INFORMED BUDGETEER

TREASURY REPORT STUDENT LOAN RATES

- The Treasury Department on February 26, released its long awaited report concerning upcoming interest rate change for student loans. Beginning July 1, 1998 interest rates for new student loans will be set at the 10- year bond rate, +1%. (*Bulletin* estimates this to be about 7.1%.) This change was enacted as part of the Student Loan Reform Act of 1993, (part of OBRA 1993). The rate is currently based on the 91 day T bill + 2.5% in-school and T bill +3.1% during repayment. (*Bulletin* estimates this to be about 7.1%.)

- Some private and government economists have sounded the alarm that the scheduled shift from the 91-day T bill to the 10-year bond as a basis for setting student loan rates will result in significant loan access problems in the Federal Family Education Loan program (FFEL) because student loans will have little or no profit to lenders in the private sector.

- The Treasury report acknowledges that basing student loan interest rates on the 10 -year bond rate is inefficient and will not provide adequate returns to lenders to maintain a stable FFEL program. The report further states, however, that their analysis shows that the rates of return under the current T-bill structure are "too generous".

- Treasury only looked at "large" lenders in their report, but posits that these lenders could absorb yield reductions between 47 and 82 basis points and still remain in the program. The report does not address the issue of whether all students could continue to receive FFEL loans if they so choose, or if yield reductions at or beyond these levels will result in access problems for borrowers considered to be at greater risk for default. Further, the Treasury report makes no specific recommendations with respect to the July 1, 1998 scheduled change.

- One noteworthy issue raised in Treasury's report is their acknowledgment of "difficulties with regulatory determination of student loan interest rates" and that a more market-based approach for determining these rates, such as an auction system, could be considered." In other words, when the market sets the interest rates for these loans, we will know what rate of return is essential for lenders to participate in the program.

✎For a complete copy of The Financial Viability of the Government- Guaranteed Student Loan Program visit our website at: www.senate.gov/~budget/republican.

GAO UPDATES LONG-TERM BUDGET PROJECTIONS

- The General Accounting Office presented updated long-term projections of the federal budget at a Senate Budget Committee hearing on February 25.

- In their testimony, GAO emphasized that their budget simulations are not forecasts but indications of the general direction of the budget and economy based on what we know today. Nonetheless, a long-term perspective on the budget is important because some changes in government policies are best phased in over long periods of time and decision makers need some understanding about long-term cost consequences.

- GAO's simulations indicate that the prospect of budget surpluses over the next decade has substantially improved the long-term budget picture. In prior simulations (1992 and 1995), GAO projected budget deficits of 10% of GDP by no later than 2016. Now, GAO's model shows the budget in surplus until about 2013, and deficits do not reach 10% of GDP until 2040.

- Although improved, the long-term budget outlook remains a problem because of the coming retirement of the baby boom generation. Even the prospect of budget surpluses for a decade or more early in the 21st century is not enough to offset the rapidly growing aging population and the relative decline of workers. Between 1997 and 2030, the number of workers per Social Security beneficiary is projected to drop from 3.3 to 2.0, a decline of nearly 40%. With growing Social Security, Medicare, and Medicaid costs, by 2040 debt held by the public would reach 100% of GDP, the highest since World War II.

- But GAO also makes it clear that, without the projected surpluses over the next 15 years, the long-term outlook would be considerably worse. Under a scenario in which the near-term surpluses are lost through spending increases or tax reductions, GAO projects that budget deficits would reach 100% of GDP by 2033, or eight years earlier than if the surpluses had been used to retire debt.

LIV: RULED UNCONSTITUTIONAL IN FEDERAL DISTRICT COURT

- On February 12, 1998 Judge Thomas F. Hogan of the United States Federal District Court for the District of Columbia ruled that the Line Item Veto is unconstitutional because it violates the procedural requirements of Article I of the Constitution (the Presentment Clause) and the concept of balance of powers. He wrote: "because the Line Item Veto Act impermissibly violates the central tenets of our system of government, it cannot stand."

- This ruling resolved the litigation that arose as a result of the President's cancellation of two provisions which were included in last year's reconciliation bill. Originally three plaintiffs filed suit and the cases were consolidated. One group of plaintiffs, the National Treasury Employees Union settled their case late last year. In that case, the Administration conceded that the cancellation authority had been improperly used. The remaining plaintiffs, the City of New York and the Potato Growers proceeded and oral arguments were heard in January.

- In the Byrd v. Raines, decision last summer, the Supreme Court held that members of Congress lacked standing, particularly in the absence of any exercise by of the item veto authority. Consequently, the Court never reached the constitutional question in that case. In this decision, the District Court found that both plaintiffs possessed the requisite standing. The Court felt that the two provisions of law in question had granted a specific benefit to each of the plaintiffs and that the President's cancellations took those benefits away - thus constituting a sufficient injury for the Court to find standing.

- At issue in City of New York, et al. v. Clinton, was the President's cancellation of section 4722© of the Balanced Budget Act of 1997 (BBA). This provision was an "item of new direct spending" under the LIV Act and resolved an issue between the State of New York and HCFA in favor of the State. At issue was whether state expenditures derived from certain state health care provider taxes qualify for Medicaid reimbursement.

- Snake River Potato Growers, Inc., et al. v. Rubin, called into question the President's cancellation of section 968 of the Taxpayers Relief Act of 1997. This provision was a "limited tax benefit" under the LIV Act. It would have allowed the owner of the stock of a qualified agricultural refiner or processor to defer recognition of capital gains on the sale of such stock to an eligible farmers' cooperative. The plaintiffs in this case, argued that they were potential purchasers.

- In declaring the LIV unconstitutional, the Court granted the plaintiffs' motions for summary judgment and thus issued what is known as a declaratory judgment. Because the plaintiffs did not seek, the Court did not enter any injunction. This means that at this point no one (i.e the Administration) has been ordered to take any particular action (i.e. release any funds).
- The Justice Department has filed its notice of appeal and motion to expedite the proceedings. It is expected that the Supreme Court will take up these items at its conference on February 27. If so, we

may have a briefing and argument schedule by later this week. If the Court adopts Justice's proposed schedule, briefs will be due in April and oral arguments will be held by the end of April. Such a schedule would permit the Court to issue a ruling before it recesses in June. Assuming that the Supreme Court agrees that the plaintiffs have standing, which seems much more likely this time around, the Court will resolve the constitutional question.

- In the mean time, what becomes of the canceled items? To date, the Justice Department is divided as to the effect of the ruling on previously canceled items. With respect to the items in the Military Construction bill, it is out of their hands. These should now be available because of the Congress' override of the President's veto. With respect to the New York Medicaid issue and the farmers' cooperative tax provision, one would expect that all parties in those cases would withhold any further action until the Supreme Court resolves the appeal. That leaves a variety of appropriations (representing approximately $101 million in outlays) and one limited tax benefit (affecting insurance companies and representing approximately $23 million in revenues in FY '98) somewhat in limbo.

- Even if the Supreme Court rules by June, and assuming it upholds the decision and finds the LIV to be unconstitutional, the fiscal year will be three-quarters over. The question then will be whether or not the Court's ruling should be applied retroactively so as to reinstate the canceled items (note, that some of these funds are "no-year" money and thus could still be expended despite the lateness in the fiscal year). Because there have been instances where the effect of a ruling was not retroactively applied, such as in the Miranda case, hopefully the Court would address the issue in its ruling.

- Without such guidance from the Court, this could place the Administration in a sticky situation in an election year: withhold the funds because the Court does not specifically order their release - despite the clear intent of the ruling and the likelihood of a unified budget surplus this year; or release the funds - despite the fact that by canceling them in the first place, the Administration felt the spending was not appropriate.

- The Article I Question: In finding that the Act violates Article I, the Court felt that the cancellation authority violates the concepts of bicameral passage and presentment by producing laws (i.e. laws without the canceled items) without following these necessary procedures.

- In rejecting arguments that the Act does not "veto" anything and that the law remains the same after a cancellation - only the spending does not occur - the Court went so far as to quote the old adage: When I see a bird that walks like a duck and swims like a duck and quacks like a duck, I call it a duck.

- The Separation of Powers Question: The Court completely rejected the arguments that the Act should be evaluated in light of delegation jurisprudence. The Court felt that lawmaking is purely a congressional/legislative power and may not under any circumstances be delegated - regardless of how narrowly tailored the delegation is.

- The Court acknowledged that Congress may delegate certain rulemaking authority to the other branches of government; but only so long as the authority so delegated is an appropriate one for that branch. The opinion is very clear, that lawmaking is not something that may be delegated.

- Although the supporters of the Line Item Veto have always argued that the cancellation authority was not the making of law but rather the execution of it -- in that the effect of the Act is to make all spending subject to the discretion of the President for 5 days -- it seems that the Court just could not get past the feeling that cancellation was an act of legislating rather than executing.

ECONOMICS

FEDERAL RESERVE'S MONETARY REPORT TO CONGRESS

- Chairman Greenspan recently presented the Federal Reserve's biannual economic report to Congress. While noting many factors behind today's favorable economic backdrop, he stressed that the recent rise in productivity growth has been crucial in offsetting the inflationary effects of rising wages and thus permitting higher, sustainable growth.

- Since 1995, productivity has risen at a 1.8% annualized pace, versus an historical average of 1.1%. The Chairman believes this partly reflects a rise in trend productivity growth and is not solely a function of the business cycle.

- Despite favorable underlying momentum, the Fed expects growth to slow in 1998 as strong domestic demand is tempered by Asia's negative impact on US net exports.

- The Fed notes that "the outlook for 1998 is clouded with a greater-than usual degree of uncertainty". In addition to Asia, Greenspan expressed concerns over: 1) recent aggressive bank loan extension and high equity prices, 2) the prospects of a rise in protectionist or isolationist sentiment, and 3) complacency about inflation.

- On a brighter note, however, Greenspan noted that today's stable economic backdrop should make the economy less vulnerable to whatever adverse shock might arise.

- He also complimented Congress and the Administration for their deficit reduction efforts, arguing that this was a factor behind recent declines in long-term interest rates. However, he warned that entitlement reform must be undertaken to ensure that this favorable trend continues.

- The Fed's central tendency forecasts are roughly in line with OMB's and CBO's, although CBO is slightly more pessimistic on inflation.

1998 FORECASTS
(in Percent)

	Fed Reserve*	OMB	CBO
Growth, Q4/Q4			
Nominal GDP	3.75 - 4.5	4.0	4.5
Real GDP	2.0 - 2.75	2.0	2.3
CPI	1.75 - 2.25	2.2	2.4
Average Level, Q4			
Unemployment Rate	4.75	5.0	4.9

*Central Tendency

CALENDAR

March 4: Preliminary CBO Estimates of President's FY 199 Budget.

INFORMED BUDGETEER

TREASURY REPORT STUDENT LOAN RATES

- The Treasury Department on February 26, released its long awaited report concerning upcoming interest rate change for student loans. Beginning July 1, 1998 interest rates for new student loans will be set at the 10- year bond rate, +1%. (*Bulletin* estimates this to be about 7.1%.) This change was enacted as part of the Student Loan Reform Act of 1993, (part of OBRA 1993). The rate is currently based on the 91 day T bill + 2.5% in-school and T bill +3.1% during repayment. (*Bulletin* estimates this to be about 7.1%.)

- Some private and government economists have sounded the alarm that the scheduled shift from the 91-day T bill to the 10-year bond as a basis for setting student loan rates will result in significant loan access problems in the Federal Family Education Loan program (FFEL) because student loans will have little or no profit to lenders in the private sector.

- The Treasury report acknowledges that basing student loan interest rates on the 10 -year bond rate is inefficient and will not provide adequate returns to lenders to maintain a stable FFEL program. The report further states, however, that their analysis shows that the rates of return under the current T-bill structure are "too generous".

- Treasury only looked at "large" lenders in their report, but posits that these lenders could absorb yield reductions between 47 and 82 basis points and still remain in the program. The report does not address the issue of whether all students could continue to receive FFEL loans if they so choose, or if yield reductions at or beyond these levels will result in access problems for borrowers considered to be at greater risk for default. Further, the Treasury report makes no specific recommendations with respect to the July 1, 1998 scheduled change.

- One noteworthy issue raised in Treasury's report is their acknowledgment of "difficulties with regulatory determination of student loan interest rates" and that a more market-based approach for determining these rates, such as an auction system, could be considered." In other words, when the market sets the interest rates for these loans, we will know what rate of return is essential for lenders to participate in the program.

✎For a complete copy of The Financial Viability of the Government- Guaranteed Student Loan Program visit our website at: www.senate.gov/~budget/republican.

GAO UPDATES LONG-TERM BUDGET PROJECTIONS

- The General Accounting Office presented updated long-term projections of the federal budget at a Senate Budget Committee hearing on February 25.

- In their testimony, GAO emphasized that their budget simulations are not forecasts but indications of the general direction of the budget and economy based on what we know today. Nonetheless, a long-term perspective on the budget is important because some changes in government policies are best phased in over long periods of time and decision makers need some understanding about long-term cost consequences.

- GAO's simulations indicate that the prospect of budget surpluses over the next decade has substantially improved the long-term budget picture. In prior simulations (1992 and 1995), GAO projected budget deficits of 10% of GDP by no later than 2016. Now, GAO's model shows the budget in surplus until about 2013, and deficits do not reach 10% of GDP until 2040.

- Although improved, the long-term budget outlook remains a problem because of the coming retirement of the baby boom generation. Even the prospect of budget surpluses for a decade or more early in the 21st century is not enough to offset the rapidly growing aging population and the relative decline of workers. Between 1997 and 2030, the number of workers per Social Security beneficiary is projected to drop from 3.3 to 2.0, a decline of nearly 40%. With growing Social Security, Medicare, and Medicaid costs, by 2040 debt held by the public would reach 100% of GDP, the highest since World War II.

- But GAO also makes it clear that, without the projected surpluses over the next 15 years, the long-term outlook would be considerably worse. Under a scenario in which the near-term surpluses are lost through spending increases or tax reductions, GAO projects that budget deficits would reach 100% of GDP by 2033, or eight years earlier than if the surpluses had been used to retire debt.

LIV: RULED UNCONSTITUTIONAL IN FEDERAL DISTRICT COURT

- On February 12, 1998 Judge Thomas F. Hogan of the United States Federal District Court for the District of Columbia ruled that the Line Item Veto is unconstitutional because it violates the procedural requirements of Article I of the Constitution (the Presentment Clause) and the concept of balance of powers. He wrote: "because the Line Item Veto Act impermissibly violates the central tenets of our system of government, it cannot stand."

- This ruling resolved the litigation that arose as a result of the President's cancellation of two provisions which were included in last year's reconciliation bill. Originally three plaintiffs filed suit and the cases were consolidated. One group of plaintiffs, the National Treasury Employees Union settled their case late last year. In that case, the Administration conceded that the cancellation authority had been improperly used. The remaining plaintiffs, the City of New York and the Potato Growers proceeded and oral arguments were heard in January.

- In the Byrd v. Raines, decision last summer, the Supreme Court held that members of Congress lacked standing, particularly in the absence of any exercise by of the item veto authority. Consequently, the Court never reached the constitutional question in that case. In this decision, the District Court found that both plaintiffs possessed the requisite standing. The Court felt that the two provisions of law in question had granted a specific benefit to each of the plaintiffs and that the President's cancellations took those benefits away - thus constituting a sufficient injury for the Court to find standing.

- At issue in City of New York, et al. v. Clinton, was the President's cancellation of section 4722© of the Balanced Budget Act of 1997 (BBA). This provision was an "item of new direct spending" under the LIV Act and resolved an issue between the State of New York and HCFA in favor of the State. At issue was whether state expenditures derived from certain state health care provider taxes qualify for Medicaid reimbursement.

- Snake River Potato Growers, Inc., et al. v. Rubin, called into question the President's cancellation of section 968 of the Taxpayers Relief Act of 1997. This provision was a "limited tax benefit" under the LIV Act. It would have allowed the owner of the stock of a qualified agricultural refiner or processor to defer recognition of capital gains on the sale of such stock to an eligible farmers' cooperative. The plaintiffs in this case, argued that they were potential purchasers.

- In declaring the LIV unconstitutional, the Court granted the plaintiffs' motions for summary judgment and thus issued what is known as a declaratory judgment. Because the plaintiffs did not seek, the Court did not enter any injunction. This means that at this point no one (i.e the Administration) has been ordered to take any particular action (i.e. release any funds).
- The Justice Department has filed its notice of appeal and motion to expedite the proceedings. It is expected that the Supreme Court will take up these items at its conference on February 27. If so, we

may have a briefing and argument schedule by later this week. If the Court adopts Justice's proposed schedule, briefs will be due in April and oral arguments will be held by the end of April. Such a schedule would permit the Court to issue a ruling before it recesses in June. Assuming that the Supreme Court agrees that the plaintiffs have standing, which seems much more likely this time around, the Court will resolve the constitutional question.

- In the mean time, what becomes of the canceled items? To date, the Justice Department is divided as to the effect of the ruling on previously canceled items. With respect to the items in the Military Construction bill, it is out of their hands. These should now be available because of the Congress' override of the President's veto. With respect to the New York Medicaid issue and the farmers' cooperative tax provision, one would expect that all parties in those cases would withhold any further action until the Supreme Court resolves the appeal. That leaves a variety of appropriations (representing approximately $101 million in outlays) and one limited tax benefit (affecting insurance companies and representing approximately $23 million in revenues in FY '98) somewhat in limbo.

- Even if the Supreme Court rules by June, and assuming it upholds the decision and finds the LIV to be unconstitutional, the fiscal year will be three-quarters over. The question then will be whether or not the Court's ruling should be applied retroactively so as to reinstate the canceled items (note, that some of these funds are "no-year" money and thus could still be expended despite the lateness in the fiscal year). Because there have been instances where the effect of a ruling was not retroactively applied, such as in the Miranda case, hopefully the Court would address the issue in its ruling.

- Without such guidance from the Court, this could place the Administration in a sticky situation in an election year: withhold the funds because the Court does not specifically order their release - despite the clear intent of the ruling and the likelihood of a unified budget surplus this year; or release the funds - despite the fact that by canceling them in the first place, the Administration felt the spending was not appropriate.

- The Article I Question: In finding that the Act violates Article I, the Court felt that the cancellation authority violates the concepts of bicameral passage and presentment by producing laws (i.e. laws without the canceled items) without following these necessary procedures.

- In rejecting arguments that the Act does not "veto" anything and that the law remains the same after a cancellation - only the spending does not occur - the Court went so far as to quote the old adage: When I see a bird that walks like a duck and swims like a duck and quacks like a duck, I call it a duck.

- The Separation of Powers Question: The Court completely rejected the arguments that the Act should be evaluated in light of delegation jurisprudence. The Court felt that lawmaking is purely a congressional/legislative power and may not under any circumstances be delegated - regardless of how narrowly tailored the delegation is.

- The Court acknowledged that Congress may delegate certain rulemaking authority to the other branches of government; but only so long as the authority so delegated is an appropriate one for that branch. The opinion is very clear, that lawmaking is not something that may be delegated.

- Although the supporters of the Line Item Veto have always argued that the cancellation authority was not the making of law but rather the execution of it -- in that the effect of the Act is to make all spending subject to the discretion of the President for 5 days -- it seems that the Court just could not get past the feeling that cancellation was an act of legislating rather than executing.

ECONOMICS

FEDERAL RESERVE'S MONETARY REPORT TO CONGRESS

- Chairman Greenspan recently presented the Federal Reserve's biannual economic report to Congress. While noting many factors behind today's favorable economic backdrop, he stressed that the recent rise in productivity growth has been crucial in offsetting the inflationary effects of rising wages and thus permitting higher, sustainable growth.

- Since 1995, productivity has risen at a 1.8% annualized pace, versus an historical average of 1.1%. The Chairman believes this partly reflects a rise in trend productivity growth and is not solely a function of the business cycle.

- Despite favorable underlying momentum, the Fed expects growth to slow in 1998 as strong domestic demand is tempered by Asia's negative impact on US net exports.

- The Fed notes that "the outlook for 1998 is clouded with a greater-than usual degree of uncertainty". In addition to Asia, Greenspan expressed concerns over: 1) recent aggressive bank loan extension and high equity prices, 2) the prospects of a rise in protectionist or isolationist sentiment, and 3) complacency about inflation.

- On a brighter note, however, Greenspan noted that today's stable economic backdrop should make the economy less vulnerable to whatever adverse shock might arise.

- He also complimented Congress and the Administration for their deficit reduction efforts, arguing that this was a factor behind recent declines in long-term interest rates. However, he warned that entitlement reform must be undertaken to ensure that this favorable trend continues.

- The Fed's central tendency forecasts are roughly in line with OMB's and CBO's, although CBO is slightly more pessimistic on inflation.

1998 FORECASTS
(in Percent)

	Fed Reserve*	OMB	CBO
Growth, Q4/Q4			
Nominal GDP	3.75 - 4.5	4.0	4.5
Real GDP	2.0 - 2.75	2.0	2.3
CPI	1.75 - 2.25	2.2	2.4
Average Level, Q4			
Unemployment Rate	4.75	5.0	4.9

*Central Tendency

CALENDAR

March 4: Preliminary CBO Estimates of President's FY 199 Budget.