiefs of Staff; and Robert J. Lieberman, Deputy Inspector General, Department of Defense. **2:30 pm**

February 13: Hearing on the Budget Outlook and Tax Policy; Witnesses: Dr. Martin Feldstein, Professor of Economics, Harvard University; Dr. Kevin Hassett, Resident Scholar, American Enterprise Institute; and Gene Sperling, Guest Scholar in Economic, Foreign Policy and Governmental Studies, Brookings Institution.

February 15: Medicare Reform and Prescription Drugs; Witnesses: Kathleen Means, Senior Health Policy Advisor, Patton Boggs LLP; Dr. Marilyn Moon, Senior Fellow, The Urban Institute; Dr. Robert Reischauer; President, The Urban Institute; and Dr. Gail R. Wilensky, John M Olin Senior Fellow, Project HOPE.

SBC COMINGS & GOINGS!

L Chairman Domenici's Senate Budget Committee staff continues to add to its long list of distinguished alumni and future alumni:

- **Cheryle Tucker** has been the SBC transportation analyst for two years. She is moving to the House Appropriation Subcommittee on Transportation to join a number of SBC alumni currently at House Appropriations. At least she will know what a 302(b) is! Best Wishes, we look forward to seeing you when budget and appropriations cross paths.

- **Kathleen Weldon** joins the Committee taking on Medicare, Medicaid and federal health care programs. Formerly Assistant Deputy Mayor, Policy and Budget with Mayor Richard Riordan, L.A., California, Kathleen has a degree from Stanford, and her Masters in Public Policy from Harvard University.

- **Saber Mayhugh** also joins the Committee as the agriculture analyst. Saber most recently was employed by Conagra, Inc. in Omaha, Nebraska but lived across the state boarder in Avoca, Iowa. In Iowa he farms (and will continue to manage and farm) a 500 acre corn and soybean operation. Besides being a farmer, Sabre is a co-founder of a small high tech investment company, an artist, a grain merchandiser, and a graduate of Harvard .