Thursday, November 16, 2017

Dear CEF Members:

I. Implications of tax reform proposals (or other deficit-deepening legislation) for nondefense spending

- **Impact of adding $1.5 trillion to the deficit** – Sheryl's update yesterday laid out the current status of tax reform and budget and appropriations legislation, and how they are linked. As a step towards completing its fiscal agenda, the House today passed a tax reform plan that will have the effect of adding about $1.4 trillion to the deficit over the next ten years. The Senate is still working on its version of the legislation. If a tax cut of about that size is enacted, it could lead to spending cuts in two different ways.

  1) **Automatic sequestration** – The Office of Management and Budget (OMB) tallies up the deficit impact of all revenue and direct spending legislation enacted that year. If the total has made the deficit worse, the Statutory Pay-As-you-Go-Act triggers automatic across-the-board cuts deep enough to offset the deficit impact. Enactment of the current tax reform proposals will trigger these additional sequester cuts.

     This sequestration does not affect discretionary spending, and many direct spending programs are exempt, including Social Security and most income support programs. Other direct spending programs have special rules that limit how much they can be cut, including student loans and Medicare. A sequester cut to student loans would not reduce the size of the loan but would increase the borrower's origination fee by the same percentage as the sequester cut. For example, if a 6% sequester is triggered, origination fees would increase by 6% from what they currently are (there are different fees for Stafford and PLUS loans). The House Budget Committee Democratic staff reports that sequestration offsetting this tax bill would double origination fees on student loans.

     However, the Congressional Budget Office estimates that the total savings available in the programs subject to the sequester would not be enough to offset the deficit impact of the tax cuts. In other words, even after taking the maximum cuts under the special rules and even if all other eligible direct spending programs were entirely eliminated – including the Department of Education's vocational rehabilitation state grant program – that wouldn't be enough to offset the deficit impact of the tax bill on a year to year basis.

What will Congress do? – In the recent past, when Congress enacted large tax cuts or new direct spending, the legislation included instructions telling OMB no to include the deficit impact on the statutory PAYGO scorecard. I think that is likely to happen this time, as well.

2) **Large deficits spur efforts to cut spending –** The second way large tax cuts could lead to spending cuts is less direct, but possibly more likely. In the past, enacting unpaid-for tax cuts led Congress to address the resulting deficits with deep cuts to non-defense spending. The Budget Control Act of 2011 is an example of this approach, which first capped discretionary spending and then further cut both discretionary and direct spending through its sequestration, which is still ongoing. The Republican budget resolution already assumes even deeper spending cuts to non-defense discretionary and direct spending programs.

   NDD United letter highlighting threat to non-defense spending – Today NDD United sent aletter to Congress making this point in urging opposition to the tax cut proposals or other legislation that will worsen the deficit. Other organizations, including many CEF members, have included this argument in letters opposing the tax proposals.

- Sarah

Sarah Abernathy, Deputy Executive Director

1800 M Street, NW
Suite 500 South
Washington, DC 20036
T: 202-327-8125
abernathy@cef.org
www.cef.org
Twitter @edfunding