Bob Greenstein:
Thank you everybody. Good morning. Thanks David and Margy. There are a lot of block grant proposals in the President's budget floating around Washington. There is a lot of turf to cover.

If you go through President Bush's budget that was issued in early February, you find that it includes proposals to convert to a block grant various programs including: the Medicaid program, Section 8 Housing Voucher program, Head Start, child welfare, job training, and the administrative costs in running the Unemployment Insurance program, a proposal that has implications for Unemployment Insurance benefits as well. The Welfare Reauthorization Bill that passed the House of Representatives contains a proposal to start the Food Stamp program down the road toward a block grant, which would put five states initially into a block grant. Both the House welfare bill and the administration's welfare proposal contain a so-called super waiver provision that many of us view as itself starting various programs down a road that begins with sweeping waivers that vitiate federal rules governing these programs, imposes a block-grant-type cap on the amount of federal funds made available to a state for programs covered by a state's super waiver, and — if numerous states use super waivers to alter federal programs sharply — could lead to block grants as a seemingly logical next step.

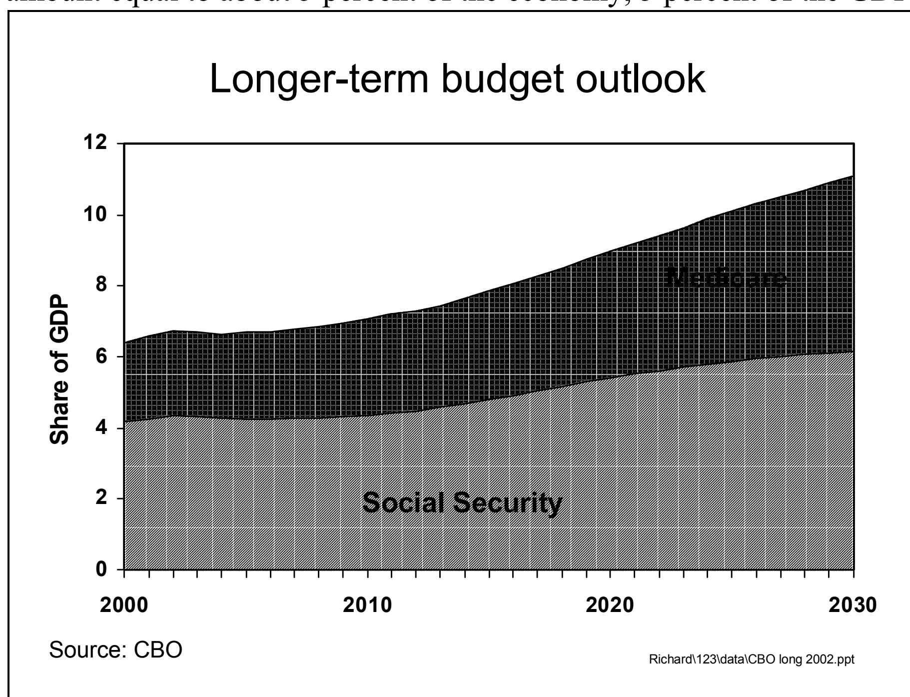
Why the broad interest in moving so many domestic programs to block grants? There are a number of factors, and clearly interest in moving more decisions from the federal to the state level is one of them. But I submit to you that probably the single most important reason to the administration and many of its close supporters, and I think the most important thing to understand about the block grant proposals as a group, is that they are an essential and integral part of the architecture that goes with the very large tax cuts we're now seeing proposed, as I'll explain in a couple of minutes.

The President's own budget projects, under his policies without further changes, that the federal budget will never get out of deficit in a single year in the next 50 years and will ultimately reach deficits of a magnitude year after year that would be quite damaging to the economy. This is not two or three years from now; we're talking 15-20 years down the road. Of course the administration does not propose that we run deficits of that magnitude. Its answer for how to escape this is that ultimately federal spending – that vague term with a capital "S" – needs to be cut.

More explicit is one of the administration's closest allies, Grover Norquist, head of Americans for Tax Reform. Grover essentially says, 'Look, one side of this is the tax cuts and the other side is that over 20-25 years we're going to try to cut the domestic side of the federal government in half.' Now, this administration is not dumb. They are very savvy. They know very well that if they propose alongside these tax cuts deep gouges in specific programs where you can identify the families that would be hurt, it would not go over well. Look at the firestorm just on leaving out of this year's tax cut many working families earning between $10,000 and $25,000.
The administration has clearly understood from day one that if it publishes deep cuts in specific programs in its budget — with the potential to harm identifiable groups of families, children, elderly, and people with disabilities — this would reduce its ability to get its tax cuts enacted. It has pursued a different strategy. I think the block grants are a fundamental part of that strategy. It is a strategy to reduce very gradually, over time, the federal government's financing role in an

array of programs as the tax cuts are fully phasing in and are draining more and more revenue from the federal treasury. To illustrate this, I'd like to spend the next few minutes showing you what the federal budget picture looks like, not this year or next, but somewhat farther down the road. At the end of this talk, I'll cover what I believe are some signs of hope, but the next few minutes are going to be pretty gloomy.

So we start with the long-term demographic picture. When the Baby Boom generation retires, Social Security and Medicare costs go way up. Sometimes you hear people say, "You can't predict the budget three or four years out, how can you predict anything that far out?" We can't precisely predict the economy in future decades, but we know how old Americans of different ages are today. The demographics are largely baked into the cake. As this chart shows you, Social Security and Medicare between the year 2000 and 2030 will increase in costs by an amount equal to about 5 percent of the economy, 5 percent of the GDP.

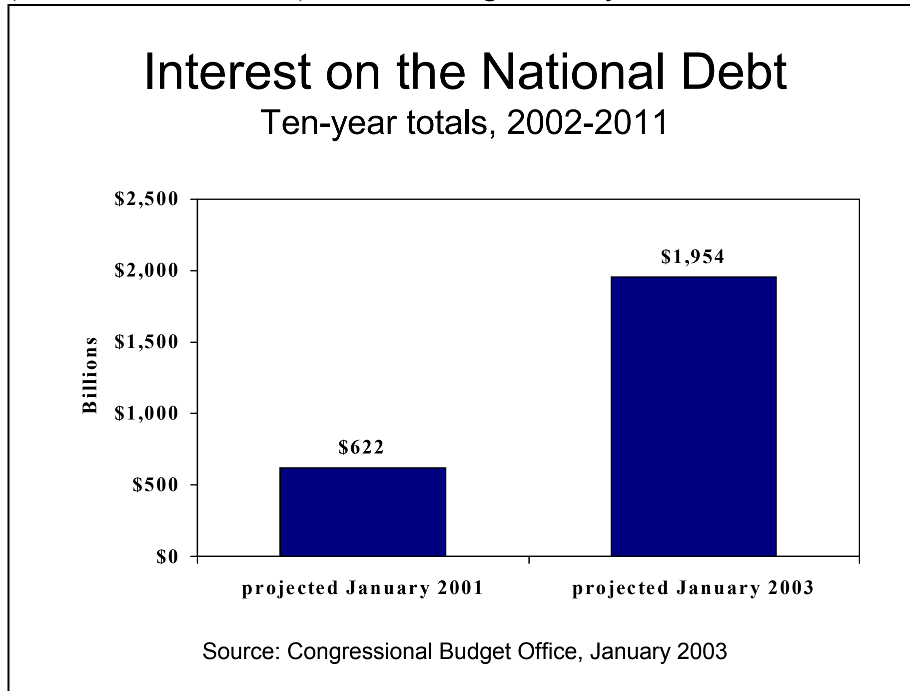


How big is 5 percent of the GDP? Larger than the entire US defense budget. So this is a big increase. I could've done the chart a different way and also put in Medicaid long-term care, and if I did, the increase would be still larger.

So the challenge that a number of us have seen coming for a number of years is, how do we navigate this period without savaging the rest of the federal budget? One partial answer, just partial, appeared to emerge at the end of the 1990's. And that was that, if we largely eliminated the federal debt in the years when the Boomers were in their peak earning years, before they began retiring, we could eliminate $200 billion a year that the federal government pays in interest on the national debt, which would ease the squeeze by $200 billion a year when the Boomers retire. But that hope is now largely gone.

In January 2001, the Congressional Budget Office projected that we would spend $620 billion on interest payments on the debt over the next 10 years as the debt went down and the interest

payments fell. By this January, CBO predicted we would spend $1.95 trillion – that is nearly $2 trillion – on interest payments on the debt over the same period. That was before the new tax cut was enacted. The estimates are now heading up towards the $2.5 trillion level. If you are facing a demographic and long-term budget situation that looks like this, you have to ask yourself the question: would the first step you want to take be actions that cause the federal revenue base (federal tax collections) to contract significantly?



Now some people say, "Look, the 2001 tax cut was not a big tax cut. It was $1.35 trillion over 10 years. Not tiny, but not all that big." The problem with that analysis is that the tax cut wasn't really $1.35 trillion over 10 years. It only appeared to be so due to a series of gimmicks, including slow phase-ins and artificial ending dates on tax cuts when there would be overwhelming pressure to continue those tax cuts. So if one wants to look down the road at the budget, you have to ask, what is the cost?

Now I'm just on the 2001 tax cut for the moment. What is the cost of that tax cut when it is fully in effect? What would be its cost if it is made permanent, which is a signature White House proposal?

It turns out that the 2001 tax cut is sufficiently costly that when fully in effect it is five times the entire HUD budget, four times what the federal government spends on education at all levels – elementary, secondary, higher ed – combined. Here is a similar story in graphic terms.

Annual Cost of Tax Cut Compared to Agency Budgets

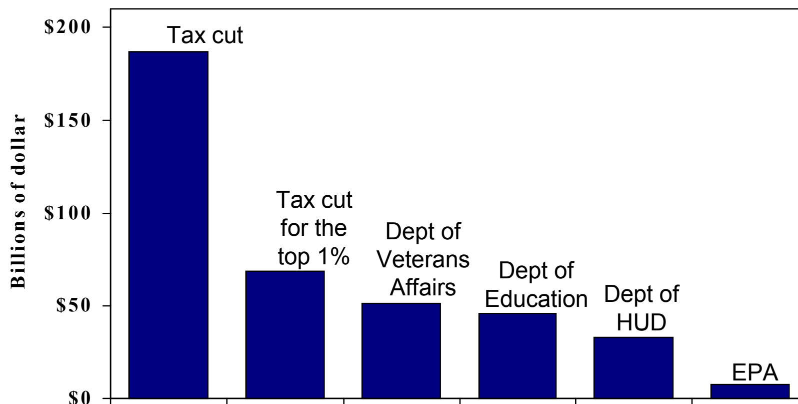
When fully in effect, the annual cost of the tax cut will be:

- Five times as large as the budget of the Department of Housing and Urban Development
- Four times the budget of the Department of Education
- More than three times the Department of Veterans Affairs and Department of Transportation budgets
- Twenty-four times larger than the EPA budget

You can see one aspect of the magnitude of the revenue losses from the '01 tax cut when you look at the second bar of the next graph. It tells you that when the tax cut is fully in effect, the cost of the tax cut just for the wealthiest 1 percent of the people in the country is larger than everything the federal government spends on education. It is about twice everything the federal government spends on housing and urban development.

The Tax Cut and Agency Budgets

Comparable annual costs



Note: Figures for the tax cut represent the annual cost when fully effective (including AMT relief), scaled to the size of the economy in 2002. Figures for agency budgets represent the annual average, 2001-2003.

Annual Cost of Tax Cuts for the *Top One Percent* Compared to Agency Budgets

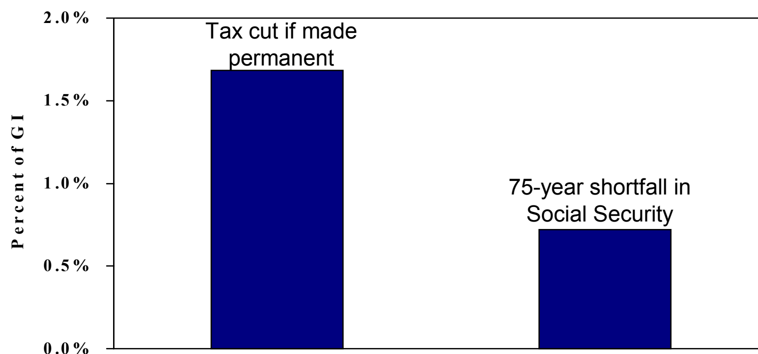
When fully in effect, the annual cost of the tax cut for the top one percent of filers will be:

- Twice the budget of the Department of Housing and Urban Development
- 1 ½ times the Department of Education budget
- Larger than the Department of Veterans Affairs and Department of Transportation budgets
- Nearly nine times as large as the EPA budget

I'm sure everyone in the room knows or has heard that Social Security eventually goes insolvent (I think it is in 2041) and that it has a significant long-term shortfall. Sometimes that shortfall is described as massive or gargantuan. Words of that sort are tossed about. You're used to hearing about the cost of the tax cut over the next 10 years and the Social Security shortfall over the next 75 years, so we and analysts at Brookings said, let's compare both of them over the same time period. Let's compare apples to apples. If the tax cut is made permanent – this is just the 2001 tax cut – its cost over the next 75 years turns out to be double the Social Security shortfall.

The Tax Cut and Social Security

Costs over the next 75 years



Social Security estimate from 2002 Trustees Report; all figures are "net present values" of costs from 2002-2076. Estimates of the tax cut assume all provisions are permanent (including AMT relief) and grow only with the economy after 2011.

At this point, a historical analogy comes to mind. In a curious historical coincidence, two Republican presidential candidates, 20 years apart, each ran for president in part on a platform of large tax cuts: Ronald Reagan in 1980; George W. Bush in 2000. Both got elected. By the summer of their first year in office, both had delivered a large tax cut. By another curious historical coincidence, not caused by these tax cuts, by their second year in office — 1982 and 2002, respectively — the country was in an economic downturn. And a combination of factors, including the tax cuts but not limited to them, had caused a dramatic – a much larger than expected – change in the budget outlook. Suddenly large, daunting deficits loomed for years to come.

What did Ronald Reagan do? In 1982, behind the leadership of Bob Dole, the Republican Chairman of the Senate Finance Committee, and Howard Baker, the Republican Senate Majority Leader, a tax increase bill was passed that essentially said, "We gave away too much revenue in 1981, more than we can afford." The tax 1982 bill subsequently signed into law by Ronald Reagan was the equivalent of scaling back 30 percent of the tax cut he got in 1981. Further, smaller tax increases followed in Reagan's remaining years. Never in Ronald Reagan's final seven years in office did he pursue a further large tax cut that wasn't paid for. Ronald Reagan wanted to cut tax rates, particularly on higher-income Americans, and he proposed reducing tax rates in 1985, but he proposed to pay for every dollar of the revenue loss by closing tax loopholes. That became the landmark Tax Reform Act of 1986.

A brief aside…we started the Center in 1981 in response to Reagan's first budget cuts. If anybody had predicted to me at the point that we were doing this that 27 years later I'd be giving talks in which Ronald Reagan is sort of the model…

So now we fast forward 20 years and history seems to repeat itself. Except this administration, faced with the same unfolding dilemma, says the answer is even larger tax cuts. We're going to lower tax rates and instead of broadening the revenue base to pay for it, we're going to cut further large holes in the revenue base.

There is beginning to be some restiveness, as you know, in the Senate. Earlier this year the Senate indicated it would not provide the votes needed to pass a tax cut "growth" bill that exceeded $350 billion in costs. So the bill the President signed two weeks ago, or 16 days ago, has an advertised cost of $350 billion. Of course, the bill is likely to end up costing $800 billion to a trillion dollars. It reaches the $350 billion figure only by having most of its provisions artificially end after two or three years, at which point there will be overwhelming pressure to extend them.

This chart simply shows you that if the provisions are extended — as the administration and its leaders in Congress fully intend to do — the ultimate revenue loss is in the $800 billion to $1 trillion range.

Cost of Bill Through 2013 If Tax Cuts Are Extended

(in billions of dollars)

Dividend and capital gains **[expires 2008]**	$325
Top bracket rate reductions	74
Child tax credit **[expires 2004]**	90
10% bracket **[expires 2004]**	45
Tax breaks for married couples **[expires 2004]**	55
Expand Sec 179 business expensing **[expires 2005]**	35
Increase AMT exemption **[expires 2004]**	18
Expand bonus depreciation **[expires 2004]**	145-400
State fiscal relief	20
TOTAL	807-1,062

Let me now try to boil it down to three numbers that tell a big story. Here are the first two numbers.

First, after the tax cut just signed, federal revenue collections this year will be at their lowest level as a share of the economy since 1959! What did the federal government do in 1959? There was no Medicare program. There was no Medicaid program. There was no Head Start. There was no Food Stamp program. There wasn't a lot of federal aid to education and barely any child care funding. Second, federal income tax revenues will be at their lowest level as a share of the economy since 1943. These are extraordinary figures. And they're made even more extraordinary by the fact that we're only five years away from when the first Boomers begin to collect Social Security benefits. We know that the costs for Social Security and Medicare will go up. 1959 and 1943 are the first two extraordinary figures.

Federal Revenues in 2003 As a Share of the Economy--A Historical Comparison

All Federal Revenues	Lowest Since 1959
Federal *Income Tax* Revenues	Lowest since 1943

The third such figure is $430 billion. What's that? When President Bush took office two and a half years ago, if you looked at every provision in the tax cut that was slated to expire but was likely to be extended, the revenue loss in the tenth year was $22 billion. Today, because of the 2001 and 2003 tax cuts, which are large tax cuts with artificial expiration dates that the administration favors extending, the cost in the tenth year, in 2013, of extending all tax cuts that are slated to expire is $430 billion in a single year.

Cost in Tenth Year of Extending All Expiring Tax Provisions

Before President Bush

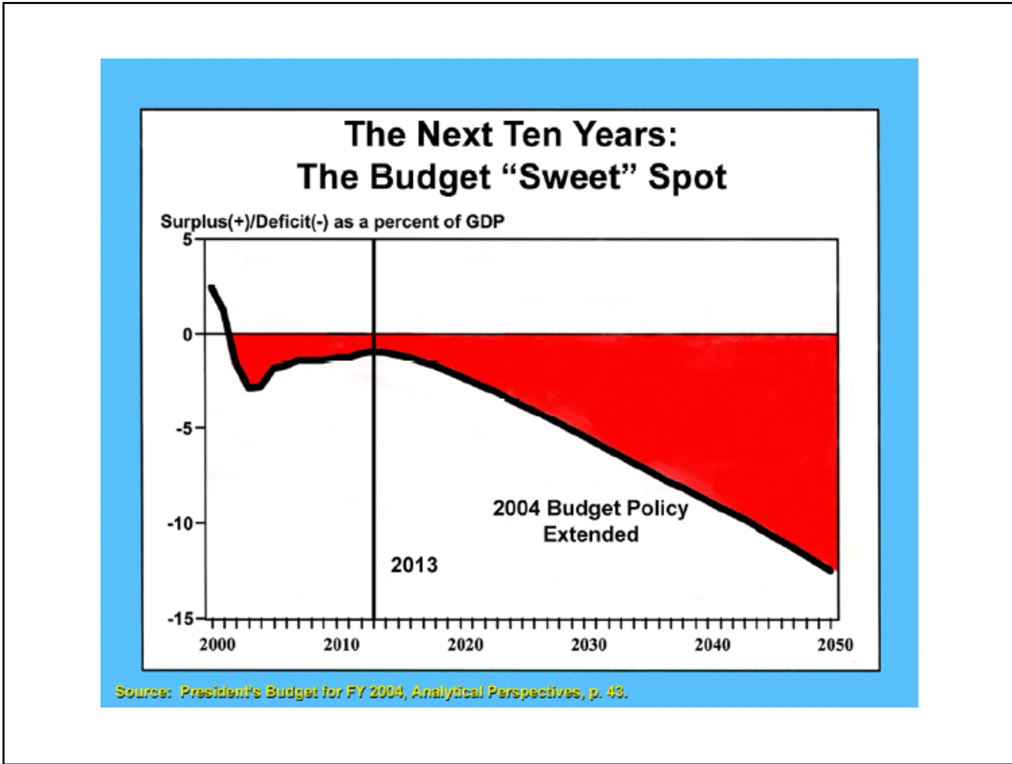
As of January 2001, the cost in 2011 of extending all expiring provisions was $22 billion

Today

The cost in 2013 of extending all expiring provisions is $430 billion

Source: Bill Gale and Peter Orszag, The Brookings Institution, "Sunsets in the Tax Code," May 26, 2003.

I mentioned that the administration's own budget projects that without further changes in policies, there ultimately will be huge deficits. Every year for the next 50 years the budget will be in deficit. The next graph is from the technical volume that accompanies the President's budget. The graph shows deficits ultimately climbing to levels that no policy maker of either party will allow to happen because of the impact such deficits ultimately would have on the economy. Look at the right-hand part of the graph. We're talking here about deficits that ultimately climb above 10 percent of GDP on a persistent basis. That is not sustainable.



I mentioned before that over the next 75 years, the revenue loss from the 2001 tax cut will be more than double the Social Security shortfall, if the tax cut is made permanent. Add in the 2003 tax cut, and the combined revenue loss over 75 years is about triple the Social Security shortfall. These figures are from a recent analysis by Peter Orszag at Brookings.

Cost of Tax Cuts and Social Security Shortfall Over the Next 75 Years

Cost of 2001 and 2003 tax cuts if made permanent	$11.5 trillion in present value
Social Security Shortfall Social Security Shortfall	$3.8 trillion in present value

The cost of the tax cuts, if made permanent, is three times as large as the Social Security shortfall

Source: Calculation by Peter Orszag, the Brookings Institution

So this is where we get back to the discussion of block grants. When you look at the emerging block grant proposals, there are a number of themes one sees – and Margy, Cindy and Will are going to talk about a number of those issues – but one of those themes is a gradual, over time, slow reduction in the proportion of the cost of these programs that the federal government would bear.

Let's take Medicaid as an example. The federal government pays its percentage share of the costs. In New York I think it is 50 percent. The Federal government pays 50 percent, the state pays 50 percent. If health care costs go up, the federal government bears its share. Under the administration's block grant proposal, by contrast, the federal government would pay a fixed amount each year. If costs went up more than that, the state would be left with all the additional costs. If the state couldn't afford it, the state could cut services or remove people from the program.

Health care costs are extremely difficult to predict in advance with accuracy. Consider the estimate the Congressional Budget Office made in 1998 of what federal Medicaid costs would be in 2002. Its estimate turned out to be too low for that one year by $17 billion. What the federal government is seeking to do here is to cap the federal contribution to Medicaid and put that cap in place before the demographic tsunami hits and there are lots more elderly people and people with disabilities on Medicaid.

The administration has been vague about the details concerning how the block grant funding levels would be adjusted over time. But it is hard to avoid the conclusion that the goal is not only to avoid federal exposure to risk of higher costs if health care costs rise faster than had been predicted, but also to move to a structure where federal funding for Medicaid eventually rises at a slower rate than the costs of insuring the lower income population.

You see a similar theme in the administration proposal for converting the Section 8 Housing Voucher program to a block grant. Currently, HUD and the Appropriations Committees each year estimate what it costs to renew all existing housing vouchers, based on rents in communities across the country. The formula has cushions in it so that if the amount allotted to a given housing agency turns out to be insufficient to renew those vouchers because rents rise more than had been predicted, the housing agency is provided the additional funding. The housing agency is assured that it has the funds to renew all vouchers that are in use.

Under the block grant proposal, that would end. There would no longer be any formula to project what is needed to renew the existing vouchers. There would simply be a block grant amount that was allocated to the states. The appropriations committees could set the amount wherever they want each year, and they'd be under considerable pressure either to have the funding level rise more slowly than rents, or what I think is perhaps more likely, simply to freeze it in many years without an adjustment for inflation. Why? At the same time that Congress was adopting this year a budget that made room for the tax cuts that have since passed, it wrote into that budget that federal funding for domestic programs that are not entitlement programs (the housing program is not an entitlement) should be cut over the coming decade. Federal funding for non-entitlement programs would be reduced $168 billion over ten years below today's levels adjusted for inflation.

So I believe there is a common theme here. Under the Medicaid block grant that's been proposed, the federal funding would likely rise over time more slowly than increases in health care costs. Under the housing block grant, federal funding would likely rise more slowly over time than increases in rents for low-income housing.

Notice the gradual reductions here, which would slowly mount over time. This is a patient, long term strategy. The tax cuts also show a patient strategy. Estate tax repeal doesn't occur until 2010. The strategists involved in developing this are patient. Grover Norquist has told a number of reporters that they're willing to take something like 20-25 years to achieve the goal of cutting the domestic side of the federal government in half. They know that if they get too impatient and move too fast, they can end up not getting that much of what they want. They've learned from Newt Gingrich's experience in 1995.

Are they right in thinking that switching to block grants would be an important part of this long-term fiscal strategy? I think the evidence suggests that they are indeed onto something.

Here's the last of the overheads:
There is a little typo here: the reference to 1982 should say 1992…..

Funding for Other Block Grants Has Not Kept Pace with Inflation

- Analysis of 11 block grants shows that inflation-adjusted funding has fallen by 11% since establishment of block grant (or 1982 if later)
- Excluding child care, funding for block grants fell 22%
- SSBG has lost 65% of its funding and LIHEAP has lost 53%

Looking back over the last decade, we looked at 11 major block grants and found that, in aggregate, funding for them has fallen 11 percent after adjusting for inflation. But that makes it look better than it is, because child care is an anomaly here. In conjunction with the enactment of the welfare block grant in 1996 and the movement of more families from welfare to work, as well as political pressures, child care funding went up. If you exclude child care, you see that for the remaining block grants, funding fell 22 percent over the decade, after adjusting for inflation. Notice in particular the social services block grant, which is down over 60 percent in this period, in inflation-adjusted terms.

I'd also like to call your attention, for a moment, to issues relating to the TANF welfare block grant. Most of the people in this room probably recall the predictions — those of us associated with them are endlessly ridiculed for them — that enactment of that law would add a million children to the ranks of the poor. Now aside from the fact that a significant part of the one million children forecast related to certain cuts in immigrant benefits and SSI for children with disabilities that were later partially or entirely reversed, it is certainly true that in the years to date, that prediction has not turned out to be accurate. But – and I really hope this is wrong – I submit to you today that there is a non-trivial potential that the million children will end up being too low, not too high. Why is that? The block grant funding structure.

When the TANF block grant started in 1997, TANF funding was essentially set at the expenditure levels that states had incurred for these programs in 1994. Now 1994 had higher levels of unemployment than 1997. The economy boomed in the late 90's, and the combination of the booming economy, stiffened work requirements, and increases in the earned income credit resulted in big movements from welfare to work. (In addition, some people lost welfare without securing employment.) The welfare rolls went down substantially. States ended up having more money in the early years of TANF than they could immediately use. States piled up unspent balances in TANF. But as the years went by, the federal TANF funding level stayed at the same level it was placed at in 1997 — that is, at the 1994 expenditure level — with no adjustment for inflation.

A couple of years ago, states were spending on TANF more than the annual federal amount they were receiving, which has remained for most states at that same level at which it was placed in 1997. States were OK for the time being because they had the unspent funds from the late 1990's that they could use to supplement this frozen annual allotment. By today, however, growing numbers of states are exhausting or have exhausted their unspent funds from the late 1990's. Federal TANF funding remains frozen. And states now face budget crises.

We are beginning to see major cuts in TANF and in child care at the state level as a result. Last week our Center released a new study of this. We found that over the last year, more than 35 states either have made or are now actively considering cuts in programs funded through TANF or the child care block grant.

Of these 35 states, at least 15 have cut back on programs to help TANF recipients improve job skills and find jobs or are considering such a step.
Eleven have cut or are considering cutting assistance to poor families with particularly severe problems by reducing funding for services like intensive case management, substance abuse treatment, or eviction prevention assistance.
At least eight states have cut or are considering cutting funding for transportation assistance related to TANF, an area for which Margy Waller has been the leading champion and pioneer in Washington.
Ten states have cut back or are considering cutting basic cash benefits, often for low-income working families.
Thirty-two states have cut child care or are considering doing so by cutting income limits, instituting waiting lists, increasing co-payments, cutting provider payments, cutting child care quality payments, or some combination of the above.

Despite this, there is no question that, if Congress passes a welfare reauthorization bill this year, it will freeze TANF funding for another five years through 2008, and the welfare block grant will still largely be stuck at that 1994 expenditure level in 2008. By 2008, the funding will have declined, after adjusting for inflation, by about 24 percent from the level it was at in the first year TANF was in operation in 1997. And what will happen when we get to TANF reauthorization again in 2008? Based on the figures I've been showing you, the budget picture will be disastrous. Consequently, there will be pressures, I fear, to freeze TANF funding for another five years. At the end of that period, we'd be down 33 percent, 35 percent, perhaps heading toward 40 percent. This is why I think there are risks that over the long-term, the million-children figure could end up being too low. This illustrates the potential impact over time of block grant funding structures, under which federal funding is capped and often is frozen from year to year, and generally does not keep pace with inflation or increases in need.

It is hard to believe the major motivation for these proposals is simply to give more flexibility to states, since in virtually every one of these programs – and you have to look program by program to ascertain the merits of specific flexibility proposals in particular programs – one can modify the programs to provide states more flexibility without converting the funding to a block grant structure. For example, last year's Food Stamp reauthorization created about a dozen new state options in Food Stamps without altering the entitlement federal funding structure.

So where does this lead us and what do we do? Strangely enough, this is the brighter side of the story. There are two twin goals here: stemming the revenue hemorrhage and preventing the shift to block grant funding structures. There are signs of progress on both fronts.

First, "Is the glass half full or half empty?" I wouldn't have predicted at the beginning of the year that the Senate would place a limit of $350 billion on the new tax cut. Certainly there are gimmicks in there to hold the cost to $350 billion on paper, the gimmicks being the artificial expiration dates for the tax cuts. But in a hopeful sign, we've had a small test in the last week or two of an effort to extend the tax cuts without "paying for" the extension. Confronted with embarrassing publicity about leaving 12 million children and 6.5 million low-income working families partly or entirely out of the child tax credit provisions of the new tax law, the Senate rushed to put those kids back in. When it did, an effort was made to attach to the low-income child tax credit provision additional provisions that would begin to repeal the expiration dates in the new tax cut law. That is what the House did yesterday. But when leaders tried to do it in the Senate, at a cost of another $80 billion that we can't afford, they found they didn't have the votes. There was an insistence in the Senate that the measure to put back the low-income families be part of a tax package that was fully paid for and did not cause further revenue losses. Moreover, while the House did pass yesterday the low-income child tax credit provision as part of a bill that costs $82 billion in further revenue losses, that happened only because the House leaders were sufficiently afraid they didn't have the votes that they used a procedure that was like a parliamentary pretzel to deny a vote on the House floor for the bill the Senate passed to help the low-income families without making that part of another substantial tax cut bill. Ultimately, there was a non-binding vote at 6:40 pm last night on the House floor on the Senate version, and it won 205-201.

Second, it was officially announced yesterday that an effort that only two or three weeks ago looked like it might succeed — an effort to get the governors, Democratic and Republican, of the National Governors Association to jointly endorse a Medicaid block grant — has collapsed. At least for the time being, there will not be an NGA proposal of that sort. The Republican Governors Association may endorse it, but it will not be a bipartisan proposal, which will make it considerably harder to get a Medicaid block grant through Congress.

In addition, as Will can relate, some of the leading Republican committee chairmen in Congress are quietly advising that they think the housing block grant proposal is unwise and do not intend to move it.

These events are not fortuitous. They didn't happen as a result of some act of God. There has been an enormous amount of work going on at the grassroots, the state level, and in Washington where there have been, for example, strange bedfellow alliances involving health care providers and health care advocates. Major progress is possible on these fronts.

If we go back to my Ronald Reagan analogy….when Ronald Reagan got not only tax cuts, but also deep budget cuts enacted in 1981, he came back for more in 1982. He proposed deep budget cuts in 1982. I still remember one of the first pieces the Center on Budget ever did was called "Ronald Reagan's Ten Most Draconian Budget Cut Proposals." It was about Reagan's second budget. I remember agonizing over which 10 to choose because there were so many. Not a single one of them was enacted. By the second year, the tide had begun to turn. No more deep budget cuts in low-income programs. By his third year in office, the cuts made in his first year in office in poverty programs began to be reversed, and, as noted, revenues had begun to be raised.

Are the events in recent weeks that I just mentioned the beginning of a similar development here? Only time will tell. I think the political forces are much tougher now than they were in 1982. We also had a divided Congress in 1982 and we don't now. The bottom line is that it comes down to the citizenry. There is a potential for a broad citizen movement, including low-income community groups, service providers, and many others, that can help stem the tide.

This is a long-term effort. This won't be over in three months or six months. This is going to require a multi-year effort, both on the revenue hemorrhage side and on the program financing side (i.e., the block grants). With sustained effort, however, there is a possibility of success. And we have to end up with success because we can't afford to fail.

Thank you.