COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET

Memo to: Board and Members
From: Carol Wait
Date: February 4, 2002

SUBJECT: The President's Budget for FY 2003

WAR TIME BUDGET OR BUDGET WAR?

The table below contains a summary of the President's Budget with and without a stimulus bill (economic security plan). The table at page two contains the CBO current policy projections for discretionary spending and differences between those estimates and the President's proposals.

The President proposes to cut discretionary spending for everything except defense and Homeland Security to offset the cost of the war against terrorism. Bipartisan majorities on both sides of the aisle and both sides of Capitol Hill almost certainly will agree to pay any cost to win the war. But there could be another war over how to pay to those costs.

President's Budget FY 2003—Summary
($ in billions--totals may not add due to rounding)

	2002	2003	2004	2005	2006	2007	Total 2003-07
Outlays--Discretionary	2,052	2,128	2,189	2,277	2,369	2,468	4,153
Defense	336	368	390	412	428	442	2,041
Non-Defense	382	405	418	423	429	437	2,112
Outlays--Mandatory	310	297	283	291	303	313	6,318
Net Interest	178	181	189	190	188	185	933
Total Outlays	2,052	2,128	2,189	2,277	2,369	2,468	11,431
Receipts	1,946	2,048	2,175	2,338	2,455	2,572	11,588
On-Budget Deficit/Surplus	-262	-259	-208	-156	-142	-139	-904
Off-Budget Surplus	155	179	195	217	228	243	1,061
Unified Budget Deficit /Surplus	-107	-80	-14	61	86	104	157
Economic Security Plan		-77	-57	-20			-141
Unified Budget Deficit(-)/Surplus without Economic Security Plan		-3	43	81	86	104	298

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Congressional Budget Office Baseline Budget Projections ($ in billions-
(totals may not add due to rounding)

	2002	2003	2004	2005	2006	2007	Total 2003-07	OMB± CBO
Outlays								
Discretionary								
Defense	351	356	363	375	381	387	1,862	179
Non-Defense	381	408	421	433	443	454	2,159	-47
Subtotal Discretionary	732	764	784	808	824	841	4,021	132
Emergency Response	22	16	7	3	1		27	27
Total Discretionary Including Emergency Response Fund	754	780	791	811	825	841	4,048	105

On the face of it, the President proposes to cut non-defense discretionary spending $47 billion below the CBO baseline through 2007. But that understates the magnitude of cuts in existing programs as non-defense discretionary includes Homeland Defense. Extrapolating from the numbers contained in the budget, we believe the actual cut to be at least twice that large.

Education appears to be the only domestic discretionary priority (excluding Homeland Defense) to get a real increase in FY 2003. Ironically, highway takes a hit because proponents of the program tied spending to dedicated receipts and those receipts are off due to the recession.

The budget has been redesigned to offer a framework for these cuts—grading programs and agencies on effectiveness, identifying some as having outlived their usefulness and otherwise arguing that the administration proposes to reduce/eliminate spending for old, out-dated and/or low priority programs to fund new high-priority initiatives.

On the Mandatory side, the budget proposes to increase spending $120 billion over the next five years. The largest increase is for Medicare—$45 billion over five years and $173 billion over ten after adjusting for Medicaid offsets—to fund a new prescription drug program for low-income seniors.. Other large increases include $35 billion over five years for the Farm Bill and $3.5 billion for Welfare Reform.

The budget contains a number of refundable tax credits that together comprise the second largest mandatory increase in the budget.

Receipts

The President proposes to reduce tax receipts by about $176 billion (FY 2003-07) and $591 billion (FY 2003-12).

- Over the first five years (2003-2007) half that amount is due to the economic stimulus proposal, 8% is to extend the R&E tax credit, and the balance is attributable mostly to new proposals;

- Over ten years (2003-12) 60% of the revenue loss flows from permanent extension of expiring provisions (most of which were enacted as part of last year's tax bill).

- The largest new tax cut proposals are for charitable giving, parents who send their children to private schools, health care and housing.

Stumbling Blocks or Opportunities?

If the House and Senate—Congress and the Administration—fail to reach agreement on a stimulus bill, budget balance looks to be an achievable goal. That could add to the degree of difficulty involvde in compromising by adding more spending and expanding on tax cuts that the budget proposes.

We do not think that Congress will pass another large tax cut this year. If we are correct—and if that becomes clear early in the year—deficits again receed as a real threat, certainly once the recession is over.

Thus, failure to enact a stimulus bill—and early agreement to put aside further large tax increases—could make the budget framework more politically realistic and workable. There still would be tension between Congress and the President over priorities. So long as budget balance is a realistic goal, however, we believe there will be more pressure on all involved to constrain overally spending.

Economic Assumptions

This year and next, CBO economic assumptions are modestly more bullish than those underlying the President's Budget. CBO anticipates higher average unemployment and modestly higher inflation over the next decade. OMB economic assumptions include lower interest rates than CBO every year except calendar 2002. Most economists agree that the recession is over—or about to be over. The question is how fast the economy will grow and whether a return to growth portends the kind of revenue windfalls we saw in the late 1990's through 2000.

Budget Process

There is a separate booklet, *The Budget System and Concepts*, that accompanies the President's Budget. It points out that *The Budget Enforcement Act* constrains legislation to increase spending or reduce receipts that is enacted through 2002. It goes on to say that the BEA expires in 2002 and the Administration will work with Congress to develop appropriate controls to ensure that enacted legislation is consistent with the proposed funding levels. Among such measures are mentioned—

- Discretionary caps;
- New PAYGO rules;
- A joint budget resolution;
- Or some other for of controls on legislative action.

The Administration also proposes in this budget fully to accrue pensions and retiree health benefits for Federal employees. This accounts for some of the mandatory spending difference between the CBO base and the President's budget. It is not a policy change. It is a bookkeeping change.

The Bottom Line

We are disappointed that the Administration did not take a stronger stand on budget enforcement.

Many in Congress will support the President's budget for defense and Homeland Security but oppose proposed cuts in other discretionary spending. Some will say we need tax increases to pay for the war. Some will want to delay the second round of rate reductions, estate tax relief and other provisions enacted last year.

The recession and the war may provide political cover for those who do not want to make any hard choices at all. They could say yes to higher defense and Homeland Security spending, and also insist on increases for other domestic categories.

The best indicator of the size of future deficits almost certainly will the President's attitude toward total spending. If the President is willing to compromise within the aggregates—but unwilling to give on the total—budget deficits may be relatively small and short lived. That outcome becomes more believable if stimulus legislation and signficant new revenue reductions enounter gridlock early in the legislative process.