Center on Budget and Policy Priorities

820 First Street NE, Suite 510
Washington, DC 20002

Tel: 202-408-1080
Fax: 202-408-1056

center@cbpp.org
www.cbpp.org

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THE PRESIDENT'S BUDGET: A PRELIMINARY ANALYSIS

An administration's budget is a statement of its priorities. This budget's priorities are clear: it features cuts in numerous domestic programs that serve low- and middle-income families alongside continued — and substantially expanded — tax cuts of very large size that concentrate their benefits on people high on the income scale. The new budget also contains continual significant increases in defense and homeland security spending.

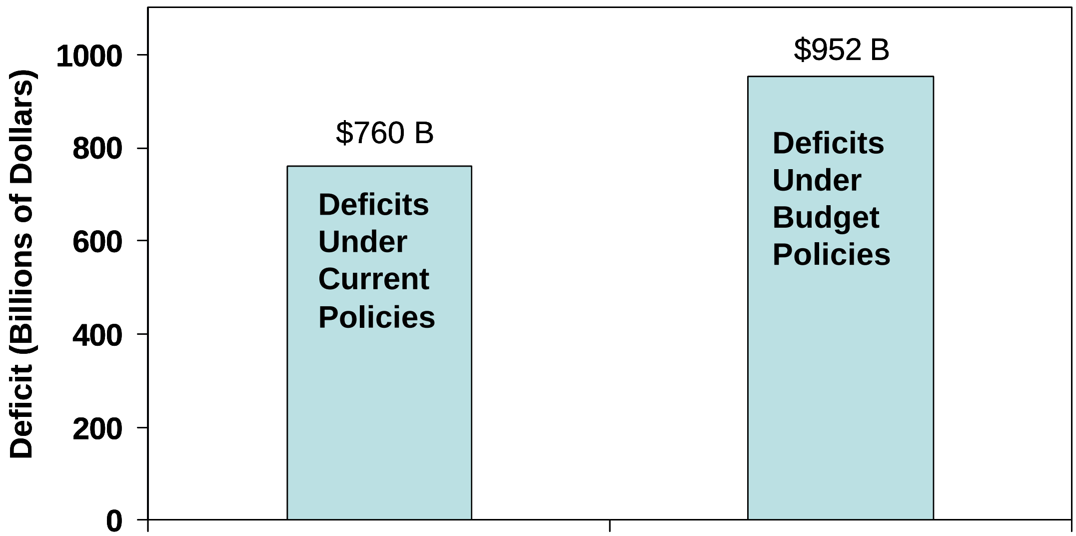
This analysis assesses the President's budget on three basic criteria — fiscal responsibility, fairness and balance (i.e., does it call for shared sacrifice?), and the degree to which it is transparent (does it conceal or omit basic budget information or resort to budget gimmickry?). This analysis indicates that the budget falls well short on all three standards.

Is the Budget Fiscally Responsible?

The Administration's budget would increase the deficit over both the short run and the long run. The budget proposes significant reductions in a broad array of domestic programs, but those reductions would *not* be used to reduce the deficit. Instead, they would be used to offset a fraction of the costs of the tax cuts the President proposes. Since the tax cuts and the defense and homeland security increases the President is proposing would cost substantially more than his domestic program cuts would save, the net effect of the new budget would be to make deficits larger than they otherwise would be.

- The budget would reduce expenditures by $191 billion over five years through cuts in non-defense programs (i.e., domestic and international programs) outside homeland security. This includes reductions in both discretionary (i.e., annually appropriated) programs and entitlement programs.
- However, the budget proposes $285 billion in tax cuts over the same period, and $1.7 trillion in tax cuts over ten years. (Note: these figures significantly *understate* the cost of the tax cuts, because the budget fails to include the cost of continuing to provide relief from the Alternative Minimum Tax after 2006.)
- The budget also includes a $79 billion increase over five years in defense and homeland-security spending. (This does not include the additional expenditures expected from the supplemental appropriations the budget requests for 2006 and 2007 for military operations in Iraq and Afghanistan.)

President's Budget Would Increase Deficits
(Fiscal Years 2007 – 2011)



Current policy deficits exclude costs of projected emergency appropriations. For comparability, the budget deficits exclude the effect of emergency appropriations requested in the budget for 2006 and 2007. The budget deficits also do not include the cost of the President's proposal for private Social Security Accounts.

- As a result, the Administration's own numbers indicate that the *President's budget proposals would increase deficits by $192 billion over the next five years,* compared to what deficits would be if current laws and policies remained unchanged.[1] Indeed, data contained in Administration budget materials show that deficits would total $760 billion over the next five years *without* the policy changes the Administration is proposing, but would total $952 billion *with* those policy changes.

A standard part of the President's budget each year is a summary table that shows the impact of the Administration's proposed policies on the deficit. (See Table S-12 on page 364 of last year's budget.) This year, however, the Administration has *eliminated* that table from its budget publications, presumably to deflect attention from the deficit-increasing impact of its proposals. (The impact of the budget's proposals on the deficit can be constructed from data in the budget and accompanying Administration budget information, which is what we have done.)

The budget would cause even larger increases in deficits *outside* the five-year budget window. The budget fails to provide numbers for revenues, expenditures, and deficits for years after fiscal year 2011, an omission that masks the budget's large effects in swelling long-term deficits. The Administration proposes to make its tax cuts permanent. Since most of the current tax cuts are in

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[1] The $192 billion total includes the increased interest payments on the debt that would have to be paid because of the effects of the Administration's proposals in increasing deficits and debt. Note: the deficit estimates used in this paper do not include the effects of the Administration's proposal to convert part of Social Security to private accounts. Were that proposal included, the increases in the deficit that the Administration's proposals would cause would be larger.

The baseline used here is the Administration's current services baseline, adjusted to remove the effect of making the 2001 and 2003 tax cuts permanent. (The Administration includes *in its baseline* the costs of its proposal to make the tax cuts permanent, in order to make that proposal appear costless.) The Administration's baseline — and the baseline used here — do not assume any future supplemental appropriations for operations in Iraq and Afghanistan or for domestic emergencies. To avoid overstating the impact of the President's proposals on the deficit, expenditures from emergency funding that the President is requesting for 2006 and 2007 have been excluded from the calculations here.

effect through 2010, the overwhelming bulk of the cost of making the tax cuts permanent would occur outside the five-year budget period.

- The sole year that the budget covers in which a large share of the annual costs of making the tax cuts permanent is evident is 2011. Data in the budget show that in that year, the budget's proposals would cause the deficit to be $116 billion higher than would otherwise be the case.
- Moreover, if relief from the Alternative Minimum Tax is continued, as it surely will be, the effect of the Administration's policies on the budget in 2011 would be to increase the deficit by another $95 billion, for a total of about $210 billion that year.

Even these figures for 2011 significantly understate the long-term effect the President's budget would have in swelling the deficit. Several of the additional tax cuts the Administration is proposing — including costly proposals related to health savings accounts and to retirement and lifetime savings accounts — are designed such that their costs in the first five or ten years would be substantially smaller than their costs in subsequent decades, when they would lose huge amounts of revenue. The budget shows the Administration's Health Savings Accounts proposals would cost a whopping $156 billion over the first ten years, but the costs would be even higher in subsequent ten-year periods. In addition, past analyses by the Congressional Research Service have estimated that the Administration's retirement and lifetime savings account proposals would ultimately cost $300 billion to $500 billion per decade (measured in today's dollars).

In short, the budget would make the nation's looming long-term budget problems even more serious than they already are and continue to "dig the hole deeper."

Is the Budget Fair and Balanced?

Although the fiscal consequences of the tax cuts enacted in recent years are becoming increasingly apparent, the Administration has responded not by reassessing any of those tax cuts, but by proposing sharp cuts in many domestic programs, alongside an array of costly new tax breaks. The tax cuts would favor the most well-off, while the program cuts would primarily affect low- and middle-income Americans.

Sizeable Program Cuts

- The budget would cut expenditures for **non-defense discretionary programs** outside homeland security by a cumulative total of $125 billion over the next five years, as compared to what expenditures for these programs would be if funding for the programs simply remained at the 2006 level, adjusted only for inflation. By 2011, expenditures for programs in this part of the budget would be cut an average of 10 percent.
- Cuts would be made in hundreds of domestic discretionary programs across the budget, including education programs, environmental protection programs, numerous programs to assist low-income families, children, and elderly and disabled people, and research related to cancer, heart disease, and other medical conditions.
- **Program Terminations**: For example, among the domestic discretionary programs that would be terminated are:

- The *Commodity Supplemental Food Program*, which provides nutritional food packages for less than $20 a month to more than 400,000 low-income elderly people, one-third of whom are over age 75;
- The *Preventive Care Block Grant*, which is operated by the Centers for Disease Control and Prevention and provides grants to states for preventive health services for underserved populations;
- The *TRIO Talent Search* program, under which colleges and universities — in many cases, Historically Black Colleges and Universities — assist disadvantaged secondary school students (two-thirds of whom are minority) by providing them with academic, career, and financial counseling so they will better be able to finish high school and attend college;
- The *Community Services Block Grant*, which provides funding for a range of social services and other types of assistance to low-income families and elderly and disabled individuals.

Other programs that would be terminated include: the Emergency Watershed Protection Program, Gaining Early Awareness and Readiness for Undergraduate Programs, and Safe and Drug Free Schools Grants.

- **Deep Program Cuts**: Among the domestic discretionary programs that would be cut deeply are:
  - *Section 202 housing for the low-income elderly* — funding in 2007 would be cut 26 percent below the 2006 level, even before adjustment for inflation.
  - *Section 811 housing for low-income people with disabilities* — cut 50 percent in 2007.
  - *Community Development Block Grant* formula grant program — cut 20 percent in 2007.
  - *Community Oriented Policing Services* (COPS), which promotes community policing primarily by putting police on the streets — cut 79 percent in 2007.
- **Cuts in child care:** The President's budget also calls for cuts in discretionary child care funding for children from low- and moderate-income families, with the cuts totaling $1 billion over the next five years as compared to the fiscal year 2006 funding levels adjusted for inflation. Data from the President's budget show that at the proposed funding levels, the number of children receiving child care assistance in 2011 would drop by more than 400,000 as compared to the number who received assistance in 2005.
- These cuts would be made despite the fact that domestic discretionary programs have not contributed to the return of budget deficits. After having been cut in inflation-adjusted terms in fiscal year 2006, total funding for domestic discretionary programs outside homeland security is *lower* now as a share of the economy than it was in 2001. (It has fallen from 3.4 percent of GDP in 2001 to 3.1 percent of GDP this year.)

The budget also proposes reductions in various **entitlement** programs. These proposals include some cuts that would not directly affect people in need, such as the changes that the Administration is proposing in Medicare, which would save $36 billion over five years and $105 billion over ten years. A number of the Medicare proposals would represent sound policy if they were used for deficit reduction rather than to help finance tax cuts.

But the entitlement changes in the budget also include proposals that would adversely affect vulnerable families and individuals. For example, the budget proposes to cut the Social Services Block Grant, which provides funding to states to provide social services for low-income and vulnerable populations, by $500 million — or 30 percent — in 2007.

- The budget also contains new cuts in *Medicaid*, which provides health insurance to low-income children, parents, seniors, and people with disabilities. The budget proposes *legislative* changes in Medicaid that would reduce federal Medicaid funding by a net of $1.5 billion over five years and $5.1 billion over ten years, as well as *regulatory* changes that would reduce federal funding by an additional $12.2 billion over five years. (No ten-year figure is provided for the regulatory changes.) A substantial majority of these Medicaid changes would be achieved by shifting costs to states. That likely would induce many states to reduce eligibility or scale back health benefits for low-income Medicaid beneficiaries, possibly by using the authority that the just-passed budget reconciliation bill gives states to increase co-payments, impose premiums, and narrow the health services that Medicaid covers.

- The new budget thus includes cuts in many programs and services for low-income households. These cuts would come on top of the cuts made in Medicaid, child-support enforcement, Supplemental Security Income for the elderly and disabled poor, and other low-income programs in the budget reconciliation bill that Congress just approved, and would come at a time when the number and percentage of Americans living in poverty has increased for four consecutive years.

Regressive Tax Cuts

Although the budget includes significant domestic program reductions, they would be heavily outweighed by the tax cuts.

- The budget shows that its proposed tax cuts would cost $285 billion over five years and $1.7 trillion over ten years.[2] As explained earlier, these figures understate the cost of the tax cuts because they leave out the costs of AMT relief after 2006.

- Over *ten* years, the cost just of making expiring tax cuts permanent and extending AMT relief would be approximately $2.8 trillion, not counting the added interest payments on the debt, and $3.3 trillion when the interest costs are included. Those figures do not include the additional costs of the new tax cuts the President is proposing for health savings accounts, retirement and lifetime savings accounts, and other items. In future decades, the combined cost of the various tax cuts the President is proposing would be massive.

- Tax cuts for high-income households account for a large share of these sizeable tax-cut costs. Analysis by the Urban Institute-Brookings Institution Tax Policy Center shows that when fully in effect, the tax cuts enacted in 2001 and 2003 (including AMT relief) will provide an average tax cut of $650 for the middle fifth of households, but of $136,000 for people who make over $1 million a year. (These figures are in 2004 dollars.) The tax cuts, if made permanent, would provide an estimated $900 billion in tax cuts over the next ten years to the top one percent of households, with more than $600 billion of this amount going to the 0.2 percent of households that make over $1 million a year.

[2] These figures, from the Treasury Department publication "General Explanations of the Administration's Fiscal Year 2007 Revenue Proposals," include both revenue and outlay effects of the tax proposals.

Budget Includes Social Security Cuts

The President's budget contains four Social Security benefit reductions that would save $2.2 billion over five years and $6.3 billion over ten years. (In addition, the President's budget shows that the private accounts it favors would add $712 billion to the deficit over ten years, an amount that would grow substantially larger over time.) One troubling proposal in the budget would *eliminate Social Security's lump sum death benefit*. Under current law, surviving spouses or children are entitled to a one-time payment of $255 in the event of the death of a beneficiary. This money can be used for any purpose, including helping to defray the costs of a funeral. Although the reform or elimination of the death benefit might be part of a balanced plan to address the deficit or Social Security's financial imbalance, it is difficult to justify asking vulnerable families to give up what might be a meaningful sum to them at the same time that the President is proposing hundreds of billions of dollars of tax cuts for the most affluent.

Another Social Security proposal would require children age 16 or 17 to be in school in order to collect Social Security dependent benefits. Under current law, children of retired, deceased or disabled workers can be eligible for such benefits. Encouraging children to stay in school is a worthwhile goal, but it is not clear if the Administration's approach would be too broad and result in problems. For example, it is unclear if the proposal would allow exceptions for certain very vulnerable children who have difficulty remaining in school, such as some children with severe mental illness.

A third proposal would save money by strengthening enforcement of the windfall elimination provision/government pension offset provision, which is part of Social Security. This appears to be a sensible proposal designed to more effectively enforce sound provisions in the law which seek to ensure that Social Security benefits properly take into account other state and local pensions earned outside the Social Security system.

- The new tax cuts the Administration is proposing to add on top of the existing ones also would be skewed heavily toward households at the top of the income spectrum. The Tax Policy Center has found that the benefits of the proposals for retirement and lifetime savings accounts, which have been part of the last several Administration budgets, would be geared heavily to the most affluent Americans. Similarly, there is little question that the President's HSA tax breaks would be of greatest value to those at the top of the income scale, both because the key HSA tax cuts being proposed would be worth the most to people in the top tax brackets and because the President's proposals would allow families to shelter $10,500 every year in a HSA, something only affluent people could afford to take full advantage of.

Eventually, the costs of these very generous tax cuts would have to be offset. To the extent that the tax cuts ultimately were financed by still larger cuts in domestic programs or by tax increases broadly spread across the population, the end result would be a shift in resources from poor and average Americans to those who already are the most well-off.

Is the Budget Honest and Transparent?

The budget conceals or omits information essential to assessing its impacts on deficits and on programs and services that affect millions of Americans.

- The budget omits the costs of funding U.S. operations in Iraq and Afghanistan after 2007.

- The budget also omits the cost of extending relief from the Alternative Minimum Tax after 2006. CBO estimates show that extending AMT relief will reduce revenues by $914 billion over the next ten years if the Administration's tax cuts are made permanent. (Making the tax cuts permanent greatly increases the cost of AMT relief.)

- The omission of such information makes various Administration claims, such as the claim that the deficit will be cut in half over five years, rather hollow. (Even if deficits do decline in 2009 to half what the Administration projected the 2004 deficit would be in February 2004, using inflated deficit projections at that time, this would not represent a significant accomplishment. Deficits will rise sharply again soon after 2009, in part as a result of the Administration's own policies.)
- Even more serious, the budget fails to contain figures for revenues, expenditures, and deficits for years *after* 2011. This omission prevents policymakers and the public from seeing how high the deficits would be in those years under Administration budget policies — and how substantially the deficits in those years would be increased by those policies. Adding to this problem, the Administration also took the step of eliminating the standard budget summary table that shows the effects of the budget's proposed policies on the deficit over the next five years.

Conclusion

Unfortunately, this budget fails the tests of fiscal responsibility, fairness and balance, and transparency. The nation and its policymakers can do better.

APPENDIX

What Caused Deficits to Return?

Despite claims that the main culprit in this fiscal deterioration is "runaway domestic spending" or growth in entitlement spending, the primary reason for the change from surplus in 2000 to the deficit in 2005 is lagging revenues. In 2000, the surplus equaled 2.4 percent of GDP. In 2005, the deficit equaled 2.6 percent of GDP. This is a negative swing in the nation's fiscal position of 5.0 percent of GDP. During this period, revenues declined from 20.9 percent of GDP in 2000 to 17.5 percent of GDP in 2005, a drop of 3.3 percent of GDP. Thus, *66 percent* of the downturn in the fiscal situation since 2000 (some 3.3 percent of GDP out of the total deterioration of 5.0 percent of GDP) is attributable to the drop in revenues.

Moreover, revenues in 2005 were lower as a share of GDP than the average for the 1960s, the 1970s, the 1980s, or the 1990s. By contrast, total spending was 20.1 percent of GDP in 2005, up 1.7 percent of GDP from 2000 but lower than in any year from 1980 through 1996.

Similarly, data that the Office of Management and Budget released in conjunction with the budget shows that increases in domestic discretionary, international, and entitlement spending (including the prescription drug benefit) account for only 28 percent of the cost in 2006 of legislation enacted since January 2001. Tax cuts account for 36 percent of the cost of that legislation, with the remaining 35 percent attributable to increased funding for defense and homeland security.

Although increased spending for domestic programs has played a relatively modest role in the return of deficits since President Bush took office, the President's budget puts virtually the entire burden of budget-tightening on those programs.