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Budget Reconciliation in the 105th Congress: Achieving a Balanced Budget by 2002

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Summary

Achievement of a balanced federal budget by 2002 was a high priority for the 105th Congress and the President. After months of negotiations and debate, starting in February 1997 and ending in July 1997, congressional leaders and the White House forged a consensus on legislation to accomplish this goal. The legislation, signed into law by President Clinton on August 5, 1997, sets "caps" on discretionary spending, constrains entitlement programs, and on balance reduces federal taxes.

Last spring the White House and congressional negotiators reached an agreement on a broad outline of tax and spending changes. As announced on May 2, 1997, the plan envisioned an estimated $190 billion in cumulative deficit reductions over the FY1998-2002 period. When coupled with lower interest payments (arising from the reduced need to borrow) the federal budget would reach approximate balance in 2002.

As reflected by wide margins of passage of the FY1998 budget resolution, the plan generally garnered broad congressional support. Its proponents pointed out that it fulfilled major promises made by both parties, and if successful, it would lead to a budget surplus for the first time since FY1969. While each party wanted fulfillment of more of its respective policy agenda, proponents argued that it struck a viable set of compromises and avoided the budget gridlock that plagued attempts to enact a budget plan in the 104th Congress. Some of its critics complained that its impact was delayed and too small and relied too heavily on lower current law deficit estimates made by the Congressional Budget Office. They contended that not enough was being proposed to rein in long-range entitlement spending, which is expected to rise significantly when the post World War II baby boomers reach retirement age. Others contended that the tax reductions were skewed too heavily toward higher-income people and that the revenue losses would grow dramatically in the long-run.

The budget resolution called for two reconciliation bills, one on spending (H.R. 2015), a second on taxes (H.R. 2014), which both chambers took up and passed in June 1997. After resolving differences in their respective bills, as well as issues raised by the Administration, both chambers passed final versions at the end of July. The President signed them into law as the Balanced Budget Act of 1997 (P.L. 105-33) and the Taxpayer Relief Act of 1997 (P.L. 105-34) on August 5, 1997.

The legislation includes spending reductions totaling $241 billion over the first 5 years, offset by $46 billion in new spending initiatives and a net $80 billion in tax reductions. Almost half of the spending reductions was to result from limiting growth in the federal government's largest health benefit programs, Medicare and Medicaid ($112 billion in Medicare and $7 billion in Medicaid). Another 37% was to come in discretionary programs by constraining their growth at levels below inflation. Other savings were to come from auctioning licenses for using a portion of the airwaves for wireless communication services, increases in federal agency and employee contributions to the Civil Service Retirement Fund, various changes in veterans programs, and cuts in student loan programs.

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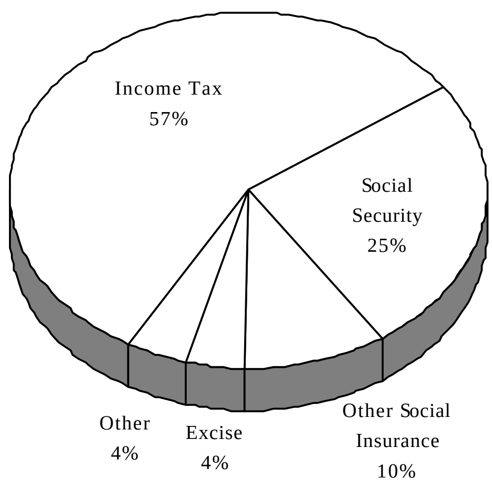
Budget Reconciliation in the 105th Congress: Achieving a Balanced Budget by 2002

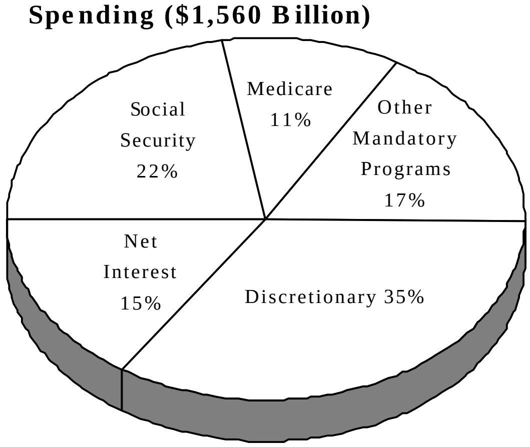
Both the Congress and Clinton Administration set achievement of a balanced federal budget by 2002 as a high priority for the 105th Congress. After months of negotiation this past spring, an agreement was reached between the White House and congressional negotiators on a broad outline for spending and tax changes that would result in a small budget surplus of $2 billion by 2002. As announced on May 2, 1997, the plan envisioned an estimated $190 billion in cumulative deficit reductions over the 5-year period, FY1998-2002, resulting from spending and tax policy changes to be enacted in two budget reconciliation bills. When coupled with $14 billion in lower interest payments (arising from the reduced need to borrow) the federal budget would reach approximate balance in 2002. The legislative changes combined with the lower interest payments were estimated to total $204 billion in cumulative deficit reductions over the period.

The Federal Budget At A Glance, FY 1996 Actuals...

Revenues ($1,453 Billion)



Spending ($1,560 Billion)



The May 2nd plan called for enactment of both spending and tax reductions. The spending reductions were to total $306 billion over the 5-year period. Offsetting this amount would be $31 billion in new spending initiatives and a net $85 billion in tax reductions (a number of tax increases would partially offset the tax reductions), bringing the aggregate deficit reduction down to $190 billion.

Spending and Tax Changes in the May 2nd Plan

As originally set out in the May 2nd plan, 45% of the spending reductions ($138 billion of the $306 billion in total reductions) would result from limiting growth in discretionary programs (i.e., those requiring annual appropriations) at levels below inflation ($77 billion in defense constraints; $61 billion in nondefense constraints). Another 42% was to occur in the federal government's largest health benefit programs, Medicare and Medicaid ($129 billion together; $115 billion in Medicare and $14 billion in Medicaid). Most of the Medicare savings would have come from limiting payments to providers including a 1-year freeze on payments to hospitals. Medicare Supplementary Medical Insurance (SMI) also would generate savings by having its premium level set to cover 25% of its costs. Other major budget savings involve the auctioning of portions of the electromagnetic spectrum (these are licenses for using a portion of the airwaves for certain wireless communication services; $26 billion); increases in federal agency and employee contributions to the Civil Service Retirement Fund ($5 billion); various changes in veterans programs (totaling $4 billion); and cuts in student loan programs ($2 billion).

No changes were to be made to Social Security benefits, and while it was assumed that the Bureau of Labor Statics (BLS) would make changes in calculating the Consumer Price Index (CPI) resulting in lower automatic cost-of-living adjustments in federal entitlement programs, no legislative action was stipulated.[1]

Increases in spending were to result from expansion of health insurance for children without medical coverage ($16 billion); reinstatement of Supplemental Security Income (SSI) and Medicaid benefits for certain legal immigrants whose eligibility was to end as a result of the welfare reforms enacted in the 104th Congress ($10 billion); additional selective funding for the basic welfare grants to states created by the new welfare law ($3 billion); expansion of waivers from certain work requirements for food stamp benefits ($1.5 billion); relief from premium increases for certain low-income Medicare SMI recipients ($1.5 billion); and added funding for environmental initiatives including acceleration of clean up at a number of "Superfund" sites ($1 billion).

Although the specifics of the $85 billion net tax reduction package were left to be determined by congressional tax-writing committees (Ways and Means and Finance), principal among the changes assumed to be included in the bill were broad-based capital gains tax reductions, significant estate tax reform, a $500 per child tax credit, and education-related tax measures totaling $35 billion. Assumed revenue increases would result from extension of expired taxes on airline tickets, departures,

[1] The FY1998 budget resolution assumes a 0.3 percentage point reduction in CBO's annual CPI forecasts beginning in 1999 to reflect upcoming technical changes by BLS.

cargo and fuel. Further agreed to and assumed in the budget resolution was that the net tax reductions would not exceed $250 billion over 10 years. (The tax bill also was to include an increase in the federal debt ceiling intended to assure the Treasury Department has ample borrowing authority until late 1999.)

The FY1998 Budget Resolution

In the weeks following the announcement of the agreement, more details of the plan were worked out. The House and Senate Budget Committees then began drafting FY1998 budget resolutions intended to set forth spending and revenue targets to be achieved each year throughout the 5-year period and instructing the relevant authorizing committees to alter their programs to reconcile their projected spending and revenue to the targets. Both Houses passed their respective versions (H.Con.Res. 84 and S.Con.Res. 27) prior to the Memorial Day recess — the House on May 21, 1997 by a vote of 333-99; the Senate on May 23, 1997 by a vote of 78-22. Congress passed the final resolution on June 5, 1997; the House by a vote of 327-97 and the Senate by a vote of 76-22.

Major amendments raised in floor action sought to increase funding for highways and mass transit programs and add more funds to a proposed expansion of health insurance for uninsured children. In a 214-216 vote the House rejected an amendment by Representative Shuster on May 20, 1997 that would have increased transportation funding in the resolution by $12 billion over the 5-year period. He would have offset the increase with an across the board 0.39% reduction in discretionary spending and proposed tax cuts. A similar Senate amendment offered by Senators Warner and Baucus on May 22, 1997 was tabled by a vote of 51-49. In another vote on May 21, 1997, the Senate tabled an amendment (55-45) by Senators Hatch and Kennedy to increase spending by $20 billion to further expand medical coverage for uninsured children. (This would have been on top of $16 billion built into the resolution for children's health insurance sought by the President and included in the May 2nd budget plan.) The Hatch/Kennedy measure would have paid for the expansion and contributed an additional $10 billion toward deficit reductions by raising federal taxes on cigarettes by $0.43 a pack. Numerous other defeated amendments ranged from adding $109 billion to discretionary spending to increasing the net tax cut from $85 billion to $161 billion. When all floor action was complete only minor changes had be made to the basic outline of the May 2nd plan.

How the Spending and Tax Changes Were to be Legislated

The discretionary savings arising from the 13 annual appropriations bills were to be achieved by setting aggregate, government wide "caps" on discretionary spending. They were set year by year by passage of the FY1998 budget resolution (the cap for FY1998 was put in force by passage of the resolution; the caps for the next 4 years were to be triggered by passage of the budget reconciliation bills). Subcaps for defense and non-defense appropriations were set for FY1998 and, upon passage of the reconciliation bills, for FY1999 as well (only the aggregate caps would apply for the last 3 years, FY2000-FY2002).

The entitlement changes were to be achieved largely through alteration of authorizing legislation, such as the Social Security Act (they were to require amendments to Title XVIII for the Medicare changes, Title XIX for Medicaid, Title IV for welfare, and Title XVI for SSI). This was to occur through some form of aggregate budget reconciliation bill. Under the budget reconciliation process each authorizing committee is required to report its proposed spending (or tax) changes to their respective budget committees (8 committees in both the House and Senate were instructed to do so in the FY1998 budget resolution). Typically, the budget committees package the numerous bills into an omnibus budget reconciliation bill. This year there were two reconciliation bills — a spending measure and a tax measure.

Table 1. Increases/Reductions in Spending and Revenue Required by Reconciliation Instructions Contained in FY1998 Budget Resolution, by House and Senate Committees
($s in millions)

House committees[a]	Type	1998-2002	Senate committees	Type	1998-2002
Committee Entitlement Reform Targets Specified in Budget Resolution					
Agriculture	OT	1,500	Agriculture, Nutrition, and Forestry	OT	1,500
Banking and Financial Services	OT	-1,590	Banking, Housing, and Urban Affairs	DR	-1,590
Commerce	OT	-138,938	Commerce, Science, and Transportation	DR	-26,496
Education and the Workforce	OT	1,208	Energy and Natural Resources	OT	-13
Government Reform and Oversight	OT	-3,098	Finance	OT	-100,646
Government Reform and Oversight	DR	-1,829	Governmental Affairs	DR	-5,467
Transportation and Infrastructure	OT	-736	Labor and Human Resources	OT	-1,792
Veterans Affairs	OT	-3,796	Veterans Affairs	OT	-2,733
Ways and Means	OT	-87,607			
Tax Relief and Miscellaneous Reforms					
Ways and Means	R	84,973	Finance	R	-85,000

House committees[a]	Type	1998-2002	Senate committees	Type	1998-2002
Summary:					
Direct spending: Totals less dual committee assignments		-136,851			-137,237
Revenue: Totals less dual committee assignments		83,144			-85,000
Items assumed but not reconciled (Commerce)		-1,367			
Items allocated when legislation reported (Commerce & Transportation)		1,000			

OT=Outlays **DR**=Deficit Reduction **R**=Revenues (Deficit reduction refers to cases where Committee has jurisdiction over outlays and revenues that may be used to reach their targets.)

Source: Conference Report on the Concurrent Resolution on the Budget (H.Con.Res. 84, H.Rept. 105-116); and *Congressional Record*, June 5, 1997.

[a] Items may be reconciled by more than one committee. Dollar amounts reflect duplicated totals.

Issues Arising From Budget Measures

As reflected by the margin of passage of the FY1998 budget resolution, the May 2nd budget plan generally garnered broad support in the Congress. Its proponents pointed out that it fulfills major promises made by both parties, and if successful, it will lead to a budget surplus for the first time since FY1969. While each party wanted fulfillment of more of its respective policy agenda, proponents argued that it strikes a viable set of compromises and avoids the budget gridlock that plagued attempts to enact a balanced budget plan in the 104th Congress (a major dispute with President Clinton led to a vetoed budget plan in 1995). Some of its critics complained that its impact is delayed and too small, and relies too heavily on baseline budget revisions (referring to a $225 billion reduction in projected current law deficits made by CBO in the final days of reaching an agreement).[2] They contended that not enough was being proposed to rein in long-range entitlement spending, which is expected to rise significantly when the post World War II baby boomers reach retirement age. Others contended that the tax reductions are skewed too heavily toward higher-income people and that they are back-loaded, meaning that the revenue losses will grow substantially in the long-run.

Disputes over these and other issues emerged as the House and Senate considered their respective bills. The House Democratic leadership and Democratic members of the Ways and Means Committee offered an alternative tax bill in committee and on the floor. Both were defeated along strong party line votes. Their stated intent was to shift more of the bill's reductions toward middle and lower-income segments of the population. Senate Democrats offered an alternative package

[2] These reductions were based on updated revenue projections from the Treasury showing higher receipts and an improved economic outlook over CBO's earlier projections.

as well to the one proposed by the Finance Committee and it too was defeated. In addition to voicing concerns about the distribution of the tax cuts, the Administration raised objections as to how the respective House and Senate bills would distribute the $35 billion in education-related tax relief agreed to in the May 2nd plan. Measures to gradually raise the asset exemption for estate taxes, index capital gains, scale back the "alternative minimum" corporate tax, offset the proposed $500 per child tax credit to take into account other low-income tax preferences, and extend ethanol subsidies also were at the heart of the controversy.

Issues on the spending side also generated a split between the parties, but not as distinct as with the tax cut vote. The overall margin of passage of the two spending bills was relatively large (270-162 in the House and 73-27 in the Senate), but neither chamber achieved a majority of support from Democrats (they voted only 51-154 for passage in the House and 21-24 in the Senate).

A key issue was how legal immigrants, who would otherwise be cut off from SSI this summer, would be reinstated. The Administration favored continuing to make new awards to disabled immigrants (who were in this country as of August 22, 1996) as provided for in the Senate bill. The House bill, by contrast, avoided a benefit cutoff for all immigrants (disabled and aged alike) but precluded new benefit awards.

In the health area, controversy centered over measures adopted in both Houses to create a medical savings account (MSA) demonstration. Supporters said that MSAs would provide greater choice of medical coverage for recipients and aid in the resolution of Medicare's long-range financing problems. Critics contended that MSAs would undermine the basic insurance nature of the program as well-to-do and healthy recipients opt for the MSAs and cost $2 billion during the budget period. Further controversy persisted over Senate measures to gradually raise the age of eligibility for Medicare from 65 to 67; to means test part of Medicare by requiring higher SMI premiums (now $43.80 a month) for recipients with incomes above $50,000 ($75,000 for a couple) (this was a substitute for a Finance Committee measure to means-test the SMI deductible); and impose a $5 per visit copayment for home health care. In Medicaid, concern was raised about how the cuts would be distributed, state by state, and whether the proposed $16 billion expansion of medical coverage for children ought to be through Medicaid or a new block grant. Also controversial was proposed language restricting funds for abortions (except in cases of rape, incest, or when necessary to save the woman's life) under the children's health initiative (in both House and Senate versions of the bill); and a House measure to make changes in medical malpractice law including imposing a $250,000 cap on noneconomic damage awards (i.e., for pain and suffering).

In addition, following on the failed attempt to add funding in the budget resolution to expand medical coverage of uninsured children, the Finance Committee proposed, and the Senate approved, a measure to raise cigarette taxes by $.20 a pack with part of the $15 billion proceeds being earmarked for an $8 billion increase in the proposed $16 billion medical coverage expansion. There was no comparable measure in the House bill.

Differences in House- and Senate-Passed Bills

Reflecting the May 2nd plan worked out with the White House, the budget resolution called for two reconciliation bills, one on spending, a second on taxes. The spending bill was to come first. The House passed its spending bill on June 25 and its tax bill on June 26. The Senate passed its versions on June 25 and June 27.

There were several important differences between the House and Senate versions of the bills. With regard to welfare provisions, the Senate spending bill differed from the May 2nd budget plan and the House bill in extending SSI eligibility for legal immigrants who entered the United States before August 23, 1996 if they become disabled and apply for benefits by September 30, 1997; and exempting legal immigrant children who enter the United States after August 22, 1996, from the 5-year ban on Medicaid eligibility. In addition, under the House bill (but not under the Senate bill), the value of cash benefits and food stamps would count toward the minimum wage requirement for welfare recipients in workfare jobs.

Among the major differences affecting Medicare, the Senate bill proposed a gradual increase in the Medicare eligibility age from 65 to 67, "means-testing" of the Medicare SMI premium, and a $5 per visit copayment for home health services. None of these measures were in the House-passed bill. In addition, the Senate bill would allow 100,000 individuals to participate in a medical savings account demonstration program compared to a proposed 500,000 participants under the House plan.

With regard to tax legislation, H.R. 2014 as passed by the House, included a provision that would prevent some low-income individuals from receiving the full $500 per child tax credit. Controversy arose over preclusion of the credit from being refundable in cases where there was no tax liability. The Senate bill provided for some refundability but not as much as the President wanted. The Senate bill also raised cigarette taxes by $.20 a pack with part of the proceeds being earmarked for an $8 billion increase in the proposed $16 billion expansion of medical coverage for children. The House bill only included the originally agreed to expansion (i.e., as provided in the May 2nd plan) and did not raise cigarette taxes. Although basically similar in their broad features, the bills also took different approaches to providing the $500 child credit (the Senate version required it be invested in educational savings accounts at age 13 and over), educationally-related tax benefits, aviation-related excise taxes, indexation of capital gains (the Senate bill did not index them), changes in the corporate alternative minimum tax (the Senate bill made no changes), and ethanol subsidies (the House bill would have continued the subsidies through 2000; the Senate bill would have continued them through 2007 decreasing them gradually).

Legislative Activity — Floor Action and Conference Negotiations

The Senate began consideration of its spending bill, S. 947 (the Balanced Budget Act of 1997), on June 23 and completed action on June 25 (passing the bill 73-27; the Senate passed H.R. 2015 substituting the text of S. 947 as amended). The House took up its version (H.R. 2015) on June 25 and completed action the same day (passing the bill 270-162). The Senate began debate of its tax bill (S. 949, Revenue Reconciliation Act of 1997) on June 25 and passed the measure on June 27 by a vote of 80-18 (the Senate passed H.R. 2014 substituting the text of S. 949 as amended). The House bill (H.R. 2014, Taxpayer Relief Act) was passed on June 26 by a vote of 253-179. Conference negotiations to reconcile differences between the two bodies and with the President began on July 10, 1997. On July 30, conference reports on both measures were filed in the House. The same day, the House approved the spending bill. The following day, the Senate approved the spending bill and both chambers approved the tax bill. In doing so, congressional Republican leaders met their goal of completing action on both reconciliation measures prior to the start of the August recess.

On June 24, the Senate took up 9 amendments to S. 947. Among the approved measures was an amendment (Roth/Moynihan) to substitute income-related SMI premiums for a committee measure to create an income-related SMI deductible. By a 62-38 vote, the Senate also affirmed the Finance Committee's measure to gradually increase Medicare's eligibility from age 65 to 67 beginning in 2003. It also approved an amendment to require mental health parity (equal coverage for the treatment of mental and physical conditions) for children who are covered under the budget agreement's health initiative (Wellstone/Domenici amendment). There were failed attempts to strike a provision requiring a $5 copayment for home health care visits (Kennedy/Wellstone amendment tabled by a vote of 59-41) and to strike the provision creating income-related SMI premiums (Kennedy amendment tabled by a 70-30 vote).

On June 25, the Senate approved amendments to: extend SSI benefits to legal immigrants who were in the United States as of August 22, 1996 and later become disabled (Lautenberg amendment) (the House bill does not extend eligibility to individuals who become disabled after August 22, 1996); and to increase revenue estimates from spectrum auctions from $15.9 billion to $20 billion. The Senate rejected an attempt to strike the limitation on federal funds for abortions (except in cases of rape, incest, or when necessary to save the woman's life) under the children's health initiative (Lautenberg amendment by a vote of 39-61). In procedural votes, the Senate rejected amendments to: provide Medicaid eligibility for disabled children who lose SSI benefits; strike the Medicare changes affirmed by the Senate the day before (these changes would gradually increase Medicare's eligibility age from 65 to 67 beginning in 2003, means-test SMI premiums, and impose a $5 copayment for home health care visits); provide food stamp benefits to the children of legal immigrants; and to allow vocational educational training to count toward the work requirement under Temporary Assistance for Needy Families. A provision to allow Texas to privatize the administration of its welfare programs was withdrawn after a budget point of order was raised against it.

On June 25, the House took up its version of the spending bill (H.R. 2015). Prior to going to the floor, the House bill was amended to add $1 billion (to the already proposed $500 million) to offset SMI premium increases for low-income Medicare beneficiaries; and to increase revenue estimates from broadcast spectrum auctions from $9.7 billion to $20.3 billion. A failed attempt was made to remove a state option to expand health care for children through block grants.

On June 26, the House took up its version of the tax bill (H.R. 2014). The House approved the bill the same day by a vote of 253-179 (a narrower margin of passage than for the House spending measure, H.R. 2015). The vote was cast along party lines (there was one Republican vote *against* and 27 Democratic votes *for* the bill) demonstrating a lack of bipartisan support for the measure. Prior to the bill's passage, an amendment that would have targeted benefits to middle and lower income groups was defeated (Rangel amendment, in the nature of a substitute, by a vote of 197-235). An attempt to alter provisions relating to capital gains tax reductions, estate and gift taxes, the child tax credit and tax reductions related to educational expenses, among other changes, was also defeated (Peterson (MN) motion by a vote of 164-268).

The Senate took up its tax bill (S. 949) on June 25 and completed action on the measure on June 27. The Senate bill, passed by an 80-18 vote with 29 Democrats voting *for* the measure and 4 Republicans voting *against* it, received broader bipartisan support than its counterpart in the House. On June 26, an amendment to raise the cigarette tax by $0.20 per pack to provide an additional $8 billion (out of an estimated $15 billion in revenues) over 5 years for children's health care was approved by voice vote (Roth amendment on behalf of the Senate Finance Committee). In a procedural vote, a measure to raise the cigarette tax another $0.11 per pack to fund the 100% deduction of health insurance costs by the self-employed was rejected (Durbin amendment by a vote of 41-58). The Senate rejected measures to: target more tax relief to working and low-income families (Daschle amendment, in the nature of a substitute, by a vote of 38-61); establish a $1 million lifetime cap on capital gains deductions (Dorgan amendment by a vote of 24-75); eliminate the capital gains tax reductions after 2002 if a balanced budget is not achieved (Dorgan amendment by a vote of 34-64); and impose a tax on hardrock mining companies for the use of federally owned land in the West (the tax was estimated to be $700 million a year) (Bumpers amendment by a vote of 36-63).

On June 27, the Senate approved measures to: increase the tax deduction allowed self-employed individuals for health insurance costs (Nickles amendment passed by a vote of 98-0); extend budget enforcement mechanisms through 2002 (Domenici/Lautenberg amendment approved by a vote of 98-2); and expand the use of individual retirement accounts for college education expenses to include primary and secondary education expenses (Coverdell amendment by a vote of 59-41). The Senate rejected measures to: strike a provision requiring that the $500-per-child tax credit for children age 13 and older be deposited in individual retirement accounts for college education expenses (Gramm amendment by a vote of 46-54); and strike a provision to extend tax preferences for ethanol producers (McCain amendment by a 30-69 vote). A number of amendments failed on procedural votes including measures to: raise the tax on cigarettes another $0.23 per pack to provide an additional $12 billion for children's health (Kennedy/Daschle amendment); and require the President to submit balanced budgets after 2002 and subject legislation that would increase the deficit after 2002 to a 60 vote point of order (Frist amendment). The bill, as reported by the Senate Finance Committee, would achieve an estimated $77 billion in net tax reductions over 5 years (the budget resolution calls for an $85 billion net tax reduction). Senate Majority Leader Lott stated his desire to close the gap in estimated net tax reductions during conference negotiations.

More than 80 Members were appointed to the conference negotiations. Discussion on the spending bill began on July 10, 1997 and on the tax bill on July 11, 1997. As an expression of its Members' sentiment, the House passed a non-binding resolution on July 10, 1997, by a vote of 414-14, instructing its conferees not to accept the Senate-passed measure raising the Medicare eligibility age from 65 to 67 and that welfare recipients participating in "workfare" projects be guaranteed minimum wage and related workplace protections. The House also rejected a motion, 199-233, to instruct its conferees to drop the House-passed provision to "index" capital gains but to extend more of the $500 per child tax credit and various education tax benefits to lower income families and students.

Another issue raised by a bipartisan group of House members was whether an enforcement mechanism should be included in the bills to require Congress and the President to cut spending or delay tax cuts if the spending or revenue targets underpinning the reconciliation legislation were not met. A free-standing measure (H.R. 2003) was introduced that would trigger automatic spending cuts and cancel (or delay) tax cuts if a gap in the targets arose and Congress and the President did not act to close it. It also established caps on specific entitlements, as well as on entitlements as a category. Fulfilling an earlier commitment to its sponsors, the House leadership brought the bill up for a vote on July 23, 1997, but it was defeated 347-81.

For its part, the Administration offered an alternative tax reduction package during the July 4th recess that made a number of concessions designed to close some of the gap between its preferred tax cuts and those passed by the House and Senate. The President did signal willingness to consider means-testing of Medicare benefits; however, disagreement remained between the President and congressional negotiators on which agency should administer the collection of SMI premiums. The President argued for the Treasury Department (in conjunction with the Internal Revenue Service) as the collection agency, not the Department of Health and Human Services as specified in the Senate plan.

On July 24, Republican leaders presented the Administration with a unified (House-Senate) Republican budget plan. Major items in the tax plan, which provided for net tax reductions of $89 billion over 5 years, included the indexation of capital gains (an item over which the President had threatened a veto); an increase in the estate tax exemption from $600,000 to $1.2 million over 10 years; a $500-per-child tax credit that would allow families receiving the EITC to carry forward any unused portion of the credit for up to 3 years (it was not to be refundable as argued for by the President); and an education tax credit of up to $1,500 for the first two years of post-secondary education and up to $5,000 for the third and fourth years. The plan included the creation of education savings accounts; however, disagreement persisted over whether families with children ages 13 to 17 would be required to invest in these accounts the proposed $500-per-child tax credit as outlined in the Senate plan. The initial revised offer also did not include the Senate's provision to increase cigarette taxes by 20 cents per pack to fund children's health care. On the spending side, differences persisted over the inclusion of benefits for legal immigrants who become disabled, job and wage protections for welfare recipients who participate in "workfare" projects, and means-testing of Medicare SMI premiums.

Agreement on Final Bills

On July 28, White House officials and congressional Republican leaders announced that a tentative budget agreement had been reached. After further negotiations to work out final details, conference reports on both measures were filed in the House on July 30. The compromise spending plan did *not* include Medicare proposals to means-test SMI premiums, increase the eligibility age from 65 to 67, or require a $5 copayment for home health care; however, it would establish a bipartisan commission to study long-term Medicare funding issues and allow for 390,000 participants in a medical savings account demonstration program. The plan would also provide $24 billion for children's health coverage ($8 billion more than provided under the May 2nd budget plan) and gradually increase the federal cigarette tax by 15 cents per pack by 2002 (this provision was originally in the Senate tax bill). Resolving another item of contention, the plan did *not* include a provision to exclude welfare recipients in workfare projects from minimum wage standards and workplace protections. On July 30, a provision was added that would provide federal funding and tax breaks for the District of Columbia and give the financial control board authority over some District agencies.

The tax bill would expand the child tax credit to include families receiving the EITC and individuals with incomes up to $75,000 ($110,000 for couples). The credit would be $400 per child under age 17 in 1998 and $500 thereafter. The plan would increase the estate tax exemption from the current level of $600,000 to $1 million over 10 years. It would also provide $40 billion in education tax benefits including tax breaks for families participating in state-sponsored prepaid tuition programs and a $1,500 credit for the first and second years of post-secondary education. Families with children ages 13 to 17 would have the *option* to invest the child tax credit in tax-deferred Individual Retirement Accounts for higher education expenses. (A Senate-approved provision to allow withdrawals from education savings accounts for private or parochial elementary and secondary school expenses was dropped from the final measure upon the insistence of the President.) Although the measure does not include the "indexation" of capital gains, it would reduce the top capital gains tax rate from 28% to 20% and eventually to 18%. A last minute provision was added to the measure by Republicans related to the credit of revenue from cigarette taxes toward the proposed $368 billion settlement owed to the government by the tobacco industry.

On July 30, the conference report on the spending bill (H.R. 2015, H.Rept. 105-217) was taken up by the House and approved the same day by a vote of 346-85. (Rules requiring a lapse of three days before a vote is taken on a conference report were waived by a vote of 226-202). The vote reflected strong bipartisan support with 193 Republicans and 153 Democrats voting *for* the measure and 32 Republicans, 52 Democrats, and 1 Independent voting *against* it. The Senate began consideration on July 30 and approved the measure on July 31 by a vote of 85-15 (with 12 Republicans and 3 Democrats voting *against*).

On July 31, both chambers took up the conference report on the tax bill (H.R. 2014, H.Rept. 105-220). They completed action on the measure the same day. In the House, the bill was approved by a vote of 389-43 (with 1 Republican and 42 Democrats voting *against*). In the Senate, the measure was approved by a vote of 92-8 (with 8 Democrats voting *against*). (Prior to its passage, Senator Durbin raised a point of order against the legislation over a last minute provision pertaining to the use of cigarette taxes as a credit toward the proposed tobacco industry settlement. The Senate waived the point of order by a vote of 78-22.)

On August 5, the President signed the two bills into law as the Balanced Budget Act of 1997 (P.L. 105-33, H.R. 2015) and the Taxpayer Relief Act of 1997 (P.L. 105-34, H.R. 2014).

On August 11, the President exercised the first use of his new "line item veto" authority — created by the Line Item Veto Act signed into law in April 1996 (P.L. 104-130) — to cancel three provisions in these new laws: a spending provision pertaining to New York's use of health provider taxes to match federal Medicaid payments (5-year savings estimated at $200 million); a tax provision that would allow U.S.-based insurance companies, banks and investment firms to delay taxes from overseas income (5-year savings estimated at $317 million); and a tax provision that would allow individuals to defer taxes on profits from the sale of food processing facilities to farmer cooperatives (5-year savings estimated at $98 million). These line item vetoes may face legislative and judicial challenges. Congress can restore the provisions by a majority vote; however, a second veto by the President would require a two-thirds majority in both chambers to override the veto. Legal challenges to the constitutionality of the line item veto are likely in the future.

Revenue and Outlay Changes Resulting From Reconciliation Legislation
($s in billions)

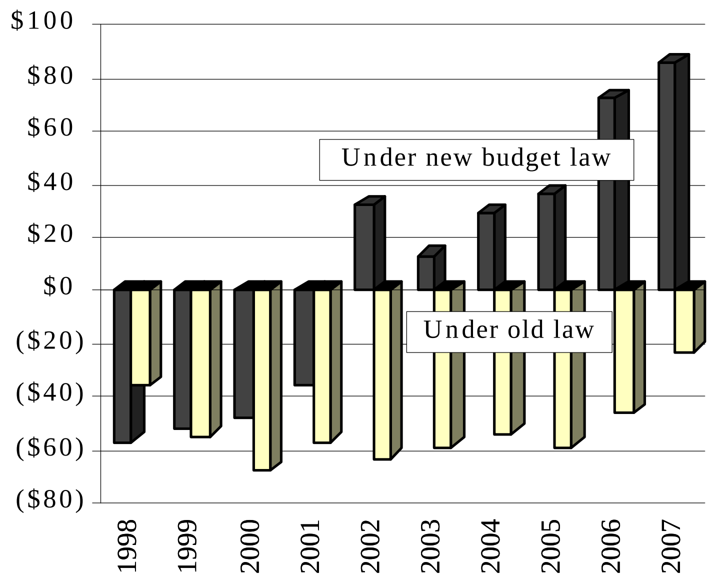
	FY1998-FY2002		FY1998-FY2007	
Spending reductions		$241.3		$843.4
Discretionary:	88.8		380.5	
Mandatory programs:				
Medicare	112.0		385.0	
Medicaid	7.2		36.9	
Other mandatory	33.4		41.0	
Subtotal	152.6		462.9	
Spending increases		(45.6)		(90.1)
Net tax reductions		(80.0)		(242.0)
Total changes in spending & taxes		115.7		511.3
Reduction in interest costs		+2.4		+82.7
Total deficit reduction		$118.1		$594.0

Table 2. Projected Federal Outlays, Revenues, and Deficit or Surplus, Fiscal Years 1997-2007
(fiscal year, $s in billions)

	1997	1998	1999	2000	2001	2002
Outlays	1,612	1,691	1,750	1,799	1,857	1,888
Revenues	1,578	1,635	1,698	1,751	1,821	1,920
Deficit (-)/surplus (+)	-34	-57	-52	-48	-36	+32
	2003	**2004**	**2005**	**2006**	**2007**	
Outlays	1,987	2,073	2,178	2,253	2,361	
Revenues	2,000	2,101	2,214	2,324	2,447	
Deficit (-)/surplus (+)	+13	+29	+36	+72	+86	

Source: Congressional Budget Office, *The Economic and Budget Outlook: An Update*, September 1997.

Changes in 10-Year Budget Outlook Projected from Reconciliation Legislation
(Deficit or surplus, in billions)



Source: CBO, Sept. 1997.

Highlights of the spending and tax legislation follow.

Table 3. Highlights of the Balanced Budget Act of 1997

Medicare	• creates net savings of $115 billion by limiting annual reimbursement to hospitals, physicians, and other providers • allows 390,000 participants to purchase government-financed medical savings accounts in place of traditional Medicare • reallocates some home health expenditures from the HI trust fund to the SMI trust fund • maintains SMI premiums at 25% of program costs and phases in over 7 years the cost of the home health reallocation into SMI premiums • expands preventive care benefits • expands managed care options • establishes a National Bipartisan Commission on the Future of Medicare by December 1997 • excludes Senate-approved provisions to means-test Medicare SMI premiums; raise eligibility age from 65 to 67; and require a $5 copayment for home health care services
Medicaid	• net savings of $13 billion • adds $1.5 billion to assist low income individuals with Medicare SMI premiums • restores benefits for disabled children who lose SSI due to new eligibility guidelines • reforms disproportionate share hospital payments • repeals Boren amendment requiring States to pay “reasonable and adequate” rates to hospitals and nursing homes
Children’s health	• provides $24 billion for children’s health care including $20.25 billion for State Children’s Health Insurance Program
Welfare	• maintains SSI benefits for both elderly and disabled legal immigrants receiving benefits on or before August 22, 1996 • authorizes SSI eligibility for legal immigrants who entered the United States on or before August 22, 1996 and who later become disabled • creates welfare-to-work grants totaling $3 billion in fiscal years 1998 and 1999 • provides States with option to waive food stamp work requirement for certain individuals • provides new money for work/training for food stamp recipients
Cigarette tax	• increases cigarette tax by 15 cents per pack by 2002 (from 24 cents to 39 cents); funds to be used in part for children’s health care (The revenue effects of this provision are included in the estimates for the tax reconciliation bill.)
Civil service retirement	• increases federal agency and federal employee contributions to the Civil Service Retirement and Disability Trust Fund

Table 3. Highlights of the Balanced Budget Act of 1997

Veterans benefits	• achieves \$2.7 billion savings through extension of current law provisions including the \$90 pension limit for persons in Medicaid nursing homes
Housing	• achieves \$1.8 billion savings through extension of current law provisions including those pertaining to section 8 housing
Spectrum auctions	• generates \$21.4 billion in revenues from spectrum auctions
	Budget Enforcement Provisions
Discretionary spending limits	• extends discretionary spending limits through 2002 • separate limits for defense and nondefense discretionary spending in fiscal years 1998 and 1999 • single limit for defense and nondefense discretionary spending in fiscal years 2000 through 2002 • separate limit for the Violent Crime Reduction Trust Fund through fiscal year 2000
PAYGO	• extends pay-as-you-go requirement that direct spending and tax legislation be deficit neutral through fiscal year 2002 • requires that all legislation be deficit neutral for at least 5 years after enactment
Congressional budget process	• permanently extends 5-year coverage and enforcement of congressional budget resolutions among other changes

Table 4. Highlights of the Taxpayer Relief Act of 1997

Child tax credit	• provides $500 tax credit per child age 16 and under ($400 in 1998) • establishes eligibility for individuals with incomes up to $75,000 and couples with incomes up to $110,000 • permits partially refundable credit for families receiving the EITC • assumes $5 billion savings from EITC fraud reduction
Capital gains	• reduces the top capital gains tax rate from 28% to 20% on assets held for a minimum of 18 months (up from 12 months) • reduces the capital gains tax rate from 15% to 10% for lower income brackets • for assets purchased after 2000 and held at least 5 years, capital gains tax rate goes down from 20% to 18% and from 10% to 8%
Education tax benefits	• establishes tax credit of up to $1,500 for the first and second years of college • establishes tax credit of up to $1,000 ($2,000 by 2002) for the third and fourth years of college • permits annual tax deduction of up to $2,500 for interest paid on student loans • authorizes tax free treatment for state prepaid tuition plans
Estate taxes	• increases estate tax exemption from $600,000 to $1 million over 10 years ($1.3 million for family farms and small businesses effective immediately)
Home sales	• provides tax exemption of up to $500,000 ($250,000 for single filers) in gains from the sale of a principal residence
IRAs	• expands coverage and other reforms of Individual Retirement Accounts including penalty-free withdrawals for first-time home purchases; the doubling of income limits for tax deductible contributions to existing IRAs over 10 years; and creates new backloaded IRAs with tax-free withdrawals if account is held for at least 5 years and the account holder is at least age 59½
Self-employed	• gradually increases deduction for health insurance costs of self-employed individuals to 100% by 2007
Airline tax	• extends and reduces domestic airline ticket tax from 10% to 7.5% by 2000 • implements airport-to-airport flight fee ($1 in 1998; $3 by 2002) • replaces $6 international departure tax with $12 tax on international arrivals and departures

Table 5. Discretionary Spending Limits, as of August 15, 1997, Fiscal Years 1998-2002
($s in millions)

	1998	1999	2000	2001	2002
Defense[a]:					
Budget authority	269,000	271,500	na	na	na
Outlays	267,958	266,742	na	na	na
Nondefense[a]:					
Budget authority	252,623	255,699	na	na	na
Outlays	284,038	289,365	na	na	na
Violent Crime Reduction[b]:					
Budget authority	5,500	5,800	4,500	na	na
Outlays	3,592	4,953	5,554	na	na
Overall discretionary[c]:					
Budget authority	na	na	532,693	542,032	551,074
Outlays	na	na	560,018	565,339	561,326
Total discretionary:					
Budget authority	527,123	532,999	537,193	542,032	551,074
Outlays	555,588	561,060	565,572	565,339	561,326

Source: Congressional Budget Office, *The Economic and Budget Outlook: An Update*, Sept. 1997.

na = not applicable

[a] Included in overall discretionary category beginning in 2000.

[b] Included in overall discretionary category beginning in 2001.

[c] Includes defense and nondefense categories in 2000; includes defense, nondefense, and violent crime reduction categories in 2001 and 2002.

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