Testimony before the Democratic Caucus's Task Force on Children and Families on the Bush Administration's Budget Proposal's Impact on Working Families

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I. Introduction

Although the economy is showing signs of growth, a closer look reveals that the U.S. economy is still bifurcated. Output expanded at a strong pace in the second half of 2003. At the same time, millions of Americans still cannot find the jobs that they want and desperately need.

The first "job loss" recovery since World War II has taken its toll on America's working families. The economy lacks millions of jobs that typically should have been created at this point in a recovery. Because employment growth has been negative or slow for most of the recovery, wage growth has also been flat. While working families don't see big gains in their paychecks, prices for important consumer items – such as education, housing, and health care – are outpacing prices for other items. Caught in this squeeze, households have borrowed record amounts of debt. Despite historically low interest rates, the debt service burden of households is near record highs.

The severity of the "job loss" recovery could have been avoided with more efficient fiscal policy. Instead of an effective temporary spending measure, large tax cuts were enacted in 2001, 2002, and 2003 that do not seem to have had a big effect on GDP growth. For example, tax cuts accounted for only 13% of the strong growth rate in the third quarter of 2003, i.e. 87% growth resulted from other sources. This is largely because most of the fiscal effects were designed to occur in future years, when a stimulus was hopefully no longer needed. Second, the cuts favored higher income earners, who are less likely than lower income earners to increase their spending. Third, they created large structural deficits that could jeopardize the recovery through higher interest rates in later years. More efficient fiscal policy could have boosted growth and employment through well designed, temporary measures and avoided long-term risks.

The Administration's budget for 2005 adds insult to injury for working families. Many of the programs that could help to ease the burden of the "job loss" recovery for working families are being cut. Support for workforce training, education, housing, and child care are being cut at a time when working families need them more. The President's budget also undermines existing federal health insurance efforts. Many working families who rely on such efforts would face severe cutbacks. Also, new programs supposedly designed to increase benefit coverage for working families, are just another tax cut for the rich and are unlikely to benefit those who need them most.

II. Households in a Bind

The labor market has experienced the worst performance in a recovery since the end of WWII. This is the first time in a recovery that the labor market showed fewer jobs 26 months into the recovery than at the start of the recovery (figure 1). More specifically, 366,000 jobs were created between September 2003 and January 2004, but there are still 2.6 million fewer jobs than at the start of the recession in March 2001 (BLS, 2004a).

These numbers need to be seen in context, though. Typically in a recovery employment growth is strong. Employment increased each month by an annualized average of 2.8% during the first 26 months of each of the prior four recoveries (table 1)[1]. If employment had grown in this recovery at the same rate, employment in January 2004 would have been 8.8 million jobs higher than it actually was. Even if employment grew five times faster than it did during the past five months through November 2004, these would be the worst three years of a labor market recovery in any recovery since WWII.

Not only is employment growth lagging, earnings growth is essentially flat. After adjusting for inflation, average hourly earnings in December 2003 were essentially flat. The annualized increase in hourly earnings, 0.2%, in December 2003 was the lowest increase since 1994. Inflation-adjusted hourly wages increased by a total of 1.3% from the start of the recovery to December 2003, about half of their typical rate of increase in a recovery.

A better measure for household incomes are weekly earnings, instead of hourly wages. Inflation adjusted weekly earnings show how those fared, who had a job. In inflation adjusted terms, average weekly earnings decreased 0.6% in December 2003. In the recent recovery, real weekly earnings were a total 0.4% higher after 25 months of the recovery, compared to a typical 3.3% increase in prior recoveries. That is, earnings for workers, who have a job, have been more or less flat throughout the recovery.

The weak labor market has put significant pressures on working families. Employment is down and earnings are flat. This suggests that total household income – sum of all wage and salary income – has also been flat, amid a growing economy. While GDP has been growing strongly - 4.0% in the fourth quarter following 8.2% in the third quarter of 2003 – total wage and salary income saw meager annualized increases of 0.8% and 1.3% at the same time. Consequently, wage and salary income as share of GDP has precipitously declined for several quarters (figure 2).

At the same time, prices for important consumer items have grown faster than overall prices. Since March 2001, consumer prices rose by 5.1%. In comparison, prices for medical care grew by 12.5%, home prices by 17.4%, and prices for education increased by 19.2% during the same period (BLS 2004b; OFHEO 2003).

More importantly, these prices are increasing at a time that prices on important household items are rising, too, and employers are reducing their benefits. For instance, the share of private sector workers covered by an employer-sponsored health plan appears to be declining, as for example, large employers are reducing health insurance coverage for their employees (Glied, 2003). Further declines in health insurance coverage are likely as many employers have indicated that they would either reduce coverage or raise costs of health insurance coverage for their employees (Kaiser, 2003).

[1] The prior four recoveries are chosen to make changes in employment comparable to changes in earnings. Earnings data are only available from 1964 forward. If all post-war recoveries are considered, the average annualized employment growth during the first 26 months of a recovery increases to 3.5%.

The increase in medical costs is particular worrisome. These likely increases in out-of-pocket medical expenditures for working families come at a time when households have to also make up for reductions in other benefits out of their slow growing income. Most notably, the share of private sector workers who are covered by an employer sponsored pension plan has declined in recent years (Purcell, 2003). In 2002, only 53.5% of private sector workers, who worked full-time year-round, were covered by an employer sponsored pension plan.

Thus, although economic growth seems to be stronger, this has not translated into much more income for working families. Fewer jobs were available, income growth was slow or stagnant, and at the same time, out-of-pocket expenditures were increasing because costs for important items were rising and because employers reduced health and pension benefits.

To escape this squeeze, households borrowed more. Consumer credit, i.e. credit card debt and loans for consumer items, amounted to a record 39% of wages and salaries in the third quarter of 2003 (figure 3) (BOG, 2004; BEA, 2004). Total household debt reached a record high 115% of disposable income in September 2003 (BOG, 2004a). Despite historically low interest rates, consumer debt service burdens have remained near record highs. Since the start of the recession, the debt service burden of households has been above 13% of disposable income – a level never seen before since the Federal Reserve began collecting the data in 1980 (BOG, 2004b).

III. Failure to Provide Effective Stimulus in Past Years

The need for an effective economic stimulus was first debated in the second half of 2001, when the U.S. economy found itself caught in the first recession in more than a decade, exacerbated by the terrorist attacks of September 11, 2001. An efficient economic stimulus would have been large enough to substantially boost growth in the short-run, while being temporary, so as not to jeopardize the economy's long-term growth and economic stability. Instead, the largest fiscal policy measures, the tax cuts, in 2001 and beyond were back loaded, meaning that most of the impact would come in later years, when the economy had presumably recovered. Also, they were top heavy, i.e. they were tilted towards tax cuts for high income earners, who are typically less likely than lower income earners to spend the additional income, thus reducing the short-term stimulative effect.

Fiscal policy can come in the form of tax cuts and spending increases. The point of counter-cyclical fiscal policy, such as tax cuts or spending increases in a recession, is to ensure that stronger economic and employment growth returns earlier than it would have without policy intervention. Moreover, as growth returns, deficits incurred during the recession should decline allowing governments to repay their debt. Because fiscal policy measures in the recession and the recovery were ill-designed, growth was slower than otherwise would have been the case.

Economic policies during the recession and recovery relied heavily on tax cuts, many of which were back loaded, i.e. larger tax cuts occurred in later years than in the immediate future. The first tax cut was enacted in early 2001, totaling more than $1.3 trillion over 10 years (JCT 2001a). Although not initially intended as stimulus, the first tax cuts occurred in late 2001, when the recession was already in full swing. The estimated total for 2001 amounted to $72 billion, with $40 billion for households in the form of so-called rebate checks, and $32 billion for corporations. Thus, the recession saw less than 5% of the estimated tax cut. Further tax cuts followed under the “Economic Security and Worker Assistance Act of 2001,” totaling an estimated $157 billion over 10 years. Although $8 billion were made available for extended unemployment benefits and another $9 billion to help pay for health care for the unemployed and the poor in 2002, the vast majority, $72 billion, of fiscal losses in 2002 came in the form of tax cuts (JCT, 2001b). And when the economic recovery took longer than expected, Congress passed the “Jobs and Growth Tax Relief Reconciliation Act of 2003,” with an estimated price tag of $350 billion over 10 years (JCT, 2003). Almost half of this tax cut was due to an acceleration of tax cuts already enacted to occur in 2004 instead of later years, and another $148 billion resulted from reduced taxes on corporate dividends, mostly expected to occur between 2005 and 2008. Less than 20% of this tax cut was scheduled to go into effect in 2003, the second year of the “job loss” recovery.

Taxes were reduced substantially during the recession and the recovery. From Fiscal Years 2001 to 2003, the total cost of the federal tax cuts was approximately $264 billion (JCT, 2001, 2002, 2003). In addition, Steuerle (2003) estimates an additional $286 billion in revenue losses from reduced taxable income in 2003 alone.

Spending Increases Limited

The spending part of fiscal policy is reflected in increased government expenditures at the federal, state and local levels. Although the federal government increased its spending, it was largely in the areas of defense and homeland security. If the government wanted to help create more jobs efficiently, it could have considered temporary spending increases. Importantly, federal non-defense spending was only about half of what defense spending was during the period. Important public needs, such as renovations of schools in disrepair, could have been addressed through increased federal spending. Also, lackluster state and local government spending could have been easily augmented by increased federal aid in the form of general assistance (Sawicky, 2002). The economic consulting firm Economy.com (2003) found that providing state fiscal relief would provide a much bigger bang for the buck than the Administration’s proposals – more than 10 times that of the dividend cuts, for example.

Comparing government spending in the recent recession and recovery with changes during previous recessions illustrates the accidental character of government spending in this recession and highlights the more heavy reliance of the federal government on tax cuts, rather than spending increases in the most recent recession. Table 2 shows that government spending relative to GDP did not increase as much during this recession as it did in prior recessions. However, it grew faster in this recovery than in previous ones. Importantly, though, the rise in government spending was almost exclusively attributable to increases in defense spending, which rose relative to GDP for the first time during a recovery since the 1940s.

Tax Cuts Inefficient Stimuli Because of Back Loading and Favoring High Income

In comparison to increases in government spending, tax policy is meant to boost personal consumption and investment. There is no doubt that tax cuts helped to improve consumption during the recovery. But the stimulative effect could have been larger. First, as far as fighting a recession is concerned, tax cuts beyond the period of an employment slump serve no purpose. However, the majority of the enacted tax cuts were expected to take place after the recession and recovery were over. Thus, there is some likelihood of a negative impact on economic growth, as discussed further below.

Second, total consumption increases were comparatively small relative to the size of the tax cuts, largely because they were tilted towards higher income households. For instance, the centerpiece of the initial tax cuts in 2001 were so-called rebate checks for single filers of up to $300 and for joint filers of up to $600. However, 51 million taxpayers were not eligible for the full rebates since their incomes and their income taxes were too low (CTJ, 2001). Ultimately, only about 28% of the rebate checks were spent in the first three months[2] [3], suggesting that they were less than an effective economic stimulus, which would depend on money being spent quickly. The fact that this tax cut was largely ineffective in spurring consumption was due to the fact that it excluded many low and moderate-income earners, who would have been more likely to spend the money than higher income earners.

The propensity to exhaust one's tax cut in spending is expected to diminish with rising income. A tax cut disproportionately benefiting upper income persons provides less bang for the federal buck. For 2001-2005, 55% of the 2001 tax cut had been targeted to the top 20% of taxpayers (ITEP, 2002). If all the sunsets on cuts were removed, by 2013 the top 20% of income earners would realize 69% of tax cuts (Gale and Orszag, 2003)[4].

In comparison, the 2003 cuts were targeted directly to investment income – capital gains and dividends. One problem with this strategy is that other factors could easily offset any stimulus due to tax breaks. In particular, businesses must expect increased revenues from sales to permit them to recover their investment costs. Such expectations in a slow economy depend on consumption and employment, which remained low, and with it capacity utilization (Weller et al., 2004). The particular design of the investment-focused cuts on capital gains and dividends in 2003 was problematic

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[2] As a result of the tax rebates disposable income grew by an estimated $43.2 billion between July 2001 and September 2001. Although consumption declined in the wake of the terrorist attacks in September 2001, it quickly recovered in the months that followed. From July 2001 through December 2001, however, households spent $31.1 billion less than would have been expected given the boost to disposable income.

[3] December 2001 is chosen as the end date because additional tax cuts took place on January 2002.

[4] Many middle income families in the range of $40,000 to $60,000 received significant gains from the tax cuts as long as they were headed by married couples and had children, which excludes a substantial share of families in this income range (Greenstein 2003).

because they changed the relative returns of financial assets and therefore encouraged some portfolio adjustment, rather than increased savings. The main provisions – the dividend and capital gains tax cuts – had little to do with stimulus. Indeed, Goldman Sachs singled out the dividend provision as "especially ineffective as a stimulative measure, providing only eight cents on the dollar." Secondly, the tax cuts rewarded some savings that would have been undertaken in any event. Thus, lower costs of capital did not have the intended effect of spurring business investment (Weller et al., 2004).

There are reasons to be skeptical about the effectiveness of fiscal policy in the recent recession and recovery. Specifically, the Administration used tax cuts as their predominant counter-cyclical policy tool. However, these tax cuts were "back-loaded," i.e. they scheduled much of the revenue losses in the future, when the economy presumably is no longer in need of a stimulus. Such "back-loading" is highly inefficient as most of the fiscal effects will occur at a time, when the need for a fiscal stimulus has presumably vanished. The tax cuts were also biased towards higher-income persons, which reduced the consumption impact of the tax cuts.

IV. Large Structural Deficits Could Jeopardize Fledgling Labor Market Recovery

Fiscal efforts over the past few years were not only allocating public resources inefficiently, they also created large structural deficits, with serious repercussions for economic growth and stability. Thus, the structural deficits largely created by decisions to reduce taxes could ultimately impede a stronger labor market recovery, thus robbing middle class families of many job opportunities.

Prior to the release of the President's 2005 budget, a number of independent organizations, including Goldman Sachs, the Concord Coalition, Decision Economics and the Center on Budget and Policy Priorities were projecting deficits of more than $5 trillion for the next 10 years, even assuming a return to strong growth (Sperling, 2004). The Administration's 2005 budget is much more optimistic, but leaves out a numbers of important items. For instance, the costs of making the tax cuts permanent are excluded, which would amount to $2.2 trillion (CBPP, 2004). Similarly, granting Alternative Minimum Tax (AMT) relief would equal $658 billion for the next ten years (CBPP, 2004). Also, additional defense spending for the occupation in Afghanistan and Iraq, among other items, could total an additional $0.4 trillion in the next decade (CBPP, 2004). Thus, the total deficit for the coming 10 years could sum to $5.2 trillion (CBPP, 2004). Although the President's 2005 budget differs in a few important aspects in the short-run, the long-term costs of the structural deficits under realistic assumptions are likely to also top $5 trillion.

A fiscal policy that does not jeopardize national savings provides a sufficient pool of capital on which investors can draw, and keeps interest rates low for long-term economic growth and stability (Gale and Orszag, 2003; Rubin et al., 2004). The current outlook of continuous, massive deficits, on the other hand, threatens to reduce national savings in the long-term, thus weakening future growth and leaving a less prosperous smaller economy. Further, the specter of large structural deficits also raises the possibility of financial disarray, as confidence in the U.S. economy is lost due to economic mismanagement (Rubin et al., 2004; Sperling, 2004). Higher interest rates, fewer available funds for investments, and slower growth are likely consequences.

The perception of a fiscally unsustainable future can decrease confidence in economic management and increase the perceived risk of investing in the United States. The Bank for International Settlements (2003) issued a warning that the Bush tax cuts had "not been helpful" in promoting global confidence in U.S. public finances. Rubin et al. (2004) write, "The inability of the federal government to control the budget deficit could be interpreted as a broader failure of the nation to address its economic problems, and thus prompt a loss of business and consumer confidence, which would undermine capital spending and real economic activity." Financial analysts at the top investment banks have recently echoed the view that even now deficits have been keeping long-term rates higher than they otherwise would be (Rosenberg, 2003; Goldman Sachs, 2004). Thus, the fiscal outlook for long-term, large structural deficits may already be taking its toll on the economy, thus keeping economic growth and employment creation below its potential in the coming years.

V. Cut Backs in Programs Affect Those Already Hurt by the Job Loss Recovery

Recent budget decisions have not only created large structural deficits, fiscal cuts for fiscal year 2005 could also exacerbate the financial problems working families are in. The President's 2005 budget makes large cuts into the very programs that working families, who were hurt by the "job loss" recovery, rely on. For one, cut backs in workforce training programs make it harder for those without a job to acquire new skills that will help the in reentering the labor force when new jobs become available. In the same vein, public assistance for education has been cut in this budget, too. Second, as the weak labor market has adversely impacted families' income, they are more in need of public assistance for big-ticket items, such as housing and childcare (Boushey et al, 2001). Housing assistance has been cut back, despite home prices outpacing wage and other prices, as has been childcare assistance. Third, public support for health and pension benefits continues to shift risks onto individuals and offer greater rewards for higher income individuals than for low and moderate income families.

Non-security Discretionary Spending Already Small, yet Prime Target for Cuts

Most of the budgetary programs that working families rely on for support fall into a new budgetary category that the Center for American Progress calls Non-Security Discretionary Spending (NSD) (CAP, 2004). NSD is arrived at by taking total domestic discretionary spending and subtracting out defense, international and homeland security, and 9/11-related spending. It provides a clear picture of the magnitude by which different tax and spending policies are affecting the fiscal outlook and also offers an overall picture of our defense and security budget.

Spending for programs that matter most for working families has already been flat prior to 2005. NSD spending as a share of GDP, while somewhat higher than under the Clinton Administration, was essentially flat during the first three years of the Bush Administration. Virtually all of the increase in funding for discretionary programs is attributable to increases in our defense, international, and homeland security budgets, which rose from 3.4% of GDP in 2001 to 4.7% in 2004 (table 3).

Moreover, the President's 2005 budget reduces NSD, which will disproportionately hurt working families. The President's 2005 budget calls for a 0.1% nominal increase in funding for domestic programs outside homeland security, which translates into a real cut of 2.4% below what is necessary to maintain current services. This cut brings total NSD spending as a share of GDP back to its 2000 level of 3.2%.

It is important to keep in mind that, while the President's 2005 has targeted NSD spending for likely spending cuts, NSD is not the culprit behind the erosion of the federal government's fiscal position. The dramatic swing from surpluses to deficits we have seen since 2001 occurred while NSD spending remained virtually unchanged. We have moved from a surplus of 1.3% of GDP in 2001 to a deficit of 4.5% of GDP in 2004 – a swing of 5.8% of GDP. Yet in 2001 and 2004, NSD remained unchanged at 3.4% of GDP.

Instead, the Administration's tax cuts are the overwhelming contributor to the increase in our projected deficits. In 2005, the contribution of the tax cuts to the swing from projected surpluses to deficits is 18 times as large as the contribution of this new definition of NSD spending. In fact, the total funding for domestic discretionary programs outside homeland security will be $9 billion according to the President's 2005 budget below the CBO estimates from January 2004. In essence, the President's budget makes a conscious trade off between tax cuts for the wealthiest one percent versus providing income support to moderate and low income families (Kogan and Greenstein, 2004).

Training and Education Support for Working Families Inadequately Funded

The President's 2005 budget reduces the support for training and education programs that could help workers find new jobs when employment growth gains momentum. It is important to keep in mind, though, that the President's proposed "21st Century Jobs Initiative" to train workers for "jobs of the future" does nothing to create new jobs. Importantly, though, the president's proposed $250 million to fund education and training by community colleges is a pittance relative to need. The nation's community colleges have been hammered by the states' fiscal crises. California and Florida alone have cut enrollments by more than 90,000 (AACC, 2004). The president's community college proposal would support education and training for roughly 60,000 students nationwide (based on the maximum Pell Grant of $4,050) – just two-thirds the number of slots already cut in two states alone.

Other education programs, both at the primary education level and for college education, are also inadequately funded, adding to pressures on working families.

Employees need to acquire new skills to remain competitive in a rapidly changing labor market with currently few job opportunities. Simultaneously, rising education costs are increasing the demand on their pocket books, when public support is waning.

Despite rhetoric to the contrary, the Administration is leaving millions of children behind with respect to education by failing to fully fund the programs he signed into law in the No Child Left Behind Act ("NCLBA"). The President's FY2005 budget will contain $9.4 billion less than his own pledge of funding for NCLBA (CAF, 2004) and over $7 billion less than what was authorized for Title I, the program designed to eliminate achievement gaps between groups of students (CDF, 2004). The President's 2005 budget also eliminates funding for 38 existing education programs and level funds critical programs such as after-school care and rural education (CDF, 2004).

Despite the funding crisis in public schools, the President has proposed diverting millions of dollars in federal resources to voucher proposals that exempt private schools receiving federal funds from the same accountability in the No Child Left Behind Act. These failed promises come at a time when state and local communities are struggling with the worst budget shortfalls since WWII, leading to reductions in instruction time and lay offs of quality teachers and school staff. For example, over half of Iowa's school districts have already laid off teachers or support staff, increased class sizes or cut back or delayed purchases of books and technology. Ohio, a leader in state funding for early childhood education, has eliminated more than one third of its Head Start slots, with 6,238 fewer children being served and dozens of teachers laid off across the state.

It is not only primary education that gets short-thrift from the President's budget, but also college education, contributing to the financial pressures for working families. The President's budget once again fails to deliver on a promise to increase federal college scholarships or Pell grants for millions of students in need. Instead, it freezes the maximum grant award and proposes further cuts or freezes in student aid sources (King, 2003). While the President's 2005 budget proposes an increased Pell grant for some students taking a certain course of study, this proposal is capped so that less than three tenths of 1 percent of all college students (33,000 of 15.8 million) will have access to it (Kronholz, 2004).

Having attempted to cut the maximum Pell Grant from $4050 to $4000 in his fiscal year 2004 budget, President Bush now proposes to freeze the maximum Pell Grant at $4050 in fiscal year 2005, ignoring the declining buying power of the grants (Kronholz, 2004). The 2002-03 maximum Pell Grant was worth $500 less than the maximum Pell grant in 1975-76 (adjusted for inflation). The Administration points to an overall increase of $856 million for Pell, but most of that money will be used to address the projected increase in recipients (Kronholz, 2004). This amount does nothing to increase the maximum awards and just begins to cover the $2.5 billion shortfall in funding for the current academic year (projected to increase to 3.7 billion by the end of 2004-2005) caused by increasing numbers of eligible students – in large part due to a failing economy – without commensurate increases in funding (Kronholz, 2004).

Reductions in support for college bound students could not come at a worse time. Tuition and fees at colleges have risen by as much as 40 percent in some states (College Board, 2003). Students are taking on high student loan debt levels ($17,000 on average), working long hours that hurt their academic and overall college experience, or forgoing college altogether (Boushey, 2003). According to a recent report by the Congressional Advisory Committee on Student Financial Assistance (ACSFA), more than 4 million high school graduates will not attend a four-year college and 2 million will attend no college at all due to financial barriers (ACSFA, 2004). In other words, middle class families are feeling the squeeze between low income growth and high cost increases, so that their opportunities to get good jobs in the future are reduced.

Public Support for Housing and Childcare Reduced

As working families find themselves in a bind, public support for housing and childcare, the two biggest cost items for households, is being reduced in the President's 2005 budget.

The President's 2005 budget cuts Section 8 housing assistance by $789 million to $18.5 billion, intensifying the unmet need for affordable housing. Although the dollar amount cut is $789 million, because of rising costs, this actually represents a cut of $1.75 billion from the amount needed to keep serving currently assisted families (CDF, 2004). As a result, as many as 150,000 families with children will be denied Section 8 vouchers at a time when housing costs have risen significantly. Of the 2 million households that receive Section 8 rental vouchers, 52% are families with children, making Section 8 the main source of housing assistance for low-income children. Under current funding levels, only about one-fourth of eligible households receive vouchers, leaving three out of four to struggle with the high costs of housing. According to a survey by the U.S. Conference of Mayors, emergency shelter assistance increased by an average of 13% in the 25 cities surveyed in 2003. Of the 25 cities, 80% expect requests for shelter by homeless families with children to increase. Families with children comprise 40% of the homeless population, and unaccompanied youths make up 5% (U.S. Mayors and Sodexho, 2003).

Further, the President's 2005 budget funds after-school programs at only half the $2 billion promised in the President's education reform law (CDF, 2004). Proposed level-funding at $999 million leaves behind 1.32 million children who should receive after-school services (CDF, 2004). Every afternoon, the parents of as many as 15 million boys and girls worry that their children have nowhere to go for safe, educational, adult-supervised activities (CDF, 2004). These hours between the school bell and the dinner bell are when children are most likely to be using illegal substances or to become victims of violent crime (CDF, 2004).

Working families will feel the pinch from the President's 2005 budget not only from reduced public support for housing, but also from cuts to childcare programs. By the Bush Administration's own estimates, their budget would slash at least 200,000 children from the childcare rolls by 2009, neglecting the child care needs of low-income working parents. The President's budget proposal last year resulted in at least 100,000 children losing assistance, for a total of 300,000 children cut off as a result (CDF, 2004).

There is significant evidence, however, that the assessments produced by the White House underestimate the number of children who will lose child care assistance. The Center for Law and Social Policy and the Center on Budget and Policy Priorities estimate that as many as 447,000 children stand to lose child care assistance by 2009, based on the Bush budget's proposed funding levels (CDF, 2004).

The cuts to housing and childcare come at a time, when low and moderate income families are struggling. In the last three years, the number of jobless parents has risen by nearly 2 million and the number of parents unemployed longer than six months has tripled. Moreover, the failure of Congress to renew emergency extended unemployment compensation meant that record numbers of jobless workers ran out of unemployment benefits in January (Shapiro, 2004).

Cuts to Health Insurance and Ineffective Pension Reforms Amid Fewer Employer Sponsored Benefits

The President's 2005 budget's handling of health insurance and pension issues is characterized by three factors. First, it could limit funding and possibly even reduces it. Second, it cements the shift of risks from employers to employees. Third, it offers additional tax incentives for high-income earners, who are least likely to require additional support.

First, the President's budget undermines existing federal health insurance efforts. More than 40 million children and poor adults who rely on the Children's Health Insurance Program and Medicaid would also face severe cutbacks due to the President's continued push for block grants and the failure to reauthorize much-needed funding. This will make it harder for cash-strapped states to sustain health services for the poor (CBPP, 2003; Families USA, 2004).

Second, the risks inherent in preparing for eventual illnesses or retirement are increasingly shifted to individuals. The President's budget cements this trend in a number of ways. For instance, the budget includes proposals for individual tax credits. These $2,000-3,000 tax credits for family health coverage, which often cost $10,000 or more, will still leave health insurance unaffordable (Families USA, 2004). Meanwhile, these tax credits may result in employers dropping coverage and some workers who have coverage today to join the ranks of the uninsured. Further, the President's 2005 budget includes a proposal for Association Health Plans (AHPs). AHPs, which allow small employers to band together to purchase health insurance and which exempt them from state insurance laws, will lead to greater discrimination against sick and disabled people. Today, state laws protect against discrimination in the sale of health insurance and the proposed AHP legislation would nullify those protections (CAP, 2004; Families USA, 2004).

Third, the President’s budget creates new tax incentives for higher income earners, who are less likely to need them, to gain health insurance or pension coverage. For one, the budget includes additional funds for Health Savings Accounts (HSAs). Over the next 10 years, the federal government would forego tax revenues to create such accounts to the tune of $24.7 billion in addition to spending for HSAs already included in the recent Medicare bill. This proposal provides tax cuts for the wealthiest and healthiest Americans and will do little for the many millions of others who cannot afford high-deductible insurance policies (Families USA, 2004).

The 2005 budget revives the President’s proposal for Lifetime Savings Accounts (LSAs) and Retirement Savings Accounts (RSAs), albeit in modified form. Individuals would be allowed to contribute up to $5,000 annually before taxes. Capital income accruals and withdrawals from these accounts would be tax free. These accounts would favor higher income individuals, who can expect higher tax rates in retirement than lower income individuals. Also, since the proposals allow small business owners to contribute larger amounts to tax advantaged accounts than existing accounts, it stands to reason that small business owners will likely abandon existing retirement plans, thus adversely impacting low and moderate income households (CAP, 2004; Engen and Gale, 2000).

Conclusion

The President’s 2005 budget negatively affects working families in a number of ways. Budgetary decisions in prior years were inefficient in preventing or at least moderating the “job loss” recovery. This was largely because they emphasized back-loaded, top heavy tax cuts in later years over temporary spending initiatives that could have offered the economy more immediate relief.

The President’s 2005 budget responds to the growing budget deficits that resulted from large tax cuts by cutting a number of programs outside of defense and homeland security. In fact, government discretionary spending outside of defense, homeland security and related items is slated to decline from 3.4% of GDP in 2004 to 3.2% of GDP in 2005. The reason for this drop is partly that the Administration’s current proposal cut a number of programs that are important for working families. These programs could help working families to navigate between slow income growth and rising costs.

Further, the budget also jeopardizes a fledgling recovery in the labor market, as large structural deficits loom. These large deficits can ultimately result in higher interest rates, lower national savings, and thus smaller investments and less growth, followed by slower employment growth and reduced living standards.

Working families have lived through the worst labor market recovery in any recovery since WWII. Policymakers should focus on easing the burden of working families by creating good job opportunities and through adequate funding of important government programs. At the same time, policymakers should make serious attempts to rein in large structural deficits that otherwise could put growth and economic stability in jeopardy in the medium-term.

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Tables and Figures:

Table 1
Household Variables in Historical Perspective

	During Recession Mar. 01 – Nov. 01	Current Recovery Nov. 01 – present	Prior Recoveries (Average)
Total Non-farm Employment (total change)	-1.2	-0.6	6.2
Manufacturing Employment (total change)	-6.6	-9.6	5.1
Real Hourly Earnings Growth			
Total Change	1.4	1.3	2.4
Average Monthly Change	2.0	0.6	1.1
Real Weekly Earnings Growth			
Total Change	0.5	0.4	3.3
Average Monthly Change	0.8	0.2	1.5
Average Weekly Earnings, Current Dollars (total change)	1.2	5.1	12.2
Consumer Price Index (total change)			
All Items	0.8	4.3	9.2
Medical Care	3.0	9.3	15.3
Education	4.2	14.4	N/A
Real Wage and Salary Disbursements (total change)	-1.2	0.5	9.2
Consumer Debt as a Percentage of Wages and Salaries (period average)	35.8	38.0	25.2

Notes: All figures are in percent Prior recoveries refers to the average change of the first 26 months of the prior four recoveries, which are chose to make changes in employment comparable to changes in earnings. If all post-war recoveries are considered, the average annualized employment growth during the first 26 months of a recovery increases to 3.5%. Education cost data has only been collected since 1993 and therefore are not included in the prior recovery section. Wage and CPI data exist only through December 2003 and are for the first 25 months of the recovery. Sources: Bureau of Labor Statistics, Current Employment Survey; Consumer Price Index – Urban Consumers; Bureau of Economic Analysis, National Income and Product Accounts; Board of Governors, Federal Reserve System, Flow of Funds Accounts for the United States.

Table 2
Government Spending during Recessions and Recoveries, 1947 to 2003

Recession date	Federal government		Federal defense		Federal non-defense	
	Recession	Recovery	Recession	Recovery	Recession	Recovery
1948:IV-1949:IV	0.7	2.3	0.2	3.5	0.5	-1.2
1952:II-1953:II	-2.0	-2.6	-1.6	-2.3	-0.4	-0.2
1957:III-1958:II	0.8	-0.8	0.4	-1.2	0.4	0.4
1960:II-1961:I	0.5	0.4	0.4	-0.1	0.0	0.5
1969:IV-1970:IV	-0.6	-0.6	-0.7	-0.8	0.1	0.2
1973:IV-1975:I	0.5	-0.7	0.2	-0.5	0.3	-0.2
1980:I-1982:IV	1.4	-0.30	1.3	-0.1	0.1	-0.2
1990:III-1991:I	0.4	-0.5	0.3	-0.6	0.1	0.1
2001:I-2001:IV	0.3	0.9	0.2	0.7	0.1	0.1
Average all prior recessions	0.2	-0.4	0.1	-0.3	0.1	-0.1

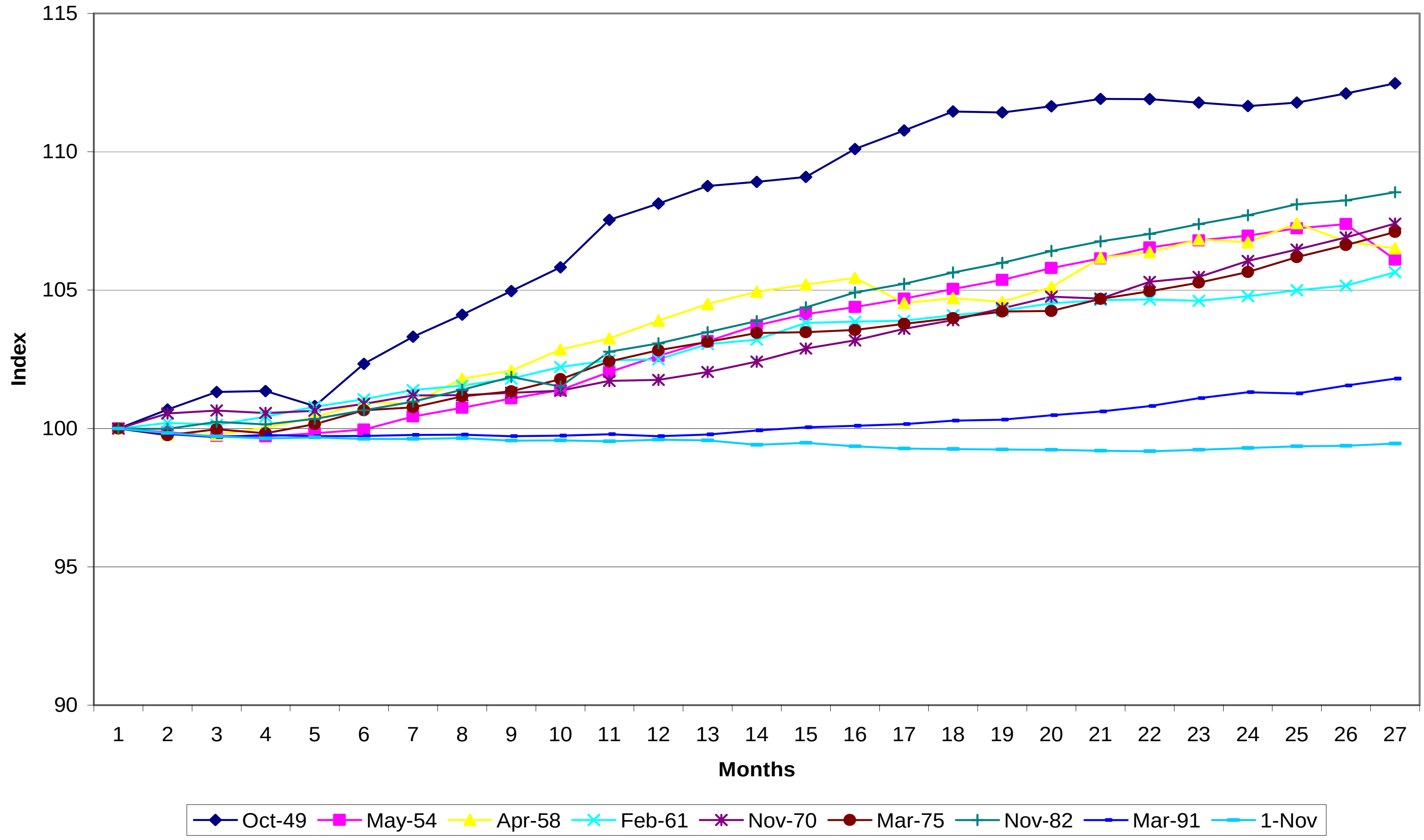
Notes: All figures are percentage point changes. For recessions, the change is the actual percentage point change from the peak to the trough relative to GDP. For recoveries, the change is the percentage point change relative to GDP during the first six quarters after the trough of the business cycle. The average for all prior recessions, excludes the data for the most recent recession.
Source: ?

Table 3
Non-Security Discretionary (NSD) Spending as Share of GDP, 1995 to 2005

	Defense, International, Homeland Security, and 9/112 Relief*	Non-Security Domestic Programs
1995	4.0	3.4
1996	3.8	3.2
1997	3.6	3.2
1998	3.5	3.1
1999	3.5	3.2
2000	3.4	3.2
2001	3.4	3.4
2002	4.3	3.5
2003	4.8	3.5
2004	4.7	3.4
2005	4.0	3.2

Note: Total domestic discretionary spending is adjusted to include funding for discretionary transportation programs and to remove year-to-year distortions due to funding anomalies. In addition, supplemental appropriations for FY 2001 are included in FY 2002, in order to attribute them to the Administration under which they were enacted. These adjustments follow the methodology of a Center on Budget and Policy Priorities report from 12/31/03 – see appendix to that report for more details.
* Domestic homeland security figures for 2001 through 200 are estimates based on OMB and data. For years prior to 2001, homeland security figures are estimates based on the Administration's 2002 report "Securing the Homeland, Strengthening the Nation." Figures on Post-9/11 funding for NYC and airline relief are from Senate Budget Committee Democratic Staff, "What Has Caused Growth in Discretionary Spending?" (May 5, 2003). Historical figures have been updated to incorporate newly available Administration data associated with the President's budget release. The Administration data show a lower level of total homeland security spending in 2001 than CBO had estimated in their Economic and Budget Outlook. Since our estimates of homeland security funding in 1995-2000 are benchmarked off of the 2001 level, using the new estimate has slightly lowered our estimates of homeland security funding in those years (and therefore slightly raised our estimates of NSD funding).

Figure 1: Employment During Recovery, 26 Months Out

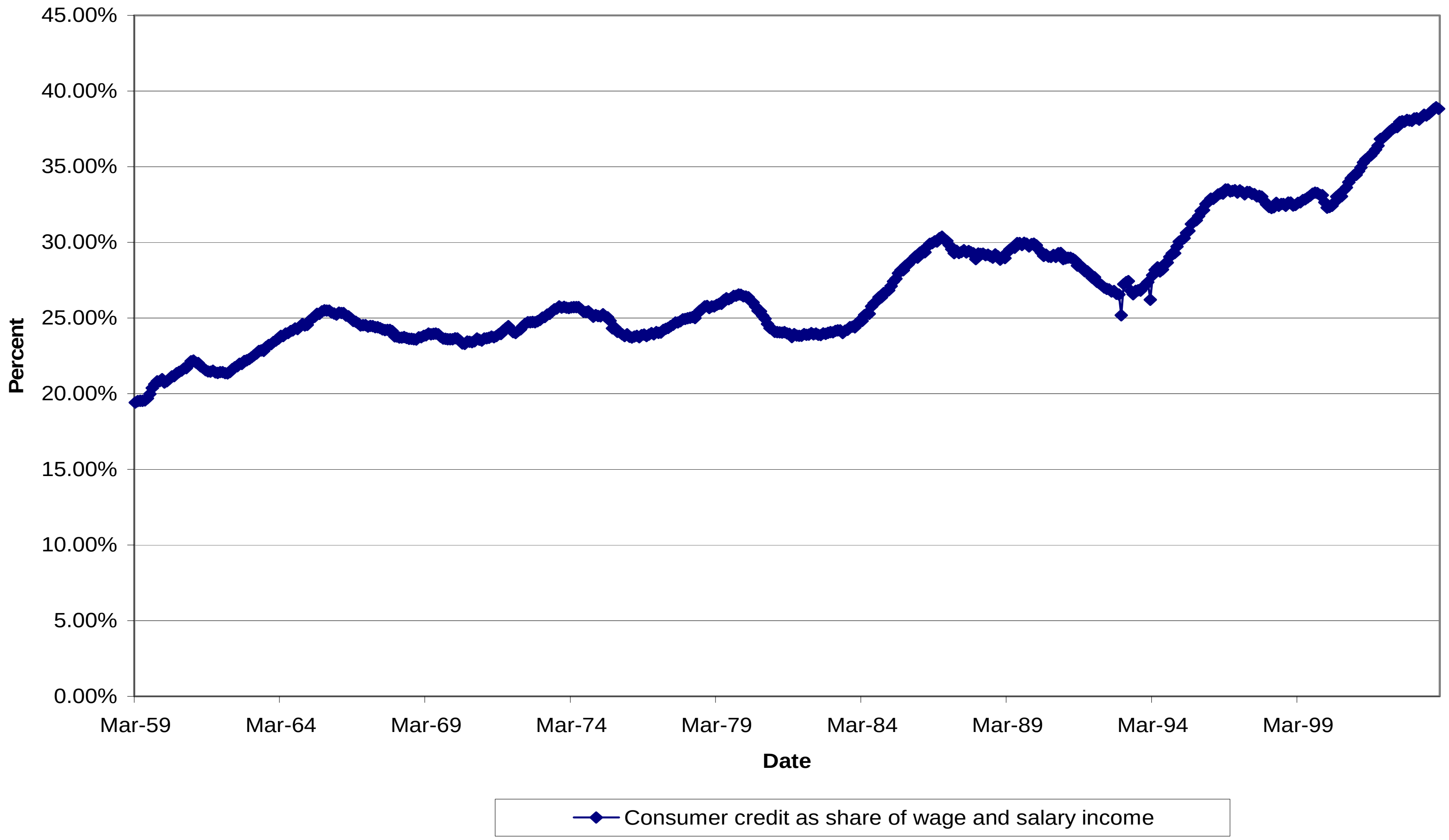


Source: Bureau of Labor Statistics; Non-farm Employment.

Figure 2: Wages and Salaries Relative to GDP, 1947 to 2003

Source: Bureau of Economic Analysis, National Income and Product Accounts

Figure 3: Consumer Credit as Share of Wage and Salary Income, 1959 to 2003



Source: Board of Governors, Federal Reserve System, Consumer Credit; Bureau of Economic Analysis, National Income and Product Accounts.