107th Congress, 1st Session: No. 19 July 16, 2001

INFORMED BUDGETEER

A CASE OF THE POT CALLING THE KETTLE BLACK

- Over the past few weeks, members who opposed the recently enacted tax cut (which cost $1.35 trillion over eleven years) have further denounced it because, they say, it has caused the projected surplus levels to dip below the level of the Social Security plus Medicare Hospital Insurance surplus in certain years.
- In order to make this pronouncement, tables have been circulated and charts have been displayed that show the CBO May baseline adjusted for the enacted tax cut as well as all of the other policies assumed in the budget resolution, whether enacted or not.
- The *Bulletin* would like to remind its readers that an amendment that was offered during Senate floor consideration of the tax cut reconciliation bill (S.A. 674) by Senators Carnahan, Daschle, Johnson and Corzine, cut taxes by $1.26 trillion over eleven years.
- Every Democrat, except Sen. Miller, voted for this amendment, including the entire Democratic Leadership and all of the Democratic members of the Senate Budget Committee.
- The table shows that the Carnahan-Daschle amendment cut taxes by $41 billion less in 2001, *but $27 billion more in 2002* compared to the final conference agreement.
- For the record, if one uses the method of plugging the tax cut into the budget resolution and comparing it to the May CBO baseline, the Democrats' tax alternative causes the surplus to dip into Medicare HI in 2002 and in 2005.

Cost of Enacted Tax Cut vs. Carnahan-Daschle-Johnson-Corzine Alternative
($ in Billions, JCT estimates)

	'01	'02	'03	'04	'05	'01-'11
Alternative Amendment	-33	-64	-83	-101	-115	-1,259
Conference Agreement	-74	-38	-91	-108	-107	-1,349
Final vs. Alternative	-41	27	-8	-6	8	-90
On-Budget, less HI surplus, under alternative*	48	-1	3	4	-5	

* Assuming budget resolution policies compared to May CBO Baseline

FY 2001 SUPPLEMENTAL TO CONFERENCE

- Conferees are expected to meet this week on H.R. 2216, the FY 2001 Supplemental Appropriations bill. The final bill will go to the White House having largely met the President's desire to fashion a bill within the 2001 discretionary spending caps and without funding designated as emergency spending.
- The Senate-passed bill totals a net of $6,544 million in discretionary BA and $1,307 million in discretionary outlays. Of that total, $5,920 million in BA and $996 million in outlays is defense spending, and $624 million in BA and $311 million in outlays is non-defense spending. When mandatory spending of $936 million for mandatory veterans benefit programs is added, the Senate-passed bill totals $7,480 million in BA and $2,243 million in outlays for FY 2001.
- In Senate action, any additional funding that was added was also offset. Additional spending of nearly $100 million was added for storm damage repair to army and air national guard facilities in Oklahoma and Texas ($15.7 million); for humane treatment of animals through USDA ($3 million); assistance through USDA for producers in the Klamath Basin of Oregon and California ($20 million); assistance to the State of Washington for damages associated with the Nisqually earthquake ($16.8 million); Alaska rail study ($2 million); repairs for damages associated with ice storms in Arkansas and Oklahoma ($24 million); Alaska spruce bark beetle response ($2.5 million); flood damage in West Virginia ($5 million); drought assistance in the State of Washington ($2 million); and housing on the Turtle Mountain Indian reservation ($5 million).
- Additional offsets were taken from the emergency oil and gas loan guarantee program, military construction, FAA grants-in-aid contract authority, and employment and training funding available to state agencies under the Food Stamp Act.
- The House-passed bill nets to $6,545 million in discretionary budget authority and $1,341 in discretionary outlays. This amount includes a net of $5,846 billion in BA and $992 million in outlays for defense programs, and $699 million in BA and $349 million in outlays for non-defense programs. With the addition of $936 million for mandatory veterans benefits, the House-passed bill totals $7,480 million in BA and $2,277 million in outlays for FY 2001.
- A conference issue will be the House inclusion of $438 million in emergency spending, offset by a rescission of $389 million in FEMA disaster relief funding. The Senate-passed bill includes no such emergency spending or offset.

RETURN OF THE LOCKBOX

- Last week, the Senate voted yet again on a proposal to put the illusory Medicare surpluses in a "lockbox." The Medicare lockbox amendment garnered 53 votes (of a required 60) in March, but was supported by only 42 Senators this time around.
- The amendment would have taken the Hospital Insurance portion of Medicare off-budget in an attempt to protect supposed program surpluses. But as the Bulletin has stated before (see February 20, 2001), **there is no Medicare surplus**. In fact, the Medicare program as a whole is running deficits.
- Here is a quick review of how the Medicare program is financed. The Hospital Insurance part of Medicare (also known a HI or Part A) is funded largely by dedicated Medicare payroll taxes (along with some general fund revenues) and covers primarily hospital services. This part of Medicare is expected to run a surplus of nearly $400 billion over the next 10 years. In general, this is the "Medicare surplus" that people claim needs protection.
- But Part A accounts for only a 56% (and declining) share of the total annual spending on Medicare. The other part of Medicare--Supplemental Medical Insurance (also known as SMI or Part B)--accounts for the remainder of Medicare spending. Services covered by Part B include physician visits, outpatient services, and home health care. According to CBO, Part B spending will total $100 billion in 2001. And $70 billion of this will come from general tax revenues!
- The so-called "surpluses" in Part A of Medicare are more than offset by the general revenue transfers that go to Part B of the program. As the table below shows, when we compare the total cost of the Medicare program to its dedicated payroll tax revenues, Medicare will run a deficit of $56 billion in 2001 and nearly $1 trillion over the next 10 years.

Medicare Surplus (+) and Deficits (-)
($ in Billions)

	2001	2002	2002-2011
Part A Surplus	28	38	397
Part B Deficit/Surplus	-6	-1	13
Total Trust Fund Surplus	22	37	410
General Fund Transfer to Part A	-8	-12	-153
General Fund Transfer to Part B	-70	-83	-1248
Total General Fund Transfers	-78	-95	-1402
Total Medicare Deficit	-56	-58	-992

Source: CBO May 2001 Baseline, totals may not add due to rounding.

- Why does Medicare have this strange, bifurcated structure? Back in 1965 when Medicare was created, health insurance was generally divided between hospital costs and physician costs. This division was replicated in Medicare by creating Parts A and B of the program. But while the private insurance market has moved on and unified payments for the whole range of medical services, Medicare has retained this outdated distinction between hospitals and physicians. This financing structure makes no sense in today's health care marketplace.

- The last thing we need to do is create a "lockbox" that casts in stone a 1965 financing structure for a program that desperately needs to be brought into the 21st century.

- Important steps have been taken to ensure that Medicare funds are used only for Medicare. In the FY2002 budget resolution, Medicare funds were explicitly preserved for Medicare through the language that governs each of the reserve funds that were established for other specific spending purposes. Monies from those reserve funds can only be released as long as doing so does not "reduce the on-budget surplus below the level of the Medicare Hospital Insurance Trust Fund surplus in any fiscal year covered by this resolution." Those who voted for the budget resolution voted to ensure that Medicare funds are used only for Medicare.

- Too often, proponents of a "lockbox" argue that this political ploy is needed to protect the solvency of the Part A trust fund. But the *Bulletin* wants to make it very clear: **using Part A funds for any purpose has no impact on the solvency of the trust fund!** Whether the current Part A surpluses are used for debt reduction, prescription drugs, or any other spending, the government issues an IOU that is considered an asset of the trust fund. Those assets are used to determine solvency. The Part A trust fund is projected to remain solvent until 2029, and the presence or absence of a lockbox will not change that date.

- The real problem facing Medicare is not the solvency of its trust fund but its long-term fiscal sustainability. Putting imaginary surpluses in a lockboxdoes nothing to ensure that Medicare will be available to future generations.

THE POSTAL SERVICE'S BUDGET: RETURN TO SENDER?

- On July 1st the U.S. Postal Service raised for a second time this year a number of its delivery rates, so the *Bulletin* would like to give its readers a timely overview of the nation's largest civilian employer.
- The history of the Postal Service is rooted in the founding days of America. The Second Continental Congress of 1775 established its own post office out of fear and distrust of the British, who controlled the mail at the time. The modern Postal Service wasn't incarnated until the passage of the Postal Reorganization Act of 1970 (39 U.S.C.A. § 201). Under this Act, the Service was established as a self-supporting government-owned agency. By 1982, direct public subsidies were completely phased out.

- Today, the Service covers all of its costs from postage and fees. It does receive an appropriation from Congress, however, to compensate for revenue forgone in providing statutorily free and reduced rate mail for the blind and visually impaired and for overseas voting. Under the Revenue Forgone Reform Act of 1993, Congress is required to reimburse the Service $29 million each year until 2035, for services performed but not paid for in the 1990s.

- The Post Office employs approximately 900,000 civilians and delivers 668 million pieces of mail a day to 113 million addresses six days a week. Today, to break even (as required by law), the Service estimates it needs an average of about $2.00 in postage for each delivery point every day. It has a statute-backed monopoly in the delivery of letters in the U.S., and unlike some of its competitors (e.g., Federal Express), it does not pay any taxes. On the other hand, it is mandated to provide service to every household in America.

- Though the Postal Service earned a record level of net income of almost $1.8 billion in 1995, income has fallen steadily through the latter half of the 1990s and into 2000 (see chart below). The Service's financial outlook has deteriorated significantly. It is now forecasting a deficit between $1.6 billion to $2.4 billion for this year and $1.5 billion to $2.5 billion next year, assuming no further increases in postal rates. In addition, the Service's debt is approaching its $15 billion statutory ceiling without any debt reduction plan. The General Accounting Office placed the Postal Service on its High Risk List for the first time ever, identifying a number of major management challenges and program risks facing the Service.

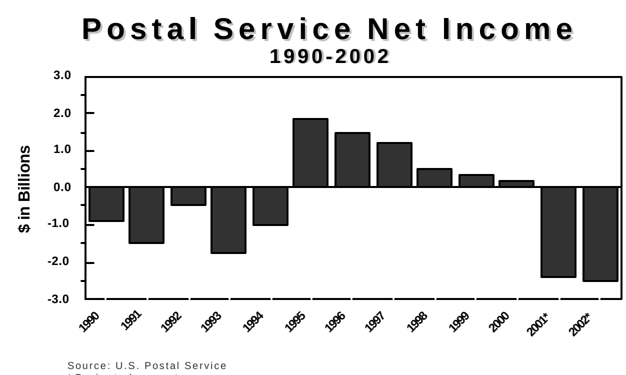
- The Service has reacted to these financial woes by twice raising their prices this year alone. For example, the first ounce of a first class letter has been increased to $0.34. The cost of sending a postcard has risen by a penny to $0.23 and senders of first-class bulk and advertising mail as well as magazines will see their prices go up too.

- The Service must also examine ways to improve its productivity, use new technologies effectively and control its costs to improve its financial position.

- Postal productivity – the relationship between the Service's "output" of delivering mail and the resources expended has only increased by 11 percent since 1971. According to the Service's own measurement system, the average delivery time for First-Class mail overall has been getting longer. The average delivery time in 1981 was 1.68 days, 1.83 days in 1991 and 1.93 days over the past year. The Service has spent billions of dollars on various automation programs, yet labor costs, as a percentage of the agency's expenditures, have remained steady at 80 percent since 1970.

- Two trends have changed the face of the Postal Service. First, a technological revolution changed the way in which people communicate with each other. Second, the Service eventually and inevitably began to take on the characteristics of most federal agencies: (1) it continues to expand without a focused strategic plan (2) it has developed serious financial management problems (3) it is unable to increase its efficiency and productivity and (4) it wastes millions of dollars due to mismanagement.

- The Service's challenge will be more difficult considering the extensive statutory and regulatory restrictions (i.e., universal postal service requirement, binding arbitration requirement, rate-setting process and facility closure restrictions) it still faces today unless the current structure of the Service is seriously reexamined and statutory constraints are altered. It appears the Postal Service framework established by Congress in 1970 is outdated and is not sufficient for the Service to keep pace with today's market dynamics. More businesslike management is required to maintain the financial integrity of the Service and the foundation for universal mail service.



CALENDAR

<u>July 18</u>: HEARING. "Defense Spending and Budget Outlook"; Witness: Deputy Secretary of Defense, Paul Wolfowitz. 10 AM; SD-608.

<u>July 19:</u> SBC staff brief by NIH. Dr. Ruth Kirschstein (Acting

Dir.). TOPIC: NIH budget. 10:30 AM; SD-608.

July 20: SBC staff brief by selected agency budget officers and CRS. TOPIC: How Federal agencies budget for emergency spending. 10 AM; SD-608.

July 23: SBC staff by CBO, the National Association of State Budget Officers, and GAO. TOPIC: How states budget for emergency spending and how the state example can be applied to Federal budgeting. 10 AM; SD-608.