Memo to: Board and Members
From: Susan Tanaka and
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Date: February 6, 1997

SUBJECT: The President's Budget For FY 1998

The Administration will recommend that Congress pass a 5-yearJoint Budget Resolution, including limits for both discretionary and direct spending. Joint resolutions are intended to become law. If Congress passes such a resolution, including caps for discretionary spending and entitlements, rules and procedures to enforce those limits and otherwise hold Congress and the President accountable for any changes to the plan, the United States finally would have a real budget and we could be well on our way toward more responsible fiscal policies for the future**.**

The deficit goes up before it goes down. Last year's deficit was $107 billion, but the deficit under the President's policies, would not drop below $100 billion until the new millennium.

President's FY 1998 budget
OMB Estimates
$ in billions*

	1996	1997	1998	1999	2000	2001	2002	2003	2004	1998-2002 5-Year Totals
Revenues	1,453	1,505	1,567	1,643	1,727	1,808	1,897	1,986	2,189	8,642
Outlays	1,560	1,631	1,688	1,761	1,814	1,845	1,880	1986	2,148	8,987
Deficits	107	126	121	117	87	36	17	**	17	344

* For more detail, see Attachment 6
** Less than $500 million

Even with a $17 billion unified budget surplus in 2002, government would have to borrow $5 billion from the public, for off-budget direct loan activities, primarily student loans. In plain English, that means: if the off-budget credit activities of government were on-budget, the budget would not be in balance.

The deficit is $208 billion higher – over five years (FY 1998 - FY 2002) than it was in the President's last budget. These are not baseline differences between CBO and OMB. This is the President's Budget, on the face of it, based on the Administration's numbers. The economic outlook is improved since last year, otherwise the deficit would be up $239 billion over last year's version. See Attachments 1 and 2.

The Medicare numbers in this budget are virtually identical to last year. The President's proposals would reduce Medicaid spending, below the levels in the President's FY 1997 budget. The Medicaid per capita cap is a carry-over from last year's budget; the additional savings appear to come from changes in disproportionate share payments. Despite all the hoopla over "coming half way" toward the Republican Congress, and despite lower cost projections under current laws and policies, total Medicare spending goes down only $4 billion compared to last year's budget (five years 1998-2002). There is very little new in Medicare policy. The President proposed last year to keep Medicare Part-B premiums at 25% of program costs; and the Administration proposal to shift home health services from the HI Trust Fund to general revenue financing under Part-B, in last year's budget.

Using CBO numbers, the deficit under the President's policies will be about $50 billion in FY 2002. The Administration proposes to end most of their tax cuts, and cut everything but Social Security across-the-board, to get to budget balance using CBO numbers. We understand this will "trigger", much like last year, except that this year's version would cut entitlements as well as discretionary spending.

Comparison of Capped Baselines*

$ in billions

	1997	1998	1999	2000	2001	2002	1998-2002 5-yr. Totals
Congressional Budget Office (January 1997)							
With Fiscal Dividend	124	119	143	158	142	154	716
Without Fiscal Dividend	124	120	147	171	167	188	793
Value of the Dividend	**	-1	-4	-13	-25	-34	-77
Office of Management and Budget (February 1997)							
With Fiscal Dividend	128	114	127	118	99	91	549
Without Fiscal Dividend	128	117	139	140	128	126	650
Value of the Dividend	0	-3	-12	-22	-29	-35	-101
Memo							
Difference between post-dividend baselines: OMB less CBO	4	-5	-16	-40	-43	-63	-167

* Both CBO and OMB baselines reflect the1998 discretionary cap and inflation adjustments for discretionary spending after 1998.

** Less than $500 million

Confusion over economic assumptions and baselines is bound to continue. The Budget points out that Administration forecasts have been more accurate than CBO's in recent years. Indeed, the economy has performed better than either OMB or CBO projected, since the President took office. On that basis, the Administration will argue that they expect the tax cuts to continue indefinitely – and they do not expect the automatic spending reductions to occur. But over the long run, both CBO and OMB projections have been more rosy than reality. The administration's assumption that recent good news will continue indefinitely seems to us unwarranted and unwise.

To make matters worse: last year we had four baselines; this year we have six; multiply by two – one of each for OMB and CBO. With twelve possible baselines, everyone should be able to identify some starting point to illustrate almost anything they want.

The Administration forecasts higher growth, a lower CPI, lower unemployment and interest rates than either CBO or the Blue Chip. On average, the Administration projects corporate profits will six-tenths of one percent of GDP higher than the CBO assumptions. That is important, because corporate profits are taxed twice. This assumption, therefore drives revenue estimates up and accounts for much of the difference between the OMB and CBO assumptions. (See Attachment 3)

All three forecasts assume the economy will continue to grow at a steady pace. None assumes so much as a minor downturn. There are no wars, no large emergencies factored into any of these forecasts. If the most pessimistic of these projections holds true, the result will be the longest period of expansion in U.S. history.

Looking out to the middle of the next century, the long term assumptions underlying this budget are bizarre. Current services deficit projections grow to 16% of GDP (CBO projections, of course are higher). Compared to that, deficits between 1% and 3% of GDP appear to have no positive effect on the size of the economy. Only interest rates change dramatically under these two very different fiscal policy outlooks.

Then there are the long-range Medicare projections. Real per-capita growth rates for HI fall from 4.1% to between 1.5% and 2%, even as the old are getting older, technology is putting upward pressure on health care costs, babyboomers turned grandparents likely will exercise a lot of political muscle.

Growth rates in SMI fall from 7% to below 1%. Medium-term projections do show Medicare Part-B premiums rising 7% per year, on average, in real terms, between 2002 and 2010. Why wait until 2002?

S***hort-lived tax expenditures, creative financing and other gimmicks***. Setting a goal, i.e., balancing the budget in 2002, is an important first step toward putting our fiscal house in order. However, the goal of budget balance in a given year invites chicanery – and this budget includes its full share of gimmicks -- all intended to increase revenues and/or reduce spending in the magic year. (See Attachment 4)

What happened to bipartisanship and progress toward the goal of budget balance? None of this would be surprising, except that the President and Congress keep announcing they have agreed on a goal: balance the budget by 2002 and cut taxes. The deficit path in this budget looks a lot like the President's December 1995 proposal. The Budget he submitted last February contained a more reasonable path to budget balance and lower total deficits, reflecting negotiations with Congress and improved economic conditions. Since then, the economic outlook has improved further; but this budget backslides; the deficits go up and, contrary to recent media reports, there is no substantial movement on major issues such as Medicare or taxes. (See Attachment 5)

Our elected officials like their jobs. They will continue to avoid hard choices – no matter how urgent or necessary those choices may be – if they fear losing elections because they do the right thing. Public education matters. If a President who cannot run for re-election won't take on this task, who will?

The deficit problem gets much worse after 2002, under current laws and policies. To solve our longer term problems will require structural changes in the post popular government programs: Social Security and Medicare; most recent proposals to solve those problems include some tax increases. There is little in this budget to prepare the American public for changes such as these. The real risk is that the current budget debate will make matters worse.

Tax Proposals in the Budget are included at Attachment 7.

Tax Expenditures, current law and proposed changes are included at Attachment 8.

Reminder: The Committee will celebrate our fifteenth birthday at dinner March 4. The following day, we will convene a symposium on the topic, "2002 or Bust: Balance What Budget, When and for How Long?"

If you want to attend either or both events, and have not registered, please contact our office as soon as possible.

We will release the report on the first phase of our ***Graying of America*** project at the symposium.