Joint Economic Committee Democrats

Representative Pete Stark (D-CA) – Senior Democrat

Economic Policy Brief

October 2004 (revised November 2004)

The Bush Economic Record: Economic Failure and Misguided Policies

Executive Summary

For the fourth straight year of the Bush presidency, the economy has underperformed expectations, leaving a large jobs deficit. In September 2004, there were 1.6 million fewer private sector jobs than there were when President Bush took office. There were 7 million fewer jobs than the Bush Administration predicted there would be in its first post-9/11 economic forecast in early 2002. This year, job creation has barely been enough to keep pace with population growth and has been only about half of what the Administration predicted it would be as recently as February.

The consequences for ordinary Americans of this economic failure are serious. After adjusting for inflation, median household income has dropped over $1,500 during President Bush's term, 2.0 million more Americans are unemployed, 4.3 million more Americans are living in poverty, and 5.2 million more Americans are without health insurance.

The President and his Republican supporters in the Congress have had one policy and one policy only to deal with this record of poor economic performance—tax cuts. But those tax cuts have not worked. They were ineffective at stimulating job creation in the short run; they were unfair, going disproportionately to very high-income taxpayers; and they were fiscally irresponsible, contributing significantly to squandering the hard-won budget surpluses the President inherited. As a result, we are left ill prepared to deal with the imminent retirement of the baby boom generation.

Meanwhile, other important national priorities have been neglected or mishandled. For example, health care expenditures have been increasing, and health insurance premiums, including Medicare premiums, have been rising explosively. In 2005, some 2.5 million seniors will have their entire Social Security COLA taken away by a record increase in Medicare premiums. Seniors will have to wait until 2006 for prescription drug coverage under the Medicare law passed last year, but the healthy and wealthy non-elderly benefit immediately from the tax-advantaged health savings accounts (HSAs) created in the same legislation. The President's preferred policy of tax deductions and tax credits for health insurance carries a high budget cost, offers little to the uninsured, and could undermine existing coverage.

The President's misguided proposals for Social Security would weaken the financial condition of the program dramatically. The private accounts he favors would cost $2 trillion or more to implement. That would entail cutting benefits or raising taxes—or letting the budget deficit grow even larger.

Unlike past presidents—including his father—President Bush allowed the federal extended unemployment insurance benefits program to expire at the end of 2003 when the number of long-term unemployed and people

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This Policy Brief is based on the "Views of the Senior Democrat," which will be included in the Joint Economic Committee's Annual Report.

exhausting their regular state benefits was still high. In 2004, as long-term unemployment has remained high, there is no longer help for those workers.

Nor has there been help for people struggling to escape poverty. Welfare caseloads continued to decline, even as the number of poor households experiencing the kind of economic hardship traditionally addressed by welfare went up. But instead of recognizing that serving fewer people at the same time that poverty is going up and unemployment is high is a sign of failure, the Bush Administration has perversely trumpeted welfare reform as a success.

With the economy still struggling to climb out of the most protracted jobs slump since the 1930s, President Bush will have the worst jobs record of any president since Herbert Hoover. The President's policies have not addressed the major problems facing American families today and they have undermined our long-term fiscal health, making it harder to confront tomorrow's challenges.

The Bush Economic Record

A Protracted Jobs Slump

Net job destruction. The economy finally stopped hemorrhaging jobs a year ago, but job growth since then has been weak. As a result, through September 2004 there is still a substantial jobs deficit on President Bush's watch. Driven by massive losses in manufacturing, private sector payrolls have shrunk by 1.6 million jobs under President Bush (**Chart 1**). There has been some net job creation in the government sector, but the overall deficit in total nonfarm payrolls is still a hefty 800,000 jobs.

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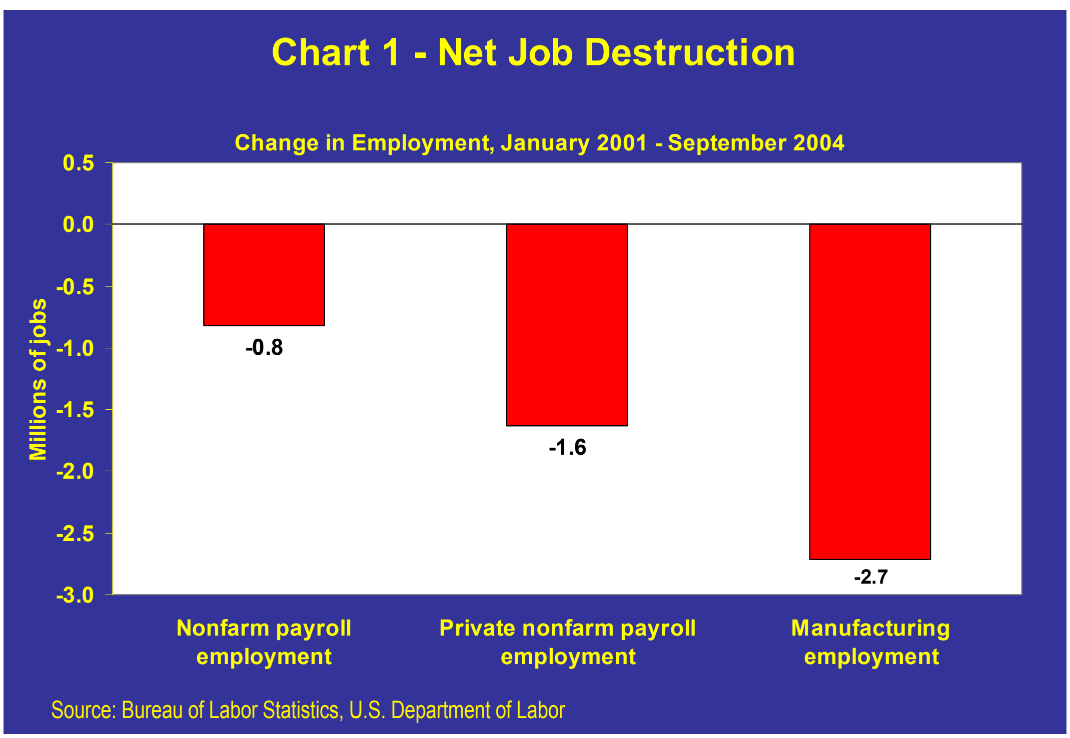
The recession that precipitated those job losses began in March 2001 and ended in November 2001. But payroll employment continued to decline until August 2003. Both the ongoing loss of jobs following the end of the recession and the fact



that there is still a substantial jobs deficit so long after the start of the recession are unprecedented in business cycles going back to the 1930s. Focusing on the post-World War II episodes for which we have consistent data, the pattern of job loss and partial recovery in this latest business cycle is very different from that of the average of all other post-World War II cycles (**Chart 2**).

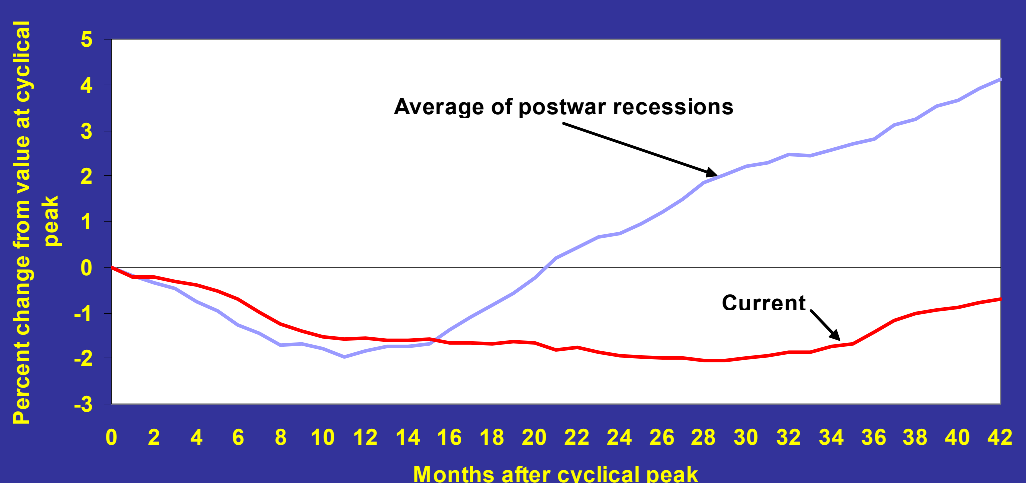
Typically, job losses in a recession end after 12-15 months and the jobs deficit is completely erased within two years. Prior to the current episode, the longest it took to get back the jobs lost in a recession was 31 months for total nonfarm employment and 33 months for private sector employment. That was in the 1990-91 recession and the ensuing "jobless recovery." As of September 2004, it has been 42 months since the start of the recession, and the jobs slump persists.

Nonfarm payroll employment in September 2004 was 7 million jobs short of the Administration's first post-9/11 forecast in February 2002.

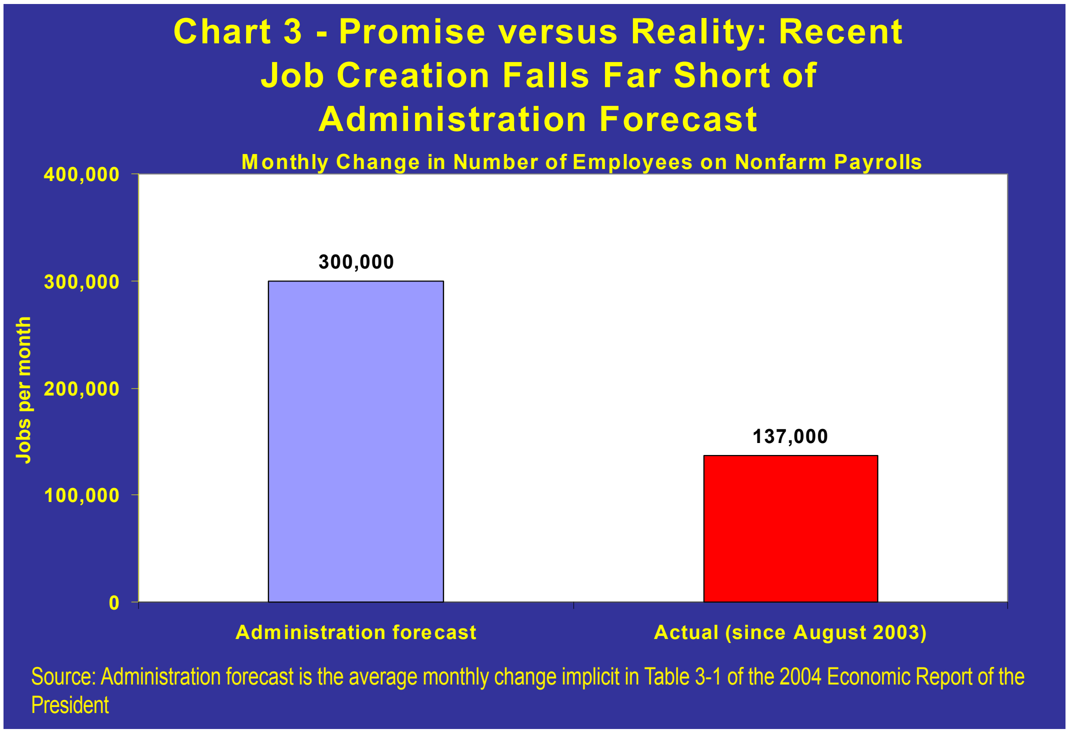
Weak job growth in the past year. In each of its economic forecasts going back to February 2002, the Bush Administration has been projecting an imminent economic recovery with employment gains on the order of 300,000 jobs per month. We are still waiting to see sustained job growth anything like that. Much as the President wants to tout the 1.8 million jobs created since August 2003, that figure translates into just 137,000 jobs per month—less than half of what the Administration has been forecasting (**Chart 3**).

In fact, a rate of 137,000 jobs per month is barely enough to keep pace with the trend-rate of growth in the labor force for an economy that is already at full employment. It is nowhere near enough to restore the jobs lost in the recession and to employ people who finally begin looking for work again after having stayed out of the labor force when job prospects were poor. Those considerations

Chart 2 - Change in Total Nonfarm Payrolls in the Current and Previous Cycles



Source: JEC Democratic Staff calculations using data from the U.S. Department of Labor and the National Bureau of Economic Research.



are reflected in the Administration's forecast of 300,000 jobs per month. However, reality has fallen far short of that promise. Nonfarm payroll employment in September 2004 was 7 million jobs short of the Administration's first post-9/11 forecast in February 2002.

Apologists for the Administration's poor jobs record sometimes argue that the payroll employment data understate job creation under President Bush. They point to larger job gains in a different official survey, the survey of households. They also point to expected revisions in the payroll numbers. Upon closer inspection, however, those arguments are weak (**Box 1**). Most experts believe that trends in the payroll employment data are the best indicator of job creation, and the revisions are likely to be modest. Moreover, the growth in employment reflected in the household survey is also much weaker in the current business cycle than it has been in past recoveries.

In summary, there is overwhelming evidence that President Bush has presided over the most protracted jobs slump since the 1930s. As a result, he will have the worst jobs record of any President since Herbert Hoover, and he will be the first President in over 70 years to preside over a net loss of private sector jobs (**Chart 4**).

Higher Unemployment and Reduced Labor Force Participation

The payroll employment data paint the clearest picture of the protracted labor market weakness in the U.S. economy since early 2001. But other data paint a similar picture of labor market weakness.

Unemployment remains high. The unemployment rate in September 2004 was 5.4 percent. Those who would like to argue that the economy is strong often suggest that this is satisfactory, based on the average rate of unemployment over the past 30 years. But that argument misses the point that such an unemployment rate is very disappointing compared with the period immediately before President Bush took office. September's 5.4 percent unemployment rate is 1.2 percentage points higher than it was when President Bush took office and higher than it ever was

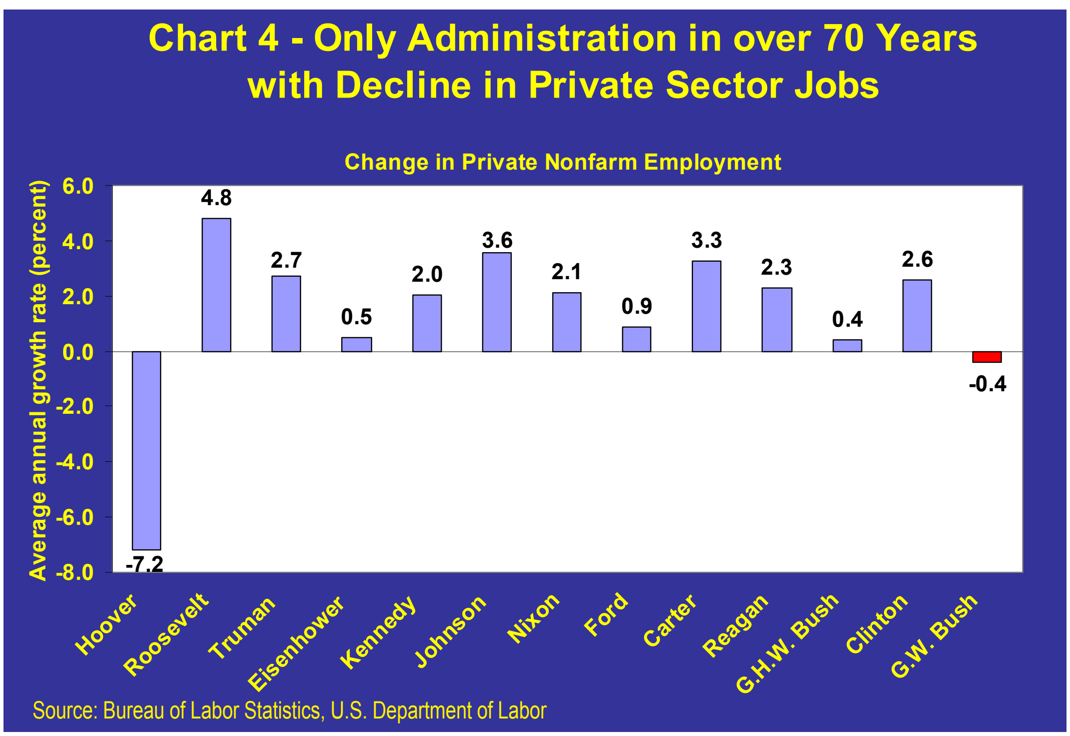
Box 1: Are Job Losses Overstated?

The Bureau of Labor Statistics (BLS) has two different measures of employment. One is based on a survey of nonfarm establishments and asks employers how many jobs they have on their payrolls. The other is based on a survey of households and asks people whether or not they have a job. While nonfarm payroll employment has declined since early 2001, employment based on the household survey has increased.

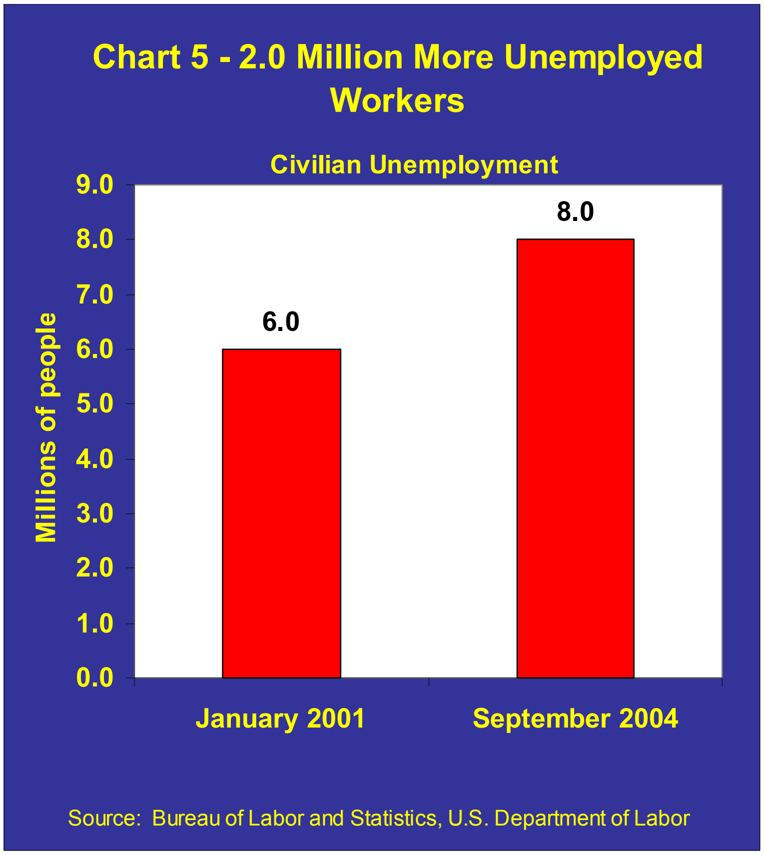
In theory, the household survey might be picking up sources of job creation that are not captured by the payroll survey, but that does not appear to be the case. Nor is the payroll employment data seriously underestimating job creation in new businesses that are not included in the establishment survey.

The payroll and household data differ in scope and coverage. For example, the payroll data do not include those who say they are self-employed, while the payroll data count each job of a person holding more than one job. No one has fully reconciled the differences between the two, but most experts, including the BLS, the non-partisan Congressional Budget Office, and Federal Reserve Chairman Alan Greenspan, believe that trends in the payroll employment data are the best indicator of job creation.

If the payroll employment data were seriously underestimating job creation in new businesses, that would show up and be corrected early next year when the BLS releases its annual "benchmark" revisions of the payroll data, which are based on information from virtually all establishments. However, preliminary evidence released by the BLS in October suggests that the next revisions are likely to be modest and would not materially affect the picture we have of a long jobs slump and only a modest jobs recovery.



during the entire four years of President Clinton's second term. Eight million people are out of work—an increase of two million since President Bush took office (**Chart 5**).



Labor force participation remains low. Labor market conditions are actually weaker than the unemployment rate suggests, because the unemployment rate fails to reflect the large decline in labor force participation since early 2001. At that time, more than 67 percent of the population aged 16 or over was working or looking for work. That proportion declined as the economy shed jobs, but it has stayed low even as payroll employment has started to grow again. At 65.9 percent, the labor force participation rate in September 2004 is the same as it was in February 2004 and as low as it has been at any previous time back to 1988.

September's 5.4 percent unemployment rate is 1.2 percentage points higher than it was when President Bush took office and higher than it ever was during the entire four years of President Clinton's second term.

People can leave the labor force for all kinds of reasons, including going back to school or pursuing other activities outside the labor market, but discouragement over job prospects appears to be a major reason for the latest decline. That can be seen, for example, in the BLS's alternative measures of labor underutilization. In particular, the broadest measure, which includes people who want to work but have given up looking and workers who have had to settle for part-time work, was 9.4 percent in September 2004, 2.1 percentage points higher than it was when President Bush took office.

The fraction of the working-age population with a job is down sharply. Reflecting the combined effects of the rise in the unemployment rate and the decline in labor force participation, the proportion of the working age population with a job fell from 64.4 percent when President Bush took office in January 2001 to 62.3 percent in September 2004. That translates into nearly 5 million fewer people working than would be working if the employment-population ratio had stayed the same as it was when President Bush took office.

Long-term unemployment remains high. One final measure of unemployment distress is the proportion of those currently unemployed who have been out of work for more than 26 weeks—the amount of time a worker can collect regular unemployment benefits. That figure has been above 20 percent for two full years, the longest such stretch since the late 1940s, when the Labor Department started keeping track of such data.

A Squeeze on Paychecks

While workers have endured the most protracted jobs slump since the 1930s, the rest of the economy has fared better. For example, real (inflation-adjusted) gross domestic product (GDP)—the broadest measure of economic output—has been growing since the end of 2001. The disparity between the output market and the labor market is explained by extraordinary growth in labor productivity (output per hour). Thus far in the recovery, employers have been able to squeeze more and more output from their workers without substantially expanding their hiring. In particular, since the start of 2001, output in the nonfarm business sector grew at a 3.1 percent average annual rate, even though hours worked declined at a 1.2 percent average annual rate.

...[W]orkers' share of national income is the lowest it has ever been in the more than five decades for which we have data.

Productivity gains are not reflected in real wages. Only a fraction of the resulting strong productivity growth has translated into higher real earnings for workers. Although productivity has risen at a 4.3 percent annual rate since the start of 2001, real compensation per hour (which includes not only wages and salaries but also benefits) has risen at just a 1.4 percent annual rate. Moreover, benefits, including employer contributions to health insurance, have been rising faster than wages and salaries. When benefits are excluded, workers' take-home pay has barely kept up with inflation. For example, the usual weekly earnings of full-time workers grew just 0.2 percent per year faster than inflation between the end of 2000 and the end of 2003. That compares with a growth of 1.7 percent per year from the end of 1996 to the end of 2000.

The President may think the economy has turned the corner in 2004, but workers are still waiting to see that reflected in their paychecks. In the first nine months of this year, real average hourly earnings are down 0.6 percent and real average weekly earnings are flat.

Wages and salaries have reached a record low as a share of national income. The combination of lost jobs and sluggish earnings growth for those still working has caused the share of national income going to compensation of employees (wages plus benefits) to fall by over 2 percentage points since President Bush took office. That translates into a current shortfall of roughly $215 billion. In other words, if labor's share of national income had not fallen, workers would be receiving $215 billion more in aggregate wages and benefits. Focusing just on wages and salaries, workers' share of national income is the lowest it has ever been in the more than five decades for which we have data.

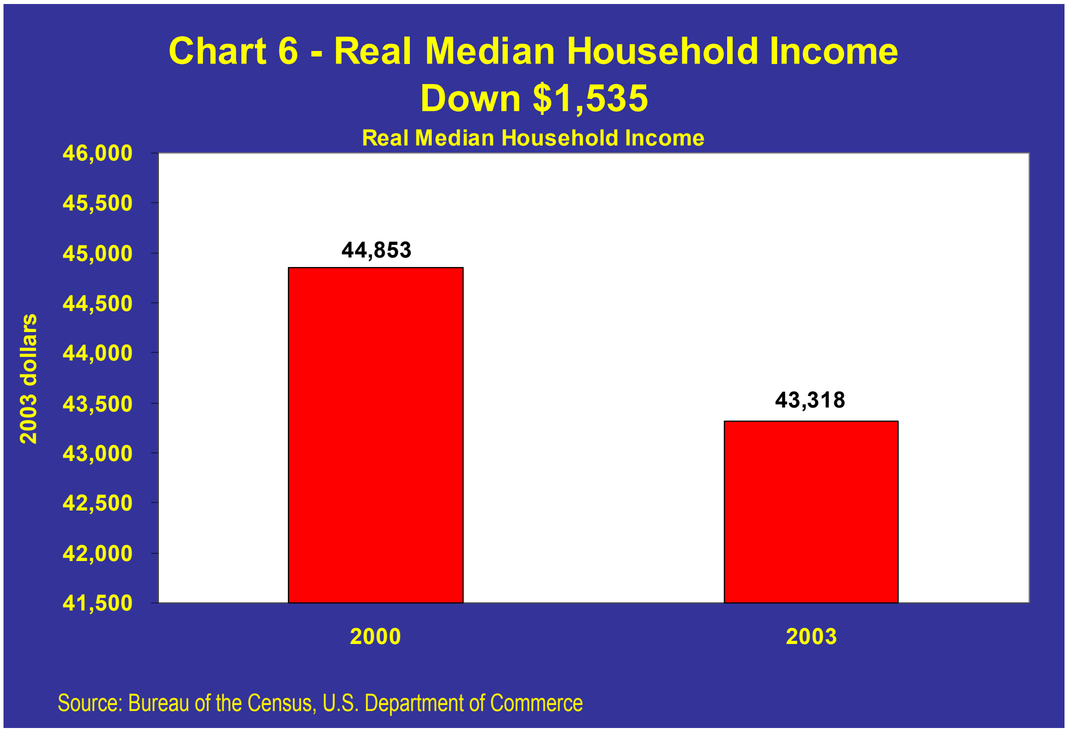
The flip side of the declining share of labor compensation in national income in recent years has been a rising share going to business profits. While the aggregate wages and benefits of workers have increased just 11 percent (before taking inflation into account) since President Bush took office, business profits have increased 51 percent.

Falling Household Incomes, Rising Poverty, and Declining Health Insurance Coverage

The consequences of a persistent weak job market for middle and lower-income Americans have been serious. Two reports by the Joint Economic Committee Democrats provide the details (*Poverty Has Increased and Real Income Has Fallen since 2000*, and *The Number of Americans without Health Insurance Rose for the Third Straight Year in 2003*).

During the Bush years, real median household income has fallen over $1,500.

After adjusting for inflation, median household income fell slightly to $43,318 in 2003. The median is the income of the household at the exact middle of the distribution. Half of all households have higher income and half have lower income. During the Bush years, real median household income has fallen by over $1,500 (**Chart 6**). With a continued weak labor market and stagnant real (inflation-adjusted) wages, real median income is unlikely to bounce back much if at all in 2004.



Overall, real median income has decreased by 3.4 percent since the start of the Bush Administration. But that decline has not been uniform across major racial and ethnic groups: median household income declined by 2.0 percent among non-Hispanic whites, by 6.3 percent among blacks, and by 6.9 percent among Hispanics.

Declines in household income have occurred across the income distribution. The poorest fifth of all households experienced the greatest proportional decline in average real income (7.9 percent). The average real income of the richest fifth of all households fell by only 3.2 percent.

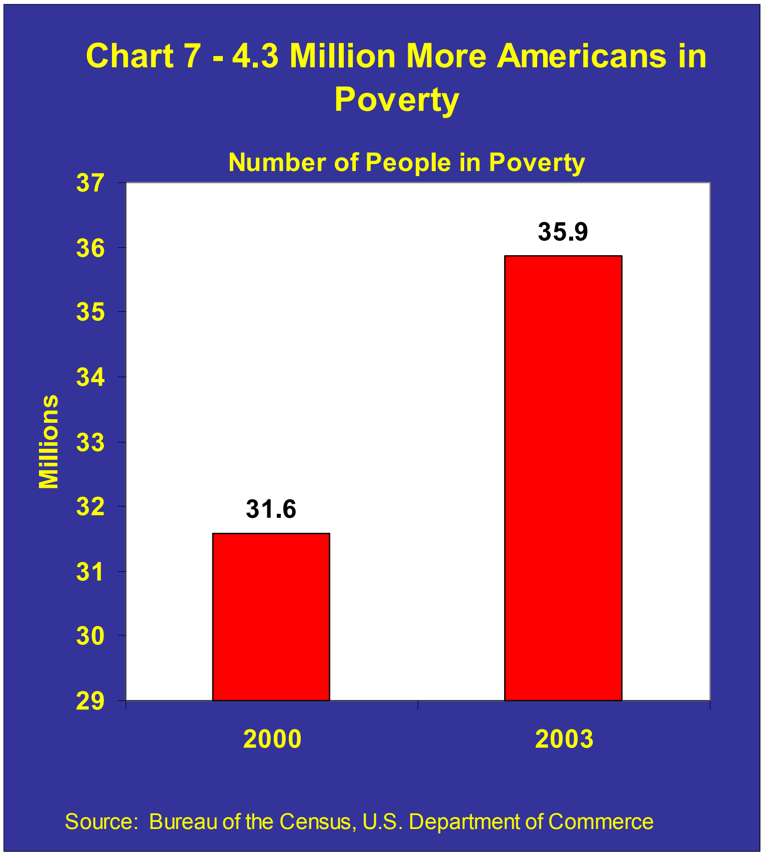
The number of Americans living in poverty increased by 1.3 million to 35.9 million in 2003, when the official poverty threshold for a family of four was $18,810. Since the start of the Bush Administration, the number of Americans living in poverty has increased by 4.3 million (**Chart 7**).

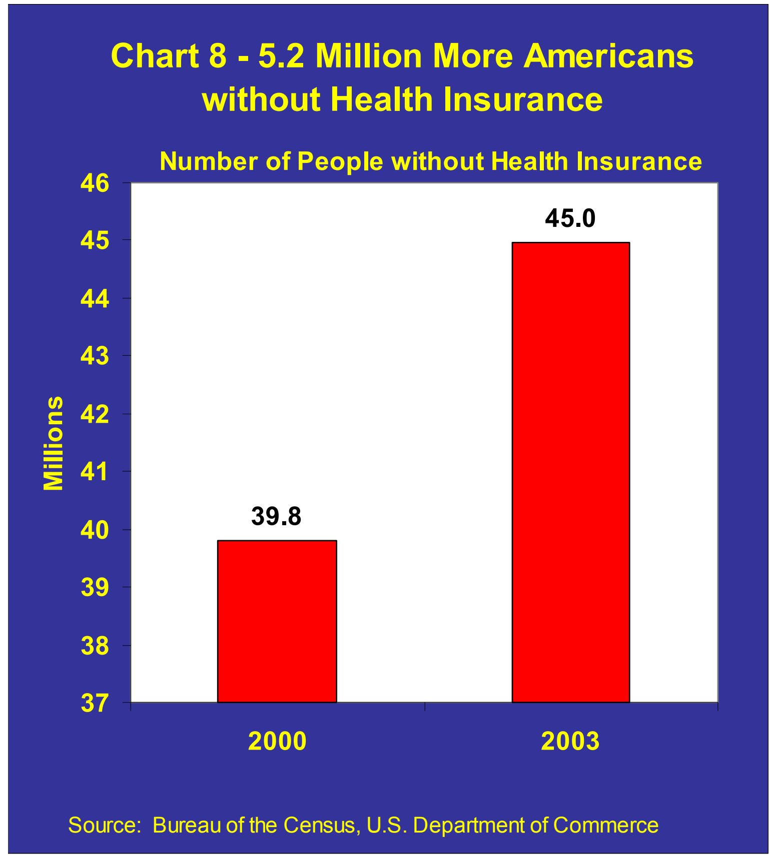
...[M]ore than one in six American children are now living in poverty.

The poverty rate increased from 12.1 percent in 2002 to 12.5 percent in 2003. That made the total increase during the Bush Administration 1.2 percentage points. In 2003, the poverty rate for children under 18 years of age rose 0.9 percent to 17.6 percent, so that more than one in six American children are now living in poverty. Among major racial and ethnic groups, the poverty rate was 24.3 percent for blacks in 2003 and 22.5 percent for Hispanics.

Finally, the number of Americans without health insurance rose for the third straight year to 45 million, 15.6 percent of the population. Millions more spent part of the year uninsured. Since 2000, the number of uninsured has risen by 5.2 million (**Chart 8**). More Americans are now without health insurance than in any year with reported data, which go back to 1987.

The percentage of Americans with employer-sponsored health insurance dropped to 60.4 percent





in 2003, the third straight year employer coverage has declined. The total number of people with employer sponsored coverage has fallen by 3.8 million since 2000.

Misguided Republican Policies

When critics of his policies point to the persistent jobs slump and adverse trends in household income, poverty, and health insurance coverage, President Bush argues that the economy has turned the corner and his policies are working. But that claim does not stand up to analysis. The President's policies, which have disproportionately benefited those who are already well-off, have not produced a strong jobs recovery in the short run. They have not addressed the needs of those most likely to be disadvantaged by a weak labor market. They have not increased health insurance coverage. And they have not strengthened the country's ability to deal with the challenges that will be raised by the retirement of the baby-boom generation.

Unfair, Ineffective, and Fiscally Irresponsible Tax Cuts

The President has pushed for and achieved a major tax cut in each year of his term. Critics have argued that those tax cuts have disproportionately benefited the richest American households. New estimates by the Congressional Budget Office (CBO) of the distributional impacts of the first three major Bush tax cuts confirm that those tax cuts have been skewed toward the rich. That tilt toward the rich also helps explain why the tax cuts have been remarkably ineffective at stimulating job creation in the short run: effective jobs stimulus requires generating new spending, while tax cuts for upper-income taxpayers are more likely to generate saving. Finally, if the President is successful in his efforts to make these tax cuts permanent, they will put a large hole in the federal budget for years to come.

The Bush tax cuts are skewed toward the rich. An analysis by the JEC Democrats, *New CBO Analysis Confirms That the Bush Tax Cuts Are Skewed Toward the Rich*, finds that in 2004 the average tax cut for the 1 percent of households with the highest incomes is more than 70 times larger than the tax cut for middle-income households (**Chart 9**). That calculation includes the tax cuts from temporary investment incentives that expire at the end of 2004. But even when those provisions are excluded, the tax cut for the top 1 percent of households is still 40 times as large as the cut for the middle class.

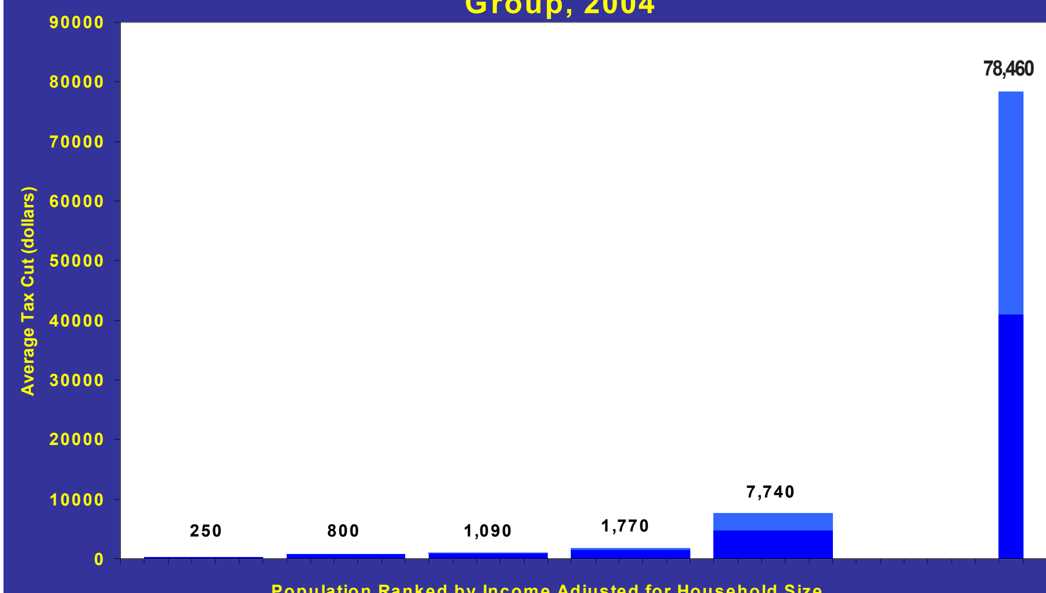
...[I]n 2004 the average tax cut for the 1 percent of households with the highest incomes is more than 70 times larger than the tax cut for middle-income households.

The president has repeatedly justified tax cuts for the highest-income taxpayers as necessary to promote small businesses. But the facts do not support this justification. According to IRS data, less than 3.5 percent of the 18.6 million small business tax returns for 2002 reported income of $200,000 or more, well below the income required to reach the top two income tax brackets. In contrast, the Treasury department claims that over 75 percent of tax returns in the top-income tax bracket are from small business owners. But this claim is highly misleading.

The Treasury includes in its definition of "small business owners" wealthy investors in small companies who may have little to do with everyday operations. President Bush and Vice President Cheney both report income that would classify them as small business owners according to the Treasury department definition. The Treasury definition also includes CEOs and other top executives of major corporations who report trivial amounts of income from speaking fees and other outside activities.

Using the Treasury definition but limiting it to taxpayers who derive at least half of their income from business activities, the percentage of small business owners among taxpayers in the top tax bracket falls to 25 percent. Limiting the definition only to those who derive more than half their income from owning their own business and not from partnerships or small corporations, the percentage of

Chart 9 - Average Bush Tax Cut by Household Income Group, 2004



Note: Darker area of each bar excludes the effect of bonus depreciation.
Source: JEC Democratic Staff calculations based on Congressional Budget Office analysis

small business owners in the top tax bracket falls to about 5 percent.

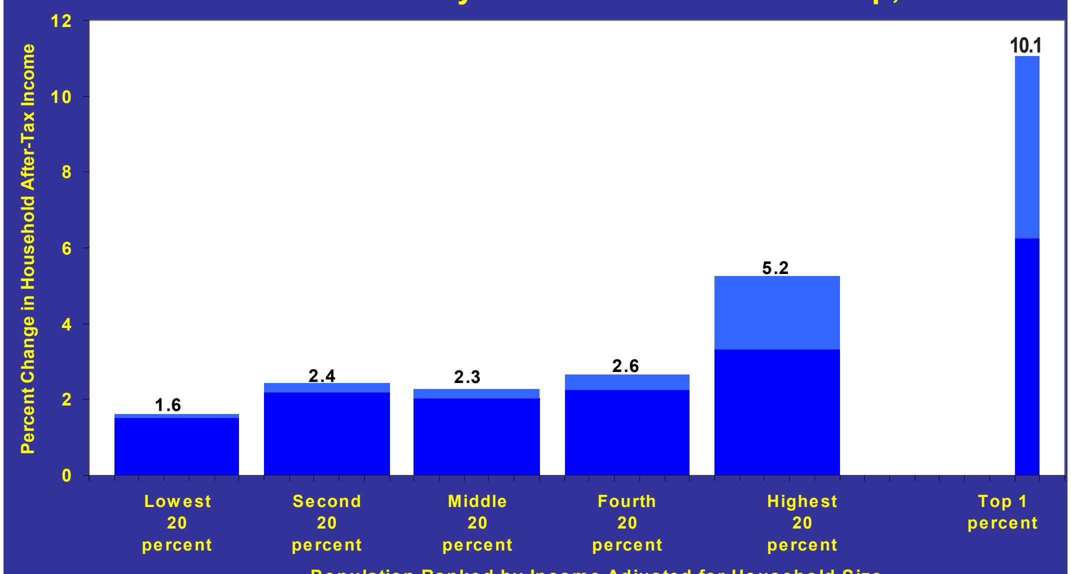
The President and his supporters also argue that the rich deserve larger tax cuts because they pay a larger fraction of the income tax. While it is true that the income tax is progressive, the benefit to the rich from the 2001-2003 tax cuts has been disproportionate. In particular, in 2004 the percentage increase in after-tax income resulting from the tax cut is four times larger for the top 1 percent of households than it is for the middle 20 percent of households (**Chart 10**). Even excluding the effect of the temporary investment incentives, the percentage increase in after-tax income is still 2½ times larger for the top 1 percent of households.

The Bush tax cuts have been ineffective at creating jobs. Quite apart from the unfairness of this distribution, the fact that the Bush tax cuts have been skewed toward the rich has blunted their effectiveness in stimulating job creation. The sheer magnitude of the Bush tax cuts has provided some fiscal stimulus in the short run. However, with their emphasis on cuts in marginal tax rates affecting upper-income taxpayers, dividend tax relief, and repeal of the estate tax, the Bush tax cuts have had a low jobs-stimulus "bang" for their fiscal cost "buck."

For example, the private forecasting firm Economy.com estimates that three-fifths of the cost of the Bush tax cuts was in proposals that generated 60 cents or less of additional spending per dollar of revenue loss. That compares with alternative stimulus policies more favored by Democrats such as extending unemployment benefits ($1.73 of additional spending per dollar of revenue loss) or aid to fiscally strapped state and local governments ($1.24).

The Bush tax cuts will have harmful long-run consequences for interest rates and the trade deficit. Effective job-creating stimulus should be fast-acting and concentrated at the time when the economy has idle industrial capacity and unemployed workers who can be put back to work. The tax cuts of the last few years, in contrast, have much of their impact in the future. Once the economy is in a sustainable economic recovery and producing close to its capacity, fiscal stimulus from tax cuts is counterproductive. When the economy is already producing all it can, the extra

Chart 10 - Change in After-Tax Income as a Result of the Bush Tax Cuts by Household Income Group, 2004



Note: Darker area of each bar excludes the effect of bonus depreciation.
Source: JEC Democratic Staff calculations based on Congressional Budget Office analysis

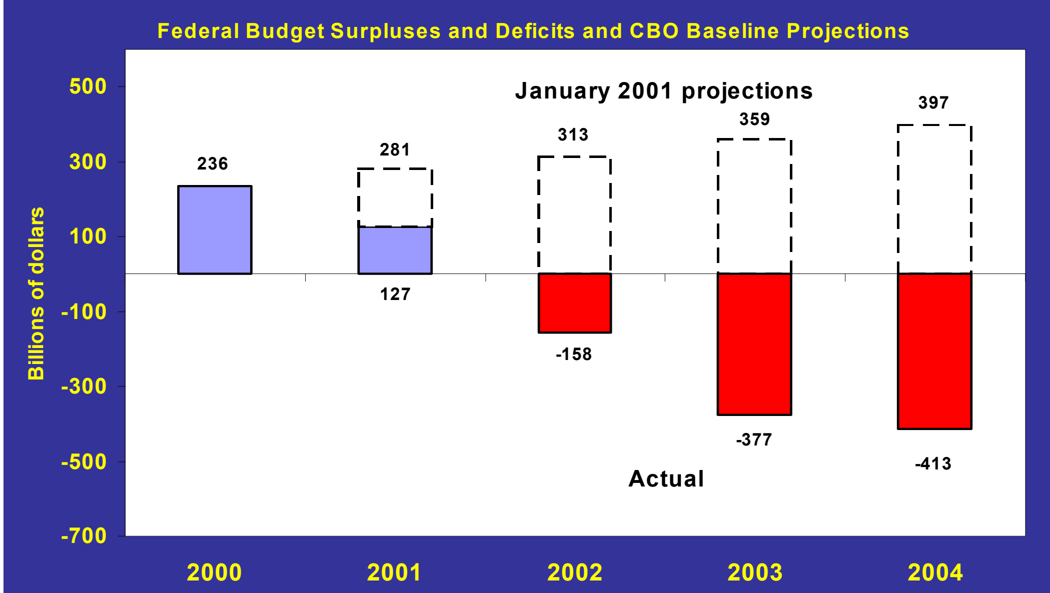
demand stimulated by the tax cuts must be offset by reduced demand elsewhere. Typically, this means some combination of the following: a tighter monetary policy, which forces up interest rates and discourages productive investment; increased purchases from abroad, which increase the trade deficit; and increased foreign borrowing, which inflates the value of the dollar and discourages U.S. exports.

For most of the past few years, large federal budget deficits have not had an appreciable effect on interest rates, because private investment demand has been weak. However, the Federal Reserve has begun to raise interest rates, and interest rates may well have to be pushed higher than they would be if the budget deficit were under control. Meanwhile, we have seen a continuing deterioration of the trade deficit, which has been very disruptive to manufacturing and other trade-sensitive industries. The current account deficit, which is a measure of how much we are borrowing from abroad is now over 5 percent of GDP.

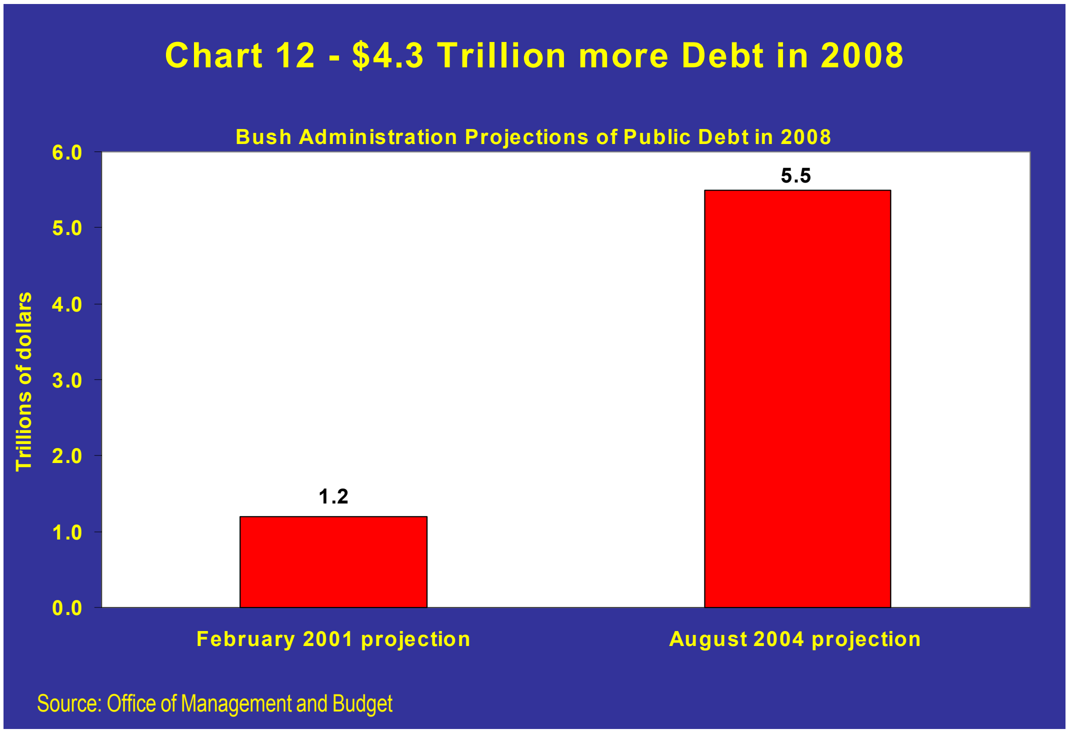
Individuals will feel the effect of higher interest rates directly in their mortgages, car payments, and student loans. Future standards of living will be held down because we have not made investments that raise productivity and wages. Ongoing interest obligations and the need to pay off our foreign borrowing will come at the expense of future national income.

The Bush tax cuts have been fiscally irresponsible. The long run economic harm from the Bush tax cuts arises from their impact on the budget deficit and the national debt. The President's abandonment of fiscal responsibility has created a legacy of deficits and debt that is vastly different from the situation he inherited. On President Bush's watch, large projected surpluses have turned into large deficits (**Chart 11**). What in 2001 was projected to be a $397 billion surplus in fiscal year 2004 has turned out to be a $422 billion deficit. In January 2001, the Bush Administration forecast that the federal debt would be paid down to just $1.2 billion in 2008; in their latest projection the 2008 debt is now expected to rise to $5.5 trillion (**Chart 12**).

Chart 11 - Large Projected Surpluses Turned into Large Deficits



Source: Congressional Budget Office



No Compassionate Conservatism for the Unemployed or the Poor

In times of economic weakness, the social safety net is supposed to cushion the economic blows to workers who lose their jobs through no fault of their own and to the economically disadvantaged who struggle to find work to support their families. But neither extended unemployment benefits nor welfare functioned as well as they should have in the long jobs slump of the past four years.

Failure to continue federal extended unemployment benefits. In the past, the federal government has enacted extended unemployment benefits for those who have exhausted their 26 weeks of regular state unemployment insurance (UI). Those extended benefits were kept in place until labor market conditions improved substantially. As usual, federal extended unemployment benefits were enacted in the current job slump, but they were less generous than in the past and were terminated prematurely, as shown in the JEC Democrats' report, *Job Loss in the 2001 Recession Was Greater Than it Was in the Previous Recession but Federal Unemployment Insurance Was Less Generous*.

The President and the Republican Congress failed to renew the federal extended benefits program at the end of last year. They did so even though the economy was still 2.5 million jobs in the hole and the rate at which workers were exhausting their regular UI benefits was still twice as high as it was when the program enacted in the 1990-91 jobs slump ended. As noted earlier, September 2004 was the 24th month in a row that the long-term unemployed were 20 percent or more of the total number of unemployed.

Failure to address the contradiction between declining welfare caseloads and increased need. The Bush Adminstration and the Republican Congress have shown a similar lack of compassionate conservatism in their treatment of Temporary Assistance for Needy Families (TANF), the main income support program created by welfare reform in 1996. As shown in the JEC Democrats' report, *TANF Caseload Declines, Despite Rise in Poverty*, the need for such income assistance grew in the 2001 recession and subsequent jobs slump. Poverty increased, especially among TANF's target population of children and their families, and unemployment increased for women who maintain families, leaving them with fewer opportunities to support themselves. While other parts of the safety net expanded to meet the increased need, cash welfare assistance did not.

The only response from the Bush Administration has been continually to repeat the rhetoric that welfare reform is working. The Administration refuses to acknowledge that decreased welfare receipt during a period of increased need is a problem. Welfare reform was supposed to increase economic self-sufficiency, not poverty—though many former welfare recipients still live in poverty. Many policymakers had cautioned that the success of welfare reform could not be judged solely by what happened in the strong economy of the late 1990s, and that the real test would come in a recession. But instead of addressing the problems that have been revealed by the recession when it was time to reauthorize the program, the Republican House of Representatives proposed an even more draconian approach that would make the problems worse. Fortunately, that approach did not become law.

No Compassionate Conservatism for the Elderly and Uninsured

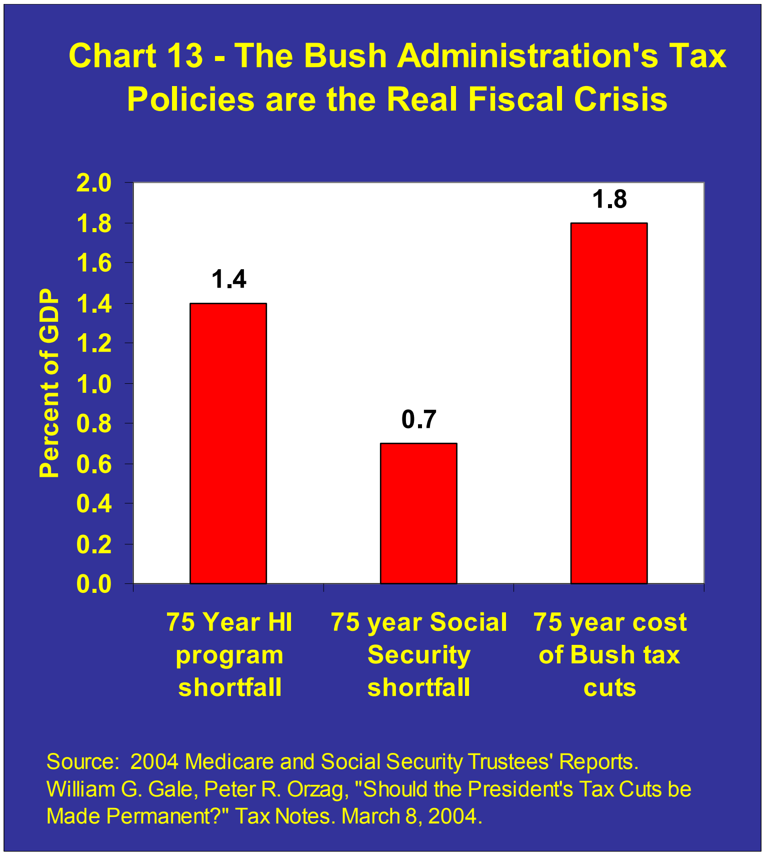
The President's tax-cut dominated approach to policy has left the country with an enormous fiscal deficit for years to come. Meanwhile, we face the imminent retirement of the baby boom generation, which will put enormous pressure on Social Security and Medicare. In addition, the health care crisis is worsening, and the number of Americans without health insurance is growing. As a series of reports by the JEC Democrats have made clear, however, the Republican approach to health and retirement issues fails to adequately address any of these issues.

The Administration's tax and spending policies—not Social Security and Medicare—have created the real fiscal crisis. The latest annual reports from the Social Security and Medicare trustees estimate that the 75-year actuarial shortfall in Social Security is equal to 0.7 percent of GDP and the 75-year actuarial shortfall in Medicare is equal to 1.4 percent of GDP. Those are projections that should compel policymakers to address the needs of two vital programs for our nation's seniors. However, the Bush Administration has instead pursued policies that erode rather than improve, solvency, as detailed in the JEC Democrats' report, *Keeping the Social Security and Medicare Trustees' Reports in Perspective: The Administration's Tax and Spending Policies Are the Real Fiscal Crisis*.

In the near term, the Congressional Budget Office estimates that every dollar of Social Security and Medicare surpluses over the next 10 years will be used to meet other general fund budget expenditures rather than reducing debt and strengthening our ability to meet the demographic challenge posed by the retirement of the baby boom generation. In the longer run, if Congress permanently extends all of the Bush tax cuts and enacts politically necessary reforms to the alternative minimum tax, the cumulative revenue loss will equal 1.8 percent of GDP over a 75-year period, an amount roughly the same size as the combined Medicare and Social Security shortfalls (**Chart 13**). Tax cuts for the wealthy are clearly a higher priority for the Bush Administration than preserving Social Security and Medicare.

The need to protect the Social Security COLA. Unlike most private pensions and other forms of retirement annuity income, Social Security benefits include an annual cost-of-living adjustment (COLA) that is designed to compensate for increased costs of rent, gas, food, and other living expenses. Unfortunately, rising health care costs and last year's Medicare law threaten this valuable cost-of-living protection by driving up Medicare premiums, which are deducted from most beneficiaries' Social Security check.

In early October, the Bush Administration announced the largest premium increase in Medicare history: 17.4 percent, or $11.60 a month. Shortly thereafter they announced that the annual Social Security COLA for 2005 would be 2.7 percent. For the average retiree with a monthly Social Security check of $914, nearly half of the $25 per month COLA would be needed to



cover the increase in the Medicare premium.

The JEC Democrats' report, *Medicare Premiums are Undermining the Social Security COLA—New Data shows Impact by State and Congressional District*, highlights Congressional Budget Office estimates showing that next year, some 2.1 million beneficiaries nationwide will have their entire COLA taken away by the Medicare premium increase leaving nothing for price increases in other goods and services. Almost 13 million beneficiaries will have over 50 percent of their COLA absorbed by the Medicare premium increase. The report finds that beneficiaries in all states and congressional districts would benefit from legislation proposed by Democrats to limit the increase in beneficiaries' Medicare premiums to 25 percent of their Social Security COLA.

Another JEC Democrats' report, *Rising Medicare Premiums Undermine the Social Security COLA: New Medicare Law Could Cut Benefits for Some*, shows that this year's experience is not an aberration. Ongoing increases in health care costs and soaring premiums under the new Medicare Prescription Drug Act will continue to erode the COLA in years to come.

Failure to address the growing health care crisis. Health care costs have risen sharply under President Bush and 5.2 million more Americans are without health insurance. The Bush approach to health care policy promises little relief, since it does not address the underlying problems.

People lack health insurance because coverage is unaffordable and often unavailable. One-third of the people without insurance have household incomes under $25,000, and two-thirds have incomes under $50,000. About three-fourths of the uninsured between the ages of 18 and 65 are working full- or part-time, but don't have access to or cannot afford coverage through their employer. The President's approach to addressing these problems is a variety of tax deductions and credits that carry a high budget cost, fail to make health insurance more affordable or accessible to the uninsured, and could undermine existing coverage.

The first step in implementing the President's approach was the creation of health savings accounts (HSAs), which allow people with qualified high-deductible health insurance to open a tax-advantaged account for health care spending. HSAs were a last minute addition to the Medicare Prescription Drug legislation passed last year—though seniors are not even eligible to open an account.

HSAs are a costly tax subsidy to the healthy and wealthy. The real losers from HSAs are those with lower incomes or chronic and costly health conditions. Combined with the high-deductible insurance coverage required to establish an account, HSAs have the potential to jeopardize traditional employer-provided coverage, drive up insurance deductibles, and raise out-of-pocket costs for working families.

The President's next step for moving people into high deductible health insurance was a $25 billion proposal in his fiscal year 2005 budget that would add a tax deduction for high-deductible health insurance premiums for taxpayers with health savings accounts. That proposal failed to get enacted in this Congress, but Republicans are unlikely to abandon their efforts to add this deduction.

A JEC Democrats' report, *The President's Costly Tax Deduction for High-Deductible Health Insurance Offers Little to the Uninsured and Could Undermine Existing Coverage*, shows that the vast majority of uninsured families would get little or nothing from such a new tax deduction. High-income healthy families with HSAs could shelter more each year, but the new tax deduction for health insurance premiums would be worthless to low-income families.

In the name of addressing the uninsured, the Administration has also proposed health insurance tax credits to subsidize health insurance coverage. However, the JEC Democrats' report, *Administration's Health Insurance Tax Credit Proposal Fails to Provide a Real Solution to the Uninsured*, finds that the amount of the credit would not put coverage within reach for low-income families. In addition, it would encourage enrollment in a market that is notoriously difficult to access and that offers coverage that is not only inadequate but also expensive.

A tax credit works to expand health insurance coverage only if several criteria are met. First, quality health insurance must be available. That means health insurance reform is a necessary ingredient, yet the Bush proposal lacks any market reforms. Second, the tax credit must be refundable. Otherwise, most of the uninsured will not be able to benefit because their incomes are too low. Third, people must be able to get the credit at the time they purchase the insurance. Finally, the credit must be large enough to make health insurance affordable.

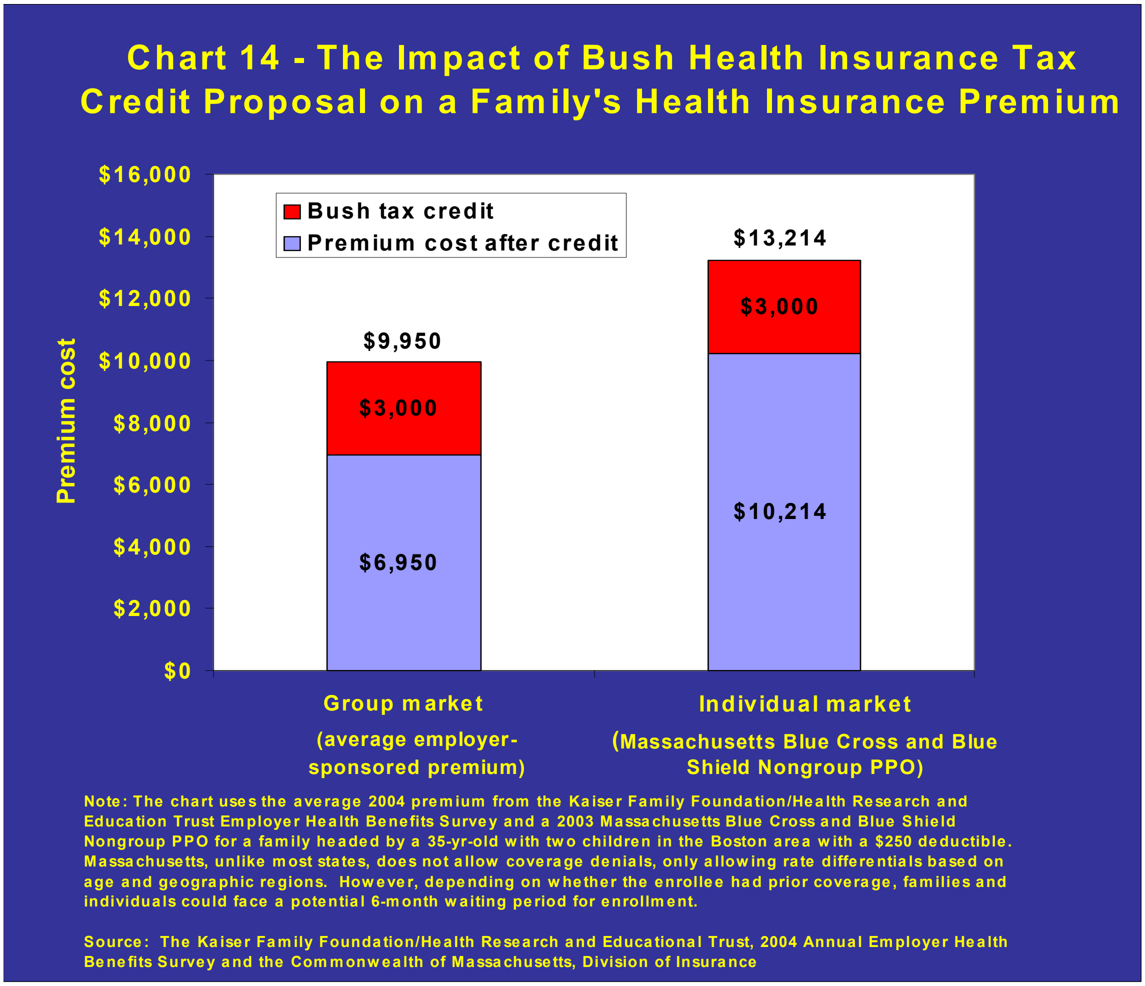
The President's plan fails to meet these requirements. With average employer-sponsored premiums at nearly $10,000 for a family, his health tax credit would cover only a small fraction of the cost of health insurance policies for most uninsured families (**Chart 14**). It would do nothing to address the lack of access in the loosely regulated non-group market, where premiums are even higher.

Privatization is not the answer for Social Security. Social Security is one of the country's most popular and successful programs. Currently 90 percent of people aged 65 or older receive some payment from Social Security. About two-thirds of aged Social Security beneficiaries receive at least half of their income from Social Security. For about 20 percent, Social Security is the only source of income. In 2002, Social Security kept13.1 million elderly people from poverty. Without Social Security the poverty rate among the elderly would have been nearly 50 percent.

The Administration advocates replacing part of Social Security with a system of personal saving accounts. Yet, as the final report from the President's Commission to Strengthen Social Security demonstrates, it is not possible to replace part of Social Security with personal accounts and maintain the solvency of the program without large transfers from general revenues or large cuts in Social Security benefits.

Privatization would worsen Social Security's financial position. Currently all projected Social Security revenues are needed to finance benefits promised to current and future retirees. Under the main plan developed by the President's Commission, Social Security would divert a portion of payroll tax revenues to individual accounts while continuing to pay benefits to current retirees. This would drain $1.8 trillion from the Social Security trust funds in just the next ten years, and speed-up by two decades (from 2042 to 2021) the year in which the trust funds are exhausted.

Privatization would reduce benefits for future retirees. Compared with the benefits promised under current law, the Congressional Budget Office estimates that the Commission's main plan would cut the annual benefit of an average earner retiring in 2065 from $26,400 to $14,600—a benefit cut of 45 percent. This estimate includes the individual account payout under privatization. Because disability benefits and benefits for young survivors are based on retirement benefits, deep cuts in retirement benefits would also



cut promised disability benefits and young survivor benefits by 48 percent by 2075. These cuts would not be offset by payouts from individual accounts because disabled workers and young survivors would not have had enough time to accumulate contributions.

Privatization would also increase economic risks. The Social Security program now provides retirees with a predictable benefit that keeps pace with inflation, and is payable as long as the person or his or her spouse is alive. In contrast, the returns from personal accounts are uncertain, depend upon the ups and downs of the stock market, and are not guaranteed to last for a lifetime.

Conclusion

In 2004, the economy is still struggling to climb out of the most protracted jobs slump since the 1930s. Four years of tax cuts have failed to generate a strong and sustained jobs recovery, but they have contributed to squandering the fruits of the strong economy and fiscal discipline of the 1990s. The country faces the imminent retirement of the baby boom generation with a legacy of large budget deficits from the policies of the past few years. All President Bush and his Congressional allies have to offer is more tax cuts and health and retirement policies that will dig the deficit deeper without providing meaningful solutions to the country's most serious problems.

Note: Chart 11 was revised on November 15, 2004 based on new CBO data.

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