Peter G. Peterson Foundation
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Budget Conference Committee: Fiscal Options Available

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INTRODUCTION

The budget conference committee is three weeks away from its December 13 deadline for finding agreement on a budget framework for fiscal year 2014 (FY 2014), which began on October 1. The conference's primary goal is to approve a bipartisan plan, reconciling differences between the budgets passed by the House and Senate earlier this year. However, with a number of additional fiscal issues looming, conferees can also choose to take further action to break the cycle of brinksmanship and set our country on a sounder long-term path.

A large, comprehensive plan that addresses our long-term structural deficits is clearly the best way forward for America's future economy. However, more modest proposals, which would begin to take meaningful steps towards putting our debt on a sustainable path, would also be worthwhile.

Specifically, the conferees have a number of important fiscal reform opportunities, including:

- Funding the government for the remainder of FY 2014, avoiding another partial government shutdown on January 15
- Preventing a second round of across-the-board sequestration cuts on January 15
- Avoiding funding problems surrounding the debt ceiling on February 7
- Determining whether to extend a number of tax provisions that expire on December 31 (often referred to as "extenders")
- Addressing the reduction in Medicare's physician payments effective January 1 (the "Doc-Fix")

A successful conference agreement — or budget resolution — would include a plan for overall levels for spending, revenues, deficits and debt. While it would not directly change spending and revenue laws, a budget agreement would set the framework for subsequent legislation, and could address some or all of the fiscal issues highlighted above.

Congressional lawmakers agreed to a budget conference when they voted on October 16 to end the partial government shutdown and avoid defaulting on federal obligations. The conference aims to report back to the rest of the Congress and the American people by December 13. While it is far from certain that the conferees will reach an agreement, both sides have indicated their desire to move past the shutdown and "work together to grow the economy and tackle our debt responsibly."[1]

[1] Joint Statement from Chairman Patty Murray and Chairman Paul Ryan, October 16, 2013

COMPARING THE HOUSE AND SENATE BUDGET PROPOSALS

The 2014 budget dispute has been simmering since March, when the Senate and the House passed their plans; the Senate proposing $185 billion more in federal spending and $20 billion more in revenues for FY 2014 than the House (see Table 1). The largest differences between the two plans were in healthcare and non-defense discretionary spending.

Table 1: Comparison of Fiscal Year 2014 Budget Resolutions

$ in billions	2013	2014		Difference
	Actual	House	Senate	Total Difference (Senate-House)
Revenues	$2,774	$3,003	$3,023	$20
Outlays	$3,454	$3,531	$3,715	$185
Deficits (-)/Surplus(+)	-$680	-$528	-$693	-$165
Debt Held by the Public	$11,976	$12,850	$13,060	$210

SOURCE: Data from the House Budget Committee, *Concurrent Resolution on the Budget Fiscal Year 2014*, House Report 113-17, March 2013; Senate Budget Committee, *Concurrent Resolution on the Budget FY 2014*, Senate Report 113-12, March 2013; Department of the Treasury, Bureau of the Fiscal Service, *Final Monthly Treasury Statement*, October 2013. Compiled by PGPF.
*NOTE: Figures may not add up due to rounding.

FUNDING THE GOVERNMENT FOR FY 2014 AND SEQUESTRATION

To reopen the government on October 17, policymakers agreed to a short-term continuing resolution (CR) to fund discretionary — or annually funded — programs through January 15. These discretionary programs cover a large number of government activities — everything from national defense to the FBI, highways, national parks, maintenance of the U.S. Capitol, and the National Academy of Sciences. Altogether, these programs account for only about one-third of total federal spending; the remaining two thirds (spent primarily on Social Security, Medicare, Medicaid, federal employee retirement, unemployment benefits and food and nutrition assistance programs) are known as "mandatory" programs, and are not subject to annual approval.

The short-term CR has given lawmakers time to reach an agreement to fund the government for the rest of FY 2014. As part of these negotiations, lawmakers will also have to contend with previously agreed-upon statutory limits on defense, non-defense and total discretionary spending. These limits were originally established by the 2011 Budget Control Act (BCA) for fiscal years 2013 to 2021, and were subsequently reduced in response to the failure of last year's supercommittee. The reduced discretionary cap extends from FY 2014 to FY 2021, totaling $718 billion in deficit reduction. For FY 2014, the total cap was lowered by $91 billion.

> Although the House and Senate plans' revenue levels are only $20 billion apart for FY 2014, the two plans diverge more significantly over time.

If the budget conference does not comply with the caps, sequestration — or across-the-board cuts — will be triggered. In FY 2013, $85 billion in discretionary spending was cut from the federal budget through sequestration. Across-the-board-cuts can be harmful because they do not allow policy makers to prioritize funding to departments with the greatest need or to programs with the best performance.

While policymakers for the most part agree that sequestration is not the best way to reduce government spending — and could harm our national security, our economic recovery, or both — so far, they do not agree on an alternative. They continue to disagree over the level of funding for discretionary programs as well as the allocation of that funding between defense and non-defense programs.

The CR set FY 2014 discretionary spending at an annualized level of $986 billion, which is about $20 billion above the new cap of $967 billion. The difference can be explained by defense — the CR's annualized level of spending for defense of $518 billion exceeds the $498 billion defense cap by $20 billion. Given this discrepancy, not only will lawmakers need to reach agreement on a level of spending to keep the government open, but they also need to determine whether such spending will include another sequester of the $20 billion in defense or some other measure to achieve the same deficit savings.

HOUSE AND SENATE DISCRETIONARY SPENDING DIFFERENCES

The House proposal for discretionary spending met the total cap of $967 billion for FY 2014, while the Senate essentially rejected the $91 billion reduction to the spending limit. As a result, the House and Senate started around $92 billion apart in their funding plans for regular — or capped — spending for defense and non-defense programs, with the House at $966 billion and the Senate at $1,058 billion (see Table 2).

Table 2: FY 2014 Budget Authority

$ in billions	2014 Caps	Continuing Resolution	House	Senate	Difference: Senate less House
Regular Spending Subject to Caps					
Defense	$498	$518	$552	$552	$0
Non-defense	$469	$468	$414	$506	$92
Subtotal: capped spending	$967	$986	$966	$1,058	$92
Additional Spending					
Overseas Contingency Operations					
Defense	--	$87	$86	$0	-$86
Non-defense	--	$11	$7	$50	$44
Subtotal	--	$99	$93	$50	-$43
Disaster Relief and Other	--	$12	$0	$12	$12
Subtotal: additional spending	--	$110	$93	$62	-$31
Total Discretionary Spending					
Defense	$498	$605	$638	$552	-$86
Non-defense	$469	$491	$421	$568	$148
Total	$967	$1,096	$1,059	$1,120	$62

SOURCE: Data from the House Budget Committee, *Concurrent Resolution on the Budget Fiscal Year 2014*, House Report 113-17, March 2013; Senate Budget Committee, *Concurrent Resolution on the Budget FY 2014*, Senate Report 113-12, March 2013; Office of Management and Budget, *OMB Sequestration Update Report to the President and Congress for Fiscal Year 2014*, August 2013; and Congressional Budget Office, *Letter to the Honorable Paul Ryan*, September 12, 2013; House Appropriations Committee, *Revised Suballocation of Budget Allocations for Fiscal Year 2014,* June 2013.
Compiled by PGPF.
*NOTE: Figures may not add up due to rounding.

In increasing the discretionary caps to their pre-sequester level, the Senate would allocate $37 billion more for non-defense discretionary spending in areas such as transportation, education, training and social services, and community development; and $54 billion more for defense spending, compared to the FY 2014 caps.

Although the House proposal stayed within the FY 2014 limit of $967 billion for regular discretionary spending level, it increased defense spending by $54 billion to $552 billion and offset this increase by cutting non-defense spending by about the same amount. The House also proposed extending spending caps another two years through 2023, and giving non-defense agencies greater flexibility to allocate reductions in spending.

The House and the Senate also differed in their allocation of additional discretionary spending, spending that is not constrained by the BCA caps. The House proposed $93 billion in such additional spending for overseas contingency operations, as military operations in Afghanistan and other related activities are known, of which $86 billion would be allocated to the

Department of Defense. The Senate, on the other hand, proposed $63 billion in additional spending, but allocated it all to non-defense programs and disaster relief, and none to defense. In total, the House would spend $86 billion more on defense than the Senate, and the Senate would spend $148 billion more on non-defense than the House.

DEBT CEILING

The conferees also must address the statutory limit on U.S. Treasury debt. The agreement to reopen the government included temporary relief from the statutory debt limit, but that relief ends on February 7. If policymakers fail to raise the debt ceiling, the United States could again risk a technical default on some of its obligations.

The debt ceiling controls the amount of debt the U.S. Treasury can issue to finance government operations. It does not determine the level of spending for those operations. An agreement by the conferees to establish overall spending and revenue levels, together with the subsequent legislation to meet those targets, would determine how much the government would need to borrow. Presumably, a successful agreement and legislation on the budget would also include a commensurate increase in the debt ceiling.

EXPIRING TAX PROVISIONS – A.K.A. "EXTENDERS"

The House and Senate budget resolutions also reflect disagreement about how much revenue the federal government should collect. Although the House and Senate plans' revenue levels are only $20 billion apart for FY 2014, the two plans diverge more significantly over time. Over the next ten years, the Senate plan raises $923 billion more revenue than the House plan.

> The more that Congress relies on short-term, last-minute fixes, the more difficult it will be to establish long-term fiscal solutions.

As the budget conferees debate revenue levels, they face the automatic expiration of more than 50 tax provisions on December 31, 2013. Many of these provisions have been routinely extended in the past. Some of them are broadly used and popular (such as the tax credit for research and experimentation); others benefit more narrow constituencies (such as the 7-year recovery period for motorsport entertainment facilities). Of the provisions set to expire, the single most expensive in FY 2014 is bonus depreciation, which provides faster write-off of business investments and was enacted as an economic stimulus measure in 2008. Renewing 100 percent of the expiring tax provisions would reduce projected revenues by $54 billion in FY 2014, and continuation of such provisions would reduce revenues by $938 billion over 10 years.

CBO's "current law" budget projections assume that all of these tax provisions will expire at the end of the year. If Congress decides to extend some or all of them, which is likely, budget conferees will need to agree either: (a) on lower spending or additional revenue measures to offset the lost revenue associated with the extension of these provisions; or (b) to waive the statutory pay-as-you go (PAYGO) requirement that applies to nearly all of the tax provisions, which would increase deficits and debt.

MEDICARE'S SCHEDULED REDUCTION TO PHYSICIAN PAYMENTS (A.K.A. THE "DOC-FIX")

Another important issue that the budget conferees will need to address is Medicare's physician payment rates, which are set each year using a formula called the sustainable growth rate (SGR). Under this formula, on January 1, 2014, physician payment rates will be reduced by more than 24% unless Congress specifically takes action to change or delay the payment rates.

The SGR was established in 1997 as an attempt to slow the growth in the costs of Medicare. As health care costs and the volume of Medicare patients have grown in recent years, however, the SGR has proven to be an ineffective way to control healthcare spending. In every year since 2003, Congress has voted to waive these required reductions in payment rates, resulting in a total of nearly $150 billion in additional spending. Therefore, these short-term "doc-fixes" have removed the intended impact of the SGR, which was to contain the growth of Medicare costs.

In the current budget negotiations, budget conferees need to decide whether they would like to again delay the problem temporarily, or work to address the problem at its core. If Congress acts now to replace the SGR, CBO estimates that the budgetary costs to the federal government would be $14 billion for 2014, or about $175 billion over ten years.

Bipartisan health policy experts have proposed options to permanently address the SGR that would also encourage physicians to move away from Medicare's predominant fee-for-service payment system and adopt alternative payment approaches that reward care coordination and health outcomes over the volume of services delivered.

A WINDOW OF OPPORTUNITY

The bipartisan committee should embrace the chance to make significant progress to stabilize our long-term debt. The more that Congress relies on short-term, last-minute fixes, the more difficult it will be to establish long-term fiscal solutions. With the next round of deadlines quickly approaching, now is the time to have the difficult conversation about how to create a sustainable fiscal future for America. Governing by crisis is no way to run a country.