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POLICY POINTS

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AS CONGRESS FINISHES WORK ON THE BUDGET, TAX CUTS AND BUDGET CUTS ARE GROWING

In the name of reducing the deficit, last month the House passed roughly $50 billion in cuts over five years in entitlement programs such as Medicaid, child support enforcement, student loans, and food stamps. Some House Members are calling for an across-the-board cut in discretionary (i.e., non-entitlement) programs as well. This cut, which would affect everything from Head Start to environmental protection to education to housing assistance for the poor, would come on top of cuts in discretionary programs already approved during the normal appropriations process.

This week, however, the House's true priorities became clear when it passed a series of tax cuts that would cost more money than all of its program cuts would save. As a result, the House approach would actually *worsen* the deficit, in 2006 and future years.

The Push for More Tax Cuts

The House passed four tax-cut bills this week: the reconciliation tax bill, a one-year extension of relief from the Alternative Minimum Tax (AMT), tax incentives for states hit by Hurricane Katrina, and a package of five small tax provisions. Their combined cost is roughly $95 billion over the next five years.

The House's tax reconciliation bill costs about the same amount as the tax reconciliation bill passed by the Senate, but unlike the Senate bill, the House bill does *not* include provisions related to the AMT and Katrina. House leaders chose to vote on those two items separately. That allowed the House to fit more-controversial tax cuts — most notably, extensions of capital gains and dividend tax cuts — into the reconciliation bill, where they would be protected against a Senate filibuster. This strategy appears aimed at increasing the total amount of tax cuts ultimately enacted.

More than three-quarters of the benefits of the House tax cuts would go to the 14 percent of U.S. households with incomes above $100,000. The capital gains and dividend tax cuts are especially tilted toward high earners: nearly half of their benefits would go households making over $1 million. These millionaire households, which will make up just 0.3 percent of all households in 2009, would receive an average tax cut of $32,000 apiece from these two tax cuts alone.

The Push for an Across-the-Board Spending Cut

Congress this year has cut fiscal year 2006 funding for domestic discretionary programs by an average of 2.3 percent below the 2005 level adjusted for inflation — that is, 2.3 percent below the level needed to maintain the current level of services. (Some programs were cut by less than this amount; others were cut by more.) Some in the House want an additional cut of one or two percentage points across domestic discretionary programs.

When combined with the cuts already enacted or agreed to by House and Senate appropriators, a one percent across-the-board cut would have a significant effect. For instance, funding for:

- the Community Development Block Grant, which funds activities ranging from improving roads to rehabilitating blighted buildings and helping the homeless, would be cut by 15.7 percent, or $777 million;

- EPA funds to states to ensure clean drinking water would be cut by 12.3 percent, or $243 million; and

- children and families services programs, which include Head Start (which would be reduced by 25,000 children), services for abused and neglected children, and small programs such as abstinence education and services for homeless youth, would be cut by 3.8 percent, or $350 million.

Further, an across-the-board cut of one percent would, by itself, eliminate federal rental housing assistance for up to 65,000 low-income households.

Reining in "Runaway" Spending, or Offsetting Part of New Tax Cuts?

Even if the House does approve an across-the-board cut of one or two percent, the total program cuts it approves this year — including the cuts in entitlement and discretionary programs it has already endorsed — would be smaller than the tax cuts it passed this week. This means, in effect, that the House's program cuts would be used *not* to reduce the deficit, as supporters suggest, but instead to finance a portion of the tax cuts, which primarily benefit the well-off.

Supporters of large cuts in domestic programs also claim that appropriations for domestic programs have exploded in recent years. But as the table below shows, domestic discretionary programs have remained steady as a share of the economy since 2001. While overall funding for discretionary programs has grown as a share of the economy, *all* of this increase has come in defense and related security areas (including homeland security and postwar reconstruction in Afghanistan and Iraq).

Table 1: Funding Growth in Defense and Domestic Discretionary Programs, 2001-2005

	Defense and related security programs	Domestic discretionary programs
Increase as a share of GDP	+1.2% of GDP	No change
Average annual growth rate, after adjusting for inflation and growth in the size of the U.S. population	9.5% per year	1.9% per year

Conferees Should Adopt Senate Approach, Despite Its Significant Flaws

As House-Senate conferees seek agreement on budget and tax legislation, they would be well advised to follow the approach of the Senate. Among other things, the Senate:

- achieved savings in entitlement programs while largely protecting low-income Americans from harm, partly by scaling back subsidies for special interests such as drug manufacturers and managed care companies; and

- passed tax cuts that are less costly and less egregiously skewed to upper-income households than the House's tax cuts.

The Senate approach has significant flaws as well. It too would increase the deficit, since the Senate's tax cuts would outweigh its program cuts, and the Senate's tax cuts are tilted toward the top (though not as much as the House's). Nevertheless, the Senate approach is both fairer and more fiscally responsible than the House approach.

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