

August 2, 2006

PUTTING THEIR CARDS ON THE TABLE: Senate Budget Bill Indicates Intention to Pay for Tax Cuts by Sweeping Cuts in Programs for Middle- and Low-Income Households

by Robert Greenstein and Isaac Shapiro

The tax cuts enacted since 2001 have been financed through borrowing — that is, through higher deficits. The sharp estate-tax cut that was approved by the House of Representatives on July 29 and is about to be considered in the Senate would be deficit financed, as well. A new Treasury Department analysis issued on July 25 acknowledges, however, that if tax cuts are made permanent, they eventually must be paid for. The difficult task of adopting “offsets” — cuts in programs or increases in other taxes — has been postponed but not eliminated.

Because the tax cuts have not yet been paid for, the balance sheet on the tax cuts — whether Americans at various income levels will come out ahead or behind, once the measures adopted to pay for the tax cuts are factored into the equation — is incomplete at this point. Only when the cuts in government programs or increases in other taxes that ultimately are instituted are taken into account will the tax cuts’ full effects on American households be discernible.

The Senate majority leadership has

KEY FINDINGS

- A new Treasury analysis acknowledges that the recent tax cuts, if made permanent, eventually must be paid for. Legislation approved by the Senate Budget Committee would effectively do that. While the legislation will not be enacted this year, it offers what *Investor’s Business Daily* has called a “vision statement” for how to extend the tax cuts and address deficits.
- The Senate bill would impose austere discretionary funding caps that would lead to deep cuts in domestic discretionary programs (unless Congress refused to honor the President’s defense requests). It also would impose annual deficit targets and require cuts in entitlement programs if those targets were not met. It would impose no fiscal restraints on new or existing tax cuts.
- If the tax cuts are extended, entitlement programs would have to be cut \$206 billion a year by 2012. If these savings were achieved through the bill’s automatic entitlement cuts, there would be deep cuts in everything from Medicare and veterans disability compensation to school lunches and assistance for the elderly and disabled poor.
- Yet the bill’s deficit target in 2012 would be met *without* such budget cuts if the tax cuts were *not* extended or were financed through revenue-raising measures. Essentially, the bill charts a course under which the bill’s severe domestic program cuts would be used to pay for the tax cuts, rather than to reduce deficits.
- The tax cuts are tilted toward the most well-off. The budget cuts would hit low- and middle-income households hardest. As a result, most Americans would end up net losers under the “vision” that the Senate bill represents.

now begun to develop a vision for how to pay for the tax cuts and address projected deficits. On June 20, the Senate Budget Committee approved legislation (S. 3521) that would radically alter federal budget procedures and lead to deep cuts in domestic programs over time. Although it is unlikely this legislation will be enacted this year, the legislation is important because it appears to reflect a growing consensus among many conservatives about how to extend the tax cuts and start addressing deficits. *Investor's Business Daily* has described this legislation — which was introduced by Senate Budget Committee Chairman Judd Gregg, has been co-sponsored by 26 other Senate Republicans, and was approved by the Budget Committee on a party-line vote — as a “vision statement.”¹ The bill has won plaudits from the Heritage Foundation, the American Enterprise Institute, and other conservative groups.

As other analyses by the Center on Budget and Policy Priorities have shown, the legislation that the Senate Budget Committee approved would lead to sharp reductions in domestic discretionary (i.e., non-entitlement) programs. If the recent tax cuts are extended, the Budget Committee legislation would result in strikingly large cuts in entitlement programs, as well.

The Budget Committee bill would establish deficit targets for each year. It would require that all entitlement programs except Social Security be automatically cut across-the-board by whatever percentage is needed to hit the deficit target for the fiscal year in question. To hit the target for 2012 while extending the tax cuts and relief from the Alternative Minimum Tax — and in the case of the estate tax, adopting the sharp reductions in the tax that the House passed July 29 — would require cutting entitlement programs by an estimated \$206 billion that year, in addition to the cuts that the bill would mandate in discretionary programs. Entitlement programs other than Social Security — including Medicare, veterans programs, school lunches, and basic assistance programs for the poor, among others — would have to be cut an average of 15.6 percent to hit that year's target.

The Senate Budget Committee bill has been described by its proponents as legislation that is needed to tackle the deficit. The bill is structured, however, to shield tax cuts from fiscal discipline. Furthermore, the deep domestic program cuts that the bill would engender would essentially finance the tax cuts, rather than reduce deficits.

This can readily be seen. The bill would set a deficit target of 0.5 percent of the Gross Domestic Product in 2012 and subsequent years and, as noted, would trigger automatic cuts in entitlement programs of the depth needed to hit this target. But if the Administration's tax cuts are *not* extended, or if they are paid for through other measures (including offsetting revenue-raising measures), then the projected deficit already will be below 0.5 percent of GDP in 2012. In other words, in the absence of the tax cuts, the deficit target that the bill would set for 2012 would be met *without any* of the deep cuts in domestic programs the bill is designed to produce.

In fact, over the period from 2007 to 2016, if the tax cuts are extended, the Senate bill would lead to an estimated \$1.6 trillion in cuts to entitlement programs. If the tax cuts are *not* extended, the Senate bill would lead to \$80 billion in entitlement cuts over this period. That is, over the 10-year budget window as a whole, 95 percent of the entitlement cuts the Senate bill would trigger would be

¹ Jed Graham, “GOP Budget Hawks Make Push to Require Broad Spending Cuts,” *Investor's Business Daily*, July 3, 2006, p. A1.

averted if the tax cuts are not extended or are financed by offsetting revenue-raising measures. (See Figure 1.)

How Deep Would the Budget Cuts Be?

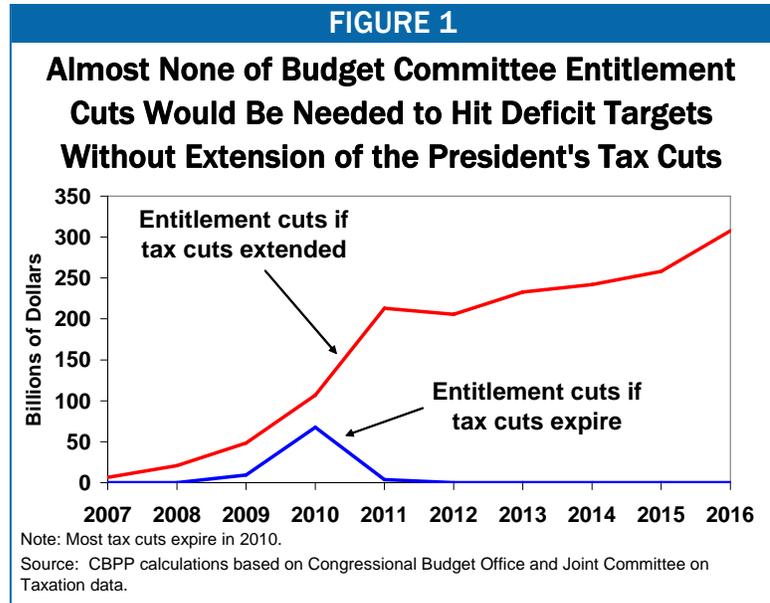
The magnitude of the budget cuts that the bill would require is stunning. The bill would establish caps on overall funding for discretionary programs for each of the next three years, with the caps being set at the discretionary funding levels proposed in the

Administration's most recent budget. Unless Congress funded defense and international programs at levels below those the President has requested, Congress would have to institute cuts in domestic discretionary programs equal in size to those the Administration has proposed. Under the Administration's budget, every domestic discretionary area in the budget would be cut by 2009, except science, space and technology.

For example, under the Administration's budget, the acclaimed women, infants, and children nutrition program (WIC) would be cut \$459 million in 2009 (relative to the 2006 funding level, adjusted for inflation) and would serve up to 680,000 fewer low-income pregnant women, infants, and children under age five.² Similarly, 420,000 low-income elderly people would be cut from the Commodity Supplemental Food Program, which would be terminated.

In addition, in 2009, funding for the National Institutes of Health, the federal focal point for medical research, would be cut \$2.5 billion, while the community oriented policing services program (COPS), which helps state and local governments put police on the street, would be cut 75 percent. Similarly, EPA's clean water and drinking water programs would be cut nearly one fifth in 2009, and funding for energy conservation would be cut 23 percent. (All reductions in discretionary programs described here are measured relative to the Congressional Budget Office baseline, which equals the 2006 funding levels for these programs, adjusted for inflation.)

The entitlement cuts are especially noteworthy. If all entitlement programs except Social Security were reduced by the same percentage, which is how the bill's automatic cuts would work, then cuts of the following magnitude would be instituted in 2012 (see Appendix 1 for a description of how these cut levels were calculated):



² This is the amount by which WIC caseloads would have to be reduced under the current program structure, if funding for the program in 2009 were set at the level shown in the President's budget. The Administration also has proposed shifting part of the costs of the WIC program to states. If that proposal were adopted, the number of people served through WIC would have to be cut 295,000 by 2009.

- Medicare would be cut \$83 billion, which works out to an average of \$1,750 per beneficiary;³
- Veterans injured in combat would have their disability compensation benefits reduced an average of \$1,543, while families of veterans who died serving the country would be subject to average benefit cuts of \$2,293;
- The funds that schools receive for the school lunch program would be reduced substantially, with schools having to increase the prices charged to middle-income children for their school lunches by about 66 cents a lunch;
- A full-time minimum-wage worker with two children would face a cut in the Earned Income Tax Credit of \$798;
- Working-poor families with two children who receive food stamps would have their food stamp benefits cut an average of \$670 a year, even though food stamps currently average only \$1.06 per person per meal; and
- Poor people who are elderly or have serious disabilities would see *both* their food stamps and their Supplemental Security Income benefits cut, with many facing SSI benefit cuts of more than \$1,000 a year. Under current law, a poor elderly widow is expected to receive a total of \$6,560 from SSI benefits and food stamps in 2012. Under the bill, she would find this already-low level of income reduced by about \$930 — to \$5,630 — and her income would fall from 60 percent of the poverty line to 51 percent.

**Net Effect of the Budget Cuts and Tax Cuts:
Most Americans Would Lose, But High-income Households Would Gain Handsomely**

As noted, these budget cuts would only be necessary under the Senate Budget Committee bill because of the tax cuts. The “vision statement” that the bill represents is consequently a clear expression of priorities: deep cuts in domestic programs to finance large tax cuts.

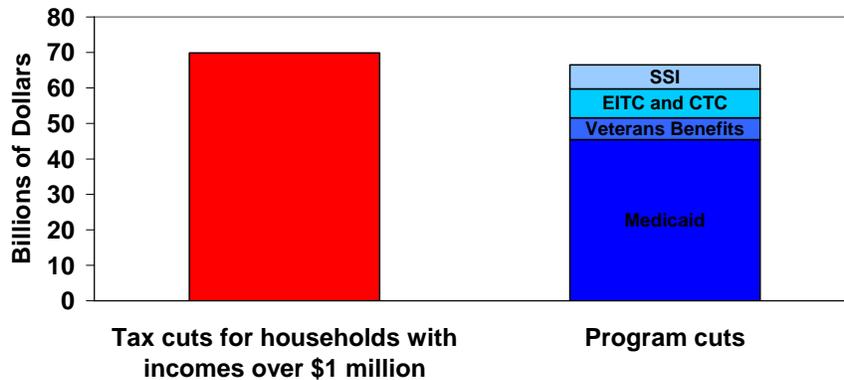
This raises the question of how households at different income levels would fare from this combination of tax cuts and budget cuts. The answer is that most lower- and middle-income households would be net losers once the tax cuts were paid for, while high-income households would be very large net winners. This should not be surprising. The tax cuts for high-income households are far greater than the tax cuts that other households receive, while budget cuts that are made in domestic programs tend to have their most pronounced effects on low- and middle-income households.

- Assuming the tax cuts are extended, the size of the budget cuts that would be made in means-tested entitlement programs in 2012 (i.e., in entitlement programs limited to households with low or moderate incomes) would be about *four times* the size of all tax cuts that the bottom 40

³ It is not clear how the Medicare savings of \$83 billion, which works out to an average of \$1,750 per beneficiary for the 47.5 million beneficiaries projected to be in the Medicare program in 2012, would be attained. The savings could be attained by: increasing the amounts that beneficiaries must pay in premiums, deductibles, and co-payments; lowering payments to hospitals, doctors and other health care providers; reducing the health care services that Medicare covers; or through a combination of approaches.

FIGURE 2

In 2012, Tax Cuts for A Few Hundred Thousand Wealthy Taxpayers Would Slightly Exceed Budget Committee Cuts in Key Programs Affecting Tens of Millions of Households



Note: In 2012, there will be an estimated 450,000 households with incomes over \$1,000,000. In contrast, there will be 64 million Medicaid beneficiaries, 7.5 million SSI recipients, and 16 million people receiving the refundable EITC. In 2004, the most recent year for which these data are available, about 240,000 veterans and veterans' families received veterans compensation or pension benefits.

Source: CBPP calculations based on CBO, Tax Policy Center, and Joint Committee on Taxation data. Figures assume that the President's tax cuts are extended, the Budget Committee's caps on discretionary programs are complied with, and the Budget Committee's deficit targets are met through its proposed across-the-board cuts in all entitlement programs except Social Security.

percent of households would receive that year.⁴ Moreover, these households also would be affected by the reductions in other entitlement programs such as Medicare and by the cuts in discretionary programs. As noted above, working-poor families and low-income people who are elderly or have disabilities would face the loss of hundreds of dollars or more in benefits as a result of the budget cuts. Many of them would be pushed significantly deeper into poverty.

- Most middle-income families would be worse off, as well. Data from the Urban Institute-Brookings Institution Tax Policy Center indicate that the average household in the middle fifth of the income spectrum would gain about \$820 from the tax cuts in 2012, assuming the tax cuts are extended and relief from the Alternative Minimum Tax is continued. Most of these households would be likely to lose more than that from the budget cuts under the Senate Budget Committee's bill.

If all entitlement programs except Social Security were cut by the same percentage, then the Medicare cuts alone would be the equivalent of \$1,750 per beneficiary in 2012. As noted above, disabled veterans would stand to lose an average of \$1,543 each. In addition, middle-class families with two school children could pay \$235 more per year for their children's school lunches. Middle-class families and individuals would face significant income losses from cuts in an array of other programs as well, such as student loans, and also could be adversely affected by cuts in such areas as police and environmental protection. (Note that not all middle-income households receive aid from these programs and that the sample cuts are not additive — e.g., few households are aided by Medicare *and* veterans benefits *and* the school lunch program. Nonetheless, the examples illustrate a basic truth about the Senate policy

⁴ Tax Policy Center estimates show the bottom 40 percent of households will receive an average tax cut of \$260 in 2012.

blueprint: most middle-class households would wind up as net losers. See Appendix II.)

- In contrast, households with incomes exceeding \$1 million in 2012 would receive an average tax cut exceeding \$150,000 that year, according to the Tax Policy Center. In fact, the overall cost of the tax cuts that would go to households with incomes over \$1 million would slightly exceed the *combined savings* from the cuts in Medicaid, veterans benefits, the Earned Income Tax Credit, the refundable component of the Child Tax Credit, and the Supplemental Security Income program. (See Figure 2.)
- Similarly, the top one percent of households (those with incomes of more than \$520,000 in 2012) — a group that would receive tax cuts averaging about \$61,000 that year — would receive more in total tax cuts than the savings from the \$83 billion in Medicare cuts that would be instituted if all entitlements were reduced by the same percentage.

The size of the tax cuts that high-income households would secure would dwarf the reductions in benefits from government programs to which they would be subject. They would be the big winners.

Appendix I. Estimating the Reductions in Entitlement Programs

This analysis includes a series of estimates regarding the entitlement reductions that would be produced under the bill that the Senate Budget Committee has approved. These estimates of the size of the reductions in various entitlement programs assume that the recent tax cuts, as well as relief from the Alternative Minimum Tax, are extended, that the estate-tax reductions just passed by the House are adopted, and that overall funding levels for discretionary programs are set equal to the discretionary caps that the bill would impose through 2009 (and in years after 2009, are set equal to the 2009 discretionary cap, adjusted only for inflation). Under these assumptions, projected expenditures for entitlement programs other than Social Security would have to be reduced by 15.6 percent to meet the bill's deficit target in 2012, the year in which the deficit target would drop to its ultimate level under the bill of 0.5 percent of GDP.

The estimates of reductions in specific programs presented here show what a 15.6 percent cut in projected expenditures for entitlement programs other than Social Security would mean for benefit levels in various programs, assuming that (as would be the case under the bill's automatic cut mechanism) all entitlements except Social Security were reduced by 15.6 percent across the board. The method used here generally assumes that the 15.6 percent reductions in particular programs would be achieved by reducing the benefit levels provided under the programs by 15.6 percent.

For example, a 15.6 percent cut in the veterans' disability compensation program would mean that veterans' disability benefits would be cut by 15.6 percent on average. This would result in veterans who were injured in combat being subject to an average reduction of \$1,543 in their disability compensation payments in 2012. The same approach was used to estimate reductions in programs such as food stamps, Supplemental Security Income, and the Earned Income Tax Credit.

In practice, if Congress were able to enact legislation to institute cuts in these programs in specific ways rather than allowing the programs to be cut automatically, the cuts could be designed so that some beneficiaries would receive larger cuts and others would receive smaller cuts. For instance, the veterans' disability compensation program could be cut by 15.6 percent overall by eliminating benefits altogether for some categories of current beneficiaries while leaving benefit levels unchanged for others. In addition, Congress could elect to cut some entitlement programs less deeply than 15.6 percent if it approved legislation to cut other entitlement programs more deeply than 15.6 percent.

Appendix II. To What Degree Would Various Households Gain or Lose If the Tax Cuts are Offset Entirely by Spending Reductions?

An earlier paper that the Center on Budget and Policy Priorities and the Urban Institute-Brookings Institution Tax Policy Center jointly issued in 2004 examined the distribution of the 2001 and 2003 tax cuts if the tax cuts were made permanent *and* were paid for.⁵ That paper examined two alternative scenarios for financing the tax cuts.

One of the two scenarios bears some broad similarities to the approach taken in the Senate Budget Committee bill. That scenario assumed that each household would pay an equal dollar amount each year to finance the tax cuts. Thus, about one-fifth of the budget cuts needed to pay for the tax cuts would be borne by each fifth of households.⁶ As the joint paper explained, “Something close to this scenario could occur if the tax cuts were financed largely or entirely through spending cuts.”

The joint paper found that under this scenario, nearly four-fifths of households would ultimately lose more from the budget cuts than they would gain from the tax cuts. The Senate Budget Committee plan follows the basic approach that underlies this scenario in that it would, in effect, pay for the tax cuts entirely through spending cuts.

To apply the approach of the earlier paper here, assume that each household would pay an equal dollar amount to finance enough of the tax cuts to hit the Senate bill’s deficit target of 0.5 percent of GDP in 2012. To do so would cost \$1,318 per household. Yet the middle fifth of the household would receive an average tax cut of \$820 in 2012. Hence, the middle fifth of households would lose an average of \$498 each. The lowest-income fifth of households would lose an average of \$1,278 each. (To hit the Senate bill’s deficit target of 0.5 percent of GDP in 2012, about two-thirds of the tax cuts would need to be offset. If the full cost of the tax cuts were to be offset by spending reductions, middle- and low-income households would lose significantly more than just noted.)

By contrast, the top one percent of households would receive tax cuts averaging \$61,000 in 2012. If, due to the Senate bill, these households also had to pay \$1,318 apiece in 2012, they would end up with an average net *gain* of nearly \$60,000. Those with incomes of more than \$1 million would end up with an average net gain of more than \$150,000.

⁵ William G. Gale, Peter R. Orszag, and Isaac Shapiro, “The Ultimate Burden of the Tax Cuts: Once They are Paid For, Low- and Middle-Income Households Likely to be Net Losers, On Average,” Urban-Brookings Tax Policy Center and Center on Budget and Policy Priorities, June, 2, 2004.

⁶ This calculus is roughly accurate for middle-income households, as available Census data (the data are somewhat limited in scope) indicate that about one-fifth of government spending on benefit programs goes to the middle fifth of households.