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March 13, 2006

THE SENATE BUDGET COMMITTEE'S BUDGET PLAN
A Brief Analysis

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Summary

The Senate is scheduled this week to consider a budget plan that the Senate Budget Committee adopted last week on a party-line vote. The plan — known as a budget resolution — is similar in a number of respects (but not in others) to the budget proposed earlier this year by President Bush. It would cut domestic "discretionary" (or non-entitlement) programs substantially over the next five years, but the savings from these program reductions would be more than offset by tax cuts and defense spending increases. Despite the claim by Committee Chairman Judd Gregg (R-NH) that the plan "makes good on the President and the Congress' pledge to cut the deficit in half by 2009….," the plan would, in fact, *increase the deficit over the next five years by $266 billion* above what it would be if current policy was left unchanged.

EFFECT OF SENATE BUDGET COMMITTEE PLAN ON THE DEFICT
(in billions of dollars, fiscal years)

	2007 - 2011
CBO current-policy deficits*	$681
Discretionary programs	
Defense and international	$121
Domestic	-$92
Entitlement programs	-$14
Tax Cuts	$228
Net interest	$23
Total change in deficit	**$266**
Budget Committee plan deficits*	$948

Note: Numbers do not add to totals because of rounding.

* For comparability, the baseline projections used here do not assume that emergency funding appropriated in 2006 will be provided at the same level in 2007 and each succeeding year, and the Budget Committee plan amounts shown here do not include the effects of emergency spending that the plan assumes for 2006 and 2007.

** Revenue reduction is shown as positive because it increases the deficit.

The Senate Budget Committee plan would reduce expenditures for domestic programs by $106 billion over five years, with the cuts totaling $92 billion in domestic discretionary — or annually appropriated — programs and $14 billion in entitlement programs. In contrast, spending for defense and international programs would be *increased* by $121 billion, with nearly all of the increase coming in the defense area. The plan also calls for tax cuts totaling $228 billion over the next five years. When additional interest costs are included, the net increase in the deficit amounts to $266 billion over five years.

Moreover, the deficits that would occur under the Budget Committee plan likely would be considerably higher than these figures indicate. For instance, this analysis excludes the cost of the emergency appropriations the Budget Committee plan assumes for 2006 and 2007. If the costs of these emergency appropriations are included, deficits under the Budget Committee plan are $192 billion higher over the next five years.

More importantly, actual deficits under the policies assumed in the Budget Committee plan almost certainly would be much higher than the plan assumes because the plan leaves out various costs that are virtually certain to be incurred. The plan includes no funding for operations in Iraq and Afghanistan after fiscal year 2007. It is inconceivable that no costs will be incurred after September 30, 2007, even if the number of U.S. troops in the region is reduced between now and then.

In addition, the Budget Committee plan sharply understates the cost of its tax cuts. The "Chairman's Mark" — the document that Senator Gregg issued describing his plan — indicates that the plan is designed so that most provisions of the 2001 and 2003 tax cuts could be made permanent. The plan reflects the costs through 2011 of extending these tax cuts. But the Budget Committee resorted to a large gimmick here — it artificially lowered the costs of extending these tax cuts by assuming that relief from the Alternative Minimum Tax would expire at the end of 2006, despite the fact that no Member of Congress favors that and the chance of AMT relief actually terminating is essentially zero. By assuming that AMT relief will end, the Committee is implicitly assuming that the number of taxpayers subject to the AMT would skyrocket from fewer than four million today to 34 million in 2011, and that a swollen AMT would cancel out a sizeable share of the 2001 and 2003 tax cuts, making the cost of extending those tax cuts look much smaller than it really is.

Inclusion of AMT relief through 2011, which the Committee clearly supports and which virtually every lawmaker, lobbyist, and tax policy expert expects to happen, would cause the cost of the Committee's tax cuts to *more than double*. If AMT relief is provided through the five-year budget period and all of the other expiring tax cuts supported by the Budget Committee are extended through 2011, the reduction in revenues totals $605 billion — some $377 billion more than the $228 billion tax-cut figure printed in the Budget Committee's documents.

In addition to laying out a blueprint for the budget for the next five years, the Budget Committee plan proposes several changes in budget procedures. The plan would establish a new Senate rule affecting entitlement programs. Under the rule, if the Budget Committee Chairman determines two years in a row that the share of Medicare expenditures financed by general revenues will exceed 45 percent within the next six years, then the Senate would be prohibited from considering legislation that increases the cost of *any* entitlement program (unless the increase is offset in the same bill by cuts in other entitlement programs or an increase in revenues). This rule, which would likely be triggered early next year, would impose strict constraints on measures to increase any entitlement program (not just Medicare) — including programs for poor families, veterans, and people with severe disabilities — while imposing *no* comparable discipline on new tax cuts, including tax cuts for wealthy individuals and large corporations. This new rule also endorses the misguided, ideologically-based argument that progressive income taxes (the main source of general revenues) should not be considered as part of any plan to deal with the long-term problems that Medicare faces. This means that more of the burden of shoring up Medicare would have to fall on Medicare beneficiaries and on workers who pay the relatively regressive payroll tax. (For a full discussion of this new Senate rule, see "Robert Greenstein, Richard Kogan, Edwin Park, and James Horney, "President and Senate Budget Committee Embrace Misguided "45-Percent Trigger,"" Center on Budget and Policy Priorities, March 13 2006.)

Plan Would Increase the Deficit by $266 Billion

If current laws and policies remain unchanged and the tax cuts are not extended, deficits are projected to total $681 billion in 2007 through 2011.[1] The deficit would decline from a projected $334 billion this year to $13 billion in 2011. If the policies in the Budget Committee plan are adopted instead, deficits still would decline over the next few years (although the deficit would start back up in 2011) but by considerably less than CBO has projected. The deficit would be *higher* in every year than if no changes in policies are made.

Not counting the cost of the emergency appropriations proposed in the Budget Committee plan (to be consistent with baseline projections that assume no future emergency appropriations), the deficit would be $266 billion higher in 2007 through 2011 than if no changes in policy are made. In 2011 alone, the deficit under the Budget Committee plan would be $166 billion, or $152 billion higher than projected under current policies.

This increase in the deficit would come despite the $106 billion over five years in reductions that the Budget Committee plan would make in domestic programs (including both discretionary and entitlement programs). The proposed $121 billion increase in spending for defense and international programs, together with $228 billion in tax cuts, as well as the increased costs for interest payments on the debt, would far outweigh the $106 billion in domestic programs cuts. The net result, as noted, is $266 billion more in deficits. The reductions in domestic programs would be used not to reduce the deficit but to offset a portion of the cost of the tax cuts and defense spending increases.

Discretionary Programs

Not counting the emergency supplemental funding in the Budget Committee plan,[2] the plan proposes virtually the same amount of total discretionary funding for each of the next five years as the President proposed in his budget. Over the five-year period as a whole, the total amount the Budget Committee plan proposes for discretionary programs is just $1 billion — or two one-hundreths of one percent — above what the President requested.

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[1] This estimate is based on the baseline projections of the Congressional Budget Office, which generally assume laws governing taxes and entitlements are not changed and that the same level of discretionary funding as provided for 2006, with an adjustment for inflation, will be appropriated in 2007 and subsequent years. Thus, the CBO baseline estimate and the estimate used here do not assume that tax cuts scheduled to expire under current law are extended.

Unlike the published CBO baseline projections, the estimate used here does not assume that the emergency supplemental appropriations enacted in 2006 for military activities in Iraq and Afghanistan, hurricane relief, and the fight against avian influenza will mechanically be repeated every year from 2007 through 2011. As a result, the baseline deficit cited here is $391 billion lower than CBO's $1.072 trillion official baseline deficit for those years. For CBO's March 2006 baseline projections, see the March 3, 2006 letters from Acting CBO Director Donald Marron to Senators Thad Cochran and Robert C. Byrd at http://www.cbo.gov/ftpdocs/70xx/doc7055/03-03-Prelim_Analysis.pdf.

[2] The President proposed a total of $145 billion in emergency funding (or budget authority) for fiscal years 2006 and 2007 ($92 billion for 2006 and $53 billion for 2007). Of this, $125 billion is for defense and international programs and $21 billion for domestic programs. The Senate Budget Committee plan assumes the same $92 billion in 2006 emergency funding, but proposes a total of $90 billion in emergency funding for 2007. It proposes total funding of $160 billion for defense and international programs over the two years and $22 billion for domestic programs.

Compared to the President's budget, the Budget Committee plan makes modest adjustments in how this discretionary funding would be used. The Committee plan assumes that in each of the next five years, $2 billion that the President proposed for international programs and $3 billion that he proposed for defense will be shifted to domestic discretionary programs, with the result that the cuts in domestic discretionary programs would be $5 billion smaller each year than those the President proposed. [3]

Even if this shift were to occur (budget resolution assumptions about the distribution of discretionary funding do not bind the Appropriations Committees), the plan would still result in substantial reductions in domestic discretionary programs. The Budget Committee plan assumes that funding for domestic discretionary programs would be cut in 2007 by $7.4 billion, or 1.9 percent, below the level provided for these programs in 2006, adjusted for inflation. The cuts in funding for domestic discretionary programs would grow with each succeeding year and total $125.4 billion over five years.[4]

In 2011, the funding proposed for domestic discretionary programs would be $42.1 billion — or 10 percent — below the amount needed to maintain the current level of funding adjusted for inflation. That reduction is similar to, although slightly less deep than, the 11.1 percent reduction proposed in the President's budget.[5] With overall domestic discretionary reductions of this scope, it would be difficult to avoid cuts even in high-priority domestic programs.[6]

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[3] It is unlikely that funding for defense programs would ultimately be reduced $3 billion a year below what the President has requested even if that amount of regular defemse discretionary funding is shifted to domestic programs. Large emergency supplemental appropriations will certainly be enacted for 2007 (the Senate Budget Committee plan assumes nearly $86 billion in emergency funding for defense in 2007) and are likely to be enacted for succeeding years as well. This emergency funding, which generally would be provided for the same budget accounts funded through regular appropriation, could make up for reductions in regular funding for defense programs. For an explanation of how this could work, see Richard Kogan and Jim Horney, "Why the Application of the Expected Across-the-Board Appropriations Cut to Defense is Likely to be Purely Cosmetic," Center on Budget and Policy Priorities, January 6, 2006.

[4] Because expenditures (or outlays) lag behind funding (i.e., appropriations or budget authority) this $125 billion reduction in funding over five years would result in the $92 billion reduction in expenditures over this period that is shown in the table on page 1.

[5] According to Administration data, the cuts proposed in the President's budget for 2011 for discretionary programs other than defense and homeland security would average 13 percent, compared with the 2006 level of funding adjusted for inflation. See Richard Kogan, Isaac Shapiro, and Katharine Richards, "The Hidden Cuts in Domestic Appropriations: OMB Data Reveal Deep Funding Cuts after 2007," Center on Budget and Policy Priorities, February 9, 2006. The estimates of the size of the cuts reported in this paper are slightly lower than those reported in the February 9 paper because the estimates cited here are based on CBO rather than OMB baseline data and because they cover all discretionary programs other than defense and international programs; in other words, funding for domestic homeland security is included in domestic funding totals here, rather than being excluded as it is in our previous paper. (We cannot exclude homeland security funding here because the Senate Budget Committee has not provided information about the level of homeland security funding it has assumed in its plan.) If domestic homeland security funding is increased, as proposed for 2007 in the President's budgets, then funding for domestic discretionary programs other than homeland security programs would have to be cut more than stated here.

[6] For an analysis of the effect of the cuts in domestic discretionary funding proposed by the President's budget, see James Horney, Sharon Parrott, and Arloc Sherman, "Program Cuts in the President's Budget: Cuts Grow Deeper Over Time and Will Hit States Hard," Center on Budget and Policy Priorities, February 23, 2006.

In contrast to the cuts proposed for domestic discretionary programs, the Budget Committee plan calls for substantial increases for defense and international programs above the levels provided in 2006, adjusted for inflation. These increases would be in addition to the emergency funding the plan assumes will be provided for operations in Iraq and Afghanistan. The plan calls for an increase in defense funding above the 2006 appropriated level, adjusted for inflation, of $13.4 billion in 2007 and $136.3 billion over five years. Funding for international programs would be increased by much smaller amounts (although by a larger percentage in 2007 and 2008) — $1.1 billion in 2007 and $6.1 billion over five years.[7]

In addition to the increases proposed in regular defense funding, the Budget Committee plan includes $156 billion in emergency funding in 2006 and 2007 for operations in Iraq and Afghanistan. The plan leaves out the costs of operations in those countries in years after 2007.

Entitlement Programs

The Budget Committee plan calls for a net reduction in entitlement spending of $14 billion over five years. The plan limits its reconciliation instructions, however, to the Committee on Energy and Natural Resources, which is directed to report legislation reducing spending by $3 billion over five years. This would allow the Energy Committee to report legislation opening the Arctic National Wildlife Refuge to drilling; that legislation would be considered under the fast-track reconciliation procedures that prohibit filibusters. This would allow the ANWR legislation to be passed with the support of 50 Senators (and the vote of the Vice President to break a tie) instead of the 60 needed to end a filibuster. Unlike last year, no other committees would be directed to achieve entitlement cuts through the reconciliation process.

The Budget Committee plan assumes some other entitlement reductions, such as an $11.1 billion reduction in Medicare over five years. In the absence of a reconciliation directive instructing committees to produce legislation achieving these savings, however, the cuts that the budget plan assumes in Medicare and other entitlements programs are unlikely to occur.

Nevertheless, these assumed savings in Medicare could create procedural problems for other entitlement proposals assumed in the resolution. The Budget Committee plan calls for increased expenditures of $699 million over five years for health care entitlement programs other than Medicare, including funding intended to extend Transitional Medical Assistance for one year and to fill a funding hole that otherwise will cause a number of states to cut their State Child Health Insurance Programs in 2007.[8] Under Senate rules, if (as expected) the Medicare savings that the

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[7] The emergency funding proposed in the Senate Budget Committee plan for 2006 and 2007 is not included in these figures. Similarly, the emergency funds already appropriated for 2006 are excluded from the base level of funding for 2006 that is used here for comparison purposes.

[8] The Chairman's Mark states that the Budget Committee Plan includes funding for these and two other health care initiatives proposed in the President's budget — to increase health department vaccines for children and to implement the Cover the Kids initiative. Altogether, the cost of these four initiatives totals more than $2.3 billion over five years. However, the Budget Committee plan assumes a net increase in non-Medicare health entitlement spending of only $699 million over five years. (This amount is not stated in the text of the Chairman's Mark, but can be determined by comparing total mandatory health — function 550 — outlays specified in the Mark with CBO's baseline projections of such expenditures.) Thus, the Budget Committee plan either does not fully fund these initiatives or assumes unspecified reductions in non-Medicare health entitlement programs that would offset the cost of these initiatives.

budget plan assumes are not adopted, then the health care measures that would entail increased costs will require 60 votes to pass on the Senate floor, unless their costs are offset. The Committee's plan also assumes legislation that would increase flood insurance expenditures in 2006 and 2007 by $5.6 billion to meet obligations related to the hurricanes that hit the Gulf Coast last year.

Revenues

The Budget Committee plan assumes tax cuts totaling $228 billion over five years. As described in the Committee's documents, this amount is intended to accommodate the tax cuts that are currently being considered as part of the conference that is trying to work out the differences between the tax reconciliation bills the House and Senate approved last year. Those tax-cut measures include a two-year extension of the capital gains and dividend tax cuts and a one-year extension of relief from the Alternative Minimum Tax. The Senate Budget Committee plan also is intended to accommodate the extension of other tax cuts enacted in 2001 and 2003 that are slated to expire by the end of 2010, along with the extension of certain other tax provisions that are slated to expire before 2010, such as the research and experimentation tax credit.

The $228 billion in tax cuts over five years is less than the cost of the tax cuts in the President's budget. The Congressional Budget Office estimates that the President's tax proposals would reduce revenues by $282 billion over the five-year period. The primary difference appears to be that the Senate resolution does not assume various new Administration tax proposals, such as those related to Health Savings Accounts. Rather, the Senate Budget Committee plan appears to embrace only those Administration proposals that would extend previously enacted tax cuts.

The Budget Committee plan does, however, play some of the same budget games that the President's budget uses to heavily understate the cost of its tax cuts. In particular, the Budget Committee plan follows the President in assuming only a one-year extension of relief from the Alternative Minimum Tax. According to estimates by the Urban Institute-Brookings Institution Tax Policy Center, if AMT relief expires at the end of 2006, the number of taxpayers affected by the AMT will explode from about 3.6 million taxpayers last year to 33.9 million in 2011 (assuming the 2001 and 2003 tax cuts are extended). The Senate Budget Committee plan implicitly assumes that this swollen AMT will cancel out some of the benefits of the tax cuts for millions of taxpayers, making the extension of the tax cuts appear much less costly on paper that it actually would be. This lower cost is an illusion, because no one believes that AMT relief will be allowed to expire and that the AMT will be allowed to hit 34 million taxpayers. Rather, it is universally expected that Congress will continue providing relief from the AMT to mitigate its impact, particularly on middle-class taxpayers.

Congressional Budget Office estimates indicate that if the tax cuts the Budget Committee would extend are made permanent and the AMT relief in place for 2005 is permanently continued and indexed for inflation, the $228 billion five-year cost of the Budget Committee's tax-cut agenda rises to $605 million — or $377 billion more than the amount the budget resolution acknowledges. If the Budget Committee's plan had come clean about the cost of continuing AMT relief and other popular tax cuts that are slated to expire but always are routinely extended, the deficits it shows would be much higher and would be above $300 billion in 2011.

Budget Process Changes

The Budget Committee plan includes several provisions to alter budget procedures in the Senate. One proposal would prohibit consideration of legislation providing emergency funding for defense programs for 2007 if that legislation would cause the total amount of emergency funding for 2007 (for defense and nondefense programs combined) to exceed $90 billion. This prohibition could be waived with 60 votes.

It currently requires 60 votes in the Senate to consider emergency funding for *nondefense* programs. The Budget Committee proposal would add a constraint on emergency funding for defense, but only after total emergency funding for 2007 has reached $90 billion, a very large amount.

Medicare 45-Percent Trigger

Although the defense emergency funding provision is not very strict, at least it highlights the problem of providing a large share of defense funding outside of the normal budget process and places some constraint on that practice. Another proposal included in the Budget Committee plan, however, is misguided and troubling. That is the establishment of a new Senate rule tied to a provision of the 2003 Medicare prescription drug legislation that seeks to limit general-revenue financing for Medicare.

The provision in question, added behind closed doors in the conference on the 2003 Medicare drug legislation, requires the Medicare trustees to include in their annual reports on Medicare's finances an estimate of the year in which general revenues will finance at least 45 percent of total Medicare costs. By law, Medicare Hospital Insurance is financed primarily by payroll taxes, while Medicare physician's coverage and the new Medicare drug benefit are financed primarily by a combination of general revenues and beneficiary premiums.[9]

Under the 2003 law, once the trustees estimate in two successive reports that the 45-percent level will be reached within the next six years, the President is required to include a proposal in his next budget to alter Medicare so the 45-percent threshold will not be exceeded.[10] Congressional

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[9] Beneficiary copayments cover part of the costs of the services provided by all three parts of Medicare.

[10] In directing the trustees to calculate the percentage of Medicare expenditures financed by general revenues, the Medicare drug law requires the percentage be determined in the following manner. The trustees calculate the percentage that total Medicare expenditures minus dedicated revenues (i.e., revenues *other than* general revenues) make up of total Medicare expenditures. Because "total Medicare expenditures minus dedicated revenues" is very similar but not strictly identical to "general revenues supporting Medicare," the 45-percent threshold is not strictly based on general revenues. We and others refer to the 45-percent threshold as applying to general revenues for ease of discussion.

Dedicated revenues are defined in the Medicare drug law as Medicare Part A payroll taxes, the portion of income taxes on Social Security benefits that is dedicated by law to the Medicare Part A trust fund, Medicare beneficiary premiums, and "clawback" payments from state Medicaid programs, which finance a portion of the cost of the Medicare drug benefit for low-income beneficiaries who are enrolled in Medicaid.

Some observers mistakenly believe that the "general-revenue share" of Medicare financing will increase when the parts of Medicare that are funded by general revenues (physician services and prescriptions drugs) grow faster than the part of Medicare that is funded by payroll taxes (hospital services). As defined in the 2003 prescription drug legislation, however, the "general-revenue share" of Medicare funding increases whenever total Medicare expenditures grow faster than dedicated revenues. Under this definition, the "general-revenue share" of Medicare actually increases more rapidly committees with jurisdiction over Medicare would report the President's proposal or other Medicare legislation by June 30 of that year.

The Budget Committee plan would build upon this provision of the prescription drug law by establishing a new Senate rule in the form of a point of order that would take effect once it has been determined two years in a row that the 45-percent threshold will be exceeded within the next six years. (The rule provides that the Budget Committee Chairman would make this determination, presumably on the basis of the findings in the annual trustees' reports.) The new rule would prohibit consideration of any legislation that would increase costs for any entitlement program (not just for Medicare), unless the legislation contained measures fully offsetting the costs through a reduction in other entitlements or an increase in revenues. It would require 60 votes to waive this point of order.

Based on the Medicare trustees' projections, the new point of order would likely take effect one year from now. It could impose an additional barrier to legislation intended to improve an entitlement program, although legislation raising entitlement costs already faces a 60-vote hurdle in the Senate unless the budget resolution provides for such an increase, which has been rare in recent years. But as a companion CBPP paper explains, the real significance of the Budget Committee's proposal is that it endorses the misguided and ideologically-driven notion that the 45-percent threshold represents a meaningful measure of the health of Medicare and the federal budget.[11] The Budget Committee proposal also is unbalanced: it would use the 45-percent threshold to further tighten budget constraints on legislation to increase entitlement programs — including programs for the poor, veterans, and the seriously disabled — while imposing no constraints on new tax cuts, including larger tax breaks for well-off individuals and corporations.

Medicare faces serious long-term challenges, but the 45-percent trigger established by the Medicare drug law is not well designed to address them. To the contrary, the 45-percent threshold is an arbitrary benchmark that is inconsistent with Medicare's basic financing structure and is laden with ideological overtures. By law, Medicare physicians' coverage and the new Medicare drug benefit are *supposed to be* financed by general revenues (as well as beneficiary premiums) rather than by payroll taxes. That a particular share of Medicare costs are financed by progressive income taxes rather than by regressive payroll taxes is not itself a problem, just as it is not inherently problematic that defense, education, or space exploration are financed by general revenues. That the 45-percent level will be reached soon (the trustees projected last year that it will be reached in 2012) also is of little significance. The 45-percent threshold will be reached in a relatively few years even if Medicare costs rise much more slowly than is currently projected.

Of particular concern, complying with the 45-percent threshold would *rule out certain approaches to strengthening Medicare's finances rather than allowing all approaches to be on the table*. By and large, the only approaches that could be considered would be those favored by individuals on the right of the

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if Medicare expenditures for hospital services grow *faster* than expenditures for physician services and prescription drugs. That is because increases in Medicare costs for drugs and physicians services lead to increases in beneficiary premiums, which are counted as dedicated revenues, while increases in Medicare hospital insurance costs do not, because Medicare hospital insurance does not charge premiums. (Under the 2003 legislation, an increase in dedicated revenues reduces the amount of "general-revenue funding," because "general-revenue funding" is defined as total Medicare expenditures minus dedicated revenues.)

[11] See Robert Greenstein, Richard Kogan, Edwin Park, and James Horney, "President and Senate Budget Committee Embrace Misguided "45-Percent" Trigger, Center on Budget and Policy Priorities, March 13, 2006.

political spectrum. In particular, the 45-percent trigger seems designed more to rule out scaling back any part of the 2001 and 2003 tax cuts and using some of the proceeds to help address even a fraction of Medicare's financing needs, as part of a larger Medicare reform package, than to address Medicare's solvency problems forthrightly.

The claim that the new point of order is only intended to encourage the President and Congress to address Medicare long-term financing problems is not persuasive. A prohibition that also applied to consideration of deficit-financed tax-cut legislation would be far more likely to spur the President and Republican leaders in Congress to take action on Medicare than a prohibition limited to entitlement increases, which they generally oppose anyway and which already face budget constraints. Despite this, tax cuts would be exempt from the point of order the Budget Committee plan would establish.

Conclusion

The Budget Committee plan fails the tests of fiscal responsibility and fairness. It calls for substantial cuts in domestic discretionary programs in 2007 and the following four years. At the same time, it proposes substantial tax cuts. Moreover, in spite of the sacrifices it would demand of millions of Americans who rely on various domestic programs related to health care, education, public safety, environmental protection, and other such activities, the plan would cause deficits to be larger than if none of its policies were adopted.