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Budget Resolutions Set Stage for Costly Reconciliation

Summary

- On February 21st, the Senate passed a budget resolution with reconciliation instructions. The House followed suit with its own budget resolution on February 25th that provided separate reconciliation instructions
- Historically, reconciliation bills have taken an average of 155 days to enact from the date a budget resolution is passed. Based on that precedent, it would be reasonable to assume this budget resolution process could extend into late July 2025 (which also loosely coincides with early estimates of the debt ceiling "x-date")
- The top-line figures outlined in each budget resolution support elevated longer-dated Treasury yields, all else equal
    - The Senate and House budget resolutions call for reconciliation that increases the budget deficit by up to $500 billion and $4 trillion over a 10-year horizon, respectively, with the most important differences being the House's extension of the 2017 Trump tax cuts (the Senate punts until later this year) and the Senate's lack of offsets
    - The Committee for a Responsible Federal Budget estimates that reconciliation will result in a debt-to-GDP ratio of ~125% compared to ~115% under current law by 2034
- The House proposes lifting the debt ceiling in a reconciliation bill. If the debt ceiling is not addressed in reconciliation, it will likely need to be addressed in a must-pass bill requiring bipartisan support

The Senate and House each recently passed budget resolutions following a protracted debate in the House with fiscal hawks about cost savings. Although these resolutions don't actually do anything to the budget today, they pave the way for the reconciliation bill(s) that could ultimately impact the deficit and Treasury issuance. *[For those unfamiliar with the basics of budget reconciliation, you can read more about that process at the end of this report.]*

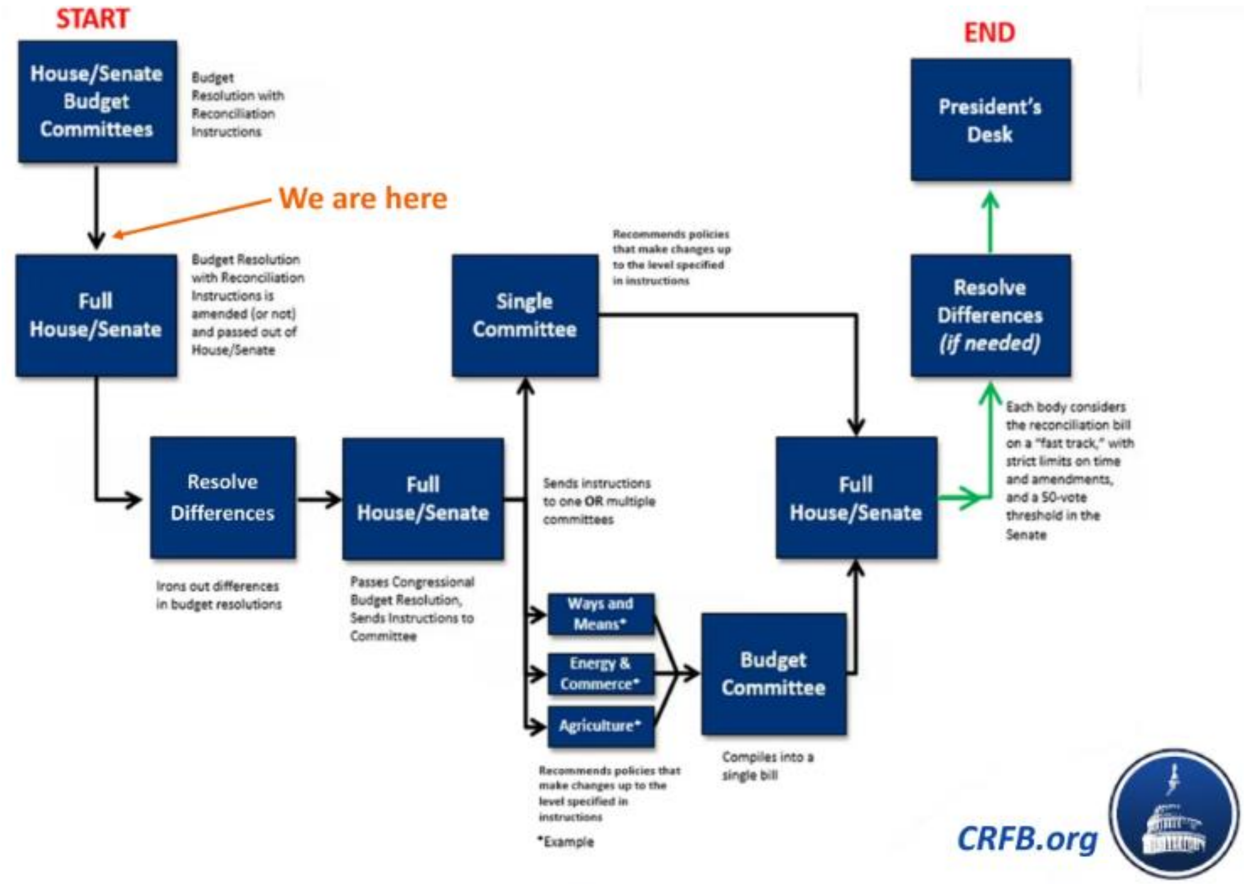
So, you may be wondering – if they don't really do anything, what do these budget resolutions tell us about the budget reconciliation bills to come and what are the next steps?

<u>Reconciliation Process</u>

Graphic 1 below from the Committee for a Responsible Federal Budget provides a flow chart showing specific steps in the budget reconciliation process. Step one of the process is exactly what happened over the last few weeks – Congress passed a budget resolution that instructs congressional committees to draft legislation that either increases or decreases the deficit by the amounts specified in the resolution (see graphic 3 for those amounts by committee).

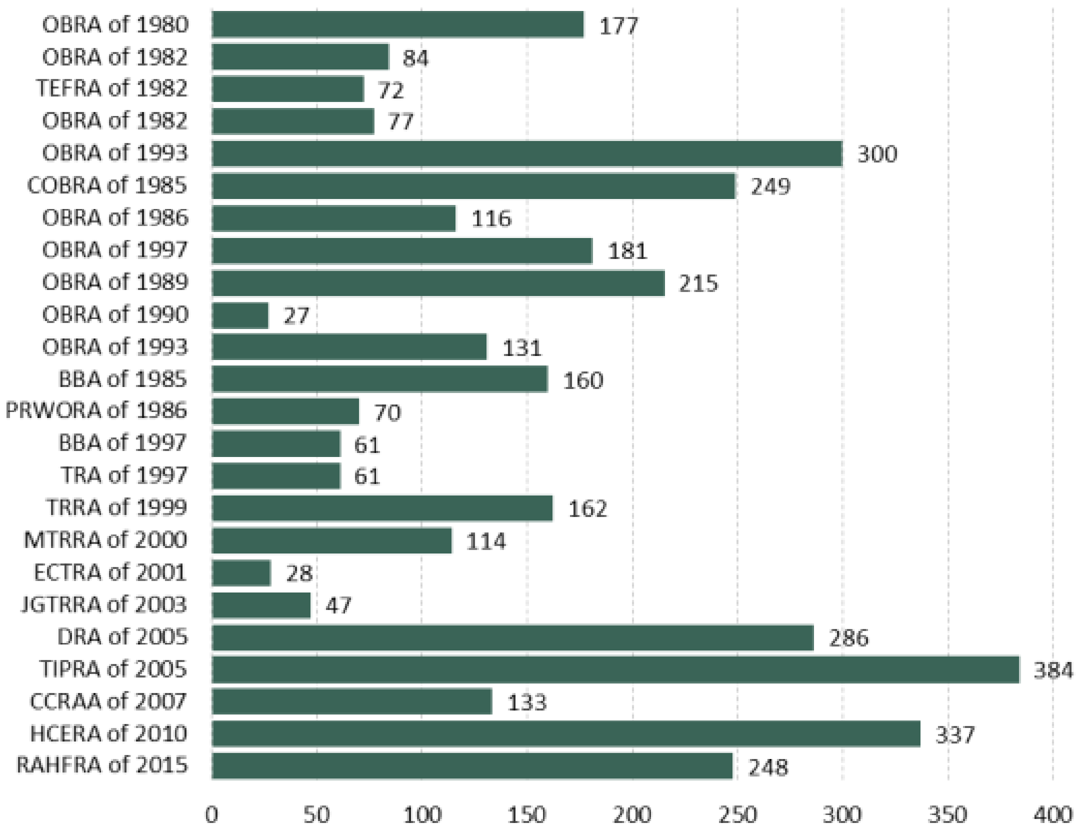
Now, the GOP has to make a final decision between the House's one-reconciliation bill approach (that addresses immigration, energy, military, and tax all at once) and the Senate's two-reconciliation bill approach (that first addresses immigration, energy, and military and later separately addresses tax). Then, congressional committees will draft detailed legislation that conforms to what was outlined in the budget resolution. In the Senate, the minority party will have the opportunity to raise points of order against specific provisions and request that the (non-partisan, un-elected, career staffer) Senate Parliamentarian rule against the provision in question for removal from the bill. [As a side note, one could argue that the Senate Parliamentarian has a significant amount of power on policy for an unelected official].

<u>Graphic 1: Budget Reconciliation Process/Timeline</u>



How long it takes for the House and Senate to move through these steps depends on the: i) overall urgency (any imminently expiring provisions or debt ceiling lapses?); ii) affected policy areas (debates on what to include); and iii) size of the GOP's majority (smaller majorities may delay the process). Between 1980 and 2016, it took an average of 155 days to enact a reconciliation bill from the time the respective budget resolution was adopted (Graphic 2). Applying this historical precedent, it is possible that the budget reconciliation process extends into the end of July 2025. That timeline would coincide with early estimates of the debt ceiling "x-date."

Graphic 2: Number of Days (from Budget Resolution Adoption) to Enact Reconciliation Bills 1980-2016 (Congressional Research Service)



Additionally, the House started this Congress with its smallest majority since 1931. As a result, smaller factions within the GOP can wield more power than normal, such as "blue state"/swing state Republicans that are looking to push back on specific tax policies that disproportionately affect their constituents (state and local tax deduction cap from 2017). In the Senate, there are also a few more independent-minded members that could potentially push back against the House's more aggressive plans similar to what we've seen on some Presidential nominees (for example, Senators Murkowski – AK, Collins – ME, McConnell – KY, Curtis – UT, and Cassidy – LA). It will take some time to work through each members' issues.

Bottom line: there is likely still some time before this reconciliation bill is completed.

Budget Resolutions Estimated Deficit Impact

Graphic 3: House and Senate Budget Resolution Comparison (H.Con.Res. 14 and S.Con.Res. 7)

Committee	Senate	House
	Reduce the Deficit by "At Least" ($ billions)	
Ag, Nutrition, and Forestry	(1)	(230)
Energy and Natural Resources	(1)	(880)
Environment and Public Works	(1)	(1)
Finance	(1)	-
Health, Education, Labor, Pensions	(1)	(330)
Financial Services	-	(1)
Oversight and Gov Reform	-	(50)
Transportation/Infrastructure	-	(10)
Subtotal	**(5)**	**(1,502)**
Committee	**Increase the Deficit by "No More Than" ($ billions)**	
Armed Services	150	100
Commerce, Science, and Trans	20	-
Homeland Security and Government	175	90
Judiciary	175	110
Ways and Means	-	4,500
Subtotal	**520**	**4,800**
Net Identified Deficit Impact	**515**	**3,298**

Senate is vague about its savings and opts for language setting a $1 billion floor. Meanwhile, the House includes larger numbers to appease fiscal hawks.

Military

"Border security"

Trump tax cuts

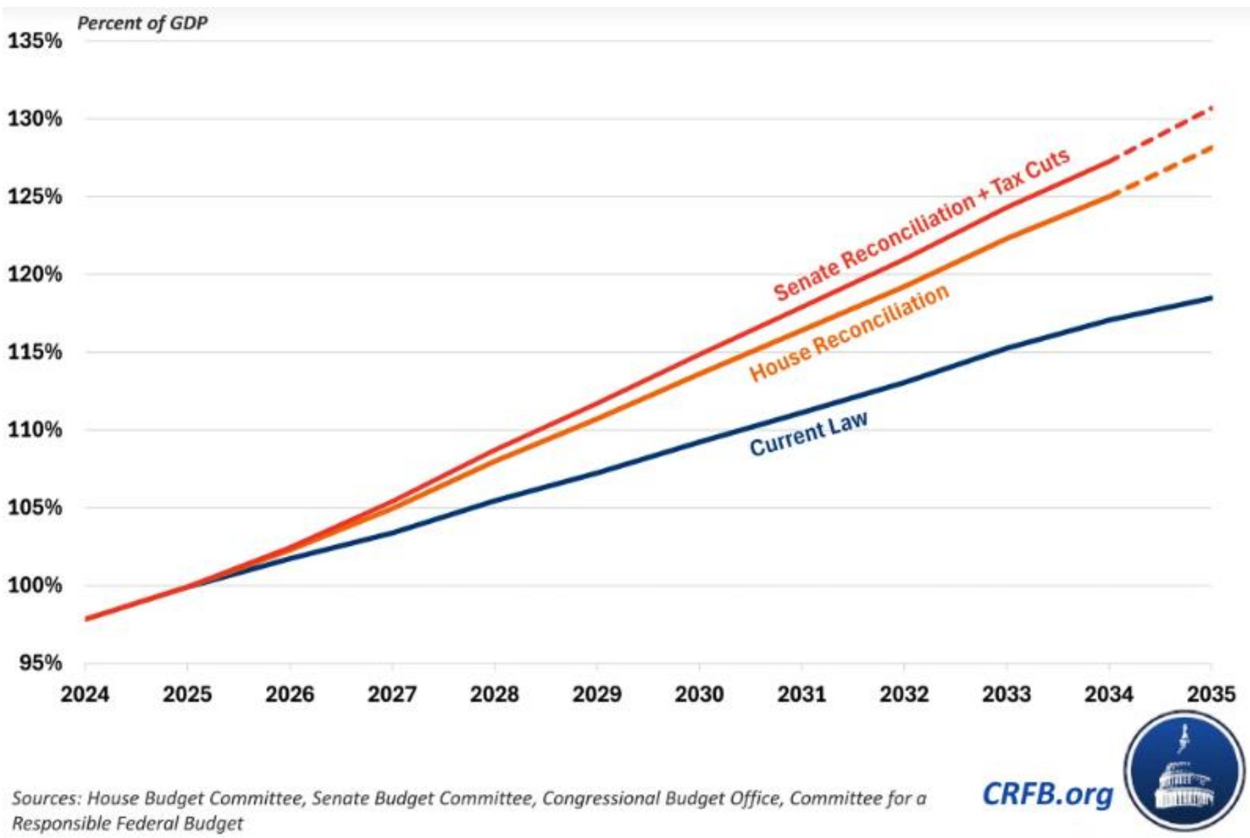
The biggest differences between the Senate and House budget resolutions are:

- Tax provisions – the House extends/expands Trump's 2017 tax cuts whereas the Senate punts them to later this year. Adding the Trump tax cuts drives the cost up by approximately $4.5 trillion over 10 years before considering offsets (ignoring budget scoring techniques described on the last page of this note). At some point this year, those tax cuts will be delivered regardless of today's choice between a one- or two-bill approach
- Savings – the Senate defaulted to legislative language directing "at least" $1 billion in deficit reduction from five committees each. That technically leaves some flexibility to find more savings, including possibly fully offsetting the cost. However, don't count on it (more on that in the next bullet). Meanwhile, the House had to include larger minimum savings to appease fiscal hawks and get the budget resolution over the finish line
- Cost estimate "baseline" -- after the House budget resolution vote, Senate Finance Chairman Mike Crapo said that the House approach would need to be changed to apply the "current policy" baseline to move forward. No surprise – that reduces the perceived cost over the budget horizon, but not necessarily the ultimate deficit impact (a brief description of current law and current policy baselines are included at the end)
- Debt limit – the House budget resolution proposes raising the debt limit by $4 trillion. The Senate punts that issue to later, which outside of reconciliation would likely need to be

addressed in must-pass legislation, such as a government funding bill. Treasury bill yields around the estimated “x-date” are already starting to move higher

The Congressional Budget Office, which functions as the official “scorekeeper” of legislative changes, probably won’t provide official cost estimates on anything until an actual reconciliation bill is drafted. For now, think tanks such as Committee for a Responsible Federal Budget (CRFB), Bipartisan Policy Center (BPC), Tax Foundation, Tax Policy Center, and others have attempted to estimate the deficit impact (Graphic 4 shows CRFB’s estimate of the levels in each resolution).

Graphic 4: Committee for a Responsible Federal Budget Estimate of Changes to Debt-to-GDP[1]



Both resolutions are far from deficit neutral, which is concerning given higher Treasury issuance in recent years amid wider deficits (~6% of GDP as of the end of 2024[2]). Taken together, without adequate offsets, the levels set out in this budget resolution are supportive of elevated longer-dated Treasury yields, all else equal.

[1] CRFB: “Chartbook: Reconciliation 101,” February 28, 2025
[2] CBO: “Monthly Budget Review: Summary for Fiscal Year 2024,” November 8, 2024

What to Watch in Budget Reconciliation

As the reconciliation process continues, below are a few key items to be watching:

- One vs two bill approach -- Senate Republicans think it makes more sense to run two different bills -- notch an early easier win with a border/energy reconciliation bill and follow later this year with a more contentious tax-related reconciliation bill. However, that increases the risk of failing to pass one of the measures
- Real offsets – we would welcome any effort by the House or Senate to pursue real cost savings to reduce the deficit impact. Unfortunately, we aren't optimistic this process will avoid budget gimmicks that reduce the perceived cost, such as claiming higher economic growth will completely offset the costs or using a "current policy" baseline
- SALT cap adjustments -- demands by "blue state" House Republicans to further relax the state and local tax deduction (SALT) cap either by raising or eliminating it (estimated cost between $225 billion and $1 trillion, respectively, over the horizon[3])
- Efforts to expand the 2017 Trump tax cuts – on the campaign trail, Trump went further than his 2017 tax cuts by promising to exempt Social Security benefits, tips, and overtime from taxes, as well as lower the corporate tax rate
- President Trump wildcard -- the President has historically been known to add last minute requests, such as when he tried to add $2,000 direct payments to individuals in the December 2020 COVID relief bill after his administration had already successfully negotiated/completed a bill

Other Issues to Monitor Related to U.S. Debt

A few other issues we will be monitoring that are tangential to budget reconciliation and/or the deficit:

- Changes in Treasury Secretary Bessent's thinking on Treasury issuance – Treasury Secretary Bessent recently indicated the Treasury is a "long way off" from increasing longer-dated Treasury issuance opting to maintain the approach of recent years with higher Treasury bill issuance. He had previously been skeptical of his predecessor's preference for higher Treasury bill issuance (as have other Trump officials like Stephen Miran)
- Quarterly Treasury refundings -- related to the above, the market isn't expecting changes to Treasury coupon issuance until later this year after Congress gets through the debt ceiling expiration and the reconciliation bill is enacted. However, expectations around issuance will be increasingly important once those legislative hurdles are passed
- Debt limit -- if the House approach to reconciliation is chosen, the debt limit could be resolved in the reconciliation bill. Similar to what has occurred around other debt ceiling deadlines, Treasury bill issuance is expected to temporarily decline as the Treasury exhausts extraordinary measures and runs down its cash balance closer to the "x-date," which will likely lead to richer

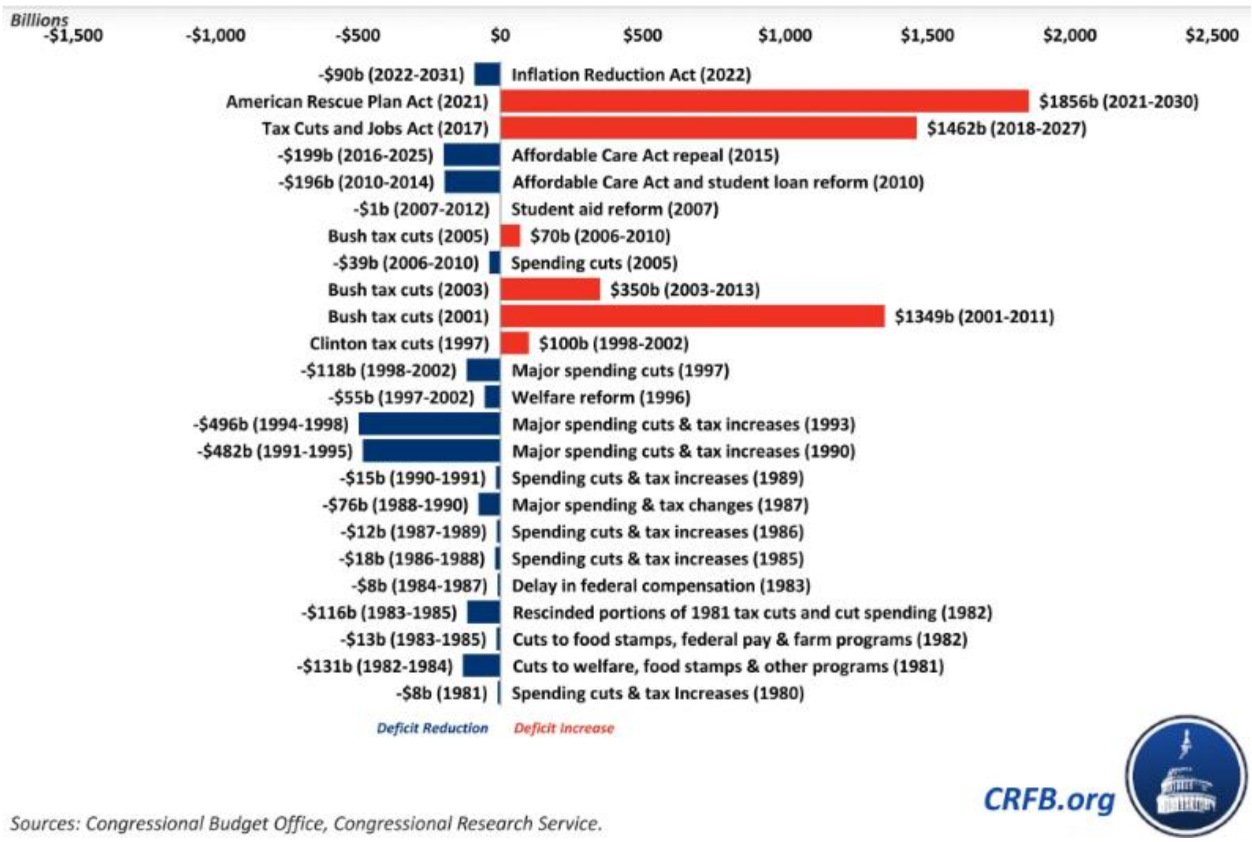
[3] Tax Policy Center: "A $20,000 SALT Cap Would Be Costly And Most Benefit High-Income Households," January 9, 2025

levels (aside from bills maturing around that date). Bill supply and levels should revert to more normal levels once the limit is resolved

Budget Reconciliation Basics

Budget reconciliation is an increasingly important procedural and legislative tool under the Congressional Budget Act of 1974 to move certain types of legislation quickly, primarily by limiting the amount of time of debate on the floor and avoiding the Senate's 60-vote threshold. Between 1980 and 2022, reconciliation has been common and resulted in 23 enacted bills. Recent notable legislation enacted using reconciliation includes the Affordable Care Act (Obamacare), Tax Cuts and Jobs Act (2017 Trump tax cuts), American Rescue Plan Act, and Inflation Reduction Act[4].

Graphic 5: Past Reconciliation Bills and Deficit Impact[5]



There are a few important nuances to consider with respect to reconciliation[6]:

- Subject matter -- reconciliation is only meant to affect policies that change spending, revenues, and/or the debt ceiling. Importantly, anything can technically remain in a reconciliation bill if no senator raises a point of order

[4] House Committee on the Budget: "Budget Reconciliation Explainer," January 10, 2025
[5] CRFB: "Chartbook: Reconciliation 101"
[6] Center on Budget and Policy Priorities: Introduction to Budget Reconciliation," May 6, 2022

- Minority party rights -- related to the above bullet on "subject matter," the minority party in the Senate can challenge "extraneous" provisions under the "Byrd Rule" for removal. Ultimately, the Senate Parliamentarian has the final say on a provision's inclusion or exclusion when challenged by the minority party. Generally, "extraneous" is any provision that: i) increases spending or decreases revenues if the budget impact is "merely incidental"; ii) isn't within the jurisdiction of the committee recommending the provision; iii) raises deficits outside of years covered by the reconciliation bill ("out years"); or iv) changes Society Security's retirement, survivors, or disability costs or revenues. If no senator raises a point of order against an "extraneous" provision, then the provision may remain in the bill. Additionally, the "Byrd Rule" can allow for inclusion of provisions without a budgetary effect if they are determined by the Parliamentarian to be "terms and conditions" for other provisions in the bill that do have a budgetary effect
- Floor debate – reconciliation limits debate to 20 hours (however, there is no limit to the number of amendments leading to what is referred to as a "vote-a-rama" on remaining amendments)
- Amendments – any amendments offered to a reconciliation bill must be "germane" (relevant to the subject matter) to the underlying bill unless waived by a three-fifths majority vote
- Cost estimates – the House resolution appears to rely a "current law" baseline for determining the deficit impact of reconciliation whereas the Senate appears to rely on a "current policy" baseline. Under a "current law" baseline, CBO estimates spending and revenues based on laws enacted through an expiration date, and they are expected to end. In contrast, under a "current policy" baseline, CBO estimates spending and revenues from the assumptions that previously enacted laws with expirations are extended (regardless of the expiration date). As a result, the official cost estimate for a bill applying a "current policy" baseline may appear lower regardless of the actual budgetary impact. This maneuver could give Republicans some breathing room on finding cost savings, but only if fiscal hawks agree.[7]

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[7] Bipartisan Policy Center: "The 2025 Tax Debate: All About That Base(line)," January 15, 2025 and Committee for a Responsible Federal Budget: "'Current Policy Baseline' Gimmick Could Explode the Debt," February 27, 2025