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COMBINED EFFECT OF SENATE PROPOSALS WOULD BE TO FINANCE NEAR-REPEAL OF THE ESTATE TAX WITH CUTS IN MEDICARE, VETERANS BENEFITS, SCHOOL LUNCHES, AND OTHER PROGRAMS

by Robert Greenstein and Richard Kogan

At the urging of Senate Republican leader Bill Frist, the Senate last week considered a House-passed proposal to repeal most but not all of the estate tax. The measure contains no "offsets"; its large cost would be financed through higher deficits.

In June, the Senate Budget Committee approved a far-reaching bill to make major changes in federal budget rules. Crafted by committee chairman Judd Gregg and co-sponsored by Senator Frist and 24 other Senate Republicans, the bill includes a provision that would establish binding deficit targets, which would be set at 0.5 percent of the Gross Domestic Product for 2012 and all years thereafter. In any year in which the deficit targets would otherwise be missed, automatic across-the-board cuts would be triggered in every entitlement program except Social Security.

Policymakers who have pushed for repeal of most or all of the estate tax (and for other tax cuts) often act as though tax cuts are a "free lunch," the costs of which need never be faced. As economists and budget analysts frequently explain, however, this is not so. Sooner or later, someone has to pick up the bill.

KEY FINDINGS

- Senate Republican leaders continue to push proposals to permanently eliminate most of the estate tax. They also have endorsed a measure the Senate Budget Committee passed June 20 to make far-reaching changes in the budget rules. That bill requires deficits to be reduced to 0.5 percent of GDP in 2012 and succeeding years, and triggers automatic across-the-board cuts in all entitlement programs except Social Security if the targets would be missed.
- **CBO estimates show that if the Bush income tax cuts are extended, deficits will exceed the targets the Budget Committee bill sets by almost $200 billion a year in 2012 (and more in succeeding years), even after the large cuts the Budget Committee bill calls for in discretionary programs are made. This gap would have to be closed by entitlement cuts (unless tax cuts are scaled back or revenues raised in some other manner, or discretionary programs are cut even more deeply).**
- The costly estate-tax measure would trigger deep entitlement cuts under this approach. Every dollar in lost estate-tax revenue would trigger an additional dollar in entitlement program cuts.
- Under the automatic budget cuts in the Budget Committee bill, the legislation to eliminate most of the estate tax would trigger cuts over the 2007-2016 period of: $115 billion in Medicare, $61 billion in Medicaid and SCHIP, $9 billion in SSI benefits for the elderly and disabled poor; $8 billion in veterans benefits, and $3 billion in school lunch and child nutrition programs. The entitlement-program cuts would dwarf those contained in the budget reconciliation bill enacted earlier this year.

The Gregg bill places a spotlight on how these tax cuts would be paid for. Taken together, the reductions in the estate tax recently approved by the House and the Gregg budget-enforcement bill would result in multi-million dollar tax cuts for the estates of the wealthiest Americans who die, with these lavish tax cuts being financed by large reductions in health care, retirement, and other benefits on which millions of ordinary Americans rely.

How the Gregg Bill Works

In addition to setting these deficit targets, the Gregg bill would impose austere three-year caps on the overall level of appropriations for discretionary programs (i.e., programs that are not entitlements), with the caps being set at the appropriations levels proposed in the President's budget for each fiscal year through 2009. These caps are designed to lock in discretionary cuts of the depth that the President's budget proposes.

Congressional Budget Office projections show that if the President's tax cuts are extended (except for repeal of the estate tax) and relief from the Alternative Minimum Tax is continued, the projected budget deficit in 2012 and every year thereafter will be close to *$200 billion above the level* needed to hit the Gregg bill's deficit targets, even if discretionary programs are cut sharply enough to fit within these caps. Under the Gregg bill, this entire difference would have to be made up with cuts in entitlement programs, unless Congress cut discretionary programs *below* the caps or raised taxes.

This means that under the Gregg bill, *every dollar that a tax-cut bill loses in revenue must eventually be made up by cutting a dollar out of entitlement or other mandatory programs* (unless discretionary programs are cut more deeply, other tax cuts are terminated or scaled back, or other revenue-raising measures are adopted). The revenue losses from tax-cut bills would make the gaps between deficits and the deficit targets larger than they otherwise would be, which in turn would necessitate deeper budget cuts to hit the targets. Tax cuts consequently would trigger larger automatic across-the-board cuts in entitlement programs, unless other deficit-reduction measures were enacted.

Table 1
Cuts in Various Entitlement Programs Triggered by House Estate-Tax Plan
(in billions of dollars)

	Cuts 2007-2016
Medicare	115
Medicaid/SCHIP	61
Federal Civilian Retirement	16
EITC/Child Tax Credit	9
Military Retirement	9
Unemployment Insurance	9
SSI for elderly and disabled poor	9
Veterans disability compensation and pensions	8
Food stamps	7
School lunch/child nutrition	3
Farm Programs	3
Total entitlement cuts	**268**

The Budget Cuts that the House-Passed Estate-Tax Provision Would Trigger

The revenue losses resulting from the House-passed reductions in the estate tax thus would have to be made up (under the Gregg bill) by reductions in entitlement programs. The automatic cuts that the Gregg bill would trigger (in the absence of other action) would reduce all entitlements except Social Security by the same percentage. (The Gregg bill exempts Social Security from the automatic cuts.)

Enactment of the House estate-tax provisions would trigger $268 billion in entitlement cuts over the 2007-2016 period, with $214 billion of these cuts coming in the second five years (2012-2016). These cuts would dwarf the $39 billion over five years in entitlement cuts contained in the budget reconciliation legislation enacted in February.

Table 1 displays the cuts that would have to be made in various entitlement programs to offset the increases in deficits the House-passed estate-tax plan would cause. The Table is based on the official cost estimate that the Joint Committee on Taxation has issued of the estate-tax provisions in the House bill. (The official cost estimate assumes that the capital gains tax rate — to which the lower estate tax rate would be tied under the House bill — will revert to 20 percent after 2010, when the current 15 percent is slated to expire. If the 15 percent capital gains rate is extended, as most supporters of the House bill intend, the bill's costs will be greater, and the cuts in entitlement programs that it would necessitate consequently would be larger.)

Would These Cuts Happen?

For Senators who favor the House estate-tax plan and have endorsed the Gregg bill, these findings will not be welcome. They may seek to dismiss these findings.

- One argument they may make is that under the Gregg bill, Congress could pass legislation to cut the budget enough so that the bill's automatic cuts would not be needed to hit the deficit targets. This is certainly true. But unless discretionary programs are cut even more deeply (or unless measures are passed to scale back other tax cuts or otherwise increase tax revenues, something that Members of Congress who support the House and Gregg bills overwhelmingly oppose), any budget cuts enacted to offset the deficit-enlarging effects of the House bill would have to consist of cuts in entitlement programs. As a result, any argument that certain entitlement programs would be cut less deeply than shown in Table 1 (or not cut at all) is merely an observation that certain entitlement programs could be cut less deeply than shown in Table 1 if other entitlement programs were cut *even more deeply* than the table shows.

- Another argument that may be made is that the House estate-tax cuts would trigger a surge in economic growth and pay for themselves. Such an argument is dismissed by mainstream economists. (For a discussion of the flimsy nature of claims that eliminating most or all of the estate tax would have a large positive effect on economic growth, see the recent CBPP analysis of these claims.[1])

A point could be made that few, if any, Members of Congress favor allowing the estate tax to return in 2011 to its parameters under the pre-2001 tax law. Many Senators who oppose the House estate-tax plan support making permanent the estate-tax rules that will be in effect in 2009, when the first $3.5 million of an estate — $7 million per couple — will be exempt and the top rate will be 45 percent. Were that approach to be adopted, the entitlement cuts that would be triggered under the Gregg bill would be a little more than *half* the size of the cuts shown in Table 1.

[1] Aviva Aron-Dine, "Estate Tax Repeal Would Decrease National Saving," Center on Budget and Policy Priorities, June 8, 2006.

Conclusion

As economists and budget analysts often point out, there is no budgetary free lunch in tax cuts or spending increases. Sooner or later, they have to be paid for.

This applies to the costly House estate-tax provision. And the Gregg bill indicates how Senate leaders intend the cost to be paid. Under the course that the Senate leadership is pursuing, as reflected in the House and Gregg bills, multi-million-dollar tax cuts for the estates of the wealthiest individuals in the nation would likely be financed by steep cuts in basic health, retirement, and other benefits for tens of millions of other Americans of more modest means. There is serious question as to whether these are the priorities that the American public would favor if supporters of the House estate tax bill and Gregg bill acknowledged that this is the course they seek to chart.