Center for American Progress

1333 H Street, NW, 10th Floor
Washington, DC 20005
Tel: 202 682.1611 • Fax: 202 682.1867

www.americanprogress.org

Budgeting for Katrina and Beyond

Robert Gordon, John S. Irons and Jennifer Palmieri*

September 23, 2005

Hurricane Katrina and the resulting devastation in the Gulf Coast have reignited the debate over national priorities in the federal budget. Progressives must respond in a way that reflects their own priorities. America must return to long-term fiscal discipline—by repealing spending on tax cuts for the most fortunate, by slashing spending on giveaways to corporations or congressional pet projects, and by protecting the Americans who, like Katrina's victims, already live on the edge.

The following principles should govern progressive budgeting today:

1. The top deficit-reduction priority must be bringing down the massive long-term deficits that now project as far as the eye can see. Bringing down long-term deficits will maximize growth, minimize the need for future tax increases and/or painful budget cuts, and ensure the nation can respond to future crises. The real priority is the long term, not simply "paying for Katrina"—particularly when that would mean deep, one-time cuts in discretionary aid to America's most vulnerable

2. At minimum, Congress cannot allow more spending on new tax breaks for the wealthiest. The tax cuts are the single largest contributor to the record run-up of deficits in the last four years and we cannot afford to continue to spend billions of dollars in tax breaks for Americans who are already well-off. In any sensible plan to restore fiscal discipline, repeal of

*Authors are Senior Vice President for Economic Policy, Director of Tax and Budget Policy, and Vice President of Communications, Center for American Progress

those tax cuts for upper-income individuals would be the single largest step. Ultimately, we should undertake a comprehensive review of all the tax cuts and develop a budget that will permit the country to meet its most immediate needs in a fiscally responsible way. But any program must, at minimum, not allow new tax breaks for the most fortunate at a time when so many Americans are suffering.

3. Spending cuts should strike first and foremost at the corporate subsidies and congressional earmarks that have been the hallmark of the last four years. While President Bush has not vetoed a spending or tax cut bill since he became president, he has enacted historic giveaways to drug, energy, and any number of other corporations. At the same time, earmarking has reached historic heights.

4. The victimization of the Gulf Coast's poor by Katrina cannot become an excuse to victimize the rest of America's poor through budget cuts. The Republican Study Committee's proposals, among others, to cut Medicaid by $225 billion, to increase Medicare premiums by $85 billion, and to cut $4.5 billion from rural economic development would visit a second hurricane on poor people across America.[1]

1 Our Fiscal Hole

Even before Katrina, massive deficits and weak revenues, left unaddressed, threatened our ability to respond to national emergencies. The pre-Katrina deficit for 2005 was expected to be $331 billion, and five-year deficits were projected to be $1.6 trillion.[2] Last year, federal revenues were at their lowest level

[1] Cost figures are for 10-years. Rural development cuts are from the reduction of federal funds to the Department of Agriculture's Rural Community Advancement Program. See Republican Study Committee, "Operation Offset: RSC Budget Options 2005," September 21, 2005 (revised September 22), available at http://johnshadegg.house.gov/rsc/RSC_Budget_Options_2005.pdf.

[2] Congressional Budget Office, "The Budget and Economic Outlook: An Update," August 2005; recent estimates available at http://cbo.gov/showdoc.cfm?index=1944&sequence=0.

as a share of the economy in almost 50 years. This comes at a time when we are spending massive amounts abroad for the war and reconstruction in Iraq and when there are vital domestic priorities going unmet.

Katrina also exposes the fact that we have longer-term budget challenges. Responding to recent events would certainly have been less painful if the administration had maintained sound tax and budget policy. Instead, the nation currently has long-run structural imbalances in federal budget policy.

1.1 Need to reduce deficits

Each dollar borrowed is a dollar that must be paid back with interest tomorrow. This means passing on higher taxes to future generations of Americans. This means owing money to foreign banks, and foreign governments. This means less money available for domestic investments. Altogether, exploding deficits mean a weaker nation and a weaker economy.

While nations occasionally need to incur budget deficits to invest in their future or to address short-term needs, such as rising unemployment due to a recession or a natural catastrophe, fiscal responsibility requires that governments keep the growth of deficits in check.

Before Katrina, the federal deficit was well over $331 billion for 2005, and was set to remain above $300 billion for the next five years. The addition of additional spending for Katrina-related aid will likely add to that total.

2 Center for American Progress Proposals

Given our nation's budget problems and the lack of leadership to address those problems, the Center for American Progress is proposing several measures to restore fiscal sanity over the long term. Although these measures do not represent the comprehensive progressive agenda, they do represent the sensible first steps toward restoring fiscal discipline.

2.1 No More Spending on New Tax Cuts for the Most Fortunate

The first rule of holes: if you're in one, stop digging.

The hurricane illustrated an important point—our nation has vital domestic priorities that are going unaddressed. Our national infrastructure—including levies, bridges, ports etc.—is not as sound as it should be. Investing money today will save money tomorrow. To begin to effectively address these issues, we need to ensure that we have a solid base of revenue.

- No new spending on tax cuts for upper-income taxpayers and millionaires.
  - The plan to enact $70 billion in additional tax cuts later this year should be scrapped.
  - Tax cuts for upper-income individuals that have already passed but that have not yet taken effect should be reversed before they take effect; restoring two provisions that overwhelmingly affect upper-income tax payers (the PEP/Pease provisions) would save $27.9 billion over the next five years.[3]

These measures represent the bare minimum necessary to restore fiscal responsibility. A more comprehensive plan would:

- Reverse the tax cuts for those who benefited the most under Bush's tax changes. As a start,
  - Reverse the capital gains and dividends cuts for those making more than $1 million per year.[4]
  - Reverse the rate reductions for high-income taxpayers.

[3] Estimates of PEP/Pease repeal from Tax Policy Center, available at http://taxpolicycenter.org/TaxModel/TMDB/TMTemplate.cfm?Docid=744.

[4] According to the Tax Policy Center, 22 percent of qualified dividends were paid to those making more than $1 million, and 58.6 percent of qualified capital gains went to this group.

2.2 Need to Cut Spending on Corporate Subsidies

Congress should begin by eliminating corporate subsidies embedded in recent legislation. Specifically, Congress should:

- Allow the federal government to negotiate for lower prices for prescription drugs, and allow Medicare recipients to purchase drugs via mail. From this second item alone, the federal government could save at least $33.6 billion over five years, and $86 billion over 10 years.[5]

Corporations should be asked to do their fair share as well. Congress should:

- Reverse the corporate tax giveaways included in the FSC/ETI corporate tax bill that passed last fall—raising up to $22 billion over five years, and $54 billion over 10.[6]
- Reexamine elements of the energy bill: repealing subsidies to the fossil fuel industry contained in the recent energy bill would save $8.5 billion over the next five years. [7]
- Crack down on offshore tax shelters, saving $13 billion per year, or $65 billion over five years.[8]

Overall, by shifting funds towards their most effective use, we will in effect strengthen the economy.

2.3 Need to Eliminate Waste

Many earmarks aimed at specific congressional districts are not necessary, are not the best use of scarce federal dollars, and should be reversed. Congress

[5] Figures are for mail order drugs alone. See The Lewin Group, "Mail-Service Pharmacy Savings: A Ten-Year Outlook for Public and Private Purchasers," August 2005. Available at http://www.pcmanet.org/newsroom/pr_08/Lewin_Study.pdf.

[6] Derived from Joint Committee on Taxation estimates of "American Jobs Creation Act of 2004," available at http://www.house.gov/jct/x-68-04r.pdf.

[7] Joint Committee on Taxation, "Estimated Budget Effects Of The Conference Agreement For Title XIII. Of H.R. 6, The Energy Tax Incentives Act Of 2005," available at http://www.house.gov/jct/x-59-05.pdf.

[8] For details, see Center for American Progress, "A Fair and Simple Tax Plan for Our Future," available at http://www.americanprogress.org/tax.

should:

- Reexamine the recently passed highway bill and reduce earmarked spending by at least 50 percent, saving up to an estimated $4.9 billion.[9]

2.4 Need to Strengthen Support for America's Most Vulnerable

Furthermore, it would not be fair to ask only our nation's poorest to foot the bill for emergency spending. Quite the contrary—Katrina illustrated the importance of supporting those most in need. Congress should:

- Defeat current plans to cut spending on health care for low-income families.
- Expand the eligibility to receive the child tax credit by reducing the earnings threshold to $5,000.
- Enhance the earned income tax credit to increase the take-home pay of millions of low-income working Americans.

2.5 Total Savings

The total savings from the expenditure and the tax provisions would be $174 billion (see Table 1).

Savings on the tax side would be substantial. The five-year cost of simply extending the preferred rate for capital gains and dividends beyond 2008 for millionaires alone would be $11.6 billion, and the 10-year savings would be $84.2 billion.[10] Reversing the Bush tax cuts for the wealthiest would raise significant revenue above this amount as well.

[9]Press reports indicate there are 6,371 earmarks at a total cost of $24 billion; see Associated Press, "Bush signs $286.4 billion highway bill," August 10, 2005. http://msnbc.msn.com/id/8894520/page/2/. Due to funding formulas, however, not all of the these savings would be realized by removing the earmarks, and the exact amount would depend on the particular earmarks chosen; see James Kuhnhenn, "Recovery's cost forces lawmakers to reassess pet spending projects," Knight Ridder Newspapers, September 20, 2005,

Table 1: Five-year Cost Savings from Expenditure-Related Budget Items

	Five-Year Cost Savings (Billions)
Corporate Subsidies	
Mail-Order Prescriptions	$34
2004 FSC/EIT	$22
Energy Bill Savings	$8.5
Offshore Tax Shelters	$65
Waste	
Highway Earmarks	$4.9
Tax Changes	
Capital Gains / Dividends	$12
PEP/Pease	$28
Total	$174

available at http://news.yahoo.com/s/krwashbureau/_wea_katrina_congress.

[10]Total cost of extending the capital gains and dividend tax reductions is $22.1 billion (Congressional Budget Office, "Budget Options," February 2005, available at http://cbo.gov/showdoc.cfm?index=6075&sequence=19). Those making more than $1 million per year receive about 52.7 percent of the benefits from this tax reduction (Tax Policy Center, "Reduction in Rates for Long-Term Capital Gains and Qualifying Dividends, Distribution of Federal Tax Change by Cash Income Class, 2005," April 6, 2005, available at http://www.taxpolicycenter.org/TaxModel/tmdb/TMTemplate.cfm?DocID=813&topic2ID=60&topic3ID=62&DocTypeID=1).