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CLASP Audio Conference Series Transcript

The Fiscal Squeeze: What Does Tax Policy Have to Do With It? Friday, April 2, 2004, 12:30-1:30 pm (ET)

The Third Audio Conference of the 2004 CLASP Audio Conference Series, "The Squeeze: Helping Low-Income Families in an Era of Dwindling Resources"

JOHN HUTCHINS: Hello, and welcome to the third call in the 2004 CLASP Audio Conference Series, *The Squeeze: Helping Low-Income Families in an Era of Dwindling Resources.* My name is John Hutchins, and I'm the Communications Director here at CLASP. Today's call is entitled, "The Fiscal Squeeze: What Does Tax Policy Have to Do With It?"

I'm pleased to be joined by two experts on the subject: John Corlett, from the Center for Community Solutions in Cleveland, Ohio; and Bob Greenstein, from the Center on Budget and Policy Priorities here in D.C.

Welcome to you both.

In addition, we've added a special guest for today's call, CLASP's Policy Director, Mark Greenberg, who will offer a brief update on what happened this week on the Hill regarding TANF reauthorization.

Welcome, Mark.

MARK GREENBERG: Hi, John.

JOHN HUTCHINS: We have a great audience for today's call. We estimate that there are at least 600 people listening in at 150 locations in 32 states and D.C.

I want to remind our listeners that they're welcome to send me questions via email during the call. My email address is jhutchins@clasp.org, and that address is also in the call-in instructions that you received.

Let me offer some background on our guests before we begin.

John Corlett has been involved in public policy and advocacy for more than 20 years. He is currently Senior Fellow and Director of Public Policy and Advocacy at the Center for Community Solutions in Cleveland, Ohio, which until last week was called the Federation for Community Planning. John's work focuses particularly on health and human service issues in the state and county budgets. He currently serves as Co-Chair of the Emergency Campaign to Protect Ohio's Future, a statewide budget advocacy group. He has received numerous awards, including the Outstanding Advocate of the Year award by the Ohio Association of Area Agencies on Aging.

Robert Greenstein is the Founder and Executive Director of the Center on Budget and Policy Priorities. He is universally recognized as the nation's foremost expert on the federal budget and the impact of tax and budget proposals on low-income people. He is quoted regularly in the press and is frequently asked to testify on Capitol Hill. In 1996, Bob was awarded a MacArthur Fellowship for making the Center on Budget and Policy Priorities a "model non-partisan research and policy organization." Prior to founding the Center, Greenstein was Administrator of the Food and Nutrition Service at the U.S. Department of Agriculture, where he directed the agency that operates the federal food assistance programs.

Before we begin our discussion of tax and budget policy, though, let me turn to CLASP's Mark Greenberg and TANF reauthorization.

Mark, there was a flurry of activity on Capitol Hill this week on TANF. What happened?

MARK GREENBERG: There were many developments over the week, but the bottom line is that reauthorization remains incomplete and the future remains very unclear.

More specifically, the TANF reauthorization bill came to the Senate floor on Monday. The first thing to be considered was an amendment by Senator Snowe and Senator Dodd and a number of other senators to increase child care funding. There was a very strong bipartisan vote, ultimately a 78-to-20 vote in favor of this amendment to add $6 billion over a five-year period in additional child care funding to the bill.

After the child care vote, for a number of reasons, the process essentially stopped moving forward. There were disagreements about the number of amendments to be considered, how much time to take, which amendments should be considered, and whether the process should be tied to a set of explicit agreements about going to conference. Senator Daschle and Senator Frist had extensive negotiations through the week and, ultimately, were not able to reach agreement. Senator First filed what's known as a motion for cloture, which is essentially a motion to limit debate and the number of amendments. That was voted on yesterday. It failed by a near straight party-line vote. It's an amendment that needed 60 votes in order to win. All Republicans voted in favor; all Democrats, except Senator Miller of Georgia, voted against.

We now wait to see what happens next. The bill could be brought up again in the Senate. They may not bring it up further this year. There still has to be some resolution in terms of an extension of funding beyond the next three months, but we now wait to see what happens next.

JOHN HUTCHINS: And what do you think is going to happen next—or maybe what *should* be happening next?

MARK GREENBERG: There does have to be some further action this year because TANF has been essentially on quarter-to-quarter funding. There have now been six extensions of the funding. There was another extension this week. Current funding goes until the end of June. So Congress has to take some further action within the next three months, either to provide for a straight extension, an extension with conditions, or to make an effort to try to revive the bill in the Senate.

At CLASP, we hope that Congress and the Administration can work together and complete work on a reasonable reauthorization bill this year. We think that there is an enormous cost to states

and families in a process that keeps dragging on, that it would surely be a good thing to get some of the positive features of the Senate bill enacted into law, such as the child care funding, the child support provisions, the more reasonable approaches to work requirements.

We think it is important that Congress complete work on reauthorization and do so in a reasonable bill. We hope it is possible to do so, but the process has gotten caught up in a set of difficult issues in the back-and-forth between the parties and the way in which the Senate operates, and it is, frankly, unclear whether it's going to go further this year.

JOHN HUTCHINS: Bob, you've been following this very closely, too. What are your thoughts about what happened this week and about what the next step should be?

ROBERT GREENSTEIN: Well, I agree with everything that Mark just said. There were certainly some elements of positive news this week. The degree of overwhelming support in the Senate for the child care amendment—I think the vote was something like 78 to 21—a majority of both parties voted in favor of the child care funds. That's certainly helpful for ultimate discussions on the child care funds should this bill ever get to a conference with the House.

Given that the bill was on the floor for a few days, some things clarified as to likely amendments that might be offered or might pass. It now looks likely that if the bill does come back on the Senate floor, for example, that an amendment to broaden eligibility of legal immigrants will pass. It appears at this point that if the bill can get through the Senate, it's likely to be a relatively decent bill.

As Mark noted, the current funding extension goes through June 30th. This issue isn't going to go away. It is unclear whether, if the bill dies for the year, the funding will be extended in a clean manner without conditions, or whether there will be efforts to start taking provisions, including troublesome provisions of the House bill, and adding them to the extension as a condition for this quarter-by-quarter extension of the money.

All of these are among the reasons why I agree with Mark that the hope is that things can get worked out.

If you read the papers, you may think the principal stumbling block to moving forward, for example, is the minimum wage issue. At the end of the day, that's not the principal stumbling block. The principal stumbling block is that there has been a pall cast over conference deliberations on bills where the House has a very conservative bill and the Senate has a more moderate bill. There's been a pall over conferences ever since the Medicare conference report in which Senate Democratic conferees other than two were barred from being allowed into the conference room.

The Senate Democrats are now insisting on some assurances regarding conferences and blocking major bills from going to conference in the absence of such assurances. For months, no major bill has gone to conference.

The ultimate stumbling block in working things out this week on the Senate floor on the welfare bill was that an agreement was not reached with regard to the conference. Until this gets worked out, progress on a welfare bill in the Senate is likely to be stalled.

JOHN HUTCHINS: Thanks, Bob, and thanks, Mark, for the update on TANF.

Let’s turn now to the subject of this Audio Conference, which is tax and budget policy.

Bob, let’s start by orienting our listeners to the current federal fiscal situation. It’s pretty bleak, isn’t it?

ROBERT GREENSTEIN: Unfortunately, it’s even bleaker than you think. The problem is not that we face a budget deficit in the vicinity of $450 billion or more for the current fiscal year. Running deficits, even substantial deficits during periods when the economy is weak, is not a problem. In fact, it can be helpful in stimulating the economy.

The problem is that even after the economy recovers and is growing substantially, the forecasts are for deficits to remain at substantial levels and then to explode as we get towards the end of the decade and we have the twin events—if the tax cut is made permanent—of the full tax cut (including estate tax repeal) taking effect and the baby boomers beginning to retire and Social Security and Medicare costs rising.

A series of independent analysts—ourselves, the Concord Coalition, Goldman Sachs, Brookings, and others—have all concluded that if we remain on the current policy course—that is to say, if we extend the tax cuts enacted in ’01 and ’03, fully fund the administration’s multi-year defense plan, and make no cuts in domestic spending—cumulative deficits over the next 10 years will be about $5 trillion and then they’ll rise to much higher levels in decades after that and eventually get to levels that would significantly damage the economy over time.

JOHN HUTCHINS: But some in Congress are arguing that the problem isn’t insufficient revenue over time but out-of-control spending. Is that true?

ROBERT GREENSTEIN: Let’s distinguish the current deficit problems from the long-term deficit problems. What a number of people in Congress allege is that we start with the fact that only three years ago the official projections were for budget surpluses of about $5 trillion over the next 10 years. Now, the budget deficits for that same 10-year period are projected to be in the $4 to $5 trillion range. So we’re taking of a swing from surplus to deficit of more than $9 trillion.

The rhetorical argument is sometimes made that this is because of out-of-control spending. But the budget data clearly show that the out-of-control spending argument is not accurate.

Analysts measure trends over time in spending and taxes by looking at federal spending and federal tax revenue collections as a percentage of the U.S. economy. While federal spending has risen significantly in the past three years, even today, in 2004, federal spending as a percentage of the economy will be lower than in any year from 1975 through 1996. Given that, it’s very difficult to say that there’s been some huge spending explosion that has brought back the deficit.

So where did the deficit come from? Federal tax revenue is now at its lowest level as a share of the economy since 1950, and federal income tax revenue is at its lowest level as a share of the economy since 1942. What we have now is a federal government that is not your 1950 federal government. There was no Medicare, Medicaid, food stamps, lots of other things in 1950. But we have revenue levels that are down at that point. So, at the current time, the collapse in revenues is the primary factor in the return of deficits.

If we look out 10, 15, 20 years into the future, what you have is a combination—if we make the tax cuts permanent—of low levels of revenue coupled with what will be, after the baby boomers retire in large numbers, record levels of spending at that time.

So, in the long term, it's taxes and spending both. But in terms of the immediate deficits and this $9 trillion swing over the past three years, it is much more a result of collapse of revenues than out-of-control spending.

JOHN HUTCHINS: Let me bring John Corlett into the discussion.

John, last year the National Governors Association said that states were facing their worst budget crises since World War II. How bad has it been for states and has it gotten any better in the last year or so?

JOHN CORLETT: I think it's been extremely challenging for states in terms of trying to balance their budgets over the past three years. For example, in the last three years, states had to close a cumulative budget gap that approached about $200 billion, which is a significant amount.

I think the shortfalls are beginning to shrink somewhat for the fiscal year that's coming up, fiscal year 2005. But at the same time, even though the size of the shortfalls may be shrinking, the cuts are getting harder and harder to achieve and sustain. For example, in the early part of these shortfalls in '01 and '02, states might have had rainy day funds or other funds that they could use to balance their budgets and avoid having to make the kind of horrendous cuts that states are making in health and human services and education programs. They're turning to that now because they've done a lot of the easy stuff that they were able to do earlier in this fiscal crisis.

JOHN HUTCHINS: Thank you.

Bob, going back a moment to the question of how we got to the situation that we're in now—this huge $9 trillion swing that you mentioned—has it all been because of tax cuts? What's the effect of the economy and maybe 9/11 on the story?

ROBERT GREENSTEIN: It's a good question. One can look at the Congressional Budget Office numbers to answer the question.

For starters, the swing is roughly speaking about two-thirds due to policy changes that Congress and the President made in both taxes and spending and about one-third due to factors that policymakers don't have direct control over. There are two things that they don't have direct control over; one, of course, is the economy. Changes in the economy reduce revenues; when the economy slows down you collect fewer revenues and you also pay out more in things like unemployment insurance benefits. Both of those add to deficits.

And secondly—and more important than the economy—is that we have had very big changes in what are called technical budget estimates. It is almost entirely on the revenue side that this change has occurred. Three years ago, the Congressional Budget Office and the Office of Management and Budget projected that, for a given size U.S. economy, a certain level of federal tax revenue would be generated. They've now concluded that the estimates they were using three years ago were much too high. Part of it has to do with issues relating to capital gains and the stock market, as well as other factors. These factors are not all fully understood, but suffice it to say that the level of revenues we thought would be produced for any given level of the

economy—and that provided a basis for policymakers thinking they had all this extra revenue they could eliminate through tax cuts—turns out to have been based on overly optimistic assumptions that substantially overstated revenues.

Economic and what we call "technical" changes accounted for a third of the swing from large surpluses to large deficits. The other two-thirds of the swing were the result of policy changes.

Let's look at those things that policymakers had control over—at that two-thirds of the swing that was due to decisions that Congress and the President made. If you look, for example, at the deficits we have in the current year compared to the surpluses projected for 2004 three years ago, and you look at that portion of the swing that's due to policy, you find the following. About 58 percent of the fiscal deterioration is due to the tax cuts, about 30 percent of the fiscal deterioration is due to increased national security spending—by which I mean spending for defense and homeland security and increased international spending in places like Iraq and Afghanistan. About nine percent of the swing is due to increases in entitlements as a result of legislation Congress passed. That nine percent figure will grow somewhat larger over time due to the Medicare drug benefit. And about three percent, the smallest share, is due to increases in appropriations for domestic non-entitlement programs.

JOHN HUTCHINS: Thank you.

John was just describing how dismal the situation has been in the states. What is the role of federal tax and spending policies, Bob, in the recent state budget crisis?

ROBERT GREENSTEIN: Unfortunately, they've played a significant role. The federal government has done one thing to aid states. In the federal tax-cut legislation that was enacted last May, $20 billion was provided in fiscal relief, half in general relief and half in Medicaid. That relief runs through this summer and then expires. Some of us believe it ought to be extended at a minimum at some level, but it seems unlikely that will occur.

The degree to which federal policies have deepened state fiscal crises more than offsets the $20 billion in help. There are a series of federal activities that have made state budget crises worse. The first is that, because most states with an income tax tie their definition of taxable income to the definition used in the federal tax code, when Congress passes legislation that shelters or exempts various forms of income from taxation or allows faster write-offs, unless states decouple their tax codes from the federal tax code in that area, states lose revenue, too. So, a number of states lost revenue as a result of one of the business tax cuts enacted in 2002 and enlarged in 2003.

There's also a very close relationship between state estate taxes and the federal estate tax. And without getting too technical, there is a part of the federal estate tax law known as the State Estate Tax Credit, and most states with an estate tax built their estate taxes around this credit. Congress not only, in 2001, repealed the federal estate tax as of 2010 but also phased out this State Estate Tax Credit over a four-year period with the credit being phased out entirely as of 2005, I think. The result of this is that states are losing significant amounts of state estate tax revenue unless they restructure their state estate taxes and essentially decouple them from the federal tax code.

There also are issues regarding the loss by states of sales taxes on sales that are made over the Internet rather than in brick-and-mortar stores and other issues relating to the Internet where the federal government, either by acting or by failing to take needed action that states have requested,

has precluded states from collecting revenue on certain transactions. As use of the Internet expands, this has caused states to suffer growing revenue losses.

There also are unfunded mandates in various areas, including education.

And, finally, there's a long-standing trend where some health care costs have been shifted from the federal government to the states. This is a result of the fact that, over a number of years, medical practice has been de-emphasizing hospital stays and using drug therapies and outpatient visits and things like this more. The way that Medicare and Medicaid have been structured, up until passage of the recent prescription drug bill, for those low-income elderly and disabled people who get both Medicare and Medicaid, Medicare is the primary payer for hospital costs and Medicaid has been the sole payer for drug costs. Medicare is 100 percent federally funded, while Medicaid funding is split between the federal government and states. As medicine moves to reduce emphasis on lengthy hospital stays and toward greater reliance on drug therapies, this has had the effect of shifting some costs from Medicare to Medicaid and, hence, from the federal government to the states.

Iris Lav here at the Center and others who work on state fiscal issues at the Center have done a study where their estimate is that, in all these areas combined, federal policy has actually cost the states about $175 billion over four years. So, the benefit to states from federal fiscal relief is $20 billion, but the loss due to other federal policies is $175 billion. Bottom line: federal policies have significantly worsened state fiscal crises.

JOHN HUTCHINS: Let's take a step backwards for a second. This is a question for both of you, and let's start with John.

Many members of our audience are program people—administrators, advocates, researchers, working on particular programs that serve poor people. Why is it important for them to pay close attention to tax and budget policy?

JOHN CORLETT: We have an expression we use around here: just follow the money. I mean, you've got to understand where the money comes from that funds your programs. Our work in the State Fiscal Analysis Initiative, I think, has really heightened our awareness of that. It also brings a new set of advocates to those issues. In our state, in Ohio, legislators were initially surprised to see health and human service and education advocates talking about tax policy, as opposed to just talking about their particular budget line item.

I think you've got to understand where the money comes from, how government is financed, in order to make your case for additional resources or to protect those resources.

JOHN HUTCHINS: Bob, do you have anything to add on why it's important for program people to pay particular attention to tax and budget policy?

ROBERT GREENSTEIN: Tax and budget policy is the bottom line, given that at both federal and state levels we face serious budget crises. At the state level, the crisis has been particularly acute in the last couple of years. It should ease some as the economy recovers, but then it will come right back as the baby boom generation retires.

We have problems at both federal and state levels on tax structure. We have problems at both federal and state levels on squeezes that will be caused as the baby boomers retire in large

numbers. And there is a steadily mounting risk that over time, funding for many programs could be squeezed down and out unless we address: one, the larger issues posed by revenue levels; two, the structure of taxation, particularly at state levels where you have antiquated tax systems under which revenues generally don't grow in tandem with the economy; and, three, the expenditure issues that will be posed, particularly at the federal level, as the baby boomers retire in large numbers.

These are huge issues. The risk is that if people who work on various individual program areas or services say, well, that's not my area, I just work on health care or child welfare or housing or whatever it may be—and there isn't a larger involvement over time—the consequences will be severe. You can just add the numbers up. If nothing changes, the combination at the federal level of inadequate revenues and added outlays for primarily but not exclusively health care programs for the elderly and disabled threatens to squeeze everything else.

JOHN HUTCHINS: Let's talk a little bit about the specifics of the effects of the budget crises in the states.

John, unlike the federal government, nearly all states have to balance their budgets. How have states been dealing with their budget crises—have they raised taxes? Cut programs? Both?

JOHN CORLETT: Well, unfortunately, it's been more of the latter. Since 2001, about 30 states have either expanded their tax bases or increased state tax rates to lessen the decline in revenue. I think that's about $18.4 billion, according to work done by the Center.

And, unfortunately, a lot of the taxes that are getting increased tend to be more of the regressive taxes. During the boom years of the 1990s, we cut taxes that had tended to make our tax systems more progressive, and, during the downturn, we are increasing regressive taxes instead of increasing progressive taxes. And now we're …

JOHN HUTCHINS: Could you describe the difference between regressive and progressive?

JOHN CORLETT: In terms of progressive, you're asking those who can afford to pay more to pay a larger share than those who can't. For example, a lot of states have or are decreasing their top rate of their income tax, going to a more flat tax, meaning that those who are extremely wealthy pay the same rate as those who aren't.

I think we saw a lot of that and a lot of program reductions. Thirty-four states cut eligibility for public health insurance, 23 states cut eligibility for child care subsidies, 11 states even made cuts in K-12 education funding. And we've certainly seen all of these things in Ohio in different programs that have seen their funding reduced or their funding eliminated.

JOHN HUTCHINS: Why don't you tell us a little bit more specifically about what has happened in your state? How has Ohio dealt with its big budget shortfalls?

JOHN CORLETT: Ohio's budget crisis has been largely driven by the dramatic reduction in jobs in this state. Since 2001, we've lost over 200,000 jobs and that has led to a direct reduction in income tax collections in the state. We've also seen a sort of melting away or elimination or dramatic reduction in the corporate franchise tax. There was a time when corporate franchise taxes made up almost 20 percent of our general revenue in the state; now it's down to below five percent.

Those factors working together really put the pressure on Ohio's budget. In response to that, the state initially made a series of really painful budget cuts. But in this most recent budget that the state passed—we do a two-year budget in Ohio—we put in place a temporary one penny increase in our state sales tax. That generates about $2.6 billion and was a significant factor in avoiding some just horrendous cuts in health insurance and K-12 education and child care that might otherwise have happened.

I think it was in large part due to the work of a lot of advocates in Ohio who came together in a coalition to say "no more cuts and we've got to look at the revenue side of things."

JOHN HUTCHINS: Bob, it's not just program cuts that can hurt low-income families; it's also the way taxes are structured. Can you talk a bit about the impact of certain kinds of taxes and transfers on the poor, both those that are positive and those that are negative?

ROBERT GREENSTEIN: The particular tax provision that is of greatest assistance to low-income families at the federal level, and in a number of states as well, is the Earned Income Tax Credit, which is a refundable tax credit for low-income working families with children. By refundable, we mean that if you qualify for the credit and you don't owe income tax you still get the credit amount for which you qualify. The IRS sends you a check.

And on a somewhat smaller scale, the child tax credit is partially refundable. The refundable part of that phases in for working families with children that have incomes above about $10,500 a year.

Now in looking at the current budget situation, the Senate-passed budget resolution assumes cuts in the Earned Income Tax Credit. While the Congressional budget resolution will not be completed until after Congress returns from the Easter recess, there is a significant possibility—I would say a likelihood—that it will require, through what's called a reconciliation instruction, the Senate Finance and House Ways and Means Committees to report legislation that cuts some billions of dollars. Some of that amount could come from cutting the Earned Income Tax Credit.

I do find it fairly remarkable that, at a point when the tax cuts passed in 2001 and 2003 are resulting, according to the Brookings Institution and Urban Institute Tax Policy Center, in average tax cuts of $113,000 a year for people with annual incomes over a million dollars, there's talk of cutting the Earned Income Tax Credit for fiscal reasons.

You could as well draw the contrast with what is probably the single largest low-income cut now before Congress: a proposal in the President's budget to underfund the Section 8 Housing Voucher Program, the nation's largest low-income housing assistance program, by $1.6 billion in the coming fiscal year. A cut of that magnitude would require public housing authorities to take such steps as cutting the number of families with vouchers by a quarter of a million, or alternatively raising rents on these families, most of who are below the poverty line, by an average of $850 a year.

So we have this contrast between these huge tax cuts at the top and the first steps toward some pretty significant budget cuts at the bottom.

JOHN HUTCHINS: Well, you both have described a pretty bleak situation. Let's turn a moment to talk about how we might get out of this mess.

Bob, where are we in the budget process in Congress this year and how is it likely to play out over the next few months?

ROBERT GREENSTEIN: The House and Senate have both passed budget resolutions or budget plans. They're in conference on them. The main point of disagreement is over something called pay-as-you-go rules.

In 1990, under President Bush's father, on a bipartisan basis, a rule was put into law under which all tax cuts and entitlement expansions had to be paid for. You could pay for tax cuts and entitlement expansions either by raising another tax or cutting another entitlement (or cutting another part of the same entitlement.) That regime played a significant role in helping to move us from deficits to surpluses in the 1990s. It's since expired.

The Administration and the House Republicans want to resurrect pay-as-you-go for entitlement expansions only. If you wanted to improve a low-income entitlement, or a veterans benefit, or Medicare, you would have to pay for it. You would only be allowed to pay for it by cutting another entitlement. If there was an egregious tax shelter that Congress hadn't intended but that clever tax accountants had found a way to open up and everyone agreed you should close it, you still would not be allowed to use the savings from that to finance an entitlement expansion, such as an increase in mandatory child care spending. Meanwhile, all new tax cuts—including new tax shelters and tax loopholes—would be free. Congress would not have to pay for them.

By contrast, by a 51-to-48 vote, the Senate voted to reinstate the pay-as-you-go rule as it existed in the 1990s—so that it would apply to tax cuts and entitlement expansions both and so that you could pay for tax cuts or entitlements expansions on either side of the tax-and-entitlement ledger. There's now somewhat of an impasse over this, so I'm not too sanguine about the outcome, given that the House Republican leadership and the White House have indicated that a true restoration of pay-as-you-go requiring all tax cuts to be paid for is something they will vigorously oppose. We could get a cosmetic compromise that on the surface looks like it's extending the pay-as-you-go rule to tax cuts to some degree but that, when you examine the fine print, turns out not to mean very much.

There's also a big issue that's going to come a little later in the year and that is that the House will consider a bill, an actual statute, to change the rules under which the federal budget is written and under which Congress operates on spending and tax legislation. The particular proposal that the House Budget Committee has passed and that'll come to the House floor probably in May would put caps or ceilings for each of the next five years on the total amount of money that Congress can appropriate for non-entitlement programs. It would put those caps at levels that effectively would lock in steadily deeper cuts in domestic programs with each passing year until the cuts reached about $36 billion a year by the fifth year. In addition, the House bill, as I noted, reinstates the pay-as-you-go rule for entitlement increases but exempts all tax cuts.

There are also two major bills that have been introduced in the House by various factions within the House Republican caucus that have additional provisions which, if enacted, would result in massive cuts in mandatory, or entitlement, programs. Specifically, these bills contain a so-called entitlement cap provision that would necessitate cuts in entitlements other than Social Security totaling $1.8 trillion over the next 10 years, which would mean that most entitlements would be cut significantly. We have an analysis of this on our website.

I do not think the entitlement cap provision will pass this year; it's too severe. But it gives you a sense of the fact that those who favor big tax cuts and are starting to look at the huge deficits that lie ahead are starting to produce legislation that is consistent with the Grover Norquist's starve-the-beast strategy and that would begin to eviscerate parts of the federal government over time. This is a debate we're going to be in for years to come.

JOHN HUTCHINS: Do you think that the Bush Administration has an overall strategy to starve the federal government by enacting these permanent tax cuts that will choke off revenue and then putting caps on both entitlement and discretionary spending? Is that too Machiavellian?

ROBERT GREENSTEIN: I think different people who favor big tax cuts have different views on this. There are some extraordinary statements that have been made in recent days by House Republican leaders saying that there is no need to place tax cuts under the pay-as-you-go rule because tax cuts don't lose revenues; they pay for themselves.

There may not be a single reputable economist in the United States who believes that. The President's own Council of Economic Advisors acknowledged in each of its last two reports that, while they believe tax cuts help the economy, that tax cuts do not pay for themselves. But you have some people who are still drinking this extreme supply-side elixir and thinking that there will be this magic economic explosion and that tax cuts will pay for themselves.

Those who understand these issues—including people who favor large tax cuts and have some understanding of economics and taxation—recognize that tax cuts won't pay for themselves. Nevertheless, many people who favored the 2001 and 2003 tax cuts did not start out favoring these tax cuts out of a Machiavellian strategy to starve the beast. They saw large budget surpluses and convinced themselves the tax cuts were affordable. But now that the budget picture has changed and the choice is there—that if you make tax cuts you have to start to starve the beast, and that if you don't want to starve the beast, you have to scale back the tax cuts—those who favor the big tax cuts are now clearly coming down in the starve-the-beast camp.

JOHN HUTCHINS: John, let's turn for a second to what happened in Ohio. You worked out a successful budget campaign to help Ohio deal with its budget crisis. Can you walk us through what happened and how you were able to be successful?

JOHN CORLETT: I think some of the key things about why we were successful in Ohio—and I should say that although we were successful in terms of protecting a number of programs and services, there were services that still were cut. It wasn't as if we got everything that we wanted in Ohio. But I'm not sure that ever happens.

But I think the key factors in our success were, one, that we started early, that we developed a diverse coalition that included a lot of different interests. We had key groups involved in the beginning, like AARP, the Children's Defense Fund in Ohio, the Public Children's Service Association of Ohio, and even philanthropic organizations like the George Gund Foundation.

And so together we also knew that we need resources to wage a successful campaign to get the legislature's attention because the dynamics of politics in Ohio—I mean, we are a state that is controlled in both the General Assembly and all of our statewide offices by one party, the Republican Party, and so that presented some challenges for us in terms of trying to get our message across.

So we raised about $175,000 to do that from the key partners and others. With those resources, we did some early polling, did some message development, we organized a rally at one point at the state capital that brought about 5,000 people to Columbus, which was the largest event that had been there in quite some time.

The other thing that we did that was important was used some of those resources to provide small stipends or small grants to community-based organizations who were in key legislative districts to help us organize and find people who could engage their elected officials on behalf of a more humane budget.

In the end, we did about 300 legislative visits, did a lot of work with media, editorial boards, and ended up restoring and protecting and increasing about $300 million worth of funding. We were pleased with that because when the budget first came out the governor had proposed removing about 50,000 from the Medicaid program, wiping out funding for the Second Harvest food banks, and eliminating a number of optional services, which I don't know that I would consider them optional: dental, vision, chiropractic, podiatric care for 800,000 very poor adults who were on Medicaid.

There were a lot of things at stake when we started, and a number of those things we were able to avoid or head off. But I think it was because we worked as a group and worked jointly. And as issues got taken care of everybody stayed at the table and kept working to try and make sure that everything that we cared about got covered or accomplished.

JOHN HUTCHINS: John, what have other states done on the revenue side to deal with their budget shortfalls? Have any been successful with more progressive forms of revenue enhancement than say the increased sales tax you mentioned?

JOHN CORLETT: Well, yes, I mean, we did a couple of other things in Ohio, too. I mean, we did some base broadening in terms of our sales tax, which I think people see as a good thing. And we did a little bit of corporate tax reform—although not nearly enough—by increasing the corporate minimum tax.

One of the states that we look at in terms of being successful is New Jersey. New Jersey did a number of things, particularly on the corporate tax side, that get at this problem that is occurring across the country where we see aggressive tax planning resulting in corporations seeing their corporate liability just kind of shrink to next to nothing.

The tax commissioner here in Ohio made the statement at one point that five of our largest corporations in the state only paid $50 in corporate franchise taxes.

JOHN HUTCHINS: Wow.

JOHN CORLETT: Now he didn't say who they were. But it sort of gets at the problem that folks are not picking up an equal share of the cost of funding these essential state services.

JOHN HUTCHINS: Bob, maybe this would be a good time to talk about the advocacy work that you and the Center have been doing on the state level. Could you describe your state advocacy program for us a little bit?

ROBERT GREENSTEIN: Part of the Center is called the State Fiscal Project. It started about 1992 or so. In fact, a lot of people may not recognize that the Center now has about as many staff and resources working on state-level policy as on federal-level policy. It's about 50-50.

We conduct a substantial amount of cross-state research and analysis on an array of fiscal policy issues, budgets, and taxes, as well as on a variety of low-income programs. And we work very closely with state organizations that work on budget and tax policy issues, particularly in state capitals. The closest working is with about 24 organizations that are part of what's known as the State Fiscal Analysis Initiative Network. John's organization is one of those. But we also work with scores of other state groups that are not explicitly a part of that initiative.

Our work with the state groups focuses on budget issues, tax issues, helping to analyze state budgets, producing state-by-state data of various kinds from Census runs that aren't economical for individual state groups to do on their own. We also work closely with states on a variety of strategies, ranging from things like decoupling their estate tax or their business depreciation rules from the federal rules to avoid losing revenues, to establishing and expanding state Earned Income Tax Credits, of which there are now 17, as well as taking advantage of various federal options under programs like food stamps, Medicaid, state child health insurance programs, and others.

JOHN HUTCHINS: John, from the perspective of a member of the Center's State Fiscal Analysis Initiative, how would you describe how it helps you with your work?

JOHN CORLETT: I think it's made all the difference for us in terms of being keyed in to what's happening at the national level and how that affects the states. Bob just mentioned the issue of decoupling from the business depreciation, some of those tax measures that were included in federal tax legislation. We got that information from the Center on Budget and Policy Priorities, and we ran with it here in Ohio and were able to persuade the state to decouple. And that saved our state about $160 million. I have no doubt that if we hadn't done that, that $160 million would have come out of things that we care about like health care, education, early care and education, child care.

I sense this growing effort that's being led at a national level on the right to starve the government—Grover Norquist and his allies. That is showing up here in Ohio as well, and the State Fiscal Analysis Initiative helps us keep track of those things and develop strategies across states that can help us overcome it.

JOHN HUTCHINS: Bob, as John's example just described, you and the Center have done some amazing work educating policymakers, and advocates, and the media, and the public about tax and budget policy.

From an advocacy point of view, what are the challenges of making a progressive argument about taxes palatable when everyone loves a tax cut?

ROBERT GREENSTEIN: I think there are two aspects to that. One is that I do think there is a gradual growing understanding among the public that the kinds of deficits we face over the long term pose a very serious challenge. We can see the increased public understanding and the change in some of the national mood, for example, in the votes in the Senate where there were 60 votes or so for the huge tax cut in 2001, but last year's tax cut had to be scaled back to get it through and Vice President Cheney had to break the tie. And this year, as I noted, by 51-48 the

Senate voted that all future tax cuts, including extension of existing tax cuts, should have to be offset.

The second issue is really framing the debate in terms of national priorities and trying to make sure—this is equally true at the state level—that the public understands that there are no free lunches. And so if you make certain kinds of tax cuts, you ultimately will have to make corresponding budget cuts or be left with what many would view as inadequate resources to address national needs, whether they be in the area of health care, or education, or other things.

But I think all of us need to do a much better job in framing these tradeoffs. As long as the perception is that there are no hard choices, it is a free lunch, you can have it all, naturally the public's going to avoid the hard choices, policymakers will avoid them, and those policymakers who want to make the hard choices will fear retribution at the ballot box by being accused of being a tax increaser or whatever.

I think those are the two key issues: educating people on the fact that there are serious fiscal problems with lots of consequences and we do face hard choices, and trying to frame what those hard choices are. I also think it's of particular importance, at least in terms of the federal issues, to make it clear how large some of these tax cuts at the top are. But having said that, it's too easy for people on this Audio Conference to think that the federal government could come up with all the revenues to do all of the things they'd like to see if it simply suspended the tax cuts at the very top. Unfortunately, that isn't the case. There will have to be tough choices in everything from various programs to the level of Medicare premiums that Medicare beneficiaries pay to some of the tax cuts for the middle class as well.

JOHN HUTCHINS: Let's look to the future for the last couple moments.

John, when the economy improves, state revenues will likely increase. Won't that create new pressure to cut taxes further in states? How can states guard against getting into the same kind of situation they've just found themselves in?

JOHN CORLETT: Well, I think to the extent that we can be organized. When we went through this the last time in Ohio over 10 years ago, one of the things that we did was create a rainy day fund. I think, actually, it'll be a while before we have in Ohio a sort of a requirement that a certain amount be in that rainy day fund. So it'll be a while before we have any available money for tax cuts, I think.

But I think we are organized now as a coalition and we've got this sort of fiscal capacity and tax capacity in the state that didn't exist before. And so I think we just need to make the case and educate people about why it's important to fund these services and to make the point for fairness and equity as well in terms of the tax code.

JOHN HUTCHINS: Thanks.

Bob, you were mentioning hard choices in the future, and the huge baby boom generation is scheduled to begin retiring soon and start drawing down on the two big entitlements, Social Security and Medicare. A report came out just last week saying that Medicare will be insolvent by 2019. How bleak does the long-range future look?

ROBERT GREENSTEIN: The overall long-range fiscal future is exceedingly bleak if you extend out the line for the level of revenues we'll collect if we make the Bush tax cuts permanent and remain on the current course with regard to program expenditures. I forget which year it is, but sometime within the next 20 years or so, there would be no money left for anything beyond Social Security, Medicare, Medicaid, defense, and interest payments on the debt. This may give you a sense of how tough the choices are.

In the area of Social Security and Medicare, one should sharply distinguish them. The challenges are much more daunting in Medicare than they are in Social Security. In Social Security, the shortfall over 75 years is not huge. A new important book by Peter Orszag of Brookings and Peter Diamond of MIT, shows, for example, how in a relatively progressive fashion, through a combination of relatively modest, gradually phased-in benefit reductions and payroll tax adjustments, one could restore Social Security solvency in perpetuity.

In Medicare, it's much tougher because, in Medicare, the long-term cost increases are not simply a result of the baby boomers' retirement. They are at least as much a result of the fact that health care costs in the U.S., not just in Medicare, not just in Medicaid, but in the entire U.S. health care system, are rising at very rapid rates. In fact, they've been rising faster in the private sector than in Medicare and Medicaid; this is not something that Medicare and Medicaid themselves are causing. The combination of the aging of the population and the steady increase in health care costs, a lot of which is related to medical advances and breakthroughs that prolong life and improve health but add to costs, makes it really difficult to figure out what to do on the Medicare front.

I would add one key point here with regard to Social Security. A lot of people on the call may think that the only thing that can "starve the beast" are more tax cuts. That would not be correct. We may see a Social Security so-called reform bill that starves the beast as much as one of the big tax cuts. For example, if Congress were to design a piece of legislation that, instead of making benefit and payroll tax changes within Social Security, closed the whole Social Security financing gap by requiring huge sums to be transferred from the rest of the budget in perpetuity into Social Security, that would put an even bigger crimp on the rest of the budget.

Unfortunately, most of the current Social Security proposals, particularly most of the current privatization proposals, try to deal with the so-called transition costs of moving to private accounts by taking trillions of dollars from the rest of the budget to cover those costs that could necessitate trillions of dollars of additional budget cuts in the rest of the budget over time.

We have to make some changes in Social Security. Medicare, we're going to have to figure out. Some larger restructuring of the health care system so that health care costs don't rise as rapidly would be desirable, but it's extremely difficult to do. We're also going to have to face things like significant increases in Medicare premiums for beneficiaries. I would protect the low-income beneficiaries and the states from such increases so that they don't get socked. I'd use maybe a third of the savings from an increase in Medicare premiums to shield state budgets and low-income people from the effects of such an increase. But right now, neither party is willing to talk about things like Medicare premiums, Social Security benefit adjustments, or much in the way of payroll tax modifications. If we never do any of those things and we never undo the Bush tax cuts, then 20, 30, 40 years from now, federal and state budgets with respect to an array of social programs will be in a different universe than they are today.

JOHN HUTCHINS: On that upbeat note, I want to thank both of you, Bob Greenstein and John Corlett, as well as Mark Greenberg, for taking the time out of your busy schedules to participate in today's Audio Conference. Thanks also to Nick Johnson of the Center on Budget and Policy Priorities, and Soleste Lupu, the CLASP Audio Conference Coordinator, for their help in planning this call. I encourage our audience to fill out a quick Web-based evaluation form which we are emailing to you right now.

Please join us for our next audio conference on Friday, May 7th, entitled, "Financing Child Welfare: What Policies Best Protect Children?" I'll be joined by Cassie Statuto Bevan of House Majority Leader Tom DeLay's office; Nick Gwyn, Minority Staff Director of the House Subcommittee on Human Resources; and Rutledge Hudson, recently of CLASP and now of the Children's Defense Fund.

Thanks to all of you for joining us today.

[This transcript was proofed and corrected by Mark Greenberg and John Hutchins of CLASP, Bob Greenstein and Nick Johnson of the Center on Budget and Policy Priorities, and John Corlett of the Center for Community Solutions.]