CBO TESTIMONY

Statement of
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before the
Subcommittee on Select Revenue Measures
Committee on Ways and Means
U.S. House of Representatives

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NOTICE

This statement is not available for public release until it is delivered at 3:00 p.m. (EST), Tuesday, November 16, 1993.

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Mr. Chairman and Members of the Subcommittee, I appreciate this opportunity to testify about the proposal to permit individual income tax payers to determine automatic reductions in federal spending. The proposal is contained in H.R. 429, introduced last January by Congressman Walker, and is intended to help reduce the deficit.

HOW WOULD THE PROPOSAL WORK?

H.R. 429 would allow taxpayers to check off as much as 10 percent of their individual income tax liabilities to go into a "Public Debt Reduction Trust Fund." The proposal would mandate automatic reductions in federal spending that are exactly equal to the total amount checked off by taxpayers. The bill would not increase or decrease income tax liabilities; it would affect only the spending side of the budget, not the tax side. It would require spending cuts across the board for all programs except Social Security, deposit insurance, and net interest, which are specifically exempt.

Establishing a trust fund alone has no budgetary effect. The deficit can be reined in only by substantive measures to trim spending or raise taxes; such actions would automatically curtail the Treasury's borrowing. If legislation does not cut spending or raise taxes, creating a special fund would not reduce the deficit. Thus, any reductions in deficits, debt, and interest costs connected with this proposal would stem wholly from the spending reductions that it might trigger.

The legislation puts such spending reductions on a swift timetable. For virtually all taxpayers, the tax year ends in December, and returns are due by the following April 15--April 15, 1994, in the case of income tax returns for 1993. The Treasury would have two weeks to estimate the total checkoff contained in roughly 120 million returns before reporting that total on May 1. Automatic across-the-board cutbacks in spending equal to the total amount checked off would begin the following October 1 (when the new fiscal year starts) or 15 days after the Congress adjourns to end its session, whichever is later.

In the period between May 1 and its adjournment, the Congress could substitute other spending reductions for the required sequestration, but it could not substitute revenue increases. The sequestration that is triggered by H.R. 429 would be in addition to any that might be required under other provisions of the Balanced Budget and Emergency Deficit Control Act--namely, any sequestration that might be necessary to enforce the discretionary spending caps, the pay-as-you-go rules for mandatory spending and revenues, or the maximum deficit amount. The same timetable would be repeated every year, expiring only when the public debt is paid off.

The mechanics of H.R. 429 are unclear or impractical in some respects:

- Requiring the Treasury to report on May 1 appears to be unrealistic. That date is just two weeks after the filing deadline and a full month before the effective deadline for processing most returns and refunds. At best, the Treasury could base its estimate on a sample of returns. The bill does not envision any corrections to the May 1 estimate that might be justified by a more complete tally, or by including taxpayers who ask for an extension or those who file amended returns.

- H.R. 429 subjects many programs to sequestration that under the current budget procedures are wholly exempt from automatic cutbacks, or whose reductions are now limited under special rules. A few examples are federal employees' pensions, unemployment compensation, numerous programs providing assistance to low-income people, and Medicare. Thus, new definitions and procedures need to be spelled out stating how reductions are to be carried out in these programs. In addition, a number of accounts that would be subject to sequestration under H.R. 429 fund existing legal or constitutional obligations of the federal government that cannot be cut (for example, salaries of federal judges appointed under Article III of the Constitution).

- Finally, it is not clear how one year's cuts should affect outlays in future years--in other words, whether such cuts should "stick" or not. H.R. 429 provides that "all obligational authority reduced under this section shall be done in a manner that makes such reductions permanent." Congressman Walker's staff have indicated that this language is intended to ensure that the checkoff and the resulting sequestration for one year put spending on a *permanently* lower path. That is, programs would be barred from returning to the presequestration levels of benefits, appropriations, or payment formulas in fiscal years beginning after the year to which a sequestration initially applied. However, the bill needs to be clearer about the mechanics by which each direct spending account should be irrevocably reduced and about the adjustments that would be required in the discretionary spending caps or baseline calculations. In providing illustrative estimates of this proposal--including those in this statement--the Congressional Budget Office (CBO) has always based its analyses on the intended effect and not on a strict interpretation of the bill as it is drafted.

HOW MANY TAXPAYERS WOULD PARTICIPATE?

More fundamental than any questions about the mechanics of the checkoff is the big uncertainty: how many people would choose to participate? In this respect, experience offers little guidance. In fact, CBO has no way to estimate with any confidence how many taxpayers would elect the checkoff, for how much, and for how many years.

Other income tax checkoffs are not analogous. Checkoffs such as those for the Presidential campaign fund, or state and local income tax checkoffs, generally permit *additional* spending for the stated purposes. (Furthermore, with the exception of political campaign checkoffs, most require the taxpayer to pay more--generally by accepting a smaller refund.) I should also mention that existing checkoffs are not particularly popular. The percentage of federal income tax returns earmarking $1 or $2 for the Presidential Election Campaign Fund has slipped from about 28 percent in the early 1980s to less than 20 percent at present. State checkoffs for activities as varied as wildlife conservation, prevention of child abuse, and other purposes have average participation rates of around 1 percent to 3 percent.

Unlike these other checkoffs, however, under the provisions of H.R. 429 taxpayers would opt to cut, not increase, spending. Participants would have no choice about the mix of spending cuts, nor could they voice a desire for greater spending--factors that may affect their participation. The wording and location of the checkoff on the tax return and any accompanying instructions may prove crucial, and public information campaigns conducted by citizens' groups or interest groups could sway some choices.

ILLUSTRATIVE CALCULATIONS

Obviously, we have no crystal ball for judging participation in the income tax checkoff envisioned by H.R. 429. But on several occasions, at Congressman Walker's request, we have provided illustrative estimates of the largest possible impacts. These assume that all taxpayers choose the checkoff in every year for the maximum 10 percent of liabilities.

Our illustrative estimates are based on our most recent baseline projections, published in September in *The Economic and Budget Outlook: An Update* (see Table 1). These projections sketch the likely path of spending and revenues if current laws and policies remain unchanged. They reflect the big

TABLE 1. CBO BASELINE PROJECTIONS (By fiscal year, in billions of dollars)

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Revenues											
Individual income taxes	512	545	593	628	661	699	735	778	811	851	894
All other	639	699	740	774	811	847	881	912	956	997	1,040
Total	1,150	1,244	1,332	1,403	1,472	1,547	1,617	1,690	1,768	1,848	1,934
Outlays											
Social Security a/	302	319	337	354	372	391	410	431	452	475	499
Interest a/	198	203	217	230	242	253	265	278	292	311	327
Deposit insurance a/	-26	14	-10	-10	-8	-4	-4	-4	-3	-3	-3
Medicare	143	160	178	196	216	239	264	292	323	357	395
Medicaid	76	88	100	112	125	139	155	172	190	210	231
Other mandatory programs	243	241	240	239	256	266	275	285	295	305	316
Discretionary spending	547	542	542	548	547	547	564	581	598	616	634
Offsetting receipts b/	-67	-70	-74	-76	-80	-85	-89	-93	-97	-102	-107
Total	1,416	1,497	1,529	1,592	1,670	1,747	1,840	1,941	2,050	2,168	2,292
Deficit (-) or Surplus (+)	-266	-253	-196	-190	-198	-200	-223	-251	-282	-320	-359
Debt Held by the Public	3,249	3,507	3,713	3,919	4,137	4,357	4,601	4,873	5,176	5,517	5,896
Memorandum:											
Total Nonexempt Outlays	1,009	1,031	1,060	1,094	1,144	1,192	1,259	1,329	1,406	1,488	1,576

SOURCE: Congressional Budget Office, September 1993 baseline projections. The projections assume compliance with the discretionary spending caps in the 1990 Budget Enforcement Act and the Omnibus Budget Reconciliation Act of 1993.

a. Program exempt from sequestration under Congressman Walker's proposal.

b. Offsetting receipts are effectively exempt because they are not associated with sequesterable budgetary resources.

package of deficit reductions enacted last August in the Omnibus Reconciliation Act of 1993. About half of federal government revenues come from individual income taxes, and the rest from other sources; only the former are tied to spending cuts under the plan. About one-third of spending would be exempt from automatic reductions under the proposal, and the remaining two-thirds potentially subject to cuts (although as previously noted, some of this spending would be impossible to cut because it fulfills legal or constitutional obligations).

The proposed income tax checkoff would have a delayed effect on spending and could not reduce the deficit until fiscal year 1995. Recall that taxpayers will file returns for 1993 liabilities by next April 15. Under the proposal, the Treasury would inform the Congress on May 1 of the required cuts; sequestration, if any, would not begin until October 1994, the start of fiscal year 1995 (or somewhat later if the Congress is still in session). Under the same assumptions that Congressman Walker previously specified, spending cuts could total as much as $51 billion in 1995, the first year--or 10 percent of 1993's individual income taxes (see Table 2). They could reach almost $250 billion in 1998 and--together with interest savings--could result in a balanced budget. If taxpayers continued to mark the checkoff, presumably to pay off the public debt, sequestration could exceed $700 billion in 2003.

TABLE 2. ILLUSTRATIVE MAXIMUM EFFECTS OF PROPOSAL (By fiscal year, in billions of dollars)

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Maximum Effect on Deficit and Debt											
Assumed Checkoff Amount a/	51	55	59	63	66	70	74	78	81	85	89
Automatic Spending Cuts b/											
Nonexempt programs c/	0	0	-51	-107	-172	-242	-321	-409	-506	-613	-731
Interest savings	0	0	-1	-6	-15	-27	-45	-68	-98	-136	-182
Total	0	0	-53	-113	-186	-269	-366	-477	-604	-749	-913
Resulting Outlays	1,416	1,497	1,476	1,479	1,484	1,478	1,474	1,463	1,445	1,419	1,380
Deficit (-) or Surplus (+)	-266	-253	-144	-76	-12	69	143	227	323	429	554
Debt Held by the Public	3,249	3,507	3,661	3,753	3,785	3,736	3,614	3,409	3,107	2,699	2,166
Maximum Effect on Sequesterable Programs											
Baseline Outlays for Nonexempt Programs d/	1,009	1,031	1,060	1,094	1,144	1,192	1,259	1,329	1,406	1,488	1,576
Cumulative Sequestration c/	0	0	-51	-107	-172	-242	-321	-409	-506	-613	-731
Resulting Outlays for Nonexempt Programs	1,009	1,031	1,008	986	972	950	937	920	900	874	845
Percentage Reduction	0	0	-5	-10	-15	-20	-26	-31	-36	-41	-46

SOURCE: Congressional Budget Office.

a. CBO has based this analysis on the assumption, previously specified by Congressman Walker, that all individual income tax payers would choose the maximum checkoff, 10 percent of liabilities. Although tax collections (on a fiscal year basis, as shown earlier in Table 1) are not the same as liabilities (which are on a calendar year basis), they are similar enough for this illustration.

b. Taxpayers would designate the checkoff in returns filed on or before April 15, and sequestration would begin the following October (or at the end of the Congressional session, if later). Hence, there is a two-year lag between the time taxpayers incur liabilities and the spending cuts that they could order.

c. According to Congressman Walker's staff, it is intended that a single year's checkoff should generate savings in all future years, as programs are barred from returning to previous spending plans or benefit formulas. Additional legislative language would be needed to achieve this result.

d. In Congressman Walker's proposal, only Social Security, deposit insurance, and net interest are exempt. Offsetting receipts are effectively exempt because they are not associated with sequesterable budgetary resources. The Congress can substitute other spending reductions (but not revenue increases) for the required sequestration.

Such outcomes would be a dramatic departure from the current budgetary path. In 2003, the cumulative sequestration could exceed 45 percent of nonexempt spending; the government could run a surplus of more than $500 billion; and only $2.2 trillion of debt might remain (versus $5.9 trillion under the current outlook). A corollary is that outlays would have long since stopped growing. In fact, nonexempt outlays--all spending except that for Social Security, net interest, and deposit insurance--would fall in every single year after 1995. Again, this illustration portrays the largest possible effects of the proposal, and more modest assumptions about participation would shrink the savings.

CHANGE IN FISCAL DECISIONMAKING

Decisions about fiscal matters--the level and mix of taxes and spending--are currently made in the same manner as other important decisions of the federal government. Members of the Congress and the President propose, consider, and eventually enact laws that determine the fiscal policy of the federal government. Citizens participate through elections, in which every eligible individual has one vote, and by communicating their preferences to elected representatives in a number of ways. This proposal would remove one of the critical decisions about fiscal policy--the level of spending--from this process.

Under the proposal, this decision would be made by means of the income tax checkoff.

Not only would this process circumvent the established system of representative government, it would drastically alter the relative influence of citizens on this decision. Unlike Presidential and Congressional elections, a relatively small number of taxpayers will cast most of the votes at stake. People in the top one-fifth of the income distribution account for about half of all adjusted family income and about three-quarters of all income tax liabilities; the top 5 percent account for about one-quarter of all income and nearly half of income tax liabilities. Their choices on the income tax checkoff would dominate the totals in dollar terms. In fact, this distribution of income tax liabilities could lead to troubling results. If the top 5 percent of taxpayers (who pay nearly one-half of all individual income taxes) all chose the maximum checkoff, they could generate almost half the possible savings presented in the illustration--even if the other 95 percent preferred to maintain or even to increase spending. The latter group would be virtually voiceless in this exercise.

CONCLUSIONS

The illustrations I have provided here, like all of CBO's previous work on this topic, are purely hypothetical. Neither CBO nor other analysts have any idea how many taxpayers would actually elect the checkoff or the tax liabilities of those who would choose it. Participation could change dramatically as spending cuts deepened and the budget moved into surplus.

The more compelling question is not how much this proposal would cut the deficit but whether it is an appropriate way for a representative government to make spending decisions. Our constitutional system provides that popularly elected representatives make choices about the levels and mix of spending and taxes. H.R. 429 would give extra votes to some taxpayers, above and beyond their vote for elected representatives, but would structure this vote in an asymmetric fashion; only spending cuts--but no spending increases and no tax increases--are on the ballot. The implied philosophy has been summed up as "one dollar, one vote." We hope that in its considerations the Congress will focus on the philosophical and institutional issues posed by this legislation, rather than on the admittedly speculative budget numbers. It should also recognize that there are other ways to reduce the budget deficit, ones that have been used with some success in 1990 and 1993.