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INFORMED BUDGETEER

BUILDING A DEPARTMENT COSTS A FISTFUL OF DOLLARS

- Over the summer, CBO has prepared several cost estimates (see table below) of various versions of legislation that would create a new Department of Homeland Security (DHS): the President's proposal–H.R. 5005 as introduced; H.R. 5005 as considered by the whole House; and the version reported by the Senate Governmental Affairs Committee (Lieberman substitute). Each version of the legislation would create the DHS by transferring existing entities and by adding new programs that currently do not exist.

CBO Estimates of Five Year Cost for Bills Creating a Department of Homeland Security
(BA for authorized levels, $ in billions)

	H.R. 5005,as introduced[/a]	H.R. 5005 as reported[/b]	Lieberman Substitute[/c]
Consolidation and Administration	1.1	1.2	1.2
New Programs Authorized			
New federal building	–	0.6	–
Intelligence analysis center	0.1	0.1	0.1
R&D Program	–	1.6	2.3
Nat'l Bioweapons Defense Cntr.	2.2	–	2.2
Additional human resource cost	–	*	1.2
DOJ - Immigration	–	1.1	1.1
Firefighting grants	–	–	2.0
Amtrak grants	–	–	1.2
Other	*	0.1	0.1
Subtotal, New Programs	2.3	3.5	10.2
TOTAL	**3.4**	**4.7**	**11.3**

Source: SBC Republican Staff, using CBO cost estimates. Totals may not add due to rounding.
* Less than $50 million.
/a The President's proposal to create a Department of Homeland Security was introduced by Representative Armey, at the request of the President, on June 24, 2002.
/b As ordered reported by the Select Committee on Homeland Security on July 19, 2002.
/c The Lieberman substitute to H.R. 5005 (Senate amendment number 4471) is an amended version of S.2452 and was agreed to by the Senate Committee on Governmental Affairs on July 25, 2002. (The committee originally reported S. 2452 on June 24, 2002).

- In creating a new department that would be the fourth largest in terms of discretionary funding and the third largest in terms of FTEs, one issue is the budgetary cost of consolidating currently scattered activities into one entity and administering that entity on an ongoing basis. The President claims that the costs of the management and administration of the new department will be funded from savings achieved by eliminating redundancies inherent in the current structure.

- In his June 6 speech outlining the new department, the President said: "The reason to create this department is not to [increase] the size of government, but to increase its focus and effectiveness. The staff of this new department will be largely drawn from the agencies we are combining. By ending duplication and overlap, we will spend less on overhead, and more on protecting America."

- Naturally, when CBO released its estimate of the President's proposal (H.R. 5005, as introduced) with the summary sentence that implementing the legislation would cost "about $3 billion" over the 2003-2007 period, many in the press locked on to that figure as a repudiation of the Administration's argument that the new department would save money, without bothering to understand or explain what the $3 billion figure represents.

- While calling it a $3 billion price tag is true on its face, that leaves out important layers of analysis. When examining such a plan to combine existing programs with newly proposed ones into a new department, CBO provides answers for several questions about the levels of resources involved. The specific answer for each of these questions cannot be found in the summary sentence that the bill "would cost about $3 billion"; CBO's detailed table and "Basis of Estimate" section instead provide the relevant information.

- One question that CBO addresses is the net budgetary impact of reorganizing the agencies involved and administering the new department. CBO puts the one-time start-up costs (to hire, house, and equip new managerial personnel) in the first year at $150 million, with minimum annual costs thereafter at about $225 million to provide for the new department's "centralized leadership, coordination, and support services" that are not now currently performed anywhere in the federal government. (Such estimated costs do <u>not</u> assume that employees who currently work in the DC area are relocated to a central location within the next five years or that existing deficiencies in communications and computer infrastructure are addressed.)

- Thus, the total CBO estimate of the net additional cost for making one new agency out of many existing federal entities is $1.1 billion over five years. This is <u>not</u> the savings in overhead that the President suggests would occur, but when some in the press write the "cost of merging agencies could total $3 billion or more by 2007," that is not accurate either.

- Another question that CBO examines is the cost of entirely new programs that the homeland security bills would authorize and place in the new department. For example, in the introduced version of H.R. 5005, CBO estimates that new programmatic activities would cost $2.3 billion over the next five years. Nearly all of this amount is attributable to the Bio-Weapons Defense Analysis Center, which does not currently exist but which the President included in his overall homeland security request in his 2003 budget (a request level that the *Bulletin* suspects has been accepted by most participants in the homeland security debate as a good predictor of funding to be enacted for homeland security for 2003.)

- Adding the cost of these new authorizations to the additional cost of creating one entity out of many yields a five-year estimate of $3.4 billion in budget authority and $3 billion in outlays – the total additional cost of creating a DHS as specified in the President's proposal and the figure oversimplified by the press. (By comparison, the Lieberman substitute would add $10.2 billion in new programs –some unrelated to the task of creating a DHS out of existing federal activities–bringing the total CBO cost estimate for that proposal to $11.3 billion.)

- To sum up, the fact that it could cost more than $1 billion over five years to reorganize agencies and administer DHS has not been addressed by the Administration in its opportunity to amend the President's 2003 budget request. In contrast, the President claims that the cost of new elements in the department, as well as the management and administration units, will be funded from savings achieved by eliminating redundancies inherent in the current structure.

- The unsubstantiated assertion that DHS will not cost taxpayers any additional money is dismissed by many who study the issue. CBO has not only disagreed with the President's claim, but has provided an analysis on the record to support its conclusion.

THE GOOD, THE BAD, AND THE UGLY OF SEQUESTRATION

- The enforcement mechanisms and Senate super-majority points of order of the budget process are still set to expire at the end of this month, and yet some of the usual requirements of that budget process grind on, though almost universally ignored, even by budgeteers.

- Case in point – while we were gone, CBO released its sequestration update report on August 15, and OMB followed with its own on August 19. Recall that we have two mechanisms to control discretionary spending and PAYGO effects (mandatory spending and revenues) that are enforced by a cancellation of budgetary resources–known as sequestration. While CBO's report is advisory and OMB's report is the one used for implementing the law, the reports are enlightening by both their similarities and their differences.

- First, the good news. With respect to discretionary spending in FY 2002–which is nearly over and is the last year for which there are caps–both CBO and OMB project that total discretionary spending is still *below* the final adjusted spending limits, even after the supplemental. So there is no risk of a discretionary sequester later this fall (except for the remote possibility that legislation is enacted before the end of September that increases nonemergency discretionary appropriations in 2002 by more than $942 million).

- The bad news comes from the PAYGO scorecard for 2003, where both CBO and OMB have recorded approximately $125 billion in legislative effects that have not been offset, indicating a sequester is necessary. (Although the cost of legislation enacted after September 30th will no longer be added to the PAYGO scorecard, the law requires the scorecard to be maintained through 2006. Both agencies reflect PAYGO balances, resulting from legislation already enacted, approaching $150 billion in each year from 2004 through 2006. See table below.)

Comparison of CBO and OMB
PAYGO Sequestration Update Balances
($ in billions)

PAYGO Scorecard Balance	2002 & 2003	2004	2005	2006
CBO	123	143	145	145
OMB[/a]	126	145	139	142

Source: CBO and OMB
/a OMB's report omits the effects of the Sarbanes-Oxley Act of 2002 (P.L. 107-204), enacted July 30, and the Trade Act of 2002 (P.L. 107-210), enacted August 6, because OMB did not complete its estimate of the PAYGO effects of that legislation. CBO's balance does include a PAYGO effect from the Trade Act of about $1.4-$1.5 billion in each year, and an insignificant PAYGO effect from the Sarbanes-Oxley Act.

- Now, such bad news is so bad that it will reflexively trigger what has become inevitable good news (or simply expected non-news). There has not been a PAYGO sequestration of mandatory resources since the scorecard started in 1991(though there were sequesters of mandatory resources under the Gramm-Rudman process before 1991). Congresses and Presidents have always agreed to "turn off" looming PAYGO sequestrations through a variety of mechanisms.

- Could mandatory spending possibly be reduced by over $125 billion in FY 2003 when Congress and/or the President are talking about a prescription drug benefit, tax cuts, and mandatory agriculture assistance, among other things? Not to worry – it is axiomatic that this fall a 2003 PAYGO sequestration will be avoided, as long as the Congress remembers to reset the PAYGO scorecard to zero.

- What is ugly about this vestige of the budget process is the apparent disrepair into which it has fallen. OMB's report suggests that to satisfy the sequestration demanded by a $125 billion PAYGO balance, the universe of maximum budgetary resources available for sequester amounts to only $31 billion. CBO says the universe is nearly double OMB's – at $57 billion. Both pale in comparison to the PAYGO balance because many of the largest mandatory spending programs are either exempted in whole (Social Security and Medicaid) or in part (Medicare and Commodity Credit Corporation). But, why are they so different from one another (see table below)?

Estimates of Cancelled Budgetary Resources
Under Potential 2003 PAYGO Sequester
($ in billions)

	Total expected spending in 2003[/a]	**Amount that would** CBO[/b]	**be sequestered** OMB[/b]
Medicare	233	10	8
CCC[/c]	12	12	6
Child Tax Credit	6	6	/d
USF	6	6	/d
SCHIP	4	4	/d
Child Support	4	4	1
Crime Victims	1	1	1
Other	NA	14	16
TOTAL		**57**	**31**

Source: SBC Republican Staff, based on CBO and OMB Sequestration Update Reports.
Totals may not add due to rounding.
/a Total expected spending for 2003 reflects CBO's baseline estimate of outlays.
/b Both CBO and OMB have omitted several relatively new accounts from the sequesterable base, even though such accounts are not exempted by law: DOD Tricare for Life, Sept. 11 Victims Compensation Fund, and Compensation for Air Carriers.
/c OMB did not adjust its sequesterable base for the increased spending added by the farm bill.
/d While OMB agrees with CBO that the law does not exempt these accounts from sequestration, OMB believes it would not know how to implement a cancellation of budgetary resources, so it omits these accounts from its total estimated sequestration.

- Some of the total difference ($26 billion) between CBO and OMB's 2003 PAYGO sequester results simply from differences in baseline estimates for the programs (about $4 billion worth). More interestingly, for three specific programs (the refundable portion of the child tax credit, the Universal Service Fund, and the State Children's Health Insurance program) OMB has made the choice not to include their $16 billion in budgetary resources. Even though these programs are not explicitly exempted by law from sequestration, OMB believes it would not know how to implement a cancellation of budgeting resources for them. Finally, OMB's report has not yet adjusted for the $6 billion increase in budgetary resources that the farm bill has provided to the Commodity Credit Corporation (CCC) for 2003.

- Given the fuzziness with which the PAYGO process is implemented, it perhaps should not be surprising that, to the extent the Senate might try to continue some semblance of the budget enforcement process into 2003, it is considering extending PAYGO-type discipline in the Senate only by maintaining the supermajority enforcement tools that would otherwise revert to simple majority points of order at the end of this month. This is perhaps a sign that any remaining value of the PAYGO process stems not from the threat of a sequester, but from the 60 votes that most new direct spending or tax cuts would have to muster.

- And there is one more question: will we even be looking at these issues a year from now? While prospects for extending the BEA appear dim at this point, one can at least hope that the next Congress will find renewed enthusiasm for a real debate in the Budget Committee and the floor of the Senate with respect to our budget processes and budget enforcement rather than the piecemeal approach that has transpired over the last 18 months.