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How the Budget Resolution Will Make or Break Revenue-Neutral Tax Reform

By Harry Stein   September 25, 2017

The "Better Way" tax plan, published by the Office of House Speaker Paul Ryan (R-WI) as a blueprint for House Republican policy, claimed to support a "tax reform that is revenue neutral," meaning that the overall legislation would not change the total revenues collected by the federal government.[1] If a revenue-neutral tax reform reduces tax rates, for example, it would have to pay for that reduction by raising revenues in other ways, such as scaling back tax preferences. Senate Majority Leader Mitch McConnell (R-KY) says that tax reform must be revenue-neutral because, "We have a $21 trillion debt."[2] But the actual tax plans released so far, including the framework published on September 27 by majority leaders in Congress and the White House, are not revenue-neutral and would significantly increase budget deficits.[3]

The commitment to revenue-neutral tax reform will be put to the test in the upcoming budget resolution, in which Congress will make important decisions that shape the upcoming tax debate. The budget resolution will likely include reconciliation instructions that create a fast-track process for Congress to pass a subsequent bill that conforms to those instructions. The Senate can pass this subsequent reconciliation bill with a simple majority instead of 60 votes, meaning that the majority can pass a bill using reconciliation without any Democratic votes.[4]

When it comes to taxes, there are four politically realistic possibilities for reconciliation instructions:

1. **Revenue-neutral tax reform:** This provides no overall tax cut.
2. **Deficit-neutral tax cut:** Sometimes mislabeled "deficit-neutral tax reform,"[5] this allows lawmakers to cut spending to pay for tax cuts.
3. **Deficit-financed tax cut:** This allows lawmakers to increase deficits with tax cuts.
4. **Tax cut with spending cuts and higher deficits:** This allows lawmakers to cut spending and increase deficits to finance even larger tax cuts.

Unfortunately, these four possibilities do not include the option that Congress should choose—revenue-positive tax reform. Sustaining commitments such as Social Security, Medicare, and Medicaid will require more revenues to meet the increased needs of an aging population, and the United States can afford these programs while remaining a low-tax country by international standards.[6] Raising revenues to fund job-creating investments in sectors such as education, child care, and infrastructure would grow the economy and increase wages.[7] This is not a likely outcome, however, given the current political composition of Congress.

For the same reason that the United States will need more tax revenues in the future, anything less than revenue-neutral tax reform would threaten everything from national defense and homeland security to Social Security, Medicare, Medicaid, education, and even food assistance.[8] The government's ability to protect the country and meet the basic needs of every American family would be imperiled.

A tax cut reconciliation bill could include spending cuts in the same legislation, or the deficits created by the tax cuts will provide an excuse to cut those programs down the line. While deep program cuts would harm all Americans, any tax cuts allowed by Congress are almost certain to disproportionately benefit the wealthiest Americans and biggest corporations, based on plans from President Donald Trump and some congressional leaders.[9]

The reconciliation instructions in the budget resolution will decide whether Congress can use spending cuts or budget deficits—or both—to cut taxes for wealthy and corporate elites. In this way, Congress will make some of its most important decisions about tax policy in the budget resolution, before debating the actual tax legislation.

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Option 1: Revenue-neutral tax reform

Even the conservative anti-tax organization Americans for Tax Reform, which pressures lawmakers to sign a pledge to oppose any tax increase, recognizes that tax cuts are not tax reform. According to Americans for Tax Reform, "The whole idea behind tax reform is to collect the same amount of money as today, but in a smarter way … Real tax reform is revenue-neutral."[10] Tax reform requires tough choices about how to simplify the tax code by scaling back tax preferences. By allowing tax cuts without corresponding reductions in tax breaks, Congress is avoiding those tough choices.

The budget resolution may include reconciliation instructions to many congressional committees, but for taxes, the relevant reconciliation instruction is the one that goes to the tax-writing committees—the House Committee on Ways and Means and the Senate Committee on Finance. This reconciliation instruction will be a simple target that instructs the tax-writing committees to change revenues or deficits by a certain amount.

If the bill produced by the committee follows the reconciliation instruction, Congress can use the fast-track reconciliation procedure that lets the Senate pass the bill with a simple majority instead of meeting the 60-vote standard.

A reconciliation instruction does not include policy details, but the instruction to the tax-writing committees can require revenue-neutral tax reform if it passes two tests. First, the instruction cannot allow higher budget deficits. Second, the instruction must ensure that the tax-writing committees keep their reconciliation bill focused on taxes, by using a revenue target instead of a deficit target.

Many spending programs—such as Medicare, disability benefits, child welfare, and unemployment insurance—are also under the jurisdiction of the tax-writing committees.[11] If the reconciliation instruction to the tax-writing committees uses a deficit target, the tax-writing committees could slash these programs to pay for tax cuts without increasing deficits.

Since reconciliation instructions are required to mandate some kind of change, an instruction for revenue-neutral tax reform could direct the tax-writing committees to produce legislation that increases revenues by some insignificant amount, such as $1. The two key elements of this instruction are that it does not allow higher budget deficits and that it requires a change in revenues instead of a change in deficits.

Option 2: Deficit-neutral tax cuts

If the reconciliation instruction directs the tax-writing committees to produce legislation that changes deficits, even if this is just a miniscule change, it would pave the way for potentially massive tax cuts paid for with spending cuts. While some policymakers call this option deficit-neutral tax reform, it is not tax reform. Instead, it is tax cuts and spending cuts combined in the same bill.

A new reconciliation instruction to the tax-writing committees that uses a deficit target would pave the way for the congressional majority to revive their effort to repeal the Affordable Care Act (ACA), even though the reconciliation instruction they are currently trying to use expires on September 30.[12] While the tax-writing committees are not the only committee involved in this process, *Politico* reports that "95 percent of health care policy" goes through the Senate Finance Committee, according to a Republican congressional staffer discussing future prospects of ACA repeal in reconciliation.[13]

The efforts to repeal ACA show how Congress can use a reconciliation instruction with a deficit target to cut programs for working families to pay for tax cuts for the wealthy and big businesses. The ACA repeal bills are reconciliation bills pursuant to the fiscal year 2017 budget resolution Congress passed in January 2017.[14] This is why the Senate can pass ACA repeal despite unified Democratic opposition. This budget resolution instructed two committees with jurisdiction over health care and taxes to produce reconciliation bills that each reduced deficits by at least $1 billion over 10 years. One way that the House-passed American Health Care Act followed this instruction was by cutting Medicaid by $834 billion over 10 years—enabling hundreds of billions of dollars in tax cuts for the wealthy and big businesses while still reducing deficits enough to follow the reconciliation instruction.[15]

The FY 2018 budget resolution passed by the House Budget Committee—which would pave the way for its tax plan—includes a reconciliation instruction for the House Ways and Means Committee to report legislation reducing deficits by at least $52 billion over 10 years.[16] Since this instruction uses a deficit target, it allows spending cuts to pay for tax cuts.

The House Budget Committee characterizes its instruction as enabling spending cuts alongside "deficit-neutral tax reform."[17] If the House Ways and Means Committee cuts spending by exactly $52 billion in its reconciliation bill, then this bill could only include revenue-neutral tax reform, since any tax cuts would drive the total deficit reduction below the required $52 billion. But spending cuts exceeding $52 billion could be used to pay for tax cuts; if that were the case, this would not be a tax reform bill.

Since the tax-writing committees also have jurisdiction over major federal programs, a deficit-based instruction to these committees that claims to be about tax reform could enable massive spending cuts and tax cuts, including major elements of new ACA repeal legislation. Congress could even cut Medicare by turning it into a voucher program to pay for a lower corporate tax rate—two policies advocated in the FY 2018 House budget resolution and enabled by its reconciliation instructions.[18]

Option 3: Deficit-financed tax cuts

Separate from whether the reconciliation instruction provides a revenue or deficit target to the tax-writing committees, Congress will also have an important choice to make about whether to increase deficits with its tax bill. If the reconciliation instruction uses a revenue target, it could explicitly allow the tax-writing committees to reduce revenues by a certain amount instead of requiring revenue-neutral reform. This reduction in revenues would increase deficits.

Using the budget resolution to pave the way for higher deficits would be a jarring reversal for the congressional majority. Congress would have to scrap bipartisan pay-as-you-go (PAYGO) rules that are meant to prevent deficit-increasing legislation, including the Senate's PAYGO rules that were made permanent in 2015 with the support of 47 Republicans who are still in the Senate.[19] Supporting higher deficits would fly in the face of the dire warnings of a "looming fiscal crisis" in earlier congressional Republican budgets.[20] In 2012, House Speaker Paul Ryan (R-WI) even published a report—when he chaired the House Budget Committee—that concluded with the following warning:[21]

> *Without bold new leadership, the unsustainable trajectory of the national debt will trigger a sharp and sudden debt crisis that would threaten national security, hit seniors and low-income Americans the hardest, and leave all Americans with a diminished future. This looming crisis represents an enormous challenge, but it also represents a defining choice: whether to continue down the path of debt, doubt, and decline or put the nation back on the path to prosperity.*

This hysterical rhetoric was wrong on the facts. Consistently low interest rates on the Treasury bonds that finance the national debt show that, for now and for the foreseeable future, investors are fully confident in American fiscal strength.[22] But such rhetoric has been a defining feature of Speaker Ryan's political career.[23] By using budget reconciliation to further increase the national debt, Speaker Ryan would be answering his own "defining choice" by choosing to go further down what he calls "the path of debt, doubt, and decline."

Sadly, fiscal hysteria from politicians such as Speaker Ryan tends to be nothing more than a justification to attack programs for working families while still cutting taxes for the wealthiest Americans and biggest corporations.[24] If President Trump and congressional leaders enact deficit-financed tax cuts, sooner or later they are sure to use the higher deficits caused by those tax cuts as leverage to enact the massive cuts to health care, food assistance, education, the environment, and other sectors that are advocated in their budget proposals.[25]

Option 4: Tax cuts with spending cuts and higher deficits

Instead of using a revenue-losing reconciliation instruction, the budget resolution could instead give the tax-writing committees a deficit-increasing instruction. Since this would be a deficit target, not a revenue target, it would let Congress finance tax cuts with both spending cuts and higher deficits. This kind of reconciliation instruction would state how much tax cuts could increase deficits, similar to a revenue-losing instruction, but it would also allow an unlimited amount of additional tax cuts offset by spending cuts.

While the House budget resolution does not currently allow deficit-financed tax cuts—just tax cuts paid for with spending cuts—Senate Republicans have reportedly reached an agreement to pass a budget resolution that would allow tax cuts to increase deficits by as much as $1.5 trillion over 10 years.[26] If the Senate budget resolution uses a deficit target, instead of a revenue target, then spending cuts could be used to offset additional tax cuts that exceed $1.5 trillion.

FIGURE 1

How budget reconciliation instructions could allow tax cuts instead of tax reform

The budget could require revenue-neutral tax reform or allow tax cuts financed by spending cuts and/or deficits

Tax cut advocates may claim that deficits from tax cuts will be reduced or eliminated because of higher economic growth, but these claims rely on an outdated and disproved theory that cutting taxes for the wealthy and corporations will increase economic growth and create jobs for everyone else—a concept known as trickle-down economics.[27] Instead, tax cuts for the wealthy and corporations will undermine economic growth and eliminate middle-class jobs. Tax cuts will result in cuts to programs such as Medicaid, education, food assistance, infrastructure, and scientific research—hollowing out investments that have a clear positive impact on economic growth.[28]

Conclusion

Congress will make some of its most important decisions about tax policy in the budget resolution, before lawmakers turn to the tax bill itself. And while some congressional leaders have said that they support revenue-neutral tax reform, the reconciliation instructions in the budget resolution will test whether rhetorical support for revenue-neutral tax reform translates into a real commitment to this policy goal, or whether Congress simply intends to pass tax cuts for the wealthy and corporations.

Those tax cuts could be paired with cuts to programs for working families in the same legislation. Or the resulting budget deficits could be used as leverage to cut those same programs later. The bottom line is that if Congress passes a tax cut for the rich financed by either budget deficits or spending cuts—or uses both pathways for even larger tax cuts—the American people will be left holding the bag.

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Endnotes

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