file Reconciliation

July 26, 1993

MEMORANDUM

TO: HILLARY CLINTON

FROM: MELANNE VERVEER

RE: RECONCILIATION ISSUES

Hillary,

According to Bob Greenstein there are some serious reconciliation issues not getting adequately addressed and, given that decisions will be made in the Conference in the next 48 hours, time is running out.

1 - EITC - Bob told me that he has been personally negotiating with the Congressional Black Caucus to assure them that the President's EITC goals can be met with a lower spending figure. The House mark for EITC is $28.3 billion. Bob has assured them that $21 billion would be adequate (this after discussions with Panetta and guarantees we would not go lower). However, on "Meet the Press", Bentsen apparently indicated we'd settle for $18 billion (the Senate's mark). Bob feels he can't negotiate in good faith when the administration sends counter signals, moreover, he said many members are complaining that they can't get a consistent response from the White House.

2 - Emergency Unemployment Compensation. The EUC program is scheduled to expire in October. If no action is taken, jobless workers will get no additional benefits despite an almost 7% unemployment rate. One option to deal with this issue, which is also of real political significance, may be to address it on the reconciliation bill. George Bush got killed on this issue and the jobless problem at the time was less severe. Bob talked to Panetta who he said seemed to be hearing about this for the first time. It appears that we have no plan at this point focused on EUC. (See memo 1)

3 - Entitlement Control/Inflation Adjustment. The House reconciliation bill does not include an inflation adjustment for the entitlement targets. If inflation begins to climb and the targets are not met, serious entitlement cuts will have to be made by the President - a prospect he should not have to confront. (See memo 2)

4 - An option on tax - spend ratio - The Administration might want to pursue the possibility of counting that portion of the EIC that offsets the gasoline tax as a revenue offset rather than a spending increase. This could get us about $2 billion from the spending column to the tax reduction side, according to Greenstein. (See memo 3)

456-6244

FAX MESSAGE COVER SHEET

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TO	Melanne Verveer	**DATE** 7/27/93
FROM	Robert Greenstein	
ATTN		

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CENTER ON BUDGET AND POLICY PRIORITIES

THE TAX-SPEND RATIO AND THE RECONCILIATION CONFERENCE

The conference faces a major obstacle. It must achieve at least one dollar in spending cuts for each dollar in tax increases. If the Senate's way of determining what constitutes a tax and what constitutes spending is used, only $5 billion to $6 billion in spending over five years can be restored to the Senate bill if the total package is to achieve $500 billion in deficit reduction. If the package is to achieve a slightly smaller amount of deficit reduction — such as $495 billion — only about $7 billion to $8 billion can be added back.

Yet the spending difference between the House and Senate bills is about $29 billion. There are differences in the earned income credit ($10.1 billion), Medicare ($8 billion), food stamps ($7.3 billion), family preservation and child welfare services ($1.5 billion), child immunizations ($1.4 billion), unemployment insurance ($0.3 billion), and other areas. In addition, Rep. Charles Rangel has proposed to shift a portion of the empowerment zone funding from tax breaks to spending within the small amount of spending available. It will be very difficult to satisfy competing political pressures and also achieve important Administration objectives.

A potential remedy

There is a potential way to ease (although not to fully solve) this problem. The critical question is the extent to which the increase in the earned income tax credit (EITC) is considered a tax reduction rather than a spending increase.

When the reconciliation bill was considered on the House floor in May, the House Budget Committee and the House leadership presented the full $28 billion EITC increase as a tax reduction. This helped the House's tax-to-spend ratio substantially. By contrast, the Senate portrayed as a tax reduction only the part of the EITC that reduces a family's income tax liability. The remainder of the EITC, which is provided to families in the form of a check by the IRS, is counted by the Senate as a spending increase. The Senate approach conforms to the technical classification used by CBO in listing what portion of the EITC is an "outlay" and what portion is accounted for on the revenue side of the budget. Of the Senate's $18 billion EITC expansion, just $1.5 billion is considered to be a revenue reduction under this approach. The other $16.5 billion is counted as a spending increase.

This approach, however, does not take into account a basic fact — one of the purposes of the EITC increase in the reconciliation bill is to offset the higher energy taxes that EITC households will have to pay. Under the Senate's method of counting

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what is a tax and what is a spending increase, the higher energy taxes that working poor households will pay are counted as tax increases, but the larger EITC payments these households will receive to offset those taxes are counted as spending increases rather than revenue offsets. This makes the tax-to-spend ratio look worse than it would if the part of the EITC increase that offsets the energy tax were considered a tax reduction.

Accordingly, the Treasury Department or the Joint Tax Committee could be asked to determine how much of the EITC increase would be used to offset either income tax or a household's energy tax increase. That portion of the EITC expansion could then be counted as a revenue reduction when the tax-to-spend ratio was computed. The remainder would still be considered as a spending increase.

This approach would shift a relatively modest amount — probably about $2 billion to $2.5 billion — from the spending increase side of the ledger to the tax reduction side. This modest change would ease the substantive and political problems being caused by trying to achieve the desired tax-to-spend ratio in conference under the Senate's current way of portraying what is a tax and what is a spending item.

Can this work or will it look like a gimmick?

Republicans can be expected to criticize this. But if this approach is not used, the Republicans will launch sharp attacks anyway against whatever tax-to-spend ratios the White House and the Congressional leadership present. The Republican attacks have focused chiefly on how several components of the reconciliation bill that are much larger — such as interest payments on the debt and user fees — are treated. Whether the modest portion of the EITC that offsets the energy tax is counted as a revenue reduction will not appreciably change the Republican attacks.

Much more important is what moderate-to-conservative Senate Democrats like David Boren and John Breaux think. If this idea is appropriately presented, they might be willing to accept it; after all, it is *not* a gimmick. It is strongly defensible on the merits.

After all, the earned income credit increase is in part an offset to the energy tax. This has been clear ever since the President proclaimed in February that despite the energy tax, his budget would not raise average tax burdens on households with incomes under $30,000. Moreover, in May when Senator Boren unveiled his budget proposal eliminating the energy tax, he cut the EITC increase by $15 billion. His explanation was that with no energy tax, a larger EITC would not be needed; he clearly acknowledged that one function of the proposed EITC increase is to offset the energy tax. And Senator Breaux has defended the gasoline tax increase in Louisiana by noting repeatedly how many Louisiana families would receive an EITC increase to offset it. Louisiana ranks second in the nation in the proportion of tax returns that claim the EITC.

A defensible case also can be made to the media. If a family's taxes are raised $50 through an energy tax increase and cut $50 through an offsetting EITC increase, why should that be considered as constituting a tax increase and a spending increase? If part of the purpose of the EITC increase is to cancel out the energy tax for low- and moderate-income working households so there is not a net increase in the federal taxes they pay, why not portray it as such?

It's worth noting when the Tax Reform Act of 1986 was passed, it was widely described by the Reagan White House, Members of Congress of both parties, and the media as being "revenue-neutral." In fact, the bill contained a substantial EITC increase. If the approach currently being used by the Senate to classify what is a tax and what is spending had been followed at that time, the Tax Reform Act could have been labeled a "tax-and-spend" bill.

Is this approach politically feasible?

On July 16, I presented this idea to Larry Stein, staff director of the Senate Budget Committee. He noted that it would be difficult to make any change in the way Senate Democrats were counting what is a tax and what is spending. He was not especially encouraging about this idea. But he stated that this idea was much better and more defensible than an earlier idea advanced by some Administration officials to count as a tax reduction the portion of the EITC increase that can be said to offset the payroll tax. He commented that if this idea had surfaced at the time of the Finance Committee mark-up, it probably could have seen sold. In addition, Larry agreed that the idea was worth looking at in case it still proved politically feasible during the reconciliation conference.

The idea could prove important for both political and substantive reasons. It would enable the Administration to include a few more of its worthy social investments in the reconciliation package. And the additional inclusions could prove of particular importance in retaining support from the Black Caucus.

The keys to whether this idea can be used are probably Senators Boren and Breaux. (Conservative House Democrats should have no problem with it; they accepted a House approach under which *all* of the EITC increase was counted as a revenue reduction.) Senators Boren and Breaux surely want smaller tax increases and larger spending cuts, but they also want a reconciliation package to pass. The legislative director of another member of the Finance Committee has privately said to us that if, at the appropriate time during the conference, Secretary Bentsen were to meet with Senator Boren to explain this idea and show Boren how modest it is — and also stress its political value in holding the reconciliation package together — Senator Boren might go along. (It could be emphasized to Senator Boren that the additional amount to be classified as a revenue reduction — probably about $2 billion — is quite small, far below the $25 billion in EITC expansion costs that the House has portrayed as a revenue reduction.) The legislative director to the Senate Finance Committee member also commented that if Senator Boren did not object, Senator Breaux probably would not be a problem. And if Boren and Breaux did not object, this approach probably could be used.

July 21, 1993

CENTER ON BUDGET AND POLICY PRIORITIES

ENTITLEMENT CONTROL MECHANISMS AND THE RECONCILIATION CONFERENCE

A critically important issue in the reconciliation conference concerns entitlement control mechanisms. A provision proposed on the Senate floor by Senator Sasser, with the support of the Senate Democratic leadership, is very similar to the entitlement control provision approved by the House. The Sasser provision does, however, contain two very important improvements. It adjusts the entitlement targets if inflation proves higher or lower than forecast. It also provides a one percent margin of error — that is, it triggers action if the entitlement target is exceeded by at least one percent. The House version triggers action if the target is exceeded by one-half of one percent.

The Sasser proposal was supported on the Senate floor by every Senate Democrat present except Richard Shelby. (Patty Murray was sick and did not vote.) This provision is not in the Senate bill because 60 votes were required for its inclusion; it received 54 votes. The Senate proposal is expected to be "on the table" in conference.

It should be. The differences on inflation adjustments and the margin of error may sound technical, but they have profound implications for the White House. They could even affect the President's reelection prospects.

Under the House version, it is very likely that the entitlement target will be breached, perhaps several times over the next three years. When this occurs, Republicans can be expected to seize on the breach of the entitlement targets as evidence the Administration is mismanaging government spending. Furthermore, when the target is breached, the President may find himself in the difficult situation of either having to propose new cuts in popular entitlements, possibly in an election year, or trying to explain why he isn't taking action to offset a breach and thereby inviting sharp attack from both Ross Perot and the Republicans.

Why is a breach of the targets so likely under the House version? Because the House provision locks in the CBO economic assumptions reflected in the budget resolution, including the assumption that inflation will be *only 2.7 percent per year* for each of the next four years. This is one of the lowest, if not the lowest, multi-year inflation forecasts CBO has ever issued. CBO itself apparently no longer believes this forecast; it plans to raise the inflation forecast when it revises its economic forecast this summer. (See attached article from *Congress Daily*.)

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When inflation is higher than forecast, entitlement costs increase, due in no small part to the effects of inflation on cost-of-living adjustments in Social Security and other indexed programs. *But this does not mean the deficit rises.* CBO and OMB analyses have shown that when inflation increases, revenues also rise, with the result that there is little change in the deficit.[1]

For this reason — i.e., that a higher-than-expected inflation rate does not materially affect the deficit — all previous entitlement cap proposals have provided for a full inflation adjustment. The Bush Administration proposal designed by Richard Darman had a full inflation adjustment. So did the Boren entitlement cap proposal and the Nunn-Domenici proposal. So also did the entitlement cap proposal included in the Dole budget plan offered on the Senate floor. Only the House version lacks such an adjustment.

Indeed, the entitlement control proposal originally designed by Rep. John Spratt had an inflation adjustment. It was removed at the behest of Rep. Charles Stenholm. Furthermore, the discretionary caps established in the 1990 budget agreement — and extended in the pending reconciliation bill — have an inflation adjustment. It seems bizarre to deny for entitlements an adjustment made for discretionary programs.

The entitlement control proposal offered by the Senate Democrats on the Senate floor contained language to make precisely the same inflation adjustment in the entitlement targets as is made in the discretionary caps. In some years, this has resulted in the discretionary caps being adjusted downward; in other years, the caps have been adjusted upward. In the next several years, the adjustments would very likely be upward adjustments, because the 2.7 percent per year inflation forecast reflected in the budget resolution is expected to be too low.

It is important for the White House that an inflation adjustment be included in the final entitlement control provision emerging from conference. Otherwise, the President may find himself in an untenable position. Without such an adjustment, higher-than-expected inflation is likely to cause a breach of the targets.[2] Such a breach would be likely in 1996, among other years. If this occurs, the program contributing most to the breach would be Social Security. The President will

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1 See Office of Management and Budget, *Budget Baselines, Historical Data and Alternatives for the Future*, January 1993, pp. 158-161, and Congressional Budget Office, *The Economic and Budget Outlook: Fiscal Years 1994-1998*, January 1993, pp. 110-112.

2 Of course, a breach in the targets could also be caused by other factors. The most likely factor to cause a breach would be greater-than-forecast cost increases in Medicare and Medicaid. CBO and OMB have generally underestimated Medicare and Medicaid cost increases in recent years.

probably not wish to cut Social Security. But if he proposes to cut other entitlement benefits to make up for the amount that Social Security has contributed to the breach, constituencies of the other programs will howl. If the President proposes not to take action to offset the breach, the Republicans and Ross Perot will pounce.

The President doesn't need this. It is especially unjustifiable since higher-than-expected inflation has little impact on the deficit.

A related issue is whether the requirement to act should be triggered if the entitlement target is breached by one percent (as in the Senate leadership proposal) or by one-half percent (as in the House bill). The one-half percent margin of error is too small. It amounts to about $4 billion. The margin of error in the original Gramm-Rudman-Hollings bill was $10 billion, and the Budget Enforcement Act of 1990 raised this to $15 billion.

The President is likely to be placed in a politically difficult situation any time that action is required because of a breach of the target. He may have to propose cuts he does not favor. Or, he may be forced to accept a slowdown, just before the election, in the phase-in of universal access to health care. A one percent margin of error lessens the chances such events will occur.

A one percent margin of error is highly defensible; with it, an overage of as little as one percent triggers action. An overage that equals just a fraction of one percent can be considered *de minimis*. Moreover, if entitlement costs exceed the entitlement target by less than one percent — or less than about $8 billion — the impact on the $6 trillion U.S. economy will be negligible.

Both the inflation adjustment and the one percent margin of error were considered during the House negotiations on this issue conducted just prior to consideration of the reconciliation bill on the House floor. These proposals were opposed by Rep. Stenholm. Rep. Stenholm's principal objection to the House package, however, was that the overall package had a substantial energy tax and, in his view, insufficient spending cuts. If the final package has a smaller energy tax and more entitlement cuts than the House version, as it inevitably will, it ought to be possible to secure these modest and crucial modifications in the entitlement cap proposal. These modifications also will help with the Black Caucus and with liberals such as Henry Waxman, who may be unhappy over the additional Medicare reductions.

July 6, 1993

ROUTE TO

NATIONAL JOURNAL'S CongressDaily

Pg. 1 of 5 3:00 PM • Tuesday, June 8, 1993

ECONOMY

CBO Projects Slightly Slower Growth, Higher Inflation

In preliminary economic projections it will provide to its advisory board this week, the CBO is forecasting slightly slower growth, slightly lower interest rates, slightly higher inflation and slightly lower unemployment rates than it forecast in January, according to figures obtained today by *CongressDaily*. The new CBO projections, which are subject to revision before being released this summer, call for continued modest economic growth of 2.7 percent this year, 2.8 percent in 1994 and 2.7 percent in 1995. In January, the CBO's publicly released growth forecast called for 2.8 percent this year, 3 percent in 1994 and 2.9 percent in 1995. The new, preliminary CBO numbers also project 3.3 percent inflation this year, 3 percent in 1994 and 3.1 percent in 1995. In January, the CBO projected inflation rates of 3 percent this year and 2.7 percent in both 1994 and 1995.

In January, the CBO projected that the interest rate for three-month Treasury bills would average 3.1 percent this year, 3.7 percent in 1994 and 4.4 percent in 1995. But the new short-term interest rate projections call for lower rates and a slower rate of increase: 3 percent this year, a 3.4 percent rate in 1994 and a 3.8 percent rate in 1995. On unemployment, the CBO in January forecast a jobless rate of 7.1 percent this year, 6.6 percent next year and 6.2 percent in 1995. The new projections have those rates falling a bit: 6.9 percent this year, 6.4 percent in 1994 and 6 percent in 1995.

The CBO numbers also show quarterly calendar year projections not normally released publicly. For 1993, growth in the first quarter was 0.9 percent and is projected to be 3 percent in each of the next two quarters and 2.8 percent in the fourth quarter. The CBO projects growth to remain steady at 2.7 percent in seven of the eight quarters of 1994 and 1995; in the first quarter of 1995, it is projected to be 2.8 percent. Inflation was 3.8 percent in the first quarter this year and the CBO projects it will be 3.4 percent, 2.8 percent and 3 percent for the next three quarters. In 1994, the CBO projects inflation for the four quarters at 3 percent, 2.9 percent, 3.3 percent and 3.1 percent. And in 1995, the CBO says inflation will be 2.9 percent in each of the first two quarters, rising to 3.3 percent and falling to 3.1 percent.

Interest on three-month Treasury bills is projected to stay at 3 or 3.1 percent this year, rising to 3.6 percent by the end of 1994 and rising again in 1995, from 3.7 percent in the first quarter and going up 0.1 percent in each of the next three quarters to 4 percent at year's end. And the jobless rate, which was 7 percent in the first quarter of this year, is projected to fall to 6.8 percent by the fourth quarter this year and continue dropping to 6.2 percent by the fourth quarter of 1994 and to 5.9 percent by the end of 1995.

BUDGET

Cochran Says Clinton Btu-Tax May Be Dead ...

The Clinton administration has reduced the size of its proposed energy tax and may have dropped the whole idea of a Btu tax, according to one Senate GOP leader present at this morning's bipartisan congressional leadership meeting at the White House. President Clinton and his Democratic allies have avoided the phrase "Btu tax" for several days. Clinton said this morning: "I don't want to get into the name game here. I'm interested in the principles of the

The Washington Post

AN INDEPENDENT NEWSPAPER

Those Entitlements

A MAJOR ISSUE in conference on the reconciliation bill will be whether to impose a spending cap on otherwise open-ended entitlements. The House legislation would do so; the Senate version would not. Our own sense is that it is a bad idea. In the past it has mainly been a dodge—a way of going on record in favor of spending cuts in the abstract without having to specify which spending; the showy proposals have also been unworkable. If the conferees nonetheless have to include a cap to obtain the votes they need, they should do it carefully.

Entitlements are an artificial target. The label lumps together programs from military retirement to farm price supports whose only common characteristic is that they are exempt from the annual appropriations process. Contrary to their reputation as the kudzu of the budget, most such programs have been well behaved in recent years. The exceptions, and great offenders, have been the giant health care programs, Medicare and Medicaid. They and Social Security, the stately largest entitlement, are the principal reasons that entitlements now consume so alarming a share of the budget.

The likely effect of a cap and no more would be either (1) to put great pressure on other entitlements, including particularly those that aid the poor, in order to compensate for health care costs, and/or (2) to cut the health care programs outside the context of broader health care reform. The latter alternative would not eliminate health care costs, but simply shift them from the federal government to other payers such as the states and the privately insured.

The right way to bring these costs under control is through systemic reform, as the president is gearing up to propose. If Congress is nonetheless determined to impose caps now:

1. They should be adjusted for population (Social Security costs, for example, depend in part on how many people reach retirement age each year) and should float with the economy. That means adjusting them upward if the inflation rate proves higher than anticipated or if the economy is weaker and more people are driven onto the unemployment insurance and food stamps rolls. The very purpose of these countercyclical programs is to increase support in times of need. Surely the entitlement cutters don't want to stop that. The House bill is pretty good on all these factors but inflation.

2. If costs exceed the adjusted caps in any year, it's fair enough to require that Congress step in. The rules should not allow it to look the other way, as it did when Medicaid costs exploded in recent years. But Congress should be free to respond by raising taxes, cutting spending or signing its name to the higher deficit, however it chooses. The rules should force an explicit response, not try to dictate which kind.

3. There are tax as well as spending entitlements: the system should force attention to both. The government helps to pay the medical bills of the elderly and poor through Medicare and Medicaid. It also helps to pay the health insurance premiums of the working population through the tax code. Employer-paid health insurance premiums are excluded from employee income for tax purposes, at a current annual cost to the Treasury of $43 billion. If the goal is to get at the deficit by putting a lid on entitlements, why not also these? Or is that not quite the goal, and do only some entitlements count?

CENTER ON BUDGET AND POLICY PRIORITIES

July 16, 1993

CBO's Low Inflation Estimates Could Force Entitlement Cuts If Entitlement Control Mechanism Does Not Include Inflation Adjustment

The entitlement control mechanism included in the House reconciliation bill would require Presidential and Congressional action if the level of entitlement spending, based on current economic and technical forecasts, was exceeded in the future. Unlike the caps on discretionary spending, there would be no adjustment if the actual or projected rate of inflation exceeded the forecasts prepared by CBO in January 1993. Without this inflation adjustment, there is a strong likelihood that the entitlement targets will be exceeded in each of the next few years due to the low inflation estimates prepared by CBO earlier this year.

The CBO January 1993 forecast projected that the Consumer Price Index would rise 2.7 percent per year for each of the next four years. *This is the lowest inflation forecast CBO has issued since at least the mid-1970s and perhaps the lowest multi-year forecast ever issued.*

CBO itself apparently no longer believes this forecast; it reportedly plans to raise the inflation forecast when it revises its economic forecast this summer. (See the attached article from *Congress Daily*.) Wharton Econometrics currently projects that the Consumer Price Index will rise 3.4 percent in fiscal year 1994, 3.6 percent in fiscal year 1995, 3.9 percent in fiscal year 1996, 3.8 percent in fiscal year 1997, and 3.7 percent in fiscal year 1998.

The amounts by which entitlement spending could exceed projected levels because of overly optimistic inflation projections are substantial. For every percentage point that the inflation rate exceeds CBO's projected 2.7 percent, entitlement spending — excluding deposit insurance — will increase approximately $8 billion in FY 1994 and slightly more each subsequent year. If the inflation rate remains at levels higher than 2.7 percent for more than one year, as now seems likely, entitlement spending will grow by cumulatively larger amounts.

In fact, *if inflation follows the course projected by Wharton Econometrics, the entitlement targets would be exceeded by $20 to $30 billion by fiscal year 1996.*

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CENTER ON BUDGET AND POLICY PRIORITIES

TO: Carol Rasco
Greg Simon
Gene Sperling

FROM: Bob Greenstein

RE: Unemployment Insurance — The Problems That Face The Administration and The Options Available to It

Background

The unemployment rate remains high at 7.0 percent. Nearly nine million Americans are out of work. In addition, the number of *long-term* unemployed — those out of work for more than half a year and still looking for a job — now stands at 1.7 million. This number is nearly as high as in 1982, when the unemployment rate averaged 9.7 percent.

Unemployed workers qualify for up to 26 weeks of regular unemployment benefits. When these benefits run out, they receive "emergency unemployment compensation" (EUC) benefits. Some 1.4 million unemployed workers nationwide are now drawing EUC benefits.

Serious problems lie ahead. The EUC program is scheduled to expire October 2. If EUC expires and no other action has been taken, most jobless workers whose regular benefits run out after October 2 will receive no additional jobless benefits of any sort.

- Today, 25 states have unemployment rates at or above 6.5 percent, and 21 have jobless rates at or about 7.0 percent. But only 13 currently meet the criteria to pay extended benefits to workers whose regular unemployment benefits run out. This isn't a problem currently because the EUC program supersedes the extended benefits program. It will be a large problem once EUC expires on October 2.

- A large number of states with high unemployment rates do *not* meet the criteria to pay extended unemployment benefits. These criteria have two components: a state's average unemployment rate for the most recent three-month period must be at least 6.5 percent *and* the state's unemployment rate for the three-month period must be *at least 10 percent higher than the state's unemployment rate in the same three-month period of either of the two previous years*. Thus, if a state's unemployment rate is now 7.7 percent, it meets the extended benefits criteria only if its

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unemployment rate in the same months of either 1991 or 1992 was at or below 7.0 percent. States whose unemployment rates have remained high for two years but are not still climbing do not qualify.

- Among the states with high unemployment rates that do not qualify for this reason are such large states as New York, Texas, Michigan, Pennsylvania, and Florida.

- Furthermore, many of the states that will meet the criteria to provide extended benefits after October 2 have not passed the necessary state legislation enabling them to do so. *Only three of the 13 states that currently meet the extended benefit criteria have passed this legislation.* There may be reluctance to pass such legislation because states must pay 50 percent of the extended benefits costs, and a number of states have largely or entirely depleted their state unemployment trust funds due to the prolonged stretch of high unemployment. (States that deplete their trust funds must borrow from the federal unemployment trust fund just to pay regular unemployment benefits. They must pay sizable interest charges on these loans and repay them fairly promptly or else have a tax imposed on employers in their states.) Most state legislatures have now adjourned for the year without passing this legislation.

  Among the states that would meet the extended benefits criteria but have not passed the necessary state legislation are California, Illinois, and New Jersey.

- About a quarter million workers are now exhausting their regular unemployment benefits each month. The large majority of those who exhaust their regular benefits after October 2 stand to receive no further assistance.

Political significance

The political consequences are large. If most jobless workers whose regular benefits run out after October 2 can obtain no additional jobless aid despite a national unemployment rate of close to 7 percent, the Clinton Administration and the Democratic Congress will be subject to sharp criticism. Both Republicans and the media will recall the tough Democratic attacks on George Bush in 1991 over his failure to seek additional weeks of aid for the long-term unemployed. Yet the number of long-term unemployed today is *50 percent higher* than it was in 1991. The Administration does not have an option of doing nothing.

Options

As I see it, the Administration has two options: 1) include temporary changes in the extended benefits program in the reconciliation conference report, or 2) secure legislation in September that extends the EUC program. Given the controversy last week over the emergency financing of the flood relief bill, it is very possible that an EUC extension could only be passed if it were "paid for."

1. The reconciliation option

The Administration and the Congressional leadership could seek inclusion in the reconciliation bill of a provision that temporarily suspends the requirement that to qualify for extended benefits, a state's unemployment rate in the most recent three-month period be at least 10 percent higher than its rate in the same three months of either of the two previous years, along with a companion provision temporarily increasing from 50 percent to 75 percent (or some similar percentage) the federal matching rate for extended benefits. Both temporary provisions could be put in place for a period such as six months. These provisions would enable all states with unemployment rates of at least 6.5 percent to qualify for extended benefits during this period. In addition, since states would have to pay a smaller share of extended benefits costs during that time, most states could be expected to participate in the extended benefits program.

There is precedent for such an approach. An extended benefits requirement similar to the current 10 percent requirement was suspended temporarily in the late 1970s in response to a comparable problem. At that time, as now, a number of states had experienced a prolonged period of high unemployment and failed to meet the tightly-drawn extended benefits criteria because their unemployment rate was not sufficiently higher than their unemployment rate in the preceding years.

At present, the Senate reconciliation bill has no such provisions. The House bill *permanently* raises to 75 percent the federal matching rate for extended benefits. It does not include a provision affecting the 10 percent requirement.

The House provision costs $300 million over five years. I do not know the cost of raising the matching rate for just six months and accompanying it with a temporary suspension of the 10 percent requirement. My guess is that it would be in the $500 million range, but that's a guesstimate.

One other point about this option should be noted. The House reconciliation bill also extends a temporary part of the federal unemployment tax that is scheduled to expire in a few years. This temporary component of the tax, which employers pay, equals 0.2 percent of the first $7,000 of employees' wages. The House extension brings in $2.1 billion over five years.

I understand that the Labor Department opposes extending this tax in reconciliation because it wants to preserve such an extension as a mechanism to pay for the dislocated workers program the Department is now designing. If something like $500 million were needed in the reconciliation conference report to make these temporary changes in the extended benefits program, an extension of this tax for a period of less than a year would cover the cost.

2. <u>EUC Extension Option</u>

If the reconciliation option is not used, there will be no alternative to seeking an EUC extension in September. The question is whether it can pass as an emergency measure, possibly with a second flood relief bill if there is one in September, or whether an EUC extension would have to be paid for. Given the flap this past week on the House floor about the first flood relief bill, there is a reasonable chance it would have to be paid for.

There are ways an EUC extension could be designed to reduce its cost. The cost could be reduced by limiting EUC to states in which unemployment exceeds a specified level, rather than providing it in *all* states as is done at present. EUC benefits could be shut off — or limited to a much shorter number of weeks (an approach that might be necessary for political reasons) — in states with unemployment rates below 6.0 percent or 6.5 percent. (As noted, the extended benefits program is limited to states with unemployment rates equal to or exceeding 6.5 percent.)

In addition, the EUC program could be designed in such a fashion that it would terminate before its scheduled expiration date if the *national* unemployment rate dropped below 6.5 percent for two consecutive months. Thus, if the recovery accelerates and the unemployment rate unexpectedly drops, federal funds would not continue to be expended for EUC benefits. Such a provision might be helpful politically in seeking to pass an EUC extension bill.

Just how much an EUC extension would cost would depend on how long the program was extended (it would probably be desirable to extend it until some time in February) and what provisions were made to shorten the duration of benefits, or end them, in states with lower unemployment rates.

Conclusion

Needless to say, the Administration and the Congressional leadership need to decide quickly what course to follow. If the reconciliation option route is chosen, immediate action will be needed.

Failing either to address this issue in reconciliation or to seek an EUC extension — or seeking an EUC extension but failing to get it through Congress due to a dispute over paying for it — would be politically damaging for the Administration. It would also be undesirable on policy grounds given the high levels of long-term unemployment that persist.

July 26, 1993

August 4, 1993

MEMORANDUM TO WHITE HOUSE STAFF

FROM: Gene Sperling

SUBJECT: Memos on Dole Reply and Retroactivity

Attached are two memos: The first is our Rec Room Reply to the Dole Response to the President last night. The second is a two-page summary on the truth on retroactivity. There is significant misunderstanding on this latter issue, so we need to get the facts out.

SENATOR BOB DOLE AND THE FACTS

Senate Minority Leader Robert Dole told the American people that there were four questions they had to ask. Unfortunately, there were serious misstatements in all four of the questions he discussed.

I. DOLE AND THE FACTS ON TAXES:

MISSTATEMENT #1:

BOB DOLE SAID THAT RETROACTIVE TAXES WERE UNFAIR AND UNPRECEDENTED.

FACTS: THE PRESIDENT HAS ALWAYS BEEN CLEAR AND DIRECT ON RAISING TAXES ON THE TOP 1%.

- Only the top 1.2% of individual taxpayers pay more.
- The President said in the most clear manner possible throughout the entire campaign, the transition and in his original proposal on February 17, 1993 (which had a January 1, 1993 effective date) that he would push for a modest tax increase on the top 1% of Americans, those making over $180,000.
- From Michael Eisner to Lee Iacocca, many well off Americans shifted income to 1992 because it was clear that taxes were going up on the top 1% in 1993.

OVER 90% OF SMALL BUSINESSES WILL BENEFIT FROM THE TIMING OF THE TAX CHANGES: Only 4% of businesses owners make over $180,000, and will be affected by the starting date of the tax January 1, 1993 effective date. **Yet, well over 90% of small businesses will benefit from a menu of tax cuts that start on January 1, 1993 or earlier.** Increased expensing starts on January 1, 1993, over 90% of small businesses will receive or be eligible for additional tax cuts because of the timing of the tax changes. <u>In addition, small companies, larger companies and others will be eligible for other additional tax cuts that are retroactive to June 30, 1992:</u>

- Research & Development tax credit
- Low-income housing tax credit
- Employer provided education assistance
- Targeted Jobs Tax Credit
- 25% Self-Employed Health Deduction

- **THERE HAVE BEEN RECENT TAX PROVISIONS ENACTED INTO LAW WHICH WERE RETROACTIVE AND VOTED ON BY REPUBLICANS AND SIGNED BY REPUBLICAN PRESIDENTS:** Despite claims that retroactive tax increase are unheard of, the fact is that Ronald Reagan signed retroactive tax increases in 1981, 1984 and 1986 that were voted favorably on by Republicans.

Economic Recovery Tax Act of 1981. Provisions limiting tax straddles. Signed into law by President Reagan on 8/13/81, effective 6/23/81.

Deficit Reduction Act of 1984. Signed into law by President Reagan on 7/18/84. Several retroactive items:

a. Restriction of income tax credits - effective 1/1/84
b. Restriction of income averaging - effective 1/1/84
c. Restriction of depreciation of luxury cars - effective 6/18/84
d. Restriction of business leasing deductions - effective 5/23/84
e. Restriction of bonds, other debt instruments -some effective 3/1/84
f. Postponement of expensing - effective 1/1/84
g. Restriction of finance leases - effective 1/1/84

Tax Reform Act of 1976: Increased the alternative minimum tax on individual from 10% to 15%. The corporate alternative minimum tax was similarily increased to 15%. Both increases were effective after December 31, 1975. The act was passed on October 4, 1976.

Tax Reform Act of 1986. Repeal of investment tax credit. Signed into law by President Reagan on 10/22/86, effective 1/1/86.

Retroactive Taxes are Not Historically Rare: There are at least 12 additional times that retroactive taxes have been passed.

MISSTATEMENT #2: The Clinton plan contains $260 Billion of new taxes and Fees.

FACTS: As the Washington Post said this morning, the Senator exaggerated the number of taxes which is $241 billion in new taxes -- not $260 billion. The $260 billion figure includes user fees which are spending cuts, not taxes. These are the same user fees that Republican alternatives counted as spending cuts. Senator Dole is inconsistent in that he counts the "fees" as taxes even though he counted the same "fees" in his plan as spending cuts. Indeed, program specific payments that prevent taxpayers from subsidizing specific services have always been counted as reductions in government outlays.

- In 1985, Senator Dole was the point person on a deficit plan, in which they specifically counted fees as spending cuts.

- The 1990 bi-partisan plan had user fees, and they were clearly scored by the Republican Administration's OMB as spending cuts.

- In Dole's 1993 Republican alternative, he specifically counts the same amount of fees as cuts as the Clinton plan does.

TAX MISSTATEMENT #3: Senator Dole gave the impression that there was a new Clinton estate tax rate increase retroactive to January 1, 1993?

FACTS:

- There are no new taxes on estates in the President's plan. None. The only tax that affects estates is an extension ofan estate tax rate that has applied since 1987 -- not a new tax. In fact, this tax rate was retained and extended in 1984 and 1987 in bipartisan bills negotiated with Senator Dole playing a lead role.

- Only the **estates of the very wealthy** are affected. The rate applies only to estates over $2.5 million in value. The average worth of the estates affected is $10 million. The rate affects only 1,000 estates out of the 1.2 million individuals who died this year.

- This provisi... in the conference agreement, which extends the top estate tax rate which expired at the beginning of the year, **was passed by the Congress last year** (in HR 11). Estate planners around the country were well aware of the provision, and the likelihood of enactment in the next tax bill.

II. DOLE AND THE FACTS ON SPENDING CUTS

MISSTATEMENT: Senator Dole stated that 80% of all of the cuts come after the 1996 election?

FACTS: As to the timing of the cuts, around 60% of the spending cuts come in the last two years -- a reasonable pace to phase in cuts, when you consider what is practicable, humane and best for avoiding economic contraction. Every specific cut in reconciliation will be voted into law at the same time that taxes are -- not a moment later -- and there is a hard freeze that ensures that discretionary spending is cut by 13% over 5 years.

•According to CBO, on the other hand, it is Senator Dole who has approximately 75% of his spending cuts in the last two years, a far higher percentage than this agreement.

SENATOR DOLE AND THE FACTS ON JOB CREATION

TEMENT: "Back in January, the non-partisan Congressional Budget Office told us that, 'If Congress did not do anything, if we did not pass any economic package, our economy would create 9.4 million new jobs over the next four years. President Clinton now says that his plan will create perhaps 8 million jobs -- new jobs over the next four years. In effect, by passing the President's plan, we could lose 1.4 million jobs."

There are several problems with Dole's argument. For example, he doesn't tell you the following:

- After the last four years -- the worst record of private sector job creation since the Hoover Administration -- it's nice to have a debate over whether the economy will create 8 million or 9 million jobs. Under the Clinton Administration, the economy has created an average of 148,000 jobs per month -- more than seven times the private sector job growth rate in the Bush Administration.

- What Senator Dole seems to be saying is that we can do nothing and create jobs. But we learned over the last four years that you can't create jobs through wait-and-see, do nothing economics. The fact is that studies show that our plan can accomplish both $500 billion in deficit reduction and 8 million new jobs.

- The CBO number he cites is actually 8.8 million jobs and that at least two independent forecasters (DRI and Wharton Econometrics) have projected the economy to create 9 million jobs under the Clinton plan. And unemployment is projected to be lower under the President's plan than under the January CBO projection.

- Many independent analysts agree that if we don't pass the plan there will be a severe reaction in the financial markets -- which would have a negative impact on job creation. CBO has always maintained that deficit reduction is essential for long-term economic health. Recently, Federal Reserve Chairman Alan Greenspan testified to the importance of passing a $500 billion deficit reduction plan.

- Studies released by the Joint Economic Committee and the National Venture Capital Association indicated that two of the plan's small business incentives alone will add 200,000 additional jobs over the next five years.

IV. SENATOR DOLE AND THE FACTS ON NATIONAL DEBT

MISSTATEMENT: The Federal debt will grow one trillion under the Clinton plan over the next five years.

FACT: What Bob Dole did not tell you is that the debt would grow even more under his plan than under the Clinton plan.

- Senator Dole failed to mention that his own plan lowers the deficit $100 billion less by his own admission and his own paper describing the plan. Senator Dole looked the deficit in the eye and blinked. Bob Dole is asking for a budget that would move us $100 billion farther away from deficit reduction -- and that is if you count all of his "entitlement cap" and "across-the-board" caps.

- We inherited the a $300 Billion deficit, and the largest run up in the deficit in history. President Clinton responded with the largest deficit reduction in history. During that transitional period time the debt will grow unfortunately because of the build up over the last 12 years. Yet, the 'ebt will be $500 billion less because of the President's deficit reduction package and it would be $100 billion higher if the Congress chose Senator Dole's plan instead of the President's.

THE FACTS ON RETROACTIVITY

SUMMARY

1. THE TAXES AFFECT ONLY THE TOP 1% -- THOSE COUPLES MAKING OVER $180,00 (AGI) -- AND THE PRESIDENT WAS CLEAR AND DIRECT ON HIS INTENTION TO INCREASE TAXES MODESTLY ON THESE 1% OF TAXPAYERS:

2. OVER 90% OF SMALL BUSINESSES WILL BENEFIT FROM THE TIMING OF THE TAX CHANGES:

3. THERE HAVE BEEN RECENT TAX PROVISIONS ENACTED INTO LAW WHICH WERE RETROACTIVE AND VOTED ON BY REPUBLICANS AND SIGNED BY REPUBLICAN PRESIDENTS:

4. THERE IS NO NEW INCREASE IN THE ESTATE TAX: THE TOP RATE ON ESTATES OF OVER $2.5 MILLION IS JUST BEING EXTENDED.

FOUR MAIN POINTS

1. THE PRESIDENT HAS ALWAYS BEEN CLEAR AND DIRECT ON RAISING TAXES ON THE TOP 1%.

- Only the top 1.2% of individual taxpayers
- The President said in the most clear manner possible throughout the entire campaign, the transition and in his original proposal on February 17, 1993 (which had a January 1, 1993 effective date) that he would push for a modest tax increase on the top 1% of Americans, those making over $180,000.
- From Michael Eisner to Lee Iacocca, many well off Americans shifted income to 1992 because it was clear that taxes were going up on the top 1% in 1993.

2. OVER 90% OF SMALL BUSINESSES WILL BENEFIT FROM THE TIMING OF THE TAX CHANGES:

- Only 4% of businesses owners make over $180,000, and will be affected by the starting date of the tax January 1, 1993 effective date.

- **Yet, well over 90% of small businesses will benefit from a menu of tax cuts that start on January 1, 1993 or earlier.** Increased expensing starts on January 1, 1993, over 90% of small businesses will receive or be eligible for additional tax cuts or benefits because of the timing of the tax changes. <u>In addition, small companies, larger companies and others will be eligible for other additional tax cuts that are retroactive to June 30, 1992:</u>

    - Research & Development tax credit
    - Low-income housing tax credit
    - Employer provided education assistance
    - Targeted Jobs Tax Credit
    - 25% Self-Employed Health Deduction

3. THERE HAVE BEEN RECENT TAX PROVISIONS ENACTED INTO LAW WHICH WERE RETROACTIVE AND VOTED ON BY REPUBLICANS AND SIGNED BY REPUBLICAN PRESIDENTS: Despite claims that retroactive tax increase are unheard of, the fact is that Ronald Reagan signed retroactive tax increases in 1981, 1984 and 1986 that were voted favorably on by Republicans.

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Tax Reform Act of 1986. Repeal of investment tax credit. Signed into law by President Reagan on 10/22/86, effective 1/1/86.

At least a Dozen More Historical Examples: Retroactive taxes are not historically rare, There are at least 12 additional times that retroactive taxes have been passed.

4. THERE IS NO NEW INCREASE IN THE ESTATE TAX: THE TOP RATE ON ESTATES OF OVER $2.5 MILLION IS JUST BEING EXTENDED. Senator Dole gave the erroneous impression that there was a new Clinton estate tax rate increase retroactive to January 1, 1993.

- There are no new taxes on estates in the President's plan. None. The only tax that affects estates is an extension of an estate tax rate that has applied since 1987 -- not a new tax. In fact, this tax rate was retained and extended in 1984 and 1987 in bipartisan bills negotiated with Senator Dole playing a lead role.

- Only the **estates of the very wealthy** are affected. The rate applies only to estates over $2.5 million in value. The average worth of the estates affected is $10 million. The rate affects only 1,000 estates out of the 1.2 million individuals who died this year.

- This provision in the conference agreement, which extends the top estate tax rate which expired at the beginning of the year, **was passed by the Congress last year** (in HR 11). Estate planners around the country were well aware of the provision, and the likelihood of enactment in the next tax bill.

MEMORANDUM

TO: Melanne Verveer

FROM: Marian Wright Edelman

DATE: July 7, 1993

RE: Four Steps Needed for Enactment of a Clinton Administration's Initiative for Children

---

1. **The White House should take steps to strongly defend the President's immunization proposal as adopted by the House in conference. It will also be necessary to secure the cooperation of Senator Bumpers for a satisfactory conference agreement on immunization.** Senator Bumpers single handedly convinced the Senate to gut the Finance Committee provision, itself a scaled back version of the President's proposal for the federal government to pay for bulk purchase and distribution of vaccines for all pre-schoolers. **The Senate passed Bumpers plan saves on the cost of Medicaid-purchased vaccines, <u>but it would not provide funding to immunize even one additional child</u>. See enclosed chart describing House, Senate Finance, and Senate Immunization provisions.**

SENATORS MITCHELL, MOYNIHAN, BUMPERS AND REPRESENTATIVES FOLEY AND ROSTENKOWSKI SHOULD BE TOLD THAT THE HOUSE PASSED IMMUNIZATION PROVISION IS A BOTTOM LINE ADMINISTRATION PRIORITY.

2. **The White House should secure Senate approval for increased appropriations for Head Start and immunizations in FY94.** The President's proposed $1.4 billion increase for Head Start and $300 million for immunization could not be accommodated within the bounds of the Labor HHS appropriation (without significant cuts in current spending levels for other worthy programs).

Mr. Natcher provided only an additional $500 million for Head Start and $108 million for immunization. As the action moves to the Senate it is essential to get a Head Start increase of at least $850 million to have any hope of securing $700 million in conference. It would be embarrassing for the President to secure an increase of no more -- or even less -- than was achieved in the Congress under Bush last year.

It is crucial that the Head Start increase not come at the expense of the funding necessary for the other parts of the President's immunization strategy: increased appropriations of $300 million to keep immunization clinics open longer hours; to reach out to parents with information on where and why to immunize their children; and to set up tracking systems to remind parents when immunizations are due.

3. **Strong White House intervention is necessary to ensure that the conferees do not drop the Administration's Family Preservation and Support provisions adopted by the House but not the Senate, not because of the substantive objections, but because of potential "Byrd Rule" difficulties.** (The President's proposal would authorize new spending not offset elsewhere in the Reconciliation bill by spending cuts). The $1.5 billion cost would make a major contribution to reducing abuse and neglect and unnecessary foster placements and is much smaller than similar provisions passed twice before. **Chairmen Rostenkowski and Moynihan need to hear that these provisions are near the top of the Administration's priorities.**

4. **The** President should frame the following four issues as included in the House bill as "a Children and Families Initiative:"

   - immunization
   - family preservation and support
   - Leland anti-hunger provisions
   - Earned income credit

This would enable child and family advocates to rally around the full agenda; provide political cover for some members who would vote to help children although uncomfortable about the mix of budget cuts and tax increases; and lend coherence to a diverse set of investments. A significant Clinton investment program for children and families could be accomplished with the following outcome in conference:

$ 1.2 billion for purchasing and distributing vaccines
$ 1.5 billion for family preservation and support
$ 5.0 billion for food assistance to families with high housing costs.
$18.0 billion for expansion of the earned income credit for working families and
$25.7 billion bottom line
====

Some combination of taxes and other spending cuts are needed to make room for these investments.

Enclosure: Chart on House, Senate Finance, and Bumpers Amendment/Sheet on Family Preservation Provisions

Immunization Provisions in the Budget Reconciliation Bills

	House-Passed Version	Senate Finance and Labor Committee Provisions	Senate Passed Version (Bumpers Amendments)
Vaccine Assurance	**Yes** - Vaccines for all children without insurance coverage for immunizations.	**Yes** - Vaccines for uninsured and underinsured children with incomes below 75 percent of their state's median income.	**No** - States only required to bulk purchase vaccines for Medicaid programs.
No. of Additional Children Eligible for Immunization	**11.1 million**	**7.9 million**	**None**
Parent Education and Outreach for Medicaid-covered Children	**Yes** - Medicaid required to inform parents and establish immunization agreements with WIC and Title V Maternal and Child Health Programs.	**Yes** - Same as House.	**No.** The Medicaid improvements were deleted by the Bumpers Amendments.
Improved Medicaid Reimbursement	**Yes** - Sufficient fees for immunization services required so Medicaid children can get immunized by private physicians.	**Yes** - Same as House.	**No** - The Medicaid improvements were deleted by the Bumpers Amendments.
Improved Medicaid Coverage of Immunizations	**Yes** - Medicaid must cover all recommended vaccines, and managed care plans must provide immunization services.	**Yes** - Same as House.	**No** - The Medicaid improvements were deleted by the Bumpers Amendments.
State Vaccine Purchase at Centers for Disease Control (CDC) - Negotiated Prices for Non-Medicaid Children.	**Yes** - HHS must negotiate on behalf of the states for vaccines at the same prices and terms as under the CDC contracts.	**Yes** - Same as House.	**No** - Manufacturers may refuse to sell vaccines at CDC negotiated prices to states for non-Medicaid children.
Protection on Grant Reductions	**Yes** - There are no provisions for punitive sanctions against AFDC parents.	**Yes (Partial)** - Allow demonstrations in 5 states if services are available and other protections are in place.	**No** - States may impose sanction on AFDC families even if services are unavailable or if the parent has religious objections.
Immunization Registries	**Yes** - Authorizes $50 million in FY 1994 and $152 million in FY 1995 to establish immunization registries.	**Yes** - Authorizes $152 million in FY 1994 for immunization registries.	**Yes** - Leaves Labor Committee provisions intact.
Immunization Service Delivery, Education, and Outreach	**Yes** - Authorizes $680 million in FY 1994 and such sums in following years.	**Yes** - Authorizes $250 million in addition to current CDC grants for FY 1994.	**Yes** - Leaves Labor Committee provisions intact.
Vaccine Injury Compensation Program	**Yes** - Permanently extends vaccine excise tax and simplifies requirements of the compensation program.	**Yes** - Similar to House.	**Yes** - Similar to House.

MAINTAIN THE PRESIDENT'S FAMILY PRESERVATION AND SUPPORT PROVISIONS PASSED BY THE HOUSE IN THE OMNIBUS BUDGET RECONCILIATION BILL

HOUSE: The President's Family Preservation and Support Provisions ($1.5 billion over five years) are in the House-passed Budget Reconciliation Bill.

SENATE: No Family Preservation and Support Provisions are in the Senate Budget Reconciliation Bill due to procedural problems, although the Rockefeller-Bond Family Preservation and Child Protection Reform Bill (S. 596) is pending in the Senate.

WHAT THE FAMILY PRESERVATION AND SUPPORT PROVISIONS DO:

1. Prevent child abuse and neglect by providing funds for family support programs, like Arkansas' HIPPY program, Parents as Teachers, and Family Focus, all of which teach parents early how to protect, nurture and support their children;

2. Help states develop and expand programs for families in crisis which keep children safe and families together and prevent the unnecessary use of costly out-of-home care;

3. Improve the quality of foster care and adoption assistance for children who cannot be protected at home; and

4. Enhance accountability for the provision of effective services for vulnerable children and families.

WHY THE FAMILY PRESERVATION AND SUPPORT PROVISIONS MUST BE ENACTED:

1. The crisis facing families and child protection agencies continues to escalate. Just last year, 2.9 million children, an average of about 8,000 a day, were reported abused and neglected, almost a tripling since 1980. More than three children a day died of maltreatment. Child protection agencies and courts are both overloaded.

2. These are the most significant federal reforms for abused and neglected children in over a decade. **Congress passed more generous reforms last year, which were vetoed as part of the Urban Aid/Tax bill by President Bush.**

FUNDING FOR FAMILY PRESERVATION AND SUPPORT CANNOT BE FURTHER REDUCED

o The $1.5 billion Family Preservation and Support package in the House Budget Reconciliation Bill already is less than one-quarter of the size of the package originally introduced in 1990 by Representative Downey, less than one-half of that passed last August by the House of Representatives as part of the Downey-Panetta Children's Initiative, and $.7 billion less than the final Bentsen Downey provisions passed last October as part of the Urban Aid/Tax bill and re-introduced this year by Senators Rockefeller and Bond.

URGENT NEXT STEPS

o Urge Chairmen Rostenkowski and Moynihan and the House and Senate leadership to include the Family Preservation and Support provisions in the final Budget agreement.

Congress of the United States
House of Representatives
Washington, DC 20515

June 22, 1993

The Honorable Dan Rostenkowski
Chairman
Committee on Ways and Means
House of Representatives
Washington, D.C. 20515

The Honorable Martin Sabo
Chairman
Committee on the Budget
House of Representatives
Washington, D.C. 20515

Dear Chairmen:

As new Members of Congress, many of us faced difficult choices in voting for Reconciliation package. In the end, we supported the package because it reduced the deficit substantially and in a progressive manner and included some critical provisions proposed by President Clinton for disadvantaged children and their families.

The Reconciliation package is important for its contribution in reducing three deficits: a budget deficit, an investment deficit, and a social deficit. To reduce the two latter deficits and make needed investments for the future, it is imperative that the final reconciliation bill address the serious problems affecting poor children and their families. The two major provisions proposed in this area by President Clinton -- the increase in the Earned Income Tax Credit, and the Mickey Leland childhood Hunger Initiative to enhance food assistance for poor children and their families -- are both in the House bill. We appreciate your leadership in including both of these in the bill.

The EITC expansion is essential to reward work and pave the way for welfare reform. It reaches a key goal set forth by President Clinton -- if parents work full-time year-round, their children should not grow up in poverty.

The Mickey Leland initiative, developed over recent years on a bi-partisan basis, would reduce hunger and combat homelessness among poor children and their families. It also would strengthen the incentives for collection of child support payments and boost incentives to work.

These two provisions are essential for another reason: both the EITC and the Leland initiatives are necessary to ensure that the energy tax, whatever its final size, does not tax poor households deeper into poverty.

The Senate bill treats two provisions in troubling ways. It does not contain the funds included in the budget resolution for the

Leland initiative. Further, it reduces the proposed EITC expansion by $10 billion through the elimination of the expansion of proposed credit to poor childless workers and by cutting back on the proposed increase for families with children.

Under the Senate bill, families of four with a full-time minimum wage worker would not be lifted to the poverty line. And more than three million families with children would receive lower EITC benefits than under current law, even as their taxes are rising due to the transportation fuels tax.

Moreover, by eliminating the childless worker component of the EITC and the Leland initiative, the Senate bill would tax the large majority of poor Americans further into poverty, an unacceptable outcome.

We strongly believe that the final Reconciliation bill should retain the full increase in the Earned Income Tax Credit and the Mickey Leland initiative as proposed in the President's budget.

We appreciate your consideration of our views on these important matters.

Sincerely,

Eva M. Clayton

Earl F. Hilliard

[illegible]

Melvin L. Watt

James E. Clyburn

[illegible]

Lucille Roybal-Allard

Lynn C. Woolsey

Sherrod Brown

Nydia M. Velázquez

Mike [illegible]

Jerrold Nadler

Alcee L. Hastings

Bob Filner

Leslie Byrne

Ed Pastor

Corrine Brown

Anna G. Eshoo

Walter Tucker III

Cynthia McKinney

Karan English

Lynn Schenk

Karen Shepherd

[illegible]

Bobby Scott

Carrie P. Meek

Albert R. Wynn

Mel Reynolds

Eric Fingerhut

Dan Hamburg

Maurice Hinchey

Eddie Bernice Johnson

Bobby L. Rush

José E. Serrano (D-NY)
Chairman

Lucille Roybal-Allard (D-CA)
Vice Chair

Ed Pastor (D-AZ)
Secretary-Treasurer

Congress of the United States
Congressional Hispanic Caucus
103rd Congress

E (Kika) de la Garza (D-TX)
Ron de Lugo (D-VI)
Solomon P. Ortiz (D-TX)
Bill Richardson (D-NM)
Esteban E. Torres (D-CA)
Ileana Ros-Lehtinen (R-FL)
Xavier Becerra (D-CA)
Henry Bonilla (R-TX)
Lincoln Diaz-Balart (R-FL)
Luis Gutierrez (D-IL)
Robert Menendez (D-NJ)
Carlos Romero-Barceló (D-PR)
Frank Tejeda (D-TX)
Nydia Velázquez (D-NY)
Robert Underwood (D-Guam)

Richard V. López
Executive Director

June 24, 1993

The Honorable William Jefferson Clinton
President of the United States
The White House
Washington, D.C. 20500

Dear Mr. President:

We, the undersigned Members of the Congressional Hispanic Caucus, voted for the House Reconciliation bill based on the principles reflected in the bill: that it reduced the deficit substantially, that the deficit reductions were equitable, and that it included important initiatives for America's low- and moderate-income families and communities. We are concerned that the Senate bill moves away from these principles and excludes critical components of the House-passed bill.

In our view, the final conference agreement on the Reconciliation bill must include the following provisions:

- Equitable distribution of the burden of Medicare cuts. The Senate bill achieves an additional $19 billion in Medicare cuts over the 2-year freeze passed by the House. Unlike the House cuts, The Senate cuts are unevenly borne by Hispanic and other low-income communities. While the Senate cuts would reduce Medicare expenditures by an additional 20.2 percent nationwide over the House cuts, Medicare expenditures in poor, Hispanic communities represented by Members of the Congressional Hispanic Caucus would be additionally cut by 44.1 percent. Medicare cuts should not be borne by the most disadvantaged populations.

- Earned Income Tax Credit Increase (EITC). The House bill adopts your proposal to expand the EITC by $28 billion to help offset the energy tax and to ensure that full-time, year-round working families of four are no longer poor. The Senate bill reduces your proposal by $10 billion by providing a smaller increase for families with children and by eliminating the expansion of the credit to poor workers without children. As a result, the Senate bill pushes these poor workers further into poverty, and even reduces somewhat current benefit levels for some families with children. This is a dramatic and unacceptable departure from your original EITC proposal adopted with our strong support in the House.

The Honorable William Jefferson Clinton
June 24, 1993
Page 2

- **Mickey Leland Childhood Hunger Act.** This measure, which has passed the full House in the past, provides additional food assistance to very low-income households including families with children and elderly individuals. The bill helps promote self-sufficiency and work, and also helps offset the regressive effects of the final energy tax. The most significant provision targets assistance to families with children that are forced to choose currently between paying the rent and feeding their families.

- **Empowerment Zones.** These tax incentives will ensure that impoverished communities will receive badly needed assistance to create jobs and improve the local economy. Given the disappearance of most of the stimulus package and the entitlement cuts likely to be enacted as part of the Reconciliation bill, these incentives are critical if these communities are to receive any assistance in this package.

The final conference agreement should include the House-passed EITC increase, the Mickey Leland and empowerment zones provisions, and assure that cuts made to Medicare be equitable.

Further, we would note our strong opposition to any entitlement cap or control mechanism that goes beyond the agreement reached in the House. In fact, we believe that a few important issues should be revisited during the conference's consideration of this issue to ensure the best and most reasonable mechanism is adopted.

Our support for the House bill was partly shaped by the inclusion of the aforementioned provisions. The Caucus will carefully scrutinize the aforementioned programs prior to a vote in the House.

Sincerely,

José E. Serrano, Chairman	Lucille Roybal-Allard
Xavier Becerra	Carlos Romero-Barcelo
Nydia Velazquez	Frank Tejeda
Ron de Lugo	Bill Richardson
Luis Gutierrez	Ed Pastor

Solomon P. Ortiz

Robert Menendez

Robert A. Underwood

Esteban E. Torres

CENTER ON BUDGET AND POLICY PRIORITIES

June 29, 1993

THE SENATE FINANCE COMMITTEE'S ACTIONS IN REMOVING $10 BILLION FROM THE CLINTON EITC EXPANSION

In action on the budget reconciliation bill last week, the Senate Finance Committee scaled back the Earned Income Tax Credit expansion proposed by the Clinton Administration by $10.1 billion over five years, shrinking it from $28.3 billion to $18.2 billion. The full Senate is expected to approve the Finance Committee EITC provisions without change. The House approved the original Clinton EITC provisions as part of its reconciliation bill last month.

The Finance Committee dropped entirely the Clinton proposal to provide a modest EITC to poor workers without children, cutting about $5 billion. The Committee also reduced the proposed expansion for families with children by about $5 billion. All families with children that qualify for the EITC, including those at very low income levels, would receive a smaller EITC benefit under the Finance Committee package than under the Clinton proposal. More than three million families would receive a modestly smaller EITC benefit than under current law.

As part of the actions it took on the reconciliation package, the Finance Committee replaced the Administration's energy tax with a substantially smaller transportation fuels tax. Serving as an offset to the energy tax was not, however, the sole purpose of the President's EITC proposal. Equally if not more important was fulfilling the pledge that if a parent in a family of four worked full-time year-round, the family should not have to live in poverty. Due to the reductions the Finance Committee made in the EITC proposal, this goal would not be met.

Moreover, millions of poor households would receive no offset to the transportation tax. The administration's proposal to offset the effects of the energy tax on low-income households included three components — the EITC changes, an increase in food stamp benefits, and an enlargement of the low-income energy assistance program. Not only did the Senate Finance Committee scale back the EITC improvements, but the Senate reconciliation bill includes none of the proposed $7.5 billion food stamp increase. In addition, the proposed energy assistance increase is moribund, a victim of the need to squeeze non-entitlement spending within the tight budget ceilings established by the 1990 budget agreement. The combined effect of these developments is that millions of low-income workers would receive no EITC increase — and would have no offset to prevent the increased levy on gasoline and other fuels from taxing them deeper into poverty. The large numbers of poor who have no earnings and are not eligible for the EITC, including the elderly and disabled

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poor and the low-income unemployed, also would receive no offset and would slip farther into poverty.

The EITC proposal adopted by the Finance Committee thus has three major shortcomings:

- It fails to offset the transportation tax for millions of working poor households. This is due in large part to the Committee's rejection of the proposed EITC for poor workers without children.

- It makes several million working families with children worse off than they would be under current law, cutting their EITC by up to $77 in tax year 1994 — and up to $55 in subsequent years — while simultaneously subjecting them to the transportation tax.

- It fails to achieve the President's goal of lifting a family of four with a full-time year-round minimum wage worker to the poverty line, even if the family receives food stamps and the minimum wage is indexed to inflation, as President Clinton proposed during the campaign.

The Finance Committee and Workers Without Children

The Clinton Administration proposed that a very modest EITC be established for childless workers with incomes of less than $9,000 per year. The credit would equal 7.65 percent of their first $4,000 in earnings, providing a maximum credit of $306. The credit would phase down once income passed $5,000 and phase out entirely when income reached $9,000. The average benefit would be about $175.

This proposal has substantial merit, and not only because it would offset the effects of the energy tax on these households. The poorest fifth of households without children is the single group in the U.S. population whose federal tax burdens have increased most since 1980. A Congressional Budget Office analysis shows that their overall federal tax burden has risen *38 percent* during this period (that is, the proportion of income consumed by federal taxes rose by 38 percent among these households). This is much larger than the increase in tax burdens borne by any other group of households in any income category. (See Table 1.)

This sharp tax increase occurred in large part because of a series of increases in Social Security, gasoline, alcohol, and tobacco taxes. For low-income families with children, these regressive tax increases were generally offset through EITC expansions. For poor workers without children, no offsetting actions were taken. The resulting tax increases these workers bore were substantially larger than the

Table 1

Changes in Federal Tax Burdens, 1980-1993

Household Category	Change in the Percentage of Income Consumed by Federal Taxes
Non-elderly households without children	
poorest fifth	+38%
middle fifth	5
top fifth	-3
Families with children	
poorest fifth	-19%
middle fifth	1
top fifth	1
Aged	
poorest fifth	-22%
middle fifth	-14
top fifth	-11
All households	
poorest fifth	4%
middle fifth	-2
top fifth	-3

Source: Congressional Budget Office data published in House Committee on Ways and Means, *1992 Green Book*, pp. 1526-7.

modest income tax reductions they received as a consequence of the 1986 Tax Reform Act.

Moreover, although the 1986 Tax Reform Act sought to establish a principle that those who work but are poor should not be subject to federal income tax and thereby taxed deeper into poverty, the Act failed to achieve this goal for single workers. They are the one group of workers who continue to pay income tax despite their poverty. They begin owing income tax when their earnings reach $6,050, nearly $1,500 below the poverty line for single individuals.

The new EITC for childless workers proposed by the Clinton Administration would remedy this problem, bringing the point at which single workers begin to owe income tax about to the poverty line. The Finance Committee's decision to eliminate this new credit puts that goal out of reach. Thus, under the Finance Committee package, a regressive tax would once again be levied with no offset provided to poor workers without children. Once more, these workers would be taxed deeper into poverty. As Figure 1 shows, these workers already bear unusually high tax burdens, much higher than those born by other low-income groups.

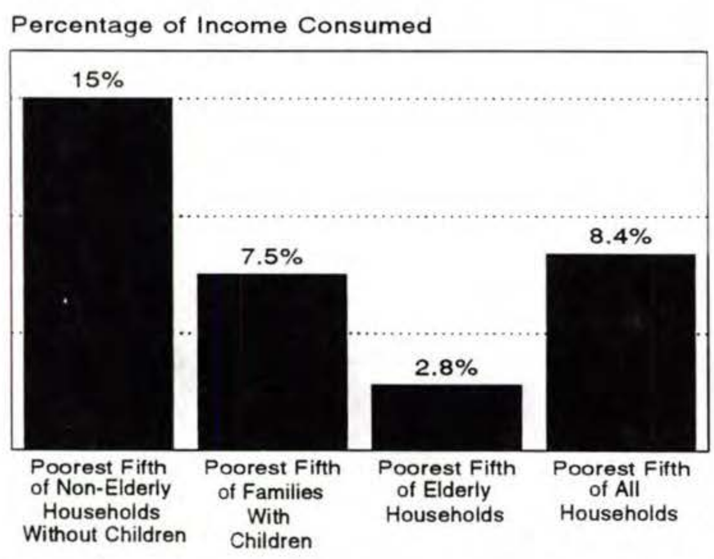
Some have sought to dismiss the importance of the EITC for childless workers, arguing that most of those who would benefit are individuals in their twenties, including a substantial number of graduate students. These assertions have been made with no supporting data. Extensive data on the characteristics of the childless workers who would be eligible for the Clinton EITC have recently become available. The data show these assertions to be groundless.

- Census data show that no more than two percent of the childless workers who would be eligible for the credit are students mixing work with graduate studies.

- More than half of the childless workers who would qualify have no more than a high school education.

- Finally, a new Congressional Research Service study shows that three-fifths of these childless workers are age 30 or over.

Figure 1
Percentage of Income Consumed by Federal Taxes
for Different Low-Income Groups, 1993



Source: Congressional Budget Office Data published in House Committee on Ways and Means, 1992 Green Book, pp. 1526-7.

The Census data also indicate that these workers are employed an average of 33 weeks during the year and work more than 32 hours a week on average during these weeks. They work nearly 1,100 hours per year on average but earn wages that average only $5.67 an hour. They are not typically individuals who work for only a few hours per week or a few weeks per year.

Families With Children

The Finance Committee also scaled back the Clinton Administration proposal to expand the EITC for families with children. The Committee did so in three ways:

- The Finance Committee shaved the size of the EITC increase. When phased in fully, the maximum EITC benefit for families with two or more children would be $56 smaller than under the Clinton plan. The maximum benefit for families with one child would be $22 smaller.[1]

- The Finance Committee package also would phase down the EITC more quickly for families that have two or more children and incomes of more than $11,000.[2] When combined with the reduction in the size of the maximum benefit, the overall effect would be to set EITC benefits for families that have two or more children and incomes in the $11,000 to $27,000 range from $56 to $200 lower than under the Clinton plan. In addition, the EITC income limit for families with two or more children would be set at $27,000, rather than at $28,000 as under the Clinton plan.[3]

- Finally, the Committee phased in the EITC increase more slowly than the Administration had proposed, particularly for families with two or more children. Under the Clinton proposal, the increase would take full effect in tax year 1995. Under the Finance Committee plan, the increase for families with two or more children would take full effect in tax year 1996, meaning that most families would not see the full EITC increase until the spring of 1997 when they filed their 1996 tax returns.

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[1] This would be the result of: setting the credit for families with two or more children at 39.0 percent of the first $8,500 in earnings rather than at 39.66 percent as proposed by the Clinton Administration; and setting the credit for families with one child at 34.0 percent of the first $6,000 in earnings rather than at 34.4 percent as proposed by the Administration.

[2] Under the Clinton plan, the benefits these families receive would drop $19.83 for each additional $100 of income. Under the Finance Committee package, their benefits would fall $20.72 for each additional $100 in income.

[3] All dollar figures in this paper are expressed in 1994 dollars. Under current law, the EITC income limit is $23,760.

There would still be significant EITC increases under the Finance Committee plan. The maximum EITC benefit would rise from $1,836 to $2,040 for families with one child and from $1,998 to $3,315 for families with two or more children. But a substantial number of families with one child would have their EITC benefits reduced rather than increased. And families of four with a full-time worker would be left short of the poverty line.

Families Made Worse Off

More than three million working families with one child would be made worse off. In tax year 1994, all families with one child and incomes between $12,110 and $23,760 would get a smaller EITC than they would receive under current law. A family with $12,600 of income would receive a $77 smaller EITC. A family at $20,000 would get a $56 smaller EITC. In tax years after 1994, families in the $12,000 to $23,760 income range would lose $55 compared to current law. These families also would face a tax increase due to the transportation fuels tax.

The Finance Committee proposal — like the Clinton plan — would wisely terminate two supplemental EITC credits now in the law that unnecessarily complicate the EITC. These are an extra credit for families with a child under one and an additional credit for families that pay part or all of the cost of health insurance premiums that cover a child. But this means that families with one child that now receive either of these credits — and have income in the $12,000 to $23,760 range — would have their EITC reduced by significantly more than $55 when compared to current law, while also having to pay the fuels tax.[4]

Falling Short of the Poverty Line

Finally, the changes made in the Senate reconciliation bill will leave families of four with a full-time minimum wage worker short of the poverty line, thereby failing to meet one of the President's key goals. The Clinton proposal was designed to bring families of four with a full-time worker to the poverty line if the family also received food stamps. This plan was based on calculations showing that net minimum wage

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[4]Families in this income range would have suffered an EITC benefit loss under the Clinton plan as well, but the loss would have been smaller. Moreover, the proposed food stamp and low-income energy assistance increases in the Clinton budget would have enabled some of these families to offset both their EITC loss and their energy tax increase. As noted, the Senate reconciliation bill does not include the Administration's proposed increase in food stamp benefits, and the increase requested for low income energy assistance appears to be virtually dead.

earnings for 40 hours of work for 52 weeks,[5] plus the EITC benefits proposed by the Administration and current food stamp benefit levels, would lift a family of four just about exactly to the poverty line. The plan also assumed that the Administration's proposed increase in food stamp benefits would about equal the energy taxes these families would pay, thereby preventing those taxes from pushing these families back into poverty.

Under the Senate reconciliation bill, the EITC benefits for such families are scaled back by $56 compared to the Clinton plan. And while the transportation fuels tax is substantially smaller than the Clinton energy tax, the offsetting food stamp increase has disappeared entirely. As a result, these families would be left about $150 to $200 short of the poverty line if they received food stamps (and if legislation to index the minimum wage is approved). For those not receiving food stamps, the shortfall would be much greater. It would also be greater if legislation to index the minimum wage ultimately is not enacted.

Conclusion

The Senate reconciliation bill achieves major progress in reducing the deficit and does so in a progressive manner. The overwhelming bulk of its revenue increases would come from those at high income levels. In addition, the bill still includes a sizable EITC expansion.

But the low-income portions of the bill have significant weaknesses, especially when compared to the House bill and the Clinton budget. By deleting the EITC expansion for poor workers without children, the bill nudges these workers deeper into poverty. By scaling back the EITC expansion for families with children and failing to include the Administration's food stamp proposals, the bill makes millions of working families with one child worse off than under current law. It also fails to bring families of four with a full-time minimum wage worker to the poverty line. Major improvements are needed in the conference committee.

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[5] Net minimum wage earnings equal earnings after payroll taxes are deducted. The Clinton plan assumes the minimum wage is indexed.

CENTER ON BUDGET AND POLICY PRIORITIES

THE EARNED INCOME TAX CREDIT AND BLACK WORKERS

I. Families With Children

♦ Approximately 40 percent of all black families with children would be eligible for the earned income credit under the Clinton proposal and the House bill.

♦ More than half of all black *working* families with children — about 53 percent — would be eligible for the earned income credit under the proposal.

♦ On average, EITC eligible black families with children earn about $11,540, work about 41 weeks per year, and are employed 37 hours during these weeks.

Families With Two or More Children

♦ Approximately 60 percent of the black families eligible for the earned income credit under the proposal are families with two or more children. These families would see the largest increase in their EITC benefits.

♦ Under current law, those black families with two or more children who are eligible for the EITC receive an average credit of about $1,115. These families would see their EITC benefits increase to an average of $1,945 under the Clinton proposal; they would receive an average benefit increase of more than $800 per family.

♦ Under the EITC provisions passed by the Senate, the average benefit for eligible black families with two or more children would be $80 lower than under the Clinton proposal.

♦ The Clinton proposal extends the EITC to an additional 135,000 black families, nearly all of whom have two or more children. The Senate proposal extends the EITC to a smaller number of black families.

Families With One Child

♦ Approximately 48 percent of eligible black families with one child would receive a *lower benefit under the Senate version of the EITC proposal than under current law.* (The average benefit for black families would still be higher than under current law.)

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♦ The average credit for black families with one child would be about $1,210 under the Clinton proposal, $1,190 under the Senate bill, and $1,050 under current law.

II. Childless Workers

Under the Clinton proposal, an earned income credit is extended to childless workers who earn less than $9,000. The maximum credit is $306. *This proposal is deleted in the Senate version of the Reconciliation bill,* but included in the House version.

♦ Approximately 22 percent of all non-elderly black childless workers — almost 1.4 million people — would be eligible for the credit under the proposal.

♦ The average credit for these workers would be about $175.

CENTER ON BUDGET
AND POLICY PRIORITIES

THE EARNED INCOME TAX CREDIT AND HISPANIC WORKERS

I. Families With Children

♦ Approximately 45 percent of all Hispanic families with children would be eligible of the earned income credit under the Clinton proposal.

♦ Almost 60 percent of all Hispanic *working* families would be eligible for the earned income credit under the proposal.

♦ On average, EITC eligible Hispanic families earn $13,175, work about 44 weeks per year, and are employed about 40 hours during these weeks.

Families With Two or More Children

♦ Appproximately 67 percent of Hispanic families eligible for the credit under the Clinton proposal have two or more children. These families would see the largest increase in their credit under the Clinton proposal.

♦ Under current law, those Hispanic families with two or more children who are eligible for the EITC receive an average credit of about $1,250. These families would see their EITC benefits increase to an average of $2,200 under the Clinton proposal; they would receive an average benefit increase of about $950 per family.

♦ Under the EITC provisions passed by the Senate, the average benefit for eligible Hispanic families with two or more children would be about $94 lower than under the Clinton proposal.

♦ The Clinton proposal extends the EITC to an additional 155,000 Hispanic families, nearly all of whom have two or more children. The Senate proposal extends the EITC to a smaller number of Hispanic families.

Families with One Child

♦ Approximately 49 percent of eligible Hispanic families with one child would receive a *lower benefit under the Senate version of the EITC proposal than under current law.* (The average benefit for these families would still be higher than under current law.)

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♦ The average credit for Hispanic families with one child would be about $1,340 under the Clinton proposal, $1,320 under the Senate bill, and $1,190 under current law.

II. Childless Workers

Under the Clinton proposal, an earned income credit is extended to childless workers who earn less than $9,000. The maximum credit is $306. *This proposal is deleted in the Senate version of the Reconciliation bill,* but included in the House version.

♦ Approximately 20 percent of all Hispanic childless workers — about 780,000 people — would be eligible for the credit under the proposal.

♦ The average credit for these workers would be about $175.

CENTER ON BUDGET AND POLICY PRIORITIES

TO: Howard Paster
Melanne Verveer

FROM: Bob Greenstein

There's one item we talked about Friday morning that I realize may need some clarification. As you'll recall, we talked about the problems the Senate EITC changes would cause, and I noted that if one roughly split the difference between the House and Senate EITC provisions — adding back $4.8 billion of the $10.1 billion the Senate cut — the most serious problems could be addressed. (The $5.3 billion reduction from the Clinton proposal would be achieved by phasing in the EITC expansions over three years rather than two and dropping childless workers who are under 25 or over 64).

If, however, we are limited to the amount the Senate provided for the EITC, these problems cannot be addressed. There is little reconfiguring that can be done within the Senate spending level. I see only one thing to do to free up resources that the Senate has not already adopted as a savings measure — and this would pick up only a few hundred million dollars.* Yet solving the most serious problems created by the Senate EITC changes requires several billion dollars.

Thus, it is not possible, within the spending level the Senate has provided for the EITC, to meet the President's goal of getting families of four with a full-time worker to the poverty line. Nor is it possible to avert losses in the EITC for several million families with one child, a particular problem if there also is an energy tax increase of some amount. It also would not be possible to provide any offset to the energy tax for poor workers without children, an issue of major importance to Reps. Rangel and Mfume (and also to us).

*The Senate phases in the EITC expansion for families with two or more children over three years, but phases in the expansion for families with one child over two years. Phasing in both expansions over three years would add some savings not included in the Senate bill, but the savings would be small.

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CENTER ON BUDGET
AND POLICY PRIORITIES

June 24, 1993

THE SENATE FINANCE COMMITTEE'S ACTIONS IN REMOVING $10 BILLION FROM THE CLINTON EITC EXPANSION

In action on the budget reconciliation bill last week, the Senate Finance Committee scaled back the Earned Income Tax Credit expansion proposed by the Clinton Administration by $10.1 billion over five years, shrinking it from $28.3 billion to $18.2 billion. The full Senate is expected to approve the Finance Committee EITC provisions without change. The House approved the original Clinton EITC provisions as part of its reconciliation bill last month.

The Finance Committee dropped entirely the Clinton proposal to provide a modest EITC to poor workers without children, cutting about $5 billion. The Committee also reduced the proposed expansion for families with children by about $5 billion. All families with children that qualify for the EITC, including those at very low income levels, would receive a smaller EITC benefit under the Finance Committee package than under the Clinton proposal. More than three million families would receive a modestly smaller EITC benefit than under current law.

As part of the actions it took on the reconciliation package, the Finance Committee replaced the Administration's energy tax with a substantially smaller transportation fuels tax. Serving as an offset to the energy tax was not, however, the sole purpose of the President's EITC proposal. Equally if not more important was fulfilling the pledge that if a parent in a family of four worked full-time year-round, the family should not have to live in poverty. Due to the reductions the Finance Committee made in the EITC proposal, this goal would not be met.

Moreover, millions of poor households would receive no offset to the transportation tax. The administration's proposal to offset the effects of the energy tax on low-income households included three components — the EITC changes, an increase in food stamp benefits, and an enlargement of the low-income energy assistance program. Not only did the Senate Finance Committee scale back the EITC improvements, but the Senate reconciliation bill includes none of the proposed $7.5 billion food stamp increase. In addition, the proposed energy assistance increase is moribund, a victim of the need to squeeze non-entitlement spending within the tight budget ceilings established by the 1990 budget agreement. The combined effect of these developments is that millions of low-income workers would receive no EITC increase — and would have no offset to prevent the increased levy on gasoline and other fuels from taxing them deeper into poverty. The large numbers of poor who have no earnings and are not eligible for the EITC, including the elderly and disabled

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poor and the low-income unemployed, also would receive no offset and would slip farther into poverty.

The EITC proposal adopted by the Finance Committee thus has three major shortcomings:

- It fails to offset the transportation tax for millions of working poor households. This is due in large part to the Committee's rejection of the proposed EITC for poor workers without children.
- It makes several million working families with children worse off than they would be under current law, cutting their EITC by up to $77 in tax year 1994 — and up to $55 in subsequent years — while simultaneously subjecting them to the transportation tax.
- It fails to achieve the President's goal of lifting a family of four with a full-time year-round minimum wage worker to the poverty line, even if the family receives food stamps and the minimum wage is indexed to inflation, as President Clinton proposed during the campaign.

The Finance Committee and Workers Without Children

The Clinton Administration proposed that a very modest EITC be established for childless workers with incomes of less than $9,000 per year. The credit would equal 7.65 percent of their first $4,000 in earnings, providing a maximum credit of $306. The credit would phase down once income passed $5,000 and phase out entirely when income reached $9,000. The average benefit would be about $175.

This proposal has substantial merit, and not only because it would offset the effects of the energy tax on these households. The poorest fifth of households without children is the single group in the U.S. population whose federal tax burdens have increased most since 1980. A Congressional Budget Office analysis shows that their overall federal tax burden has risen *38 percent* during this period (that is, the proportion of income consumed by federal taxes rose by 38 percent among these households). This is much larger than the increase in tax burdens borne by any other group of households in any income category. (See Table 1.)

This sharp tax increase occurred in large part because of a series of increases in Social Security, gasoline, alcohol, and tobacco taxes. For low-income families with children, these regressive tax increases were generally offset through EITC expansions. For poor workers without children, no offsetting actions were taken. The resulting tax increases these workers bore were substantially larger than the

Table 1

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All households	
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Source: Congressional Budget Office data published in House Committee on Ways and Means, 1992 Green Book, pp. 1526-7.

modest income tax reductions they received as a consequence of the 1986 Tax Reform Act.

Moreover, although the 1986 Tax Reform Act sought to establish a principle that those who work but are poor should not be subject to federal income tax and thereby taxed deeper into poverty, the Act failed to achieve this goal for single workers. They are the one group of workers who continue to pay income tax despite their poverty. They begin owing income tax when their earnings reach $6,050, nearly $1,500 below the poverty line for single individuals.

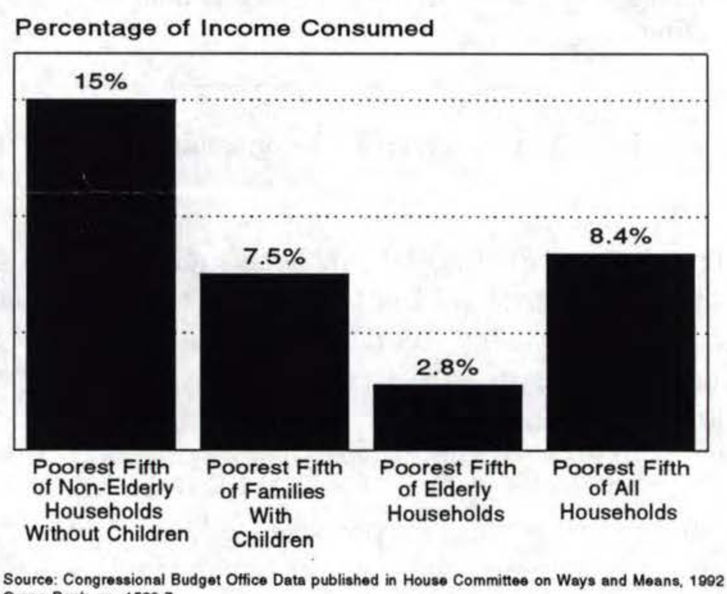
The new EITC for childless workers proposed by the Clinton Administration would remedy this problem, bringing the point at which single workers begin to owe income tax about to the poverty line. The Finance Committee's decision to eliminate this new credit puts that goal out of reach. Thus, under the Finance Committee package, a regressive tax would once again be levied with no offset provided to poor workers without children. Once more, these workers would be taxed deeper into poverty.

Some have sought to dismiss the importance of the EITC for childless workers, arguing that most of those who would benefit are individuals in their twenties, including a substantial number of graduate students. These assertions have been made with no supporting data. Extensive data on the characteristics of the childless workers who would be eligible for the Clinton EITC have recently become available. The data show these assertions to be groundless.

Census data show that no more than two percent of the childless workers who would be eligible for the credit are students mixing work with graduate studies. More than half of these workers have no more than a high school education. In addition, a new Congressional Research Service study shows that three-fifths of these childless workers are age 30 or over.

The Census data also indicate that these workers are employed an average of 33 weeks during the year and work more than 32 hours a week on average during these weeks. They work nearly 1,100 hours per year on average but earn wages that average only $5.67 an hour. They are not typically individuals who work for only a few hours per week or a few weeks per year.

Percentage of Income Consumed by Federal Taxes
for Different Low-Income Groups, 1993



Source: Congressional Budget Office Data published in House Committee on Ways and Means, 1992 Green Book, pp. 1526-7.

Families With Children

The Finance Committee also scaled back the Clinton Administration proposal to expand the EITC for families with children. The Committee did so in three ways:

- The Finance Committee shaved the size of the EITC increase. When phased in fully, the maximum EITC benefit for families with two or more children would be $56 smaller than under the Clinton plan. The maximum benefit for families with one child would be $22 smaller.[1]

- The Finance Committee package also would phase down the EITC more quickly for families that have two or more children and incomes of more than $11,000.[2] When combined with the reduction in the size of the maximum benefit, the overall effect would be to set EITC benefits for families that have two or more children and incomes in the $11,000 to $27,000 range from $56 to $200 lower than under the Clinton plan. In addition, the EITC income limit for families with two or more children would be set at $27,000, rather than at $28,000 as under the Clinton plan.[3]

- Finally, the Committee phased in the EITC increase more slowly than the Administration had proposed, particularly for families with two or more children. Under the Clinton proposal, the increase would take full effect in tax year 1995. Under the Finance Committee plan, the increase for families with two or more children would take full effect in tax year 1996, meaning that most families would not see the full EITC increase until the spring of 1997 when they filed their 1996 tax returns.

There would still be significant EITC increases under the Finance Committee plan. The maximum EITC benefit would rise from $1,836 to $2,040 for families with one child and from $1,998 to $3,315 for families with two or more children. But a substantial number of families with one child would have their EITC benefits

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[1]This would be the result of: setting the credit for families with two or more children at 39.0 percent of the first $8,500 in earnings rather than at 39.66 percent as proposed by the Clinton Administration; and setting the credit for families with one child at 34.0 percent of the first $6,000 in earnings rather than at 34.4 percent as proposed by the Administration.

[2]Under the Clinton plan, the benefits these families receive would drop $19.83 for each additional $100 of income. Under the Finance Committee package, their benefits would fall $20.72 for each additional $100 in income.

[3]All dollar figures in this paper are expressed in 1994 dollars. Under current law, the EITC income limit is $23,760.

reduced rather than increased. And families of four with a full-time worker would be left short of the poverty line.

Families Made Worse Off

More than three million working families with one child would be made worse off. In tax year 1994, all families with one child and incomes between $12,110 and $23,760 would get a smaller EITC than they would receive under current law. A family with $12,600 of income would receive a $77 smaller EITC. A family at $20,000 would get a $56 smaller EITC. In tax years after 1994, families in this income range would lose $55 compared to current law. These families also would face a tax increase due to the transportation fuels tax.

The Finance Committee proposal — like the Clinton plan — would wisely terminate two supplemental EITC credits now in the law that unnecessarily complicate the EITC. These are an extra credit for families with a child under one and an additional credit for families that pay part or all of the cost of health insurance premiums that cover a child. But this means that families with one child that now receive either of these credits — and have income in the $12,000 to $23,760 range — would have their EITC reduced by significantly more than $55 when compared to current law, while also having to pay the fuels tax.

Families in this income range would have suffered an EITC benefit loss under the Clinton plan as well, but the loss would have been smaller. Moreover, the proposed food stamp and low-income energy assistance increases in the Clinton budget would have enabled a number of these families to offset both their EITC loss and their energy tax increase. As noted, the Senate reconciliation bill does not include the Administration's proposed increase in food stamp benefits, and the increase requested for low income energy assistance appears to be virtually dead.

Falling Short of the Poverty Line

Finally, the changes made in the Senate reconciliation bill will leave families of four with a full-time minimum wage worker short of the poverty line, thereby failing to meet one of the President's key goals. The Clinton proposal was designed to bring families of four with a full-time worker to the poverty line if the family also received food stamps. This plan was based on calculations showing that net minimum wage earnings for 40 hours of work for 52 weeks,[4] plus the EITC benefits proposed by the Administration and current food stamp benefit levels, would lift a family of four just

[4]Net minimum wage earnings equal earnings after payroll taxes are deducted.

about exactly to the poverty line. The plan also assumed that the Administration's proposed increase in food stamp benefits would about equal the energy taxes these families would pay, thereby preventing those taxes from pushing these families back into poverty.

Under the Senate reconciliation bill, the EITC benefits for such families are scaled back by $56 compared to the Clinton plan. And while the transportation fuels tax is substantially smaller than the Clinton energy tax, the offsetting food stamp increase has disappeared entirely. As a result, these families would be left about $150 to $200 short of the poverty line if they received food stamps (and if legislation to index the minimum wage is approved). For those not receiving food stamps, the shortfall would be much greater. It would also be greater if legislation to index the minimum wage ultimately is not enacted.

Conclusion

The Senate reconciliation bill achieves major progress in reducing the deficit and does so in a progressive manner. The overwhelming bulk of its revenue increases would come from those at high income levels. In addition, the bill still includes a sizable EITC expansion.

But the low-income portions of the bill have significant weaknesses, especially when compared to the House bill and the Clinton budget. By deleting the EITC expansion for poor workers without children, the bill nudges these workers deeper into poverty. By scaling back the EITC expansion for families with children and failing to include the Administration's food stamp proposals, the bill makes millions of working families with one child worse off than under current law. It also fails to bring families of four with a full-time minimum wage worker to the poverty line. Major improvements are needed in the conference committee.

CENTER ON BUDGET
AND POLICY PRIORITIES

SOME COMMENTS ON
SPENDING ISSUES IN THE RECONCILIATION CONFERENCE

Clearly, the single most important task in conference is striking an agreement that can pass on both the Senate and House floors. On the Senate side, the principal danger is that Senator David Boren and several others may jump ship if too much spending is added to the Senate package. On the House side, the chief danger appears to be that a significant part of the Black and Hispanic Caucuses may defect if their key priorities are not met.

This leads to two conclusions: the amount of spending that can be added to the Senate package will necessarily be limited; and a reasonable portion of the funds that can be added need to be targeted on restoring key elements of the Clinton budget that also are Black and Hispanic Caucus priorities.

Spending Reductions in the House and Senate Bills

The Senate bill contains $256.1 billion in spending cuts. Under a comparable way of measuring the cuts, the House bill has $227.4 billion.[1] The difference is $28.7 billion.

Given the concerns of Senator Boren and several other Senators, it seems likely that at least half of the additional spending cuts contained in the Senate package will need to be preserved in conference. This memo outlines an approach in which more than half of the additional spending cuts in the Senate bill are retained; under this approach, the spending reductions in the Senate bill would be lowered by about $12.5 billion. The memo asks the question: how might $12.5 billion best be used to support Administration priorities, achieve desirable policy outcomes, and retain Black and Hispanic Caucus support?

The memo recommends fitting within this spending target by splitting the difference between the House and Senate on the EITC, providing $5 billion for the Mickey Leland Child Hunger Prevention Act, retaining the full House family preservation provision, supporting immunizations at closer to the House than the Senate level, and retaining a portion of the House extended unemployment benefits

[1] The House and Senate "score" their spending cuts differently. The House counts all of the expansion in the earned income credit as a revenue reduction. The Senate counts only about one-tenth of the EITC expansion — the amount that reduces taxes owed — as a revenue reduction. It counts the "refundable" part of the EITC as a spending increase. If the House scoring method is used, the House bill has $253 billion in net spending reductions, while the Senate bill has $273 billion.

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provision to avert large-scale cut-offs of unemployment benefits this fall and next winter in states with high unemployment levels. (The unemployment benefits portion has a very small cost but a cut-off of benefits could be very politically dangerous to the White House while also causing significant hardship.) The memo also concludes that given the limited funds available, the Medicare reductions should be left at the Senate level.

Competition for Spending

There are a number of areas where the House and Senate differ on spending issues. In each area, the Senate spending level is below the House level — the Senate either cuts more or, in the area of initiatives, adds less. Among the key areas of difference are:

• Earned income credit	$10.1 billion
• Medicare	8.0[2]
• Food stamps	7.3
• Family preservation	1.5
• Immunization	1.2
• Unemployment insurance	0.3
• Trade adjustment assistance	0.3

Of these areas, two that have been identified as being of particular concern to the Black Caucus are the earned income credit and food stamps. They also are two of the most important items on policy grounds. (Empowerment zones are not included on this list; they constitute a revenue reduction, not a difference in spending levels. They are not affected in the same manner as these other items by the apparent need to produce at least one dollar in spending reductions for each dollar in tax increases.)

EITC

The Senate EITC provisions fall short in three crucial areas. They fail to achieve the President's goal that if a family of four has a parent who works full-time

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[2] Technically, the House has $3.6 billion *more* in Medicare reductions than the Senate, rather than about $8 billion less. In the House, jurisdiction over Medicare is split between the Ways and Means Committee and the Energy and Commerce Committee. In complying with their reconciliation instructions, the two Committees used different and competing ways of achieving the required level of Medicare savings. Assuming that these differences would be resolved in conference, the House Budget Committee incorporated both sets of savings provisions into the House reconciliation bill. If both sets of savings provisions are counted, the House bill has $61.4 billion in Medicare cuts. However, the House Budget Committee, assuming that these differences would ultimately be worked out, describes the House bill as having about $50 billion in Medicare savings.

year-round, the family should not be poor. In addition, the Senate provisions make more than three million low-income working families with children worse off — cutting their EITC by $55 per year while subjecting them to the transportation tax. Finally, and especially serious, the Senate provisions omit the modest EITC the Administration proposed for very poor workers without children. Congressional Budget Office data show that no group of households at any income level have had their federal taxes raised as much since 1980 as these households have. The effective federal tax rate paid by the poorest fifth of households without children — that is, the percentage of income they pay in federal taxes — *has risen 38 percent* since 1980. On average, the poorest fifth of households without children pay 15 percent of their meager incomes in federal taxes. By contrast, the poorest fifth of families with children pays 7.5 percent, while the poorest fifth of elderly households pays 2.8 percent.

Eliminating the proposed EITC for poor workers without children while raising energy taxes would boost their taxes further and effectively tax them deeper into poverty. Black Caucus Chairman Kweisi Mfume has said that eliminating the EITC for poor workers without children, as the Senate has done, is unacceptable. Rep. Charles Rangel also opposes dropping the credit for poor workers without children.

Food stamps

The Administration's food stamp provisions are very important. From the standpoint of poor children, I would argue that retaining a healthy chunk of these proposals is perhaps the highest priority in conference.

It is well understood that low-income offsets are needed to prevent the energy tax from pushing poor households deeper into poverty. Less widely understood is the fact that the EITC only performs part of the job. The current EITC (which does not include workers without children) covers *fewer than one-fourth* of all households below the poverty line. Other offsets are needed to reach poor families without earnings and poor elderly and disabled people.

The Administration has recognized this; its budget included proposed increases in low-income energy assistance and food stamps as part of the offset package. But the energy assistance increase appears moribund, a victim of the reductions made in the budget resolution in the total amounts that can be spent for discretionary programs. The Administration has not included energy assistance on the list of investment priorities it has given to the Appropriations Committees.

That leaves food stamps as the only potential offset for the energy tax borne by households without earnings. Food stamps also are needed as an offset for some of those EITC families — of whom there are more than three million — who either will get no EITC increase under the Clinton plan or will get a small EITC decrease.

Serving as an offset to the energy tax is not, however, the only or even the primary reason the food stamp provisions are important. These provisions are very significant for other reasons as well:

- The food stamp provisions are highly targeted on very poor children and their families and are carefully crafted to avert homelessness among these families — or at a minimum, to prevent these families from having to choose between eating adequately throughout the month and paying their rent and utilities bills. In this vein, the legislation is designed to eliminate a glaring inequity in the food stamp program under which those families with children whose housing costs consume more than half of their incomes are treated more harshly than elderly households who pay over half of their incomes for housing. A provision in the Administration's food stamp legislation would address this problem. It would treat families with children that bear very high housing cost burdens the same as elderly households in this situation are treated, boosting the food stamp assistance provided to families with children that have these very high housing cost burdens. This provision is the centerpiece of the bill. It has been hailed — and included in legislation introduced in recent years — by Pete Domenici and a number of other leading Members of both parties.

- The food stamp provisions also are necessary if the President's "making work pay" goal — that families with a parent working full-time should be raised to the poverty line — is to be met. Under the Administration's formula for getting these families to the poverty line, the proposed food stamp increase was presumed to cancel out the energy tax, while the EITC increase lifted the families to the poverty line. If there is no food stamp increase, however, part of the EITC increase must be used to offset the energy tax hike. This will leave these families short of the poverty line.

  In addition, the Administration's plan to raise families with a full-time worker to the poverty line assumes these families get food stamps. Under the Clinton plan to "make work pay," a combination of full-time minimum wage earnings, the EITC, and food stamps are supposed to raise these families to the poverty line. In fact, only one-third of the working poor do get food stamps. The Administration's food stamp proposal contains provisions to enable more of the working poor to receive stamps. These provisions further the President's goal of making work pay; their inclusion in the food stamp legislation is another reason the legislation is needed.

Still another problem that the food stamp provision would address involves the interaction between food stamps and the EITC. Under current food stamp law, a family's EITC payment is counted against the food stamp assets limit starting 30 to 60 days after the EITC payment is received. If the Clinton EITC proposal passes, the EITC benefits received by many working poor families will exceed the food stamp assets limit, which is just $2,000. As a result, *families that don't spend their EITC very rapidly will lose all of their food stamps.* Yet without food stamps, they will remain several thousand dollars below the poverty line, and the President's goal of "making work pay" will not be met. Moreover, perverse incentives will be created for families to spend their EITC benefits fast. The Administration's food stamp legislation remedies this problem, too.

- Third, the Administration's food stamp bill strengthens child support enforcement (and thus helps pave the way for an important component of welfare reform). The current food stamp benefit structure contains disincentives for custodial parents on AFDC to help track down absent parents and collect child support from them. It also contains disincentives for absent parents to pay child support. The Administration's food stamp legislation fixes both of these problems.

The food stamp proposals also should be a high priority for another reason. If not included in the reconciliation bill, they will be dead for at least the next four years. There will be no way to finance them under the pay-as-you-go rules; the financing mechanisms are in the Ways and Means Committee and the Finance Committee, and those committees will not reduce their own programs or raise revenues to finance expansions in an Agriculture Committee program. Initiatives under the jurisdiction of the Ways and Means Committee and the Finance Committee may have other opportunities for passage; the food stamp initiative will not.

Sorting out priorities on the spending side

Given the limited funding that will be available on the spending side, tough choices must be made. The strong recommendation here is to concentrate more on EITC and food stamps — issues of critical importance both to poor children and to the Black and Hispanic Caucuses — and less on Medicare. The cuts in Medicare were reduced on the Senate floor to a more reasonable level that would not appear to jeopardize health care reform or injure Medicare beneficiaries. The Senate's additional Medicare savings provisions are targeted entirely on providers.

A conference package should, in my view, also include three less costly items — the House family preservation provisions, immunizations, and a key House provision on unemployment insurance. A package dealing with all of these areas can fit within the overall $12.5 billion level set forth here. The following package would restore about $12.5 billion in spending to the Senate package. (It would be about $16 billion below the House spending levels.)

1. *EITC*: Split the difference between the House and Senate. The House goes down about $5 billion, while the Senate goes up about $5 billion. Slightly more than $5 billion could be saved from the House bill in two steps:

    - Phase the expansion for families with children in over three years — rather than over two as the budget proposes — while otherwise leaving the Clinton proposals for families with children untouched. The Senate bill already has a three-year phase-in for families with two or more children, although not for families with one child. The Joint Tax Committee has estimated this will save $3.5 billion.

    - Raise the age limit for the EITC for childless workers from 22 to 25 and place an upper age limit at the 65th birthday. Many elderly who have adjusted gross incomes below $9,000 and thus would qualify under the Clinton EITC proposal are not actually poor; they have Social Security benefits that do not count as part of their AGI. Also, their Social Security COLA will effectively offset their energy tax.[3] Eliminating 22 to 24 year-olds is more troublesome on policy grounds, but about 30 percent of the childless workers in this age category are students, whereas hardly any of those 25 and over are students. Savings from these changes would be $1.7 billion, according to the Joint Tax Committee.

2. *Food stamps*: Retain $5 billion of the House food stamp benefit provisions. Both the House and Senate bills contain $100 million to $200 million in food stamp administrative cost savings, as proposed by the Administration. Hence, the net food stamp increase would be slightly below $5 billion, when compared to current law.

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[3] An increase in gasoline or other energy costs will show up in the Consumer Price Index. As a result, it will be reflected in a higher Social Security COLA.

These savings could be achieved by phasing in some provisions and dropping others. Provisions that should be retained include those that assist poor families with very high housing costs, the provisions needed to achieve the President's goal of rewarding work and "making work pay," the provision that provides a broad offset to the energy tax, and provisions that promote child support enforcement and collections.

3. *Family preservation*: The family preservation and child welfare provisions of the House bill, which cost $1.5 billion, have already been pared back from earlier family preservation bills. They should be retained to the fullest extent possible.

4. *Immunization*: A compromise may be possible that places the cost somewhere between the House and Senate versions, although closer to the House level. HHS staff tell me a solid package can be developed for about or modestly less than $1 billion.

   One possible area for savings may involve a recovery of state Medicaid windfalls that would result from the new immunization initiative. If feasible, recovering these windfalls so that more funds are available for initiatives such as family preservation, EITC, and food stamps seems wiser than allowing the windfalls to remain at the state level.

5. *Unemployment insurance*: This is a very important issue for the White House to consider. The current emergency unemployment compensation program ends September 30. The national unemployment rate remains close to seven percent. In 18 states, including some of the most populous, it exceeds seven percent. In California, it was 8.7 percent in May.

   Many states with high unemployment rates will qualify after September 30 to pay extended unemployment benefits to the long-term unemployed. For these benefits to be paid, however, states have to put up 50 percent matching funds. *Hardly any states have enacted legislation to provide the matching funds under the revised extended benefits program enacted last year.* Furthermore, the very states where the benefits are needed most, such as California, are the states that can least afford to pay these matching amounts at the present time. It is expected that many states which will qualify for extended benefits will not provide the matching funds.

   As a result, the availability of unemployment benefits is likely to diminish sharply in a number of hard-hit states. In addition to causing significant hardship, this could cause political damage for the Administration in places like California. Recall how George Bush was hurt on the unemployment benefits issue.

The House bill has a provision that addresses this problem by raising the federal matching rate for extended benefits. Its cost is small — about $300 million. It would be desirable to retain this provision in conference. It may be possible to reduce the cost of this provision by scaling the federal matching rate to the level of unemployment in a state and/or by making the higher matching rates temporary. If the higher rates are made temporary, they can help states make a transition from the current period — in which benefits for the long-term unemployed are fully federally funded — to a period in which states again pay half the cost of such benefits. Given the high level of unemployment and the severe fiscal difficulties in some states, such a transition is needed if the House provision is not retained on a permanent basis.

6. *Medicare*: Some $9 billion for Medicare was restored on the Senate floor. The additional Medicare reductions contained in the Senate bill now appear to be at a level that would not adversely affect beneficiaries or the Administration's forthcoming health care reform proposal. Given the limited amount in spending that can be added back to the Senate reconciliation bill, I would recommend leaving Medicare at the Senate level.

The priority spending recommendations thus would look as follows:

EITC	+ 4.9 billion
Food stamps	5.0
Family preservation	1.5
Immunization	up to 1.0
Unemployment Insurance	<u>0.15 to 0.3</u>
TOTAL	**up to 12.55 - up to 12.7**

Empowerment Zones

The Black Caucus also is very interested in empowerment zones. Rep. Rangel's two top priorities on the Ways and Means part of the conference will apparently be the EITC and empowerment zones. Chairman Rostenkowski has said that the conference report sent to the House floor will need to include empowerment zones.

As noted, the empowerment zone proposal is a tax reduction, not a spending increase. Some increased revenues achieved in conference, relative to the Senate bill, could be used to restore empowerment zones in part or in full without diminishing the level of spending reductions in the package.

Entitlement Control Mechanisms

A final, but critically important, issue concerns the entitlement control mechanism. The provision proposed on the Senate floor by Senator Sasser, with the support of the Senate Democratic leadership, is very similar to the provision approved by the House. The Sasser provision does, however, contain two very important improvements. It adjusts the entitlement targets if inflation proves higher or lower than forecast. It also provides a one percent margin of error — that is, it triggers action if the entitlement target is exceeded by at least one percent. The House version triggers action if the target is exceeded by one-half of one percent.

The Sasser proposal was supported on the Senate floor by every Senate Democrat present except Richard Shelby. (Patty Murray was sick and did not vote.) This provision is not in the Senate bill because 60 votes were required for its inclusion; it received 54 votes. The Senate proposal is expected to be "on the table" in conference.

It should be. The differences on inflation adjustments and the margin of error may sound technical, but they have profound implications for the White House. They could even affect the President's reelection prospects.

Under the House version, it is very likely that the entitlement target will be breached, perhaps several times over the next three years. When this occurs, Republicans can be expected to seize on the breach of the entitlement targets as evidence the Administration is mismanaging government spending. Furthermore, when the target is breached, the President may find himself in the difficult situation of either having to propose new cuts in popular entitlements, possibly in an election year, or trying to explain why he isn't taking action to offset a breach and thereby inviting sharp attack from both Ross Perot and the Republicans.

Why is a breach of the targets so likely under the House version? Because the House provision locks in the CBO economic assumptions reflected in the budget resolution, including the assumption that inflation will be *only 2.7 percent per year* for each of the next four years. This is one of the lowest, if not the lowest, multi-year inflation forecasts CBO has ever issued. CBO itself apparently no longer believes this forecast; it plans to raise the inflation forecast when it revises its economic forecast this summer. (See attached article from *Congress Daily*.)

When inflation is higher than forecast, entitlement costs increase, due in no small part to the effects of inflation on cost-of-living adjustments in Social Security and other indexed programs. *But this does not mean the deficit rises.* CBO and OMB analyses have shown that when inflation increases, revenues also rise, with the result that there is little change in the deficit.[4]

For this reason — i.e., that a higher-than-expected inflation rate does not materially affect the deficit — all previous entitlement cap proposals have provided for a full inflation adjustment. The Bush Administration proposal designed by Richard Darman had a full inflation adjustment. So did the Boren entitlement cap proposal and the Nunn-Domenici proposal. So also did the entitlement cap proposal included in the Dole budget plan offered on the Senate floor. Only the House version lacks such an adjustment.

Indeed, the entitlement control proposal originally designed by Rep. John Spratt had an inflation adjustment. It was removed at the behest of Rep. Charles Stenholm. Furthermore, the discretionary caps established in the 1990 budget agreement — and extended in the pending reconciliation bill — have an inflation adjustment. It seems bizarre to deny for entitlements an adjustment made for discretionary programs.

The entitlement control proposal offered by the Senate Democrats on the Senate floor contained language to make precisely the same inflation adjustment in the entitlement targets as is made in the discretionary caps. In some years, this has resulted in the discretionary caps being adjusted downward; in other years, the caps have been adjusted upward. In the next several years, the adjustments would very likely be upward adjustments, because the 2.7 percent per year inflation forecast reflected in the budget resolution is expected to be too low.

It is important for the White House that an inflation adjustment be included in the final entitlement control provision emerging from conference. Otherwise, the President may find himself in an untenable position. Without such an adjustment, higher-than-expected inflation is likely to cause a breach of the targets.[5] Such a breach would be likely in 1996, among other years. If this occurs, the program contributing most to the breach would be Social Security. The President will

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[4] See Office of Management and Budget, *Budget Baselines, Historical Data and Alternatives for the Future*, January 1993, pp. 158-161, and Congressional Budget Office, *The Economic and Budget Outlook: Fiscal Years 1994-1998*, January 1993, pp. 110-112.

[5] Of course, a breach in the targets could also be caused by other factors. The most likely factor to cause a breach would be greater-than-forecast cost increases in Medicare and Medicaid. CBO and OMB have generally underestimated Medicare and Medicaid cost increases in recent years.

probably not wish to cut Social Security. But if he proposes to cut other entitlement benefits to make up for the amount that Social Security has contributed to the breach, constituencies of the other programs will howl. If the President proposes not to take action to offset the breach, the Republicans and Ross Perot will pounce.

The President doesn't need this. It is especially unjustifiable since higher-than-expected inflation has little impact on the deficit.

A related issue is whether the requirement to act should be triggered if the entitlement target is breached by one percent (as in the Senate leadership proposal) or by one-half percent (as in the House bill). The one-half percent margin of error is too small. It amounts to about $4 billion. The margin of error in the original Gramm-Rudman-Hollings bill was $10 billion, and the Budget Enforcement Act of 1990 raised this to $15 billion.

The President is likely to be placed in a politically difficult situation any time that action is required because of a breach of the target. He may have to propose cuts he does not favor. Or, he may be forced to accept a slowdown, just before the election, in the phase-in of universal access to health care. A one percent margin of error lessens the chances such events will occur.

A one percent margin of error is highly defensible; with it, an overage of as little as one percent triggers action. An overage that equals just a fraction of one percent can be portrayed as *de minimis*.

Both the inflation adjustment and the one percent margin of error were considered during the House negotiations on this issue conducted just prior to consideration of the reconciliation bill on the House floor. These proposals were opposed by Rep. Stenholm. Rep. Stenholm's principal objection to the House package, however, was that the overall package had a substantial energy tax and, in his view, insufficient spending cuts. If the final package has a smaller energy tax and more entitlement cuts than the House version, as it inevitably will, it ought to be possible to secure these modest and crucial modifications in the entitlement cap proposal. These modifications also will help with the Black Caucus and with liberals such as Henry Waxman, who may be unhappy over the additional Medicare reductions.

FOOD STAMPS AND THE RECONCILIATION CONFERENCE

It is well understood that low-income offsets are needed to prevent the energy tax from pushing poor households deeper into poverty. But the EITC only performs part of the job. The current EITC (which does not include workers without children) covers *fewer than one-fourth* of all households below the poverty line. Other offsets are needed to reach poor families without earnings and poor elderly and disabled people.

The Administration has recognized this; its budget includes increases in low-income energy assistance and food stamps as part of the offset package. But the energy assistance increase appears moribund, a victim of the reductions made in the budget resolution in the total amounts that can be spent for discretionary programs.

That leaves food stamps as the only potential offset for the energy tax borne by households without earnings. Food stamps also are needed as an offset for those EITC families, of whom there are more than three million, who either will get no EITC increase under the Clinton plan or will get a small EITC decrease.

Serving as an offset to the energy tax is not, however, the only or even the primary reason the food stamp provisions are important. These provisions, which are known as the Mickey Leland Child Hunger Prevention Act, are needed to reduce hunger among poor children and to help bring working families out of poverty.

- The food stamp provisions are highly targeted on very poor children and their families and are carefully crafted to avert homelessness among these families — or at a minimum, to prevent these families from having to choose between eating adequately throughout the month and paying their rent and utilities bills. In this vein, the legislation is designed to eliminate a glaring inequity in the food stamp program under which those families with children whose housing costs consume more than half of their incomes are treated more harshly than elderly households who pay over half of their incomes for housing. A provision in the Administration's food stamp legislation would address this problem. It would treat families with children that bear very high housing cost burdens the same as elderly households in this situation are treated, thereby boosting the food stamp assistance provided to families with children that have these very high housing cost burdens. This provision is the centerpiece of the bill. It has been hailed — and included in legislation introduced in recent years — by Pete Domenici and a number of other leading Members of both parties.

- The food stamp provisions also are necessary if the President's "making work pay" goal — that families with a parent working full-time should be raised to the poverty line — is to be met. Under the

Administration's formula for getting these families to the poverty line, the proposed food stamp increase was presumed to cancel out the energy tax, while the EITC increase lifted the family to the poverty line. If there is no food stamp increase, however, part of the EITC increase must be used to offset the energy tax hike. This will leave these families short of the poverty line.

Equally serious, under current food stamp law, a family's EITC payment is counted against the food stamp assets limit starting 30 to 60 days after the EITC payment is received. This is a serious problem. If the Clinton EITC proposal passes, EITC benefits will exceed the food stamp assets limit, which is just $2,000. Families that don't spend their EITC very rapidly will lose all of their food stamps. Yet without food stamps, they will remain several thousand dollars below the poverty line, and the goal of "making work pay" will not be met. In addition, perverse incentives will be created for families to spend their EITC benefits fast. The Administration's food stamp legislation remedies this problem; this is another reason it is needed.

Also, the Administration's plan to raise families with a full-time worker to the poverty line assumes these families get food stamps. A combination of full-time minimum wage earnings, the EITC, and food stamps are supposed to raise these families to the poverty line. In fact, only one-third of the working poor do get stamps. The Administration's food stamp proposal contains provisions to enable more of the working poor to receive food stamps. This, too, furthers the President's goal of making work pay.

- Third, the Administration's food stamp bill is important to improving child support enforcement (and thus helping to pave the way for an important component of welfare reform). The current food stamp benefit structure contains disincentives for custodial parents on AFDC to help track down absent parents and collect child support from them. It also contains disincentives for absent parents to pay child support. The Administration's food stamp legislation fixes both of these problems.