# COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET



Memo to: Board and Members
From: Carol Cox Wait
Date: February 8, 2000

SUBJECT: BUDGET ISSUE UPDATE
THE PRESIDENT'S BUDGET FOR FY 2001

**First, we should say how nice it is to write about balanced budgets and surplus projections. Second, we must remark, surplus politics seem to be at least as difficult as were huge budget deficits.**

**So much money—so little time**. The Budget debate begins this year where it left off when Congress adjourned last fall.

- How big is the surplus? That depends on where you start. The President chooses to start with a baseline that defines as much spending as possible as "in the base".

- The fundamental difference between the Administration and Republican majorities in Congress remains: who should decide how to spend the surplus—Washington DC or voters back home? By defining the baseline up, the President leaves as little money as possible for tax cuts. Republicans almost certainly will choose the polar opposite position—arguing that any spending above the 1997 BBA caps is an increase over current law. That would make the surplus about $1 trillion bigger than the President's starting point.

- Republicans and Democrats in Congress may continue to exaggerate their differences. Almost all want increased spending for both defense and domestic discretionary programs. Majorities in both parties want to vote for some sort of marriage penalty relief, prescription drug subsidy for old folks, and HMO bill of rights. But the devil as always is in the details and it is unclear at this writing whether they will be able to reach agreement on specific legislation. That probably will depend on whether the President and a bipartisan majority in Congress decide it is in their (electoral) interests to make progress toward their respective goals. They could decide that it is in their interests (in the fall elections) to blame each other for failure to enact even partial solutions to the problems that seem to be most pressing on voters' minds.

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**President's Budget 2001**
($ in billions—totals may not add due to rounding)

| | Actual 1999 | 2000 CBO* | 2000 Pres | 2001 | 2002 | 2003 | 2004 | 2005 |
|---|---|---|---|---|---|---|---|---|
| **Total Spending** | 1703 | 1769 | 1790 | 1835 | 1895 | 1963 | 2041 | 2125 |
| Social Security | 321 | 327 | 329 | 340 | 350 | 360 | 372 | 385 |
| All Other | 1382 | 1442 | 1461 | 1495 | 1545 | 1603 | 1669 | 1741 |
| **Total Receipts** | 1827 | 1945 | 1956 | 2019 | 2081 | 2147 | 2236 | 2341 |
| Social Security | 444 | 480 | 477 | 500 | 522 | 544 | 567 | 599 |
| All Other | 1383 | 1465 | 1479 | 1519 | 1559 | 1603 | 1669 | 1742 |
| **Total Surplus** | 124 | 176 | 167 | 184 | 186 | 185 | 195 | 215 |
| Social Security | 123 | 153 | 148 | 160 | 172 | 184 | 195 | 214 |
| All Other | 1 | 23 | 19 | 24 | 14 | -- | -- | 2 |
| **Gross Debt** | 5606 | | 5686 | 5769 | 5855 | 5947 | 6034 | 6118 |
| **Debt Held by the Public** | 3633 | 3455 | 3476 | 3305 | 3134 | 2963 | 2781 | 2578 |

*CBO estimates for FY 2000 are identical for all three baselines published by the agency in January.

**Too bad! We got here first.**

For all practical purposes, the President's Budget leaves no on-budget (non-Social Security) surpluses for future administrations and future congresses. It transfers $170 from general fund surpluses to Social Security and Medicare Trust funds (all but $15 billion) after President Clinton leaves office. If this Congress agrees, any divergence from that strategy in future years would force a "reduction" in Social Security and Medicare Trust Fund balances.

**Defining away the surplus**

CBO published three baselines in January. The capped baseline assumes the 1997 BBA caps for discretionary spending this year and next. That would require substantial cuts in appropriations but it is current law. They also published a "freeze" baseline and a baseline fully adjusted for inflation in 2001-2010.

The President's Budget for FY 2001 adopts a baseline assuming full inflation adjustments for all discretionary spending between 2001 and 2010. It also includes the President's supplemental appropriations requests for FY 2000.

- The budget would increase spending by $1,544 trillion over ten years, compared to the CBO capped base, and$464 billion compared to the fully inflated baseline.

- It allocates $170 billion (net) to tax cuts. The Administration would transfer to the Social Security and Medicare trust funds all remaining on-budget surpluses. That wipes out the entire on-budget surplus.

- Thus the Administration minimizes surpluses available for tax reductions and leaves nothing on the table after they leave office.

**Economic assumptions, technical re-estimates and higher surplus projections**

CBO, OMB and private economic forecasts continue to improve. Projected surpluses continue to grow with the improved forecasts. The short-term outlook benefits from better than expected productivity growth and technical revisions to the BEA analysis that boosted GDP. Both CBO and OMB forecast the economy for 2000 and 2001. Their out-year projections are essentially straight-line trends intended to average the impacts of any recession or boom.

The CBO and OMB projections are substantially similar, certainly within any reasonable margin of error.

Both CBO and OMB expect inflation and interest rates will rise slightly from this year's levels. CBO assumes somewhat higher rates through 2002. After that, CBO projects rates trending down toward 1999 levels. OMB assumes interest rates remain elevated through the 10-year budget window. Thus OMB's interest rate projections are higher than CBO's after 2002.

Lower estimates of health care inflation, throughout the 10-year budget window, make a major contribution to CBO's increased surplus projections. In our view, this may be the most questionable of the assumptions on which growing surplus projections are based.

**So much for Social Security and Medicare reform.**

The President's Budget and prevailing campaign rhetoric don't just put off Social Security and Medicare reform. The budget and the rhetoric are bound to leave voters with the impression that we can solve the long-term problems in both systems painlessly.

- Almost everyone in both parties will agree to use Social Security surpluses to retire debt. That is good. Lower debt means lower interest cost in future budgets. Debt reduction increases savings available for productive private investment and thus promotes productivity and overall economic growth. But debt reduction does not alter promises to pay benefits in future years. And absent change, existing Social Security and Medicare benefit commitments *will force* future politicians to raise taxes, cut other programs drastically, or borrow so heavily as to endanger the nation's economy. Future presidents and future congresses could reduce the rates of growth in Social Security and Medicare, but delay magnifies the size of the changes that will be necessary to make future benefits affordable.

- "Extending Trust Fund Balances"—by crediting some part of on-budget surpluses to the Social Security and/or Medicare trust funds—may be beneficial to the overall budget if it results in greater debt reduction; but "extending trust fund solvency" does nothing to address the fundamental problems in those two programs. Rather, it represents an explicit commitment to use general fund (income tax receipts) to pay benefits in future years.

  Social Security and Medicare Hospital Insurance are financed by dedicated payroll taxes. Medicare Part B [or Supplemental Medical Insurance (SMI) to pay non-hospital costs] is financed through a combination of voluntary withholding of premiums from beneficiaries' Social Security checks and Federal general revenues. When SMI first was enacted, beneficiary premiums were supposed to pay 50 percent of costs. Today, beneficiary premiums pay only 25 percent and general fund (income tax receipts) cover 75percent of costs.

  Should the Federal government begin to pay part of the cost of Social Security and/or Medicare Hospital Insurance costs from income tax receipts? That is a legitimate topic for debate. The debate, however, should be very clear. It should not be conducted in code words such as "using surpluses to extend Social Security and Medicare".

Let us be very clear. Federal trust fund balances have no impact at all on government's ability to meet benefit commitments. Trust fund balances are invested in U.S. Treasury debt. Paying benefits requires cash. To turn trust fund balances into cash, future congresses and presidents need tax revenue or they will need to borrow. They can make revenue available for this purpose by cutting programs other than Social Security and Medicare. They can borrow so much as to threaten the country's basic economic well being. Or someone, sometime, will be forced to do something to moderate the growth in Social Security and/or Medicare benefits.

- The budget does not contemplate changes to make Social Security or Medicare more affordable in future years. This President and this Congress clearly are not going to do anything toward that goal. To make matters worse, they are making it harder for those elected in future years to do what must be done. They talk about "extending trust fund solvency" and "individual accounts" as if either or both would solve the Social Security problem. All the while they know that is not true. And that is really too bad.

**Misleading budget presentations**

The following are examples of large items that tend to distort aggregate budget presentations.

The budget includes about $100 billion in proposals for new and increased fees over the next ten years displayed as negative outlays.

It shows the entire amount of the President's proposal to expand the Earned Income Tax credit as a change to revenues—even as the footnote tells us all but $3.5 billion of the $20.5 billion "revenue impact" really represents increased outlays.

The Administration continues to show their proposed subsidies for retirement accounts as a tax expenditure. Last year CBO said this was a spending program. CBO is not likely to change their view this year.

The budget includes nearly $100 billion in so-called tax loophole closing. (This in addition to the tobacco tax increases discussed in the next paragraph.) Almost all of these proposals have appeared in earlier budgets. Congress rejected them when they were trying to reduce deficits and balance the budget. Whether or not you think that "closing tax loopholes" is a good idea or not, Congress almost certainly will reject these proposals, now that they are basking in huge surplus projections.

The budget proposes to increase tobacco excise taxes nearly $66 billion — substantially similar to the amounts in last year's budget—though the increases are described somewhat differently this year. The Administration knows Republicans in Congress are unlikely to enact any new taxes in the current surplus environment. Last year Administration officials continued to press for tobacco tax increases, right up until the end of the session, to offset the cost of "high priority" spending.

It appears that the goal is to "force Republicans to choose" between tobacco tax increases and popular programs (such as Medicare pharmaceutical benefits). Republicans likely will respond this year, as they did last. Republican Congressional Leaders will say that high priority spending can be financed from on-budget surpluses.

But the inclusion of tobacco and other tax increases, fees etc., makes it possible for the Administration to include far more spending in the budget than they can finance from on-budget surpluses. We estimate that about one third of the President's policy proposals are "paid for" in this manner. That makes it possible for the President to argue that we can have it all—huge spending increases, tax cuts, debt reduction, and general fund contributions to the Social Security and Medicare trust funds.

**Tax cuts in the budget**

On its face, the Budget shows $351in tax cuts and $255 billion "net tax relief including refundable credits". Refundable tax credits are entitlement spending outlays. In addition, it shows $85 billion in "other provisions that affect revenues"—read tax increases. Last year, CBO said that the President's proposals would produce a net revenue increase, if they all were enacted. The CBO re-estimate of this year's budget well may reach the same conclusion.

**We are including as attachments to this update:**

1. A table showing the differences between the CBO capped and inflated baselines and the Administration current services projections.

2. A comparison of the CBO and OMB Economic Projections.

3. List of New Spending initiatives from the President's Budget.

4. List of Revenue Initiatives from the President's Budget.