CENTER ON BUDGET AND POLICY PRIORITIES
820 First Street, NE, Suite 510, Washington, DC 20002
Tel: 202-408-1080 Fax: 202-408-1056 center@cbpp.org www.cbpp.org

Revised March 5, 2004

ANALYSIS OF THE PRESIDENT'S BUDGET

by Robert Greenstein and Richard Kogan

Overview

The nation faces increasingly serious budget problems. Rather than address them, however, 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 limited in scope and are heavily outweighed by the deficit-increasing proposals. Furthermore, the deficit-reducing proposals 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.

- *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 the decline in revenues accounts for three-fourths of the unprecedented fiscal deterioration since 2000. (See table on page 9.)

- *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.

- *The budget won't cut the deficit in half.* The Administration attempts to wrap the budget in an aura of fiscal responsibility by claiming it will cut the deficit in half in five years. This claim is not credible. 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.

- *The 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. That also is the period when Social Security and Medicare costs would begin to rise more rapidly as a result of the baby boomers' retirement.

- *Disproportionate emphasis on reducing domestic discretionary programs*. The Administration singles out one relatively small part of the budget for tough treatment — domestic discretionary programs outside homeland security. These programs, which have had little to do with the recent rise in the deficit and are below historic average levels, measured as a share of the economy,[1] would increase only 0.1 percent in 2005. (The often-cited 0.5 percent figure applies to a broader category of programs that includes international programs and defense programs outside the Pentagon.) This represents a small cut when inflation is taken into account. This part of the budget would then be cut significantly deeper starting in 2006, with the cuts widening with each passing year. Indeed, starting in 2006, the large majority of domestic discretionary programs outside homeland security would be reduced. Even programs that the Administration boasts it is expanding, based on its fiscal year 2005 funding request — programs such as Title I education, the National Institute of Health, the Supplemental Food Program for Women, Infants, and Children (WIC), and low-income energy assistance — would be cut starting in 2006.[2]

  By 2009, the budget proposes to cut overall funding for domestic discretionary programs outside homeland security $45.4 billion — or 10.4 percent — below today's level, adjusted for inflation. The Administration is proposing five-year binding caps on discretionary spending to lock in cuts of this magnitude.

  A number of these cuts would cause significant hardship. For example, the low funding level proposed in 2005 for the housing voucher program, the nation's principal low-income housing assistance program, could cause the number of low-income families and elderly and disabled households receiving such assistance to be cut by 250,000. The funding levels proposed for child care programs would cause the number of children from low- and moderate-income working families who receive child care assistance to be reduced by approximately 365,000 by 2009.

  Yet the amount that these cuts would save pales in comparison to the revenue losses from the tax cuts. The savings over the next five years from all of the domestic discretionary cuts combined would be substantially less than the cost of the tax cuts just for the one percent of households with the highest incomes.

---

[1] In 2001, domestic discretionary spending outside homeland security made up 3.1 percent of GDP; in 2004, it will equal an estimated 3.4 percent of GDP. This is slightly below its average level since 1970 of 3.5 percent of GDP.

[2] OMB classifies about 6 percent or $1.7 billion of NIH funding as "homeland security," the amount for purposes categorized as biodefense, which HHS characterizes as basic research on microbial agents with bioterrorism potential, and applied research on diagnostics, vaccines, and therapies against bioterrorism. This portion of NIH funding continues to rise in every year; it is the remainder that is cut after 2005.

- *The budget consistently favors the well-to-do over low- and moderate-income working Americans*. The favoritism toward those with high incomes is evident in the new budget rules the Administration is proposing, in the singling out of domestic discretionary programs for cuts, and in the nature of the Administration's tax cuts. It also is evident in less obvious ways. For example, the budget proposes to make permanent every tax-cut provision enacted in 2001 and 2003 that predominately benefits people with high incomes. These include tax cuts that make already generous pension and retirement tax breaks still more generous for wealthy business owners and executives. But the budget fails to extend — and thus would let die after 2006 — the provision of the 2001 tax-cut law that encourages greater retirement savings by working families with incomes under $50,000. (That provision, known as the Savers' Credit, provides a tax credit that partially matches contributions made by such families to pension or retirement accounts.) This omission is reminiscent of the Administration's tax-cut proposal last year, which accelerated tax cuts enacted in 2001 for higher-income households but not a tax benefit for low-income working families with children, and which accelerated "marriage-penalty relief" tax cuts for higher-income married couples but not for low-income married couples.

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, about 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 changes its tune and does *not* 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 costs in Iraq and Afghanistan.

- In addition, the budget assumes certain savings without an accompanying proposal that would produce those 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.

Beyond the Five-Year Budget Window

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 occurs after 2009.

Indeed, making the tax cuts permanent would increase deficits by about $2 trillion over the ten-year period, from 2005 to 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.

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 approximately $35 billion *a year*.

New Budget Discipline Rules Would Give a Free Pass to New Tax Breaks and Thereby Favor Special Interests 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 rules' 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.

Budget Rule Change Would Make the Cost of Extending the Tax Cuts Disappear

The budget includes a legislative proposal to change the budget rules so the cost of extending the 2001 and 2003 tax cuts would be incorporated into the official budget baseline, even though the baseline is supposed to reflect current law. *If this change is enacted, the Congressional Budget Office will have to show legislative proposals to make the tax cuts permanent as having zero cost.*

The budget claims this would merely conform the treatment of tax cuts under the baseline to the treatment already accorded to entitlement programs. The Administration argues that if a new entitlement program is authorized for a few years and needs to be extended, the cost of continuing it is assumed in the baseline and legislation to extend the program is considered to have no cost.

But the Administration's argument is disingenuous. It glosses over a critical fact. If legislation to create an entitlement is written so the entitlement sunsets after a few years, *CBO still counts the full cost of that entitlement proposal for every year of the next ten years, as if the sunset would not occur. As a result, Congress cannot artificially lower the cost of entitlement legislation through artificial sunset dates.*

By contrast, the Administration and the Congressional leadership wrote artificial sunset dates into the 2001 and 2003 tax cuts precisely for the purpose of making the cost of the tax cuts look smaller, so that more tax cuts could be packed into the legislation without breaching Congressional budget limitations. This gimmick worked because under the current rules, CBO assumed the tax cuts had no cost in years after the sunsets.

In essence, what the Administration's proposal seeks to do is to ensure that the cost of instituting the tax cuts in years after the current sunset dates *will never be counted*, thereby making extension of the tax cuts easier to pass. This is the *opposite* of how budget rules treat entitlements. To fail to count the cost of tax cuts in years after the sunset dates, *either when the tax cuts were first enacted* ***or*** *when they are extended*, would represent one of the most flagrant budget gimmicks in recent memory.

- 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 Federal Reserve Chairman Alan 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 "Robin Hood in reverse" aspects.

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 is likely to develop to deliver entitlement expansions through the tax code, even when that would represent a more costly and inefficient approach.

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, has changed relatively little in size since 2001 as a share of the economy, and is already below its historic average level.

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. The 0.5 percent increase contains within it, however, 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 would rise by less than 0.1 percent.[3]

The tougher treatment accorded this part of the budget would have significant consequences; the budget includes cuts over the next five years in most domestic discretionary programs. For example, funding for the housing voucher program would fall more than $1.6 billion short in fiscal year 2005 of the amount needed to continue support for the vouchers in use. Unless the program were cut in other ways (such as by raising the rents charged to the poor families and elderly and disabled people who receive 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 2.2 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.

Such effects would become sharper after 2005, as the Administration is proposing much deeper cuts in domestic discretionary programs in those years. Information on the cuts the Administration is seeking in domestic discretionary programs in years after 2005 cannot be found anywhere in the budget books the Administration issued February 2. Such information is missing from the budget materials that normally contain it. One must have access to the 1,000-

[3] This figure has also been adjusted to account for anomalies in the transportation and housing budgets. For a discussion of these anomalies, see Richard Kogan, "The Omnibus Appropriations Act: Are Appropriations for Domestic Programs Out of Control?" February 1, 2004.

page OMB computer run of federal budget accounts, which underlies the budget, to find the deeper cuts the Administration is proposing for 2006 and subsequent years.

Starting in 2006, most domestic discretionary programs would be cut. The funding levels the Administration is proposing for most budget accounts are below the 2005 levels, even before adjustment for inflation. Indeed, many programs that the Administration is highlighting as programs it would increase in 2005 are slated for cuts in 2006, after the election.

For example, the budget proposes to fund child care programs for low-income working families during the 2006-to-2009 period below both their current funding level and the Administration's proposed 2005 level. The Administration's budget itself contains a table (on page 361 of the *Analytical Perspectives* volume) that 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 from its 2003 level). And this estimate likely understates the cut in child care, because it uses an assumption contradicted by data provided elsewhere in the budget. The number of children in low-income working families receiving child care assistance more likely would be 365,000 lower in 2009 than in 2004.[4]

The cuts the Administration is proposing after 2005 would widen with each passing year. By 2009, overall funding for domestic discretionary programs outside homeland security would be $45.4 billion — or 10.4 percent — below the 2004 levels adjusted for inflation (i.e., $45.4 billion below the CBO baseline for 2009), and $64 billion — or 14.1 percent — below current funding levels in real per capita terms (i.e., after adjustment for both inflation and population growth, a measure many analysts prefer).

These cuts should be taken seriously. The budget also proposes that Congress pass legislation setting binding caps on funding levels and spending levels for discretionary programs for each year through 2009. The caps would be set at exactly the overall levels contained in the President's budget for each of the next five years. If the caps were exceeded, across-the-board cuts in discretionary programs would automatically occur. It would take 60 votes in the Senate to bypass the caps.

The caps would cover overall levels for all discretionary programs (except certain transportation programs), including defense, homeland security, and domestic programs. If funding for defense and homeland security is set in future years at the levels shown in the President's budget, the amounts remaining under the caps for domestic programs outside homeland security will be exactly the amounts shown in the budget, and the reduction of $45.4 billion in 2009 will be required. Moreover, the cuts in domestic programs could be significantly larger than that. As noted above, CBO analyses indicate that the funding levels which the budget shows for defense in years after 2005 *understate* the actual costs of the Administration's own multi-year defense plan. This suggests that the amounts the Administration actually will request

[4] 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 365,000 lower in 2009 under the Administration's budget than it was in 2004, and 445,000 lower than in 2003.

for defense in future years may be significantly greater than the amounts shown in the current budget. If the proposed caps are enacted and defense ultimately is funded at higher levels than the current budget shows, the cuts in domestic discretionary programs would have to be deeper — and perhaps substantially deeper — than described here.

Yet despite these cuts, the impact on the deficit would be relatively small. The total amount of money saved through the discretionary spending cuts pales in comparison to the size of the tax cuts. Total funding for domestic discretionary programs outside homeland security would be approximately $7.5 billion below the Congressional Budget Office baseline in fiscal year 2005 and $45.4 billion below the baseline in 2009. These amounts represent a very modest fraction of the cost of the tax cuts. The tax cuts enacted since 2001 and the new tax cuts contained in the budget would cost more than $200 billion in fiscal year 2005 and either $240 billion or nearly $300 billion in 2009, depending on whether the cost of related AMT relief is included.

In fact, based on an analysis by the Urban Institute-Brookings Institution Tax Policy Center, the income tax cuts for just the top one percent of households would cost about $45 billion in 2005 and a substantially larger amount in 2009, meaning they would cost more than the total savings from all of the cuts in domestic discretionary programs. In 2005, the top one percent of households would receive income tax cuts averaging more than $31,000; by 2011, if all of the tax cuts are made permanent and AMT relief is extended, the top one percent would receive tax cuts (including from the repeal of the estate tax) averaging more than $62,000 a year.[5]

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 of GDP over the past 40 years.
- CBO and OMB data show, in fact, that declines in revenues account for about *three-fourths* of the fiscal deterioration of the past few years. (See table on page 9.)

[5] The figures on the size of the average tax cut for the top one percent of households come from the Urban Institute-Brookings Institution Tax Policy Center and are expressed in 2004 dollars.

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%

* The swing from surpluses of 2.4% of GDP to deficits of 4.2% of GDP represents a budget deterioration equal to 6.6% of GDP. This column shows the share of this deterioration that is due to the decline in revenues, as well as the share that is due to increases in spending.

Source: This table is based on CBO estimates for 2004. Using OMB estimates produces nearly identical results, with revenue declines accounting for 74 percent of the change.

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 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 century*. 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.