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U.S. House of Representatives
Domestic Entitlement Programs

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Chairman Nussle, Ranking Member Spratt, and Members of the Budget Committee:

I consider myself fortunate to address the members of the House Budget Committee. Along with the Appropriations Committee, this committee has the toughest but most important job in Congress this year. Our nation faces a budget crisis that will soon be of historic proportions. Something must be done – and the buck stops here. As a citizen, a scholar, and a former Congressional staffer, I am honored to have the opportunity to provide some humble advice to you who must make momentous decisions.

The budget problem has two dimensions. First, the short-term deficit is too high. This year the deficit is expected to be around $427 billion according to the Office of Management and Budget (OMB). Adding the costs of the war in Iraq would push the deficit still higher. If Congress extends the tax cuts, enacts a reasonable adjustment of the Alternative Minimum Tax, and allows domestic discretionary spending to increase in proportion to population growth and inflation, the deficit will average more than $500 billion over the next decade. Some observers take comfort from the fact that deficits associated with the recessions of the mid-1970s, the early 1980s, and the early 1990s were higher as a percentage of Gross Domestic Product than the current deficit. However, in all these cases Congress and the president took very strong action to reduce the deficits, both by cutting spending and by increasing taxes. But so far in this new century, neither Congress nor the president has taken serious action to reduce the near-term deficits. Worse, the current deficit could be considered more threatening than the former deficits because we are now on the cusp of baby boom retirement, an unfolding event that will place huge strains on federal finances in the decades ahead.

The lack of action on the deficit is perplexing for those of us who played a role in the Republican assault on the deficit after capturing the House and the Senate in the elections of 1994. As Bill Thomas of California, now the Chairman of the Ways and Means Committee said, “We can no longer tolerate mere promises of fiscal restraint. To do so would saddle our children, and children's children, with uncontrollable and runaway deficits” (*Congressional Record*, 1995). How can it be that in 1995 Republicans believed deficits to be the governmental version of the apocalypse and now many Republicans can muster little more than a yawn when the deficit figures are recited?

Nor do the figures I have presented so far give a complete picture of the magnitude of the deficit threat. The second budget problem we face is the long-term deficit. The leading edge of baby boom retirement begins in 2008 and intensifies in subsequent decades. The Medicare trust fund will be the first to go belly up as a result of additional spending on retirees. According to its trustees in last year’s report, Medicare will be in the red by 2019, seven years earlier than the trustees predicted in their annual report just one year earlier. Once Medicare goes broke, its financial imbalance will intensify dramatically in subsequent years. Social Security, again according to its trustees, is in better financial shape, but only in the sense that it goes broke later than Medicare. The Medicare Trustee's report informs us that the additional resources needed to meet the projected expenditures of Social Security, Medicare, and Medicaid over the next 15 years is $33.2 trillion (Board of Trustees, 2004, p. 183).

One of the more alarming perspectives on the condition of the federal budget is that if Congress makes the tax cuts permanent, enacts a reasonable fix on the Alternative Minimum Tax, and increases domestic discretionary spending to keep pace with inflation, Gene Steuerle of the Urban Institute and a former Treasury official in the Reagan administration calculates that interest on the debt, Medicaid, Medicare, Social Security, and Defense will consume all federal revenues by 2015, leaving no remaining funds to operate the rest of government (Steuerle, 2003).

These are deeply troubling scenarios that serious and nonpartisan analysts have assured us will occur during our lifetime. We're eating cake, playing our fiddles, and maximizing consumption while passing the bill to our children and grandchildren. Something must be done.

The President has proposed the toughest budget since Republicans and Democrats reached an agreement to balance the budget in 1997. Its cuts in social programs have been widely criticized, often in language of the most alarmist sort (Krugman, 2005). But here is the main point of my testimony: the deficit reduction achieved by the president's budget is the least Congress should do this year. I hope there will be bipartisan agreement on this point, but even if there is not, then Republicans, as the majority party, must accept responsibility for achieving at least the $20 billion in spending cuts next year and perhaps on the order of $300 billion over 5 years proposed by the president (Andrews, 2005). Given the size of the deficit and the burden it promises to impose on our children and grandchildren, the Bush cuts which have been so widely criticized are not much more than a promising down payment on the cuts that will be needed to reduce the deficit by half on a permanent basis.

The action needed to cut the deficit by half on a permanent basis would be much easier if Republicans were willing to consider tax increases – or at least consider not extending all the tax cuts put in place since in 2001. Even former Senator Nickles, the immediate past chair of the Senate Budget Committee and one of the strongest supporters of tax cuts, recently told the *Washington Post* that some "adjustments" might need to be made in tax cuts and other Republican policies (Weisman & Baker, 2005). Most of those who follow politics in Washington seem to believe that it is exceptionally unlikely that Republicans in Congress or President Bush will seriously consider tax cuts. So be it. Republicans are in control of both ends of Pennsylvania Avenue and, if they can hold their votes, they can protect their tax cuts and make them permanent. But if Republicans want to reestablish themselves as the party of fiscal rectitude and to alter the nation's current course of simply writing checks that our children and grandchildren must cover, it follows that their spending cuts will have to be all the deeper. It would be inconsistent with family values to do any less than prepare for the retirement of the baby boom by getting our fiscal House in order – in this case through truly remarkable cuts in spending.

Last year, for a book on the fiscal crisis published by the Brookings Institution, along with Alice Rivlin, the former head of both OMB and the Congressional Budget Office (CBO), and Isabel Sawhill, a senior official at OMB in the Clinton administration, I wrote a chapter exploring the level of spending cuts that would be necessary to bring the budget into balance within a decade (Haskins et al., 2004). Our search for spending cuts was driven by principles supported by the Republican party; namely, smaller government, minimal government interference in the economy, more power and control at the state level, and a minimum of reliance on new revenues. Figure 1 shows the levels of spending cuts and increased revenues required to balance the budget within 10 years under our budget assumptions. Our spending cuts included:

- $138 billion in commercial subsidies such as the Export-Import Bank, the Federal Aviation Administration, and various Energy Department programs,
- $123 billion in devolution of programs such as the entire Department of Education to the state and local level,
- $7 billion from the list of wasteful spending originated by this committee last year,
- $58 billion from non-defense discretionary programs, and
- $74 billion from entitlement programs.

After making this spectacular level of cuts, we still needed $134 billion in revenues to achieve the $534 billion in combined spending cuts and revenue increases required to balance the budget in 2014 under our baseline assumptions. To comply at least in part with Republican goals, the revenue raisers did not include any changes in the personal income tax rates. Rather, revenue was obtained primarily by improved enforcement of the tax code, freezing the estate tax at its 2009 level, and increasing taxes on cigarettes, alcohol, and motor fuels.

Figure 1: A Smaller Government Plan to Balance the Budget in 2014, Primarily by Cutting Spending

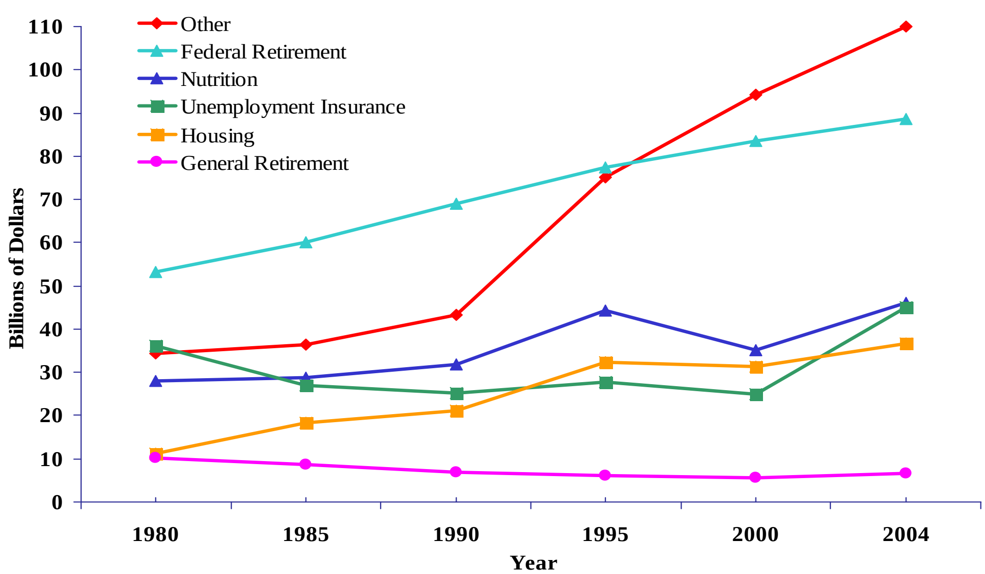
Item	*Billions of Dollars*
Total deficit reduction	687
Minus debt service savings	-153
Subtotal: tax increases and spending cuts to eliminate deficit	534
Plus funding for new initiatives	0
Total: tax increases and spending cuts to eliminate deficit	534
Changes in the budget	
Revenue change	134
Spending cuts	-400
Commercial subsidies	-138
Devolution	-123
Wasteful spending	-7
Non-defense discretionary	-58
Entitlement	-74

Source: Haskins, Sawhill, and Rivlin, “Getting to Balance: Three Alternative Plans” (authors' calculations), and Congressional Budget Office, "The Budget and Economic Outlook: An Update," August 2003. Sums do not add to totals because of rounding.

A major purpose of the Brookings exercise was to demonstrate the drastic, unprecedented level of spending cuts that would be necessary to actually balance the budget within a decade. Although we did not realize it when we put the deficit balancing plan together last year, this exercise also shows how modest are the cuts proposed by President Bush this year. I would not minimize the difficulty of actually enacting the cuts proposed by the president, as shown by the bitter response they have provoked from advocates, editorial writers, and a number of Democrats in Congress. But perhaps members of this Committee who are preparing to withstand severe criticism for being fiscally responsible will take some comfort from the much greater level of cuts outlined in Figure 1.

In turning to the search for specific places to cut spending, I have been asked by the Chairman to report to the Committee about potential cuts in the Income Security function of the federal budget. Based on the *Historical Tables* volume from the President's 2006 budget (U.S. Office of Management and Budget, 2005, pp. 53-70), Figure 2 presents changes in spending within each of the six subfunctions that comprise the Income Security function. All the figures are expressed in inflation-adjusted 2004 dollars. Several points are notable. First, the General Retirement subfunction, which consists primarily of railroad retirement, is the least interesting because it is low (under $10 billion every year) and declining. Second, Unemployment Insurance and Nutrition move in rough accord with the economy – they go up when the economy is in recession and down in times of expansion. Both grew quite considerably during and following the brief recession of 2001 but their growth is now moderating. Housing has grown throughout the period, especially in the mid-1990s and since 2000. Between 1980 and 2004, housing expenses increased from around $11 billion to over $36 billion.

Figure 2: Growth of Income Security Spending by Subfunction, 1980-2004

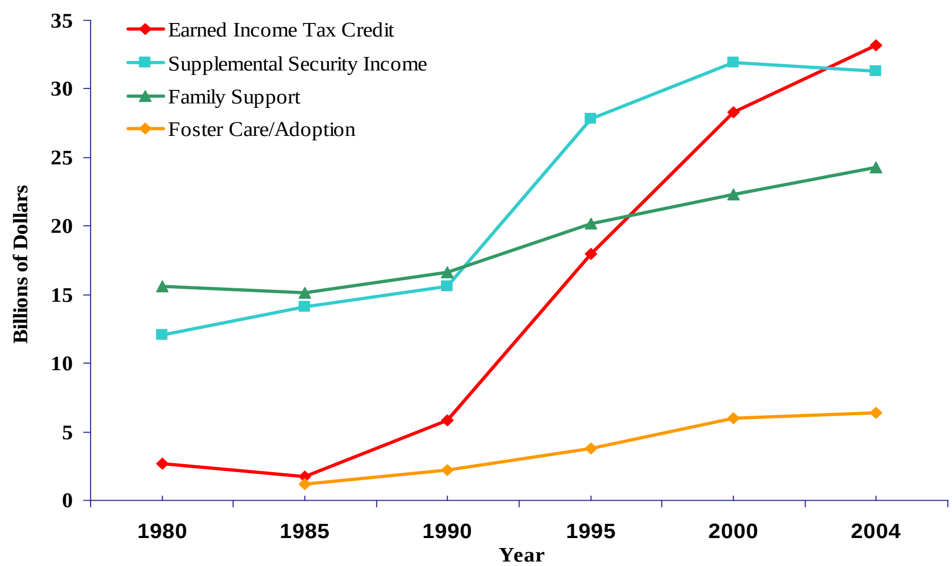


Source: U.S. Office of Management and Budget. 2005. *Budget of the United States Government, Fiscal Year 2006*

Federal Retirement, which includes federal civilian and military retirement and disability programs, has been growing relentlessly. Over the nearly 25 year period, it grew from $53 billion to nearly $89 billion. Retirement policy for federal employees deserves special attention. Spending is huge and growing, and given the high level of government employment, this account will continue to be very high in the future. Although controversial, it could be argued that providing retirement benefits to someone who is 42 years old because they have worked for 20 years is somewhat extravagant. Perhaps retirement benefits should not begin until recipients reach 55 or even 60 or 65 years of age. Those currently receiving retirement benefits could continue under the current rules, but those who retire after some future date could be phased in a year at a time to delay their receipt of retirement benefits.

The remaining subfunction is the "Other" category. Figure 3, which portrays the spending history since 1980 of several of the most important constituent programs in the Other subfunction (U.S. Office of Management and Budget, 2005, pp. 135-140), shows that growth is beginning to moderate in Supplemental Security Income (SSI) and foster care/adoption. The only program that appears to be growing rapidly is the Earned Income Tax Credit (EITC), although more recent data show that the rapid growth of EITC has now ended as well. In fact, as the projections in *Historical Tables* show, all the programs in the Other category moderate their recent rapid growth rates and several actually decline in constant dollars (including the EITC) between 2005 and 2010.

Figure 3: Growth of Outlays for Selected Programs in the "Other" Subfunction of Income Security , 1980 - 2004



There are at least three lessons emerging from these program trends within the Income Security function that can prove instructive to anyone interested in controlling federal spending. The first is represented by SSI. The 1996 welfare reform legislation and associated legislation made very substantial reforms in the SSI program. These included removing drug and alcohol addiction from the list of qualifying conditions for SSI; reducing the number of children receiving SSI by changing the definition of childhood disability and terminating one of the major procedures for determining whether a child was disabled; and ending SSI benefits for noncitizens who enter the country after 1996. The Rand corporation has estimated that just the reforms of the SSI program for children saved nearly $22 billion over the 10-year period between 1996 and 2005 (Rogowski, 2002). As this example illustrates, Congress can enact modifications to programs by limiting eligibility to produce considerable savings over the years. It should be noted that in the case of SSI, the primary rationale for enacting the program changes that resulted in savings was not to save money but to remove benefits from individuals who, under a reasonable set of criteria, should not be eligible for benefits. It is possible to imagine that the Budget Committee or committees of jurisdiction for SSI and a host of other programs would carefully examine all the programs under their jurisdiction to determine whether program integrity is being maintained.

A second lesson on ways to save money is illustrated by the Family Support line item. The major program in this line item is the Temporary Assistance for Needy Families (TANF) program, formerly Aid to Families with Dependent Children (AFDC). AFDC was an open-ended entitlement welfare program that cost more money almost every year. In the 30 years between 1962 and 1992, enrollment and spending grew in all but 7 years (U.S. Department of Health and Human Services, 2004, p. A9). The authors of the 1996 welfare reform legislation, based largely on principles that suffuse Republican thinking about welfare programs, believed that too many young people who could support themselves were relying on public welfare. AFDC and other welfare programs were, in short, luring people into dependency. In 1996 the program was converted to a block grant with fixed funding and states were required both to limit adults receiving welfare to a maximum of 5 years of benefits and to impose strong work requirements on their caseload. The block grant has kept expenditures on the TANF program flat for nine years. Taking inflation into account, federal spending on TANF, as measured by budget authority, has actually decreased every year. In large part because of the time limit and work requirements (plus a hot economy), families left welfare as never before and took jobs. As a result, cash welfare payments to families dropped from $12.0 billion in 1995 to $4.6 billion in 2002, a drop of over 60 percent (U.S. Department of Health and Human Services, 2004, p. A12); and states used most of the money saved to pay for child care and other work supports that helped families stay in jobs (there were also substantial savings on food stamps and Medicaid). Perhaps the best part of the story is that throughout this period, the average total income of these families increased every year and child poverty declined every year. In fact, the decline in child poverty was the first sustained decline since the early 1970s and poverty among black children reached its lowest level ever. Thus, by working rather than remaining on welfare, families had more money, children benefited from reduced poverty rates, and taxpayer payments for welfare declined substantially. Under some circumstances block grants to states constitute both good policy and an effective tool for saving money (Haskins, forthcoming).

A third point illustrated by spending developments in income security programs is that a good economy causes spending in many programs for low-income families to fall. The number of mothers leaving welfare for employment was undoubtedly boosted both by the sweeping changes in welfare programs and by a growing economy that produced jobs these mothers could fill. The fact that mothers were earning money rather than receiving welfare reduced welfare spending on the TANF program. Similarly, outlays on food stamps, the biggest program within the nutrition subfunction in Figure 2, fell substantially as the economy grew between 1995 and 2000. When the economy fell into recession after 2000, spending on food stamps began to rise again. The unemployment insurance program shows an even greater responsiveness to the economy than TANF and food stamps. In 2000, the year before the mild recession of 2001 hit, about $21 billion was spent for unemployment insurance benefits. After the brief 2001 recession, spending on unemployment benefits jumped to $27 billion, $49 billion, and $51 billion in 2002, 2003, and 2004 respectively. As the pattern of outlays in these three programs demonstrates convincingly, spending leaps dramatically during recessions. It follows that federal policies – including low tax rates and modest regulations – that stimulate the economy will have a major impact on helping reduce the deficit. Conversely, if the nation enters a recession in the next decade or so, federal spending and as a result the federal deficit will leap far beyond the projections in the CBO baseline.

In pursuing the analysis of potential savings from Income Security programs, I turn now to the very useful volume on *Budget Options* published by the Congressional Budget Office (Congressional Budget Office, 2005). This volume of possible cuts in spending and increases in revenues is undoubtedly well known to members of the Committee. Of course, CBO does not endorse any of the spending cuts or revenue raisers in the volume, but the volume is tailor-made for a committee looking for ways to reduce spending. Figure 4 summarizes the thirteen possibilities for reducing spending in Income Security programs from CBO’s 2005 volume and one from their 2003 volume. Enacting all these cuts would save almost $26 billion over 5 years and nearly $76 billion over 10 years.

Figure 4: Potential Savings from CBO's Budget Options Volume

Proposal	*2004-2008*	*2004-2013*
Increase housing payments	5.7	18.1
Reduce rent subsidies	0.7	2.8
Eliminate small food stamp benefits	0.5	1.0
Reduce child nutrition subsidy	3.0	6.6
Reduce $20 exclusion in SSI	0.7	1.5
Sliding scale in SSI	0.5	1.4
Remove SSI ceiling on collection of overpayments	0.4	0.9
Reduce foster care administrative training costs*	0.8	1.6
End trade adjustment assistance program	4.2	9.2
Limit cost-of-living adjustments to federal retirees	4.5	19.4
Increase insurance rate on pension programs	0.8	1.4
Reduce benefits under federal employee's compensation act	0.2	0.4
Modify formula to set federal pensions	1.3	5.2
Restructure contributions to Thrift Savings Plan	2.6	6.2
Totals	*25.9*	*75.7*

Source: Congressional Budget Office. 2005. *Budget Options*.

* Congressional Budget Office. 2003. *Budget Options*.

I would not refer to the cuts in Income Security programs outlined by CBO as low-hanging fruit, but they are all reasonable reforms that would do minimum damage to those who would have additional costs imposed on them. Some of the cuts would be criticized because the costs are imposed on low-income individuals or families. However, many of the options could be tailored so that they impose low or even no costs on families below some income criterion, say, the federal poverty line (in which case the savings would be reduced). A few of the options, such as reducing foster care administrative and training costs, limiting the cost-of-living adjustment for federal retirees, and increasing the insurance rate on pension plans would impose no direct costs on poor families.

As this brief analysis of potential spending cuts in the Income Security function demonstrates, there are no painless spending reductions to be made in the federal budget. In policymaking, fool's gold is the search for policies that have all benefits and no costs. The task of budget balancing in which Congress should engage this year is almost always a zero-sum game. My personal view is that, although the pain cannot be avoided, Congress should do its best to distribute the pain across demographic groups and regions of the country. Moreover, as someone who has worked on programs for poor and low-income families for most of my adult life, I think Congress should minimize reductions in benefits for poor families, especially those that work.

But regardless of the specific criteria followed by the Budget Committee and the authorizing committees that must make final decisions, there is no escaping the heavy burden now being imposed on the nation's future by the federal deficit. We are in the early stages of something very much like a crisis, except that it will last for many decades and will impose costs of uncertain magnitude and timing. The prudent course is to begin making the tough decisions this year that will put the budget on a path that leads to substantial deficit reduction and that will maintain the deficit at an acceptably low level. The minimum level of spending control that Congress should undertake as a first step on this path of fiscal responsibility is to equal the savings in the president's budget.

Many wise budget experts, including noted Republicans (Penner & Steuerle, 2003), believe the nation is in the early stages of a budget crisis and that the longer we wait, the more pain Congress will inflict on the nation when it makes the major decisions needed to reduce the deficit – as inevitably it must. We are now entering crisis, but far too many people are delaying action until we – or more likely, our children – are hit by chaos.

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