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INFORMED BUDGETEER

CBO'S CASE AGAINST CHRONICALLY LARGE DEFICITS

- Lately, it has been hard to tell whether federal budget deficits are enough of a concern to generate action. A recent brief by the Congressional Budget Office (CBO), the *Long-Term Economic Effects of Chronically Large Federal Deficits* (http://www.cbo.gov/ftpdocs/67xx/doc6744/10-13-Long-TermEffects_Brief.pdf), provides some motivational food for thought. CBO concludes that persistently large budget deficits jeopardize our nation's standard of living by increasing our consumption now at the expense of the next and future generations, also affectionately known as our children and grandchildren.

- Our future standard of living is largely dependent on rates of productivity growth, which are a result of combined growth in capital, labor and technology. When the government spends more than it takes in (as it is doing now and is projected to continue doing into the foreseeable future), and assuming private savings remain the same, then fewer resources in our economy are available for capital investments.

- Domestic investment affects the growth of productivity in two ways. An increase in investment raises the amount of capital available to workers, permitting each worker to produce more. According to CBO, capital investment has accounted for nearly a third of the growth in productivity since 1950. Second, an increase in investment is often associated with the introduction of new technologies into the workplace that allows managers to develop new business practices that generate more output from the same amount of capital and labor. The introduction of new technologies has accounted for nearly 40% of the growth in our productivity since 1950. Therefore, excessive consumption by the government today reduces the amount of resources available to the private sector for investment and innovation, reducing our standard of living in the future.

- While there may not be enough domestic savings to fund all of the profitable investment opportunities, foreign investors thus far have been more than happy to send their excess savings here. CBO's brief cites historical evidence that indicates that foreign investment makes up for about 40% of the shortfall in U.S. savings. As a result, labor productivity is higher than it otherwise would be because foreign investment makes possible more capital investment per worker. However, as our foreign indebtedness increases, Americans will be required to send a portion of our future income abroad to service this debt. And because foreign investment does not replace all of our forgone savings, future living standards will not be as high as they would be if we saved more.

- Finally, from the perspective of the financial markets, the increased demand for credit that results from high federal deficits tends to raise interest rates, to the further detriment of national wealth accumulation.

- Next week, the Senate will consider its first spending reconciliation bill since 1997, the Deficit Reduction Omnibus Reconciliation Act of 2005. This bill will provide an opportunity to begin making downward adjustments to the soaring track of federal spending programs and federal deficits, and to improve the odds that future generations of American taxpayers will not have their standard of living reduced by the excess consumption of their forebears.

THE CASE AGAINST THE MISCHARACTERIZATION

- The current effort to reduce the deficit started seven months ago when Congress began considering a 2006 budget resolution that would direct committees to reform spending programs that would save $34.7 billion. Ever since then, many press accounts have boiled down these congressional efforts into a reporting mantra that usually goes something like this: "committees in the House and Senate [must] produce $35 billion in budget savings over five years, mainly from entitlement programs for the low-income, such as food stamps, Medicaid and student loans."

- Just because this assertion is repeated over and over again, does that mean it is true?

- There is only one way to find out: 1) look at the policy changes that were contemplated during debate on the budget resolution and the policy changes that committees have reported out (in the Senate so far; House committees have not finished marking up yet), 2) examine the numbers that summarize the budgetary effect of those changes, and 3) assess whether the numbers back up these assertions that savings come "mainly" from programs benefiting low-income individuals (especially the three programs that are frequently listed -- food stamps, Medicaid, and student loans).

- First, consider what the budget resolution had in mind. It's true that the budget resolution was widely advertised as asking for a $10 billion reduction in Medicaid spending. But one of the expected sources of savings was intergovernmental transfers (states drawing on federal funds) and other abuses of the program that have siphoned money away from beneficiaries towards other, usually unrelated purposes (because of states' objections to correcting those loopholes, a commission was constituted to advise on how best to achieve those savings). So the Medicaid savings were <u>not</u> anticipated to come at the expense of Medicaid beneficiaries.

- The budget resolution also contemplated spending $7 billion on benefits for students in higher education (to be paid for by larger savings from reduced payments to lenders, which has been long advanced by student advocates). Spending money on students means not reducing benefits to students. The budget resolution assumed <u>no</u> changes in food stamps, which means no reductions.

- So even though the Medicaid savings instruction of $10 billion to the Senate Finance Committee was exhaustively negotiated to be achievable through program reforms that <u>do</u> <u>not</u> affect beneficiaries, some have persisted in labeling the planned Medicaid reforms as a reduction to low-income individuals. Even granting that mischaracterization for a moment, when that $10 billion reduction is combined with $7 billion of increased spending for students, then net reductions (contemplated in the budget resolution) to the low-income totaled only $3 billion (nine percent of the overall savings target). As for the rest of the $34.7 billion in savings instructions, half came from assumed reductions in spending for non-low-income programs, and the remaining 41 percent coming from assumed receipts from business relationships with the federal government.

- But regardless of what the budget resolution assumed, those assumptions were never binding on the affected committees, so the nine-percent result is academic in light of what committees have actually reported. So let's look at the actual policies in the legislation, not just the program label.

- The following table summarizes by Senate committee the budgetary effects of major program provisions that spend (**in bold**) or save money (not bold) and indicates whether spending or savings is in programs for the low-income (*italics*), in programs not focused on the low-income (not italics), or whether the savings came from offsetting receipts resulting from the private sector's business relationships with the federal government (IN ALL CAPITAL LETTERS).

BUDGETARY EFFECTS OF RECONCILIATION LEGISLATION REPORTED BY SENATE COMMITTEES ($ BILLIONS)

Committee/Program	Total for 2006-2010
Agriculture	
Commodities	-4.0
Food Stamps	*0.0*
Dairy/Milk payments	**1.0**
Commerce	
SPECTRUM AUCTION	-10.0
Digital TV converters	***3.0***
Other spending	**1.0**
Energy	
ANWR	-2.5
HELP	
PBGC PREMIUMS	-6.7
Lender payments and fees	-20.9
Student benefits	***11.2***
Finance	
Medicaid-beneficiaries	*-0.8*
Medicaid - NOT beneficiaries	-7.2
Katrina Medicaid	***1.9***
Other Medicaid spend	***1.8***
Medicare Savings	-18.1
Medicare Docs & other	12.4
Judiciary-VISA FEES	-0.6
EPW-road construction	*
Banking	
FDIC PREMIUMS	-0.3
Federal Housing Admin	-0.3
Subtotals:	
Total Net Spending for the low-income	***17.1***
Total Other Spending	**14.4**
TOTAL NEW RECEIPTS	-20.1
Total Spending Reductions (non-low-income)	-50.5
TOTAL-NET RECONCILIATION SAVINGS	-39.1

Source: SBC summary based on CBO cost estimates of reconciliation legislation reported by Senate committees to the Senate Budget Committee.
* less than $50 million

- Long-time budgeteers present during the last spending reconciliation bill in 1997 will remember that if a committee wants to spend on a program in its part of the reconciliation bill, it has to produce additional savings beyond its instruction to pay for the spending and still meet its net savings requirement.

- Consider the Finance Committee package as reported: it would save a gross $8 billion in Medicaid, but would spend $1.9 billion in Medicaid to assist Gulf Coast citizens after the hurricanes and $1.8 billion for other new Medicaid benefits, including the Family Opportunity Act. While the net $4.3 billion in Medicaid savings is likely to be labeled by bill opponents as $4.3 billion in cuts to low-income people, the actual Medicaid policies that the Finance Committee chose to achieve 90 percent of the $8 billion in gross savings do not affect the beneficiaries of the Medicaid program. Instead, they would more accurately reimburse pharmacies, drug manufacturers, and other Medicaid partners receiving payments under current law. Note also that the Finance Committee would provide an additional $10.8 billion to preserve access for seniors to physicians.

- As for students, the HELP Committee's package would spend $11.2 billion on new student benefits, while reducing subsidies and excess payments to and increasing fees from lenders by $20.9 billion. No savings would come as a result of reduced benefits for students. As for the third leg of the "reconciliation cuts mainly from the low-income" – food stamps – the Agriculture Committee's reported bill did not even address food stamps. But the Commerce Committee would spend $3 billion for low-income people (and perhaps others) to be able to purchase converter boxes to make sure their analog TVs still work after the digital TV conversion.

- The bottom-line result is that spending on programs for the low-income would increase by $17.1 billion compared to current law, not decrease (payments to doctors for seniors' Medicare services also would increase by $10.8 billion). The effect of the entire reconciliation package would be to spend more on programs for the low-income instead of spending less. Even those with arithmophobia would have a hard time continuing to assert that the $39.1 billion in net savings would come "mainly" at the expense of the low-income.

- Since it is apparent that savings are not coming mainly from food stamps, students, and Medicaid beneficiaries, how else are the committees achieving their savings?

- The largest source of savings is from reforming mandatory programs. Besides the reduced payments to and increased fees from student lenders, the bill would also produce $18.1 billion in gross savings from reduced provider payments in the Medicare program. While the net effect of the bill on Medicare would be to save $5.7 billion, that is far less than the $127 billion in Medicare savings enacted in 1997, and the $69 billion in Medicare savings enacted in 1993 (both figures adjusted to constant 2005 dollars). Reforms to agriculture commodity support programs, which overwhelming affect large, commercial producers instead of small family farmers, would save another $4 billion.

- Finally, $20.1 billion in deficit reduction would occur by payments made to the federal government by portions of the private sector that wish to begin or maintain certain business relationships with the federal government: spectrum auctions ($10 billion), insurance premiums to PBGC for insuring pension plans ($6.7 billion), bids for ANWR drilling rights ($2.5 billion), and other fees ($0.9 billion).