INFORMED BUDGETEER

SENATE 302 (B) ALLOCATIONS

- The Senate Appropriations Committee adopted FY 1999 spending guidelines for its 13 subcommittees on May 14.

- The adoption of these guidelines, referred to as 302(b)'s , was made possible before a conference agreement on the overall budget for 1999, because after passage of the Senate Budget resolution back on April 2, the Senate immediately adopted a "deeming resolution". This resolution provided the Senate Appropriations Committee its allocation of funding in the budget.

Discretionary Appropriations
($in Billions, All Discretionary: Def, Non-def & Crime)

		Freeze 98level	Pres. Request	Allocation S. Approps	vs. Freeze
Agriculture	BA	13.9	13.7	13.7	-0.3
	OT	14.3	14.0	14.1	-0.2
Commerce	BA	31.4	33.3	32.2	0.8
	OT	30.5	32.0	30.8	0.4
Defense	BA	247.4	251.1	250.2	2.9
	OT	246.6	248.5	245.0	-1.6
DC	BA	0.8	0.5	0.5	-0.4
	OT	0.6	0.5	0.5	-0.1
Energy	BA	20.7	21.0	21.1	-0.4
	OT	20.6	20.7	20.7	*
For. Ops.	BA	13.0	13.5	12.6	-0.4
	OT	12.6	13.0	12.4	-0.4
Interior	BA	13.1	14.1	13.3	0.2
	OT	13.8	14.4	13.8	*
Labor-HHS	BA	81.3	84.1	82.3	1.1
	OT	80.7	81.1	80.2	-0.5
Leg. Branch	BA	2.3	2.5	2.4	0.1
	OT	2.2	2.4	2.3	*
Mil. Con.	BA	9.2	7.8	8.5	-0.7
	OT	9.3	9.1	9.1	-0.1
Transp.	BA	12.7	12.9	13.1	0.4
	OT	39.8	40.0	39.5	-0.3
Treasury	BA	12.7	13.5	13.0	0.3
	OT	12.2	13.1	11.9	-0.3
VA-HUD	BA	70.0	70.5	70.0	*
	OT	81.1	80.8	80.8	-0.4
Emergency	BA	--	3.3	--	--
	OT	--	3.3	--	--
TOTAL	BA	528.4	541.7	532.8	4.5
	OT	564.4	572.7	561.1	-3.3
Bdgt Resltn	BA	532.8	532.8	532.8	
	OT	561.1	561.1	561.1	
+ or - Resltn	BA	-4.5	8.9	--	
	OT	3.3	11.6	--	

NOTE: Details may not add to totals due to rounding. * less than 100 million.

THE INCOME TAX OFFSET - WHAT A TANGLED WEB

- When is a dollar not a dollar? When the income tax offset is applied. The income tax offset stems from the general budget estimating convention (employed by Treasury, CBO and JCT) assumes a fixed level of GDP; that is, the policy being estimated is assumed to neither increase nor decrease the level of GDP.

- One of the components of the national income (GDP) accounts is "indirect business tax and nontax liability," the relevant characteristic being that these liabilities are taken out of the gross income of businesses before the tax base is calculated. Indirect business tax and nontax liabilities include excise taxes, customs duties, royalties, penalties and certain fees.

- Because these liabilities come out of business income, and because GDP is assumed to be unchanged, a legislated increase in such liabilities has the effect of reducing the income tax base, and therefore, the amount of income tax collected. If cigarette excise taxes are increased by $1.00 per pack, for example, indirect business tax liabilities increase by the amount of excise taxes collected, and income decreases by the amount of excise taxes collected.

- The decrease in income entails a loss of corporate and individual income tax and payroll tax revenue, offsetting approximately 25% of the revenue increase from the excise tax. The 25% figure represents the average federal tax rate on all forms of income.

- That's how a $1.00 per pack excise tax increase results in only $.75 coming in to the federal Treasury.

DEFENSE BURDEN SHARING: HOW DOES THE U.S. RANK?

- Each year, since 1981, the Defense Department reports to Congress, comparing the defense burdens borne by the U.S. and its major allies in Europe, Asia, and the Persian Gulf. This report is known as DoD's "BURDEN SHARING" report; its formal title is Report on Allied Contributions to the Common Defense, from the Secretary of Defense.

- These annual reports were initiated by Congress in the Defense Authorization Act of 1981 (PL 96-342, Section 1006) to make sure our allies are pulling their own weight to deter aggression and to prepare to meet current and future threats. The March 1998 report was recently delivered to the Congress.

- In the FY 1998 Defense Authorization Act, Congress urged U.S. allies to increase their efforts in one or more of the following areas:

  - Percent of gross domestic product (GDP) spent on defense;

  - Contributions to multilateral military activities, such as the peacekeeping force now in Bosnia;

  - Contributions to the U.S. to defray the costs of U.S. forces permanently deployed abroad, such as the 100,000 troops now in Europe, and

  - Contributions to foreign aid.

- Some may find the results surprising. According to DoD, every one of our NATO allies and our major allies in Asia and the Persian Gulf meet at least one of the four BURDEN SHARING targets, and most allies meet two or more targets. For example, all NATO allies except one (Turkey) contribute a higher share of their GDP to foreign aid than does the US, and all except two (Belgium and Luxembourg) make major contributions to military roles, missions, and combined operations within and beyond NATO's borders.

- While its share of GDP for defense is just 1 percent -- as required by its own constitution -- Japan gives the US a higher percentage of support for US troops based on its soil than any other nation (78 percent or $4.6 billion in 1996), and it donates a larger share of GDP to foreign aid (0.2%) than does the U.S. (0.14%). In the Persian Gulf, each U.S. ally spent a larger % of GDP in 1997 on defense (ranging from 14.1% in Qatar to 5.1% in the United Arab Emirates) than did the U.S. (3.4%).

- Other data may also surprise some. In 1997, next to the US, France had the highest defense budget ($42.1 billion); Japan was next at $39.7 billion; the U.K. was fourth at $35.5 billion, and Germany was fifth at $33.9 billion. Altogether these allies spent $151.2 billion on defense, but they did not even come close to the $273.0 billion that the US spent.

- Computed as a percent of GDP or other "ability to pay" measures, the U.S. does not always compare favorably to many of our allies. Using these proportional measures, the U.S. placed as follows in fiscal year 1997:

% of GDP spent on defense...............................9th
% of GDP spent on UN peace operations..........9th
% of labor force in armed forces......................15th
% of GDP spent on foreign aid.........................17th
% of GDP spent on ground combat forces........12th
% of GDP spent on naval tonnage......................7th
% of GDP spent on combat aircraft..................17th

- Of course, in absolute terms the U.S. is virtually always at the top of these measures, but it is valuable to note that based on ability to pay, many of our allies carry a meaningful burden, and often they pull more of their weight than we sometimes give them credit for.

WHO IS SCHMIDT BAKING?

- Palatable revenue offsets are proving to be a scarce commodity, even with 17,000 pages of IRS laws and regulations to work with. In fact, a few revenue raisers are being used for nearly every major tax bill. The favorite provision seems to be repealing the court ruling in *Schmidt Baking*. Unless overturned, this decision would allow corporations to use a favorable tax treatment for vacation and severance pay.

- The most-popular revenue offsets are now stretched around both the expanded IRS bill and the Education-IRA bill. Accordingly, it will be more difficult to find money for other priorities in the Budget Resolution, such as marriage-penalty relief and child-care support. With revenues at a post-war high, it is extremely arduous to find tax increases that both Houses of Congress can live with.

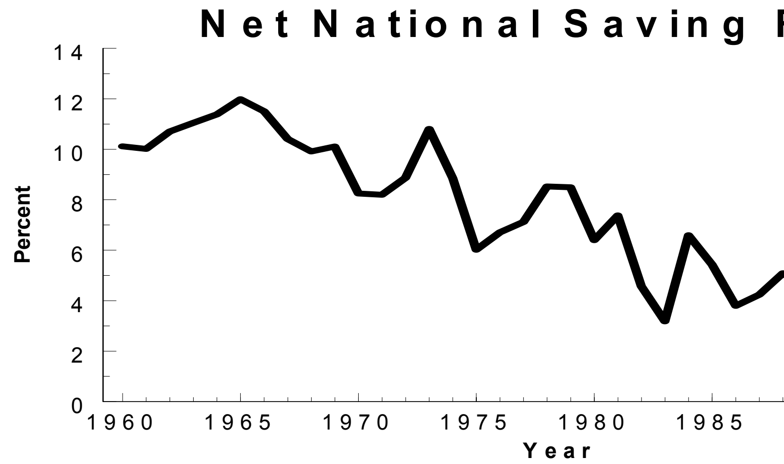
UBIQUITOUS REVENUE OFFSETS
($ in Billions)

	5-year	10-year
Finance Committee IRS Reform Bill		
Repeal Schmidt Baking	3.193	4.053
Alter foreign tax credit carry back	1.926	3.392
TOTAL	5.119	7.445
Coverdell Education- IRA Bill		
Repeal Schmidt Baking	2.715	3.446
Alter foreign tax credit carry back	0.669	2.823
TOTAL	3.384	6.269
House African-Trade Bill		
Repeal Schmidt Baking	0.269	NA

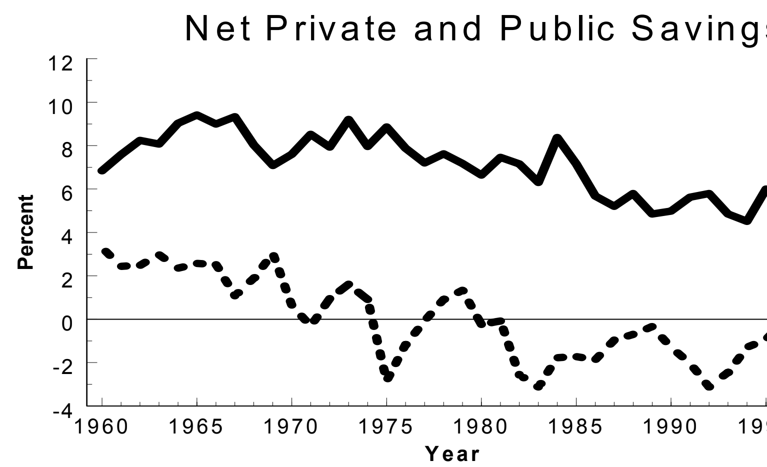
ECONOMICS

THE BENEFITS OF RUNNING A SURPLUS

- The news continues to get better on the federal fiscal front. CBO now projects a $43-63 billion surplus for FY1998, a marked improvement from the $200 billion plus deficits of the early 1990s. This federal fiscal turn-around is the main reason why our net national savings rate has nearly doubled since 1994.



Source: Dept. of Commerce



Source: Dept. of Commerce, BEA

- While the net national savings rate is still low on a historical basis, its rise has been a key factor behind the decline in interest rates and the resultant surge in business investment that we've witnessed in the last several years. Real producer durable equipment has grown at an 11% annualized pace since 1994, which has likely played a role in the unusual, late-cycle surge in productivity growth that we've seen in the last two years.

- The link between the federal fiscal position and interest rates was made quite explicit in the Treasury's latest debt announcement. Given the large inflow of tax receipts in April, Treasury said that it would issue less new debt this fiscal year than they had previously planned. As such, they decided to eliminate the three year note and will auction the five year note on a quarterly basis instead of on a monthly timetable. The lessened supply of Treasuries should help to keep interest rates low going forward.

- The economic benefits of improving our fiscal backdrop should reinforce the desire to maintain the type of strict budget discipline and budget enforcement procedures that have brought us this far.

✎EDITOR'S NOTE: Washington, D.C. can be a cruel heartless place. Canards abound. THE TOBACCO CHART which appeared in last week's *Budget Bulletin* was PRODUCED BY SENATE BUDGET COMMITTEE STAFF at the request of the Chairman in order to understand the bill as reported out of the Commerce Committee. NO OUTSIDE GROUP HAD ANY INPUT INTO THE DEVELOPMENT OF THE CHART. Any rumors or suggestions to the contrary, are untrue and worse, question the integrity of the professional committee staff.