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Budget, Appropriations, Deficit, Debt Limit, and Tax Reform

AUGUST 2013 RECESS UPDATE

The House of Representatives and Senate started their annual August recess on August 5, and will return to Washington on Monday, September 9.

As appears to have become the custom on Capitol Hill, the post-August recess will see a rush to complete the languishing budget and appropriations process, and possibly address the associated issue of sequestration, while there will also be a heated debate on raising the debt limit. In the midst of these contentious battles, there is an ongoing effort to kick start comprehensive tax reform.

Various other issues are also on the plate for Congress the remainder of 2013 – including Immigration Reform, the Farm Bill, Postal Service Reform, and reauthorization of the Water Resources Development Act. ML Strategies will an outlook for these issues in early September when Congress returns after the Labor Day holiday.

Budget Proposals and Process

Before looking ahead to Congress' post-August work on appropriations, the debt limit, and tax reform, it is important to look back to the impasse over the annual budget resolution.

The failure to pass budget resolutions is now the new normal. Congress last passed a budget resolution by the April 15 deadline in 2003 for Fiscal Year 2004, and the last time a budget resolution was approved at all was in 2009 for Fiscal Year 2010. As a result of not being able to pass a budget resolution, each chamber has, for the past three years, had to rely on a "deeming resolution" – an ad-hoc legislative mechanism whereby House- or Senate-passed budget levels are deemed to be considered enforceable.

The House passed its budget resolution for Fiscal Year 2014 on March 21, and the Senate passed its version on March 23. However, the two chambers have approved dramatically different levels of funding, making efforts to take the resolutions to conference problematic.

Although the House and Senate agreed in April to move forward with budget talks after approving their separate budget resolutions, the process has not progressed, and there is little expectation that they will reach agreement on a budget resolution this year.

Fiscal Year 2014 Appropriations & Sequestration

The House Appropriations Committee approved its Fiscal Year 2014 subcommittee spending caps – known as 302(b) allocations – on May 21. The Senate Appropriations Committee approved its FY14 subcommittee allocations on June 20.

With Fiscal Year 2013 ending on September 30, the House Appropriations Committee has approved 10 of the 12 annual spending bills for Fiscal Year 2014, while four have passed the full House. The Interior & Environment and Labor/HHS/Education bills have yet to be brought before the full committee for consideration.

In the Senate, 11 spending bills have been approved by the Appropriations Committee for Fiscal Year 2014, although not one has been taken up by the full Senate. The Interior & Environment bill remains to be moved in the committee.

The general view in Washington is that the appropriations process for FY14 has broken down and that it is conceivable that not one of the 12 spending bills will be passed as stand-alone legislation.

To better understand the fractious situation in Congress over spending levels, one only has to look at developments in the last week of July, as Congress prepared to depart for the August recess, when the House of Representatives and Senate were both unable to move the Transportation/Housing and Urban Development (THUD) appropriations bill. In the House, the bill was pulled from the floor at the last minute. This led to a public dispute among members of Republican leadership on the cause of the bill not moving forward. What makes this breakdown in the process so noteworthy is that the THUD bill was in line with the budget plan adopted by the House in March. Speaker Boehner and House Majority Leader Cantor indicated that the THUD bill had been pulled from the calendar because of the excessive number of offered amendments, and that it would be taken up when Congress returns next month. However, House Appropriations Committee Chairman Hal Rogers (R-KY) said that the bill did not have the votes for House passage and stated that the House's failure to move the legislation forward was evidence that the mandatory spending reductions of sequestration, which he labeled "unrealistic and ill-conceived," must be brought to an end. In the Senate, the THUD bill failed to secure the required 60 votes for cloture on the floor, with Minority Leader Mitch McConnell (R-KY) urging his colleagues to vote in the negative. This also led to a public dispute between McConnell and Appropriations Transportation Subcommittee Ranking Member Susan Collins (R-ME), who drafted the legislation.

When Congress returns on September 9, the House has only nine scheduled legislative days on the calendar before the end of the current fiscal year, while the Senate has 16 in-session days. Given these dynamics – widely divergent spending levels and a lack of action to date on the various spending bills – it is virtually guaranteed that Congress will, once again, pass a Continuing Resolution (CR) to keep the federal government operating when Fiscal Year 2014 begins on October 1.

A CR is a stopgap measure authorizing continued government funding for federal agencies for specific programs at, above, or below, current funding levels when Congress and the president do not finalize the appropriations process before the new fiscal year begins.

There will be some debate on the length of the CR, but it will likely last for 30 to 60 days until Congress either approves the 12 spending bills according to "regular order" (to say that this is highly unlikely would be generous), passes another short- or long-term CR, or agrees to an omnibus appropriations bill that wraps all 12 spending measures into one legislative package.

As a reminder of how the process can drag on, for the current Fiscal Year 2013, appropriations were not finalized until March 2013 – six months into the fiscal year – when Congress ultimately approved the six-month "year-long" CR that currently funds the federal government.

With regard to sequestration, it is important to remember that the very threat of sequestration in the Budget Control Act of 2011 (BCA) was intended as a means to spur Congress to reach agreement on spending cuts – in order to avoid deep mandatory spending cuts. With no agreement reached, the cuts went into effect, leading to furloughs and other cost-saving measures across the government. As sequestration has become a reality, many Democrats and President Obama have called for sequestration to end, and they have been joined in this call by some Republicans, including Chairman Rogers as well as Senator John McCain (R-AZ) who is deeply concerned about further reductions in Department of Defense spending. The White House and Senate Republicans are said to be engaging in discussions about how to end the sequestration. For the sequestration to end there must be an agreement on some other means to reduce federal spending and/or increase revenues over the next 9 years. Passing a CR for FY2014 without making other changes to resolve the sequester would extend the across-the-board cuts for non-exempt mandatory programs. For example, unless the BCA is modified for FY2014, a 2 percent Medicare provider cut will remain in effect.

On July 25, the director of the Congressional Budget Office (CBO) responded to a request by Representative Chris Van Hollen (D-MD) on how the elimination of sequestration would affect the economy. According to the CBO letter, they analyzed a proposal under which the spending cuts in effect for 2013 would be cancelled at the beginning of August and none of the reductions scheduled for 2014 would be implemented. CBO found that these actions would increase the level of real (inflation-adjusted) gross domestic product (GDP) by 0.7 percent and increase the level of employment by 0.9 million by the end of the third quarter of calendar year 2014. The letter can be found here.

Deficit Continues to Recede

Further complicating the competing goals for federal spending among the two parties on Capitol Hill, is the improving situation with the nation's debt. On Monday, August 12, the Treasury Department released its Monthly Treasury Statement for July, showing that the deficit for the month was \$97.6 billion, putting the deficit for FY13 at \$607.4 billion with two months left in the fiscal year. By comparison, at the same point in time for FY12, the annual deficit had reached \$973.8 billion. Accordingly, the government appears to be headed toward its lowest annual budget deficit in five years.

The Congressional Budget Office is predicting that the total deficit for FY13 will come to \$670 billion, which would be significantly below last year's deficit of \$1.09 trillion. Should this be the case, it will be the first time that the deficit has been below \$1 trillion since 2008.

The steep reduction in the deficit has, for some, partially relieved the sense of urgency for further mandatory spending reductions, although more conservative members of the Republican Party will continue to oppose an end to sequestration and call for further spending reductions in the appropriations process.

Debt Limit Negotiations

Harkening back to the debt limit crisis of 2011, there is growing concern that, as Congress returns in September and tackles budget and appropriations, the national debt limit will once again become embroiled in broader debates on federal spending. The federal government reached its debt limit of $16.699 trillion in May, but the Treasury Department has used what it calls "extraordinary measures" to allow the government to continue to pay its bills. It is estimated that those measures will have run their course by sometime in October, necessitating an increase in the limit – although this could lapse until November as a result of increased tax revenues resulting from the improving economy and expired tax cuts on wealthy taxpayers, and spending reductions as a result of sequestration.

Given the political fallout from the 2011 debt limit debate – and the subsequent damage to the nation's credit rating – there is a general consensus that congressional Republicans and Democrats will work with the president to avert a showdown. However, while no one is suggesting that they want the federal government to default, some conservative Republicans are indicating that they will demand that any increase in the debt limit include more spending cuts as well as entitlement reform. Democrats, including the president, have generally balked at this and say that they will insist on a "clean" debt limit increase.

Comprehensive Tax Reform

The last significant reform of the tax code occurred nearly 30 years ago in 1986 during the Reagan Administration. In the intervening years, there have been significant changes that many argue make the tax code outdated and out of line with the modern economy and technological advances.

Since comprehensive tax reform cannot possibly be achieved during one congress, current efforts to reform the tax code have been discussed for the past several years. In the last two years, the House Ways and Means Committee and the Senate Finance Committee have held nearly 60 hearings on tax reform.

On June 27, Senate Finance Chairman Max Baucus (D-MT) and Ranking Member Orin Hatch (R-UT) sent a letter to their colleagues stating that they would pursue a "blank slate" approach to comprehensive tax reform, and asking for senators to submit letters defending tax provisions that they want to see included in a comprehensive bill. The letters were due on July 26; however, there was significant resistance from senators of both parties who were reluctant to go on record as defending particular tax provisions – and in some cases for not defending certain provisions. Some senators have indicated that they would be relying on constituent input for guidance on which tax provisions they should defend, with some planning to submit a comprehensive list, while others indicated that they would likely select one or two priority provisions. Some appeared unwilling to respond to the request at all.

Republican leadership in the Senate has urged colleagues to oppose any tax reform effort that includes new revenues, while the president, in the eyes of many, diminished the chances for comprehensive tax reform to move forward when, in a speech in late July, he proposed a "grand bargain" focused on corporate tax reform and stating that such reform should be used as a means to raise funding for new stimulus programs. Republicans will insist that any tax reform be comprehensive and include reform of the tax code for individuals.

Although the road ahead for tax reform is tough, House Ways and Means Committee Chairman Dave Camp (R-MI) is said to be aiming for a draft tax reform proposal to be completed by September with an October mark-up that he hopes will reduce the top tax rate – for corporations and individuals – to 25 percent.

The difficulties in building support for comprehensive tax reform on Capitol Hill are significant, but as a part of their commitment to moving reform forward, Chairman Baucus and Chairman Camp will continue their summer "road show" over the August recess, traveling around the country in an attempt to take the debate out of Washington. Senator Baucus and Congressman Camp have also created a website www.taxreform.gov that makes the case for comprehensive reform.

Conclusion

Congress will return to Washington in early September having heard from their constituents – both Democrat and Republican, liberal and conservative – on how they should best accomplish their goals for the federal budget. With a deeply divided electorate, we anticipate that members of Congress of both parties will have heard very different visions for how the federal government should spend the taxpayers' money, and that will make for an intense, and more than likely drawn out, debate that is going to run up against some very hard deadlines related to the end of the fiscal year and the debt limit. In the past, at the 11th hour, Congress has risen to the occasion and come to, if not a solution, a temporary compromise that keeps the engine of the government running.

We will be closely monitoring developments on all of the issues discussed above in the coming weeks, and look forward to providing our next Legislative Update on the various other legislative measures that will be addressed in the remaining months of 2013.