CENTER ON BUDGET AND POLICY PRIORITIES

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FOLLOWING THE MONEY: THE ADMINISTRATION'S BUDGET PRIORITIES

by Robert Greenstein

In his address to Congress and the American people on February 27, President George W. Bush set forth his priorities for the nation. The President said education was his highest priority, and he spoke about new resources he planned to devote to education, health care, national defense and other areas. Not until half an hour into his address did he mention tax cuts, which he presented as something we can and should do because substantial resources would remain after other priorities are met.

All presidents and administrations seek to present their budgets in the most favorable light. Closer scrutiny of the numbers that underlie an administration's budget proposals, however, frequently tells a different story. The goal of this analysis is to examine the priorities reflected in the Bush Administration's budget itself, and in particular, to consider how the resources slated for areas the President has identified as priorities compare with the resources provided for the tax cut.

The analysis begins by looking at the dimensions of the available budget surplus. It then considers the size of the President's tax cut. The main body of the analysis examines how education and certain other priorities would fare, especially in comparison to the tax cut.

I. The Dimensions of the Available Surplus

Both the Congressional Budget Office and the Office of Management and Budget project a $5.6 trillion total budget surplus over the next ten years. Some $2.5 trillion of this amount (under the CBO estimate) and $2.6 trillion (under the OMB estimate) consist, however, of projected surpluses in the Social Security trust funds. These trust funds are in surplus now while the baby boomers are in their peak earning years. All of these surplus amounts will be drawn down, however, after the baby boomers retire in large numbers. The Social Security trustees project that Social Security will become insolvent (i.e., will be able to pay only about 70 percent of promised benefits, rather than 100 percent) in 2038. As a result, a bipartisan consensus has developed that the surpluses currently building in the Social Security trust funds should be set to the side and not be used for tax cuts or program increases. That reduces the available surplus to about $3 trillion over ten years.

The same logic applies to the Medicare Hospital Insurance trust fund. It, too, is in surplus now and is building reserves that will be fully consumed when the baby boomers retire. The trustees project this trust fund will become insolvent in 2029. Members of both parties say they are against using the current surpluses in the Medicare Hospital Insurance trust fund for

The Administration's budget shows that in 2011, with all provisions of the tax cut fully in effect, there would be $25 billion in increased expenditures for domestic programs and defense combined, compared to $254 billion in tax cuts. Tax cuts would outweigh program initiatives by 10 to 1.

anything other than Medicare. Setting the Medicare HI surplus to the side reduces the available surplus to $2.7 trillion under the CBO estimates and $2.5 trillion under OMB's estimates.

This does not mean, however, that $2.5 trillion to $2.7 trillion is available for tax cuts and program increases. Analyses issued by the Center on Budget and Policy Priorities, the Concord Coalition, and economists at Brookings and other institutions all find that there is a significant difference between the official CBO and OMB surplus projections and the amount actually available for policy initiatives. The reason for this is that in developing their budget forecasts, CBO and OMB must follow rules that direct them to assume rigid adherence to current law, even where doing so would represent a sharp break with a popular, current policy and the current policy is virtually certain to be maintained. To be fiscally responsible, policymakers must take account of the resources that will be used to maintain current policies in these areas; those resources cannot also be used for new initiatives.

For example, there are approximate 20 tax credits that expire every two years or so and always are extended; these tax credits enjoy broad bipartisan support. But, when making their surplus projections, CBO and OMB must assume these tax credits will expire as scheduled. A similar story holds for payments to farmers. In recent years, Congress has provided an average of $10 billion a year in payments to farmers under annual (rather than ongoing or permanent) legislation. Because these payments are not permanently authorized, the official surplus forecasts assume they will not continue. Yet whatever one may think about these tax credits and farm payments, it is virtually certain they will be continued. Accordingly, policymakers who seek to determine how much of the surplus is available for tax cuts and program initiatives need to subtract from the CBO and OMB surplus projections the cost of continuing these programs. If policymakers do not do so, they risk committing the same dollars twice.

A third example concerns the Alternative Minimum Tax. The AMT, as it is known, was

Table 1

CBO's New Baseline Projections of the Surplus, Adjusted to Reflect the Full Costs of Maintaining Current Policies

(in trillions of dollars)

	Fiscal Years 2002 - 2011
New Baseline non-Social Security Surplus [a]	3.1
Exclude Medicare Hospital Insurance (HI) Trust Fund Surplus	-0.4
Non-Social Security, non-HI Surplus	2.7
Adjustments for more realistic assumptions:	
Discretionary spending grows with population as well as inflation	-0.3
Extend expiring tax credits and reform AMT	-0.2
Continue farm payments at close to current level	-0.1
Debt service	-0.1
Total changes	-0.8
Adjusted non-Social Security, non-Medicare Surplus	2.0 [b]

[a] Assumes that discretionary appropriations are maintained at the current enacted level, adjusted for inflation.
[b] Column may not add due to rounding

established to prevent very high-income individuals from using so many tax shelters that they owe little federal income tax. Due to a widely recognized flaw in the AMT's design, however, the AMT will encroach heavily upon the middle class in coming years and hit millions of middle class taxpayers if the problems in the AMT are not addressed. These taxpayers will face higher tax bills and much greater tax complexity as a result. While 1.5 million taxpayers will be subject to the AMT this year, the Congressional Joint Committee on Taxation projects that 21 million taxpayers — including nearly half of all families of four or more — will fall under the AMT by 2011 if nothing is done. It is unthinkable that policymakers will allow the AMT to swell in this fashion; virtually all observers expect the AMT problem to be addressed. Doing so will cost a significant amount of money.

The virtually inevitable actions just in these three areas — extending the expiring tax credits, maintaining payments to farmers, and holding the AMT to roughly its current size — will consume several hundred billion dollars of the officially projected surpluses. Many knowledgeable observers expect that several hundred billion dollars more will be used to maintain current real per-capita levels of spending for discretionary (i.e., non-entitlement) programs. Maintaining discretionary spending in real per-capita terms means maintaining its purchasing power per U.S. resident by having it stay even with inflation and U.S. population growth.

The CBO and OMB surplus forecasts assume that total expenditures for discretionary programs will rise only with inflation, and not with population growth. As a result, the official forecasts assume that despite budget surpluses, there will be an overall decline in the goods and services these programs provide per U.S. resident. This seems unrealistic. Since 1990, non-defense discretionary spending has risen 25 percent faster than inflation. Moreover, it has risen 12 percent in real per-capita terms. Furthermore, defense spending accounts for half of all discretionary spending, and the Administration is expected to propose sizeable defense spending increases, including funding for a national missile defense, when it completes the defense review it is currently conducting.

Robert Reischauer, the former CBO director who now heads the Urban Institute and is widely regarded as one of the nation's leading budget experts, has said it would be a "Herculean feat" to hold discretionary spending even in real per-capita terms. Simply assuming that this "Herculean feat" is achieved reduces the available budget surplus by over $300 billion dollars more (since, as noted, the official surplus estimates assume that discretionary spending is *reduced* in real per-capita terms).

As a result, we estimate that the projected surplus that is available for tax cuts and program initiatives is about $2 trillion over ten years. (See Table 1.) The Concord Coalition has issued its own estimate of the available surplus, as have economists William Gale of Brookings and Alan Auerbach of the University of California at Berkeley. Both of these estimates are similar to ours; Concord estimates the available surplus at $2.2 trillion over ten years, while the Gale/Auerbach estimate is $1.7 trillion.[1] (See Table 2.)

Table 2

Estimates of the Available Surplus

Concord Coalition	$2.2 trillion
Center on Budget and Policy Priorities	$2.0 trillion
William Gale (Brookings Institution) and Alan Auerbach (University of California, Berkeley)	$1.7 trillion

Is it Safe to Enact Legislation Now that Commits the Full $2 Trillion?

One other critical point about the projected surpluses must be noted: the surplus forecasts are highly uncertain. The Congressional Budget Office has reported that if its surplus estimate for the fifth year (2006) proves to be off by the average amount that its projections for the fifth year have been off in the past, the forecast for 2006 will be off by 3.1 percent of the Gross Domestic Product, or more than $400 billion, for that one year alone. In other words, if the accuracy of CBO's current projection matches CBO's average accuracy in the past, the amount of the surplus that CBO is projecting for 2006 will be too high or too low by more than $400 billion. If the forecast is too high by that amount, we will run a budget deficit in 2006 (outside of the Social Security and Medicare Hospital Insurance trust funds) even if no tax cuts or program increases are enacted. The CBO report also indicates that, for the next five years as a whole, there is about a 35 percent chance — or more than a one-in-three chance — that the surplus outside the Social Security and Medicare HI trust funds will be only half as large as projected and a 20 percent chance there will be no cumulative surpluses, even if no tax cuts or program initiatives are adopted. (See Table 3.)

In addition, the CBO report notes that CBO's budget projections for the second five years of the coming ten-year period — 2007-2011 — are even more uncertain than its projections for the first five years. This is particularly significant, because more than 70 percent of the projected surpluses outside Social Security and Medicare Hospital Insurance are projected to occur in the second five years. (See Figure 1.)

Table 3

Uncertainty of CBO Surplus Projections

Chance that baseline surplus excluding Social Security and Hospital Insurance will be less than half as large as projections	35%
Chance that there will be *no* baseline surplus outside of Social Security and Hospital Insurance	20%

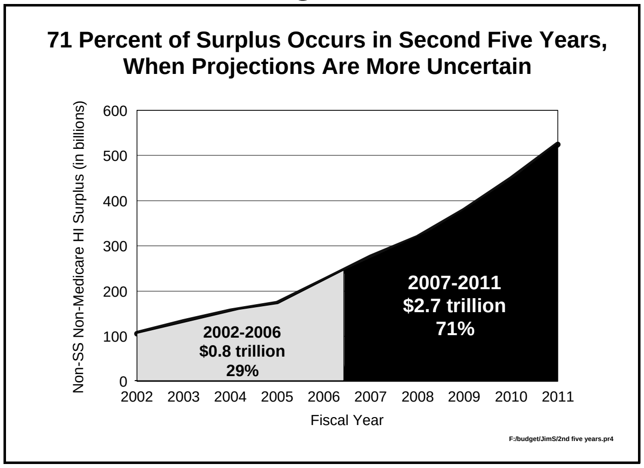
Source: CBO and CBPP Calculations

In short, the surplus projections are speculative. They are somewhat like a weather forecast — the farther you go into the future and the more long-range the forecast, the less likely it is to prove accurate. As a result, a substantial portion of the projected surpluses might not materialize. This strongly suggests that policymakers should set a healthy portion of the roughly $2 trillion in available surpluses to the side, using them for neither tax cuts nor program increases, until we see the degree to which the projected surpluses actually show up. It will be much easier to enlarge tax cuts or program initiatives if the surpluses materialize than it will be to raise taxes or cut programs if policymakers have committed most or all of the projected surpluses and the projections prove to have been overly optimistic. The course of action we are recommending here is essentially the same course that former Senators Warren Rudman and Sam Nunn, former Treasury Secretary Robert Rubin, former Commerce Secretary Pete Peterson, and former Federal Reserve chair Paul Volcker recommended in a recent Concord Coalition press conference.

II. The Dimensions of the President's Tax Cut

The best estimates are that the President's tax cut would consume significantly more than $2 trillion of the projected surpluses over the next ten years. The President's budget itself shows the tax cut would cost $2 trillion — more than $1.6 trillion in revenue reductions and almost $400 billion in added interest payments on the debt. (Any tax cut or spending increase results in interest payments on the debt that are higher than the level of interest

Figure 1



payments the CBO and OMB surplus projections assume. In making their projections, CBO and OMB assume that *all* surplus funds will be used to pay down debt; the lower the level to which the debt is reduced, the lower the amount of interest payments that must be paid on the debt. If some of the surpluses are used for tax cuts or program increases rather than for debt repayment, the debt will not be reduced as much and the interest payments on the debt will be higher than CBO and OMB project.)

This $2 trillion price tag, however, does not reflect the full cost of the tax plan over the next ten years. Every year, the Congressional Budget Office and the Congressional Joint Committee on Taxation re-estimate the budget the President has submitted. History shows that presidents' budgets not infrequently understate costs. The Joint Tax Committee now has estimated the cost of several parts of the Bush tax cut. The Joint Tax Committee has found that some of these tax cut provisions cost more than the Administration's budget indicates.

For example, the Joint Tax Committee has reported that the rate reductions in the tax bill the House of Representatives approved March 8 — which are identical to those President Bush proposed except that the phase-in of the new 10 percent bracket is accelerated somewhat — would lose $126 billion more in revenue than the President's budget shows, while the child tax credit and marriage tax provisions the House approved March 29 would add another $95 billion in revenue losses. Actions that the House has taken to date — including action by the House Ways and Means Committee on March 29 to pass a bill repealing the estate tax, which the full House is expected to approve in early April — bring the overall price tag of the tax cut to $2.2 trillion over the next ten years, unless Congress scales back some of the remaining components of the President's proposal.

Even this is not the full cost. The Joint Tax Committee also reported that enactment of the Bush tax plan would cause an additional 15 million taxpayers to become subject to the Alternative Minimum Tax. As noted earlier, if the AMT is not fixed, the number of taxpayers subject to it will swell from 1.5 million this year to 21 million in 2011. The Joint Committee has informed Congress that this number would skyrocket to 36 million by 2011 — one of every three families that owe income taxes — under the Bush plan. (See Figure 2.) The Joint Committee estimates that the cost of preventing these 15 million additional taxpayers from being subject to the AMT is $292 billion over ten years, before adding the increased interest payments on the debt that would be entailed.

Figure 2

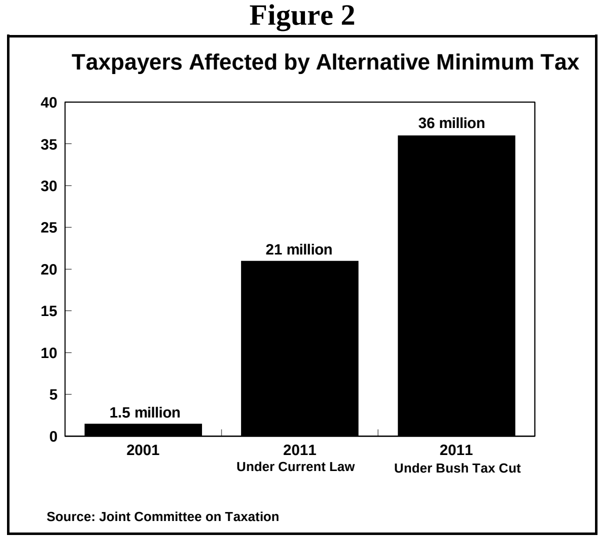


Table 4

Full Cost of the Tax Plan Proposed by President Bush (in trillions of dollars)	**10-Year Total**
Cost of Bush plan, as shown in President's budget	$1.6
Interest payments on the debt related to the tax cut, as shown in President's budget	0.4
Increase in cost as a result of House action and re-estimates by the Joint Tax Committee (including the interest payments on the additional tax cuts)	0.2
Subtotal	2.2
Additional Cost due to Alternative Minimum Tax	at least 0.3
Total Cost of Surplus Consumed by Bush Plan	**at least 2.5**

As explained above, there is no question that Congress ultimately will act to prevent the AMT from exploding in this manner. This means the Bush plan will create a need for an additional $300 billion in revenue reductions. Senior Administration officials have acknowledged at Congressional hearings that sooner or later, the AMT problem must be addressed.

Congress may chose to address the AMT problems incrementally; it has taken such an approach twice in recent years, passing short-term adjustments to the AMT law on both occasions. But while such an approach may reduce the cost for a particular Congress, the cumulative cost over the ten-year period will remain about the same. This $300 billion cost consequently needs to be taken into account in determining how much of the surplus ultimately will be consumed as a result of the President's tax cut.

The full cost of the Bush tax cut, including Congressional action to date, thus appears to be approximately $2.5 trillion over the next ten years, unless Congress pares back part of the plan to fit within the levels shown in the President's budget. (See Table 4.) Even if Congress does take action to limit the tax cut to the levels shown in the budget, the cost of the plan still is likely to be $2.3 trillion — the $2.0 trillion shown in the budget for revenue reductions and interest payments, plus the $300 billion cost that ultimately will be borne to prevent 15 million additional taxpayers from becoming subject to the AMT.

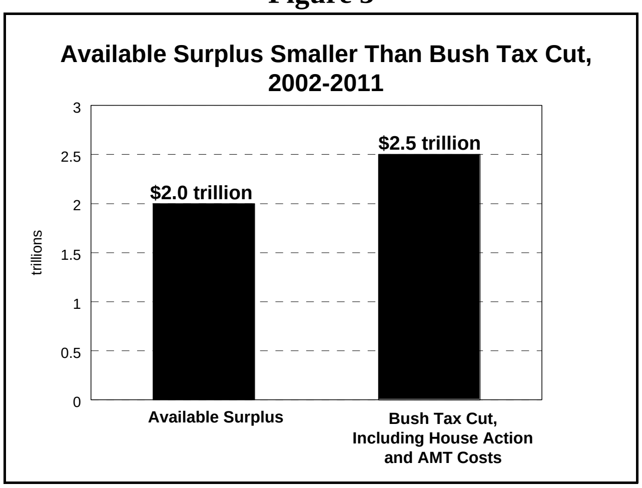
Moreover, the cost would rise to much higher levels in the second ten years the tax cut is in effect, 2012-2021. The President's budget lists a cost for the tax cut of $254 billion in 2011, before counting the additional interest payments on the debt. With the added costs the Joint Tax Committee has reported for the three tax bills moving through the House and for the measures needed to prevent 15 million additional taxpayers from falling under the AMT, the cost in 2011 rises to $340 billion, not counting interest payments.

Furthermore, this $340 billion in cost in 2011 does not reflect the full cost of the package; the House estate tax repeal bill is designed so that the full cost of estate tax repeal does not materialize until after 2011, or *outside* the ten-year budget window that Congress uses. The cost of the tax cut in the second ten years — 2012 through 2021 — would be *$5 trillion*, even before counting the increased interest payments on the debt that would have to be made as a result of the tax cut. This figure represents the cost of the three bills the

House has produced to date, along with the cost shown in the President's budget for the remaining elements of his tax-cut proposal and the cost of preventing the tax cut from causing millions of additional taxpayers to become subject to the Alternative Minimum Tax. (In constant 2001 dollars, the cost in the second ten years would be $3.7 trillion, not counting interest payments.)

The 2012-2021 period is a time when: the baby boom generation begins to retire in large numbers; Social Security and Medicare costs begin to swell mightily; and, according to the General Accounting Office, budget surpluses are projected to stop rising and start shrinking even if *no* tax cuts or program increases are enacted. The Comptroller General of the United States (who heads the GAO) recently testified that if the Social Security surplus is saved but the *non*-Social Security surplus is consumed by tax cuts and/or program increases, deficits will reappear in the total budget in about 2019 and subsequently rise to levels that are unprecedented for peacetime and eventually will damage the U.S. economy.[2] The Comptroller General also warned that while the budget forecast for the next ten years has improved, the long-term forecast has *worsened*, as a result of a consensus that health care costs will grow more rapidly over the long term than had previously been assumed. A tax cut that consumes $5 trillion in the second ten-year period would aggravate the nation's already serious long-term fiscal problems.

Figure 3



III. How Would Other Parts of the Budget Fare?

We noted earlier that the estimates of the amount of the projected surplus that is realistically available for tax cuts and program increases (if the surpluses materialize as projected) hover around $2.0 trillion over ten years. As just described, the tax cut would consume approximately $2.5 trillion of projected surpluses over this period. This suggests that unless the surpluses turn out significantly larger than projected, there will have to be either substantial budget cuts or a resort to using part of the Social Security or Medicare surpluses to help pay for the tax cut.[3] (See Figure 3.)

This picture is quite different from that portrayed in the President's address to Congress in late February. In that address, the President said there was enough room in his budget to fund both tax cuts and program initiatives in priority areas. He presented education as his top priority. He also called for increases in defense, health research, prescription drugs and certain other programs. This raises a question: How can one square the budget realities just described — that the tax cut is larger than the available surplus — with the promises in the President's address?

The answer to this question appears to be that the Administration's budget provides relatively little for any initiatives other than the tax cut and assumes substantial cuts in various programs, most of which are as of yet unspecified. The headline on a news report the *Wall Street Journal* carried on March 1, the day after the President's budget was released, aptly captures the situation. The headline reads: "Bush Offers 'Compassionate' Budget Plan: However, Numbers Appear to Contradict Rhetoric; Many Areas Face Cuts."[4]

Is Education the Top Priority?

In his address, the President told Congress and the American people: "Education is my top priority and, by supporting this budget, you'll make it yours, as well." The budget includes a table showing that education spending would increase $3.5 billion next year and $41.4 billion over ten years[5].

Administration officials have acknowledged that these figures overstate their education increases, noting they are proposing to increase some education programs but to reduce others. The $3.5 billion figure reflects the increases only, without netting out the decreases.[6] In addition, this $3.5 billion increase is measured relative to a budget baseline that the Bush campaign used last fall. Congress increased education funding in December, so some of the $3.5 billion in increases the budget claims to provide for 2002 and some of the $41.4 billion in increases it claims to provide over the next ten years are *not new money at all*, but are funds already included in the current baseline.

Other figures that the Office of Management and Budget has released show that the Administration actually is requesting a net nominal increase in operating levels for education programs of $2.5 billion next year, or three percent over the inflation rate. This is *one-third* the average inflation-adjusted rate of increase in education spending during the last four years. In other words, the area the President refers to as his highest priority — education — would have its recent rate of growth reduced by two-thirds.

Of particular note is a comparison of the amount of resources the budget would devote to increasing funding for education to the amount it would devote to the tax cut. The budget shows a $41 billion increase in education spending over ten years, a number that is an *over*estimate both because it *excludes* the reductions the budget contains in several education programs and because it *includes* various increases in education funding that Congress enacted last fall and that thus do not constitute new resources. The budget also shows more than $1.6 trillion going to the tax cut over this period, a figure that is an *under*estimate for reasons described above. Using these figures taken directly from the President's budget, the amount devoted to the tax cut would be 40 times the amount provided for initiatives to improve the nation's education system. (See Table 5.)

This disparity would grow as the years passed and the tax cut is phased in. The figures from the President's budget suggest that by 2011, there would be more than $50 in tax cuts for every dollar in education spending increases.

The contrast between education and one of the Administration's array of tax cut proposals — estate tax repeal — is particularly vivid. Estate tax is paid only on the estates of the wealthiest two percent of individuals who die. Current law provides that by 2006, estates of up to $1 million for individuals and $2 million for married couples will be exempt

Table 5

Is Education the Highest Priority?
(in billions of dollars)

	2002-2011	2011
Gross Education Increases	41.4	4.7*
Tax Cut, From President's Budget	1,646.5	253.6
Estate Tax Repeal	266.6	57.9
Estate Tax Repeal for estates of wealthiest 1 of every 1,000 people who die (largest 7% of taxable estates)	NA	28.9

*CBPP estimate

entirely from the estate tax. The President's budget proposes to use $58 billion in 2011 for repeal of the tax on estates worth more than these amounts. This is 12 times the increase proposed for the nation's education system in that year.

Indeed, the budget would use $29 billion in 2011 — six times the increase in education funding for the nation's schoolchildren — just to eliminate estate taxes on the 4,500 largest estates in the nation. A very small number of extremely large estates pay half of all of the estate tax. In 1998, some 2,900 estates paid half of estate taxes; in 2011, some 4,500 estates are expected to pay half of the estate tax. These are the estates of the wealthiest one of every 1,000 people who die. The tax reductions that these 4,500 huge estates would reap from estate tax repeal would total $29 billion in 2011, with an average tax reduction of more than $6 million for each of these estates. By contrast, the total increase in all education programs for the tens of millions of U.S. schoolchildren would amount to less than $4.7 billion that year. Relatively little would be available to raise teachers' salaries to attract more qualified people to enter or remain in teaching, in part because (as explained below) so many resources would have been used for large tax cuts for the nation's most affluent members.

Where Does the Money for the Education Increases Come From?

Even these small education increases raise a question — where does the money for them come from, since (as explained above) no surplus resources appear to remain after the tax cut is taken into account? The answer is that the education increases appear to be financed by offsetting cuts in job training and other programs.

This can be seen in several ways. The Congressional Budget Office estimates that under the Administration's budget, expenditures over the next five years for discretionary (i.e., non-entitlement) programs in the areas of education, training, employment, and social services would total $328.2 billion.[7] This amount includes the Bush education initiatives. Yet CBO also estimates that if there are *no* increases in any programs in these areas — and all of the programs remain at their current levels, adjusted only for inflation — the cost would be $328.2 billion, the exact same amount. (See Table 6.) In other words, there would be *no overall increase* in this part of the budget over the next five years.[8] What this signifies is that under the President's budget, *every dollar of increases in expenditures for education is offset by a dollar reduction in expenditures for job training, services for children or frail elderly and disabled individuals, or other programs in this part of the budget*.

The offsetting reductions are not yet known. They are not specified in the budget documents the Administration sent to Congress on February 28. Some of these reductions may be specified in more detail in the budget documents the Administration plans to send to Congress in early April. But many of these cuts may remain unspecified in the April budget materials. The documents the Administration will transmit in early April need to provide specific budget levels for discretionary programs only for fiscal year 2002. Most of the budget cuts in discretionary programs the Administration's budget framework requires will come in years *after* 2002. It is possible that little or no detail will be provided about those cuts for some time. This helps the Administration promote its tax cut, since many of the budget cuts that the

Table 6

Function 500: Education, Training, Employment, and Social Services, as Compared with the Baseline

	Outlays for Discretionary Programs 5-year Total (2002 - 2006)
Bush budget, as re-estimated by CBO	$328.2 billion
CBO Baseline	$328.2 billion

Table 7

Discretionary Spending in the Budget	
	10-year Totals (in billions of dollars)
Total Discretionary Spending Increase (from Table S-2)	+30
Discretionary Spending Initiatives for Education, Defense, Health Research and seven other smaller areas (from Table S-5)	260*
Necessary but Unspecified Discretionary Cuts	-230*

*The $260 billion figure for initiatives appears to overstate funding for domestic initiatives and understates funding for defense initiatives. For domestic initiatives, the increases appear to be relative to a baseline used in the campaign, rather than the current CBO baseline. As a result, the size of the domestic initiatives is overstated. On the defense side, these figures do not include funds for national missile defense and other defense spending increases that will be submitted after completion of the defense review.

Each dollar of additional defense spending increases will have to be accompanied by a dollar of reductions in non-defense discretionary programs to fit within the discretionary spending caps the Administration is proposing.

proposed tax cut would entail would be shielded from public view until after the tax cut was written into law. (In addition, after initially indicating it would send to Congress on April 2 the details on the funding levels it is seeking for each program for fiscal year 2002, the Administration pushed this date back to April 9 — the week *after* the Senate is scheduled to vote on the fiscal year 2002 budget plan. The House voted on the budget on March 28.)

Some sense of the size of the unspecified cuts can be gleaned from a perusal of the budget tables at the back of the budget book the Administration issued on February 28. One table shows a total increase in discretionary spending (above current levels adjusted for inflation) of $30 billion over ten years. Another table lists increases of $260 billion over ten years in discretionary spending for education, defense, health research, and seven other smaller areas for which the Administration wants to increase funding. If there are $260 billion in discretionary spending increases in these favored areas but the *total* increase in discretionary spending amounts to just $30 billion, there must be $230 billion in unspecified cuts in discretionary programs. (See Table 7.)

Furthermore, the $260 billion may understate the intended increases in areas the Administration favors because it does not include the sizeable defense spending increases the Administration is expected to request after completing its defense review. For example, the Administration's budget documents contain no funds for a national missile defense system; the funding request for this item, which could be very expensive, will come later. Since the Administration is proposing tight spending caps on *total* discretionary spending, each dollar of increased defense spending the Administration requests after completing its defense review would have to be accompanied by an additional dollar of cuts in non-defense discretionary programs (unless the Administration subsequently proposes to raise the spending caps, which might not be possible without causing a return of deficits outside the Social Security and Medicare HI trust funds). As a result, the reductions in discretionary programs outside the Administration's favored areas might have to be significantly larger than $230 billion over ten years.[9]

Tax Cuts Outweigh Program Initiatives by 10 to 1

Another way to gain a sense of the relative importance of tax cuts and other budget initiatives is to compare the net amount of new program

Table 8

Policy Changes from Baseline in 2011 Under Bush Budget
(does not include effects of policy changes on interest payments)

Net spending increases	$25 billion
Tax cuts	$254 billion

expenditures in 2011 under the President's budget with the size of the tax cuts in 2011. This is the final year of the ten-year budget period and is the most appropriate year to use, since it is the first year in which the tax cut would be phased in fully.

Using numbers directly from the Administration's budget, we find there would be $25 billion in increased program expenditures in 2011 (the majority of which would come from a modest prescription drug benefit for seniors), but $254 billion in tax cuts (a number that, as explained earlier, understates the size of the tax cut). For each dollar in tax cuts, there would be a dime of program increases.[10] (See Table 8.)

Major Problems Would Go Largely Unaddressed

The nation faces a number of major challenges. Some 43 million Americans lack health insurance. Medicare lacks a prescription drug benefit. Social Security is projected to become insolvent in 2038. The Medicare Hospital Insurance trust fund is projected to become insolvent in 2029. The proportion of children living in poverty, while lower than a few years ago, remains higher than in Canada or most of western Europe. The poverty rate among elderly women living alone is even higher than the poverty rate among children, with one in every five such women being poor. Finally, the General Accounting Office has warned that while the budget picture for the coming decade has brightened, the long-term budget outlook has deteriorated and is *worse* than was thought as recently as last year, because of new projections that health care costs will rise in coming decades at a faster rate than was previously assumed.

In every one of these areas, the budget ignores the problem or addresses only a modest fraction of the problem.

- The budget proposes $153 billion over ten years for a prescription drug benefit, far below what most analysts say it would cost to provide an adequate drug benefit.[11] Last fall, the House of Representatives narrowly approved a drug benefit that, according to recent CBO estimates, would have cost more than $200 billion over ten years. The drug benefit contained in that legislation was so modest that, according to calculations by Urban Institute president Robert Reischauer, a beneficiary's share of prescription drug costs would remain above 50 percent until the beneficiary's drug costs exceeded $12,900 in a year. The amount that the Bush budget allocates for a drug benefit is about *25 percent smaller* than the amount that last year's House legislation would have provided.

- The budget contains $72 billion over ten years for a small health tax credit for the purchase of individual health insurance policies. A tax credit of this size would be so modest that it would cover only a minor fraction of the cost of individual health insurance policies. As a result, analyses of health tax credits of this size have concluded that most low- and moderate-income individuals who are uninsured today would still be unable to purchase health insurance. The estimates indicate that at best, such a credit would have only a small effect in reducing the number of uninsured. Furthermore, such a credit might induce some employers to drop coverage because their employees would be eligible for the tax credit. Some older and less healthy employees who could no

What About the Budget Reserve?

The Administration's budget says it contains a reserve of $842 billion over ten years to meet additional needs. The reserve turns out to be a chimera, however. There will be no funds in it.

More than half of the funds in the so-called reserve turn out to be surpluses building in the Medicare Hospital Insurance trust fund. Once the Medicare HI surpluses are set aside, only a few hundred billion dollars remain in the reserve.

All of this money, however, is needed for various inevitable costs that the Administration's budget leaves out but that will surely be incurred. These include the costs discussed on pages 2 and 3 of continuing payments to farmers, extending the expiring tax cuts, and addressing the problems in the Alternative Minimum Tax so it does not hit millions of middle-class families. The costs of the three items alone are greater than the entire "reserve." Furthermore, the budget does not include money to cover the increased costs the Joint Committee on Taxation has estimated that the tax cut entails. And, as also noted, the budget does not reflect the defense increases that the Administration is expected to propose once it completes its review of the Defense Department.

Thus, rather than establishing a reserve for unforeseen contingencies and unmet needs, the budget would precipitate a return of deficits outside of the Social Security and Medicare Hospital Insurance trust funds unless the surpluses turn out to be considerably larger than currently projected or sizeable reductions are enacted in domestic programs.

longer secure employer-based coverage could have difficulty finding alternative coverage at an affordable price in the individual insurance market, even with the tax credit, and could end up becoming uninsured.

- The budget does not set aside any of the general fund surplus for transfer to the Social Security or Medicare Hospital Insurance trust funds to help restore long-term solvency to these programs. Every major Congressional proposal of recent years to restore long-term Social Security solvency, except one, has included major general fund transfers. (The one proposal that did not include such transfers featured Social Security benefit reductions and payroll tax increases of such a magnitude as to render the proposal politically infeasible.) No Medicare reform proposal has been advanced that closes more than a small fraction of Medicare's long-term financing gap, a point Senator Breaux has noted in several forums. It is difficult to conceive how legislation to restore long-term solvency to either program can be fashioned that does not include sizeable general revenue transfers, along with changes in these programs. (Reserving the portions of the projected budget surplus that will occur in Social Security and Medicare for use in those programs does nothing to restore solvency, since these surpluses already are counted in the projections that show both programs going insolvent in coming decades. While "reserving the Social Security surplus for Social Security" makes a nice soundbite, it adds no years to the program's solvency.)

- The budget contains no significant initiatives to reduce poverty. In fact, the *New York Times* recently reported that the budget documents to be submitted to Congress on April 9 will contain reductions in several programs for disadvantaged children.[12] The budget reportedly contains cuts in some low-income housing programs as well.

In addition, the large tax cut is inconsistent with new reports showing that the long-term budget forecast has grown grimmer even while the shorter-term budget picture has improved. While CBO and OMB agree that projected surpluses *over the coming decade* are larger than they previously thought, they also agree these surpluses eventually will disappear and be replaced by deficits. CBO, GAO, the Medicare actuaries, and outside experts concur that the long-term budget outlook is bleaker than they thought last year, as a result of new estimates that health care costs will rise faster in future decades than had previously been assumed.

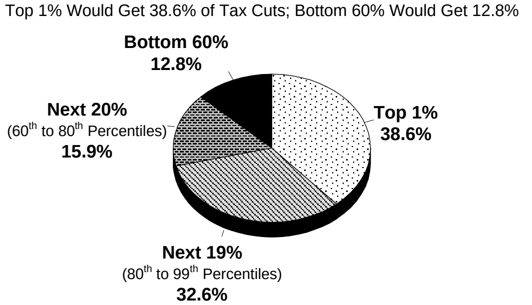
IV. What is the Top Priority: Tax Cuts for the Affluent or Education, Health, and Other Initiatives?

A final interesting set of comparisons that shed light on the budget's underlying priorities involves comparing the amount of the tax cuts that would go to those at the top of the income spectrum to the amount of resources that would be devoted to a prescription drug benefit, education initiatives, and the other areas the President has identified as priorities.

Figure 4

Shares of Tax Benefits from Bush Tax Plan Going to Different Income Groups

Top 1% Would Get 38.6% of Tax Cuts; Bottom 60% Would Get 12.8%



Source: CBPP calculations using distributional estimates from the Citizens for Tax Justice and Treasury Department

The best estimate is that just under 39 percent of the tax cut would go to the one percent of Americans with the highest incomes. Since the bottom 80 percent of the population would receive 29 percent of the tax cut, the top one percent would secure more in the tax-cut benefits than the bottom 80 percent of the population combined. (See Figure 4.) This estimate of the distribution of the tax-cut benefits (when the tax cut is fully phased in) uses the Citizens for Tax Justice estimate of the distribution of the income tax cuts in the Bush plan and the Treasury Department's established methodology regarding the incidence of the estate tax and corporate income taxes.

The proportion of the tax cut that would go to the top one percent *over the next ten years* is a bit lower than the proportion of the tax cut that would go to this group when the tax cut is fully in effect. This is because the portion of the tax package most tilted to those at the top of the income spectrum — repeal of the estate tax — would phase in more slowly than other provisions of the plan. To estimate the amount of the tax cut that would go to the top one percent over the next ten years, we separately analyzed the proposed personal income tax, estate tax, and corporate income tax changes, using the figures from the President's budget for the cost of each of these three components of the tax cut over the next ten years. This enables us to take into account the slower phase-in of estate tax repeal.

The results show that using the figures in the Administration's budget for the cost of the tax cut (rather than the higher estimates the Joint Tax Committee has produced), the top one percent of the population is found to receive $555 billion in tax cuts over the next ten years. This exceeds the amount the Administration proposes to devote to all initiatives combined. The budget includes $153 billion for a prescription drug benefit, $260 billion for increases in discretionary spending for education, defense, health research, and seven other areas (not counting decreases the budget also contains in some of these areas), and $72 billion for a refundable health insurance tax credit. These

Table 9

Tax Cuts for Top 1% vs. Initiatives
(OMB data for 2002-2011, in billions of dollars)

Tax reductions for top 1% in basic Bush tax package*	$555
Initiatives (gross, i.e., excluding offsets):	
Prescription drugs	153
Discretionary spending	260**
Other mandatory spending initiatives	2
Health insurance tax credits	72
Total Initiatives	$487

* Reflects the tax cuts in the Bush tax package, other than the proposed health insurance tax credit and a number of smaller tax incentives included in the Administration's February 28 budget book. Inclusion of these other tax cuts would raise the $555 billion figure modestly. This analysis also does not reflect the additional tax-cut costs that would stem from the actions the House Ways and Means Committee took on March 22.

** This figure overstates the initiatives the current budget contains in discretionary programs. At the same time, this figure does not reflect additional defense spending increases that are likely to be requested after completion of the Administration's defense review.

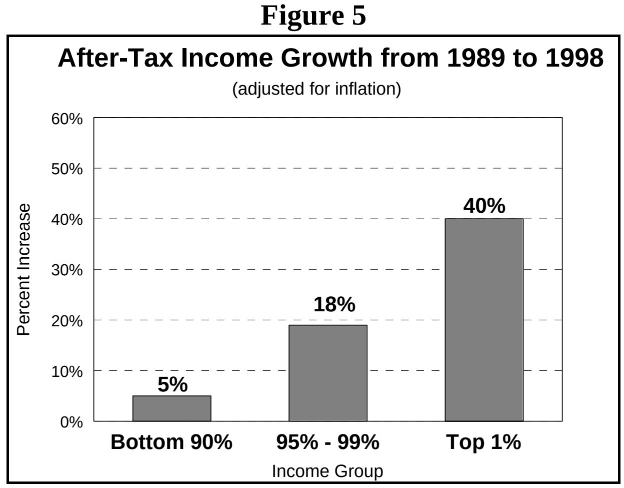
initiatives total $487 billion. (See Table 9.) This total reflects the gross cost of these initiatives; it does not reflect any offsetting cuts, either specified or unspecified, in other programs.

This analysis leads to the clear conclusion that the budget provides more in tax cuts to the most affluent one percent of Americans than it provides for all education, health, defense, and other initiatives combined. There can be little question that the tax cut is the budget's single overriding priority. A central feature of the tax cut is the degree to which it is tilted toward those at the top of the income scale.

Some supporters of the tax cut contend that it is *not* tilted toward those at the top — that many very high-income individuals would get a large tax cut because they pay such a large share of the taxes, and would pay an even larger share of federal taxes if the proposed tax cut becomes law. This argument does not withstand scrutiny. The top one percent of families pay 24 percent of all federal taxes but would receive 39 percent of the tax cut. While their share of federal *income* taxes might edge up slightly, their share of *total* federal taxes would go down. (This would occur because they would receive the lion's share of the benefits from repeal of the estate tax, and because income taxes would constitute a smaller share of total federal taxes.)

Moreover, the tax cut would widen disparities in after-tax income, which already are at their

Figure 5



Is Federal Spending Exploding?

Some tax-cut proponents argue that federal spending is exploding, and large tax cuts are needed to prevent further explosive spending growth. The budget data do not support these contentions.

In fiscal year 2000, federal spending equaled 18.2 percent of the economy (i.e., of the Gross Domestic Product). This was the lowest such level since 1966. Moreover, the Congressional Budget Office projects that federal spending will drop further, to 18.0 percent of GDP this year. Under the Bush budget, federal spending would drop to 15.7 percent of GDP by 2011. This would be the lowest level since 1951, half a century ago.

Similarly, discretionary spending stood at 6.3 percent of GDP in 2000 and is projected to remain at this level in 2001; this is the lowest such level on record. (These data go back to 1962.) Under the Bush budget, discretionary spending would fall to 5.2 percent of GDP by 2011, setting new record lows.

Table 10

Federal Spending as Percentage of GDP

	Level	Comment
2000	18.2%	Lowest level since 1966
2001	18.0%	since 1966
2011-CBO baseline	15.1%	since 1951
2011-OMB baseline	14.9%	since 1951
2011-Bush budget	15.7%*	since 1951

* Federal spending would be 15.7% of GDP in 2011, as compared to 14.9 under the OMB baseline, primarily because the tax cut would cause interest payments on the debt to be 0.6% of GDP higher than they are under the baseline.

widest level on record. IRS data shows that, between 1989 and 1998, the average income of the top one percent of families (after federal income taxes) rose 40 percent — or $171,000 per family — after adjusting for inflation. By contrast, the average after-tax income of the bottom 90 percent of the population rose five percent during this period. The average after-tax income of the top one percent thus rose eight times faster than the average income of the bottom 90 percent of families. (See Figure 5.) Furthermore, the average increase of $171,000 per family in the after-tax income of the top one percent of tax filers is several times greater than the *total* after-tax income of the typical American family.

The proposed tax cut would widen these disparities further. The tax cut would increase the after-tax income of the top one percent of families by 6.2 percent, while increasing the after-tax income of the middle fifth of families by 1.9 percent and the after-tax income of the poorest fifth of families by six-tenths of one percent. (See Table 11.) The percentage increase in after-tax income among the top one percent of families would be ten times the percentage increase among

Table 11

Tax Cut as a Percent of After-Tax Income
(when fully phased in)

	Top 1%	Next 4%	Next 15%	Fourth 20%	Middle 20%	Second 20%	Lowest 20%
Bush Tax Package	6.2%	2.4%	2.4%	2.3%	1.9%	1.2%	0.6%

Based on Institute for Taxation and Economic Policy model for income tax; Treasury methodology on distribution of estate and corporate taxes.

the bottom 20 percent of families and three times the percentage increase among the middle fifth of families.

V. Conclusion: A Question of Priorities

The findings in this report raise several questions. Is it prudent to commit virtually the entire available surplus now, given that the surplus figures are only projections and are highly uncertain? Is it a proper reflection of the priorities of the American public to commit virtually all of the available surpluses to tax cuts, with little left for other problems or opportunities? Should very large tax cuts for the wealthiest of Americans, the group that by far has secured the biggest income gains of recent years, be a higher priority than providing an adequate prescription drug benefit to the elderly and disabled, substantially reducing the number of Americans without health insurance, helping to restore long-term solvency to Social Security and Medicare, and reducing child poverty? These are questions that not only policymakers, but also the American public, should debate. A tax cut that may consume virtually all of the available surpluses for a generation or more ought not be rushed through before such a debate can take place.

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1. Gale and Auerbach estimate that $1.7 trillion will be available if discretionary spending holds steady in real per-capita terms and $1.0 trillion will be available if discretionary spending holds steady as a share of GDP.

2. Statement of David M. Walker, Comptroller General of the United States, before the Senate Budget Committee, February 6, 2001, p.8.

3. While it appears the tax cut, at $2.5 trillion over ten years, exceeds the available surplus of $2.0 trillion by $0.5 trillion, a better estimate is $0.4 trillion. The reason is that about $90 billion of tax credits that are scheduled to expire in the next year or two but are certain to be renewed are assumed to be renewed in the $2.0 trillion estimate of the available surplus and also are part of the Bush tax cut. They thus do not constitute an extra cost relative to the $2.0 trillion available surplus. Stated differently, the full, ten-year cost of the Bush tax cut is about $2.5 trillion relative to CBO's baseline but about $2.4 trillion relative to a baseline that takes into account the inevitable continuation of these expiring tax credits.

4. *Wall Street Journal*, March 1, 2001, p. A3.

5. See Table S-5, Discretionary Policy Initiatives, *A Blueprint for New Beginnings*, OMB, Feb. 28, p. 189.

6. This acknowledgment was made by a senior policy official of the Office of Management and Budget at an Urban Institute budget roundtable on March 6.

7. This is CBO's estimate of the spending levels proposed in the budget that the Administration sent to Congress on February 28. CBO has provided these figures to the Budget Committees.

8. Over ten years, this part of the budget would rise 1.5 percent.

9. The degree to which the discretionary spending cuts in non-favored areas would have to exceed $230 billion would likely be moderated by another factor. The $260 billion figure shown in the Administration's budget for discretionary spending initiatives in education, defense, health research, and other favored areas appears to overstate the increases the Administration is proposing for these areas. The increases shown for these areas appear to be relative to a budget baseline used in the Bush presidential campaign, rather than relative to the current OMB baseline. This makes the proposed increases in these areas look larger than they really are.

10. If we use CBO's re-estimates of the spending levels in the Bush budget, along with the figures cited earlier for the cost of the tax cut including House Ways and Means Committee action to date, the result is much the same — for each dollar in tax cuts, there would be 13 cents of program increases.

11. Rep. Billy Tauzin, chairman of the House Energy and Commerce Committee, recently acknowledged that the $153 billion figure is much too low. "Everybody knows that figure is gone," Tauzin said at a media briefing. See *Congress Daily*, "Bush's Medicare Drug Measure in the Red, Tauzin Says," March 22, 2001, p. 3.

12. Robert Pear, "Bush's Budget Would Cut 3 Programs to Aid Children," *New York Times*, March 23, 2001, p. A12.