

COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET

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Memo To: Board and Members
From: Carol Cox Wait
Date: February 5, 2003

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SUBJECT: President's Budget FY 2004

We will not deny, we will not ignore, we will not pass along our problems to other Congresses, other presidents, and other generations. We will confront them with focus, and clarity and courage.

President George W. Bush
January 28, 2003

The President's budget for 2004 sets out an ambitious, but costly agenda to address multiple challenges—economic weakness, international threats, and loss of security at home to name a few. The President proposes to cut taxes, increase defense and non-defense domestic spending above the rate of inflation, and to add prescription drug coverage for Medicare beneficiaries. It is hardly surprising that this budget is the first since the 1996 budget that does not reach balance within its published time horizon (five years). Though the Administration has declined to make figures available for the usual 10-year timeframe, information provided in the budget documents show that the budget would never balance under the President's policies and economic assumptions.

While we welcome the Administration's effort to restore budget enforcement provisions, the President's approach fails to achieve a firm path back to fiscal discipline and therefore, sets a dangerous precedent for future budgets.

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The President's Proposals

The President proposes to increase the deficit by nearly \$150 billion in FY 2004. In 2003, the budget includes \$31 billion in tax cuts and \$9 billion in spending to stimulate the economy. Over the five-year period, deficits would be nearly \$1 trillion higher than OMB projects under its current services baseline. (See Table 1 for the President's Budget and Table 2 for a comparison of economic assumptions.)

Key elements of the budget include:

- Economic Growth Package: \$418 billion for 2003-2008, of which \$409 billion in tax cuts;
- Total revenue reduction proposals of \$441 billion over five years and \$1.3 trillion over 10 years. The outlays from refundable tax credits that would accompany those proposals add \$34 billion through 2008 and \$116 billion through 2013. Together, the full impact of the tax provision adds up to \$494 billion over 5 years and \$1.45 trillion over 10 years;
- Medicare prescription drug benefits: \$130 billion for 2004-2008 and \$400 billion over 10 years;
- Average annual growth in total spending of 4.8 percent over the 2004-2008 period: discretionary spending would grow 3.2 percent per year on average—4.2 percent for defense and 2.3 percent for non-defense domestic spending; and
- Budget process proposals: reintroduction of caps on discretionary spending and the pay-as-you-go (PAYGO) requirement (the scoring of PAYGO legislation would show its impact over five-years) for two years; tightening the use of the "emergency" designation; a joint budget resolution; and biennial budgets and appropriations.

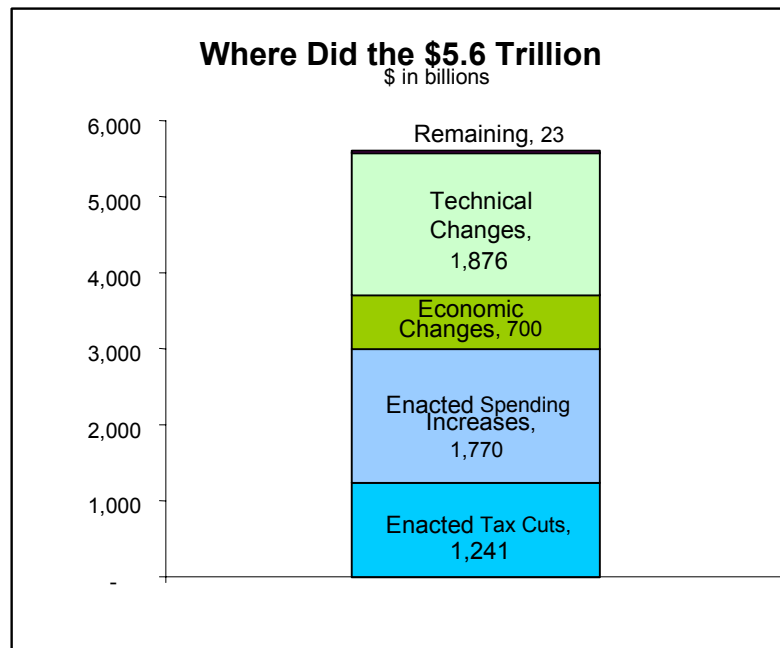
What's missing from the budget:

- Funding for the potential war with Iraq;
- Details about the prescription drug proposal for Medicare beneficiaries;
- Proposals to address long-term financing for Social Security, Medicare and Medicaid, which the Administration projects will grow from 7.4 percent of GDP this year to 8.8 percent in 2010 and 11.1 percent in 2020;
- An explanation of how the Administration would apply PAYGO to the \$1.88 trillion in revenue reductions and direct spending increases included in the budget.

Are Longer Budget Windows More Cloudy than Shorter Ones?

When budget surpluses were projected to accumulate to more than \$5 trillion over the 10-year budget window, many analysts thought that returning to a five-year window would be fiscally responsible. The 10-year surplus projections were used to justify significant tax cuts and spending increases. Now that deficits have returned, the Administration uses the fiscal responsibility argument to display only five years of estimates. In the current situation, however, because the five-year window avoids having to reveal unpleasant trends, the shortened timeframe obscures rather than clarifies the budget picture.

The Administration is correct in stating that 10-year projections are uncertain. In January 2001, CBO projected that budget surpluses would total \$5.6 trillion for the 10-year projection period (2003-2011). Those surpluses have now vanished. Where did they go? According to CBO, less than half of the disappearing surpluses can be attributed to uncertainty (13 percent to deteriorating economic assumptions and 33 percent to technical estimating factors). More than half of the change can be attributed to legislation that was enacted in the last two years—tax cuts used up 22 percent of the projected \$5.6 trillion and spending increases (including debt service) consumed another 32 percent.



The President's Economic Growth Package

The budget proposes a stimulus package totaling \$40 billion in 2003 and \$418 billion through 2008. Over 11 years, the package totals \$674 billion, 96 percent of which comes in the form of tax cuts. By contrast, Senator Daschle has proposed a much smaller and shorter-lived package (see Table 3).

Generally speaking, stimulus proposals may offer relief to some (e.g., extension of unemployment benefits), but it is very difficult to get the timing right. The spending increases or tax cuts typically occur when the economy is already in recovery.

This year is not likely to be any different. Policy makers at both ends of Pennsylvania Avenue are focused on the potential conflict with Iraq, thus reducing the likelihood that any stimulus package will be enacted soon. By the time it is, its effects are likely to hit the economy at the wrong time. Furthermore, stimulus proposals tend to address political, rather than economic, needs. Many economists (including Federal Chairman Alan Greenspan) believe that uncertainty about the international situation is the root cause of the current weakness. If that is the case, stimulus proposals cannot provide the type of assurance that is required to encourage investment and growth.

Over half of the cost of the President's plan (\$364 billion) results from the proposal to eliminate the double taxation of dividends (so that income taxed at the corporate level is not taxed again when it is distributed to shareholders). Advocates of that proposal believe that the reform would encourage greater investment and thus more economic growth. Whether the proposal would actually work as intended, however, depends on the larger budget context. With deficits as far as the eye can see, investors will also be influenced by the potential for future tax increases to finance the government's growing debt levels.

That case illustrates why the "dynamic scoring" of individual revenue proposals is so ill-advised. Many factors affect the economic performance and individual incentives to work, save, invest, and consume. Among those questions is the uncertainty of future federal policy. While additional information about potential impacts of policy proposals on the economy and the budget informs the debate, it is not possible to generate budget numbers that would be reliable.

Do Deficits Matter?

The Administration declares that deficits don't matter, at least ones as small as it projects. The question the budget does not answer is when should we be concerned about the stream of red ink? The Office of Management and Budget's (OMB) estimates include deficits that are large in terms of nominal dollars—\$304 billion in 2003—but small in relationship to the \$11 trillion economy—2.8 percent in that same year declining to 1.4 percent in 2007. The Committee has always maintained that budget balance over the business cycle should be the goal. That would allow the federal government to run deficits when the economy needs the stimulation, but then the government should run surpluses once conditions improve. Once the economy recovers in 2004, as the Administration projects, and as the nation moves away from the other events that have contributed to the current climate, the budget should regain balance, even surpluses.

Further, there is the question of political consensus. If the Administration gives up on even trying to balance the budget, why shouldn't the Congress as well? It took nearly two decades of difficult votes to bring the budget into balance in 1998. After a few giddy years of surpluses, not only did surpluses disappear, but so apparently did the agreement that the budget should balance. The demise of fiscal discipline could not come at a worse time. Baby boomers begin reaching age 66 in 2011. Lawmakers have yet to turn to the kind of policy changes that will keep entitlements affordable.

The budget does include a number of budget process proposals, which we wholeheartedly endorse:

- **Discretionary caps:** the budget proposes to set binding caps on discretionary spending for the next two years (2004-2005). (Caps on discretionary spending, which were first put into place in 1990, expired at the end of 2002.) The details of the proposal are to be announced "at a later date." Presumably, the caps would be extended consistent with each new biennial budget (see discussion below).

Proposed Caps on Discretionary Spending

(In billions of dollars)

	Estimate	Proposed Caps	
	2003	2004	2005
Budget Authority	752	782.2	813.5
Outlays	734	818.8	850.0
Allowance for Retirement Accruals*			
BA		11.1	11.3
Outlays		11.1	11.3

*Represents additional amounts that would be added to the caps if appropriations included federal employee retirement costs on an accrual basis.

- **Pay-As-You-Go (PAYGO):** The budget would renew the PAYGO requirement that expired in 2002, but includes no details. It does, however, reveal the proposals in the budget that would be subject to PAYGO amount to \$654 billion in 2004-2008 and \$1.88 trillion over the next 10 years. The PAYGO provision requires legislation that reduces revenues or increases entitlement spending above baseline levels to be offset by tax increases or cuts to entitlements. While we applaud the Administration for renewing PAYGO, we are puzzled that the budget does not offset its deficit-increasing tax and entitlement proposals.

- Biennial Budget and Appropriations: The Administration proposed to move to a biennial budget and appropriations cycle. The budget argues that the change would increase the amount of time available for oversight and would provide a more stable base of funding for government agencies. Although we support biennial budgeting, we are realistic about its dim prospects for enactment.
- Emergency Designation: The Administration proposes to define “emergency requirements” in law to reflect the following characteristics—necessary, sudden, urgent, unforeseen, and not permanent. The definition would attempt to limit the use of the emergency designation to avoid the discipline imposed by the spending caps. The Congressional Budget Act currently requires the baseline to reflect appropriated levels, thereby embedding emergency spending in the baseline. The Administration proposal to remove those amounts before the baseline is calculated.
- Joint Budget Resolution: The budget proposes a joint budget resolution that would be enforced through sequestration. As envisioned by the Administration, the resolution would set overall receipts, spending levels for discretionary and mandatory programs, and debt levels. The Committee favors a joint resolution. It would encourage the President and the Congress to agree on budget aggregates earlier in the process and then hold subsequent legislation to those limits.
- Automatic CR: If appropriations are not enacted by October 1, the budget proposes to continue funding for appropriated programs at the lower of the President’s budget or the prior year’s level.

Upcoming Events

On Saturday, February 22, Senator Wayne Allard, Congresswoman Diana DeGette, and the Denver Post will join with the Committee to host *An Exercise in Hard Choices*. Contact the Committee for details.

Table 1. The President's Budget for FY 2004

In billions of dollars

	Actual 2002	2003	2004	2005	2006	2007	2008	5-Yr Total 2004-2008
OMB February Baseline *								
Revenues	1,853	1,867	2,031	2,235	2,352	2,469	2,593	11,680
Outlays								
Discretionary	734	785	795	813	825	843	862	4,138
Mandatory	1,106	1,185	1,221	1,269	1,318	1,387	1,465	6,660
Net Interest	<u>171</u>	<u>161</u>	<u>173</u>	<u>193</u>	<u>205</u>	<u>211</u>	<u>214</u>	<u>996</u>
Total	2,011	2,131	2,189	2,275	2,348	2,441	2,541	11,794
Total deficit(-)/surplus	-158	-264	-158	-40	4	28	52	-114
On-budget	-318	-425	-330	-237	-207	-199	-192	-1,165
Off-budget	160	161	172	197	211	227	244	1,051
President FY 2004 Budget								
Revenues	1,853	1,836	1,922	2,135	2,263	2,398	2,521	11,239
Outlays								
Discretionary	734	791	819	850	870	891	926	4,356
Mandatory	1,106	1,188	1,234	1,289	1,369	1,445	1,531	6,868
Net Interest	<u>171</u>	<u>161</u>	<u>176</u>	<u>204</u>	<u>225</u>	<u>240</u>	<u>254</u>	<u>1,099</u>
Total	2,011	2,140	2,229	2,343	2,464	2,576	2,711	12,323
Total deficit(-)/surplus	-158	-304	-307	-208	-201	-178	-190	-1,084
On-budget	-317	-468	-482	-407	-412	-406	-433	-2,140
Off-budget	159	164	175	199	211	228	243	1,056
Difference: President's Budget minus the Baseline								
Revenues	0	-31	-109	-100	-89	-71	-72	-441
Outlays								
Discretionary	0	6	24	37	45	48	64	218
Mandatory	0	3	13	20	51	58	66	208
Net Interest	<u>0</u>	<u>0</u>	<u>3</u>	<u>11</u>	<u>20</u>	<u>29</u>	<u>40</u>	<u>103</u>
Total	0	9	40	68	116	135	170	529
Total deficit(-)/surplus	0	-40	-149	-168	-205	-206	-242	-970
On-budget	1	-43	-152	-170	-205	-207	-241	-975
Off-budget	-1	3	3	2	0	1	-1	5

Table 2. Comparison of Economic Projections for Calendar Years 2004-2013

	Estimated 2002	Forecast		Projected Annual Average	
		2003	2004	2005-2008	2009-2013
Nominal GDP (Percentage change)					
Blue Chip Consensus	n.a.	4.5	5.5	n.a.	n.a.
CBO	3.6	4.2	5.4	5.4	5.0
OMB	3.6	4.2	5.2	5.0	n.a.
Real GDP (Percentage change)					
Blue Chip Consensus	n.a.	2.8	3.6	n.a.	n.a.
CBO	2.2	2.5	3.6	3.2	2.7
OMB	2.4	2.9	3.6	3.3	n.a.
GDP Price Index (Percentage change)					
Blue Chip Consensus	n.a.	1.6	1.9	n.a.	n.a.
CBO	1.1	1.6	1.7	2.1	2.2
OMB	1.1	1.3	1.5	1.7	n.a.
Consumer Price Index^a (Percentage change)					
Blue Chip Consensus	n.a.	2.2	2.3	n.a.	n.a.
CBO	1.6	2.3	2.2	2.5	2.5
OMB	1.6	2.2	2.1	2.2	n.a.
Unemployment Rate (Percent)					
Blue Chip Consensus	n.a.	5.9	5.5	n.a.	n.a.
CBO	5.8	5.9	5.7	5.3	5.2
OMB	5.8	5.7	5.5	5.1	n.a.
Three-Month Treasury Bill Rate (Percent)					
Blue Chip Consensus	n.a.	1.6	2.9	n.a.	n.a.
CBO	1.6	1.4	3.5	4.9	4.9
OMB	1.6	1.6	3.3	4.2	n.a.
Ten-Year Treasury Note Rate (Percent)					
Blue Chip Consensus	n.a.	4.5	5.2	n.a.	n.a.
CBO	4.6	4.4	5.2	5.8	5.8
OMB	4.6	4.2	5.0	5.5	n.a.

SOURCES: Congressional Budget Office (using data from Department of Commerce, Bureau of Economic Analysis; Department of Labor, Bureau of Labor Statistics; Federal Reserve Board) and Office of Management and Budget

NOTES: Percentage changes are year over year.

a. The consumer price index for urban consumers.

Table 3: Comparison of Stimulus Proposals

	President's Budget	Senate Democrats (Daschle)
Individual Taxes	<ul style="list-style-type: none"> • Accelerates tax cuts enacted in 2001 EGTRRA that are scheduled to take place in 2004-2009 to 2003 instead: <ul style="list-style-type: none"> --immediate reduction in marginal rates --immediate increase in width of the 10% bracket --increase in child tax credit from \$400 to \$1,000 --elimination of the marriage penalty • Temporary increase in AMT exemption amount for 2003-2005. • Eliminate double taxation of corporate dividends (\$ 364 billion) 	<p>One-year \$300 refundable tax credit for each adult (\$600/couple) and up to 2 children, including families with payroll but no income tax liability. \$71 billion in 2003.</p>
Unemployment Assistance	See "Personal Re-Employment Accounts" under State and Local Aid below.	Extend benefits for workers who have already exhausted federal and state benefits.
Business Incentives	Increase amount qualifying for small-businesses investment incentives from \$200,000 to \$325,000 and increase limit on immediately write offs to \$75,000 in 2003. Index both limits to inflation in 2004 and beyond. .	<p>Increase amount qualifying for small-businesses investment incentives to \$75,000 in 2003.</p> <p>Provide bonus depreciation of 50% of the cost of new investment in 2003 (instead of current 30%).</p> <p>Provide a 50% tax credit in 2003 to small businesses that provide health insurance coverage to employees.</p> <p>Provide a 20% tax credit in 2003 for investments in broadband, high-speed internet infrastructure in rural and under-served areas.</p>
State and Local Aid	Personal Re-Employment Accounts: provide states with \$1.6 billion in 2003 and \$2 billion in 2004 to create new training/job search/re-employment bonus assistance to unemployed workers (up to \$3,000/beneficiary).	\$40 billion in assistance: \$5 billion for hometown security; \$6 billion for No Child Left Behind (assistance to schools); \$10 billion in increased Medicaid help; \$4 billion for infrastructure; and \$15 billion not earmarked.
Total Estimated Cost	<ul style="list-style-type: none"> • \$674 billion over 11 years • \$40 billion in FY 2003. 	<p>\$114 billion over 11 years</p> <p>\$141 billion in FY 2003.</p>