

INFORMED BUDGETEER

TAKE THAT

- Some parties have recently charged that Chairman Domenici and the Budget Committee staff made up or “twisted” numbers to show that it is possible to have a \$792 billion tax cut without dipping into the social security surplus or “decimate” government programs. For those (particularly in the Administration) who have trouble with math, this week’s *Bulletin* is here to help.
- CBO’s July Baseline projects total unified budget surpluses of \$2.9 trillion between 2000 and 2009. CBO’s published baseline assumes current law for entitlement and mandatory programs, and discretionary spending at the statutory cap level. After the caps expire in 2002, CBO assumes aggregate discretionary spending will rise by the rate of inflation.
- Many have argued that an inflated baseline for discretionary spending is not appropriate for making budgetary decisions because these programs are annually funded and have no statutory automatic increases (such as COLAs in entitlement programs). The agency budget justifications submitted every spring to Congress contain explanatory tables that reflect changes from current year levels, not from an inflated future level.
- The starting baseline for deliberation on this year’s budget resolution, H.Con.Res. 68, assumed a freeze on discretionary spending at the 1999 level, without emergencies. According to CBO estimates, if discretionary spending is frozen at the 2002 cap level through 2009, the surplus would increase by \$475 billion (including interest savings), resulting in a 10-year surplus estimate of \$3.4 trillion.
- After setting aside all \$1.9 trillion of the Social Security surplus for debt reduction, \$792 billion for the Taxpayer Refund Act, and \$173 billion in interest costs on policy changes, \$505 billion remains for other high priority budget items.
- The post- policy budget resolution assumed discretionary spending increases of \$222 billion over a freeze (roughly half the rate of inflation), mandatory spending increases for agriculture and child care, and up to \$92 billion for medicare reform (including prescription drug benefits) or debt reduction.
- Therefore, based on the July 1 CBO economic update - the budget resolution permits a tax cut of \$792 billion, 100% protection of Social Security surpluses and \$505 billion for spending programs, Medicare or debt reduction. And since the resolution assumed using \$228 billion of this remainder for spending programs, over \$277 billion of the \$505 remains available for spending or debt reduction!

Distribution of Surplus: Congressional Budget Resolution	
(\$ in billions, 10-year totals)	
	2000-2009
CBO July 1999 capped baseline with discretionary inflation after 2002	2,896
Plus: Freeze after 2002	+419
Plus Interest savings	+56
Equals: CBO July 1999 capped baseline with discretionary freeze after 2002	3,371
Budget Resolution assumptions:	
Minus: Set aside Social Security surplus	-1,901
Minus: Tax cuts	-792
Minus: Interest costs	-173
Equals: Remainder- On-budget surplus	505
Minus: Discretionary add-backs in budget	-222
Minus: Mandatory spending in budget	-6
Equals: Unused surplus available for debt reduction, Medicare or other spending priorities	277

SOURCE: Congressional Budget Office and Senate Budget Committee, Majority Staff.

- In a recent television interview, the Administration attempted to plug its dubious use of IOU transfers to shore up Social Security and Medicare trust funds. Gene Sperling, Director of the National Economic Council, flashed a newspaper headline that said “Greenspan Backs Clinton’s Plan for the Surplus -- Diverting General Revenues Toward SS Will Cut Debt, He Says”.
- However, this was another misleading presentation from the Administration. What the Administration didn’t say is that this newspaper story ran on January 29, before the President’s budget had been formally released and before its details were fully known. In fact, it turned out that there was no connection between the IOU transfers and reducing the publicly held debt. The latter could be done completely independently of the former. The Administration’s IOU transfer has been roundly criticized since firm details emerged.
- Chairman Greenspan certainly applauds the President for using the Social Security surplus to pay down the publicly held debt. However, his recent remarks to the Senate Banking Committee certainly do not seem to support the Administration’s use of IOU transfers. (These transfers compel a general fund payments to Social Security down the road – this would be financed ultimately by raising taxes on future generations.) When asked if he supported using general revenue funds for Social Security last month, the Chairman had this to say:

“We confronted this problem in the 1983 Social Security Commission, and I was impressed by the fact that a bipartisan commission was very strongly opposed to the use of general revenues on the grounds that a social insurance fund should be self-financing, fundamentally. I would very much prefer that we did not move in the direction of general revenues because in effect, once you do that, then you've opened up the system completely and the issue of what Social Security taxes are becomes utterly irrelevant.

Clearly, if you don't change either the tax structure or the benefit structure of either Social Security or Medicare, and you improve the trust funds, it could only have come from general revenues. There's no third possibility. And I'm not terribly certain that serves our budgetary processes in a manner which I think is appropriate.”

- The Administration would do well to keep up with current statements that relate to their budget plan, and not recycle 6 month old articles which were written before their budget was ever submitted for public review. You can understand their predicament, however -- very few independent authorities have supported their IOU transfers. Indeed, some Democrats have openly opposed their plan – Senator Kerrey in particular.

RECONCILIATION CONFERENCE REPORT

- The House and Senate last Thursday passed the tax-budget reconciliation conference report which avoids collecting taxes, \$792 billion over the next ten years.
- Individual income tax rates are each reduced by one percentage point, resulting in the most benefit to taxpayers in the lowest bracket. The 15% bracket is cut to 14.5% right away; all other rates are reduced in 2005.
- The measure contains a trigger, or “pause” button that would postpone rate reductions (except the first cut from 15% to 14.5%) if gross debt increases from one year to the next, measured at three points in 2003, 2005 and 2006. Based on current debt projections the triggers would be pulled and the 10-year tax cut would be reduced to over \$500 billion.
- The marriage penalty is eliminated in the standard deduction, as the deduction for joint filers is phased up until it is twice the single filer amount. In later years, the width of the lowest tax bracket is increased to 2 times the single bracket. The income

ADMINISTRATION CLUTCHING AT STRAWS

starting and ending point for the EIC for joint filers is increased by \$2,000 and indexed.

- The individual AMT is repealed over time, and the dependent care tax credit is increased and made available to more taxpayers.
- Immediately, the long-term capital gains tax rate for individuals drops from 20% to 18% and, for low-income individuals from 10% to 8%, with a one-year holding period requirement. The bill provides for capital gains indexing effective 1/1/01, with a mark to market election. The real estate depreciation recapture rate is reduced from 25% to 23%.
- IRA contribution limits are phased up to \$5,000. A variety of pension reform provisions, including provisions for expanding coverage and enhancing fairness for women, are included.
- Education savings accounts limits are increased to \$2,000 and expanded to cover elementary and secondary school expenses. School construction incentives are included, and student loans are made easier to repay.
- An above-the-line deduction for health insurance expenses is included, and the door is opened for a deduction for prescription drug insurance coverage. Expenses for self-employed health insurance are fully deductible beginning in 2000.
- Death taxes are repealed by 2009. Farm and fishing incentives are included, as well as timber, oil and gas incentives. The research and experimentation credit is extended for five years, and the Work Opportunity and Welfare-to-Work tax credits are extended for 2 1/2.
- In order to comply with Byrd rule requirements, the conference report retains the Senate provision sunsetting the tax cuts after 2009.

THAT DEJA VU FEELING

- On July 28, the Executive Board of the IMF approved a \$4.5 billion loan for Russia, its first since the financial turmoil last August. Under the terms of the loan, the IMF will pay out the money in 7 installments. The first \$640 million has already been released, however, none of the funds will ever be disbursed to Russia.
- Why? The IMF is essentially lending Russia more money to repay its existing IMF debts preventing it from default. The agreement paved the way for resumption of World Bank loans (\$1.2 billion), Japanese loans (\$1.1 billion), and debt restructuring (\$8.1 billion by the Paris Club for 2 years), which had been contingent upon new IMF funding.
- Since the collapse of the Soviet Union, the IMF repeatedly has come to the aid of Russia to help advance their transition to a market economy and democratic government. Since 1993, Russian debt to the IMF has grown from \$2.5 billion to \$16.9 billion this year, making Russia its largest debtor.

Russia's Projected Debt to the IMF (\$ in Billions)			
	1998	1999	2000
Disbursements	6.2	1.9	2.6
Principal Repayments	0.9	3.8	3.4
Charges (interest)	0.7	0.7	0.7
Outstanding Debt- end of year	19.3	16.9	16.1

SOURCE: Treasury Department NOTE: Numbers do not add to end of year totals because of exchange rate fluctuations in converting IMF Special Drawing Rights to US dollars.

- While the IMF's normal practice is to have convincing evidence of macroeconomic stabilization before offering credit, Russia has always been treated as a special case.
- In August last year, Russia defaulted on its government bonds and eventually floated the ruble, virtually isolating Russia from the

international capital markets.

- In recent months, Russia's economy has shown some life, stimulated primarily from recent rises in commodity prices, lower debt servicing costs, and higher revenues. Standard and Poor has raised slightly Russia's credit rating, and foreign investors are again buying Russian bonds, which are rising in value.
- It seems the IMF Directors have longer memories. In recent press releases, they publicly warned that "the limited recovery and the measure of stability achieved in recent months would prove unsustainable unless strenuous and determined efforts were made to reduce the fiscal deficit and to accelerate structural reforms" and "there had been little progress in structural reform since last August."
- More distressing are the conclusions by an external audit and admission by Russian government officials that Russia had lied to the IMF. In 1996, reserve figures reported to the IMF were inflated by about \$1.2 billion from transactions with FIMACO, an obscure offshore company the Russians used to manage billions of dollars of its central bank reserves (partly made up of IMF loans).
- The IMF's primary objective for its current program is to support Russian implementation of a responsible federal budget and to close and liquidate insolvent banks. As Russia prepares for its parliamentary elections this December and a presidential race next summer, the hope is that the IMF can hold the line on conditionality and break the crisis cycle that Russia has been living with for the past 6 years.

✉ EDITOR'S NOTE: The *Bulletin* will be taking a break during August recess; therefore you can expect the next *Bulletin* in your mailbox on September 13, after the Congress reconvenes for the fall session. If you need some additional beach reading, check out the Economic Bulletin, which is now on our web site.

✉ Last week, the Budget Bulletin incorrectly printed a table showing that fewer poor children are receiving food stamps and welfare cash assistance, below is the corrected table.

Poor Children Receiving Means-Tested Benefit (In thousands and percent)			
	1995	1996	1997
Number before receipt of benefits	15,717	15,426	14,898
% receiving food stamps	88.2	85.6	79.7
% receiving AFDC/TANF	57.3	54.2	50.6

SOURCE: Data from the Census Bureau, tabulated by the Center on Budget and Policy Priorities

- On a similar note, this week, the GAO issued a report finding that some of the drop in food stamp penetration rates among poor children is due to tighter food stamp eligibility requirements. However, GAO also reported that implementation of Temporary Assistance for Needy Families - TANF has been an important factor in the decline of food stamp participation. In particular, states reported that many people do not apply for food stamps because they assume that if they are ineligible for TANF, they are also ineligible for food stamps.