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POLICY POINTS

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SOME KEY FACTS CONCERNING THE PRESIDENT'S BUDGET PRIORITIES FOR 2007

In this week's State of the Union, President Bush outlined the priorities of the Administration's forthcoming budget. Several key facts necessary to understanding the impact of the President's proposals, however, were not mentioned in the speech.

1. **While the deficit is likely to shrink somewhat over the next few years, this is *in spite of* the President's policies not because of them, and deficits are projected to begin swelling again later in the coming decade.**

Projections released by the Congressional Budget Office (CBO) this week show the deficit declining over the next few years, largely as a result of the economy's continuing recovery from the recent downturn. But if the President's tax cuts are made permanent, as he proposed again this week, CBO projects rising deficits in the second half of the coming decade, with annual deficits approaching $500 billion by the end of the decade.

While the details of the Administration's budget are not yet known, it is a virtual certainty that it will not contain spending cuts large enough to offset the cost of extending the tax cuts, which would be more than $300 billion per year. Thus, the President's policies would make the deficit larger than if no changes in policy were made.

2. **While entitlement reform is needed to control deficits over the long term, any progress made in this area could be wiped out by the cost of extending the tax cuts.**

The President called for creation of a bipartisan commission to propose ways to reduce the long-term costs of Social Security, Medicare, and Medicaid. Entitlement reform is needed to cope with the coming retirement of the baby boomers, but entitlements are not the only major factors driving up long-term deficits.

If the President's tax cuts are extended permanently, their cost over the next 75 years (the standard period used to evaluate Social Security's long-term finances) will be *three times* the Social Security shortfall over that period.

As a result, much of the budgetary gain produced by entitlement reform could be wiped out by the cost of extending the tax cuts, leaving the nation little better off. In contrast, the deficit-reduction initiatives of 1990 and 1993, under

Presidents Bush (Sr.) and Clinton, were successful because they put *all* parts of the budget on the table — revenues as well as spending — and required shared sacrifice.

The last time a presidential commission was established to examine entitlements, in 1994, its agenda was not limited to spending entitlements (such as Social Security) but also included tax expenditures, which outgoing Fed chairman Alan Greenspan termed "tax entitlements." Though tax entitlements now cost the federal government more than $600 billion per year, the President's proposal for an entitlements commission appears to rule out consideration of savings in this area. If so, the commission's recommendations will not represent shared sacrifice and thus are less likely to achieve the bipartisan support they will need to succeed.

3. **Similarly, the tax cuts Congress is planning to enact under reconciliation will more than offset the budgetary gains produced by the budget cuts the House approved this week, resulting in a net increase in the deficit.**

On February 2, the Senate approved $70 billion in tax cuts under special fast-track "reconciliation" procedures; the House has already approved a similar amount of new tax cuts. While the tax cuts in the two bills differ, both bills cost well more than the $39 billion in reconciliation budget cuts — in Medicaid, student loans, child support enforcement, and other programs — that the House narrowly approved this week.

A CBO report released last week finds that the Medicaid cuts alone would require 20 million low-income people to pay more for prescription drugs, require 13 million low-income people (one-third of them children) to pay more for health care other than prescription drugs, cause 65,000 people (more than half of them children) to lose Medicaid coverage entirely because they cannot afford the new charges, and cause cutbacks in Medicaid services such as vision and dental care for 1.3 million people.

CBO has also projected that the cuts in child support enforcement funding will reduce the amount of child support collected on behalf of families with children by roughly $8 billion over the next decade.

Yet despite the painful consequences of these and other cuts, the net effect of the budget and tax reconciliation bills will be to *increase* the deficit, since all of the budgetary gains from the program cuts will effectively be used to pay for part of the tax cuts.

4. **Spending on domestic discretionary programs, which the President singled out as an area for cuts, makes up a *smaller* a share of the economy than it did in 2001.**

Only 8 percent of the cost in fiscal year 2005 of legislation enacted since 2001 came from increases in domestic discretionary programs outside homeland security. In comparison, 48 percent of the cost came from tax cuts, and 36 percent came from increases in defense, homeland security, and international operations (including operations in Afghanistan and Iraq).

In fiscal year 2006, domestic discretionary spending was a smaller share of GDP than in 2001, and in fiscal year 2007 it will be smaller still.

5. **Some of the health-related tax proposals outlined by the White House this week would expand tax entitlements for high-income people, which expand the deficit just as spending entitlements do.**

   The Administration has proposed significantly increasing the size of tax-deductible contributions people can make to Health Savings Accounts (HSAs).

   These accounts already offer unprecedented tax-sheltering opportunities, since unlike all other savings and retirement accounts, they offer both tax-deductible contributions *and* tax-free withdrawals (if the withdrawals are used for out-of-pocket medical costs).

   Moreover, HSAs, unlike IRAs, have no income limits on who can participate. As a result, affluent people who are ineligible for IRAs because of their incomes, or those who have "maxed out" their IRAs or 401(k)s, could use HSAs to shelter a greater share of their income for retirement.

   Some high-income people are expected to shift part of their retirement savings from IRAs and 401(k)s to HSAs because of HSAs' greater tax advantages. As a result, some funds that otherwise would have been placed in IRAs or 401(k)s — and taxed upon withdrawal — would be withdrawn tax free from HSAs instead. This means the true long-term cost of the President's HSA proposals will be much higher than the official five- or ten-year cost estimates.

   Finally, it must be noted that the Administration's proposals could lead to a net *increase* in the number of uninsured. By removing all of the existing relative tax advantages for employer-based coverage (and encouraging healthy, affluent persons to leave comprehensive employer-based coverage for the tax-sheltering opportunities of HSAs and high-deductible insurance policies purchased in the individual market), the Administration's proposals would almost certainly accelerate the decline of the employer-based health care system.

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