Senate Budget Committee Republican Staff
BUDGET BULLETIN
A Weekly Bulletin produced when the Senate is in session.

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202/224-6988 http://www.senate.gov/~budget/republican

108th Congress, 1st Session: No. 15 July 22, 2003

INFORMED BUDGETEER

SNATCHING DEFEAT FROM THE JAWS OF VICTORY ...(continued from last week)

- The Medicare prescription drug bill (S.1), as reported by the Finance Committee, compounds the strain of serious, long-term underfunding of the Medicare program by adding an expensive new prescription drug benefit without any reform of the underlying program.

- As last week's *Bulletin* explained, the Budget Committee increased the Finance Committee's allocation by an amount ($11 billion) beyond the bill's budgetary effect in order to make room for floor amendments that would reform Medicare and promote its long-term sustainability (yielding a total of nearly $20 billion in room over 10 years). Ultimately, this "room" was insufficient to match appetites. The discipline offered by adhering to the Committee's allocation was abandoned as the bill absorbed amendment after amendment to increase benefits. **As a result, CBO estimated today that the bill as passed by the Senate would spend $461 billion over the next 10 years**.

- (NOTE: Initial press accounts of the preliminary CBO estimate focus on the net figure of $437 billion for S.1, including $25 billion in increased tax revenues that would result from the bill. However, for purposes of evaluating the bill against the budget resolution, revenues do not count as an offset to the Finance Committee's allocation. Therefore, S.1, as passed by the Senate, spends about 13 percent more on Medicare than was allowed by the Finance Committee's remaining allocation from the budget resolution.)

- Before the final vote on this package, a bipartisan majority of the Senate made one last attempt to wring some reform out of the process (as had been promised when the reserve fund release was sought in order to keep the process moving). The Senate voted to keep alive (38-59 against the motion to table) an amendment (offered by Senators Feinstein, Nickles, Chafee, and Graham-SC) that would have related the premium charged for the Medicare Supplemental Medical Insurance program (SMI, more commonly referred to as the Part B program) to the income level of the beneficiaries paying the premium.

- Despite the significant bipartisan vote in support of the amendment, it was killed minutes later on a voice vote because of a purported threat of a filibuster of the entire bill. How can action in the Senate appear so decisive and then turn on a whim? A little background on Medicare is a useful place to start grappling with this episode.

- Even before the addition of a new prescription drug benefit, the Medicare program (both Parts A and B) already has a $13.3 trillion long-term shortfall, according to the President's 2004 budget: for current participants, Medicare benefits will exceed Medicare income (taxes plus premiums) by this amount over the next 75 years (in discounted value). (An aside: the President's budget – p. 47 of *Analytical Perspectives* – also stated: "The Administration is committed to working with the Congress to reform Medicare in a manner that does not make this unfunded promise any larger." Let's hope that commitment is brought to bear during conference negotiations.)

- The Part B portion of Medicare is a voluntary insurance program that provides coverage for (mostly) seniors' use of physicians' services. Part B benefits are partially funded from monthly premiums paid by enrollees, with the remainder funded from general revenues. (It is important to note that Part B is **not** funded by the Medicare Hospital Insurance (HI) payroll tax, which is dedicated to financing Medicare Part A – the Hospital Insurance program that covers hospital, home health, skilled nursing facility and hospice care services.)

- The Part B premium was initially intended to cover 50 percent of the cost of benefits, but over time that share declined to less than 24 percent. The drop occurred because premium increases were limited to the level of the annual cost of living adjustment provided for Social Security benefits (which is based on the Consumer Price Index), but the per capita cost of the Part B benefits rose faster (along with higher rate of increase of health care costs in the economy). Premiums are currently set to cover about 25% of the costs of the average Part B benefits for an enrollee – regardless of income – with the rest subsidized by transfers from the general fund of the Treasury – aka taxpayers.

- The Medicare trustees noted in their 2003 report that of all personal and corporate federal income revenues paid into the general fund by taxpayers in 2002, "about 7.8 percent of [them were drained off to subsidize Part B]. If such taxes were to remain at their current level, relative to the national economy, then [the amount of] SMI (Part B) [that would have to be funded by] general revenue[s] in 2077 would represent roughly 32 percent of total income taxes."

- As the Concord Coalition put it: "It makes no sense for a working couple with two children, and a $50,000 income (about the national median for family households) – trying to buy a home, trying to find affordable health insurance, trying to save for their kids' education, and trying to put aside something for retirement – to have to pay 75 percent of the Medicare premium for a retired couple whose income exceeds $150,000 a year."

- Given Medicare's unsustainable outlook and unfair burden shifted to later generations, the favored, yet doomed Feinstein-Nickles amendment was a necessary reform that owned up to this fact: S.1 significantly overpromises and underfunds the new prescription drug benefit while doing nothing to address the current long-term unfunded promises of the preexisting Medicare program.

- The amendment would have worked as follows. For 98 percent of seniors, there would be no change in their share of Medicare Part B monthly premiums. As under current law, seniors with incomes below $100,000 ($200,000 for couples) would be responsible for 25 percent of the total cost of the premium ($58.70 monthly in 2003).

- Those with incomes between $100,000-$150,000 ($200,000-$300,000 couples) would be responsible for 50 percent of the total cost of the Part B premium. Individuals with incomes between $150,000-$200,000 ($300,000-$400,000 couples) would be responsible for 75 percent of the total cost of the Part B premium. Individuals with incomes above $200,000 ($400,000 couples) would be responsible for 100 percent of the Part B premium ($234.80 per month). While the amendment would have saved only a fraction (no CBO estimate is yet available), of the cost of the new prescription drug benefit, it could have been a down payment on strengthening the Medicare program.

- How is it then that this responsible amendment was not included in the final bill?

- As the Wall Street Journal recounted in an editorial June 30th: "[Senator Kennedy] threatened a filibuster, and the Republican leadership, fearing it would lose the whole Medicare bill, had the provision rescinded by voice vote." With the reserve fund's power (to exact reform as a quid pro quo for its release) already forfeited, there was no way to guarantee passage of reforms on the floor, short of putting such threats to the test.

- Let's hope for taxpayers' sake the Conference Committee will fare better in standing up for fiscal responsibility.

MID-SESSION REVIEW OF PRESIDENT'S BUDGET IN PERSPECTIVE

- Last week, the Office of Management and Budget (OMB) released its Mid-session Review updating the Administration's projected budget outlook under its proposed policies. Some have claimed that the President's tax cuts are the primary cause of the $455 billion deficit OMB now estimates for 2003, ignoring the cost of two wars and the lingering impact of an economic recession. But the fact remains that economic and technical changes account for 53 percent of the reversal in this year's fiscal position since April 2001. War and homeland security spending account for 24 percent of the change, while the President's enacted tax cuts account for just 23 percent of the overall drop. Even without the President's tax cuts, this year's deficit would total $278 billion.

- From another perspective, of the $150 billion increase in the projected 2003 deficit since February, about $35 billion (or 23%) results from legislation enacted by Congress to increase non-defense spending for items such as assistance to states, unemployment compensation, and supplemental appropriations (including debt service).

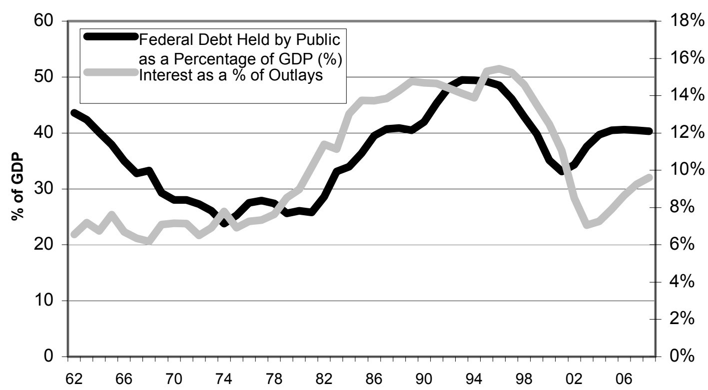
- But where would our economy be without the President's tax cuts? On July 17, the National Bureau of Economic Research (NBER) declared that the recession ended in November 2001, just five months after the enactment of the Economic Growth and Tax Reconciliation Act of 2001. Lasting only 8 months, it was one of the mildest recessions in recent history. Job losses as a share of peak employment equaled 1.2 percent, a full percentage below the average of the last ten recessions (see *Bulletin* of June 2, 2003 for a more complete discussion).

- The Department of the Treasury estimated that the economy would have been significantly worse without the benefit of the President's three tax cuts: the Economic Growth and Tax Relief Reconciliation Act, the Job Creation and Workers Assistance Act, and the Jobs and Growth Tax Relief Reconciliation Act. In the second quarter of 2003, unemployment would have been 7.2 percent, nearly 1 percentage point higher than the current rate. Real Gross Domestic Product (GDP) would also have been 2 percent lower.

- As anticipated, the powerful incentives engendered in the Jobs and Growth Tax Relief Reconciliation Act of 2003 appear to have contributed to the turnaround in the stock market. Since the President's plan was announced in February, the combined market capitalization of the NYSE and the NASDAQ has increased from $11.1 trillion to $12.9 trillion, an increase of more than 16 percent.

- By the end of fiscal year 2004, almost three years will have passed since the recession ended, and OMB estimates the deficit will still be above 4 percent of GDP. How does this compare with recent history? Two years after the 1982 and 1991 recessions, the government recorded deficits equal to 5.1 and 3.9 percent of GDP. Although the current deficit is typical in comparison to recent recessions, debt and interest outlays are significantly below the level associated with past recessions. In fact, debt in 2004 as a share of GDP is estimated to be 10 percentage points below the level recorded in fiscal year 1993. Net interest outlays will only account for 7.3 percent of total outlays, half their share in 1993.

Debt and Interest Costs Projected to Remain Relatively Low



Source: OMB, CEA

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