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CLAIMS THAT PROPOSED ENTITLEMENT CAP WOULD SHIELD MEDICARE AND NOT CAUSE MASSIVE CUTS ARE INCORRECT

Proposal Would Mandate Very Large Cuts and Place Nearly Every Entitlement Program at Risk

by Richard Kogan and Robert Greenstein

Overview

As early as the week of June 14, the House of Representatives will consider legislation to change the federal budget process. Some House Members are pushing a far-reaching measure to place a cap on overall entitlement spending, with automatic entitlement cuts instituted in any year in which the cap would otherwise be breached. This proposal is a centerpiece of H.R. 3800, the "Family Budget Protection Act," legislation introduced by Rep. Jeb Hensarling and more than 100 conservative co-sponsors, which Grover Norquist and other conservative activists and organizations have termed the "gold standard" of budget-process legislation.[1] A nearly identical entitlement cap is included in H.R. 3925, introduced by Rep. Mark Kirk and about 20 other Republican members. These entitlement cap proposals are likely to be offered as amendments to the budget-process legislation on the House floor.

In a recent paper promoting H.R. 3800, the Heritage Foundation asserts that the bill's entitlement cap proposal "would not lead to massive spending cuts," and that many entitlements such as Medicare would either be entirely exempt from cuts under the proposal or only lightly touched by it. Some Members of Congress who are promoting the entitlement cap are making similar claims, particularly with respect to Medicare.

Such statements are far off the mark and reflect misunderstanding of how the entitlement cap proposal is designed. Congressional Budget Office data show that Congress would need to make *$1.8 trillion in cuts in entitlement programs over the next ten years* to live within the entitlement caps that H.R. 3800 and H.R. 3925 would establish. Within about five years, the required cuts would reach or exceed 20 percent of the projected costs of entitlement programs. As explained below, Medicare would almost certainly be subject to significant cuts; it would be difficult, if not impossible, for Congress to meet the severe caps these proposals would establish without sizable reductions in Medicare.

The Heritage analysis misconstrues the entitlement cap proposal in several respects. It implies that the entitlement cap would apply *separately* to each individual program, so that

[1] Letter to House Speaker Hastert, May 10, 2004, signed by The American Conservative Union, Americans for Tax Reform, Citizens for a Sound Economy, Council for Citizens Against Government Waste, and the National Taxpayers Union.

entitlements that grow more slowly than the formula used to set the cap would not be affected. In fact, the legislation would establish a single, overall cap for each year that would apply to all entitlements (except Social Security) *as a group*, not to each entitlement individually. If the costs of entitlements *as a whole* would exceed the caps, cuts would be required.

Every entitlement except Social Security would be on the table as Congress struggled to fashion the cuts needed to meet the severe caps. The cuts needed to comply with the caps would be so large — about $225 billion a year by 2010 and nearly $300 billion a year by 2014 — that virtually all entitlement programs would be at risk of substantial cuts, including both more rapidly growing entitlements and slowly growing ones.

Moreover, most slowly growing entitlements would *not* be exempt from the automatic cuts that would be ordered if Congress failed to enact legislation cutting entitlement programs deeply enough to meet the cap. Most of these programs *would* be hit if the automatic cuts were triggered. More important, as just noted, Congress would face such enormous challenges in trying to find large enough cuts in entitlements to meet the caps that nearly all entitlement programs would be at risk of being cut, regardless of their rate of growth.

Impact on Medicare

The notion that certain programs such as Medicare would largely be shielded from cuts is mistaken, as well. It is true that under H.R. 3800 and H.R. 3925, some popular entitlement programs, including Medicare, would be partly or entirely exempt from the *automatic cuts* that would be triggered if Congress failed to cut entitlements enough to meet the cap for the fiscal year ahead. Heritage and some Congressional supporters of the entitlement cap have incorrectly used this aspect of the proposal to portray these programs as being partly or fully exempt from *all* cuts that would be made under the entitlement-cap legislation. In fact, under the entitlement cap proposal, the automatic across-the-board cuts are intended to serve as a *threat* that drives Congress to design and enact cuts large enough to met the entitlement caps *without* resorting to the automatic cuts. The automatic cuts are designed to be so unpalatable that Congress will feel compelled to enact major cuts in entitlements to achieve the required cuts, in order to prevent the automatic cuts from taking place.

Furthermore, it would be mathematically impossible to achieve all of the cuts needed to comply with the entitlement caps over the next ten years if Medicare and other programs that would be partially or fully exempt from the automatic cuts were left untouched or cut only modestly. If Congress responded to the entitlement cap in the initial years that the cap was in effect by declining to take action and relying on the automatic cuts instead, all entitlements *not* exempt from the automatic cuts — including farm price supports, direct student loans, TriCare military health benefits, the Earned Income Tax Credit, child support enforcement, trade adjustment assistance, vocational rehabilitation, the Social Services Block Grant, and salaries for Senators and Members of Congress — *would be entirely eliminated* by 2007 or 2008. After that point, *only Medicare and the entitlements that had been partially or fully shielded from the automatic cuts would remain as programs that could be reduced to produce the savings needed to meet the entitlement caps for years after 2008.*

In addition, it simply is not plausible that between now and 2009, Congress would sit idly by and allow all of the "unprotected" entitlement programs — including salaries for Members of Congress and Senators — to be eliminated. Avoiding that outcome would necessitate cutting Medicare and other programs that had some protection from the automatic cuts.

Arguments made by some proponents of the entitlement caps proposals are also contradictory. To those concerned about Medicare, they may imply that the entitlement cuts would be made entirely through automatic cuts and that Medicare would not be heavily affected. To those concerned with an array of other programs whose costs are not projected to grow rapidly — which includes most programs *other than* the health-care entitlements — they may imply that the cuts would come from the rapidly growing programs, such as Medicare. In fact, the cuts required under the entitlement cap proposals are so vast that all entitlement programs except Social Security would be at risk of being cut heavily.

The Depth of the Cuts

The authors of the entitlement cap proposals have not provided estimates of the magnitude of the entitlement cuts their proposals would require. But computing the size of the required cuts is straightforward. Each year's entitlement cap would be based on three factors: 1) the total cost of entitlements (other than Social Security) in the previous year; 2) the cost of inflation adjustments in those entitlement programs in which such adjustments are required; and 3) increases in the size of the population eligible for the various entitlement programs. The Congressional Budget Office has published projections of all three of these items,[2] as well as projections of entitlement program costs under current law. Based on CBO's projections, one can estimate the size of the entitlement cuts that would be required to meet the caps.

Based on the CBO data, entitlements would have to be cut by $1.8 trillion over the next decade to fit within the caps.[3] The required cuts would start in 2006 and quickly grow to about one-fifth of the projected costs of entitlement programs.

The $1.8 trillion in entitlement cuts that would be required under H.R. 3800 and H.R. 3925 is similar in size to the $2.1 trillion cost of the Bush tax cuts over the same time period (if the tax cuts are made permanent as the Administration has proposed).[4] The extensive entitlement cuts that would be required thus would largely "pay for" the tax cuts. The result would be an unprecedented transfer of income and resources from low- and middle-income children, elderly and disabled people, veterans, and the like to very-high-income households. The Urban Institute-Brookings Tax Policy Center projects that households with incomes of more than $1 million a year are receiving tax cuts that average more than $100,000 per year.

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[2] CBO projects increases in the caseload for each entitlement rather than increases in the eligible population, but the two factors are fairly similar.

[3] See Center on Budget and Policy Priorities, *Entitlement Cap Proposal Would Require Cuts Of $1.8 Trillion Over The Next Ten Years*, Greenstein, Kogan, and Friedman, March 16, 2004.

[4] The estimate of $2.1 trillion for the Bush tax cuts over the ten-year period 2005-2014 does not include the cost of additional relief from the Alternative Minimum Tax beyond 2005, which would bring the total to $2.4 trillion. Nor does it include the added interest payments on the debt that are being incurred as a result of the tax cuts.

The remainder of this analysis examines in more detail the errors in the Heritage Foundation analysis of the proposed entitlement cap and in similar claims being made by some entitlement cap supporters.

Separate Program Caps or One Overall Cap?

Heritage implies that a slowly growing entitlement program will not be affected because it will not breach the entitlement cap applicable to *that particular program*. Heritage states: "The Family Budget Protection Act takes a strong first step … by capping the growth of *each entitlement program* at the inflation rate plus the increase in the program's beneficiary population." (emphasis added)

Yet the statement that H.R. 3800 and H.R. 3925 propose individual program caps is simply incorrect. To the contrary, these bills propose an overall entitlement cap for each year, which would apply to *all entitlements taken together as a group*, not to each entitlement individually. (Social Security, alone among entitlements, is excluded and therefore not subject to the cap.) If, *as a group*, entitlements grow more rapidly than the entitlement cap formula allows, the cap is breached. Congress would be required to cut entitlement costs sufficiently to bring the total costs of entitlements back within the overall cap. Congress could cut any or all entitlements (except Social Security) to achieve the required entitlement cuts, which as noted, would total $1.8 trillion over ten years.

The CBO projections show that the principal reason that entitlements as a whole would breach the cap is that Medicare and Medicaid will grow far faster than the formula that is used to set the cap would allow. This would occur in part because the cap would be based on Medicare costs in 2005, *before* the prescription drug benefit goes into effect; the cap makes no allowance for the costs of the drug benefit. In addition, Medicare and Medicaid costs are rising faster than the formula would allow because health care costs are rising substantially, a trend that characterizes the private sector to the same or an even greater degree than it marks Medicare and Medicaid.

Does this mean Congress would choose to cut Medicare and Medicaid by *almost 30 percent* in order to leave all other entitlements untouched? Hardly. Congress almost certainly would spread the cuts more widely, hitting slowly growing entitlements as well as Medicare and Medicaid.

If Congress made proportional cuts to comply with the caps and reduced each entitlement by the same percentage, all entitlement programs would have to be cut about 20 percent by 2011. H.R. 3800 and H.R. 3925 do not dictate to Congress which entitlements to cut or how to cut them; the bills simply set overall yearly dollar caps (at levels well below what entitlement programs will cost under current law) and require cuts to bring entitlement costs within those caps. Slowly growing entitlement programs would be at the mercy of Congress and the political forces that shaped the ensuing entitlement cut legislation, just as other entitlement would be.

Congressional Cuts or Automatic "Sequestration"?

The Heritage paper also is misleading in another way. In discussing how much individual entitlement programs might be cut, Heritage conflates the requirement that *Congress* cut entitlements by $1.8 trillion over ten years to comply with the caps with the requirement that the *President* order automatic entitlement cuts if Congress fails to enact cuts big enough to fit within the caps. Heritage states:

> Entitlement caps would not lead to massive spending cuts: Earned entitlements and vital constitutional and regulatory duties would be exempt, and even the 2 percent maximum reduction for other priority programs could be absorbed by reducing the billions of dollars of waste, fraud, and abuse that plagues most agencies.

This sentence, however, applies *only* to automatic entitlement cuts, known as "sequestration," a key fact that Heritage does not explain. Under both H.R. 3800 and H.R. 3925, if Congress fails to enact sufficient cuts to reach the cap, OMB must estimate the amount by which entitlement spending would exceed the cap in the coming year and the President must order automatic cuts in entitlements to get down to the cap. Three important points must be kept in mind about these automatic cuts, however, which show why the Heritage presentation is misleading.

- If automatic cuts are needed because Congress has not cut entitlements enough, some entitlement programs would be partly or fully exempt from these automatic cuts. Programs such as interest payments on the debt, civil service retirement, and Medicare Hospital Insurance, would be fully exempt from the automatic cuts. Some other entitlements — including Medicaid, food stamps, military retirement, veterans' compensation and pensions, and (under H.R. 3800) Medicare physicians' insurance and the Medicare drug benefit[5] — would be subject to automatic cuts that could not exceed two percent per year. All remaining entitlement programs would be cut as deeply as was needed to achieve the required entitlement savings; they could be cut up to 100 percent. The box on the next page provides a partial list of programs that would be subject to unlimited automatic cuts.

The "Two Percent" Limit

For some entitlements, the size of the automatic cuts would be limited to two percent per year. The automatic cuts would be permanent reductions, however, so these programs would be cut an *additional* two percent each time that the automatic cuts were instituted, and the cuts would compound over time. If automatic cuts were made every year, the programs subject to the two-percent limit, such as Medicaid and veterans' benefits, would be cut 17 percent by 2014.

[5] Under H.R. 3925, all parts of Medicare would be exempt from sequestration. This is the only difference between the entitlement cap provisions of H.R. 3800 and H.R. 3925.

Partial List of Programs Subject to *Unlimited* Sequestration

Direct student loans
"TriCare-for-Life" military health benefits
Farm price supports and crop insurance
Extended unemployment benefits and trade adjustment assistance
"Refundable" payments under the Earned Income Tax Credit and the Child Tax Credit
Vocational rehabilitation state grants
Child care payments to states
Child Support Enforcement payments to states
Title XX social services grants to states
Payments from the Universal Service Fund
Forest Service, Park Service, Mineral Service, and other natural resources "permanent appropriations" and shared receipts
Payments from the Crime Victims' Fund, and the 911 Victims' Fund
INS, Customs, DEA, IRS, and Judiciary operations funded from user fees
Salaries of Members and Senators

- Because some large entitlements would either be exempt from the automatic cuts or subject to automatic cuts of not more than two percent per year, the automatic cuts would not be sufficient for very long to meet the entitlement cap. By 2007 or 2008, an automatic cut under which every entitlement was cut by the maximum amount allowed — with all of the programs not exempt or subject to the two-percent limit being *eliminated entirely* — would be insufficient to reduce entitlement spending enough to comply with the cap. Congress would have to make additional cuts elsewhere to reach the cap. In other words, if Congress initially made no entitlement cuts itself and instead allowed the automatic cuts to achieve the required savings, by 2007 or 2008, the programs subject to unlimited automatic cuts would have been eliminated and all further cuts would have to come from the "protected" programs.[6] An exemption from the automatic cuts consequently would not protect an entitlement program from reductions.

- Finally, under the entitlement cap proposal, automatic cuts would not be the intended method of achieving the required entitlement reductions. The automatic cuts are intended to be sufficiently unpalatable that Congress will try to avoid them; Congress is supposed to find the automatic cuts so abhorrent that it enacts cuts in entitlements that are of sufficient magnitude to reach the cap. As an indication that the proposal is designed so that automatic cuts on a repeated basis would be unacceptable to policymakers, recall that the automatic cuts would eliminate all of the programs listed in the box at the top of this page within a few years, including the program that pays the salaries of Members of Congress and Senators.

[6] The date is 2008 under H.R. 3800, which allows Medicare physician, outpatient, and prescription drug payments to be cut. Under H.R. 3925, which exempts all of Medicare from sequestration, the date on which all other programs would be eliminated by sequestration is 2007.

Appendix A:

Below is the Heritage analysis of H.R. 3800 we refer to. The portion on entitlement caps is reproduced in its entirety.

Better Budget Reform: A Guide to the Family Budget Protection Act

by Brian M. Riedl
Backgrounder #1758
May 14, 2004 | |

http://www.heritage.org/Research/Budget/bg1758.cfm

Entitlement Caps: A Key to Workable Spending Limits. A simple and effective policy of responsible budgeting would apply spending caps to entitlement programs as well as discretionary programs. The Family Budget Protection Act takes a strong first step in that direction by capping the growth of each entitlement program at the inflation rate plus the increase in the program's beneficiary population. Expenditures above cap levels would be subject to sequestration, with three important qualifications:

1. Programs such as Social Security, Medicare Part A, and the Civil Service Retirement System for federal employees would be exempt from sequestration because beneficiaries paid into the system and earned their benefits;

2. Programs that fulfill constitutional requirements, meet government commitments, and regulate economic institutions would be exempt; and

3. Certain high-priority programs (such as Medicare Parts B–D, veterans, military and retiree benefits, and specified low-income programs) could be sequestered by no more than 2 percent of their budget.

Entitlement caps would not lead to massive spending cuts: Earned entitlements and vital constitutional and regulatory duties would be exempt, and even the 2 percent maximum reduction for other priority programs could be absorbed by reducing the billions of dollars of waste, fraud, and abuse that plagues most agencies. Entitlement caps are vital to reining in runaway spending.