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CUTTING SPENDING AND BURNING THE MIDDLE CLASS

Competing proposals from Congress jeopardize the recovery and our future

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Executive summary

Although the U.S. economy clearly needs more fiscal support to address an unrelenting jobs crisis, Congress is prematurely pivoting from creating jobs to cutting spending. Less than four months after passing an $858 billion tax deal, the government is on the verge of shutting down because Congress can't agree on nondefense discretionary spending for the remaining half of this fiscal year. Congress seems to be saying that deficits don't matter when it comes to tax cuts, but deficits trump all when it comes to nondefense spending. This *non sequitur* poses grave risks to both economic recovery and the besieged middle class, and it is embodied in five budget proposals—all of which would place the entire burden of deficit reduction on spending cuts, leaving the revenue side of the equation missing. The House-passed budget alone would cut an additional $51.5 billion from nondefense discretionary spending over the next six months. And this budget proposal, which would turn the dial on unemployment in the wrong direction, is competing with proposals that would do even greater harm to the economy.

These attempts to make good on arbitrary campaign pledges to cut spending now threaten to harm disadvantaged Americans, fuel already rising poverty, impede economic recovery, and cost hundreds of thousands of Americans their jobs—all without addressing the root causes of the

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deficit. While economic hardship still abounds, many of the government programs that have eased joblessness, poverty, and hunger are now under assault by policymakers seeking to radically and rapidly cut near-term spending.

This briefing paper examines the House-passed budget and four other proposals to cut government spending while leaving spending through the tax code untouched. All of the measures would hurt job creation, and the worst of them would all but guarantee a double-dip recession.

- The House-passed Republican leadership budget would cut $61.5 billion this year and $1.3 trillion by 2021. Cuts for the remainder of this year alone would cost roughly 600,000 jobs relative to the Congressional Budget Office (CBO) January baseline and roughly 800,000 jobs relative to the higher spending level requested in the president's budget. These estimates are consistent with a variety of other estimates, including those from Moody's Analytics and Goldman Sachs.
- The Republican Study Committee (RSC) budget would cut $143.7 billion this year and $2.1 trillion by 2021. By calling for deeper spending cuts for the second half of this fiscal year and a rescission of unobligated stimulus funds, it could cost upwards of 1.4 million jobs over the next year or two. Ignoring the economic context of the recession and high unemployment, the needs of a growing population, and the compounding effects of inflation, the budget would then roll back the nondefense discretionary budget to 2006 levels ("the same level as in effect during the last year of GOP control of the Congress"). It freezes the budget at that level (unadjusted for inflation) for the next decade, decimating everything from education investments and the administration of Social Security to tax and border enforcement. Assuming an across-the-board cut, investments in education, veterans' benefits, and federal law enforcement programs would all be cut by 38.9% in 2021.
- Representative Michele Bachmann's plan would cut upwards of $430 billion over the next few years. Health care reform and financial reform would be repealed even though that would increase deficits, with repeal of health reform costing literally trillions in extra debt in coming decades. While it is impossible to estimate the savings of financial reform in terms of avoiding financial crises, we do know that the old regulatory system's failure cost the country 8.8 million jobs and $16.9 trillion in lost household wealth (peak to trough). And with respect to tax dollars, the financial crisis and economic downturn have added roughly $1.7 trillion to budget deficits over 2008-11 (relative to pre-recession, full employment forecasts).
- Senator Rand Paul's budget would all but guarantee a double-dip recession by cutting $500 billion this fiscal year, which started last October. Immediate cuts of this magnitude would almost certainly throw the economy back into recession, and could increase the unemployment rate by as much as 1.9 percentage points. As much as half of the direct effect on the deficit from the budget cuts would be lost as the economy weakens and tax revenues fall.
- The Corker-McCaskill plan would cut $6.1 trillion by 2021, if current tax policies were continued. This would require a 24.6% across-the-board cut in all noninterest spending—including Medicare and Social Security benefits. But the plan fails to curb wasteful spending through the tax code or specify what tax policies would accompany the proposed global spending caps—and correspondingly how much tax cuts would add to interest payments. Near-term, the plan would cut $769 billion in spending over 2013-15 and drain significantly more than that from economic activity, substantially delaying a return to full employment. (Even without slowing job creation, a return to pre-recession unemployment is not expected until 2015 or later.) Chronically starving the country of public investment in areas such as education, transportation, and scientific research could also sap future economic growth.

The economy and labor market remain too frail for spending cuts of these magnitudes. Significantly *more*, not *less,* investment in infrastructure, education, and state fiscal relief would be prudent, as recently urged by former Council of Economic Advisers Chair Christina Romer (Klein 2011).

Furthermore, tax policy must be part of the budget debate. Tax cuts and revenue losses from the recession account for roughly two-thirds of the expanded deficits since the start of the recession (Fieldhouse 2011a). Regressive tax cuts also created much of the structural deficit and debt that accumulated before the economy cratered. But the failure to address spending through the tax code or even acknowledge that tax policies generate net interest outlays suggests that the plans discussed in this paper are strictly intended to reduce the need for revenue rather than to reduce the deficit.

Blame is being attached to the portion of the budget not responsible for larger deficits, and unless the blame shifts to where it belongs, millions of low- and middle-income families will be forced to shoulder the fiscal burden of tax cuts disproportionately benefitting the privileged and an economic downturn that has already caused enough suffering to last a lifetime.

Introduction: Counterproductive 'austerity' plans fail two key tests

Despite the fact that the U.S. economy clearly needs more, not less, fiscal support to help push down an unemployment rate that remains far too high, a number of policymakers on Capitol Hill are trying to outdo one another with calls for ever-deeper and broader spending cuts.

Deficit reduction should not be an isolated goal, but instead balanced by both economic context and distributional concerns. The economic context—14 million Americans unemployed, and an unemployment rate unlikely to fall to pre-recession levels until 2015 or later—demands that net deficit reduction be delayed until the economy improves. Distributional concerns demand that sacrifice at the very least be shared, and preferably be weighted toward those who have fared particularly well over the last decade and have the greatest ability to survive further belt-tightening.

The newly emergent austerity plans have much in common, mainly that they all fail these two tests. First, all the plans call for spending cuts to begin quickly enough to guarantee a weakening of the still-sluggish economic recovery—some plans even would start another recession. And second, most target a comparatively narrow sliver of federal spending (nondefense discretionary spending) that disproportionately benefits low-income and working families. It is impossible to make genuine headway on deficit reduction if cuts are confined to this narrow slice of spending, and to even try would cripple the programs (or entire agencies) in this part of the budget. Furthermore, none of the plans focus serious attention on the real medium- and long-term fiscal challenges facing the United States—insufficient revenue and spiraling health care costs. Given this, the plans look more like ideologically driven attacks on government rather than serious attempts to solve a long-run fiscal challenge. Following are in-depth analyses of the five plans, and a proposed framework for comprehensively tackling our fiscal challenges (and their causes) without slowing economic recovery.

The House Republican budget: Draining public investments, leaving fiscal challenges unresolved

U.S. House of Representatives Republican leadership has called for deep cuts in nondefense discretionary (NDD) funding for the remainder of this fiscal year and has promised to freeze nonsecurity discretionary (NSD) spending at 2008 levels going forward.[1] This budget would cause steep job losses in the near-term, defund key public investments and human needs programs, and fail to resolve our long-term fiscal challenges. An extrapolation of this budget would:

- increase security funding by $112 billion while slashing back the much smaller NSD budget by $1.5 trillion over 2011-21;[2]
- cut the NSD budget in 2021 by 34% relative to an inflation-adjusted baseline; and
- induce spending cuts that for the remainder of this year alone would cost 800,000 jobs relative to the president's budget request and 600,000 jobs relative to the CBO January baseline, estimates consistent with those from Moody's Analytics, Goldman Sachs, and other private forecasters.[3]

On February 19, the House of Representatives passed the Full-Year Continuing Appropriations Act of 2011 (H.R. 1), an attempt to fulfill an election-year pledge to cut $100 billion from the president's budget request.[4] When passed in the House, the bill would have decreased nonemergency discretionary budget authority (BA)[5] by $61.5 billion, relative to a full-year extension of then-current appropriations levels and the spending levels assumed in the CBO January baseline (CBO 2011a).[6] At the time, the cuts would have been squeezed into the remaining seven months of the fiscal year.

Since the passage of H.R. 1, Congress has passed and the president has signed into law two additional short-term continuing resolutions (CRs) to avoid a government shutdown; both CRs pro-rate the cuts in the House-passed budget at a rate of roughly $2 billion a week. Relative to the most recently passed CR, the Additional Continuing Appropriations Amendments, 2011 (H.J. Res. 48), which will keep the government operating through April 8, the House-passed budget represents an additional $51.5 billion spending cut for the remaining half of this fiscal year (CBO 2011b).[7]

Since the Republican leadership budget was intended to cut $61.5 billion below the annualized level of appropriations when passed, and since the subsequent CRs prorate the cuts in H.R. 1, we use a full-year extension of the CR that expired on March 4 rather than an extension of the current CR as the baseline for evaluating the impact of the House-passed budget.

Many of the affected programs have *already* experienced real funding cuts, as appropriations under the recent CRs have not kept up with inflation and population growth.[8] The CBO baseline assumes that discretionary budget authority grows with inflation, so the spending freeze would mean incrementally deeper cuts every subsequent year. Assuming the NSD budget is frozen at 2008 nominal levels beyond 2011, the NSD budget would be cut by roughly $1.5 trillion over 2011-21, relative to the CBO January baseline (which adjusts the annualized March 4 CR for inflation).[9] By 2021, the NSD budget would fall 34.4% below the inflation-adjusted baseline. The CBO estimate of H.R. 1 also notes that the bill would affect several mandatory programs, notably by decreasing spending on Pell Grants by $66.4 billion over 2012-21.[10] Conversely, cutting $2.0 billion from current-year spending to block implementation of health care reform would end up costing $7.1 billion over 2012-21, according to the same CBO estimate. Additionally, H.R. 1 would rescind $6.4 billion in emergency budget authority, mostly from unobligated Recovery Act funds (CBO 2011c).

The House Republican leadership proposal would also result in deep cuts to public investments in education and safety net programs. H.R. 1 would cut funding for Head Start by $1.1 billion, or 15% below current funding levels; $2.1 billion, or 6.3%, from K-12 education; and reduce the maximum Pell Grant award this year and in future years (Horney et al. 2011). The Special Supplemental Nutrition Program for Women, Infants, and Children (WIC) would be cut by $752 million relative to 2010 enacted levels, a decrease of 10.4%, despite rising poverty and food insecurity.

The Defense appropriations bill would see a $7.1 billion *increase* in funding, relative to a full year extension of the March 4 CR, while the remaining 11 appropriations bills would see their funding cut.[11] Assuming the nonemergency discretionary security budget continues to grow on the same trajectory (adjusting an annualized 2011 increase for inflation), the House Republican leadership budget would increase security discretionary BA by $111.6 billion over the same period.[12]

On net, an extrapolation of this budget would decrease discretionary BA by $1.3 trillion over 2011-21, relative to inflation-adjusted levels assumed in the CBO January baseline.[13] As a frame of reference, CBO's January baseline projects cumulative deficits of $8.5 trillion over this period, and those projections assume no further extension of the Bush tax cuts. The alternative fiscal scenario, which assumes extension of Bush-era tax policies, shows deficits of $12.0 trillion over this period.[14] In other words, the proposed cuts will inflict deep pain on households that depend on these programs while actually doing little to address the causes of deficits, even if sustained over the next decade.

House Appropriations Chairman Hal Rogers attempted to defend his bill by declaring that "in many ways, this is sort of a jobs bill because it will encourage the people paying their taxes out there that this Congress finally is getting serious about controlling excess spending"

(Sanchez 2011). But this job-creation claim is shared by essentially no applied macroeconomist. Because these cuts will reduce overall demand for goods and services from an economy already operating well below capacity, we estimate these cuts will eliminate 800,000 jobs, relative to the president's NSD budget request. Relative to the lower spending level in CBO's January baseline, these cuts would result in roughly 600,000 job losses over the next year or two.[15] These estimates are almost exactly in line with other professional forecasters: economist Mark Zandi of Moody's Analytics estimated that the House Republican proposal would result in 700,000 job losses by the end of 2012 (Zandi 2011), and Goldman Sachs estimated that the cuts would slow growth by 1.5 percentage points in the second quarter and 2.0 percentage points in the third quarter of this calendar year, relative to then-current law (Phillips 2011).

Republican Study Committee: Cut faster, deeper, and broader

Not to be outdone by party leadership, the conservative Republican Study Committee (RSC) proposed a broader, deeper package of cuts (RSC 2011a). Their budget would:

- cut spending by $2.1 trillion over 2011-21 relative to inflation-adjusted levels;
- result in upwards of 825,000 job losses from the $83 billion cut for the remainder of 2011 alone;
- cut the nondefense discretionary (NDD) budget for 2021 by 39% relative to the CBO January baseline; and
- fully exempt the Department of Defense from any budget cuts while making draconian cuts throughout the rest of the discretionary budget.

Like the House Republican leadership budget, the RSC proposal would cut NSD spending for the current fiscal year back toward 2008 levels, but would force the pledged full-year cut over the remainder of the fiscal year rather than on a somewhat prorated basis, requiring a much deeper 37.4% across-the-board cut in NSD BA, relative to a full-year extension of the March 4 continuing resolution. That would generate cuts of $82.6 billion relative to the CBO baseline, which would cost close to 825,000 jobs.[16]

For 2012 and beyond, the budget proposal would cut the NDD budget back to 2006 levels, an otherwise arbitrary year that just happens to be "the same level as in effect during the last year of GOP control of the Congress," as explained by the preliminary RSC press release (RSC 2011b).[17] Scored against the CBO January baseline, this freeze would cut $2.0 trillion in NDD spending over 2012-21. Based on this extrapolation, NDD programs would see funding cuts of 38.9% by 2021 relative to the CBO January baseline—and this cut does not even take into account population growth.

The RSC plan would also eliminate the statutory inflation-adjustments for all discretionary appropriations in the CBO baseline, forcing the CBO baseline to assume real cuts in the absence of policy changes. This would make spending increases look larger than they are and spending cuts look smaller than they are. Additionally, any real funding increases for the Department of Defense—like the one in the House-passed budget—would not be reflected in future CBO budget baselines.

The RSC plan recommends $330 billion in specific discretionary spending terminations, reductions, and savings over a decade, leaving much of the cuts to the discretion of future appropriators. Specified terminations include:

- eliminating the federal subsidy for the Corporation for Public Broadcasting;
- eliminating the National Endowments for the Arts and the Humanities;
- eliminating Amtrak subsidies;
- eliminating high-speed rail grants;
- eliminating youth volunteer programs, including AmeriCorps;
- eliminating the U.S. Agency for International Development; and
- eliminating general assistance to the District of Columbia and the Washington Metropolitan Area Transit Authority.

The remaining discretionary budget cuts also assume that for every two civilian federal employees who quit or retiree only one replacement can be hired until the civilian federal workforce is reduced by 15%. Additionally, the budget would eliminate automatic pay increases for federal employees for five years (RSC 2011a).

Beyond these discretionary cuts, the RSC proposal would immediately undermine the economic recovery by *rescinding* $45 billion in American Recovery and Reinvestment Act (ARRA) funds and repealing $16.1 billion in subsequent state fiscal relief (an extension of the higher Federal Medical Assistance Percentage (FMAP) for Medicaid, CHIP, and other programs). Adding this $61.1 billion stimulus rescission to the $82.6 billion NSD cut in 2011, RSC budget cuts of $143.7 billion for 2011 would result in roughly 1.4 million job losses.[18]

The RSC plan also books $30 billion in savings from divesting federal control from Fannie Mae and Freddie Mac, which returns these agencies to the problematic hybrid status that characterized them before the housing crisis. With these cuts, the RSC proposal would reduce spending by $2.1 trillion over 2011-21. All told, the RSC proposal would almost surely undermine the effectiveness of programs and agencies in the following ways:

- An across-the-board-cut of 38.9% would cripple border security, law enforcement, investments in education and transportation infrastructure, basic scientific research, and consumer health and financial protection.
- Administration of social insurance programs, such as Medicare and Social Security would suffer, leading to worse service and greater payment errors.
- Tax administration and enforcement would be spread thin, making it easier for corporations and wealthy individuals to avoid paying their fair share. According to the IRS Commissioner, a $1 million cut to the IRS budget leads to nearly $7 million in lost revenue (Berry 2011).
- Nonetheless, the RSC commitment to making the Bush tax cuts permanent and their failure to deal with rising health care costs would still leave the core challenges of the long-run fiscal position unaddressed.

Rep. Michele Bachmann's proposal: Policy overreach under the guise of fiscal responsibility

Two Tea Party favorites have offered deficit reduction packages fixated on slashing *near-term* deficits, which are largely cyclical and have served to cushion the impact of the Great Recession. Besides not addressing the actual fiscal challenge facing the nation (the long-term problem caused by health care costs rising faster than economic growth), these plans would clearly sap the economy of momentum and all but guarantee a double-dip recession.

Representative Michele Bachmann (R.-Minn.) has produced a list of "Potential Spending Cuts and Estimated Money Saved" that total $430 billion.[19] A lack of specificity precludes extrapolating a 10-year budget plan, but based on the details provided, the Bachmann spending cut proposals would, among other things:

- repeal the Patient Protection and Affordable Care Act (i.e., health care reform) without acknowledging the substantial cost of doing so;
- shift hundreds of billions of dollars of costs from the federal budget to states, worsening the state budget crisis, hurting services for those most in need, and creating an even greater drag on economic growth; and
- repeal two key consumer protection bills—financial reform and a food safety overhaul—for insignificant savings of $12.3 billion over the coming five years.

The proposals largely shift costs to states by eliminating or scaling back block grants or entire federal agencies. Given that the Center on Budget and Policy Priorities estimates that all states faced a collective budget shortfall of $130 billion for 2011 and 44 states and the District of Columbia are projected to see a collective shortfall of $112 billion for 2012 (McNichol et al. 2011), it seems an ill-advised time to shift any costs to the states.[20] Next year will be even worse for states, however, because state fiscal relief from the Recovery Act will drop off from $59 billion to $6 billion over 2011-12.

Like the RSC proposal, Bachmann proposes repealing all unspent stimulus money, which would immediately weaken the economic recovery.[21] The most recent fiscal stimulus measures—the teachers jobs fund, an extension of the higher FMAP matching rates, and the continuation of full federal funding of extended benefits—all helped to plug state budget shortfalls. Rescinding any of these funds would unequivocally worsen the state budget crisis and amplify an economic headwind blowing against recovery.

The most curious provision of the Bachmann plan is repealing the Patient Protection and Affordable Care Act (i.e., health care reform) because the CBO has projected that repeal would *add* $210 billion to deficits over the next decade and significantly greater savings—around half a percent of GDP—in subsequent years (CBO 2011d). As noted earlier, defunding implementation by $2.0 billion this year would add $7.1 billion to deficits over 2012-21. The Bachmann proposal instead cites "unknown" savings and "larger savings in later years," neither of which is an accurate statement; repealing health care reform would mean progressively *larger* deficits in later years.

While excess health care cost growth is undoubtedly the driver of unsustainable long-term deficits, Bachmann's only specific health care proposals are repealing health care reform (which would raise deficits) and saving $12.2 billion by cutting programs aimed at providing health care to vulnerable populations: the Maternal and Child Health block grant; rural health outreach grants; health professionals grants; the National Health Service corps; Title X family planning; and all federal funding of Planned Parenthood and family-planning facilities. The Bachmann proposal also scores $44 billion in general government reform savings from halving the "number of payment errors by 2012, especially by reducing Medicare errors and earned income tax credit errors," although these supposed savings are suspect and much less likely to be realized if Medicare administration is cut, as envisioned by many of the Republican plans to reduce the federal workforce.

The list is capped with the repeal of two signature consumer protection bills. Bachmann proposes repealing the FDA Food Safety Modernization Act and the Dodd-Frank financial reform bill. The CBO estimated that the Food Safety Modernization Act would increase budget authority subject to appropriation by $1.6 billion (and outlays by $1.4 billion) over 2011-15; if fully implemented, the bill will add a paltry $92 million to next year's budget deficit (CBO 2010e). Ignoring changes to the Troubled Asset Relief Program that reduced direct spending by $11.0 billion in 2010, the direct spending and revenue provisions of Dodd-Frank would increase deficits by $10.9 billion over 2011-15 and $7.8 billion over 2011-20 (CBO 2010f).

These cuts would, combined, reduce outlays by less than $12.3 billion over 2011-15, excluding any funding subject to future appropriations associated with Dodd-Frank.[22] While it is impossible to estimate the savings of financial reform in terms of avoiding financial crises, we do know that the old regulatory system failed miserably and cost the country 8.8 million jobs, a 4.1% drop in real GDP, and $16.9 trillion in lost household wealth (measured business cycle peak to trough).[23] Three years after the start of the Great Recession, we face a jobs shortfall of 11 million (adjusted for population growth), a sweeping foreclosure crisis, and national output 5.1% below potential (Shierholz 2011a). The recession has also added roughly $1.7 trillion to budget deficits—excluding legislative changes such as the Recovery Act—over the last four years, relative to CBO's pre-recession forecast.[24] In light of these costs, the "scorable" near-term savings from repealing financial reform could easily be dwarfed with the "unscorable" societal and budgetary costs of another financial cataclysm. Similarly, the societal cost of greater incidences of food-borne illness could easily exceed $1.6 billion in budgetary savings from repealing the Food Safety Modernization Act. In both cases, potential savings to the taxpayer are minimal.

Sen. Rand Paul's budget: Cuts deepest and would halt economic recovery

The second Tea Party proposal from incoming Senator Rand Paul (R.-Kent.) has so far won the quick and deep spending cuts contest, introducing a bill "to cut $500,000,000,000 in spending in fiscal year 2011." For the remaining six months of the fiscal year, noninterest federal spending would be slashed by $500 billion, a 14.4% annual reduction in full-year funding and a catastrophic 29.9% plunge in funding for the remainder of the fiscal year. The Rand Paul budget would cause the economy to shrink between

3.3% and 5.0%, and cause the unemployment rate to jump by between 1.3% and 1.9%.[25]

Politicians and pundits often claim that raising taxes is the worst thing policymakers could do in a recession. While their Keynesian instincts on this are not terrible, the empirical fact is that spending *cuts* have much worse of an impact on a recovery. Based on CBO's projections, GDP is already expected to be 5.1% below potential this year, and the private sector is in no position to make up for another huge decrease in demand. The CBO has also indicated that general government spending provides a much larger bang-for-buck in supporting an ailing economy than do tax cuts (CBO 2010d). The Paul budget cuts would be at least partially self-defeating in the short-run if the goal is deficit reduction. The $500 billion in cuts would likely reduce economic output by between $500 and $750 billion, which would reduce tax collections and increase mandatory spending by roughly $185-$275 billion.[26] In short, probably one-third to one-half of the deficit-reducing benefits of the Paul budget cuts would leak away as the economy weakened.

Unlike the House Republican leadership and RSC plans, one really cannot project an extension of the Rand Paul budget; sustaining cuts of this magnitude (or, more realistically, cuts that grow with inflation) is not a realistic policy. But Paul himself proposes some specifics.

His plan would cut the Supplemental Nutrition Assistance Program (SNAP, formerly food stamps) to 2008 levels, effectively halving this program's reach despite rising poverty and increased hardship because of the recession. His justifications for this cut include "obesity rates are actually higher for adults and children who are below the poverty level or on food stamps" and "food stamps are not conditioned on work status and contribute to long-term dependence on the federal government" (Paul 2011a). These judgments are not empirically well-grounded; decreasing benefits may well cause a substitution toward even cheaper, less healthy foods and/or lead to outright malnourishment. Similarly, a work-based welfare model breaks down when there are roughly five unemployed workers for every job opening (Shierholz 2011b). Cutting back food stamps would worsen not just poverty and perhaps health, *but economic recovery as well*; Zandi estimates that a temporary increase in food stamps yields the highest bang per buck—$1.72 for every dollar spent—of any stimulus policy (Zandi 2010). This is because the benefits target households who will immediately spend the extra disposable income back into the economy, creating more jobs.

The Paul budget would also essentially abolish the Department of Education. The basic Pell Grant program would be maintained at $16.3 billion, a full $12.5 billion below the president's request (OMB 2010b), while the remaining $70.0 billion in federal education funding would be eliminated. These cuts would increase stress on state education budgets and the impact on the economy would further exacerbate the state and local budget crisis at a time when these governments are in no position to supplant decreased federal investments.

The Paul budget overview claims to cut the Food and Drug Administration budget by 62% for the full year, which would require a near-total shutdown of the agency for the duration of this fiscal year.[27] The Health Resources and Services Administration would see funding cut by 34% explicitly to discourage illegal immigration, because the agency provides free health clinics for migrant workers (Paul 2011a). These two proposals would surely increase the incidence of food-borne illness and cause unnecessary suffering or loss of life.

The budget also proposes a mammoth 37% cut for the National Institutes of Health solely because the president's budget requested a $1 billion increase for advanced health research, as explained by the overview document: "President Obama's FY2011 budget calls for a $1 billion increase in funding to the National Institutes of Health. Reducing federal grants in this area would realize billions in savings. Each of the [Department of Health and Human Services] cuts called for in this proposal will stop the bleeding in these ever-increasing budgets." Cuts to basic science also include a 62% cut to the National Science Foundation because "research in science is best conducted by private industry for economic purposes" (Paul 2011b) and "additional cuts" to the National Oceanic and Atmospheric Administration because it has "become bloated in its breadth and scope" by engaging in climate change research.

And those are the lucky programs. Paul proposes outright elimination of dozens of programs and even the entire Department of Housing and Urban Development. A representative list of independent agencies that are terminated in the Paul budget include: the Affordable Housing Program, Consumer Product Safety Commission, the Corporation for Public Broadcasting, and the National Endowments for the Arts and Humanities.

One aspect that sets apart Senator Paul's plan from other Republican plans is his proposal to cut the base Department of Defense budget back below 2010 levels *and* cut emergency funding for overseas contingency operations (OCO).[28] As Senator Paul notes, overseas contingency operations have cost $1.1 trillion; unfunded wars explain much of the accumulation of debt over the last decade, which cannot be said of the oft-targeted non-security discretionary budget.

Corker-McCaskil spending caps: A straightjacket but no budget

Most recently, Senators Bob Corker (R.–Tenn.) and Claire McCaskill (D.–Mo.) proposed capping total federal spending—that is, all discretionary, mandatory, and debt service expenditure—as a share of GDP. The effective cap would be gradually ratcheted down from 22.25% of GDP in 2013 to 20.6% by 2022, a full 6.2 percentage points below levels projected under CBO's alternative fiscal scenario (Corker 2011; CBO 2010a). Haphazardly squeezing the size of agencies and programs is problematic for many reasons:

- This plan amounts to massive overkill in terms of spending cuts, but entirely fails to address health care excess cost growth and revenue adequacy. Spending would be slashed by $7.6 trillion over 2013-22, relative to CBO's alternative fiscal scenario.
- The required cut of $1.5 trillion in 2022 alone would mean a 27.3% across-the-board reduction in projected noninterest spending, *including Medicare and Social Security benefits*.
- It ignores the realities of demographic change, rising health care costs, the creation of a new prescription drug benefit, increased domestic security spending, and unfunded overseas contingency operations; instead the bill arbitrarily targets the 1970-2008 historical average of spending.
- It renders government inflexible in responding to emergencies such as recessions or financial crises with countercyclical fiscal policy. In fact, if spending levels are near the cap when the economy plunges into recession, it is likely that the cap would actually throw more fuel onto the fire by requiring pro-cyclical fiscal adjustments.
- A spending cap of this size essentially repeals health care reform, which included subsidies (increasing direct spending) for the purchase of insurance in the health insurance exchanges.

This is the only budget proposal that has *not* endorsed any specific cuts and instead relies entirely on budget process reform. If the spending cap is not met, then the Office of Management and Budget would be forced to make simultaneous, evenly distributed cuts across all mandatory and discretionary programs. Overriding the cap and cuts would require a two-thirds supermajority in both chambers of Congress, a nearly impossible hurdle in an increasingly polarized Congress.

While the spending cap would not be implemented until 2013, the plan would jeopardize the anemic economic recovery by imposing huge cuts through 2015, a year in which the CBO is projecting unemployment to average 6.1% (CBO 2011a). Under the CBO baseline, adjusted for a realistically higher rate of Medicare physician payments than prescribed under current law,[29] spending would be cut by $769 billion over 2013-15, with $352 billion cut in 2015 alone.[30] By way of contrast, the extrapolated House Republican leadership budget would cut $435 billion in primary spending over 2011-15. Spending cuts of this magnitude imposed before the economy has returned to operating at its potential would imperil the economic recovery.

Based on the conservative spending estimates in the doc-fix-adjusted CBO baseline, the Corker-McCaskill plan would translate to a $4.5 trillion cut over 2013-21. By 2021, all noninterest spending would have to be cut by 16.6%. If the Department of Defense were spared the budget axe, the cap would require a greater 20.3% across-the-board cut. The cap would require a much larger 24.6% across-the-board reduction in noninterest spending relative to the CBO alternative fiscal scenario, largely because continuing the 2001 and 2003 tax cuts would substantially increase net interest payments.

A spending cap is no substitute for a balanced, methodical approach to budgeting. Tax policy has great ramifications for a spending cap (tax cuts reduce revenue, resulting in more borrowing and higher interest payments that would then force larger reductions in noninterest spending), but revenue levels are fully ignored in the Corker-McCaskill plan. The largest threat to the fiscal outlook—an extension of the Bush-era tax cuts beyond 2012—is overlooked by this draconian deficit-reduction proposal. Furthermore, by ignoring the role of the tax code in budgeting, the Corker-McCaskill spending caps would encourage lawmakers to simply shift spending programs to the revenue code.

(*Note—Since this paper was drafted, Senate Republican leadership has proposed a balanced budget amendment accompanied by a much lower global spending cap, which would effectively constrain federal outlays to roughly 16.6% of GDP. See Fieldhouse (2011b) and Greenstein (2011).)*

Tax policy: The missing half of the equation

The Obama administration recently came under unfair criticism from some politicians when the Congressional Budget Office's (CBO) January estimate of the fiscal year 2011 deficit increased by $412 billion since last August's estimate. After all, this was no surprise: passing an $858 billion tax cut package last December—which was supported by the leadership of both parties in Congress—added sizably to the deficit. For all the rhetoric lambasting "runaway spending," policymakers have turned a blind eye to a prime component of both our structural deficit and our countercyclical deficit: sweeping tax cuts.

Missing from the CBO baseline is that making permanent the Bush-era income and estate tax provisions[31] and indexing the AMT to inflation would add *$4.6 trillion* ($3.8 trillion plus $795 billion in debt service) to deficits over 2012-21, increasing cumulative deficits by 66% over this period. The bill of regularly enacted tax extenders—everything from the research and experimentation (R&E) credit to tax deferral loopholes for foreign earnings—would be another $950 billion (including debt service) over this period (CBO 2011a).

Many policymakers equate government spending to the size of government and its role in the economy. This is overly simplistic and misleading because it does not include tax expenditures—i.e., tax breaks, such as the home mortgage interest deduction, the employer-provided health insurance exclusion, and many others. These provisions occupy the vast grey area between spending and revenue provisions of the federal budget: while technically they are tax reductions, their impact on the economy is similar—and in many ways identical—to spending in that they alter economic incentives and cost money. In fact, such provisions cost a huge sum of money vastly exceeding the structural budget deficit: collectively, line-item tax expenditures total nearly $1.1 trillion for 2011 (OMB 2011).[32]

Looking to cut spending without addressing these special tax subsidies will likely result in a shift of policy objectives from the spending side of the ledger to the tax code, without improving the deficit and possibly generating less-efficient policy outcomes. Before jumping to broad spending cuts, policymakers should pursue comprehensive tax reform to simplify the outdated tax code, reduce tax rates, and reduce the deficit.

Budget battles have and will continue to revolve around the ideological debate over the proper size and role of government. Curbing tax expenditures and reforming the tax code would be a good way to define the starting point for this debate.

Responsible budget reform should be pursued; that means strengthening, not weakening the economy

Political gridlock suggests that the economy is unlikely to receive any additional fiscal stimulus in coming years. This amounts to economic malpractice by policymakers. While real fiscal challenges exist, they are mainly medium- and long-term hurdles that will only be made worse by pushing the economy back toward recession, as these five budget proposals would surely do. Policymakers must differentiate between large—but absolutely necessary—short-term deficits and longer-term structural deficits largely resulting from revenue inadequacy and rising health care expenditure.

All five of the plans described above cut spending in the near-term and would inflict great damage on vulnerable populations, yet fail to specifically address these real fiscal challenges they pretend to tackle. Deficit reduction is not a means unto itself; plans that shift costs to states and consumers, harm the economic recovery, or jeopardize long-term growth prospects fail the broader needs of the nation.

When cyclical budget deficits have retreated and the economy is strong enough to withstand structural deficit reduction, a balanced approach that mixes tax reform, new revenue sources, health care reform (which will be an ongoing process for decades to come), and targeted spending cuts will be needed. This is not to suggest that Congress should not move toward budget reform; it is merely to say that net deficit reduction should be delayed until the economy has gained momentum, the unemployment rate has dropped back toward historically normal levels, the financial sector has repaired its balance sheet, and the housing market has picked up.

Enacting additional health care reforms, such as adding a public option to compete with private insurance companies in the insurance exchanges, would be a real step toward reducing excess cost growth, which is undoubtedly the biggest budgetary challenge for policymakers. Comprehensive tax reform would be another good starting point that could improve the long-term outlook without choking off recovery. For a detailed, comprehensive approach to long-term deficit reduction that balances both the economic context and equity concerns raised in this paper, see *Investing in America's Economy: A Budget Blueprint for Economic Recovery and Fiscal Responsibility* (Our Fiscal Security 2010).

Premature fiscal retrenchment, on the other hand, would be a huge mistake with devastating consequences for both the budget and economy. Relying on the same political gridlock that has obstructed additional stimulus to also obstruct these dangerous cuts may be unsavory, but it might be the economy's best hope.

Endnotes

1. All years are federal fiscal years unless otherwise noted.

2. This calculation assumes non-security discretionary budget authority is frozen at 2008 nominal levels in 2012 and beyond. The annualized increase in 2011 security spending in H.R.1 is adjusted to inflation beyond 2011.

3. EPI previously estimated that H.R.1 would result in roughly 800,000 job losses, but this calculation measured a cut relative to the president's budget request (Thiess 2011a). Measured against the CBO January baseline, and again assuming a fiscal multiplier of 1.5 for general government purchases of goods and services, we estimate that the $61.5 billion cut prescribed in H.R. 1 would result in over 600,000 job losses.

4. On March 9, H.R. 1 was subsequently voted down 44-56 in the U.S. Senate.

5. Budget authority represents the ability to spend money or enter into contracts that will eventually result in outlays, rather than outlays themselves. It is the primary measure of programmatic funding for budgeting purposes.

6. A reduction in annual BA will result in a much larger proportional cut in BA for the remainder of the fiscal year because Congress had already approved BA through March 4 (the first 155 days of the fiscal year). The steep drop-off in BA for the remainder of the year would, however, affect various agencies' outlays differently, depending on how much of the previously authorized budget authority has been obligated.

7. Congress has now provided budget authority for the first 190 days of the fiscal year. The remaining $51.5 billion dollar cut would reduce BA for the remaining 175 days, or 48%, of the fiscal year. Cuts to full-year 2011 appropriations levels are annualized accordingly to show their relative impact for the remainder of the fiscal year.

8. The president's 2011 budget requested $478 billion for non-security discretionary spending. Extending the March 4 CR for a full year would have funded NSD agencies at $461 billion, just below the $462 billion level enacted for 2010, and 3.6% below the president's request. The March 4 CR, however, would have cut $19 billion from inflation-adjusted 2010 NSD BA, and $30 billion from total inflation-adjusted 2010 non-emergency discretionary BA. The House-passed budget, on the other hand, would cut $85 billion in NSD BA and $92 billion in total non-emergency discretionary BA relative to inflation-adjusted 2010 BA (Horney 2011).

9. As specified under the Balanced Budget and Emergency Deficit Control Act of 1985, CBO uses a weighted combination of the GDP price index and the employee cost index for wages and salaries as its inflation adjustment (CBO 2011a, 83). We use the projected growth in discretionary BA, which is bounded by these two measures of price inflation as projected by CBO, as a proxy inflation-adjustment for the non-security budget baseline.

10. The Pell Grant program has both a discretionary and a mandatory component. H.R. 1 would decrease the maximum discretionary award for 2011 and result in the elimination of the mandatory award in 2014 and beyond. See CBO (2011c) and Horney et al. (2011).

11. These calculations are based off of the CBO score of H.R. 1 as passed (CBO 2011c) and the Center on Budget and Policy Priorities estimates for current funding levels under a full-year extension of the continuing resolution (Horney et al. 2011).

12. The $4.6 billion increase in security BA for the remainder of FY2011 is annualized to $9.5 billion for the already funded 190 days of this fiscal year (multiplying by 365/175) and then adjusted for inflation, as detailed in endnote 9. If the security spending increase were not annualized, the Republican budget would increase security spending by $55.9 billion over 2011-21 and total discretionary BA would be cut by $1.4 trillion over this period.

13. Everything else being equal, net deficit reduction would be greater because of decreased debt service needs. Net interest costs would, however, depend heavily on the tax policies enacted over this period.

14. CBO's alternative fiscal scenario is meant as a more accurate reflection of current policy than the current law budget baseline. It assumes that Medicare physicians payments grow with the Medicare economic index rather than the sustainable growth rate (SGR) mechanism, that Medicaid and insurance exchange price controls are not implemented beyond 2020, and that other non-interest spending (excluding Medicare, Medicaid, insurance exchange subsidies, CHIP, Social Security, and some refundable tax credits) would be frozen at 2010 levels as a share of GDP (excluding stimulus spending) beyond 2013. The alternative fiscal scenario also assumes extension of the 2001 and 2003 tax cuts, AMT relief, and 2009 rates and exemption for the estate and gift taxes through 2020. Individual income taxes are adjusted to keep revenue constant as a share of GDP beyond 2020. See CBO (2010a, 3). We model the alternative fiscal scenario (presented as a share of GDP) using CBO's latest GDP projections (CBO 2011a).

15. There is some timing uncertainty in the translation of budget cuts to economic growth to jobs because of the lag between budget authority and outlays. This is somewhat trivial, however, as the job losses would materialize while the economy remains well below potential and unemployment remains significantly elevated above historically normal levels.

16. Again assuming a fiscal multiplier of 1.5, this $83 billion cut would reduce GDP by roughly $124 billion, or 0.82%, relative to projected GDP for FY2011 (CBO 2011a).

17. The RSC proposal was scored against the August 2010 Budget and Economic Update (CBO 2010b), extrapolating NDD BA for 2021 from 2019 and 2020 levels. Total NDD BA in 2006 was $440.2 billion (OMB 2010a), including $23.8 billion of supplemental appropriations (CBO 2010c), leaving $416.4 in non-emergency NDD BA. In modeling the RSC plan, we freeze NDD BA at $416.4 billion and score this against the CBO January 2011 baseline, which shows a lower projected path for NDD BA than the August Budget Update because of subsequent continuing resolutions.

18. For the purposes of this calculation, the rescinded Recovery Act funds are treated as FY2011 BA whereas most Recovery Act appropriations and mandatory spending budget authority was for FY2009 and FY2010. Much of the FMAP budget authority has already been obligated, so this calculation assumes payments to states would be retroactively rescinded or some future payments to states would be withheld this fiscal year.

19. Most costs appear to be an annualized rate, such as the Defense Department cuts, although some savings are clearly one-time (rescinding stimulus funds, for example) and some savings represent a five- or ten-year budget score. There is also some double counting in Bachmann's list of cuts; eliminating all earmarks will save less than $16 billion if agencies, programs, and block grants are downsized or eliminated as proposed elsewhere in the list. This total also excludes the substantial cost of repealing health care reform.

20. State fiscal years typically start in July, a quarter ahead of the federal fiscal year. The budget cuts, particularly to grants to states, would thus worsen the states' fiscal gap for both 2011 and 2012.

21. Bachmann's plan cites $60 billion in potential savings from repealing unspent stimulus spending, presumably the same proposal as the cuts cited in the RSC budget.

22. CBO did not publish an estimate of costs subject to future appropriations for Dodd-Frank.

23. The loss of household wealth is calculated by the Federal Reserve Flow of Funds Table Z1.B100 "households and nonprofit organizations; net worth." Net worth fell from $65.7 trillion in 2Q 2007 to $48.7 trillion in 1Q 2009. Net worth remained $8.8 trillion below its pre-recession peak as of the fourth quarter of 2010.

24. EPI analysis based on CBO data. This reflects $664 billion in economic revisions and $1.1 trillion in technical revisions (factors affecting revenue not directly related to CBO's economic projections, such as stock valuations) to budget forecasts for 2008-11 since the August 2007 Budget and Economic Update through the January 2011 baseline.

25. The lower bound assumes a fiscal multiplier of 1.0 and the upper bound assumes a fiscal multiplier of 1.5, which is below the midpoint of CBO's estimate for the impact of general purchases of goods and services by the federal budget (CBO 2010d). Under the two scenarios, GDP would fall from $15,032 billion to $14,534 billion (-3.3%) and $14,284 billion (-5.0%), respectively. The economy is projected to operate 5.1% below potential, and these two scenarios would move the economy further from potential GDP, to 8.2% and 9.8%, respectively. This change from potential GDP is then divided by 2.5 as a conservative estimate for the percentage point rise in unemployment by Okun's rule of thumb (assuming employment is relatively unresponsive to the change in economic output).

26. Analysis of the Congressional Budget Office's data on the cyclical component of budget deficits show that a dollar increase in actual GDP relative to potential GDP is associated with roughly a $0.37 improvement in the budget deficit (Bivens and Edwards 2010).

27. Continuing resolutions have already provided BA for the first six fiscal months (52% of full-year funding levels), so this cut would mean no additional BA for the remainder of the year. As in the case of the government shutting down from failure to extend a continuing resolution, some essential operations might continue (depending on cash management and unobligated funding from previously enacted BA), but normal operations would come to a grinding halt.

28. Bachmann proposes $178 billion of efficiency measures and savings identified by Defense Secretary Gates for deficit reduction, but no reduction in OCO funding. Secretary Gates had proposed $100 billion in efficiency savings be reinvested in other Department of Defense priorities and $78 billion be dedicated to deficit reduction.

29. This is an adjusted CBO baseline reflecting current policy for primary spending; it does not reflect the higher net interest costs that would be associated with a continuation of current revenue policies not included in the CBO baseline, such as an extension of the Bush tax cuts past 2012. Freezing physicians payments at 2011 levels, the so-called "doc fix," would cost $302 billion over a decade (including debt service).

30. Under the alternative fiscal scenario, spending would be cut by $614 billion over 2013-15, with $366 billion in cuts in 2015 alone.

31. As modified by the Kyl-Lincoln proposal, which decreased the tax rate from 45% to 35% and raised the exemption threshold from $3.5 million to $5 million for individuals (and from $7 million to $10 million for married couples), a tax giveaway benefiting only the top quarter of one percent of tax filers.

32. Note that the budgetary savings from eliminating all tax expenditures would vary because of behavioral responses and interaction effects.

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