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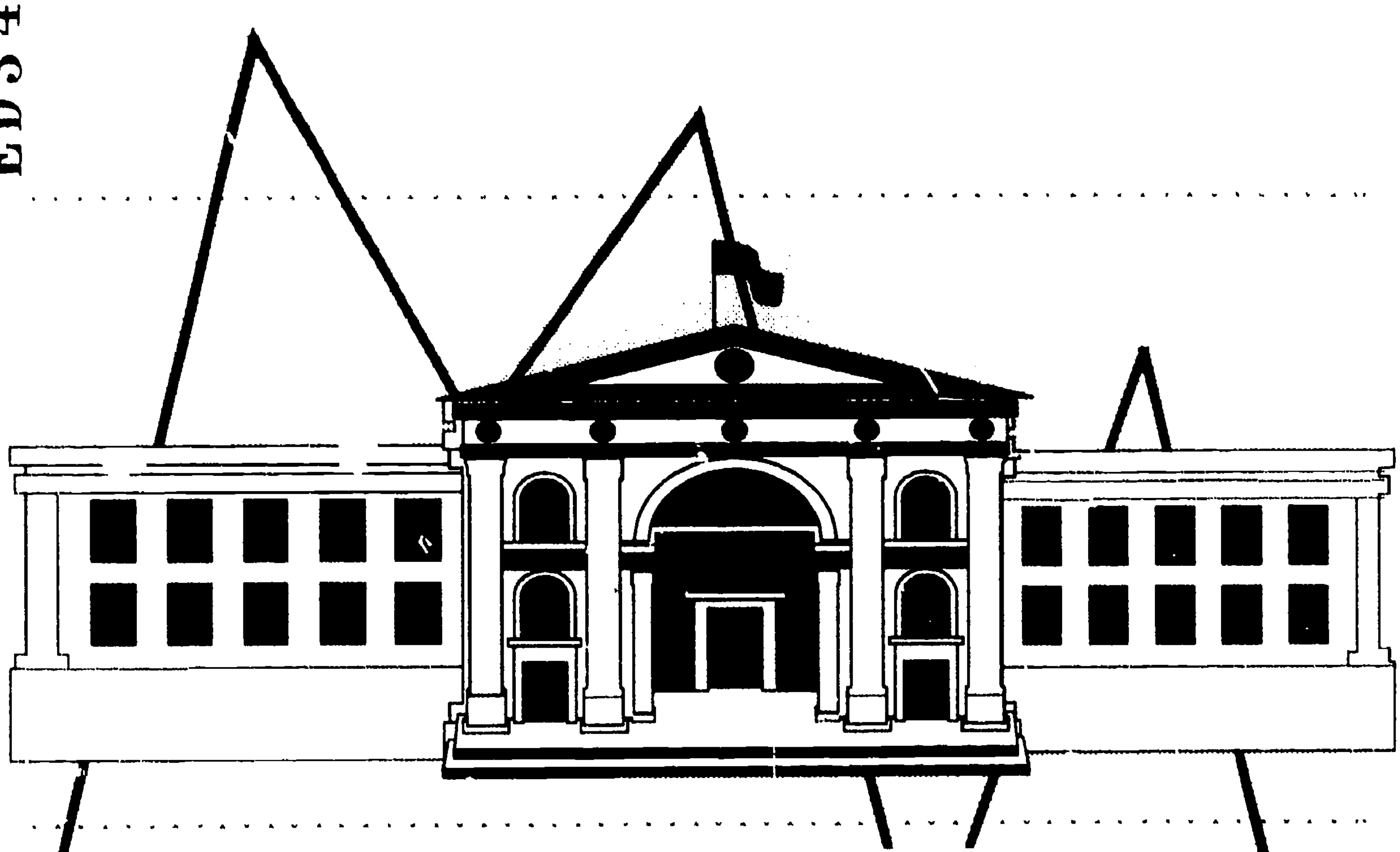
ABSTRACT

On January 29, 1992, the Bush Administration unveiled its fiscal year 1993 budget. An examination of the budget reveals a substantial gap between the administration's rhetoric concerning the budget and what the budget actually contains. An analysis reveals a budget that continues to give priority to defense over domestic spending, one that favors the very wealthy, one that has a lack of benefits to low-income families, and one that contains little to boost the economy in the short term. The budget also risks retarding long-term growth rather than enhancing it and proposes that legislation be enacted placing a ceiling on total entitlement program costs each year. The budget weakens the finances of state and local governments. These issues, along with the Administration's proposal to merge 24 disparate programs into a mega-block grant to states, are discussed in the chapters of this document. Appended are tables that indicate the budget proposal's impact on the states, proposed changes in low-income funding (FY 1992-FY 1993), and a "New York Times" editorial. (RR)

THE FISCAL YEAR 1993 BUSH BUDGET
Still Not Tackling the Nation's Problems



Center on Budget and Policy Priorities

THE FISCAL YEAR 1993 BUSH BUDGET

Still Not Tackling the Nation's Problems

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Center on Budget and Policy Priorities
Washington, D.C.

The Center on Budget and Policy Priorities, located in Washington, D.C., is a nonprofit, tax-exempt organization that studies government spending and the programs and public policy issues that have an impact on low income Americans. The Center is supported by foundations, individual contributors, and publications sales.

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I. Overview

On January 29, the Bush Administration unveiled its fiscal year 1993 budget. An examination of the budget reveals a substantial gap between the Administration's rhetoric concerning the budget and what the budget actually contains.

- In his State of the Union address, the President portrayed the budget as representing a major new direction in government policy, with sharp reductions in defense funding and increased attention to unmet needs at home. In fact, the budget represents only very modest change. Appropriations for defense (other than one-time appropriations for the Persian Gulf conflict) would decline just 3.2 percent between fiscal years 1992 and 1993, despite the dissolution of the Soviet Union. Appropriations for domestic non-entitlement programs would be frozen;[1] they would be placed $3 billion below the amount allowed under the budget agreement.

  Furthermore, total defense spending for the next five years would be just two percent below the level projected for the same five-year period in the budget the Administration presented last year when the Soviet Union was still intact.

  While the defense reductions are more modest than the Administration has portrayed them, the domestic reductions are substantially deeper than it has acknowledged. The budget envisions a *five-year freeze* on

[1] These figures concerning changes in defense and domestic discretionary appropriations between fiscal years 1992 and 1993 are not adjusted for inflation. If the appropriations levels are adjusted for inflation, the Administration's defense request for fiscal year 1993 is found to be 6.8 percent below the FY 1992 inflation-adjusted level, while the domestic request is down 3.9 percent.

appropriations for domestic non-entitlement programs, which would erode these programs significantly. The budget declines to use any defense savings to meet unmet domestic needs.

In short, in its broad defense and domestic priorities, this seems more a status quo budget that maintains previous Administration policies than a major shift in direction.

- Despite the Administration's rhetorical emphasis on the middle class, the budget favors the very wealthy and does so to a greater degree than previous Administration budgets. The capital gains tax cut proposed in the budget is larger than the President's earlier capital gains proposals. The Joint Tax Committee estimates this proposal would result in an average tax cut of $8,500 a year for those people with incomes over $200,000 who have capital gains.

  Taxpayers with incomes over $200,000 constitute the wealthiest one percent of all households in the U.S. The Joint Tax Committee analysis estimates they would receive 52.5 percent of the benefits from the capital gains tax cut. The top three percent of all households — those with incomes exceeding $100,000 — would get 70 percent of the tax benefits from this proposal.

  By contrast, the typical middle income family does not have capital gains income and would not benefit from the capital gains cut. The Joint Tax Committee estimate shows that those with incomes below $50,000 constitute 80 percent of all tax filing units but would receive just 10 percent of the benefits from the President's capital gains cut.

  Middle income families with children would receive a very modest tax cut from the proposed increase in the personal exemption. If a middle-class family had two children, it would receive a tax cut from this provision of $150 a year, slightly less than $3 per week. The typical middle-income family would not receive a tax benefit from the other tax proposals in the budget, as only a minority of middle-income families would be directly affected by those proposals.

  High-income elderly people and farmers would face reductions in Medicare benefits and farm subsidies. The total amounts they would lose, however, equal about one-seventh the amount wealthy individuals would gain from the capital gains cut.

- Low-income families with children would not benefit from the increase in the personal exemption. In addition, while the budget contains a substantial increase for Head Start and several other low-income programs, total funding for low-income non-entitlement programs would be cut $1.5 billion, or three percent, below the levels needed to keep pace with inflation.

  The Administration's press documents focus on those low-income programs that would be increased. Many other low-income programs would be cut, however, with some being reduced sharply.

- The budget contains relatively little to boost the economy in the short-term. According to OMB's figures, the legislative changes proposed in the tax and entitlement area would increase federal spending and reduce federal tax collections by a total of $7 billion over the remainder of fiscal year 1992. That equals a little over 0.1 percent of the Gross Domestic Product, too small to have a major impact.

  The President has also acted to reduce income tax withholding this year, but this is likely to have a smaller effect than the White House has claimed. It would not change the amount of income tax that people owe. As a result, many taxpayers may act to prevent their tax withholding from being reduced because they wish to make sure they do not owe the government money next year or do not lose a sizeable portion of their refund.

- More important, the budget risks retarding long-term growth rather than enhancing it. Some of its tax cuts are partially funded through gimmicks such as "timing shifts" (i.e., shifting tax collections from one year to another) that mask the full extent of the revenue losses the tax cuts would cause.

  In addition, the budget assumes the capital gains tax cut would save rather than lose money and then uses these savings to finance still more tax reductions. The Joint Tax Committee's estimates indicate the capital gains proposal would lose $15 billion in revenue over the next five years, not raise $7 billion as the White House claims.

  Over the long run, the tax proposals in the budget would increase the deficit. Many economists have warned that policies that swell the long-term deficit are likely to dampen growth rather than accelerate it.

- The budget weakens the finances of state and local governments, which are already suffering from the recession. The budget would require state and local governments to pay more taxes to the federal government, would narrow state tax bases and thereby reduce state revenue collections, and would cut some grant programs to states and localities. Many state and local governments already face substantial budget shortfalls. The revenue losses caused by the budget proposals would likely force many state and local governments to raise taxes or cut services to a greater degree than they would otherwise have to do. This would increase the drag that state and local fiscal contraction is exerting on the economy.

  Furthermore, virtually all states have regressive tax systems. Middle and lower-income households would likely bear most of the brunt of the additional tax increases and service cutbacks at the state level. The Administration's budget thus contains what might be termed hidden middle-income and low-income tax increases, but with these tax increases or service reductions shifted to the state and local level.

- Finally, the budget proposes that legislation be enacted placing a ceiling on total entitlement program costs each year. The ceilings would be significantly below the levels that entitlement spending would reach if entitlements are not cut. Under this proposal, in any year in which projected entitlement costs would breach the ceiling, Congressional committees with jurisdiction over entitlements would be directed to approve legislation reducing these costs. If legislation bringing total entitlement costs within the entitlement cap was not enacted, an automatic sequester (or across-the-board cut) of entitlement programs would be triggered, with only Social Security, unemployment insurance, and certain credit programs exempt from sequestration. All entitlement programs targeted on the poor — such as AFDC, SSI, Medicaid, food stamps, and child nutrition programs — would be fully subject to a sequester.

  There is little question that total entitlement costs are growing rapidly and pose a threat to the nation's fiscal well-being. This is due almost entirely to the explosive growth of the health care entitlements, whose spiralling cost increases reflect exploding costs in the health care system as a whole. Needed are tough cost containment measures to reform the health care system and bring health care costs under control.

  The Administration's new health care plan, however, is weak on the cost containment front. The Administration would evidently place more of the burden of constraining entitlement costs on the entitlement cap. Yet the proposed entitlement cap is a crude measure. It would likely affect a broad array of entitlements, including those not experiencing rapid growth. Moreover, if entitlement programs are pitted against each other, those with the weakest constituencies — the programs targeted on the poor — could be placed at greatest risk.

In addition, it appears that under the proposal, a tax increase could not be used in lieu of an entitlement reduction, even if it reduced the deficit as much or more. If entitlement spending was projected to exceed the cap by $10 billion in a given year, only a $10 billion reduction in entitlement expenditures could avoid an across-the-board entitlement cut. A $10 billion tax increase would make no difference. No requirement this rigid has existed since the Congressional budget process was established in 1974.

This means, for example, that savings from narrowing a tax expenditure that subsidizes the health care costs of upper-income people would not count toward meeting the entitlement cap. Nor would savings from closing a tax loophole. But reducing basic benefits for the poor in a non-health entitlement would count.

This would likely have a bearing on which income groups were affected most by the entitlement cap. Entitlement programs primarily benefit poor and middle class people. In contrast, many tax subsidies — or "tax entitlements" as a recent *Washington Post* editorial termed them — overwhelmingly benefit the well-to-do. The Administration's proposed entitlement cap thus would be likely to shield the wealthy from substantial sacrifice, while placing a greater squeeze on those in the middle and bottom of the income scale.

A far superior way of curtailing rising entitlement costs would be to reform the health care system and impose tough cost constraints on it.

These issues, along with the Administration's proposal to merge 24 disparate programs into a mega-block grant to states, are discussed in the chapters that follow.

II. Defense and Domestic Appropriations

Despite the President's emphasis in the State of the Union address on reductions in military spending and a greater focus on problems at home, the changes he proposes here are modest. The budget does not reflect a major redirection from military to domestic needs.

Overall appropriations for defense, exclusive of those for Desert Shield/Desert Storm, would drop just 3.2 percent from fiscal year 1992 to fiscal year 1993. After adjustment for inflation, this represents a 6.8 percent decline.

Meanwhile, appropriations for domestic non-entitlement programs would be frozen, declining just under four percent when inflation is taken into account. Domestic appropriations would be placed $3 billion below the FY 1993 cap set for these programs in the budget agreement — and $8 billion below the level the Congressional Budget Office estimates is needed to keep pace with inflation.

An analysis by the Senate Budget Committee points out that total defense appropriations and outlays for the next five years would change little from the levels the President proposed a year ago. Last year, he proposed a total of $1,467 billion in defense appropriations for fiscal years 1993 through 1997. Now he proposes $1,423 billion, three percent less. Similarly, last year he proposed $1,450 billion in defense outlays (or actual expenditures) during this period. Now he proposes $1,424 billion, two percent less.

The Senate Budget Committee analysis notes that in every year from fiscal 1993 to fiscal 1997, defense funding would exceed the average level provided for defense in the peacetime years of the Cold War prior to the build-up of the 1980s.[2]

[2] Senate Budget Committee Staff, *President Bush's 1993 Budget: A Review*, January 29, 1992, pp. 35-36. In this comparison, defense levels for all years are adjusted for inflation.

Table I
Discretionary Appropriations Levels*

	FY 1992 Levels	President's Proposals for FY 1993 (in billions of dollars)	Proposed change from 1992 Levels	Proposed change from levels needed to keep pace with inflation
Defense (without Desert Storm/ Desert Shield)	$291.0	$281.6	-3.2%	-6.8%
Domestic	202.7	202.9	+0.1%	-3.9%

* Excludes effects on FY 1992 levels of proposed rescissions and supplemental appropriations. If these were included, the decline in defense appropriations would be even smaller, while the figures for domestic appropriations would be largely unchanged.

Domestic Appropriations

The budget contains tough medicine for domestic non-entitlement programs (often termed domestic discretionary programs). Not only would these programs receive no benefits from a peace dividend, but they would be reduced substantially in the years ahead.

The budget contains a five-year freeze on overall appropriations for domestic non-entitlement programs. By fiscal year 1995, the third year of this freeze, total appropriations for these programs would be $24 billion — or 11 percent — below fiscal year 1992 levels, after adjustment for inflation.

Furthermore, even with this multi-year freeze, the total levels in the budget for *all* non-entitlement programs in fiscal years 1994 and 1995 — including defense and international programs — would exceed the non-entitlement spending caps set for those years by the budget agreement. (For fiscal years 1994 and 1995, the budget agreement established a single spending cap that covers domestic, defense, and international programs combined.) To address this problem, the budget contains a version of David Stockman's "magic asterisk"; it includes a notation that another $12 billion in fiscal year 1994 and 1995 spending cuts will be identified in future budgets (i.e., after the elections).[3] Since the President was adamant in his State of the Union address that defense reductions could be no deeper than those he has proposed, most or all of this additional $12 billion in proposed reductions will presumably come from domestic programs.

Achieving this additional $12 billion in savings in the domestic discretionary area — on top of the domestic non-entitlement freeze the budget proposes — would require still larger reductions in domestic programs in coming years.[4]

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[3] See House Budget Committee, *President Bush's FY 1995 Budget: A Short Summary*, January 29, 1992, p. 7.

[4] If these additional savings were all taken from domestic non-entitlement programs, total appropriations for these programs in FY 1994 would have to be approximately $25 billion — or 12 percent — below FY 1992 levels, after adjustment for inflation.

III. Budget Strongly Favors the Wealthy

In releasing the budget, the Administration noted it would reduce entitlement benefits for upper-income Medicare beneficiaries and well-fixed farmers. Medicare premiums charged to high-income beneficiaries would triple. Farm subsidies would be reduced for farm operators with off-farm incomes exceeding $100,000.

Yet these entitlement reductions turn out to be small when compared to the large tax breaks wealthy people would receive as a result of the capital gains tax cut. The net effect of the tax and entitlement changes proposed would be to confer massive tax breaks on the wealthiest Americans, while providing very modest tax reduction to most of those in the middle of the income spectrum.

Comparing Benefits from the Capital Gains Proposal to Losses from Upper-Income Entitlement Trims

In the past, the Administration has proposed excluding 30 percent of capital gains income from taxation. This would have the effect of lowering the capital gains tax rate for upper-income taxpayers by 30 percent, from a 28 percent rate to a 19.6 percent rate. In its new budget, the Administration proposes excluding 45 percent of capital gains income from taxation. This has the effect of lowering the capital gains tax rate to 15.4 percent.[5]

[5] The 45 percent exclusion would apply to profits from the sale of assets held at least three years. For assets sold after two years, there would be a 30 percent exclusion; for assets sold after one year, the exclusion would be 15 percent. This "sliding scale" would become effective in 1994. During 1992, the full 45 percent exclusion would apply to profits from the sale of assets held more than one year. In 1993, the 45 percent exclusion would apply to profits from sales of assets held at least two years.

This proposal would result in windfalls for wealthy investors. Data from a new analysis by the nonpartisan Joint Congressional Committee on Taxation, the most respected source of analysis on tax issues in Washington, indicates that households with incomes over $200,000 who have capital gains income would receive an average tax reduction of $8,500 per year from this proposal. Nearly half of all households in the over-$200,000 bracket receive capital gains income in the typical year, according to the Joint Tax Committee.[6]

The Medicare cuts that wealthy Medicare beneficiaries would face are modest by comparison. Elderly and disabled individuals with incomes exceeding $100,000 (and couples with incomes above $125,000) would pay $73.20 more per month in 1993 for Medicare Part B premiums. This amounts to an additional cost of $878.40 per year, about one-tenth of the $8,500 average tax break for wealthy investors with capital gains income.

A similar disparity is found if the total amount that high-income people would lose from the Medicare and farm price support changes is compared to the total amount they would gain from the capital gains cut. OMB estimates that the Medicare and farm subsidy provisions combined would extract a bit less than $4 billion from upper-income people over the next five years, an average of approximately $800 million a year.

By contrast, the Joint Tax Committee's analysis estimates that households with incomes over $200,000, the richest one percent of U.S. households, would receive $4.2 billion a year in tax cuts from the capital gains proposal. The top three percent of households, those with incomes over $100,000 a year, would receive $5.5 billion a year from the capital gains proposal.

Households in the over-$100,000 bracket would thus receive about seven times as much in the aggregate from the capital gains tax cut ($5.5 billion a year) as they would lose through higher Medicare premiums and reductions in farm subsidies (about $800 million). Moreover, this comparison does not include the additional benefits some wealthy households would receive from the repeal of the luxury tax on yachts and private airplanes, the easing of passive loss rules on real estate, the weakening of the alternative minimum tax on wealthy individuals, and other upper-income tax breaks in the budget.[7]

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[6] See Joint Committee on Taxation, "Distributional Effect of the Administration's Capital Gains Proposal," February 3, 1992. The Joint Committee's data also indicate that the average annual tax reduction for *all* households with incomes over $200,000, including those who do not have capital gains income and would not receive a tax cut in the typical year, would be $3,730.

[7] For a trenchant analysis of these proposals, see Statement of Robert S. McIntyre before the House Ways and Means Committee, February 5, 1992.

The Administration's Defense of a Capital Gains Tax Cut

The Administration argues a capital gains tax cut would not unduly favor the wealthy, contending that a capital gains cut would lead to massive job creation benefitting people at all income levels. The Administration also argues that if the capital gains tax is cut, wealthy investors would sell more assets and pay taxes on these sales, so their overall tax payments would not drop so much.

Both of these arguments have been heavily criticized by respected liberal and conservative economists alike. Take, for example, the argument that a capital gains cut would spur extensive job creation. Supporters claim a capital gains cut would do this by boosting savings and investment. But Henry Aaron, director of economic studies at the Brookings Institution and one of the nation's leading tax experts, has written: "Tax concessions on capital gains are a remarkably inefficient method of encouraging current real investment. Most capital gains are earned on financial assets [e.g., stocks]. The investment behavior that matters for the growth of the nation is real investment — in plant and equipment, in research and development, and in training and education of workers." Aaron notes that when one investor sells stocks to another, this generally does not result in new investment in plant or equipment, R&D, or worker training, but can yield substantial capital gains income for the investor making the sale. (Testimony before Senate Finance Committee, March 28, 1990.)

Similarly, Herbert Stein, senior fellow at the American Enterprise Institute and chairman of the Council of Economic Advisers under President Nixon, has warned that a capital gains cut would induce investors to reshuffle funds into assets like stocks that yield capital gains income. He observes:

> "Unless cutting the capital gains tax increases the rate of saving, it will only divert investment to projects that can be structured to yield capital gains away from projects that cannot. I see no reason to want such a diversion. On the question whether cutting the capital gains tax would increase saving you can get as many different answers as you can find econometricians. My own view is that the effect would be extremely small, and not worth betting on....I think that the only economic consequence we can confidently expect from reducing the capital gains tax is increased activity by lawyers and accountants in converting other income into capital gains." (Testimony before the House Ways and Means Committee, December 17, 1991.)

In a 1990 study, the Congressional Budget Office reached a similar conclusion, finding that "cutting taxes on capital gains is not likely to increase saving, investment, and GNP much if at all."

The Administration's other argument — that wealthy investors would not really secure a large tax cut — has even less merit. The Administration notes that a lower capital gains tax would lead investors to sell more assets and that the investors would pay taxes on profits from these sales. But the Administration contention that these tax payments should be considered a tax increase that lessens (or even eliminates) the tax break wealthy investors would receive is dismissed by most economists.

Investors would not choose to sell additional assets unless it was in their interest to do so because they would make even more money through these sales. (In some cases, investors might decide to sell now, believing the capital gains tax rate might be raised in the future and cause them to pay a higher rate of tax if they sold the asset at a subsequent time.) Counting the tax that would be paid on profits from these additional assets sales as though it were a tax increase imposed on these investors — and subtracting it from the large tax cuts that investors would receive from a capital gains cut — makes little sense and is given short shift by most economists. Herbert Stein has written: "...I do find laughable the attempts to show that the chief beneficiaries of a cut in capital gains tax would be middle-income homeowners [rather than the wealthy]..." Henry Aaron has commented that "the capital gains exclusion is about the most regressive tax proposal advanced with a straight face in my memory."

Tax Benefits for the Wealthy Far Exceed Those for the Middle Class

The principal tax benefit proposed for middle-income families is an increase of $500 in the personal exemption for children. For middle-income families with children, this would produce a modest tax cut.

The majority of middle-income families — most of those with incomes in the $15,000 to $50,000 range — are in the 15 percent tax bracket. Families in this bracket would receive a tax cut of $75 per child per year — or about $1.50 per child per week — from the personal exemption increase. If a family has two children, its tax cut would be $150.

The average middle-income family would not benefit from any of the other tax breaks in the budget.[8] For example, the budget's principal Individual Retirement Account expansion — a proposal to establish "flexible IRA accounts" — would primarily benefit taxpayers with incomes too high to qualify for IRA tax deductions. Under current law, married filers who have incomes over $50,000 and also have access to an employer-sponsored pension plan are ineligible for IRA deductions. (These taxpayers can still earn tax-deferred interest on IRAs.)

Most middle-income families, however, have incomes below $50,000. In 1990, the median family income in the United States was $35,353. The Joint Tax Committee has reported that in 1991, some 82 percent of all taxpayers with earnings qualified for IRA tax deductions. Some 73 percent qualified for the maximum $2,000 deduction.

Thus, most middle-income families are already eligible for IRA tax preferences and would be unlikely to use the "flexible IRA accounts" proposed in the budget.[9]

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[8] This analysis does not include the effects of the President's proposal for health care credits and deductions. These proposals were excluded from the budget documents issued by the Administration; they are not reflected in any budget tables. Furthermore, when the Administration provided more information on those proposals on February 6, 1992, it declined to propose specific methods of financing the proposals, making the effects of the proposals on different income groups impossible to evaluate. Under federal budget rules, such proposals can not be enacted unless they are fully financed. As a result, the Administration's health care proposals must be regarded as incomplete. (Also, the proposals include caps on federal Medicaid payments to states for non-institutional care provided to non-elderly beneficiaries. These caps could adversely affect the health care services provided to some poor people under Medicaid. Some health analysts argue that under the Administration's plan, some poor people would gain access to health care coverage while others would face a reduction in health care benefits.)

[9] Under current law, eligible taxpayers can deposit up to $2,000 in an IRA account and deduct up to $2,000 from income subject to taxation. Under the flexible IRAs the Administration has proposed, taxpayers would receive no deduction, but the interest earned on the account would be permanently tax-free, so long as the funds were left in the account at least seven years.

(continued...)

(Furthermore, IRS data from 1986, the last year that IRAs were deductible at all income levels, show that the percentage of taxpayers that used IRAs rose sharply as income increased. It is likely that if the Administration's IRA proposal is approved, a significantly larger percentage of families in the $100,000-to-$120,000 range would use the "flexible IRAs" than families in the $50,000-to-$70,000 range. Under the proposal, families with incomes above $120,000 would be ineligible.)

Nor would most middle-income families benefit from the Administration's proposals to allow penalty-free withdrawals from IRA accounts for a first-time home purchase or for certain educational or medical expenses. Most middle-income families do not have IRA accounts from which to make such withdrawals. In 1986, when IRA use was much higher than it is today, only 13 percent of tax filers in the middle third of the income spectrum made an IRA contribution.

Similarly, because the proposal to allow a tax credit of up to $5,000 for first-time homebuyers is limited to homes purchased between February 1, 1992 and December 31, 1992, it would affect a tiny fraction of middle-class households. Most households will not purchase a first home during this 11-month period. Many already have a home; others can't afford to make a downpayment. Congressional Research Service tax expert Jane Gravelle has estimated that only one percent of all taxpayers would benefit from this provision and that half of them would be in the top one-fifth of the income spectrum.[10]

One final point may be worthy of note. The aggregate annual benefits from the personal exemption increase — which would be spread over tens of millions of families — would be slightly *smaller* than the benefits going to the top 3 percent of the population just from the capital gains tax cut. Moreover, the benefits to the wealthy rise further when such provisions as the easing of passive loss rules on real estate investments, the repeal of the luxury tax on private yachts and airplanes, and the weakening of the alternative minimum tax are taken into account.

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[9] (...continued)

Since the "flexible IRA" does not provide an upfront tax deduction, it is unlikely many middle-class families who are currently eligible for IRAs but do not use them would elect to make use of the flexible IRAs. Indeed, throughout the history of IRAs, most families in the middle of the income spectrum have failed to use IRA tax preferences, presumably because these families could not set aside $2,000 a year for long periods of time. In 1986, only 13 percent of all tax filers in the middle third of the income spectrum made an IRA contribution.

[10] Statement of Jane G. Gravelle, Congressional Research Service, before the House Budget Committee, February 11, 1992.

The President's Presentation on Capital Gains

In his State of the Union address, the President attempted to downplay the large gap between the new benefits proposed for the wealthy and the more modest benefits proposed for other Americans. He did this, in part, by portraying the capital gains proposal as a middle-class tax cut. He stated that 60 percent of those who would benefit from a capital gains tax reduction have incomes below $50,000 a year.

The President's presentation was misleading. The critical issue is not how many of the taxpayers who would benefit from a capital gains cut fall into each income category, but rather what proportion of the tax benefits would go to each income category. As noted, the Joint Tax Committee estimates that 52.5 percent of the benefits would go to the richest one percent of taxpayers, with 70 percent of the benefits going to the top three percent. Moreover, the Joint Tax Committee analysis shows that only 10 percent of the benefits would go to those with incomes below $50,000, even though they make up 80 percent of all tax units.

The principal reason for the large disparity between the Joint Tax Committee data and the figures the President chose to cite is that wealthy investors typically have very large amounts of capital gains income and would thus receive very large tax cuts, while middle-income individuals with capital gains income usually have only small amounts of it. A recent Congressional Budget Office analysis found that in 1988, the households making up the richest one percent of the population had average capital gains income of $156,000. In contrast, the households comprising the bottom 90 percent of the population had average capital gains income of $252. Since middle-class households with capital gains income typically have small amounts of it, they would receive modest benefits from a capital gains tax cut, unlike the very large benefits wealthy investors would secure.

Suppose, for example, two households with incomes of $40,000 each received a $300 capital gains tax cut, while a household with income of $250,000 received a $10,000 tax cut. One could say, following the President's line of presentation, that two-thirds of the people getting the tax cut were middle-class. But nearly all of the tax cut benefits — more than 90 percent — would have gone to the wealthy household.

Indeed, the Joint Tax Committee data show that the average tax reduction for those households with incomes under $50,000 who would benefit from a capital gains cut would be just $263 per household. Moreover, only 2.9 percent of all tax units with incomes below $50,000 have capital gains income in a typical year and would receive any benefit from a capital gains cut. The average benefit for *all* tax units with incomes below $50,000 — including the vast majority who have no capital gains income and would receive no benefit from a capital gains cut — is $7.61 per household, according to the Joint Tax Committee data.

Finally, the President's statement that 60 percent of those who would benefit from a capital gains cut have incomes below $50,000 was itself inaccurate. The Joint Tax Committee's analysis shows that 41 percent of those who would benefit from a capital gains tax cut have incomes below $50,000. The White House appears to have massaged these numbers, probably by excluding income from capital gains when identifying which people have income below $50,000. Under such an approach, a wealthy retiree with pension and Social Security income of $35,000 a year and capital gains income of $100,000 a year would be counted as a household whose income was below $50,000.

Personal Exemption Increase Worth More to Affluent

Even the personal exemption increase in the budget would be worth more to many affluent families than to those in the middle of the income spectrum. The $500-per-child increase in the exemption would be worth $75 in the 15 percent tax bracket, where the large majority of the middle class is located. By contrast, the personal exemption increase would be worth $155 a child, more than twice as much, to a family that earns $125,000 and is in the 31 percent tax bracket.[11]

Lower-income families would not benefit from the personal exemption increase. Some 25 percent of all children — including 50 percent of black children and 45 percent of Hispanic children — would be unaffected by the increase in the children's exemption because their families have incomes too low to owe income tax. A family with one parent working full-time at the minimum wage and another parent working half-time at this level would not benefit from the personal exemption increase.

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[11] Under the 1990 budget agreement, the personal exemption phases out for married filers with incomes between $150,000 and $275,000. This provision expires after 1995. The budget does not propose to extend it.

In years through 1995, those families with children that have incomes above $150,000 would receive part or none of the benefit from the personal exemption increase. Starting in 1996, however, they would receive twice as large a benefit from the personal exemption as most middle-income families with children.

IV. The Budget and the Economy

The budget's proposals to jump-start the economy and spur recovery from the recession are unlikely to have a strong effect. Furthermore, because the tax proposals in the budget would enlarge deficits over the long run, these proposals could do more to retard long-term growth than to promote it.

Impact on the Recession

The budget is not likely to spark a strong recovery because the fiscal stimulus in the package is quite small. According to the Administration's budget figures, the legislative proposals in the budget would increase federal spending on unemployment insurance and decrease federal tax collections by a total of $7 billion in fiscal year 1992. This amounts to a little more than 0.1 percent of the Gross Domestic Product,[12] well below what most economists believe is necessary to produce a sizeable economic effect.

To be sure, the Administration hopes that its actions to change tax withholding tables will pump another $25 billion into the economy in 1992. This estimate, however, seems optimistic. As taxpayers realize their tax liability has not changed — and any reduction in tax withholding now will be offset by an increased tax liability or smaller refund next year — a substantial number may act either to have more tax withheld now or to save rather than spend some of their additional take-home pay.

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[12] The Gross Domestic Product (GDP) is increasingly used as the basic measure of economic activity, rather than the Gross National Product (GNP). The two measures are very similar. In 1990, GNP was 0.2 percent greater than GDP.

In addition, the budget contains several provisions likely to increase the drag state and local governments are placing on the economy through austerity measures. The budget would increase the taxes that states and local governments must pay to the federal government. It would also reduce states' own revenue collections. And it would cut some federal grants to states. (These issues are discussed in more detail in Chapter VI.) If enacted, these provisions would be likely to prompt states to make larger spending cuts and tax increases for their coming fiscal year, which starts July 1 in most states.

Several proposals in the budget may provide some stimulus, such as the proposals for a temporary investment tax allowance and the first-time homebuyer credit. The impact of these proposals, however, is likely to be small. For example, some homebuyers who would receive the first-time homeowner credit would be people who would have purchased a home anyway. In addition, the tax credit would primarily be spent on the sale of existing housing; it is not expected to a have large effect on new construction.[13] Overall, the amount of stimulus provided in the Administration's budget is modest.

Budget Could Slow Long-term Growth

More serious is the risk that the budget could hinder long-term growth. In a series of Congressional hearings in November and December, liberal and conservative economists alike voiced an unusual degree of consensus on what they described as the two key actions needed to foster long-term growth: action to promote private investment by reducing the federal deficit and action to raise productivity through increased government investment in such areas as education, training, early intervention programs for children, infrastructure, and research and development.

Most of the economists also warned that if a new round of tax cuts increased deficits over the long term, these tax provisions could do more to retard growth than promote it. They noted that deficits of the magnitude the nation now faces are soaking up capital that could otherwise be invested in new or modernized plants and equipment and other investments needed to make our economy more productive and competitive. Many of the economists also warned that large deficits make it difficult to provide sufficient government resources for the public investments the economy needs.

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[13] Both Urban Institute tax expert Eugene Steurele and Congressional Research Service tax analyst Jane Gravelle recently testified that the investment tax allowance will have little stimulative effect. Gravelle also noted that the homebuyer credit is unlikely to provide much incentive for new construction. Statements of C. Eugene Steurele and J. ne G. Gravelle before the House Budget Committee, February 11, 1992.

The Administration's budget, however, appears to increase rather than reduce deficits over the long term. The budget is likely to swell long-term deficits because various tax cuts it proposes are financed in whole or in part by gimmicks. (The budget would also make it likely that needed public investments would decline, due to its proposed five-year freeze on funding for domestic non-entitlement programs; the domestic non-entitlement component of the budget is the part of the budget from which most of the public investments for which economists are calling must be financed.)

For example, the Administration uses highly implausible assumptions to generate an estimate that cutting the capital gains tax would increase federal revenues by $6.9 billion through the end of fiscal year 1997. In contrast, the Joint Tax Committee estimates the proposal would result in a loss of $15.4 billion over this period. Research by Congressional Research Service tax expert Jane Gravelle and Brookings Institution economist Henry Aaron suggests that even the Joint Tax Committee estimates are optimistic and that the actual revenue loss could well be substantially larger.[14]

This issue takes on added importance because the Administration has used the savings it assumes from the capital gains cut to "pay for" some of the other tax cuts it is proposing. Since a capital gains cut is likely to lose significant sums over the long run, neither the capital gains cut nor some of the other tax proposals in the budget are adequately financed.

Also troubling are the gimmicks used to mask the full costs of the Administration's proposal to create "flexible IRA accounts." Under the Tax Reform Act of 1986, families with incomes above $50,000 who have access to an employer-sponsored pension plan can no longer take tax deductions for contributions to IRA accounts. The Administration's budget would restore substantial IRA tax preferences for families in the $50,000 to $120,000 income range. But the budget employs two devices to make its IRA provision appear to have little cost.

First, rather than making taxpayers in this income range eligible for regular IRA tax deductions, the budget makes them eligible for a new type of IRA that analysts term a "back-loaded" IRA. Under a regular IRA, taxpayers receive deductions of up to $2,000 per year when they deposit funds in IRA accounts. Taxpayers pay tax on the principal and interest in the account when they withdraw

[14] See Jane G. Gravelle, "Can a Capital Gains Tax Cut Pay for Itself?," Congressional Research Service, March 1990; Statement of Jane G. Gravelle before the House Budget Committee, February 11, 1992; and Henry Aaron, "Proposals to Exclude a Part of the Capital Gains from Taxable Income," March 28, 1990. Aaron has suggested that the Joint Tax Committee estimates be considered a "lower bound" of the possible revenue losses that capital gains tax cuts would generate.

funds upon reaching retirement age. By contrast, under a back-loaded IRA, there is no upfront deduction. If taxpayers leave the funds in the account at least seven years, withdrawals are tax-free. The interest earned by the account is never subject to taxation.

Over a long period of time, these two types of IRAs entail similar costs to the Treasury. But the *timing* of the costs differs. Back-loaded IRAs have very little cost in their early years because there is no upfront $2,000 tax deduction. As the years pass, they grow increasingly costly, as the interest earned on an increasing share of personal savings in the United States is exempt from taxation.

Knowledgeable Congressional staff report that the back-loaded IRA concept was developed several years ago as a way to restore IRA tax breaks for people with incomes above $50,000 while partially evading the budget rules that require tax cuts to be "paid for." The budget rules stipulate that the cost *over the next five years* of any tax cut must be "paid for" through offsetting tax increases or entitlement reductions. Use of the back-loaded IRA approach keeps the cost of the IRA tax break low during the next five years, thus making it easier to finance this tax break. But the back-loaded approach makes IRA costs much larger after the five-year budget period ends. A CBO analysis last year indicated the eventual five-year cost of a back-loaded IRA like that proposed by the Administration could be as much as *eight times* its cost in its first five years. Similarly, a Congressional Research Service analysis indicates the eventual five-year cost would ...ely be *ten times* its cost in the first five years.[15]

The budget also makes use of a second IRA gimmick that magnifies the budgetary sleight-of-hand. The budget would permit taxpayers who have existing IRA accounts (from which they currently cannot withdraw funds without a penalty) to withdraw these funds penalty-free during 1992, pay tax on the withdrawal, and roll over the funds into new, back-loaded IRA accounts on which all future interest earnings would be tax-free. This would produce a one-time infusion of tax revenue

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[15] CBO and the Joint Tax Committee estimated last year that the Administration's flexible IRA proposal would cost $5.2 billion over the first five years. CBO also noted that the cost could ultimately reach a level as large as $8 billion a year in fiscal year 1991 dollars, or $40 billion over a five-year period. Congressional Research Service tax analyst Jane Gravelle has estimated the ultimate cost would be $10 billion a year and $50 billion over five years. Congressional Budget Office, *An Analysis of the President's Budgetary Proposals for Fiscal Year 1992*, March 1991, pp. 41-43; Statement of Jane G. Gravelle before the House Budget Committee, February 11, 1992.

The Joint Tax Committee estimates of the Administration's new proposal for flexible IRAs shows it would have a lower cost — $0.6 billion — over the next five years. This is because the new proposal contains a provision allowing taxpayers to cash in existing IRA accounts during 1992, pay taxes on the funds withdrawn, and roll over the deposits into new back-loaded IRAs. This produces a one-time infusion of revenue, which reduces the cost of the flexible IRA provision in the first five years. But it makes the cost of flexible IRAs even larger in later years.

Budget Committee Republican Staff Issues Report Analyzing Tax Incentives, Growth, and Deficit Reduction

In November 1991, the minority staff of the House Budget Committee issued a paper entitled *Tax Incentives, Growth, and Deficit Reduction.*[*] The paper cogently presents findings from an extensive body of economic research on whether tax incentives such as capital gains tax cuts, IRA expansions, and investment tax credits spur economic growth.

The paper assesses the potential of these tax incentives to stimulate recovery from the current economic slowdown and to promote long-term economic growth. It concludes that these tax incentives would likely fail to accomplish either goal — and could make matters worse on both fronts. The paper notes: "...to get an economy out of a recession, policy must increase demand [for goods and services]," i.e., it must increase consumption. But if IRAs and cuts in the capital gains tax are effective tools for boosting savings, "they will actually slow recovery from recession because they reduce consumption..."

The paper emphasizes that "many incentives designed to promote long-term economic growth...do not revive sluggish economic activity in the short run. Indeed, they sometimes do the opposite."

The paper also finds that proposals to expand IRAs, cut capital gains taxes, and the like are more likely to *reduce* long-term growth than to accelerate it.

> "Whether aimed at increasing efficiency or growth, many 'growth enhancements' backfire. This is due to two factors. First, few incentives are very powerful. They simply do not result in huge increases in output....Sadly, most evidence suggests that saving is unresponsive to any tax incentive designed to increase it....Even the most optimistic estimates of the responsiveness of saving to taxes are too low to support the arguments that such incentives significantly boost saving and growth.
>
> "Worse, by losing revenue, many tax incentives would slow growth. The government's additional borrowing demands would use up saving that could be made available for private investment. Thus many 'growth enhancements' would actually do just the opposite of what they are intended to do: they would reduce growth through their effects on the deficit."

The paper concludes that "because of the effect of government borrowing on investment, there is no tax incentive that promotes growth as effectively as deficit reduction."

In a second paper examining IRAs, the House Budget Committee minority staff concludes "IRAs are likely to slow long-term economic growth through their effects on the deficit....To increase the amount of saving available for investment, IRAs would need to generate more than one dollar of private savings for each dollar of lost tax revenue. Otherwise, all of any increased private saving will be absorbed by a larger Federal deficit....There are no credible estimates of the effect of IRAs on saving that suggest that the saving effect can outweigh the deficit effect." The paper also notes that most middle-income taxpayers already qualify for IRA tax deductions and that proposals to expand IRAs "primarily benefit upper income taxpayers."[**]

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[*] *Tax Incentives, Growth, and Deficit Reduction*, House Committee on the Budget, Republican Staff Report, Nov. 6, 1991. An excellent discussion of these issues also appears in the "Tax Policy Goals and Choices" section of a recent House Budget Committee Majority Staff report, "Summary and Update on Congressional Budget Actions," November 25, 1991.

[**] *The Truth About IRAs*, House Committee on the Budget, Republican Staff Report, November 22, 1991. For a further discussion of IRAs, see two Center on Budget and Policy Priorities papers, *The New IRA Proposals*, June 1991, and *The Bentsen Tax Plan*, November 1991.

as ndividuals pay taxes on old IRA accounts they are rolling over. The budget uses this revenue to make the cost of the IRA tax break appear even lower over the next five years.

The tax dollars collected when these old IRA accounts are cashed in, however, *do not represent additional revenues for the government.* These are funds the government would have collected in subsequent years, anyway, when taxpayers withdrew funds from their IRA accounts as they reached retirement age. In essence, this device shifts revenues from outside the five-year budget period into the five-year period.

As a consequence, the Administration's IRA budget devices produce substantial revenue shortfalls after the five-year budget period ends. At that time, the cost of the back-loaded IRA tax break grows substantially. In addition, the one-time infusion of offsetting revenues is no longer available to offset mounting IRA costs. Finally, a substantial amount of revenues that would otherwise be collected as taxpayers reach retirement age is gone, having been collected in the early 1990s instead. The result is a revenue hemorrhage.

In short, the use of implausible assumptions that a capital gains tax cut saves money, along with IRA gimmicks that mask the full cost of the Administration's IRA proposal and shove billions of dollars in IRA costs outside the five-year budget period (while moving billions in revenue inside the five-year window), make it a near certainty the budget would increase the deficit over the long run. As a result, the budget may do more to hinder long-term growth than to increase it. (A further discussion of why the Administration's tax proposals are likely to retard growth is found in a recent *New York Times* editorial, "These Tax Cuts Stunt Growth." The editorial, which ran January 28, 1992, is reprinted at the back of this report.)

V. How Low-Income Programs Fare

The White House has touted the increases it has proposed in a number of low-income programs, such as the Head Start program and HOPE grants, which are designed to help low-income households become homeowners. The increases in these and several other low income programs are substantial.

But the budget's treatment of low-income programs is mixed. While increasing some programs, it cuts others. Some of the reductions are deep.

Low-Income Non-Entitlement Programs

For example, the appropriation for the low income energy assistance program would be cut $435 million below its fiscal year 1992 level (or $483 million below the level needed to keep pace with inflation). The HOME program, which provides block grant funds to state and local governments and non-profit organizations to address low-income housing needs, would be cut $800 million below the fiscal year 1992 level (or $848 million below the level needed to keep pace with inflation). The Community Development Block Grant would be reduced $500 million below the fiscal year 1992 level. (This would be $609 million below the level needed to keep pace with inflation.) The Community Service Block Grant, funded at a $437 million level this year, would be abolished. The box on the next page lists some of the major increases and decreases proposed in low-income non-entitlement programs.

When *all* low-income non-entitlement programs are considered as a group, the budget is found to reduce total appropriations for these programs in fiscal year 1993

Table II
Major Changes Proposed in Appropriations for Low-Income Non-Entitlement Programs

Major Increases
(in millions of dollars)

Program	Proposed Level for FY 1993	Increase over FY 1992 Level	Increase over FY 1993 Baseline	Percentage Increase over Baseline
Financial Aid for Needy Students	$7,693	$808	$601	8.5%
HOPE housing grants	1,010	649	637	170.8%
Head Start	2,802	600	530	23.3%
WIC	2,840	240	157	5.9%
Healthy Start	143	79	77	115.9%
Infant Mortality Initiative	143	78	76	113.2%
Community Health Centers	579	75	59	11.3%
Child Immunizations	344	51	41	13.5%

Major Decreases
(in millions of dollars)

Program	Proposed Level for FY 1993	Decrease from FY 1992 Level	Decrease from FY 1993 Baseline	Percent Decrease from Baseline
HOME housing grants	$700	-$800	-$848	-54.8%
Community Devel. Block Grant	2,900	-500	-609	-17.4%
Low income energy assistance	1,065	-435	-483	-31.2%
Community Services Block Grant	5	-432	-446	-98.9%
Refugee assistance	227	-184	-197	-46.5%
Public Housing operating subsidies	2,282	-168	-246	-9.7%
Low income weatherization	40	-154	-160	-80.0%
Older Americans Employment	343	-52	-65	-15.9%
Indian health	1,384	-51	-112	-7.5%

by $1.5 billion — or 2.6 percent — below the level needed to keep pace with inflation.[16] (See the tables at the end of this report for a comprehensive listing of the funding levels proposed for a wide array of low-income programs.)

In addition, in some of the programs for which increases are proposed in fiscal year 1993, the budget envisions a freeze — with no adjustment for inflation — for the following four years. As a result, some or all of the fiscal year 1993 increase is eroded over time.

[16] The Congressional Budget Office baseline for FY 1993 was used to determine the funding levels needed to keep pace with inflation. CBO assumes an inflation rate of 3.2 percent.

For example, the budget proposes to increase fiscal year 1993 funding for the WIC program (the Special Supplemental Food Program for Women, Infants, and Children) by $240 million over the fiscal year 1992 level, or $157 million above the level needed to keep pace with inflation. But WIC funding would be frozen after that. By fiscal year 1995, the number of women, infants, and children served through WIC would be *lower* than the number served in fiscal year 1992.

Low-Income Entitlements

The budget also includes several modest changes in low-income entitlement programs, along with one large change. The modest changes (in budgetary terms) come in the child support enforcement, AFDC, food stamp, Medicaid, and SSI programs. The larger change occurs in State Legalization Impact Assistance Grants. Changes would also be made in child nutrition programs.

In the child support area, the budget proposes to restructure and reduce federal incentive payments made to states for the operation of their child support programs. The budget also proposes to revise procedures for charging fees to non-AFDC families that use the child support system in order to increase the amount of fees collected. OMB estimates these two changes would save the federal government $134 million in fiscal year 1993.

Three changes are proposed in AFDC. States would be given the option to raise the program's asset limit to $10,000 for families already on the rolls so these families could accumulate savings they could use to achieve self-sufficiency. Only a small number of families would be affected. The current $1,000 assets limit would remain in effect for families applying for AFDC.

In addition, to help promote self-employment, states could opt to exclude income and resources that a family needs for a self-employment venture if the family has an approved self-employment plan.

These two liberalizations would be accompanied, however, by a cut in AFDC emergency assistance. A family's eligibility for emergency assistance would be limited to one 30-day period every 12 months.[17] This change would save $39 million in fiscal year 1993 and $203 million over the next five years. The two AFDC

[17] To help prevent evictions and utility shut-offs, use of emergency assistance funds would be permitted to pay up to three months of past-due bills.

What About Enterprise Zones?

The budget proposes to create up to 50 "enterprise zones." The capital gains tax would be abolished and other tax breaks would be conferred on profits from investments in businesses located in these zones. Workers employed in businesses in the zones who earn less than $20,000 would qualify for a refundable tax credit of up to about $500. The Administration claims its enterprise zone proposal would be of great help in reducing poverty in blighted inner-city areas.

The research data, however, suggest otherwise. In an extensive examination of the research literature on state enterprise zone programs, the Urban Institute reported in 1989: "...extensive evaluations of state enterprise zone programs have found no evidence that incentives have contributed to employment or investment growth in designated areas."

The Urban Institute study also found that "most proposed enterprise zone incentives are poorly targeted on the poor. Few of the tax benefits in the leading proposals accrue directly to the disadvantaged residents of enterprise zones. Instead much of it goes to reward businesses for behavior that will not necessarily benefit the poor."

The study examined the Bush Administration's proposal for 50 enterprise zones, a proposal the Administration submits each year. The Urban Institute estimated that even if the proposal were a complete success by the Administration's standards — an outcome the Institute considered quite unlikely — it would affect at most 1.5 percent of the U.S. poverty population. The Urban Institute study concluded that the federal resources expended to provide these generous tax subsidies in the 50 enterprise zones could better be spent expanding effective programs for low-income children. The Administration's budget shows its enterprise zone program would lose $1.8 billion in revenues over the next five years.

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* Bret C. Birdsong, *Federal Enterprise Zones: A Poverty Program for the 1990s?*, The Urban Institute, October, 1989.

liberalizations would add $6 million in costs in fiscal year 1993 and $249 million over the next five years.[18]

In the food stamp program, the Administration has again proposed that single parents cooperate with the child support enforcement program or have their food stamps cut off. This provision would be a state option next year and become mandatory in 1995. When mandatory, it would save about $30 million a year. No savings are assumed for fiscal year 1993.

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[18] These figures include added food stamp and Medicaid costs that would result from the proposed changes in AFDC income and assets rules.

The budget also contains a Medicaid proposal under which states would be required to take action to ensure that the health insurance policies of noncustodial parents provide coverage for their children. This would shift some costs from Medicaid to private health insurance. In SSI, the budget would recover overpayments by establishing procedures to withhold these amounts from Social Security payments.

The largest entitlement change would come in State Legalization Impact Assistance Grants. Under current law, states are slated to receive $1.123 billion of these grant funds in fiscal year 1993. The budget proposes to provide only $300 million in fiscal year 1993, stating that the remainder would be paid in fiscal year 1994.

Finally, the budget repeats last year's proposal to scale back school lunch and breakfast subsidies for meals served to children with incomes above 185 percent of the poverty line — and to use the savings to increase subsidies (and reduce meal prices) for children with incomes between 130 percent and 185 percent of the poverty line. This proposal lacks political support in Congress and is unlikely to attract attention. It is not designed to save money.

The budget also includes a proposal to reduce federal subsidies for meals served in family day care homes, except for homes that institute a means test in their food program. Homes using a means test would continue receiving current subsidy rates for meals served to children with incomes below 185 percent of the poverty line. This proposal represents a cut of $200 million a year.

VI. Adverse Effects on State and Local Governments

Many state and local governments are facing their most severe budget crises in more than a decade. A number of states and localities are cutting basic services and programs important for long-term economic growth, such as education and infrastructure. Many also are cutting sharply into basic benefits for the very poor. A number of prominent economists[19] have recommended a temporary increase in federal support for state and local governments as a way to help stimulate the economy while also increasing rather than reducing investments the economy needs in the long run.

The budget, however, would push states and localities deeper into fiscal distress. It would do this in several ways.

- The single largest revenue-raiser in the budget is a proposed requirement that all state and local government employees become part of the Medicare system and pay the Medicare payroll tax. State and local governments, as employers, would have to pay half this tax. It would take nearly $800 million out of state and local treasuries next year, which would be used to help pay for other tax breaks the Administration is proposing.

  This proposal has considerable merit over the long-term. Instituting it during a recession, however, would intensify state and local budget crises that are already severe in many areas.

- The proposals to cut the capital gains tax, establish an investment tax allowance, expand eligibility for IRA tax breaks, and establish other tax

[19] These include Robert Solow, Francis Bator, James Tobin, Lawrence Summers, Henry Aaron, and John Kenneth Galbraith, among others.

preferences would reduce state tax revenues. Most states that have an income tax tie their definition of taxable income to the definition used in the federal income tax code. Thus, if a form of income becomes fully or partially exempt from taxation at the federal level, it becomes exempt in many states as well. If, for example, a portion of capital gains income is excluded from the federal income tax, this also causes it to be excluded from state income tax in a number of states. States could lose more than $1 billion in revenue for 1992, and larger amounts in subsequent years, as a result of the tax preferences included in the budget. (This issue is discussed in more detail in Appendix A.)

- State and local governments could be forced to pay higher interest rates on bonds they issue. The Administration's proposal for flexible IRA accounts would create a new mechanism through which individuals could build accounts that earned tax-free interest. As the amount of funds in these accounts accumulated over time, these accounts could compete with tax-free state and municipal bonds, forcing states to pay higher rates of interest to attract sufficient investment.

- Finally, various grant programs to state and local governments would be cut. For example, the HOME program, the new block grant program providing funds to state and local governments for efforts to reduce low-income housing shortages, would be sliced more than 50 percent, from $1.5 billion to $700 million. The Community Services Block Grant, which operates through states and helps support many local agencies, would be terminated. The Community Development Block Grant, an important funding source for many cities, would be cut $500 million below last year's level. In addition, as noted in the previous chapter, federal incentive payments to state child support programs would be reduced, while federal matching funds for certain emergency assistance payments to AFDC families would be terminated. State Legalization Impact Assistance Grants for FY 1993 would also be cut.

VII. Changes in Budget Procedures: Entitlement Caps and the Use of Defense Savings to Pay for Tax Cuts

The Administration's budget proposes a major change in federal budget procedures — the establishment of an annual cap on entitlement spending. The budget also opens the door to a change in budget rules to allow defense savings to be used to pay for tax cuts.

The Administration's entitlement proposal raises serious equity issues, while the use of defense savings to pay for tax cuts would likely have adverse effects on long-term economic growth and make deep cuts in domestic programs virtually inevitable.

The Entitlement Cap

The Administration proposes to place annual caps on total entitlement spending. The caps would be set significantly below the levels that entitlement spending would reach under current law.[20]

A projection that total entitlement spending for the coming fiscal year would exceed that year's cap would trigger the budget reconciliation process. Congressional committees with jurisdiction over entitlement programs would be required to cut these programs by a large enough amount to bring total entitlement spending within the cap. If Congress failed to pass such reconciliation legislation (or if Congress passed legislation but OMB ruled that it did not reduce entitlement costs enough to

[20] Legislation including the Administration's proposal to establish an annual cap on total entitlement spending was introduced February 4, 1992 by House minority leader Robert Michel. The entitlement cap proposal is Title XLVI of the bill, H.R. 4150.

comply with the cap), an automatic sequester — or across-the-board cut — of entitlement programs would occur.

Only Social Security, unemployment insurance, and certain credit programs would be exempt from such a sequester. Low-income entitlements — AFDC, SSI, food stamps, Medicaid, and child nutrition programs — would be fully subject to sequestration, as would Medicare, veterans programs, and federal retirement programs. (These programs are fully or partially exempt from sequesters that are triggered under the Gramm-Rudman-Hollings law when deficit targets are missed, but would *not* be exempt from the new, separate sequester triggered if the entitlement cap is exceeded.)

The Administration proposes that the entitlement cap for each year be set at a level equal to actual entitlement spending in the previous year, with two adjustments. One adjustment would reflect increases in the population eligible for entitlements. The other adjustment would equal the most recent annual increase in the Consumer Price Index plus 2.5 percent. After enactment of health care reform legislation, the second adjustment would be reduced to the increase in the Consumer Price Index plus 1.6 percent.

While growing entitlement costs pose a serious problem, the Administration's proposal has major flaws. Entitlement spending is currently growing at a rapid rate for one overriding reason — the costs of health care entitlements are growing dramatically. In its new report on the budget and the economy, the Congressional Budget Office reports that "non-Social Security entitlement spending could balloon from 7.2 percent of GDP in 1992 to 8.9 percent of GDP by 2002 under current policies. [GDP stands for the Gross Domestic Product, the basic measure of the size of the economy.] All of this growth is concentrated in Medicare and Medicaid, which are propelled by the rapid rise in the cost and use of medical care."[21]

Medicare and Medicaid costs are rising sharply primarily because health care costs in the U.S. are exploding. The CBO study notes that public and private health care spending accounted for seven percent of GDP in 1970, rose to about 12 percent of GDP by 1990 and is projected to exceed 16 percent of GDP by the year 2000. Just between 1980 and 1990, CBO noted, health care costs per person rose 54 percent, after adjustment for inflation.

These soaring health care costs have led to stunning increases in federal health care entitlements. CBO reports that federal expenditures for Medicare, Medicaid, and smaller health benefit programs (such as the veterans' health care program and

[21] Congressional Budget Office, *The Economic and Budget Outlook: Fiscal Years 1993-1997*, January 1992, p. 58.

health insurance for federal employees) accounted for seven percent of the federal budget in 1970. By 1980, they made up more than 10 percent of the budget, and in 1990, they comprised 13.5 percent. CBO projects these programs will consume 22 percent of the budget by 1997 and 28 percent by 2002. CBO notes that these sharp cost increases are not limited to government health care programs; private health care spending has risen almost as fast.

In contrast, the cost of most other non-Social Security entitlement programs is not rapidly rising. Some entitlements grow sharply during recessions, but then decline during period of economic growth. Nor do the increasing costs of Social Security represent a budget problem; Social Security revenues are rising along with these costs and fully cover the costs. The Social Security trust fund is projected by the Social Security actuaries to be in balance for the next 50 years.

In short, the problem of rapidly rising entitlement costs is essentially a problem of spiralling health care costs. Rather than advancing tough cost containment proposals to constrain health care expenditures, however, the Administration would establish an arbitrary entitlement cap that could lead to large cuts in other entitlements whose costs are relatively stable

This procedure raises significant equity issues. There is a strong risk that if there is a requirement to reduce overall entitlement costs — and various entitlement programs are consequently pitted against each other — the programs with the weakest constituencies could lose. This could place in jeopardy some entitlements targeted on the poor that provide basic benefits to enable poor families and elderly and disabled people to eat, pay rent, or meet other necessities. This is one of many reasons that tough health care cost containment measures are far superior to an arbitrary entitlement cap.

Moreover, if the entitlement cap were exceeded in a given year and a sequester occurred, basic benefits in entitlement programs for the poor would be reduced. As noted, the Administration's entitlement cap proposal declines to exempt such programs from sequestration.

The proposed entitlement cap poses other problems, as well. For example, it contains no adjustment to cover the cost increases in low-income entitlements if the poor become poorer over time and qualify for larger benefits, something that has been occurring in recent years. The lack of such an adjustment could be particularly troublesome during a recession. During economic downturns, wages and work hours fall, further reducing the incomes of the poor.

In addition, no one knows how much to adjust an entitlement cap to reflect increases in the number of people qualifying for entitlement benefits during a recession. Past projections of caseload increases that would be caused by a recession have often missed the mark by wide margins. Adjustments of the entitlement cap made during a recession could prove highly inaccurate and could cause benefits to be cut at precisely the time hardship was greatest and the need for economic stimulus strongest.

Similar problems with projections would apply to other entitlements. Unforeseen weather conditions can cause farm price support payments to rise. And states set some of the key eligibility criteria for various entitlements, such as AFDC, Medicaid, and unemployment insurance. Changes in state policies can affect federal costs.

Another serious problem with the proposal is that it apparently would not allow use of a revenue increase as an alternative to a reduction in an entitlement program. Under the "pay-as-you-go" provisions of the current budget law, either a tax increase or an entitlement cut can be used to satisfy various budget requirements so long as both types of measures have an equivalent effect on the deficit. Under the Administration's entitlement cap proposal, however, this apparently would not be allowed.

Thus, if entitlement spending exceeded the cap by $10 billion in a given year and a $10 billion tax increase could be enacted, the tax increase would not count — even if it consisted of a reduction in tax expenditures for the health care costs of upper-income households. Only reductions in entitlement outlays could be used to satisfy the requirements to remain within the entitlement cap.[22]

As a result, the proposal would be likely to favor the wealthy. Entitlement programs provide a much larger share of the income of low- and middle-income households than of the wealthy. The principal source of government subsidies for upper-income households is not entitlements but various tax expenditure provisions in the Internal Revenue Code (what a recent *Washington Post* editorial termed "tax entitlements"). Many upper-income households receive tens of thousands of dollars in tax subsidies each year.

Moreover, rising tax expenditure costs pose a serious fiscal problem, themselves. For example, tax expenditures for housing rose 96 percent between 1980 and 1990, after adjustment for inflation. Tax expenditures for health care costs are

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[22] It is unclear whether, under the Administration's proposal, reducing entitlement benefits by subjecting a portion of them to taxation would count toward meeting the entitlement cap. The most efficient way to trim Social Security or Medicare benefits for well-off beneficiaries would be to increase the portion of Social Security benefits subject to taxation or to treat a portion of Medicare benefits as taxable income for those above specified income levels. Because such actions would raise revenues rather than reducing entitlement outlays, however, they might not count under the Administration's proposal.

also large and swelling rapidly. The tax expenditure for employer contributions to health insurance premiums now equals $43 billion a year.

Yet the Administration's budget contains no proposals to constrain the growth of tax expenditures. To the contrary, the budget would result in the largest increase in tax expenditures since the 1981 tax act.

In short, the proposed entitlement cap is both arbitrary and crude. It could have adverse side-effects, and it would likely have a regressive impact. An entitlement cap is a poor substitute for vigorous health care reform with a strong cost containment component.[23]

Using Defense Savings to Pay for Tax Cuts

While opposing any change in the budget agreement to enable defense savings to be used for domestic non-entitlement programs, the Administration's budget opens the door to a change in budget rules to permit defense savings to be used to pay for tax cuts.

The Administration proposes to finance a large portion of its tax cuts through a series of entitlement cuts that have met strong bipartisan Congressional opposition in the past. (As noted elsewhere in this report, the Administration also finances some of its tax cuts through savings it claims to get from cutting the capital gains tax, as well as through savings from extending the Medicare payroll tax to all state and local government employees and a number of smaller revenue-raising measures.) It is unlikely Congress will agree to pass enough of these entitlement provisions to cover the costs of the Administration's tax cuts over the next five years.

OMB director Richard Darman has addressed this issue in his introduction to the new budget. Darman states that if Congress is "unwilling to accept fully the President's pay-as-you-go financing of tax initiatives, the President would be prepared to consider modifying the Budget Enforcement Act to allow the projected defense outlay savings to offset the proposed increase in the personal exemption." In other words, the White House is willing to use defense savings to pay for tax cuts.

The use of defense savings to pay for tax cuts would have serious consequences for domestic non-entitlement programs. As noted in Chapter II, the budget ceilings for non-entitlement programs in fiscal years 1994 and 1995 are

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[23] Unfortunately, the Administration's new health care proposals are weak on the cost containment front. In its recent report on the budget and the economy, the Congressional Budget Office notes that "greater control over health spending probably cannot be achieved without significant changes in the health care system..." The Administration's proposals leave the current, inefficient system largely intact.

Polls Show Support for Using Defense Savings for Domestic Needs, Not for Tax Cuts

A *New York Times* poll conducted January 22-25 shows strong public support for using defense savings for domestic needs — and little support for using these savings to finance tax cuts.

The poll asked: "If the U.S. saves a lot of money on defense spending in the next few years, what should most of the money be used for?" Those polled were given three possible answers from which to choose: reducing the deficit, domestic needs, and tax cuts.

Some 72 percent of Americans said the savings should go to domestic needs. Fourteen percent said the savings should be applied to deficit reduction. Only eight percent said the savings should be used for tax cuts.

These findings held for Republicans, Democrats, and independents alike. Some 64 percent of Republicans, for example, said the savings should be used for domestic needs, with 21 percent favoring their use for deficit reduction. Only 11 percent of Republicans said the savings should be used to finance tax cuts

Another nationwide poll, conducted last fall by the Times Mirror Center for the People and the Press, found similar results. In this poll, those surveyed were asked: "If it turns out that less money will be spent on defense than in the past because of reduced tension between the U.S. and the Soviet Union, which ONE of the following should we do with the money we save on defense?" The possible answers were: "use it for a tax cut"; "use it to reduce the budget deficit"; "use it for increased spending on domestic problems such as health, education, and the environment"; and "don't know."

Some 61 percent of those polled said the money should be used for domestic problems, while 27 percent said it should go to reduce the deficit. Only 10 percent said the savings should be used for a tax cut.

extremely tight. Major reductions in domestic programs can be averted only if substantially deeper defense reductions are made than the President has proposed — and these savings are used to bring total non-entitlement spending within the non-entitlement ceiling. If defense savings are used to finance tax cuts instead, then it will be impossible to meet the spending ceilings without large domestic cuts. (Darman has made clear that each dollar in defense savings used to pay for tax cuts must trigger a dollar reduction in the overall budget ceiling for non-entitlement programs. With some or all of the politically feasible defense reductions used to pay for tax cuts, this would draw the noose tighter around domestic programs.)

Adverse Economic Effects

Use of defense savings to pay for an increase in the personal exemption or other tax cuts would also be likely to have adverse effects on long-term economic growth. Most economists believe the two most important steps the nation can take to foster long-term growth are reducing the deficit (and thereby increasing the pool of capital available for private investment) and increasing public investments in programs that can raise productivity such as education, training, effective children's programs, infrastructure, and research and development. The needs are large in both the deficit reduction area and the public investment area, and the one major source of potential financing to help meet these needs appears to be defense savings. The level of defense savings likely to be realized in coming years is almost certain to be insufficient fully to meet the needs for both deficit reduction and public investment.

If defense savings are siphoned off to pay for tax cuts instead, this problem will intensify. The deficit will remain at a higher level — and public investment will be lower — than would otherwise be the case. That would work counter to efforts to promote long-term economic growth.

VIII. The Administration's Block Grant Proposal

As it did last year, the Administration has proposed merging a large number of domestic programs into one large block grant to states. Some 24 programs would be consolidated in this fashion. These programs, whose expenditures will total $14 billion in fiscal year 1992, would end as federal programs. States could use their shares of the block grant funds as they saw fit.

Nearly two-thirds of the funds to be included in the block grant are funds now used in low-income programs. Some $9 billion of the $14.1 billion in funds slated for inclusion in the block grant — 64 percent of the total — are in low-income programs.

Among the low-income programs that would be merged into this mega-block grant are two smaller block grant programs that spend a substantial portion of their funds on low-income households: the social services block grant and the maternal and child health block grant. Three small programs for the homeless would also be included: education for homeless youth; literacy training for the homeless; and job training for the homeless. Another low-income program slated for inclusion in the block grant is the community service employment program for older Americans.

Merging low-income programs into such a block grant would carry risks for the poor. Historically, low-income people have constituted a weaker political constituency at the state level than at the federal level. Some state governments, faced with fiscal problems and seeking funds to maintain programs for more powerful constituencies, could decide to use some of their block grant funds for such purposes. That could diminish services for low-income families and individuals. The events of 1991, when a number of states instituted deep cuts in programs for the poor, indicate this risk is quite real.[24]

The proposed block grant would also include the federal matching funds currently provided to states to defray a portion of state administrative costs in operating AFDC, Medicaid, and the food stamp program. This poses additional problems.

Federal matching funds for state administrative costs in these programs are now provided on an entitlement basis. The federal government pays 50 percent of a state's costs in administering these programs (and higher percentages of state costs for certain activities such as the development of new computer systems and some anti-fraud efforts). Under the block grant proposal, the entitlement status of these funds would end. These three funding streams would be replaced by the block grant, which would apparently be a non-entitlement program for which funding levels are subject to the annual appropriations process.

Converting AFDC, food stamps, and Medicaid administrative funds into a block grant is not a new idea. The Reagan Administration repeatedly proposed various versions of this idea in the 1980s. Those proposals were consistently rejected as ill-advised. For example, if the economy turned down in a particular state and more people came on to program rolls, the state would have to foot 100 percent of the additional administrative costs to serve the additional caseload — since block grant funding would be fixed. This increased fiscal burden would come at a time when the state's revenues were contracting and its fiscal difficulties mounting due to the economic downturn. It would be extremely difficult for a state to fund 100 percent of the additional administrative costs in such circumstances.

In addition, merging the federal matching funds for AFDC, food stamp, and Medicaid administrative costs into a block grant would be likely to lead to a misallocation of funds among the states. In states where the low-income population increased at a significantly faster-than-average rate (either due to demographic changes or to a weakening of the economies in these states), there might not be enough block grant funds to cover rising administrative costs in AFDC, food stamps, and Medicaid. Meanwhile, other states whose economies were growing at a more robust rate might receive overly generous support.

Still another problem with the Administration's proposal lies in the tendency for block grants to have their federal funding erode over time. In the competition for federal funds, programs with defined purposes and specific constituencies generally

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[24] See Isaac Shapiro, Steven D. Gold, Mark Sheft, Julie Strawn, Laura Summer, and Robert Greenstein, *The States and the Poor: How Budget Decisions in 1991 Affected Low Income People*, Center on Budget and Policy Priorities and Center for the Study of the States, December 1991.

have fared better than programs that dispense funds to state or local governments to do with as they choose. The erosion in funding for the social services block grant and community development block grant is an illustration of this phenomenon.

Indeed, the Administration itself envisions an erosion in block grant funding starting in fiscal year 1994. The budget proposes $14.7 billion in appropriations for the block grant in fiscal year 1993, but just $14.2 billion in fiscal year 1995. In fiscal year 1997, the funding level would be $14.6 billion. This would represent a reduction of more than $2 billion between fiscal year 1993 and fiscal year 1997 — or 13 percent — after adjustment for inflation.

Finally, the proposal ignores some key principles regarding the realignment of federal and state roles that many experts and blue-ribbon commissions have sought to establish over the years. Commissions like the bipartisan Commission on Federalism and the National Purpose, which issued a report in 1985, have called for an increased federal role in financing AFDC and Medicaid as an accompaniment to the devolution of some federal grant programs to the states. The Administration's new block grant proposal moves in the opposite direction on AFDC and Medicaid, however, by reducing federal fiscal participation in these programs.

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Appendix A
Tax Proposals in President's Budget: Their Impact on the States

The budget contains several tax proposals that would, if enacted, affect state as well as federal revenues. States could lose over $1 billion in 1992, and more in subsequent years, as a direct result of these provisions.

States already face mid-year budget gaps of some $8 billion and additional gaps of at least $12 billion for the fiscal year that will begin in mid-1992. They can ill afford another blow to their revenue bases. Various noted economists, such as Robert Solow and John Kenneth Galbraith, have warned that the spending cuts and tax increases necessary to close current state and local fiscal gaps are placing a drag on the national economy. Unfortunately, however, various tax proposals in the President's budget — the investment tax allowance, the capital gains rate cut, and the passive loss deduction, among others — would exacerbate state fiscal problems.

The *investment tax allowance* would provide an additional depreciation allowance of 15 percent of the purchase price of any new equipment acquired during the remainder of 1992 if the equipment is placed in service before mid-1993. The budget puts the federal revenue loss from this provision at $6.1 billion in fiscal year 1992, a figure with which the Joint Tax Committee concurs.

Most states use federal depreciation allowances in the calculation of their state corporate income taxes and would automatically provide this allowance in their tax structures if it is adopted at the federal level. State corporate tax rates range from about five percent to about 12 percent, with the larger, industrial states tending to have rates in the higher range. Assuming that state corporate tax rates average seven

This appendix was prepared by Iris J. Lav, director of state and local programs for the Center on Budget and Policy Priorities.

percent, or about one-fifth of the federal rate, the 45 states with corporate taxes based on net income could lose $1.25 billion this year.

The revenue loss from this provision is temporary. The additional depreciation taken in the first year under the proposed Investment Tax Allowance would be offset by lower depreciation taken in subsequent years over the life of the asset. The Administration's budget shows this provision losing $7.7 billion in the first two years, then recouping $5.8 billion over the next four years. (Here, too, the Joint Tax Committee estimates are nearly identical.) For states, however, the revenue loss could not come at a worse time; to accommodate this revenue loss now, on top of current deficits, would require significant program cuts or tax increases.

The *capital gains tax reduction* proposed in the budget would reduce the effective tax rate on capital gains for most taxpayers from 28 percent to 15.4 percent. Taxpayers subject to the alternative minimum tax would pay a somewhat higher rate. The reduction operates by excluding a portion of the gain from the definition of gross income. During 1992, some 45 percent of the gain from sale of any asset that has been held more than one year would be excluded from taxation. The Administration's budget shows this provision as increasing federal revenues $600 million in fiscal year 1992, some $3.8 billion in fiscal year 1993, and lesser amounts each year through fiscal year 1996. The budget admits to a slight revenue loss in fiscal year 1997. The Joint Tax Committee's analysis of the President's proposals shows similar revenue gains in the first two years, but revenue losses totalling $19.9 billion over the subsequent four years, for a net loss of $15.4 billion through fiscal year 1997.

The concept of a capital gains tax cut producing *increased* revenues rests on certain assumptions. If 45 percent of capital gains income is excluded from taxation, total capital gains income would have to increase more than 82 percent for the government to break even. The estimate that a capital gains tax cut would increase revenues rests on the assumption that so many additional assets would be sold that the federal government would initially collect more revenues with the tax cut than without it. The revenue estimate for 1993 appears to assume a 120 percent increase in capital gains realizations that year.

The anticipation of such a robust increase in realizations is probably predicated on the experience of 1986. Taxpayers had a "window" from August through December of that year to sell assets, after which the capital gains rate rose permanently as a result of the 1986 Tax Reform Act. Consequently, some asset sales that would have occurred at a later time were accelerated into 1986. In that short "window," taxpayers sold so many assets that the amount of capital gains realized for the year was double the normal amount. After that doubling in 1986, capital gains realizations fell by 60 percent in 1987 and did not recover even to their 1985 level until 1988.

A number of researchers, including Henry Aaron, one of the nation's leading tax experts and the director of economic studies at the Brookings Institution, and Congressional Research Service tax expert Jane Gravelle, have found that a doubling of realizations is unlikely to be sustainable over a number of years. The administration's contention that its capital gains cut would result in yearly revenue gains through 1996 is not supported by the available evidence. The 45 percent exclusion is very likely to lose federal revenues, if not in the first or second year, certainly in subsequent years as the Joint Tax Committee forecasts. When it does, states will lose revenues as well.

Of the 42 states and the District of Columbia that levy a broad-based income tax, 37 use the federal definition of adjusted gross income. Twenty of these states would automatically incorporate the 45 percent capital gains exclusion, while another 13 or 14 states would likely do so through their custom of enacting conformity to each year's federal tax code.

There are three ways states may be hurt by the federal capital gains tax cut. If, as the Joint Tax Committee projects, nearly $20 billion in federal revenues will be lost between 1994 and 1997, state tax systems could lose roughly $4 billion. Second, that $20 billion federal loss is net of about $5.2 billion in revenue recaptured through the federal alternative minimum tax. Very few states conform to the federal alternative minimum tax, so few states would benefit from this recapture; as a result, there is a potential for a further revenue loss of up to $1 billion, in addition to the $4 billion, in the 1994-1997 period.

There is also a significant risk that capital gains realizations will not increase as rapidly as expected in 1992 or 1993, which would leave states vulnerable to an immediate revenue loss. If there were only a 40 percent increase in realizations in 1993 rather than a more than 80 percent increase, states could lose $1.5 billion.

Reinstituting the *passive loss deduction* for real estate developers will allow real estate losses to offset income or profits from other activities, a loophole closed in the 1986 Tax Reform Act. Both the budget and the Joint Tax Committee estimate a revenue loss from this provision of $100 million in fiscal year 1992 and $400 million in fiscal year 1993. These estimates presume that gains in real estate economic activity will be strong enough to generate increased taxable profits above and beyond the deducted losses. That may or may not occur.

Even if there is a resurgence in activity and profits overall, it is likely to play out differently in various states. Some of the states in which developers have large losses to deduct may well be the same states in which the economy is too weak and unemployment too high to generate demand for new housing. Although difficult to estimate, it is reasonable to expect that some of these states would experience significant revenue losses.

TABLE 1: PROPOSED CHANGES IN LOW INCOME FUNDING, FY 1992 - FY 1993
(Budget Authority, in millions)

	CBO FY 1992 ESTIMATED BA	OMB FY 1993 BASELINE BA 1/	FY 1993 PROPOSED BA	DIFFERENCE FROM BASELINE	PERCENT CHANGE
ENTITLEMENTS AND MANDATORY SPENDING					
AFDC & Child Support 2/	15,901	15,442	15,273	(169)	-1.1%
Child Health Insurance Tax Credit	545	610	610	0	0.0%
Earned Income Tax Credit	6,694	7,894	7,894	0	0.0%
Food Stamps	22,350	28,000	28,002	2	0.0%
Foster Care & Adoption Assistance	2,614	2,989	2,989	0	0.0%
JOBS Training for Welfare Recipients	1,000	1,000	1,000	0	0.0%
Medicaid	68,254	84,500	84,396	(104)	-0.1%
Nutrition Assistance to Puerto Rico	1,013	1,051	1,051	0	0.0%
Social Services Block Grant	2,800	2,800	2,800	0	0.0%
State Legalization Impact Assistance	0	1,123	300	(823)	-73.3%
Supplemental Security Income	17,747	21,340	21,210	(130)	-0.6%
Veterans Pensions	3,734	3,840	3,679	(161)	-4.2%
TOTAL ENTITLEMENTS	142,652	170,589	169,204	(1,385)	-0.8%

DISCRETIONARY LOW INCOME PROGRAMS	CBO FY 1992 ESTIMATED BA	CBO FY 1993 BASELINE BA	FY 1993 PROPOSED BA	DIFFERENCE FROM BASELINE	PERCENT CHANGE
EDUCATION					
Compensatory Education (Chapter 1)	6,707	6,922	6,828	(94)	-1.4%
Education for the Homeless	25	26	25	(1)	-3.1%
Financial Aid for Needy Students	6,885	7,092	7,693	601	8.5%
Head Start	2,202	2,272	2,802	530	23.3%
Higher Education (TRIOS Plus)	385	397	417	20	5.0%
Indian Education (BIA + Educ.)	489	506	518	12	2.4%
TOTAL LOW INCOME EDUCATION	16,693	17,216	18,283	1,067	6.2%
HOUSING					
Emergency Food and Shelter	134	138	100	(38)	-27.5%
Emergency Shelter Grants	73	76	17	(59)	-77.6%
HOPE Housing Grants	361	373	1,010	637	170.8%
HOME Housing Grants	1,500	1,548	700	(848)	-54.8%
Housing Counseling	6	6	4	(2)	-33.3%
Housing Congregate Services	18	18	0	(18)	-100.0%
Public Housing Operating Subsidies	2,450	2,528	2,282	(246)	-9.7%
Public Housing Drug Elimination Grants	165	170	165	(5)	-2.9%
Homeless Facilities (SAFAH)	11	12	0	(12)	-100.0%
RESTORE Grants & Loans 3/	0	0	362	362	NA
Rural Housing Loans	1,014	1,056	967	(89)	-8.4%
Rural Rental Housing Assistance	320	330	270	(60)	-18.2%
Additional Rural Housing Programs 4/	56	57	25	(32)	-56.1%
Rural Housing Vouchers	0	0	140	140	NA
Safe Haven Homeless Housing 5/	0	0	50	50	NA
Section 8 Mod. Rehabilitation, SRO 5/	105	108	0	(108)	-100.0%
Shelter Plus Care Homeless, SRO 6/	73	76	0	(76)	-100.0%
Shelter Plus Care Homeless (202) 6/	37	38	0	(38)	-100.0%
Shelter Plus Care Homeless, Rent Assist 6/	0	0	265	265	NA
Subsidized Housing 7/	7,903	8,328	7,901	(427)	-5.1%
Subsidized Housing Renewals 8/	7,355	7,262	7,262	0	0.0%
Transitional & Supportive Homeless Housing	150	155	204	49	31.6%
TOTAL LOW INCOME HOUSING	21,731	22,279	21,724	(555)	-2.5%

	CBO FY 1992 ESTIMATED BA	CBO FY 1993 BASELINE BA	FY 1993 PROPOSED BA	DIFFERENCE FROM BASELINE	PERCENT CHANGE
NUTRITION					
Commodity Supplemental Food Program	90	93	90	(3)	-3.2%
Food Donations for Low Income Groups	265	274	256	(18)	-6.6%
Emergency Food Assistance Program	165	170	165	(5)	-2.9%
WIC Supplemental Food Program	2,600	2,683	2,840	157	5.9%
TOTAL NUTRITION	3,120	3,220	3,351	131	4.1%
HEALTH					
Community Health Centers	504	520	579	59	11.3%
Family Planning	150	155	155	0	0.1%
Health Care for the Homeless	56	58	68	10	17.5%
Healthy Start	64	66	143	77	115.9%
Homeless Mental Health	36	37	36	(1)	-3.1%
Childhood Immunizations	298	308	349	41	13.5%
Indian Health	1,435	1,496	1,384	(112)	-7.5%
Indian Health Facilities	274	283	271	(12)	-4.2%
Infant Mortality Init. (Perinatal Centers)	65	67	143	76	113.2%
Maternal & Child Health	650	671	674	3	0.5%
Migrant Health Centers	55	57	60	3	5.0%
National Health Service Corps	101	104	120	15	14.7%
TOTAL LOW INCOME HEALTH	3,689	3,822	3,982	160	4.2%
EMPLOYMENT					
Job Training for the Homeless	11	12	17	5	46.8%
Older Americans Employment	395	408	343	(65)	-15.9%
Job Corps	920	949	933	(16)	-1.7%
Summer Youth Employment 9/	683	705	0	(705)	-100.0%
New Youth Training Grants 9/	0	0	1,084	1,084	NA
New Adult Training Grants 9/	0	0	1,145	1,145	NA
JTPA Block Grants 9/	1,779	1,836	0	(1,836)	-100.0%
TOTAL LOW INCOME EMPLOYMENT	3,788	3,910	3,522	(388)	-9.9%
OTHER					
Child Care Block Grant	825	851	850	(1)	-0.1%
Child Welfare Services	274	283	274	(9)	-3.1%
Community Development Block Grant	3,400	3,509	2,900	(609)	-17.4%
Community Services Block Grant	437	451	5	(446)	-98.9%
Legal Services for the Poor	350	361	350	(11)	-3.0%
Low Income Energy Assistance	1,500	1,548	1,065	(483)	-31.2%
Low Income Weatherization	194	200	40	(160)	-80.0%
Refugee Assistance	411	424	227	(197)	-46.5%
Runaway and Homeless Youth	36	37	0	(37)	-100.0%
VISTA	38	39	42	3	7.1%
TOTAL OTHER LOW INCOME DISC.	7,465	7,703	5,753	(1,950)	-25.3%
TOTAL LOW INCOME DISCRETIONARY	56,486	58,150	56,615	(1,535)	-2.6%
TOTAL ENTITLEMENT AND DISCRETIONAR	199,138	228,739	225,819	(2,920)	-1.3%

Note: Numbers may not add due to rounding. A (0) figure indicates a funding reduction of between $1 and $500,000, while a 0 may indicate an increase of less than $500,000.

1/ For low income entitlement programs, current services levels are those shown in the OMB baseline as published in the Budget of the United States Government, FY 1993. For low income discretionary programs, current service levels are those shown in the Congressional Budget Office's current services baseline as of January 1992. The baseline estimates how much funding would be necessary to maintain FY 1992 levels with adjustments for inflation from FY 1992 to FY 1993. CBO estimates that the inflation rate will be 3.2 percent for this period.

2/ Includes funds for child care services for welfare recipients, former welfare recipients, and working families at risk of becoming welfare recipients.

3/ The Administration proposes to create a new program to replace two existing programs to address the problems of troubled HUD-subsidized or assisted multi-family projects with physical, financial, or management problems. The RESTORE program would replace the existing property disposition and loan management programs which had been funded through the subsidized housing account. In FY 1992, these two programs received appropriations of $346 million.

4/ These programs include domestic farm labor housing, mutual and self-help housing, very low income housing repair grants and rural housing preservation grants.

5/ The Administration proposes to end the Section 8 moderate rehabilitation program which funds Single Room Occupancy units for homeless individuals and to replace it with a new Safe Havens program which would provide housing for the homeless mentally ill without requiring such persons to participate in remedial social services.

6/ The Shelter Plus Care SRO and Elderly & Handicapped programs would be consolidated into a single program.

7/ The figures shown here are for net new budget authority for the annual contributions for assisted housing account. The best measure of housing assistance is the number of new households that will receive assistance. The Administration proposes to provide 87,241 additional households with housing assistance, compared to the Administration estimate of 67,500 additional households assisted in FY 1992.

Of the $8.5 billion in funds available for subsidized housing (which includes the $7.9 billion in new budget authority plus some $500 million from funds recaptured from previous years), only $3 billion is directed toward new housing efforts to serve households currently without such housing assistance. The remainder of the subsidized housing account includes some $1.2 billion in appropriations for the preservation of privately owned, but federally subsidized housing projects, $2.3 billion for modernization of public housing units, and other assistance to households or units that are currently subsidized.

The proposed appropriation for public housing modernization is $509 million below the FY 1992 level; no funds are provided for the construction of new public housing units.

8/ The Department of Housing and Urban Development's estimate of the cost of renewing expiring subsidized housing contracts covering Section 8 certificates and vouchers is shown here as the FY 1992 baseline level for this program.

9/ The Administration's budget does not include a detailed accounting of its new Job Training 2000 initiative. Rather, the figures cited here are for the Administration's proposed amendments to the JTPA reauthorization pending before the Congress. These proposals would replace the existing JTPA Block Grant and Summer Youth programs with new adult and youth training programs.

TABLE 2: PROPOSED CHANGES IN LOW INCOME FUNDING, FY 1992 - FY 1993
(Outlays, in millions)

	CBO FY 1992 ESTIMATED OUTLAYS	OMB FY 1993 BASELINE OUTLAYS 1/	FY 1993 PROPOSED OUTLAYS	DIFFERENCE FROM BASELINE	PERCENT CHANGE
ENTITLEMENTS AND MANDATORY SPENDING					
AFDC & Child Support 2/	14,968	15,472	15,303	(169)	-1.1%
Child Health Insurance Tax Credit	545	610	610	0	0.0%
Earned Income Tax Credit	6,694	7,894	7,894	0	0.0%
Food Stamps	21,430	22,696	22,697	1	0.0%
Foster Care & Adoption Assistance	2,563	2,835	2,835	0	0.0%
JOBS Training for Welfare Recipients	630	885	885	0	0.0%
Medicaid	68,254	84,500	84,396	(104)	-0.1%
Nutrition Assistance to Puerto Rico	1,013	1,051	1,051	0	0.0%
Social Services Block Grant	2,800	2,800	2,800	0	0.0%
State Legalization Impact Assistance	505	921	375	(546)	-59.3%
Supplemental Security Income (SSI)	17,861	21,342	21,248	(94)	-0.4%
Veterans Pensions	3,699	3,833	3,672	(161)	-4.2%
TOTAL LOW INCOME ENTITLEMENTS	140,962	164,839	163,766	(1,073)	-0.7%

DISCRETIONARY LOW INCOME PROGRAMS	CBO FY 1992 ESTIMATED OUTLAYS	CBO FY 1993 BASELINE OUTLAYS	FY 1993 PROPOSED OUTLAYS	DIFFERENCE FROM BASELINE	PERCENT CHANGE
EDUCATION					
Compensatory Education (Chapter 1)	6,075	6,639	6,606	(33)	-0.5%
Financial Aid for Needy Students	6,495	6,911	7,161	250	3.6%
Admin. Child. Families Service Progs. 3/	3,499	3,867	4,179	312	8.1%
Higher Education for Needy Students 4/	756	793	810	17	2.1%
Indian Education (BIA &Educ.)	434	496	502	6	1.2%
TOTAL LOW INCOME EDUCATION	17,259	18,706	19,258	552	3.0%
HOUSING					
Emergency Food and Shelter	134	138	100	(38)	-27.5%
Emergency Shelter Grants	73	74	67	(7)	-9.5%
HOPE Housing Grants	0	90	118	28	31.1%
Home Housing Grants	130	286	269	(17)	-5.9%
Housing Counseling	6	7	6	(1)	-14.3%
Housing Congregate Services	8	14	5	(9)	-64.3%
Public Housing Operating Subsidies	2,203	2,464	2,271	(193)	-7.8%
Public Housing Drug Elimination Grants	76	158	182	24	15.2%
Homeless Facilities (SAFAH)	8	11	11	0	0.0%
RESTORE Grants & Loans	0	0	41	41	NA
Rural Housing Loans	738	991	929	(62)	-6.3%
Rural Rental Housing Assistance	292	346	202	(144)	-41.6%
Additional Rural Housing Programs 5/	56	56	47	(9)	-16.1%
Rural Housing Vouchers	10	6	8	2	33.3%
Safe Havens for Homeless 6/	0	0	20	20	NA
Section 8 Moderate Rehab, SRO 6/	3	15	14	(1)	-6.7%
Shelter Plus Care Homeless, SRO 7/	0	3	0	(3)	-100.0%
Shelter Plus Care Homeless (Sect. 202) 7/	0	1	0	(1)	-100.0%
Shelter Plus Care, New Rent Assist. 7/	0	0	44	44	NA
Subsidized Housing 8/	13,956	14,842	12,677	(2,165)	-14.6%
Subsidized Housing Renewals 9/	1,263	2,260	2,260	0	0.0%
Transitional and Supportive Homeless Housing	84	106	75	(31)	-29.2%
TOTAL LOW INCOME HOUSING	19,040	21,868	19,346	(2,522)	-11.5%

	CBO FY 1992 ESTIMATED OUTLAYS	CBO FY 1993 BASELINE OUTLAYS	FY 1993 PROPOSED OUTLAYS	DIFFERENCE FROM BASELINE	PERCENT CHANGE
NUTRITION					
Commodity Supplemental Food Program	89	93	90	(3)	-3.2%
Food Donations for Low Income Groups	264	272	255	(17)	-6.3%
Emergency Food Assistance Program	167	170	165	(5)	-2.9%
WIC Supplemen.. l Food Program	2,585	2,678	2,825	147	5.5%
TOTAL NUTRITION	3,105	3,213	3,335	122	3.8%
HEALTH					
Health Care Services 10/	1,902	2,349	2,311	(38)	-1.6%
Indian Health	1,088	1,490	1,342	(148)	-9.9%
Indian Health Facilities	159	210	256	46	21.9%
TOTAL LOW INCOME HEALTH	3,149	4,049	3,909	(140)	-3.5%
EMPLOYMENT					
Older Americans Employment	377	397	385	(12)	-3.0%
Training & Employment Services 11/	4,026	3,980	4,177	197	4.9%
TOTAL LOW INCOME EMPLOYMENT	4,403	4,377	4,562	185	4.2%
OTHER					
Child Care Block Grant 12/	549	1,056	787	(269)	-25.5%
Community Development Block Grant	3,068	3,249	3,339	90	2.8%
Community Services Block Grant	415	456	149	(307)	-67.3%
Legal Services for the Poor	347	360	350	(10)	-2.8%
Low Income Energy Assistance	1,134	1,926	674	(1,252)	-65.0%
Refugee Assistance	412	507	283	(224)	-44.2%
TOTAL OTHER LOW INCOME DISC.	5,925	7,554	5,582	(1,972)	-26.1%
TOTAL LOW INCOME DISCRETIONARY	52,881	59,767	55,992	(3,775)	-6.3%
TOTAL ENTITLEMENT & DISCRETIONARY	193,843	224,606	219,758	(4,848)	-2.2%

Note: Numbers may not add due to rounding. A (0) figure indicates a funding reduction of between $1 and $500,000, while a 0 may indicate an increase of less than $500,000.

1/ For low income entitlement programs, current services levels are those shown in the OMB baseline as published in the Budget of the United States Government, 1993. For low income discretionary programs, current service levels are those shown in the Congressional Budget Office's current services baseline as of January 1992. The baseline estimates how much funding would be necessary to maintain FY 1992 levels with adjustments for inflation from FY 1992 to FY 1993.

2/ Includes funds for child care services for welfare recipients, former welfare recipients, and working families at risk of becoming welfare recipients.

3/ Among the programs in this account are Head Start, Child Welfare Services and Runaway and Homeless Youth. Outlay figures were unavailable for these individual programs; as a result, outlay figures for the account are provided.

4/ This account includes special programs for disadvantaged students (TRIOs). Outlay figures just for TRIO's, as opposed to outlay totals for the account, were not available.

5/ These programs include domestic farm labor housing, mutual and self-help housing, very low income housing repair grants and rural housing preservation grants.

6/ The budget proposes replacing the existing Section 8 moderate rehabilitation program for single room occupancy units with a new housing program for the mentally ill homeless called Safe Havens.

7/ The budget proposes consolidating the two Shelter Plus Care Homeless programs into a single rental assistance program that will pair housing assistance with supportive social services.

8/ The subsidized housing account includes funds for new construction of public housing, housing vouchers, public housing modernization, and preservation of privately owned but federally subsidized housing projects.

9/ The Department of Housing and Urban Development's estimate of the cost of renewing expiring subsidized housing contracts covering Section 8 certificates and vouchers is shown here as the FY 1993 baseline level for this program.

10/ This account includes Community Health Centers, the Infant Mortality Initiative, Health Care for the Homeless, Maternal and Child Health Grants, Migrant Health Centers, and Healthy Start among other programs. Outlay figures were unavailable for these individual programs; as a result, outlay figures for the account are provided.

11/ This account includes the Job Corps, Summer Youth Employment and JTPA training assistance, among other programs. Outlay figures were unavailable for these individual programs; as a result, outlay figures for the account are provided.

12/ The Administration proposes to make FY 1993 child care block grant funds available in September, 1993. As a result, much of the FY 1993 appropriation would not actually be spent until FY 1994.

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These Tax Cuts Stunt Growth

To judge by advance leaks to reporters, the "growth" tax cuts that President Bush will announce in his State of the Union address tonight and his budget tomorrow will promote precious little growth. Taken individually, they range from inconsequential to destructive. Taken together, they would put billions into undeserving pockets — and wreck the tax code.

Economic recovery cannot be bought with a mishmash of political handouts. What the economy does need is a swift kick, most easily delivered by a temporary tax cut that doesn't drain away revenues once the economy recovers. For the long term, the economy needs a tax code that favors saving over consumption. Perhaps there's more to the Bush plan than has been leaked, but otherwise, it won't do much to hasten recovery or reform.

•

Mr. Bush reportedly plans to propose tax breaks for middle-class families, capital gains, corporate investment, first-time home buyers and retirement savings. Most of these ideas fail on the merits. In combination, they're worse.

Middle-Class Relief. The President wants to increase personal exemptions, perhaps targeted to children. This idea is triply flawed:

☐ The tax cuts would be permanent, robbing Congress of revenues desperately needed for infrastructure, children and research.

☐ Higher exemptions are unfair because they would be worth twice as much to richer families than to families in lower tax brackets.

☐ The proposal is mistargeted. *Middle-class families are suffering because their wages haven't been rising, not because their taxes have been rising.* Sluggish wages are a problem of productivity that can only be solved by more investment.

What kind of growth can be expected from a plan that has so much wrong with it?

Retirement Subsidies. Mr. Bush wants to give rich families a tax break on retirement savings already available to low-income families. Properly targeted, and financed, subsidies for savings might be good policy. But Mr. Bush's idea is a gimmick, rigged to produce a deceptive bulge in revenues in the short run — while creating a huge budget hemorrhage in 5 or 10 years.

At that point, Congress will have to cut back public programs, including investment.

Real Estate Giveaways. Apparently Mr. Bush believes America can reclaim its technological lead by building housing. He proposes to bring back wasteful tax shelters for investors in real estate, the most tax-subsidized industry. He's also expected to propose a subsidy for first-time home buyers. When economists say the U.S. needs more investment, they mean in education, telecommunications, research. Not houses.

Corporate Investment. Here, finally, Mr. Bush seems to be on track. Higher subsidies for corporate investment could promote growth. But even here there's a catch.

He's also reportedly going to propose new subsidies for saving. Putting both ideas together, the President apparently wants corporations to borrow money from tax-subsidized retirement funds in order to make tax-subsidized investments. That's a double subsidy, which could well encourage corporations to buy $100 machines that produce only $90 worth of output.

The error of simultaneously subsidizing savings and investment dramatizes the folly of piecemeal tax reform. That's why Mr. Bush would do better by pledging temporary tax cuts tonight and calling for an expert commission on long-term tax reform to report back to Congress after the November election.

Mr. Bush is likely to propose more than this list of misconceived tax cuts tonight, if only to rehearse his ill-advised capital gains cut. But unless there are some notable surprises, the tax package in his larger program looks perverse: In the name of growth, it would stunt growth.

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