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INFORMED BUDGETEER: Special Valentine's Edition

PRESIDENT'S BUDGET: FLOWERS & CHOCLATES LET THE SPENDING BEGIN

- With some many numbers floating around, we thought it would be useful to look at the main assumptions of the President's budget, OMB current services baseline (where discretionary spending grows with inflation), and CBO's freeze baseline (discretionary spending is frozen in nominal terms at the 2000 level).

- In order to see the effects of the President's proposals, one looks at the difference between his budget and OMB's current services baseline. However, there is a very large caveat with this comparison. OMB's baseline assumes that discretionary spending is $836 billion higher than CBO's freeze baseline (excluding associated debt service) over 10 years. By starting from OMB's baseline, the President doesn't have to propose increasing discretionary spending – it's already done for him!

- In addition to this increase in discretionary spending, the President proposes spending another $247 billion relative to OMB's baseline over the next 10 years – nearly 70% of this is for the Medicare drug benefit. He also shows a $4 billion and $151 billion reduction in revenues over the next five and ten years respectively. But as outlined in the accompanying bulletin piece, even this is an overstatement. (See back page)

- Thus, relative to a freeze baseline, the President proposes more than one trillion dollars in new spending over the next ten years or roughly three quarters of the projected on-budget surpluses. This highlights the fact that the true risk to our surplus estimates is on the spending side, not on the tax side as is often claimed.

President's Budget
$ in Billions

	2000	2001	2001-2005	2001-2010
Unified Surplus	167	184	965	2519
On-budget	**19**	**24**	**40**	**349**
Off-budget	148	160	925	2170
Revenues	1956	2019	10824	24201
Outlays	1790	1835	9859	21682
Discretionary	**618**	**634**	**3332**	**7054**
Publicly Held Debt	3476	3305	end 2578	end 1082
OMB Current Services				
	2000	2001	2001-2005	2001-2010
Unified Surplus	179	171	1021	2917
On-budget	**32**	**11**	**95**	**745**
Off-budget	148	160	927	2173
Revenues	1956	2010	10829	24352
Outlays	1776	1839	9808	21435
Discretionary	**609**	**635**	**3331**	**7071**
Publicly Held Debt	- -	- -	- -	- -
CBO's Freeze Baseline				
	2000	2001	2001-2005	2001-2010
Unified Surplus	176	188	1358	4179
On-budget	**23**	**22**	**379**	**1859**
Off-budget	153	166	979	2321
Revenues	1945	2016	10913	24395
Outlays	1769	1829	9555	20219
Discretionary	**603**	**624**	**3128**	**6235**
Publicly Held Debt	3455	3281	end 2162	end -614

LIKE CHOCOLATE HEARTS INVESTMENTS CAN BE SOLID, OR HOLLOW

- This week the President submitted his last budget request, and everyone and their mother has reported which spending goes up and which (if any) goes down. The President, however, is more clever than to simply tout abundant new spending. Instead, he re-terms it as "investment"– in the future, in our children, in our elders, etc.

- While most media and other observers may unwittingly accept such characterization, budgeteers would do well to closely examine the rhetoric by relying on the fundamentals of analysis. How should one proceed to evaluate whether the litany of "investments" are worthwhile? CBO's 1998 paper, *The Economic Effects of Federal Spending on...Investments*, provides a good basis for review.

- While one can think of spending on consumption as bringing immediate good or services, investment spending often provides payoffs both now and in the future. But specifically, how does investment provide such future payoffs? By increasing the rate of economic growth, which allows the economy to create more goods and services for future consumption than it would without the investment.

- So is anything bestowed with the label "investment" automatically and unquestionably desirable? For example, it is often thought that investments in infrastructure, education, and research help fuel economic growth. But given that individuals, businesses, and other levels of government spend resources in these areas, what is the necessary or appropriate role for the federal government? Are all federal "investments" created equal, or are some better than others, and how would we know?

- Benefit-cost studies and other evaluations help assess specific investments. For example, CBO reviewed studies of programs in an area featured prominently in the President's budget–Education and Training. CBO concluded that while "investments in education and training contributed substantially to past increases in the productivity of the US workforce, and hence to economic growth, it is not clear that increases in spending on those activities **by the federal government** would lead to additional growth."

- Consider a particular example. CBO notes agreement that one source of economic growth over the last half century has been the sharp increase in the rate of college matriculation. But now, given "the high rate of participation in postsecondary education, efforts to push that rate even higher may not be cost-effective." However, the President makes his use of the words "investment in education" even more questionable by his design of the "investment."

- The President has again proposed, in expanded form, a tuition tax credit for families with incomes up to $120,000, costing $30 billion over the next 10 years. As the *Washington Post* and the *New York Times* observed in editorials in late January, the proposed tax break would not increase college attendance because it would go to families whose children will go to college anyway. And to the extent that the misdirected benefit would accidentally be sprinkled on poorer families, it will be soaked up instead by colleges which would reduce the amount of aid they provide.

- Certainly there might be other reasons–that would not fall under the definition of investment--for, say, offering aid (that would have to be better targeted) to certain students, such as creating more equal opportunity. But in looking at these and other spending proposals the President advertises as "investments," budgeteers should ask: would this spending occur anyway, and if not, would it increase economic growth?

TO FUTURE GENERATIONS WITH LOVE THE PRESIDENT'S PARTING VALENTINE'S GIFT

- The President's budget team attempted to sell their IOU scheme to Congress once again last week. They appear to be emulating the Music Man – Professor Harold Hill. They offer an abundance of initially pleasing explanations, which don't hold up under scrutiny.

- **Myth 1:** "The President wants to let the Social Security surpluses build up over the first ten years and then credit the interest savings to the Social Security Trust Fund in 2011 and beyond. This will extend SS' solvency until 2050." There are several problems with this argument.

- The SSA actuaries already assume that the Trust Fund holds IOUs equal to the accumulated Social Security surpluses AND the resultant interest earnings. Thus, the Administration is telling the actuaries to **double-count** this interest savings in their calculations. Gee, if the actuaries could just triple or quadruple-count the interest, Social Security would look permanently solvent with no current pain or exertion. This is Professor Hill's think method – think SS is solvent and so it shall be.

- There is no real link between surpluses and IOU transfers, since the Administration says these IOU transfers will occur no matter what happens to our fiscal position. They acknowledge the inconsistency between rhetoric and deed, but say that the risks of surpluses not appearing are diminished by their prudent budget assumptions. Hmm, projecting that Dept. of Education spending grows 36 percent in 2001 and is frozen in real terms thereafter? Somehow, our fears are not assuaged.

- **Myth 2:** "Even though our gross debt will rise by $34 trillion as a result of the SS IOU transfers, future taxes will not have to be increased. That is because that US will have built up net assets (the opposite of net debt) equal to 25 percent of GDP in 2050 under OMB's long-term fiscal assumptions. The US can just tap these assets to pay SS benefits instead of raising taxes."

- Leave aside the political sensitivities involved in buying France or the UK. OMB's long-term model has consistently generated results that are contradicted by nearly every other modeler. Under a policy of saving the Social Security surplus (which is broadly consistent with both the President's and Congress' plan), CBO and GAO project that we will have a debt to GDP ratio of 150 percent in 2050. There won't be any net assets to tap and taxes will have to be raised to honor SS promises.

- Even if one believed the results of OMB's long-term model, one should still not be complacent. OMB projects that Social Security, Medicare, and Medicaid combined will rise from 7 percent of GDP today to a staggering 16 percent by 2050. Such growth implies that discretionary spending falls from 6.5 percent to 3 percent of GDP. Despite this, the Administration still prefers paper IOU exchanges in lieu of real reform.

- In the Music Man, Professor Hill's band materializes at the last minute, courtesy of Hollywood's magic. Unfortunately, no such magic will rescue the President's IOU scheme.

HEARTBREAK HOTEL: THE TAX CUT JUST GOT SMALLER

- The President's budget tables correctly accounted for four of the five refundable tax credits he proposes: the long-term health care credit, the workers with disabilities credit, the dependent care credit and the credit for filing income taxes electronically. That is, the receipt effects are shown in the revenue table and the outlay effects are shown in their respective spending functions.

- A mistake was made with the EITC numbers, and the outlay and revenue impacts were essentially reversed in the budget presentation. The correct revenue effect of the EITC proposal is to reduce revenues by $1.6 billion over five years and by $3.3 billion over ten, not $10.2 billion over five and $20.5 billion over ten as reported in the budget. The correct EITC outlay impact is to raise spending by $10 billion over five years and $20.2 billion over ten.

Corrected President's Revenue Proposal
$ in Billions

	2001	2001-2005	2001-2010
Gross tax cut	-4.2	-87.4	-314.3
Gross tax increase	15.0	91.3	180.8
Net tax change	10.8	3.9	-133.4
Outlay increase of five refundable tax credits	2.0	14.6	37.3

- This changes the gross and net tax numbers quite a bit. The President's budget, as corrected, really has a **$10.8 billion net tax increase in 2001, a $3.9 net tax increase over five years, and a $133 billion net tax cut over ten years** – quite a bit different from the Adminstration claim that the budget contains a net tax cut of $256 billion over ten years!

SUPPLEMENTALS ARRIVE

- Enacting the President's supplemental package would consume $8.4 billion of the $23 billion (CBO estimate) on-budget surplus projected for 2000.In addition, he also proposes a timing shift in mandatory programs – veterans compensation and SSI – for another $4.0 billion, and would spend $0.7 billion on his farm safety net proposal. Thus, almost 60 percent of the projected on-budget surplus for 2000 will have been spent (includes interest). These shifts allow the White House to spend more in the President's FY 2001 budget request and reduce amounts available to address legitimate emergency needs in the current fiscal year.

Supplementals: President's FY2000 Request
$ in Millions

	BA	Outlays
Emergencies:	2,748	1,780
Kosovo/East Timor	2,123	1,540
Defense	625	240
International Affairs		
Colombia Counter Drug	955	287
Defense	137	38
International Affairs	818	249
Disaster Aid	159	63
Defense	27	20
Non-defense	131	43
Other Emergencies	124	23
SubTotal, Emergencies	3,986	2,153
Non- Emergencies		
Dept. of Energy	89	59
HIPC	210	53
Other	135	97
Subtotal, Non-Emergencies	434	209
Rescission Proposals		
Dept. of Energy	-69	-9
Y2K	-225	- -
Dept. Housing & Urban Devel.	-109	-5
Subtotal, Rescissions	-403	-14
Repeal Proposals		
HHS Delayed Obligations	—	499
DOD prompt/progress payments	—	1,250
Pay day shift - non-DOD military	—	843
Pay day shift - DOD military	—	3,454
Subtotal, Repeals	—	6,046
TOTAL	4,017	8,394

Ì Budget Factoid Ì

In honor of Valentine's Day, the *Bulletin* presents a special matters of heart Bugdet Factoid. The National Heart, Lung and Blood Institute (NHLBI) requests $2.1 billion for 2001, an increase of $108.7 million, or +5.5 percent. Heart and vascular diseases will receive approximately $1.1 billion, an increase of $62.8 million above 2000.

ì The Senate is in recess for Valentine's Day and Presidents Day until February 22. The *Bulletin* will return on February 28.