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ANALYSIS OF THE PRESIDENT'S NEW BUDGET

by Robert Greenstein

The nation faces increasingly serious budget problems, but rather than address them, the President's budget would make the problems worse. The net result of the President's proposals would be to make deficits considerably larger than they would be without the proposals, further risking the long-term health of the economy and saddling future generations with even greater amounts of debt.

The proposals in the budget that seek to contain deficits are very limited, and are heavily outweighed by the deficit-increasing proposals. Furthermore, what deficit-constraining proposals are included are disproportionately tilted against lower- and middle-income families, while giving more affluent and powerful constituents a virtual free ride.

The following elements of the budget stand out.

- *Under the budget, tax cuts, especially for the most well-off, emerge as the Administration's highest priority.* The most striking feature of the budget is the Administration's penchant for ever more tax cuts. This is so even though the budget itself projects that federal revenues in 2004 will be at their lowest level since 1950, measured as a share of the economy, and even though the budget data show that the decline in revenues is the principal factor behind the unprecedented shift in the past three years from robust surpluses to large deficits. This raises the question: should providing people who make over $1 million a year with average tax cuts exceeding $100,000 a year be the nation's highest priority?

- *Budget won't cut the deficit in half.* The Administration attempts to wrap the budget in an aura of fiscal responsibility with the claim the budget will cut the deficit in half in five years. This claim is not credible, however. The budget uses a series of stratagems to mask the magnitude of the deficits the nation faces (and the degree to which the budget would make the deficits worse) and to make it appear on paper as though the deficit will be cut in half. The budget omits approximately $160 billion in costs in 2009 (the fifth year) that the Administration itself favors and is expected to propose in future budgets.

- *Budget obscures the long-term deficits.* By showing deficit numbers for only a five-year period, the budget conceals the marked worsening of the deficit expected under Administration policies in the second half of the coming decade. The bulk of the cost of making the 2001 and 2003 tax cuts permanent would occur after 2010, when most of these tax cuts are scheduled to expire.

- *An unbalanced approach to fiscal discipline.* The Administration singles out one part of the budget for tougher treatment — domestic discretionary programs outside homeland security. Taken together, not only would these programs be increased in fiscal 2005 by 0.5 percent or less (a real cut when inflation is taken into account), but the budget includes sharper cuts in these programs down the road, such as a reduction by 2009 of approximately 350,000 in the number of children from low- and moderate-income working families who receive child care assistance, and a reduction as soon as 2005 of as much as 250,000 in the number of low-income families with children and elderly and disabled households that receive housing assistance. The amounts that such cuts save could be saved in other ways that would not create hardship, such as scaling back a fraction of the tax cuts for wealthy households.

- *New budget rules that favor powerful interests.* The Administration proposes new budget rules that would impose fiscal discipline on entitlement programs for middle- and low-income families, but impose no discipline on new tax breaks for high-income families and corporations.

- *Revenue reductions largely explain the grim deficit picture.* The budget ignores the single largest reason for the unprecedented swing in the fiscal situation — the sharp decline in tax revenues. CBO data show that declines in revenues account for three-fourths of the fiscal deterioration since 2000.

Will the Budget Cut the Deficit in Half?

- The budget purports to show the deficit being cut in half by 2009, but meets this goal by omitting about $160 billion in costs in 2009 that the Administration itself intends to propose in future budgets. For example, the budget includes no Alternative Minimum Tax relief after 2005; the budget implicitly assumes that by 2009, some 30 million Americans will be subject to this tax. No observer expects this to happen, and the Administration itself has said it will propose a measure a year from now to provide AMT relief. (If the Administration has changed its tune and does *not* intend to propose AMT relief, then millions of Americans would not receive the tax cuts that the Administration claims its budget would provide them. The Administration cannot have it both ways.)

- The budget also shows no costs for the ongoing war on terrorism after September 30 and fails to include the funding needed in future years to fund fully the Administration's own "Future Year Defense Plan." The Administration has already acknowledged that it plans to submit a supplemental budget request in 2005 (after the election) related to military costs in Iraq and Afghanistan.

- In addition, the budget assumes some savings without an accompanying proposal that would produce the savings. In particular, the budget assumes that all of the $65 billion increase in expenditures over ten years resulting from its refundable health tax credit proposal will be offset in full. But the budget offers no proposal to achieve those savings. (It simply says the Administration will work with Congress on this.)

- When the missing costs are taken into account, the deficit is projected to equal about $400 billion in 2009 — and to be well above the target of cutting the deficit in half.

- The budget also contains cuts in years after 2005 in dozens of domestic programs for which cuts are *not* proposed in 2005, such as Title I education, the National Institute of Health, and the low-income energy assistance program. In fact, the budget contains cuts or freezes in the "out-years" for some programs that the Administration boasts it is expanding, based on its fiscal year 2005 request. Either the out-years numbers are real — in which case, the Administration is proposing an array of cuts that it is not owning up to, including cuts in programs it is claiming credit for expanding — or the numbers in the out-years are for show, with this being one more reason the claim to cut the deficit in half should not be taken seriously.

Other Misleading Elements of the Budget

By showing deficit numbers for only a five-year period, the budget conceals the marked worsening of the deficit expected under Administration policies in the second half of the coming decade. The bulk of the cost of making the 2001 and 2003 tax cuts permanent would occur after 2010, when most of these tax cuts are scheduled to expire. The bulk of the costs from the beginning of the baby boomers' retirement also occur after 2009.

Indeed, making the tax cuts permanent would increase deficits by about $2 trillion over the ten-year period (2005-2014). (This estimate includes the cost of the increased interest payments on the debt and rests upon the common-sense assumption that AMT relief will be extended.) Analysis by the Center and economists at the Brookings Institution shows that if the tax cuts are made permanent, their cost over the next 75 years will be *triple* the entire long-term (i.e., 75-year) shortfall in Social Security.

Yet another deceptive part of the budget relates to the Administration's proposal to create new tax-advantaged savings and investment accounts. This proposal features timing gimmicks that allow it to *raise* substantial revenue over the first five years. But the proposal would cause increasingly large revenue losses after that. Based on past analyses by the Urban-Brookings Tax Policy Center, the proposal ultimately is likely to cost the equivalent of at least $35 billion *a year*.

Cuts in Domestic Discretionary Programs Deeper Than Advertised

The Administration singles out one part of the budget for tougher treatment — domestic discretionary programs outside homeland security. This part of the budget includes education, child care, environmental protection, veterans health, housing, and many other areas. This part of the budget is singled out even though it constitutes just one-sixth of the budget and has changed little in size since 2001.[1]

The budget says that funding for non-defense, non-homeland security discretionary programs would rise by 0.5 percent in fiscal year 2005, a cut when inflation is taken into account. In fact, the 0.5 percent increase appears to overstate the increase in this area; the 0.5 percent increase contains within it a 23 percent increase for international assistance programs (such as the Millennium Challenge Fund) as well as increases in defense spending in agencies outside the Pentagon. (A portion of what is categorized as defense spending in the federal budget is located in other agencies, such as the defense-related nuclear weapons programs of the Energy Department.) Funding for *domestic* discretionary programs outside homeland security and outside of defense would apparently rise by less than 0.5 percent. Insufficient budget data are available at this time to come up with a precise estimate here.

The tougher treatment accorded this part of the budget would have some significant consequences; the budget includes significant cuts in an array of discretionary programs ranging from low-income housing programs to environmental protection. For example, funding for the housing voucher program, the nation's principal low-income housing assistance program, would be more than $1.6 billion short in fiscal year 2005 of the amount needed to continue support for the vouchers in use. Unless other cuts were made (such as by raising rents on the poor families and elderly and disabled people receiving housing assistance), at least 250,000 fewer low-income families and elderly and disabled households would be served.

In addition, funding for discretionary grant programs to state and local governments would decline 1.1 percent in 2005 (a decline of more than two percent after adjusting for inflation). States also would lose state tax revenue as a result of the federal tax cuts in the budget (due to linkages between federal and state tax codes).

States already face about $40 billion in deficits in state fiscal year 2005. The reduction in federal grants to states contained in the Administration's budget would result in a loss of approximately $6 billion more in buying power, which would force many states to institute deeper budget cuts or tax increases.

Yet the total amount of money saved through these cuts and freezes pales in comparison to the size of the tax cuts. Total funding for domestic discretionary programs outside homeland security would be roughly $12 billion below the Congressional Budget Office baseline in fiscal year 2005, a fraction of the cost of the tax cuts. Tax cuts that have been enacted since 2001 and the new tax cuts contained in the budget would cost more than $200 billion in fiscal year 2005. Moreover, the income tax cuts for just the top one percent of households would cost about $45 billion in 2005, or nearly four times the savings from the cuts and freezes in domestic discretionary programs.

The Administration is proposing much deeper cuts in domestic discretionary programs for the years *after* 2005. For example, the budget proposes to fund child care programs for low-income working families during the 2006 to 2009 period *below* its current funding level and

[1] In 2001 domestic discretionary spending outside homeland security made up 3.1 percent of GDP; in 2004 it will equal an estimated 3.3 percent of GDP.

below its proposed 2005 level. The Administration's budget itself contains a table (on page 361 of the *Analytical Perspectives* volume) which shows that the number of children from low-income working families who receive child care assistance would be *cut by 200,000* from its 2004 level (and by 300,000 as compared to the children served in 2003). Moreover, this estimate likely understates the cut in child care, as it uses an assumption that is inconsistent with data provided elsewhere in the budget. The number of children in low-income working families receiving child care assistance more likely would be 367,000 lower in 2009 than in 2004.[2]

The Administration's New Budget Rules: Impose Discipline on Benefits for Middle- and Lower-income Families But Not on Tax Cuts, Including Tax Breaks for Corporations and the Well-off

The budget purports to resurrect the "Pay-As-You-Go" rules that played an important role in moving the nation from deficits to surpluses in the 1990s. But the Administration proposes to structure the resurrected rules in a way that would pervert the rule's original intent. The Pay-As-You-Go rules enacted as part of the 1990 Budget Enforcement Act, and signed into law by the President's father, required that any entitlement expansions *or tax cuts* be fully paid for through offsetting entitlement cuts or tax increases. The Administration is now proposing something quite different.

- Entitlement increases would have to be offset.
- The costs of refundable tax credits — i.e., tax credits for low- and many moderate-income working families — also would have to be offset.
- But the costs of other tax cuts — including the large savings tax breaks in the budget, which would represent a bonanza for the wealthiest individuals in the country — would *not* have to be offset.
- Furthermore, the only offsets that could be used to pay for entitlement improvements would be cuts in other entitlement programs. Savings on the tax side — such as from closing abusive corporate tax shelters or other tax-avoidance scams — could *not* be used to finance entitlement benefit improvements.

For low- and middle-income Americans, government benefits are provided principally through entitlement programs. For high-income people, by contrast, government subsidies are provided primarily through what budget analysts and the Joint Committee on Taxation refer to as "tax expenditures" and Chairman Greenspan has referred to as "tax entitlements." By requiring increases in entitlement programs to be offset but not expansions of tax expenditures, the proposal has reverse "class warfare" aspects.

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[2] The Administration's table assumes that the funding that states allocate to child care programs under the Temporary Assistance for Needy Families block grant will remain constant. Yet elsewhere in the budget, the Administration shows (as CBO does, as well) that overall TANF expenditures will *fall* by $2 billion — or 11 percent — between 2004 and 2009, even before adjusting for inflation. Experience with the TANF program confirms that when TANF expenditures are reduced, TANF expenditures for child care decline. Taking this decline into account yields an estimate that the number of children receiving child care assistance would be about 367,000 lower in 2009 under the Administration's budget than it was in 2004, and 447,000 lower than in 2003.

Apart from that issue, the proposal is highly problematic from a fiscal discipline standpoint. It exempts from the Pay-As-You-Go discipline all increases in tax breaks even though they increase the deficit just as entitlement expansions do. Moreover, if entitlement increases must be offset but tax breaks need not be, an inside-the-beltway industry will develop to deliver entitlement expansions through the tax code, even when that would represent a more costly and inefficient approach.

Tax Cuts, Not Spending Increases, the Main Cause of the Swing from Surpluses to Deficits

By proposing hefty new tax cuts while cutting domestic discretionary programs and establishing new budget enforcement rules that apply to entitlements but not to tax cuts, the budget ignores the principal reason for the unprecedented swing in the past three years from large surpluses to startling deficits — the sharp decline in tax revenues.

- In 2004, revenues will total 15.7 percent of GDP according to the Administration and 15.8 percent according to CBO, the lowest level since 1950.
- Yet, spending in 2004, at 20.2 percent of GDP according to the Administration (and 20.0 percent according to CBO), will not be unusually high; it will be lower than in any year from 1980 through 1996 and slightly below its average level of 20.5 percent over the past 40 years.
- CBO data show, in fact, that declines in revenues account for about *three-fourths* of the fiscal deterioration of the past few years. (See table below.)

What Explains the Shift from Surplus to Deficits?
Federal Expenditures, Revenues, and Fiscal Balance as a Share of GDP

	2000	2004	Change	Share of Change
Expenditures	18.4%	20.0%	1.6%	24%
Revenues	20.9%	15.8%	-5.0%	76%
Surplus (+)/ Deficit (-)	+2.4%	-4.2%	-6.6%	100%

Source: CBO data

While revenues will rise some as the economy recovers, they will average only about 17.1 percent of GDP over the coming decade if the recent tax cuts are extended and AMT relief is continued. (The Administration's budget shows a somewhat higher figure, but that figure is not meaningful, since it assumes the AMT will explode into the middle class and collect tens of billions of dollars of new tax revenue each year.) The 17.1 percent-of-GDP level is below the average revenue levels for *every decade in the second half of the 20th centur*y. It is a dangerously low level for a period in which the baby boomers will begin to retire and deficits will begin to rise toward economically unsustainable levels.