

# **CBO TESTIMONY**

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**Statement of  
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**before the  
Committee on Ways and Means  
U.S. House of Representatives**

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## **NOTICE**

**This statement is not available for public release until it is delivered at 10 a.m. (EST), Tuesday, March 16, 1993.**



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Mr. Chairman and Members of the Committee, thank you for this opportunity to participate in your hearings on President Clinton's economic and budget program. My testimony will assess the Administration's budget estimates, review the Administration's budget proposals, and consider their likely effects on the shape of the economy and on the distribution of the tax burden.

The Clinton Administration has proposed an ambitious program to encourage economic growth by cutting the budget deficit and increasing government spending that could have long-term payoffs. The Congressional Budget Office (CBO) estimates that the Administration's proposals would reduce the deficit from \$308 billion in 1993 to \$205 billion in 1997. In contrast, with no change in budgetary policies, the deficit would swell to \$322 billion in 1997.

CBO's analysis is based on the proposals and estimates described in the Administration's document *A Vision of Change for America*, which was released on February 17. In early April, the President will present a formal budget containing detailed and revised budget proposals as well as updated budget estimates. Because the April budget is likely to modify or clarify some of the Administration's proposals, CBO's current analysis must be viewed as preliminary.

## CBO BUDGET PROJECTIONS

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CBO estimates that under current budgetary policies the federal deficit will total \$301.6 billion in 1993, \$286.7 billion in 1994, and \$359.7 billion in 1998 (see Table 1). These baseline projections assume that discretionary spending is held to the limits established by the Budget Enforcement Act (BEA) in 1994 and 1995 and grows at the same pace as inflation after 1995. CBO's current baseline budget projections incorporate minor revisions of those that CBO released in January in *The Economic and Budget Outlook: Fiscal Years 1994-1998*.

In CBO's estimation, the Administration's budgetary proposals would add \$6.8 billion to the deficit in 1993 and would reduce the deficit every year thereafter. Compared with the CBO baseline, the Administration's plan would reduce the deficit by \$18.6 billion in 1994, \$27.4 billion in 1995, and \$131.2 billion in 1998.

Although the Administration's policies would, on balance, reduce the deficit, its program includes many proposed spending increases and tax reductions. Most of these programmatic increases are labeled as stimulus or investment proposals in the Administration's February 17 document, but some are included in the category of "nondefense discretionary program savings." During the 1993-1998 period, the Administration's plan provides a total of \$355 billion in net deficit reduction from the CBO baseline, representing \$652 billion in gross

**TABLE 1. CBO ESTIMATES OF THE ADMINISTRATION'S POLICY PROPOSALS**  
(By fiscal year, in billions of dollars)

	1993	1994	1995	1996	1997	1998
<b>CBO Baseline Deficit<sup>a</sup></b>	301.6	286.7	284.4	290.0	321.7	359.7
<b>Deficit Reductions</b>						
<b>Outlays</b>						
Discretionary spending	0	-3.4	-7.7	-28.4	-56.2	-63.4
Mandatory spending	0	-4.2	-7.5	-17.8	-25.0	-30.8
Debt service	<u>0</u>	<u>-1.6</u>	<u>-5.2</u>	<u>-11.1</u>	<u>-20.4</u>	<u>-32.2</u>
Subtotal, outlays	0	-9.1	-20.5	-57.2	-101.6	-126.4
<b>Revenues<sup>b</sup></b>	<u>0</u>	<u>-45.8</u>	<u>-52.4</u>	<u>-68.1</u>	<u>-84.8</u>	<u>-86.0</u>
Total, Reductions	0	-55.0	-72.8	-125.3	-186.4	-212.4
<b>Deficit Increases</b>						
<b>Outlays</b>						
Discretionary spending	3.3	13.0	22.6	31.8	39.4	44.5
Mandatory spending	3.3	3.8	5.9	7.0	7.1	7.3
Debt service	<u>0.1</u>	<u>1.4</u>	<u>3.7</u>	<u>6.8</u>	<u>10.6</u>	<u>15.1</u>
Subtotal, outlays	6.8	18.2	32.1	45.5	57.1	66.9
<b>Revenues<sup>b</sup></b>	<u>0</u>	<u>18.2</u>	<u>13.3</u>	<u>11.7</u>	<u>12.6</u>	<u>14.3</u>
Total, Increases	6.8	36.3	45.4	57.2	69.6	81.2
<b>Total Changes</b>	6.8	-18.6	-27.4	-68.1	-116.7	-131.2
<b>Deficit Under the President's Budget as Estimated by CBO</b>	308.3	268.1	257.0	222.0	204.9	228.5

SOURCES: Congressional Budget Office; Joint Committee on Taxation.

NOTE: The budget estimates reflect the proposals incorporated in the President's budgetary message of February 17, 1993. In early April, the President will present a formal budget containing detailed and revised budget proposals and updated budget estimates.

- a. Assumes compliance with the discretionary spending limits in the Budget Enforcement Act through 1995; discretionary outlays are assumed to grow at the same pace as inflation after 1995.
- b. Increases in revenues are shown with a negative sign because they reduce the deficit. Estimates of the Administration's revenue proposals were prepared by the Joint Committee on Taxation.

reductions, partly offset by \$297 billion in increases. In comparison, the 1990 budget summit agreement provided for \$482 billion in net deficit reduction over five years.

### Differences Between CBO and Administration Estimates

CBO's estimate of the deficit is lower than the Administration's estimate in 1993, 1997, and 1998, but higher in 1994, 1995, and 1996 (see Table 2). These differences take into account differences in estimates of the budget baseline and the Administration's policy proposals. CBO's estimate of the baseline deficit is lower than that of the Administration in most years, but CBO also projects somewhat smaller savings from the Administration's proposals. Because the Administration's budget estimates are based on CBO's economic assumptions, all of the differences between the Administration and CBO reflect different methods of estimation.

CBO's baseline estimates differ from those of the Administration in two key respects. First, CBO projects higher tax collections after 1994 than the Administration. Differing interpretations of recent trends in corporate income tax collections explain more than half of this difference. Second, both the amount and timing of spending for deposit insurance remain in doubt. During the 1993-1998

TABLE 2. DIFFERENCES BETWEEN CBO AND ADMINISTRATION ESTIMATES OF THE ADMINISTRATION'S PROPOSED BUDGET (By fiscal year, in billions of dollars)

	1993	1994	1995	1996	1997	1998
Administration's Estimate of the Deficit	331.4	262.4	241.6	205.3	206.4	241.4
CBO Reestimates of the Administration's Baseline						
Revenues <sup>a</sup>	4.9	b	-6.2	-5.7	-16.0	-27.7
Deposit insurance	-13.9	-3.4	13.6	12.9	-1.5	-1.5
Other outlays	<u>-8.5</u>	<u>-1.8</u>	<u>-1.6</u>	<u>-3.5</u>	<u>-1.5</u>	<u>b</u>
Subtotal	-17.4	-5.2	5.8	3.8	-19.0	-29.2
CBO Reestimates of the Administration's Proposals						
Revenues <sup>a</sup>	-3.6	8.8	4.3	5.7	6.6	5.7
Debt management	0.2	1.6	2.7	3.3	3.9	4.9
Medicare	0	0.6	0.9	0.4	1.3	1.8
Pay offsets	0	0.6	1.0	1.4	1.7	2.0
Debt service	-0.2	-0.1	0.4	0.9	1.6	2.3
Other outlays	<u>-2.0</u>	<u>-0.7</u>	<u>0.2</u>	<u>1.3</u>	<u>2.5</u>	<u>-0.5</u>
Subtotal	-5.6	10.9	9.5	12.9	17.5	16.2
Total Reestimates	-23.1	5.7	15.4	16.7	-1.5	-12.9
Deficit Under the President's Budget as Estimated by CBO	308.3	268.1	257.0	222.0	204.9	228.5

SOURCES: Congressional Budget Office; Joint Committee on Taxation; Office of Management and Budget.

NOTE: The budget estimates reflect the proposals incorporated in the President's budgetary message of February 17, 1993. In early April, the President will present a formal budget containing detailed and revised budget proposals and updated budget estimates.

- a. Increases in revenues are shown with a negative sign because they reduce the deficit. Estimates of the Administration's revenue proposals were prepared by the Joint Committee on Taxation.
- b. Less than \$50 million.

period, CBO projects higher outlays for deposit insurance of \$6 billion. CBO is more pessimistic than the Administration about the anticipated outlays for savings and loans but less gloomy about the prospects for the Bank Insurance Fund.

For discretionary spending proposals, CBO has generally incorporated the Administration's requested changes in budget authority, even where a proposal is not clearly specified, but has independently estimated the resulting changes in outlays. For mandatory spending, such as Medicaid or Medicare, CBO has used its own estimates of the specific policy changes proposed by the Administration. In three cases--reforming Federal Housing Administration insurance, reforming power marketing administrations, and changing debt-management policies--the Administration has not yet outlined a specific proposal, and CBO's estimate therefore includes no savings for these items.

Differences in estimates of the Administration's policy proposals are concentrated in five areas. First, the Joint Committee on Taxation's estimates of the Administration's revenue proposals, which are shown in the accompanying tables, are about \$5 billion a year less than the Administration's estimates. Lower estimates of the amounts generated by the proposed rate increases for high-income individuals and the compliance and enforcement efforts represent most of this amount.

Second, the Administration's estimates assume savings that grow to almost \$5 billion in 1998 from changes in debt-management policies. Because the Administration has not detailed its specific changes in debt-management policies, CBO's estimate does not include budgetary savings from this source. Achieving savings of the magnitude the Administration assumes would require shifting most or all borrowing in long-term bonds and much borrowing in medium-term notes to short-term securities.

Third, CBO's estimates of the savings from the proposed reductions in reimbursement of providers in the Medicare program are below those of the Administration. The differences vary by year but approach \$2 billion in 1998. This difference in estimates is largely accounted for by the Administration's inadvertent use of different economic assumptions in estimating the effects of these proposals.

Fourth, the Administration's estimates omit the effect of the proposed reductions in federal civilian and military pay on the level of Defense Department contributions to the federal employee retirement programs. Because the agency's contributions are a set percentage of payroll, a reduction in pay will also shrink the amount of the agency's contributions, which are recorded in the budget as undistributed offsetting receipts. By neglecting to include this loss in receipts, the



Administration underestimates the deficit by amounts growing to \$2.0 billion by 1998.

Fifth, because CBO's estimate of the savings generated by the Administration's proposals is lower than that reported in *A Vision of Change for America*, CBO's estimate of the resulting reduction in the cost of servicing the federal debt is also lower. By 1998, this difference reaches \$2.3 billion.

Other reestimates to outlays are smaller, both individually and in total. CBO estimates that outlays from the stimulus package would be \$2.1 billion lower in 1993 than the Administration assumes but higher by an equal amount over the 1994-1998 period. CBO attaches higher savings to the Administration's proposals to replace guaranteed student loans with direct loans, extend customs fees, and auction rights to use the electromagnetic spectrum. CBO has lower savings estimates, however, for the Administration's proposed reforms in uranium enrichment, hardrock mining, farm price supports, Medicaid, and the federal buildings fund.

### Alternative Baseline Concepts

The budgetary savings generated by the Administration's proposals can be measured using several alternative budget baselines (see Table 3). CBO's estimates use as their starting point the CBO baseline, which assumes compliance with the discretionary spending caps established by the Budget Enforcement Act of 1990. One alternative is the uncapped baseline, which assumes that discretionary spending in the 1994-1998 period grows at just the rate of inflation. The Administration's February 17 document employs still a third baseline concept, in which nondefense discretionary spending keeps pace with inflation, but defense discretionary spending is held to the levels proposed in the Bush Administration's January 1992 budget request (with various adjustments).

The existence of competing baselines and competing estimates creates considerable confusion. The Administration, for example, states that its policies will reduce the 1997 deficit by \$140 billion--the difference between the Administration's baseline of \$346 billion and its budget estimate of \$206 billion. Using the same baseline concept as the Administration but its own estimating methods, CBO would show a reduction of \$122 billion--from \$327 billion to \$205 billion. Compared with the CBO baseline deficit of \$322 billion, however, the Administration's reductions total only \$117 billion in 1997. For the 1993-1998 period, CBO would estimate savings of \$400 billion using the Administration's

**TABLE 3. CBO AND OMB ESTIMATES OF BASELINE DEFICITS**  
(By fiscal year, in billions of dollars)

	1993	1994	1995	1996	1997	1998
<b>CBO Estimates</b>						
Uncapped Baseline Deficit	301.6	301.5	312.1	318.5	351.0	390.8
<b>Reductions</b>						
Bush Administration's defense proposals <sup>a</sup>	0.2	-5.2	-9.8	-16.3	-21.1	-26.0
Debt-service savings	<u>b</u>	<u>-0.1</u>	<u>-0.6</u>	<u>-1.4</u>	<u>-2.7</u>	<u>-4.3</u>
Subtotal	0.2	-5.4	-10.4	-17.7	-23.7	-30.3
Administration Baseline Deficit	301.8	296.1	301.8	300.8	327.3	360.6
<b>Further Reductions Required to Meet Discretionary Caps</b>						
Discretionary spending	-0.2	-9.2	-16.4	-8.9	-3.2	1.7
Debt-service savings	<u>b</u>	<u>-0.3</u>	<u>-1.0</u>	<u>-1.9</u>	<u>-2.4</u>	<u>-2.6</u>
Subtotal	-0.2	-9.4	-17.4	-10.7	-5.6	-0.9
Capped Baseline Deficit <sup>c</sup>	301.6	286.7	284.4	290.0	321.7	359.7
<b>OMB Estimates</b>						
Uncapped Baseline Deficit	319.2	306.7	306.0	313.6	368.8	418.6
<b>Reductions</b>						
Bush Administration's defense proposals <sup>a</sup>	0	-5.3	-9.5	-15.2	-20.0	-24.8
Debt-service savings	<u>0</u>	<u>-0.2</u>	<u>-0.6</u>	<u>-1.4</u>	<u>-2.6</u>	<u>-4.1</u>
Subtotal	0	-5.4	-10.1	-16.6	-22.5	-28.9
Administration Baseline Deficit	319.2	301.3	295.9	297.0	346.3	389.7

SOURCES: Congressional Budget Office; Office of Management and Budget.

- a. Includes adjustments to the Bush Administration's request as estimated by the Clinton Administration.
- b. Less than \$50 million.
- c. Assumes compliance with the discretionary spending limits in the Budget Enforcement Act through 1995; discretionary outlays are assumed to grow at the same pace as inflation after 1995.

baseline concept and \$355 billion using the CBO baseline. The differences in the figures arise because some of the Administration's discretionary savings are needed simply to comply with the BEA's spending caps.

## THE ADMINISTRATION'S PROPOSALS

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Three-quarters of the \$355 billion in cumulative deficit reduction contained in the Administration's program would stem from increases in revenues and only one-quarter from cuts in outlays. Extension of expiring tax increases and spending cuts would generate \$60 billion of the reduction in the deficit. Continuing various tax credits and other revenue-losing provisions, however, would cost \$22 billion. The Administration would increase domestic discretionary spending but reduce defense and mandatory spending. The spending increases would exceed the cuts through 1995, but the spending reductions would dominate in later years.

### Revenues

The Administration has proposed some 30 revenue-raising items, as well as a smaller number of tax reductions designed to stimulate investment and reward work (see Table 4). The major revenue raisers are an increase in income tax rates for high-income individuals and large corporations, elimination of the limit on

TABLE 4. JCT/CBO ESTIMATES OF CLINTON ADMINISTRATION REVENUE PROPOSALS  
(By fiscal year, in billions of dollars)

	1994	1995	1996	1997	1998
<b>Stimulus and Investment Proposals</b>					
Investment Credits and AMT Depreciation	-13.4	-7.1	-4.2	-3.8	-4.2
Enterprise Zones	-0.2	-0.7	-1.1	-1.6	-2.1
Expand EITC <sup>a</sup>	-0.2	-1.9	-2.0	-2.1	-2.2
Exclude Capital Gains on Original-Issue Small Business Stock	-0.0	-0.1	-0.2	-0.2	-0.2
Extend Preferences	-4.1	-3.3	-4.1	-5.0	-5.8
All Other	<u>-0.2</u>	<u>-0.3</u>	<u>0</u>	<u>0.1</u>	<u>0.2</u>
Total, stimulus and investment proposals	-18.2	-13.3	-11.7	-12.6	-14.3
<b>Revenue-Raising Proposals</b>					
Increase Top Individual Tax Rate to 36%; 26% and 28% AMT; Increase AMT Exemption to \$45,000/\$33,750; 39.6% Rate on Taxable Income Greater than \$250,000; Extend Phaseout of Personal Exemptions and Limit on Itemized Deductions	25.7	17.0	19.9	24.0	25.8
Remove Cap on HI Taxable Wage Base <sup>b</sup>	2.8	6.0	6.4	6.8	7.2
Include 85% of Social Security Benefits in AGI	2.9	6.1	6.9	7.7	8.5
Increase Income Tax Rate on Corporations	8.1	5.4	5.7	5.9	6.1
Establish Broad-Based Energy Tax <sup>b</sup>	1.0	9.4	17.0	22.1	23.5
Extend 2.5 Cents per Gallon Gas Tax <sup>b</sup>	0	0	2.6	2.7	2.7
Cap Possessions Tax Credit (Sec. 936) at 65% of Wages	0.2	0.8	1.9	2.7	2.7
Restrict Deduction for Business Meals and Entertainment to 50%	1.8	3.2	3.3	3.5	3.6
International Tax Provisions	0.4	1.1	1.0	1.0	1.1
Compliance Provisions	0.1	0.2	0.2	0.2	0.2
Change Corporate Estimated Tax Rules	0	0	0	4.3	0.9
All Other	<u>2.9</u>	<u>3.2</u>	<u>3.1</u>	<u>3.8</u>	<u>3.9</u>
Total, revenue-raising proposals	45.8	52.4	68.1	84.8	86.0
<b>All Proposals</b>					
Total	27.7	39.1	56.4	72.2	71.7

SOURCES: Congressional Budget Office; Joint Committee on Taxation.

NOTE: JCT = Joint Committee on Taxation; AMT = alternative minimum tax; EITC = earned income tax credit; HI = Hospital Insurance; ACI = adjusted gross income

a. Two-thirds of the effect of expanding the EITC is in the form of refundable tax credits. The refundable portion is not included here. It is included with the outlay proposals.

b. Net of income tax offsets.

earnings subject to the payroll tax for Hospital Insurance, inclusion in adjusted gross income of 85 percent (instead of 50 percent) of Social Security benefits above the current income thresholds, and establishment of a broad-based energy tax. The investment proposals include a temporary incremental investment credit, a permanent investment credit for small businesses, extension of the research and experimentation credit and other expiring preferences, and expansion of the earned income credit.

### Discretionary Spending

The Budget Enforcement Act established separate dollar limits on defense, international, and domestic discretionary spending for fiscal years 1991, 1992, and 1993. A single overall limit applies to discretionary spending in 1994 and 1995. The Administration has proposed extending the discretionary spending limits through 1998, but it has not yet suggested any specific levels.

In CBO's estimation, the Administration's budget is within or near the current limits on discretionary budget authority for 1994 and 1995 but exceeds the limits on outlays. In 1994, total discretionary outlays exceed the cap by \$9.7 billion (see Table 5). Of this amount, \$6.4 billion represents the 1994 outlays from the 1993 stimulus package, which the Administration proposes to treat as an

TABLE 5. THE ADMINISTRATION'S PROPOSALS FOR DISCRETIONARY SPENDING  
IN FISCAL YEAR 1994 (In billions of dollars)

Category	CBO Baseline Without Discretionary Caps		President's Budget as Estimated by CBO		Difference	
	Budget		Budget		Budget	
	Authority	Outlays	Authority	Outlays	Authority	Outlays
Defense	288.0	289.6	264.0	277.8	-24.0	-11.8
International	21.9	21.8	21.9	21.9	-0.1	0.2
Domestic						
General science, space, and technology	17.7	17.5	19.0	18.3	1.3	0.8
Energy	6.1	5.9	5.8	5.7	-0.4	-0.2
Natural resources and environment	22.3	21.9	21.7	22.6	-0.6	0.8
Agriculture	4.5	4.4	4.2	4.3	-0.3	-0.1
Commerce and housing credit	3.6	3.5	3.7	3.7	0.1	0.2
Transportation	14.4	36.5	14.8	39.2	0.4	2.8
Community and regional development	8.0	8.3	8.5	9.5	0.5	1.3
Education, training, employment, and social services	38.2	37.5	42.2	40.0	4.0	2.5
Health	21.3	20.9	22.5	21.6	1.2	0.7
Medicare	3.0	3.0	3.0	3.0	a	a
Income security	32.0	34.8	32.0	35.4	a	0.6
Social Security	0	2.8	0	3.0	0	0.2
Veterans' benefits	17.5	17.4	17.5	17.6	a	0.2
Administration of justice	14.9	15.0	15.2	15.3	0.3	0.3
General government	12.5	12.6	12.7	12.9	0.2	0.3
Allowances	<u>0</u>	<u>0</u>	<u>-3.9</u>	<u>-3.4</u>	<u>-3.9</u>	<u>-3.4</u>
Subtotal, domestic	215.9	242.0	218.9	248.8	3.0	6.9
Total, Discretionary Spending	525.8	553.3	504.8	548.6	-21.1	-4.7
Discretionary Caps <sup>b</sup>	513.2	538.9	513.2	538.9	n.a.	n.a.
Difference	12.7	14.4	-8.4	9.7	n.a.	n.a.

SOURCE: Congressional Budget Office.

NOTE: n.a. = not applicable.

a. Less than \$50 million.

b. End-of-session limits as estimated by CBO.

emergency requirement. Under the terms of the BEA, the discretionary spending limits are increased to make extra room for emergency appropriations. Even excluding the outlays from the stimulus package, the Administration's request exceeds the 1994 outlay cap by \$3.3 billion.

The Administration's proposals exceed the cap on discretionary outlays by an even larger amount in 1995. Leaving out \$3.2 billion in outlays from the stimulus package, discretionary outlays breach their limit by \$11.6 billion.

Within the discretionary spending category, the Administration proposes continued real reductions in defense and real increases in most areas of domestic spending. Defense discretionary budget authority, which totaled \$274 billion in 1993, would drop to \$264 billion in 1994 and \$249 billion by 1997--a cut of 21 percent in real terms. At the same time, domestic discretionary budget authority would grow from its current level of \$209 billion to \$262 billion--a real increase of 7 percent.

The Administration proposes to increase real discretionary spending in most domestic functions of the budget. By far the largest increases would go to education and related programs--notably, Head Start; elementary, secondary, and postsecondary education; summer youth employment and training; a new national service program for youth; and a new training program for dislocated workers.



Compared with the uncapped CBO baseline, the President's program would add \$4.0 billion in budget authority (BA) and \$2.5 billion in outlays to the education function in 1994, and \$13.4 billion in BA and \$12.7 billion in outlays in 1998.

Discretionary health programs would also receive substantial increases in funding above the uncapped baseline--\$1.2 billion in BA in 1994 and \$6.2 billion in 1998. Additional resources would be focused on research relating to AIDS and women, as well as on prevention of substance abuse. The President also proposes large increases in spending for science (for National Science Foundation research and the National Aeronautics and Space Administration), transportation (for highways and mass-transit grants), and income security (for housing assistance; the Special Supplemental Food Program for Women, Infants, and Children; and low-income home energy assistance).

The Administration's proposed reductions in domestic discretionary spending emphasize across-the-board cuts in a wide range of federal programs. The Administration treats many but not all of these cuts as allowances rather than assigning them to specific budget functions. Eliminating pay increases for civilian agencies in 1994 and limiting pay increases during the next three years would reduce discretionary outlays by \$1.6 billion in 1994 and \$3.5 billion in 1998. Eliminating 100,000 federal jobs would save \$0.9 billion in 1994 and \$1.6 billion in 1998. An additional \$0.6 billion in 1994 and \$4.2 billion in 1998 would be

saved by further "streamlining" of the federal government. Still other unspecified administrative savings would total \$0.5 billion in 1994 and \$3.5 billion in 1998.

Unlike the proposed changes in revenues and mandatory spending, the Administration's discretionary proposals cannot all be enacted into law this year but will depend on future Congressional action. Extending the limits on discretionary spending would constrain the total amount of appropriations, but annual appropriation bills will determine how the total is allocated among individual programs.

#### Mandatory Spending

The Medicare program accounts for more than half of the proposed cuts in mandatory spending (see Table 6). Major savings would be achieved by maintaining the ratio of premium charges to benefit payments for Supplementary Medical Insurance at its 1995 level; extending other expiring provisions, including those that make Medicare the secondary payer for certain beneficiaries and curtail payments for hospital capital expenditures and outpatient departments; and reducing hospital reimbursement rates. The Administration would also cut payments for medical education in hospitals, clinical laboratories, and physicians not in primary care.

TABLE 6. THE ADMINISTRATION'S PROPOSALS FOR MANDATORY SPENDING  
(By fiscal year, in billions of dollars)

	1993	1994	1995	1996	1997	1998
<b>Reductions</b>						
Medicare premiums	0	0	0	-1.3	-3.2	-5.1
Extend other expiring Medicare provisions	0	a	a	-2.0	-2.6	-3.0
Reduce hospital reimbursement	0	-1.1	-1.8	-2.1	-2.3	-2.5
Other Medicare savings	<u>0</u>	<u>-1.4</u>	<u>-2.5</u>	<u>-4.2</u>	<u>-5.9</u>	<u>-7.2</u>
Subtotal, Medicare	0	-2.5	-4.3	-9.6	-14.0	-17.9
Farm price supports	0	-0.1	-0.2	-0.8	-1.6	-1.8
Student loans	0	0.1	0.1	-1.1	-2.6	-3.1
Medicaid	0	-0.2	-1.4	-1.8	-2.1	-2.4
Civil Service retirement	0	a	-0.1	-2.2	-3.3	-3.6
Veterans benefits	0	-0.3	-0.4	-0.4	-0.4	-1.2
Customs user fee	0	0	0	-0.8	-0.8	-0.9
Spectrum auctions	0	-1.7	-1.8	-1.7	-1.0	-1.0
Pay offsets	0	1.0	1.4	1.8	2.3	2.8
Other	<u>0</u>	<u>-0.5</u>	<u>-0.9</u>	<u>-1.3</u>	<u>-1.4</u>	<u>-1.8</u>
Total, Reductions	0	-4.2	-7.5	-17.8	-25.0	-30.8
<b>Increases</b>						
Unemployment compensation	3.3	2.3	0	0	0	0
Food Stamps	0	1.0	2.0	3.0	3.0	3.0
Earned income tax credit	0	0.4	3.8	4.0	4.1	4.3
Other	<u>0</u>	<u>0.1</u>	<u>0.1</u>	<u>a</u>	<u>a</u>	<u>a</u>
Total, Increases	3.3	3.8	5.9	7.0	7.1	7.3
<b>Total</b>	<b>3.3</b>	<b>-0.4</b>	<b>-1.7</b>	<b>-10.8</b>	<b>-17.9</b>	<b>-23.5</b>

SOURCE: Congressional Budget Office.

a. Less than \$50 million.

In three other programs, savings would also arise largely from extending current savings provisions that are scheduled to expire. These items include eliminating the option for a lump-sum payment in Civil Service retirement, extending the limit on pension benefits paid to certain veterans in nursing homes, and continuing Customs Service merchandise and passenger processing fees. Additional savings would be achieved by reducing farm price-support payments, replacing the guaranteed student loan programs with direct federal loans, eliminating personal care as a mandatory benefit and making other reductions in Medicaid, and auctioning future rights to use the electromagnetic spectrum.

Increases in mandatory spending are concentrated in three areas. An extension of emergency unemployment compensation through October 2, 1993, has already cleared the Congress and was signed into law on March 4. The Administration also proposes to increase spending on Food Stamps and to expand the earned income tax credit (EITC) for low-income wage earners; the refundable portion of the EITC appears as an outlay in the budget.

### Debt Held by the Public

The Administration's proposals would slow but not halt the growth of federal debt relative to the size of the economy. On its current course, debt held by the public

will swell from \$3.0 trillion (51 percent of gross domestic product) at the end of 1992 to \$4.8 trillion (62 percent of GDP) in 1998. Under the Administration's plan, the debt would reach \$4.5 trillion, or 58 percent of GDP, in six years. The Administration's proposal for direct loans to college students would add \$54 billion to the debt in 1998 but would be matched by a roughly equal increase in interest-earning assets.

#### EFFECTS OF THE ADMINISTRATION'S PROGRAM

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The Administration's budgetary proposals are intended to spur the growth of the economy and to distribute the tax burden more progressively. How well does it accomplish these two goals?

#### Macroeconomic Implications

Enacting the Administration's proposals would affect the pattern of economic growth slightly over the next few years and could ultimately raise the level of the economy's potential output. Evaluating the proposals is complicated, however, by the recent sharp drop in long-term interest rates--a drop that largely coincided with the announcement of the policies. Ten-year Treasury note rates have fallen from 6.9 percent in early January to 5.9 percent last week. If rates remain at their

current levels--which are about 70 basis points lower than those assumed in the CBO forecast--economic activity will be given a significant boost this year and next.

The fall in interest rates was probably precipitated at least in part by the Administration's proposals, but rates fell much sooner than most economists would have expected. Other factors probably also played a role, especially the weakness of European and Japanese economies and, perhaps, a recognition that the probability of a sharp increase in inflation is low. As long as the budget package, when it is passed, sets the budget on a course toward substantially lower deficits, interest rates are likely to remain below those in the CBO forecast.

The combination of the Administration's proposals and the drop in interest rates produces a more favorable outlook than do the proposals alone. Whereas deficit reduction would dampen growth relative to CBO's economic forecast during 1994, the lower interest rates could more than offset that effect. The Administration's proposals also need not cause gross domestic product to fall below the CBO baseline after 1994. Given the steady pattern of the proposed reduction of the deficit, the amount of time people will have to adjust to the budgetary changes, the possibility of even lower long-term interest rates, and the likelihood that monetary policy could offset the fiscal restraint, the level of

economic activity in the mid-1990s is likely to differ little from CBO's baseline assumptions.

The payoff for the deficit reduction--an increase in the economy's level of potential output--would start to be realized in the late 1990s. Potential output would increase primarily because the reduction in the federal deficit would increase the net national saving rate. The Administration's proposals for additional investment spending are unlikely to provide a significant boost to potential output during this decade, though of course they may help in subsequent years or may generate benefits other than their impact on potential output.

The Administration's proposed energy tax is likely to raise inflation for a few years, but only slightly. The tax is phased in over three years, beginning in July 1994. Inflation is likely to be 0.1 or 0.2 percentage points higher for those years and then return to its baseline rate.

#### Redistributing the Tax Burden

The Administration's proposals would shift a greater share of the federal tax burden to high-income taxpayers. CBO estimates that the tax proposals would raise total average effective tax rates by 7 percent for families in the top quintile

of the income distribution and 3 percent for families in the third and fourth quintiles. Expanding the earned income tax credit would reduce the average effective tax rate by 4 percent for families in the bottom quintile (see Table 7).

Within the top quintile, the increase in taxes would be largest for the families with the highest incomes. Families in the top 1 percent would bear more than 55 percent of the burden of the new taxes. The proposal would raise the effective tax rate for these families by almost 20 percent--from about 28 percent under current law to about 33 percent under the proposal.

The quintile rankings array families by adjusted family income, a measure that adjusts family income by a measure of need based on family size. The results are similar when families are ranked by dollar income, except in the lowest income groups. The differences highlight the fact that the tax proposals do not have a uniform effect on all families with the same income. For example, the Administration's program substantially reduces the average effective tax rate of low-income families with children, who will benefit most from expansion of the EITC, but increases taxes on low-income childless families.

To compensate low-income families for the effects of the proposed energy tax, the Administration has proposed increases in Food Stamps and the Low Income Home Energy Assistance Program (LIHEAP). Including these two



**TABLE 7. CHANGES IN EFFECTIVE TAX RATES BY INCOME GROUP FROM THE PRESIDENT'S TAX PROPOSALS (In percent)**

	<u>Effective Tax Rates</u>		<u>Percentage Change in</u>		<u>Share of Change in Taxes</u>
	<u>Current Law<sup>a</sup></u>	<u>Proposal</u>	<u>Effective Tax Rate</u>	<u>After-Tax Income</u>	
<b>Families by Adjusted Family Income</b>					
<b>Income Quintile</b>					
Lowest	7.0	6.7	-4.3	+0.3	-0.9
Second	15.0	15.2	+1.1	-0.2	1.4
Third	19.3	19.8	+2.7	-0.7	6.6
Fourth	22.1	22.6	+2.6	-0.7	10.8
Highest	26.2	28.1	+7.1	-2.5	81.3
All	22.8	24.0	+5.1	-1.5	100.0
<b>Detail on Highest Quintile</b>					
81-90 Percent	24.6	25.2	+2.6	-0.8	8.4
90-95 Percent	25.9	26.5	+2.5	-0.9	5.6
96-99 Percent	26.8	27.8	+3.6	-1.3	10.8
Top 1 Percent	28.0	33.2	+18.7	-7.3	56.5
<b>Families by Dollar Income (In thousands)</b>					
<b>Income Level</b>					
Less than 10	7.5	8.0	+6.7	-0.5	0.8
10 to 20	11.5	11.8	+2.9	-0.4	1.7
20 to 30	16.9	17.0	+0.4	-0.1	0.5
30 to 40	19.8	20.2	+2.3	-0.6	3.8
40 to 50	21.6	22.2	+2.9	-0.8	5.4
50 to 75	23.4	24.1	+2.7	-0.8	11.6
75 to 100	25.2	25.8	+2.4	-0.8	6.8
100 to 200	26.1	26.8	+2.4	-0.9	8.2
200 or more	27.9	32.7	+17.6	-6.8	60.3
All	22.8	24.0	+5.1	-1.5	100.0

SOURCE: Congressional Budget Office.

NOTES: The estimates assume 1998 tax law and 1994 income levels. They include all tax proposals except the enterprise zone proposal, the proposal on corporate estimated tax payments, and miscellaneous compliance measures.

Pretax family income is the sum of wages, salaries, self-employment income, rents, taxable and nontaxable interest, dividends, realized capital gains, and all cash transfer payments. Income also includes the employer's share of Social Security and federal unemployment insurance payroll taxes, and the corporate income tax. For purposes of ranking by adjusted family income, income for each family is divided by the projected 1994 poverty threshold for a family of that size. Quintiles contain equal numbers of people. Individuals are treated as families of one. Families with zero or negative income are excluded from the lowest income category but included in the total.

Changes in individual income taxes, premiums, and entitlements are distributed directly to families paying those taxes and premiums, or receiving those benefits. Changes in payroll taxes are distributed to families paying those taxes directly, or indirectly through their employers. Changes in federal excise taxes are distributed to families according to their consumption of the taxed good or service. Changes in corporate income taxes are distributed to families according to their income from capital.

a. Current law reflects the scheduled expiration of the limitation of itemized deductions, the phase-out of personal exemptions, and the 2.5 cent component of the gasoline tax that goes into the general fund.

programs in the calculations would further reduce the estimated burden of the Administration's program on those in the lower half of the income distribution. For the groups with incomes below \$30,000, the increase in Food Stamp and LIHEAP benefits would be as large as or larger than the increase in taxes.

## CONCLUSIONS

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The proposals outlined in *A Vision of Change for America* would make a substantial contribution to reducing the deficit, but they are not sufficient to solve the long-run problem. Both CBO and the Administration estimate that, under the President's policies, the deficit would decline only through 1997 and then resume its rise. By the Administration's own projections, the deficit would reach about \$400 billion, or 4 percent of GDP, by 2003.

The Administration pins its hopes for further deficit reduction on its health reform proposals, which are scheduled for release in early May. CBO has frequently pointed out, however, that reforming the health care system is unlikely to curb government spending quickly. In the short run--say, over the next 10 years--it will be exceedingly difficult to realize significant budgetary savings as long as any reform proposal extends coverage to the uninsured, avoids shifting costs to private payers, and maintains many of the desirable aspects of the current system.

A more promising path to still lower deficits would be to make further reductions in programs or to scale back the proposed increases in the President's budget plan, as both the House and Senate Committees on the Budget have done.