CENTER ON BUDGET AND POLICY PRIORITIES

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THE ADMINISTRATION'S BUDGET RESERVE: DO THE NUMBERS ADD UP?

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The budget is said to contain a $842 billion reserve. Closer examination, however, indicates that the numbers underlying the reserve do not add up.

1. Medicare: The budget fails to set to the side the surpluses in the Medicare Hospital Insurance trust fund and creates a fiction that Medicare has no surpluses and is in deficit. Tables in the budget show that OMB actually projects that the Medicare Hospital Insurance trust will run a $526 billion surplus over the next 10 years. The Medicare HI surplus, which policymakers of both parties have voted to set to the side and not to use to finance tax cuts or other programs, amounts to *more than half* of the so-called "reserve."

In the budget, the administration tries to make this surplus disappear through a clever but misleading budget display. Medicare Hospital Insurance (Part A) is financed by payroll taxes and, to a small degree, by a portion of the income taxes that are collected from the taxation of a portion of the Social Security benefits of higher-income beneficiaries. Medicare Hospital Insurance has its own trust fund. The physician's services part of Medicare (Part B) is funded separately and, unlike Part A, was never intended to be self-financing. One-fourth of its financing of Medicare Part B comes from monthly premiums that beneficiaries pay, but the other three-fourths comes from general revenues. This is how Medicare was designed.

The administration takes the unprecedented step of adding the total costs of Medicare Parts A and B and then comparing them to Medicare revenues just from payroll taxes and premiums. Since three-quarters of Medicare Part B is intended to be funded by general revenue, the effect is to make it look like Medicare's costs exceed Medicare's income. The administration then pronounces the Medicare HI surplus as meaningless and claims that Medicare is in deficit so it has no surpluses to save. This serves the politically convenient purpose of helping to justify what otherwise would seem politically unjustifiable — failing to set aside the Medicare HI trust fund surplus and instead using it to fund other items.

Using this device to claim that Medicare is in deficit is not justifiable. By this logic, all programs funded by general revenues — including the Pentagon, the military pension Program, and the education and health research programs that the administration proposes to expand — are in deficit and thus in need of reform, as is everything in the budget not specifically financed by an earmarked tax.

By camouflaging the Medicare HI trust fund surplus and artificially making it "disappear," the Administration can turn around and add the $526 billion Medicare HI surplus to the surplus in the rest of government to make it appear as though all of these funds are available to finance the tax cut and other programs. Through this maneuver, the Administration is able to make it look as though there is more room in the budget for its tax cut and to hide the troubling trade-offs the large tax cut creates for the rest of the budget. Ironically, one of those troubling trade-offs is that if the tax cut is enacted, there will be less money available for an adequate Medicare drug benefit and for an infusion of more general revenue into Medicare as part of a Medicare reform package that restores long-term solvency to the program.

Once the Medicare HI surpluses are set to the side, only $316 billion of the Administration's $842 billion reserve remains.

2. Inevitable Costs that are Left Out. The budget leaves out a number of inevitable costs. These include:

- Continuing current payments to farmers, at a cost of about $100 billion over 10 years (Table S-11 shows spending for agricultural programs plummeting from $26.1 billion in 2001 to $14.9 billion in 2003 and smaller amounts in subsequent years, because of the administration's failure to include the virtually inevitable costs of continuing these farm payments);

- Fixing a well-known problem in the Alternative Minimum Tax so it does not subject millions of middle-class families to the AMT, which entails a cost of approximately $300 billion over 10 years if the Bush tax cut is passed; and

- Extending the expiring tax credits for 10 years (the budget shows the cost of extending most of these credits for only *one* year), which adds about another $25 billion.

- The more-than-$400 billion in costs just mentioned would also generate additional costs for interest payments on the debt. This would bring these costs to more than $500 billion, which exceeds the $316 billion left in the reserve when the Medicare HI trust fund surplus is set to the side.

3. Additional Costs the Administration has not specified. The administration's "helping hand" prescription drug proposal is supposed to be only a first step; it is limited to low-income seniors. As a candidate, President Bush said this would then be broadened into a drug benefit for other seniors as well. The budget does not include resources that could accommodate a significant drug benefit for middle-income seniors.

The budget also does not include funds for a national missile defense or other defense spending increases that are likely to emerge from the administration's defense review.

Conclusion

The "reserve" is a convenient way to avoid providing specifics in a number of areas. It obscures the fact that rather than creating a reserve for unforeseen contingencies, the budget lacks sufficient funds to avoid a return to deficits outside the Social Security and Medicare HI trust funds, unless large cuts in domestic programs — cuts that the Administration does not identify at this time — are enacted.