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BUDGET PRIORITIES UNDER THE SENATE BUDGET PLAN

Senate-Passed Budget Plan Would Cut Taxes on the Wealthiest, Raise Taxes on the Poorest Workers, Cut Most Domestic Discretionary Program Areas, and Likely Increase the Ranks of Those Without Health Insurance

Yet Proposal Would Increase, Rather than Reduce, Deficits

By Robert Greenstein, Richard Kogan, and Joel Friedman

NOTE: This report examines the budget resolution as passed by the Senate on March 12. An amendment offered by Senator Russell Feingold, which the Senate approved, would have the effect of requiring 60 votes on the Senate floor to pass the tax cuts contained in the budget resolution, unless the tax cuts are accompanied by offsetting tax increases or entitlement reductions. (The Feingold amendment would require *all* tax cuts and entitlement increases to be offset; legislation violating this stricture would be blocked by a "point of order," which would take 60 votes to overcome.) News reports indicate, however, that the House and Senate Republican Leaderships strongly oppose the Feingold amendment and will push for its removal in conference. This analysis examines, among other things, the impact the Senate plan would have on deficits *without* the Feingold amendment.

The budget resolution that Senate approved on March 12 reflects dubious budget priorities.

- The resolution would likely lead to increases in the number of people without health insurance by requiring cuts in Medicaid. It also would raise taxes and reduce benefits for low-income workers by cutting the Earned Income Tax Credit.

- Under the resolution, funding for domestic discretionary programs outside homeland security would be cut by $117 billion over five years, compared with the 2004 level adjusted for inflation. These cuts would affect nearly all domestic program areas, including education, veterans, environmental, and housing programs, among others. By fiscal year 2009, funding for these programs would fall to 2.7 percent of the Gross Domestic Product (from 3.3 percent today), the lowest level as a share of the economy since 1963.

- At the same time that the resolution would cut domestic programs and raise taxes on some low-income workers, it would provide tax breaks for the wealthiest Americans, by accelerating repeal of the estate tax and making permanent those tax cuts — such as estate tax repeal, the capital gains and dividend rate cuts, and the reductions in marginal tax rates — that provide huge benefits to the families with the highest incomes.

- Further, the tax cuts are costly, outweighing the savings from the spending cuts. The budget plan also calls for increases in defense and homeland security. As a result, the plan would add $178 billion to projected deficits over the next five years. That is, under the resolution, deficits will be $178 billion higher over the five-year period than the Congressional Budget Office projects they would be if Congress enacted no policy changes.

  In addition, because the cost of making expiring tax cuts permanent explodes outside the five-year period covered by the resolution, the resolution would add $1.3 trillion to projected deficits over the next ten years.

- Furthermore, deficits under the Senate Budget Committee plan would be another $672 billion higher if relief from the Alternative Minimum Tax is assumed to be extended for the full ten years, as most observers expect it ultimately will be. The plan shows the cost of extending AMT relief for *only one year*. This results in a substantial understatement of deficits after 2005. The estimates that the Budget Committee has issued on what the deficits would be under the plan in 2009 rest on the extremely unrealistic assumption that the number of taxpayers subject to the AMT will rise from about three million today to 30 million by 2009.

The following sections of this report provide an analysis of the Senate plan.

Tax Cuts for the Wealthy

The Senate plan continues several mostly middle-class tax cuts and also includes tax cuts that would be extremely beneficial to the wealthiest Americans. For instance, it proposes to accelerate the repeal of the estate tax by one year, from 2010 to 2009. It also assumes the permanent extension of all of the tax cuts that are of greatest value to the highest-income households — estate tax repeal, the capital gains and dividend tax cuts, and the reduction in marginal tax rates, including the top rates.

The estate tax proposal is particularly skewed to the highest-income families. Under current law, the only estates that will be subject to the estate tax in 2009 are those that exceed $3.5 million for an individual and $7 million for a couple. Accelerating estate tax repeal to 2009 would benefit only estates with assets in excess of these amounts. This would benefit only the largest one-half of one percent of all estates.

Although it accelerates estate tax repeal from 2010 to 2009 and assumes both permanent repeal of the estate tax and permanent extension of the capital gains and dividend tax cuts (which are currently scheduled to expire after 2008) and the marginal rate cuts (scheduled to expire after 2010), the plan *fails* to extend the Savers Credit even though it expires after 2006. Unlike estate tax repeal or the dividend and capital gains tax cuts, the Savers Credit is focused on families with incomes below $50,000. IRS data show that 3.7 million moderate-income working families now use the Savers Credit, which provides a tax credit to encourage retirement saving. Under the Senate Budget Committee plan, this credit would apparently end after 2006.

In total, the budget plan assumes tax cuts that would reduce revenues by $139 billion between 2005 and 2009.[1] Of this total, $80.6 billion could be considered under special "reconciliation" procedures that would protect the measure from filibuster. The $80.6 billion is comprised of the three tax cuts expiring in 2004 — the child tax credit, the 10 percent bracket, and tax breaks for married couples — and the acceleration of the estate tax repeal to 2009. Over ten years, the tax cuts assumed in the resolution, including the permanent extension of expiring tax cuts, would reduce revenues by more than $1.1 trillion.

Tax Increases for the Working Poor

In contrast to the tax cuts for high-income households, the budget proposed to *raise taxes on at least several million low-income working people* through cuts in the Earned Income Tax Credit. The "Chairman's Mark," which Budget Committee Chairman Don Nickles presented and which explains the budget plan that the Senate approved, says the plan's EITC cuts could be made in either of two ways — by repealing the EITC for very poor workers without children (which benefited 3.7 million households in 2003, according to the IRS) or, it appears, by delaying EITC refunds for families for up to a year.[2] The proposal to delay refunds surfaced once before, in 1999, when Rep. Tom DeLay pushed the idea. At the time, then presidential-candidate George W. Bush assailed it as balancing the budget on the backs of the working poor. (Mr. Bush's exact words were: "I don't think they ought to balance their budget on the backs of the poor.")

"Reconciliation" and Entitlement Cuts

Under the budget plan that the Senate Budget Committee reported, the EITC cuts discussed in this section and the Medicaid cuts discussed in the next section would have been "reconciled." The Senate Finance Committee would have been directed to report legislation cutting entitlements under its jurisdiction by a specified amount, with the EITC and Medicaid cuts discussed here assumed to comprise the required cuts. During floor debate, the Senate adopted an amendment proposed by Senator Max Baucus that removed this reconciliation directive to the Finance Committee.

The Baucus amendment did *not*, however, remove these entitlement cuts themselves from the budget plan, so the Senate plan still reflects the EITC and Medicaid cuts discussed here. A major question that the House and Senate conferees on the budget resolution will need to resolve is whether assumed entitlement cuts such as these will be subject to a reconciliation directive. If there is not a reconciliation directive, these cuts will be much less likely to occur.

If the proposal to delay refunds is not used, the other option — eliminating the EITC for poor workers without children — would increase the taxes of some of the poorest workers in the United States. This credit eases the tax burdens of these workers. It is available only to workers

[1] This $139 billion total excludes the $18 billion cost of the refundable portion of the Child Tax Credit, as these benefits are classified as expenditures in the budget.

[2] The Chairman's Mark says one way the EITC savings could occur is through "requiring more recipients to receive the benefits in their paycheck." The only way that this approach could save money in the budget is if it resulted in refund payments being delayed, by requiring the refunds to be provided in monthly installments over the 12 months *after* the time in which EITC refunds currently are paid. Such an approach was previously proposed by Rep. Tom DeLay in 1999. In contrast, proposals to include EITC benefits in paychecks in the form of advance payments (*before* the time EITC refunds would normally be paid) would likely increase costs in the budget.

earning less than $11,490 ($12,490 for a married couple without children). It equals a maximum of 7.65 percent of the first $5,100 in wages they earn and then begins to phase out once income exceeds $6,390; for its recipients, the credit offsets some or all of the employee share of payroll taxes.

Poor single individuals without children already face substantial federal tax burdens. They are the only group of taxpayers in the nation who must begin paying federal income taxes while still living in poverty. The poverty line for a single individual is projected to be $9,730 in 2004; poor single workers currently begin paying income tax when their income is $9,485. If this tax credit were abolished, they would begin paying income tax at an income of $7,950 — *nearly $2,000 below the poverty line*. Such a change would literally tax them deeper into poverty. Indeed, if this tax credit were abolished, a single worker with income at the poverty line of $9,730 would owe $922 in federal income and employee payroll taxes (or $1,667 if the employer share is taken into account).[3]

Cuts in Medicaid

The Senate plan also would cut Medicaid by more than $11 billion over the next five years, including reductions in the federal share of certain state Medicaid costs that would take effect on October 1. Many states remain in fiscal crisis, in large part because of the weak economy. Unfunded mandates and other federal actions that have increased state costs and reduced state revenues have aggravated this problem. In response, states have been cutting their Medicaid programs and thereby causing the ranks of the uninsured to rise faster. State cuts in Medicaid eligibility rules over the past two years have eliminated eligibility for 1.2 million to 1.6 million low-income people, most of them parents or children in low-income working families. By withdrawing federal Medicaid funds while states continue to face deficits, the federal government would be virtually guaranteeing a new round of Medicaid cuts and a further swelling of the ranks of the uninsured.

In response to such a proposal, Governor Dirk Kempthorne (R-Idaho) and Mark Warner (D-Virginia), the leaders of the National Governors Association, wrote to Congress on March 3: "States are currently emerging from the most severe budget crisis since World War II and nearly every state has already enacted difficult cuts to its Medicaid program, including both eligibility levels and provider payments. Federal funding reductions would force states to implement even deeper cuts by restricting eligibility, eliminating or reducing critical health benefits, and cutting or freezing provider reimbursement rates. As a result, Medicaid funding cuts could add millions more to the ranks of the uninsured and would harm our nation's health care safety net."

Reductions in Domestic Discretionary Programs

The Senate plan includes substantial cuts in domestic discretionary programs outside of homeland security. (This part of the budget covers everything from environmental protection and national parks to education, veterans health care, health research, transportation, and an array

[3] Most economists, including those at the Joint Committee on Taxation and the Congressional Budget Office, believe the employer share of the payroll tax is passed through to employees in the form of lower wages than they otherwise would receive.

of other programs.) The budget would cut funding for these programs by $18.0 billion in fiscal year 2005, with the cut growing to $36.8 billion by 2009. Over five years, funding for these programs would be cut by a total of $117 billion.[4] (These amounts represent the amount that funding for these programs would be cut below the Congressional Budget Office baseline — that is, below the fiscal year 2004 funding level, adjusted for inflation. The cut below the CBO baseline in expenditures, or outlays, would be $105 billion over five years.)

Increases for Defense, International Affairs, and Homeland Security

The budget plan would increase funding for defense, international affairs, and homeland security by $185 billion over five years. The $185 billion in increased funding is measured relative to the CBO baseline — that is, relative to the 2004 funding level adjusted for inflation. (The 2004 funding level used throughout this analysis is the funding level for *ongoing* defense and other activities in this area; it does not include the $87 billion supplemental funding for Iraq and Afghanistan enacted last fall.)

The $185 billion increase does not include the $30 billion that the Senate plan sets aside as a "reserve fund" for the anticipated 2005 supplemental to cover the cost of operations in Iraq. Although the plan includes the $30 billion for Iraq, this analysis excludes the reserve fund for purposes of comparing the plan with the adjusted CBO baseline, which also excludes future costs of operations in Iraq.

No Room for Welfare Reform

The budget plan does not include the modest resources needed to cover the costs associated with the Senate Finance Committee's TANF and child care reauthorization bill. The budget includes *no* resources in this area, despite the fact that the President's budget — and even the House-passed TANF bill — include modest costs associated with reauthorizing the TANF and child care block grants, and last year's Congressional budget resolution included modest funding for this purpose. The Administration's budget includes $4.2 billion over five years for the welfare-reform bill; the Finance Committee bill costs $4.75 billion; the House-passed bill costs $1.9 billion.

Under the Administration's budget, the House TANF bill, and the Senate Finance bill, a substantial portion of these costs simply reflect the cost of *extending current policies* that are set to expire. For example, $2 billion in costs in the Senate Finance bill and the Administration's budget reflect continuing the current Transitional Medical Assistance Program, which provides Medicaid coverage to families that have recently left welfare for work.

The budget does not include even the $200 million per year in added child care funding contained in the House-passed TANF bill and the Senate Finance Committee bill, as well as in last year's budget resolution. (The child care funding levels in these bills are themselves substantially below what states need to maintain their current child care programs, let alone to

[4] Like CBO, we include highway "obligation levels" as a type of funding in our analysis. The Senate Budget Committee has indicated that highway funding would be at levels consistent with those contained in the President's budget.

meet the increased need for child care that the bills' stiffer work requirements would create. A number of Senators, led by Senator Olympia Snowe (R-Maine), have argued that the level of child care funding in the Senate bill is insufficient.)

Under the Budget Committee plan, funds needed for welfare-reform legislation would have to come from cutting other mandatory programs under the Finance Committee's jurisdiction, such as by making deeper cuts in Medicaid or the EITC or cutting such programs as Medicare or unemployment insurance.

Increases Deficits

Despite reducing funding for domestic discretionary programs, calling for cuts in Medicaid and the EITC, and necessitating further cuts to cover costs related to welfare-reform reauthorization, the Senate Budget Committee plan would *increase* the deficit in each of the next five years. The plan would cause deficits to be $178 billion higher over the next five years than they would otherwise be (see table on next page).[5]

To be sure, the budget resolution shows the deficit declining in these years. But this progress largely reflects expected improvement in the economy, not the policy proposals in the resolution. The policy proposals in the budget plan would add $178 billion to the deficits that the Congressional Budget Office projects will occur over the next five years if no policy changes are made. The budget resolution would cause deficits to be higher because the resolution's tax cuts (and to a lesser degree, its spending increases for defense and homeland security) would cost more than its domestic spending cuts would save.

Further, even these projections mask the true size of the deficits under the resolution. First, by proposing to make expiring tax cuts permanent, the budget plan would result in very large costs beyond 2009, the last year covered by the resolution. In the following five years, through 2014, making the tax cuts permanent would cost another $1.1 trillion (including the associated interest payments on the debt), bringing to $1.3 trillion the total increase in the deficit as a result of the plan.

Second, the Senate plan leaves out funding for Iraq operations after 2005. Unlike the President's Budget, which failed to show costs for Iraq after this year, the Senate has more responsibly included a $30 billion "reserve fund" to cover the 2005 cost of operations in Iraq and Afghanistan. (The Defense Department says that the supplemental funding it will request may cost as much as $50 billion.) As noted previously, to be comparable with the CBO baseline, this analysis excludes this reserve fund from the Senate plan's totals. If the reserve fund and the associated interest costs were included in our analysis of the plan, deficits under the plan would be shown to be $46 billion higher over ten years. Even this amount likely understates how much

[5] As noted, the CBO baseline used to assess the Senate Budget Committee plan has been adjusted to treat the $87 billion fiscal year 2004 Iraq supplemental as a one-time event, removing the mechanical repetition in the baseline of this $87 billion every year after 2004. To be comparable with the CBO baseline, the spending and deficit numbers in the Senate plan have been adjusted to remove the $30 billion fiscal year 2005 supplemental for operations in Iraq that is part of the plan.

Digging the Hole Deeper:
The Senate Plan Substantially Increases Projected Deficits
Senate plan versus CBO Baseline,[1] dollars in billions

	2005	2006	2007	2008	2009	5-year total	10-year total[3]
Deficits in CBO Baseline[1]…………..	**323**	**197**	**182**	**183**	**170**	**1,055**	**905**
Senate Plan:							
- Tax cuts…………………………..	24	39	25	23	28	139	1,132
- Refundable tax credits……………	*	5	4	4	4	18	64
- Entitlement cuts…………………..	-2	-4	-5	-5	-8	-24	-54
- Domestic appropriations cuts…….	-18	-13	-17	-24	-32	-105	-281
- Defense, international, and homeland security increases[2]…	14	27	29	29	30	129	270
TOTAL policy changes……………	18	54	36	27	22	157	1,131
— interest on policy changes [2]...	0	2	4	6	8	21	171
TOTAL increase in the deficit…...	**18**	**56**	**41**	**34**	**30**	**178**	**1,301**
Resulting Deficits…………………….	**341**	**253**	**223**	**217**	**200**	**1,234**	**2,206**

	2005	2006	2007	2008	2009	5-year total	10-year total
Cost of AMT relief omitted from the budget plan, including interest[4]……...		13	35	45	57	149	672
Resulting Deficits w/ AMT relief…….	**341**	**265**	**258**	**262**	**258**	**1,383**	**2,878**

	2005	2006	2007	2008	2009	5-year total	10-year total
Note: $30 billion for 2005 Iraq supplemental, including interest (not included above)…………	15	12	4	2	2	36	46

Figures may not add due to rounding. "*" means less than $500 million.

(1) CBO revised baseline (March 2004), adjusted to treat the $87 billion 2004 Iraq supplemental appropriations bill as a one-time event. Source: CBO.

(2) Excludes expenditures from $30 billion held in reserve for 2005 a supplemental appropriation for operations in Iraq.

(3) Assumes the tax cuts mentioned in the Chairman's Mark, including the permanent extension of expiring tax cuts; assumes that entitlement cuts remain constant over time; assumes that discretionary expenditures grow only with inflation after 2009.

(4) CBO estimate of the cost of indexing the AMT and extending the treatment of non-refundable personal credits.

Note: Some of the proposed changes in taxes and entitlement programs could receive "reconciliation" protection under the resolution. Of the $139 billion of tax cuts, $80.6 billion are reconciled. Also reflected in the reconciliation instructions are the $18 billion in expenditures for the refundable portion of the Child Tax Credit that would result from extending the Child Tax Credit. Of the $24 billion of savings in entitlement programs, $21.6 billion are reconciled.

Iraq will add to future deficits, since it assumes there will be no costs whatsoever for operations in Iraq after 2005.

Finally, the Senate plan uses the same gimmick as the Administration's budget regarding the Alternative Minimum Tax. Both assume that relief from the AMT, which expires at the end of 2004, will be extended for only one year. Although both Senate Budget Committee Chairman Nickles and President Bush have acknowledged the need for a "permanent solution" to the AMT problem, both exclude the costs of permanent relief from their current budgets in order to improve artificially their deficit projections. Currently, about 3 million taxpayers are affected by the AMT; by 2006, if no additional relief is provided, the number will jump to nearly 21 million, and it will continue to grow to 44 million by 2014, according to the Urban Institute-Brookings Institution Tax Policy Center. No observer expects this to happen. Extending the current AMT relief and indexing it to inflation would cost $672 billion more through 2014, including the associated interest payments, than the one-year extension included in the plan. If this additional amount were included in the budget plan, the deficits in the plan would cumulate to $2.9 trillion over the next decade.