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# ISSUE BRIEF

NATIONAL HEALTH POLICY FORUM

## A Chicken (Nugget) in Every Pot: What's at Stake in the Budget Debate

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A discussion featuring

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# What's at Stake in the Budget Debate

Fueled by a series of budget surpluses that have yet to materialize, this year's federal budget debate has assumed qualities of the surreal as both parties have preoccupied themselves with having a "vision of the future" they can present to voters in next year's elections. Both parties' visions involve a promise to protect Medicare and Social Security. The Republican Congress would add a $792 billion tax cut over 10 years while the Clinton administration has said that it would accept a lower tax cut and would like to add an outpatient pharmacy benefit to Medicare (as part of a package estimated to cost from $46 billion to $111 billion over the decade).[1] But, so far at least, these visions are highly leveraged.

With the non-Social Security budget not yet in balance, these dreams can come true only if budget projections made by the Congressional Budget Office (CBO) and the Office of Management and Budget (OMB) turn out to be on the money. Both agencies project total budget surpluses of roughly $2.9 trillion over the next decade, about two-thirds of which will be intended to fund Social Security and the rest to cover on-budget accounts.[2] Both congressional Republican leaders and the president have said that Social Security trust fund surpluses should not be spent for other purposes. Because the Social Security surplus is ostensibly off-limits, the legislative fight concerns what to do with the projected on-budget surplus, which CBO estimates will be $14 billion in fiscal year (FY) 2000 and will grow to $178 billion in FY 2009.

In anticipation of the projected surpluses, both houses of Congress August 5 passed the Financial Freedom Act of 1999, which promises $792 billion of tax relief over the next decade, beginning with $5.3 billion in FY 2000. Clinton has said that he will veto the bill. Congressional leaders promise to send it to the White House in September, giving themselves time to present the tax cut to their constituents during the summer congressional recess. Should the president veto the bill, negotiators will be left with the task of passing appropriations bills to keep the government operating and the challenge of deciding how to compromise on budget priorities.

As the budget melodrama continues to unfold, several questions face health policymakers, including the following:

- To what degree are the projected budget surpluses "real" and to what degree are they the result of official budget scoring conventions?
- If most of the projected on-budget surpluses failed to materialize, how would the tax cuts passed by Congress and the Medicare benefit increases proposed by the administration affect future policy?
- How would the benefits of the tax cut be distributed across society?
- If the tax bill is a congressional statement of policy priorities for the next decade, have those who support covering significant numbers of America's 43 million uninsured now missed the boat?

## BUDGET PROJECTIONS

CBO estimates that, if current laws and policies remain unchanged, total federal revenues, including taxes intended to fund Social Security, will exceed total outlays by $120 billion in FY 1999. It projects that the annual surplus will grow to $413 billion in FY 2009.[3] If this series of surpluses actually comes about, federal debt held by the public will drop from about $3.7 trillion (44.3 percent of gross domestic product [GDP]) at the end of FY 1998 to $865 billion (6.4 percent of GDP) at the end of FY 2009.

Growth in federal revenues over the past fives years has driven up estimates of future budget surpluses.


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Revenues grew by an average of 8.1 percent from FY 1994 through FY 1998, while the growth in government outlays averaged 3.1 percent. CBO expects the rise in revenues to slow to 5.8 percent in FY 1999 and to continue growing at an average rate of 4.1 percent a year from FY 2000 through FY 2009. It projects annual growth in federal outlays to remain in "the 3 percent range" through FY 2009, thus driving up total surpluses.

But the agency makes the important assumption that Congress will adhere to discretionary spending caps contained in current law that are effective through FY 2002 and that discretionary spending will grow at the rate of inflation thereafter. While CBO must base its projections on current law, many analysts have said that the budget surpluses are overstated because Congress is virtually certain to spend more than the budget caps would allow. Many also note that, while CBO's economic assumptions are reasonable, it is virtually impossible to predict with much accuracy the performance of the economy over 10 years and that such projections are highly sensitive to relatively small changes in economic assumptions.

### Breaking the Caps

CBO and OMB projections assume that total expenditures for appropriated programs will remain within the caps set for appropriated programs in the 1997 budget law.[4] Remaining with the FY 2000 caps would mean cutting discretionary spending, which includes defense, below the FY 1999 level. Furthermore, the caps on discretionary spending for FY 2001 and FY 2002 are significantly lower than the FY 2000 cap when inflation is taken into account. CBO and OMB projections assume that federal spending will not exceed these caps and then will grow by the rate of inflation after FY 2002. Meanwhile, in spite of the caps in the budget law, both parties are pushing for *increases* in defense spending.

While almost everyone says that OMB and CBO are doing their projections correctly (based on the law as its stands), politicians' use of those projections has elicited satiric descriptions from a number of quarters. For example, projected budget surpluses as portrayed by Congress and the administration have been referred to as an "illusion" (in a recent Washington Post editorial),[5] a "fiction" (in a column by economics writer Robert Samuelson),[6] and as "castles in the sky" (by the Concord Coalition).[7]

CBO's projection of $996 billion in non-Social Security surplus over 10 years would be reduced by $884 billion (to $112 billion) if more reasonable assumptions were made about what the government will likely spend in the next few years, according to an analysis done by the Center on Budget and Policy Priorities (CBPP). Of the $884 billion, $595 billion disappears on the assumption that outlays for appropriated programs keep even with inflation; $80 billion goes away if emergency expenditures are taken into account (based on average spending for emergencies in FYs 1991 through 1998); and $31 billion is lost if Social Security administrative costs are considered. In addition, $178 billion would be needed to cover higher debt payments due to the higher levels of expenditures listed above. According to these assumptions, almost the entire projected surplus would be generated by the Social Security program. Thus, expenditures for major new programs or tax cuts would probably be have to be financed with Social Security surpluses, leaving less to pay down the federal debt or for other purposes.

## THE TAX BILL

In the tax legislation agreed on by the Senate and House conferees, about $400 billion in tax relief would result from reducing individual income tax rates and by reducing the so-called "marriage penalty" in the tax code.[8] If signed by the president, the legislation would drop the 15 percent income tax rate bracket to 14.5 percent in 2002 and to 14 percent in 2003. All remaining income tax rates and the alternative minimum tax (AMT) rates would drop by a full percentage point in FY 2005. In 2006, the income limits of the 14 percent rate bracket would increase by $3,000 for singles and heads of households. The marriage penalty (referring to the higher total tax liability two earners face if they are married and filing jointly than if they are unmarried and filing separately) is addressed by a phased-in increase of the standard deduction for joint filers and by increasing the width of the 14 percent bracket to twice that of the single bracket.

The bill would phase out the AMT for individuals and make adjustments to the corporate AMT at an estimated cost of $111 billion over the 10 years. (AMT is a parallel tax system intended to ensure that no one avoids income taxes.) The tax package also would reduce and then repeal the estate tax. The bill would cut individual capital gains rates but would not change corporate capital gains taxes.

The bill would increase contribution limits for individual retirement accounts (IRAs) from $2,000 to $5,000 by 2008. It would also increase income limits for Roth IRA contributions and income limits for converting standard IRAs to Roth IRAs. In addition, the bill would increase allowable annual contributions to 401(k) and other retirement accounts and would increase limits on contributions to education IRAs.

### Health Care Provisions

The most significant health provision in the tax package would create an above-the-line income tax deduction for the cost of health insurance. This deduction would not be available to individuals covered under an employer-sponsored plan if at least 50 percent of the cost of coverage were paid by the employer. Estimated to cost $31.3 billion over the 10-year period,[9] the deduction would be phased in (25 percent between 2002 and 2004; 35 percent in 2005; 65 percent in 2006; and 100 percent thereafter).[10] The self-employed could claim 100 percent of the deduction, beginning in 2000. Also beginning in that year, a person caring for an elderly relative at home could exempt about $2,750 from taxes. The bill also would phase in an above-the-line deduction for long-term care insurance bought by people not receiving a 50 percent or greater employer contribution.

The new tax deduction for health insurance would do little to reduce the number of uninsured because at least 93 percent of them either pay no income tax or are in the 15 percent income tax bracket, according to the CBPP.[11] About 18 million (or 43 percent) of the nonelderly uninsured owe no income tax and would receive no benefit from a tax deduction. Another 20 million of the uninsured pay income at the 15 percent rate. The tax deduction approved by Congress would subsidize the cost of insurance by 15 percent, not enough to induce many of them to buy coverage (especially in the market for individual health insurance where coverage tends to cost significantly more than for groups). The deduction would be worth the most to higher-income people buying their own insurance. A refundable tax credit or direct subsidy covering most of the cost of health insurance would be of greater help to lower-income people needing coverage, but the cost of such assistance would be far higher than the cost of the proposed deduction.

The proposed income tax deduction also falls far short of removing the tax code's bias toward subsidizing employment-based health coverage over individual coverage. As highlighted at a Forum meeting last November, a group of market-oriented economists and policy analysts recently has renewed the push to reform the tax treatment of health care through a series of measures that include neutralizing the bias toward employment-based coverage, limiting the open-ended tax exclusion of health benefits provided by employers and unions, and retargeting tax subsidies from higher earners to lower earners.[12]

## OUTLOOK

Conservative budget experts seem to gravitate toward two camps, one emphasizing tax cuts and a smaller role for government in the economy and the other placing greater value on the need for fiscal discipline. The tax cutters argue that Congress should take this opportunity to reduce taxes and run the risk of projected surpluses failing to materialize. If that should happen, they argue, corrections can be made later through spending cuts or tax increases. Those who favor fiscal discipline would eschew tax cuts, at least for now, and use more of any surplus to increase national savings (for example, by paying pay down the federal debt or funding retirement accounts for workers). This approach, some argue, would leave the country in a better position to finance the retirement of the baby boom generation, among other things. Both camps tend to oppose creating or expanding government programs. While the Clinton administration favors adding a Medicare drug benefit, some analysts with liberal leanings also advocate fiscal discipline.

Warnings about the wisdom of increasing federal spending or passing a large-scale tax cut have come from the nation's governors as well as from Wall Street. In a recent op-ed piece, for example, Henry Kaufman, president of a financial management and consulting firm, argued that the prospect of tax cuts large enough to threaten budget surpluses is beginning to concern participants in financial markets.[13] Kaufman linked the advance of the stock market over the past five years with the business community's perception that the government had begun putting its fiscal house in order and was shifting from being a demander of credit to repaying the outstanding debt. He pointed out that federal fiscal discipline also lowers the risk of wide swings in the business cycle because budget surpluses give the government the added tool of fiscal policy (the ability to increase government spending or cut taxes) to counteract the effects of an economic recession; in the early 1990s, he noted, because of large deficits policymakers were confined to using monetary policy to stimulate the then laboring economy.

The nation's governors have expressed concern that the budget battle will lead to cuts in federal funding for programs such as Medicaid, the Children's Health

Insurance Program, welfare, the Social Services Block Grant, child support, and education and training programs. At the recent meeting of the National Governors' Association in St. Louis, governors passed a resolution calling on Congress to maintain current commitments to state and local programs. Some were reported to be particularly alarmed by proposals to recapture unspent welfare funds,[14] which might be needed in the event of an economic downturn.

Whether Congress and the administration can forge a budget compromise this year—perhaps including more modest tax cuts than those passed by Congress and a scaled-down Medicare drug benefit—remains a possibility. But "gridlock" is more likely, according to former CBO director Robert Reischauer, now a scholar at the Brookings Institution.[15]

In order to keep the government running, Congress must pass and the president must sign 13 appropriations bills by September 30. Because negotiators are so far apart, it is likely they will have to extend the deadline. As of this writing, Congress had approved only two of these bills and several more were facing veto threats from the White House. According to the Washington Post: "Both sides are contending with spending caps too tight to meet without politically unachievable cuts in popular spending programs, but neither side wants the sole blame for exceeding the limits."[16]

One possible scenario is that budget negotiators will quietly agree to lift spending caps to basically maintain the status quo. Meanwhile, a noisy stalemate over tax cuts and Medicare reform would serve to highlight the parties' differences as they move into an election year. Deferring compromise on larger budget issues would give candidates more latitude to promise a chicken in every pot without having to defend the nuggets they had just handed out.

## THE FORUM SESSION

The meeting will begin with two presentations to be followed by a discussion including members of the audience. After addressing the issue of how much of the projected budget surplus is likely to materialize, speakers will consider the potential impact of budget proposals made by the administration and Congress and share their views about various options facing policymakers engaged in the budget debate. In addition to addressing the questions raised earlier in this issue brief, speakers will consider what combination of federal debt repayment, health care and Social Security restructuring, tax cuts, and other measures they see as reasonable and likely to be considered as the budget debate continues.

### Speakers

**Robert Greenstein** is executive director of the Center on Budget and Policy Priorities, an independent, nonprofit organization established in 1981 to analyze federal and state budget and policy issues affecting low- and moderate-income Americans. In 1994, Clinton appointed Greenstein to serve as a member of the Bipartisan Commission on Entitlement Reform. In 1979 and 1980, Greenstein served as administrator of the Food and Nutrition Service of the U.S. Department of Agriculture, where he had primary responsibility for the nation's food assistance programs, including the food stamp and school lunch programs and WIC, the Special Supplemental Food Program of Women, Infants, and Children. Greenstein received his undergraduate degree from Harvard University and has done graduate work at the University of California at Berkeley.

**William A. Niskanen, Ph.D.,** has served as chairman of the Cato Institute since 1985, having previously been acting chairman of President Reagan's Council of Economic Advisers. Niskanen is an expert in many areas of public policy including defense, education, health care, taxes, trade, and regulation. One of the most highly regarded microeconomists in the nation, Niskanen has taught economics at the University of California at Berkeley and Los Angeles. He has also served as director of economics at Ford Motor Company and as a defense analyst for the Pentagon, the RAND Corporation, and the Institute for Defense Analyses. He holds a B.A. degree from Harvard University and a Ph.D. in economics from the University of Chicago.

## ENDNOTES

1.Testifying before the U.S. Senate Committee on Finance on July 22, 1999, Congressional Budget Office Director Dan Crippen said the administration proposal would increase expenditures for Medicare and Medicaid by $111.1 billion from 2000-2009. Noting that the administration had estimated the proposal's cost at only $45.7 billion, Crippen said the new prescription drug benefit would increase outlays by $168.2 billion, offset in part by $57.1 billion in savings from fee-for-service payments changes and from greater price competition among managed care plans.

2.Concord Coalition, "Surpluses as far as the eye can see—but how good is our eyesight?" budget update, Washington, D.C., July 14, 1999.

3.Congressional Budget Office, "The Economic and Budget Outlook: An Update," Washington, D.C., July 1, 1999.

4.Sam Elkin and Robert Greenstein, "Much of the Projected Non-Social Security Surplus Is a Mirage: Vast Majority of Surplus Rests on Assumptions of Deep Cuts in Domestic Programs That Are Unlikely To Occur," Center on Budget and Policy Priorities, Washington, D.C., revised July 12, 1999.

5."The Surplus Illusion," editorial, *Washington Post,* July 5, 1999, A20.

6.Robert J. Samuelson, "Prediction Fiction," *Washington Post*, July 7, 1999, A19.

7.Concord Coalition, "Castles in the Sky," Washington, D.C., updated July 12, 1999.

8.Republican Policy Committee, U.S. Senate, "Highlights of the Conference Report to H.R. 2488, the Financial Freedom Act of 1999 (Reconciliation Bill)," Washington, D.C., August 5, 1999.

9.Republican Policy Committee, "Highlights of the Conference Report to H.R. 2488."

10."Summary of the Revenue Provisions of the Conference Agreement on H.R. 2488, the Taxpayer Refund and Relief Act of 1999," prepared by the staff of the Joint Committee on Taxation, August 6, 1999, 8.

11.Iris J. Lav and Robert Greenstein, "Is the Roth Proposal a Middle-Class Tax Cut?," Center on Budget and Policy Priorities, Washington, D.C., revised July 21, 1999, 9-10.

12.For more information on the issues surrounding these proposals, see Karl Polzer, "Retooling Tax Subsidies for Health Coverage: Old Ideas, New Politics," NHPF Issue Brief No. 728, National Health Policy Forum, Washington, D.C., November 12, 1998.

13.Henry Kaufman, "Tax Cuts: Bad for the Market," *Washington Post,* August 11, 1999, A19.

14.Dan Balz and David S. Broder, "Governors Cold-Shoulder Fiscal Fight," *Washington Post,* August 11, 1999, A4.

15.Rebecca Adams, "Clinton's Medicare Drug Subsidy Plan Is Criticized for Scope and Cost," *CQ Weekly,* July 3, 1999, 1612.

16.George Hager, "Tax Battle's Likely End: A Whimper," *Washington Post,* August 20, 1999, E1.