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THE ADMINISTRATION'S BUDGET: GAPS BETWEEN RHETORIC AND REALITY

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Initial analysis of the Administration's budget suggests substantial differences in key areas between the realities that underlie this budget and the comforting rhetoric surrounding it:

1. The supposed $842 billion contingency reserve is essentially an illusion.

- First, the reserve is inflated by more than $500 billion through a misleading presentation that camouflages the surpluses in the Medicare Hospital Insurance trust fund, which both houses of Congress voted by nearly unanimous votes last year to set aside and not to use for tax cuts or other programs. The budget artificially makes the Medicare HI surpluses "disappear" in order to make the surpluses available for tax cuts and other initiatives appear to be larger than they actually are.

- Second, the "extra" funds that constitute the reserve are generated by failing to include in the budget various costs that will inevitably occur, such as the costs of maintaining current payments to farmers, fixing the Alternative Minimum Tax so it doesn't hit millions of middle-class taxpayers, and extending a number of expiring tax credits for the full 10 years. The "extra funds" also are generated by the lack of inclusion in the budget of the costs of some key initiatives the President promised in the campaign and plans to pursue, such as a national missile defense.

- Third, the math underlying the reserve assumes that a prescription drug benefit and Medicare reform can be accomplished for $153 billion over 10 years. This amount is far below what any drug benefit that provides even modest help to middle-income seniors will cost and ignores the fact that restoring long-term solvency will require large additional sums to be devoted to Medicare from general revenues, even if controversial changes like those in the Breaux-Frist or Breaux-Thomas packages are enacted. (The Breaux-Frist and Breaux-Thomas packages would close only a modest share of the long-term funding gap in the Medicare Hospital Insurance trust fund. The need for additional general fund revenues can be avoided only if Medicare payroll taxes are raised significantly, an approach the Administration clearly does not favor.)

- Fourth, any use of the reserve for purposes other than debt reduction — i.e., for AMT relief, Medicare reform, farmers, extra defense costs, or the like — will generate extra interest costs that also must fit within the reserve.

- Fifth, the existence of the reserve also rests upon an assumption contained in the budget that cuts of several hundred billion dollars will be needed over the next 10 years in non-defense discretionary programs outside education, health research, and a few other favored areas. Such cuts will be very difficult to secure political support for, especially in a period of surpluses. They are unlikely to occur.

When realistic accounting is done, the reserve disappears and a budget hole emerges. If this budget hole is not filled, the budget will entail a return of deficits outside Social Security and Medicare (and of the use of Social Security and Medicare surpluses to fund other programs). In other words, since the reserve is inadequate to cover the likely claims against it, deficits outside of Social Security and Medicare Hospital Insurance trust funds are likely to return unless still larger cuts in domestic programs can be achieved.

The reserve turns out, upon close inspection, to be a clever accounting device that obscures more than it illuminates and cloaks the budget trade-offs the Administration's large tax cut creates. By failing to disclose the costs of a number of items and distorting Medicare financing, the budget essentially "hides the ball" and prevents policymakers and the public from seeing the trade-offs the tax cut entails. (The reserve is discussed in more detail in our accompanying piece, "The Administration's Budget Reserve: Do the Numbers Add Up?.")

2. A careful reading of the tables in the budget reveals that the budget math depends upon significant, unspecified reductions in non-entitlement programs. Table S-4 shows that the budget proposes cuts of $12.1 billion in fiscal year 2002 in discretionary programs outside defense, education, health research, and a few other favored areas. Table S-4 also shows a reduction of $8.4 billion in FY 2002 appropriations below the FY 2001 level for one-time items and earmarked items. Reductions of this magnitude in earmarked and one-time items are unlikely — each year's appropriations bills have new earmarks and one-time items. The probable result would be reductions greater than $12.1 billion next year in discretionary programs outside the favored areas. Another table (S-6) provides data showing that fiscal year 2002 funding for discretionary programs in an array of departments and agencies would be cut *below a "freeze" level* — that is, below the FY2001 level even without an adjustment for inflation. Among the agencies in which overall funding for discretionary programs would be cut below a freeze level are the Departments of Agriculture, Commerce, Energy, Interior, Justice, and Labor, and the Environmental Protection Agency.

The budget also shows that the Administration's education, defense, health research, and other discretionary initiatives would add $260 billion over 10 years, without counting national missile defense, while *total* discretionary spending would rise just $30 billion over 10 years. This means non-defense discretionary spending outside education, health research, and a small number of other favored areas *would have to be reduced $230 billion* below the current year's level, adjusted for inflation. These cuts are left unspecified. And when the Administration eventually proposes increases for national missile defense and other defense spending increases, the size of the reductions needed in other discretionary areas could grow several hundred billion dollars larger — or, more realistically, constitute another claim against an already over-subscribed "reserve."

Also of note, Table S-7 shows that the Administration is proposing new caps on total discretionary spending, to be set approximately at this year's level adjusted for inflation. Table S-12 purports to show how much each area of the budget would receive under the caps. But the figures in Table S-12 are illusory; a footnote to the table shows that the defense numbers in the table *do not include any of the defense spending increases the Administration will propose in the future*. Providing more money for national missile defense and other defense programs, as the administration is expected to do, will mean that other departments need to be cut to lower levels than the levels shown in the table, in order for total discretionary spending to fit within the caps the Administration has proposed.

What emerges is that the Administration is using the "reserve" — along with the lack of specificity regarding what it will seek for national missile defense and various other defense spending increases and what specific cuts it ultimately will propose in an array of domestic discretionary programs — to camouflage the trade-offs and tough choices its tax cut entails. Indeed, the strategy may be to show the defense increases — along with some of the proposed cuts— in the budget released *a year from now*, after the tax cut has been enacted.

3. Another point that emerges from the budget is that the Administration's tax cut costs at least $2.0 trillion. Table S-2 shows the tax cut will lose $1.62 trillion in revenue. It also shows increased interest payments on the debt of $417 billion. The overwhelming bulk of this $417 billion in added interest costs results from the tax cut. (The $417 billion reflects the added interest costs due to $1.62 trillion in tax cuts and $173 billion in net spending increases.) Since about $375 billion of the $417 billion in interest costs results from the tax cut, that brings the overall cost of the tax cut to $2.0 trillion. This $2 trillion cost does not include added costs from fixing problems in the Alternative Minimum Tax or from accelerating some of the tax cuts, which the President has said he favors.

4. The budget pays down less debt than it could. The Administration's claim that $2 trillion is the maximum amount of debt that can be paid down over 10 years rests on an assertion that there is $1.2 trillion of publicly held debt that cannot be paid down in this period. This figure is disputed by other experts. CBO has estimated that the amount of debt left outstanding at the end of ten years would be about $800 billion if the Treasury simply continues its existing policy of buying back some marketable debt before it matures. In recent testimony, Federal Reserve Chairman Alan Greenspan used a figure of $750 billion (plus some modest amounts of debt the Fed may or may not need to hold on to). Gary Gensler, the former Treasury Undersecretary who managed the Treasury's debt operations, concludes in a new analysis that the amount of debt outstanding in 2011 could be reduced as low as $400 billion to $500 billion. The Administration's figure is conveniently above these other estimates.

5. Finally, in some areas, the Administration's press releases and the President's address to Congress risk creating misleading impressions. For example, the President said last night that his budget would increase spending on Social Security, Medicare, and other entitlements by $81 billion in 2002. In fact, $68 billion of this increase represents no change in the operation, eligibility, or generosity of these programs; this $68 billion simply reflects costs that will automatically occur under current law as a result of the annual Social Security cost-of-living adjustment, increases in health care costs charged by medical providers, and an increase in the number of elderly beneficiaries. The true increase that the President is proposing in 2002 in these programs is $13 billion, about one percent of the cost of these programs, which would largely go for the "helping hand" prescription drug proposal.