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Twelve Things to Look For in President Trump's First Budget

Now several weeks into his administration, President Trump must quickly turn his attention to converting past promises, which lacked detail, into his first budget for the coming fiscal year. While presidential budgets are advisory to Congress, Republican control of both the House and Senate means that his proposals are likely to receive serious consideration. Moreover, careful scrutiny of this budget is important because history has shown that the priorities set in the first budget of a new administration tend to influence fiscal policy decisions for the next several years.

With that in mind, here are 12 questions that Trump's economic team, congressional policymakers, the media and the public should be thinking about.

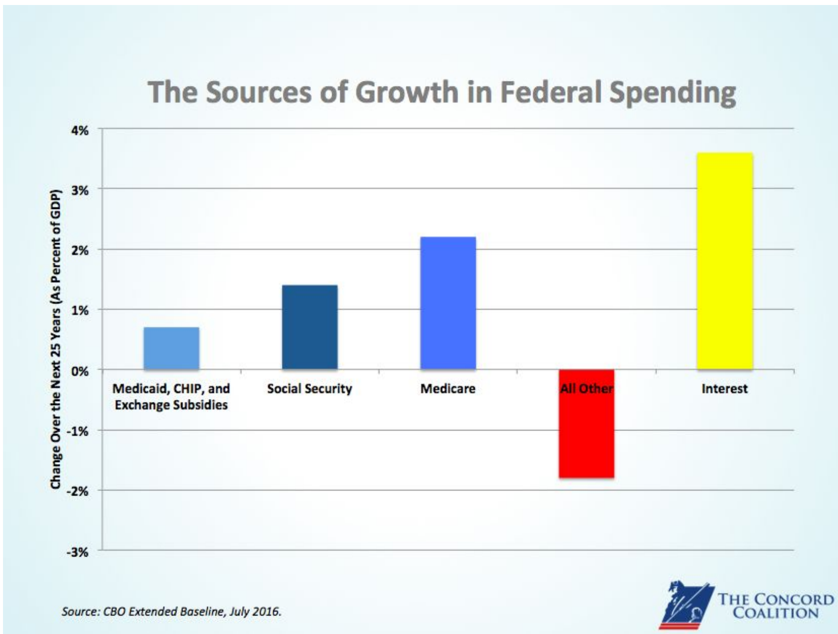
1. What is the overall fiscal target?

Without a fiscal policy target to guide decision-making, a presidential budget is nothing more than a random compilation of proposals that may or may not address our nation's fiscal challenges. Having such a goal requires policymakers to set priorities and make the necessary trade-offs.

President Trump's first budget will be presented against a backdrop of rising deficits under current law and a national debt headed steadily higher as a share of the economy. The driving forces behind this unsustainable outlook are well known: Population aging and rising health care costs are causing major benefit programs such as Medicare, Medicaid and Social Security to grow faster than both the economy and federal government revenues. It will be important that Trump's overall proposal deals with this structural mismatch.

The Obama administration's recent budgets were aimed at stabilizing the debt as a share of the economy. House Republicans have in the past aimed for a more ambitious goal of balancing the budget within 10 years, but they have more recently debated scaling that back to targeting a debt-to-GDP ratio in the future.

Trump could choose these goals or come up with a new one. But the budget should have a clearly defined goal -- one that addresses the long-term sustainability challenge -- along with a set of proposals that would credibly achieve that goal.



2. What will the budget recommend regarding repeal of the Affordable Care Act (ACA) and its replacement?

During the campaign Trump promised a full repeal of the ACA. He also suggested a set of replacement policies that he now says should be enacted along with ACA repeal. Whether, and how, his budget accounts for these promises will be a crucial test of the new administration's interest in fiscal responsibility.

While past Republican congressional budgets have included placeholders for ACA repeal, they haven't incorporated a full budgetary accounting of that repeal. They have included the deficit reduction from eliminating insurance subsidies and from cuts to the Medicaid expansion. They have not, however, incorporated the costs of repealing the ACA's revenue-raisers and Medicare cuts. The latest budget resolution, which was passed by both the House and Senate in January, included broad instructions for ACA repeal but did not specify any details.

Presidential budgets are typically more comprehensive than congressional budgets -- all the more reason why the new administration should make the full budgetary impacts of repeal and replacement explicit.

When the Congressional Budget Office (CBO) last scored full ACA repeal in 2015, it projected repeal would add between $137 billion and $353 billion to deficits over ten years, depending on economic feedback, with the amount growing after that.

Accounting for replacement plans will be even more important than accounting for repeal. That is because there are more unknowns in the trade-offs and policy changes being contemplated. While the CBO was heavily involved in analyzing the policy choices debated during the ACA's passage, the ideas being promoted by House and Senate Republicans for replacing it have not included enough detail for CBO to analyze their budgetary impact. At this point, there are even fewer details for the proposals from President Trump.

The fiscal implications of replacement, the potential disruptions to the health care system, and the effects on the health and financial well-being of millions of individuals around the country cannot be fully understood if a replacement proposal is not scored and accounted for properly and at the same time as repeal proposals.

3. Will the budget propose additional measures for controlling health care costs?

Increasing health care spending is the largest programmatic driver of the long-term fiscal challenge. Such spending is projected to increase primarily because of the aging of the population and the resulting increase in beneficiaries for health insurance. The other important contributor to spending growth is health care inflation, with health care costs growing more quickly than the economy.

This problem is projected to become more important the further into the future one looks. Such inflation is a problem for government budgeting as well as the private sector and individual wage growth.

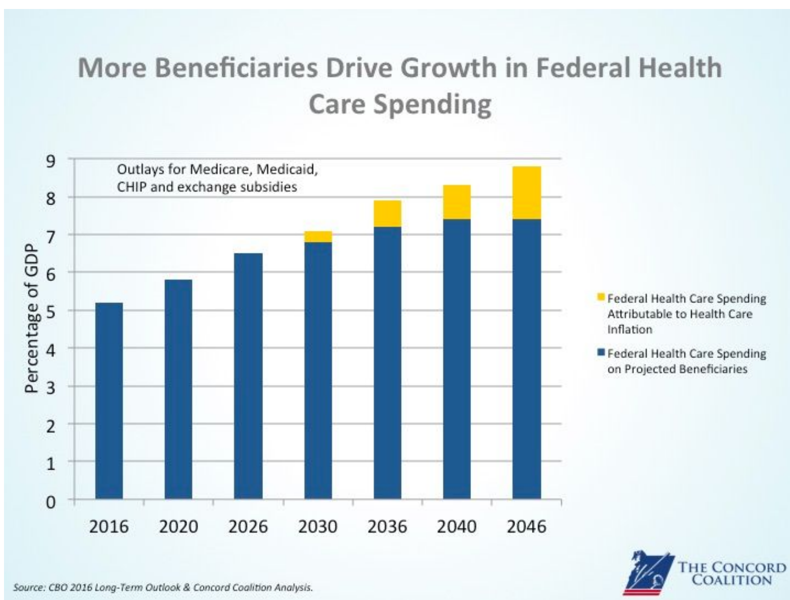
The ACA included numerous reforms designed to slow the growth of health care costs both in government programs and the private sector. Congress also recently passed bipartisan legislation designed to push down the growth of health care spending by shifting provider payments from being based on volume to being based on value.

The extent to which these reforms have already slowed the growth of health care costs -- or will slow them in the future -- is up for debate. What is clear is that cost growth has recently slowed, that projections for future federal health care spending have shrunk by significant amounts, and that nearly all health care experts believe more needs to be done to slow health care inflation.

Were ACA repeal to include cost-reduction portions such as the changes to Medicare provider payments, to the Medicare Innovation Center's tests of cost-control strategies, and to the "Cadillac Tax" on high-cost insurance, the Trump administration would need to propose other strategies for reducing health care inflation. Its proposals should tackle the underlying force of health care cost growth, not simply reduce the number of people with insurance or increase beneficiary cost-sharing. This will be an important marker for how serious the administration will be about lowering health care inflation in the future.

However, even if the Trump budget kept the ACA's cost-control efforts and their savings in place, the administration would still need to define what other policies it intends to pursue to bolster health care cost control. For Medicare alone, spending is projected to grow by over 80 percent in the next 25 years, and that assumes current cost-control efforts will continue.

To date, there has been very little discussion or details about how the Trump administration would tackle that problem -- and the budget might be the public's first opportunity to assess the new president's plan.



4. What specific tax cuts will be proposed and what are the likely revenue effects?

Based on campaign promises, tax-policy changes are likely to be the greatest source of deficit increases early in the Trump administration. However, the nature of these changes and their magnitude are difficult to discern because of the vagueness of the campaign proposals and the fact that even the limited details were altered at times.

Trump's campaign advisors pointed to a Tax Foundation estimate that the revenue loss from their tax cuts would be $4.4 trillion scored on a "static" basis (meaning without estimating the growth feedback on the overall economy of lower tax rates). The Tax Foundation itself claims that when including Trump campaign language related to the taxes paid by certain corporate structures, the static cost of the cuts is closer to $5.9 trillion.

Trump promises very positive economic feedback. However, even when the Tax Foundation applied a "dynamic" analysis to his plan -- assuming economic feedback in a model much more positive than what the Treasury Department or congressional Joint Committee on Taxation have used in the past to dynamically score proposals -- the revenue loss from the tax cuts would still be $3.9 trillion.

During the campaign, Trump's advisors asserted that the potential revenue loss would be offset by the economic effects of other policy changes in areas such as trade and regulation. The budget will be the administration's opportunity to put all of the changes together and project the economic and budgetary impact.

It is natural for every presidential administration to assume that its policies will have a positive impact on the economy. The Trump administration's first budget, however, should not rely on overly rosy growth assumptions and untested economic assertions to make the numbers work. Such things damage the credibility of the budget process and sidetrack the legislative debate.

The projections should follow recent bipartisan convention and be based on standard economic models and theory. This will ensure that accounting for the President's proposals will follow similar numbers to those used in the congressional legislative process. It will also allow the American people to better understand the impact of the budget's policies.

5. What recommendations does the budget make regarding existing spending caps set in the Budget Control Act of 2011 (BCA)?

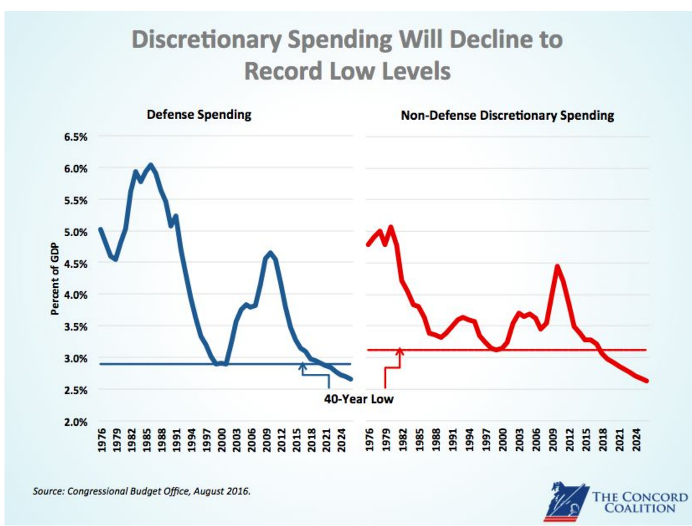
The level of spending on annual defense and non-defense appropriations (i.e., "discretionary spending"), which makes up about one-third of the budget, is currently subject to spending caps that were put in place as a deficit-reduction measure in the BCA.

These caps are very tight and extend through 2021. If adhered to, they would reduce discretionary spending to its lowest level as a share of the economy since this statistic was first tracked in 1962. In fact, these caps were never intended to go into effect. They were inserted into the BCA as a back-up plan to reduce the deficit if Congress and the Obama administration failed to agree on a better way to reach the deficit target.

The austere caps have proven problematic for passage of appropriations legislation, so Congress has twice enacted bipartisan agreements to increase discretionary spending while finding other measures to offset the costs. The last of those adjustments ends with the appropriations bills for the current fiscal year (2017). Appropriations under the first Trump budget are scheduled to be governed by the original BCA caps, which would impose a virtual freeze in Fiscal Year 2018 for both defense and non-defense programs.

President Trump confronts the decision of whether to recommend that the caps be retained as they currently exist, changed to provide partial relief, or removed completely. On the campaign trail, Trump indicated a desire to remove the cap for defense spending but not for other spending. Aside from the political difficulties this strategy might encounter, some of his own domestic discretionary spending proposals -- particularly his immigration proposals -- could necessitate lifting the non-defense cap.

It is understandable that many lawmakers on both sides of the aisle might wish to change the original caps, allowing for greater investment in various high-priority programs. It is important to keep in mind, however, that the caps were put in place to enforce a bipartisan deficit-reduction agreement. Even with these caps in place, the deficit is still projected to grow substantially in the coming years. So if the administration wants to adjust the BCA caps, it should look for offsets to cover the added spending.



6. How much will be budgeted for infrastructure and where will the money go?

A key part of the Trump campaign's policy agenda was to significantly increase investment in infrastructure.

How these investments will be financed is one big question the budget should answer. The simplest option could be direct spending by the federal government or grants to states. Other approaches could put more focus on the private sector, such as using an infrastructure bank or tax incentives for businesses that develop toll roads and other revenue-generating projects. Which of these mechanisms the Trump budget employs will impact the kind of infrastructure developed, the costs incurred, and the efficiency with which budget resources are utilized.

Another big question is whether priority will be given to new projects or to repairs on existing infrastructure. Numerous studies, including one published by the Brookings Institute, have found that repairs provide far more bang-for-the-buck in terms of greater transportation efficiency and long-term economic growth.

7. How much will be spent on increased border enforcement, including construction of a border wall?

Two core Trump campaign promises were to build an "impenetrable physical wall" on the country's southern border and to remove undocumented immigrants.

The full costs of fulfilling these promises are unknown. At one point during the campaign, Trump estimated the cost of the wall at $10 billion to $12 billion, but many experts suggest the figure could be much higher. The Massachusetts Institute of Technology Review, for example, estimates that the wall could reach a cost of $27 billion to $40 billion. More recently, an estimate by the Department of Homeland Security concluded that constructing the wall would cost more than $21 billion.

While the campaign also suggested Mexico would pay for the wall, Mexican leaders have indicated otherwise. Trump's budget will be an opportunity to see the extent to which the administration will locate other offsets for the cost of the wall aside from a proposal to impound remittances to Mexico, a plan that would likely be insufficient and difficult to fully implement.

The costs to expel undocumented immigrants would depend on how many would be deported and how quickly it would be done. Trump's recent remarks on the subject indicate his plans are in flux and could involve fewer deportations than were talked about during the campaign.

8. What will the budget recommend for war spending?

While the Defense Department's base budget is subject to spending caps imposed by the Budget Control Act, spending for the Overseas Contingency Operations fund (OCO), which essentially covers war-related costs, is exempt from the caps to provide flexibility in responding to military crises. In recent years, however, the OCO has been abused to simply get around the spending caps.

Trump's budget could continue or even exacerbate this trend by putting more basic defense items, such as rising personnel costs, into his OCO request. Alternatively, he could propose to lift the defense caps and restore the firewall between base defense costs and war-related spending. Restoring the integrity of the OCO could go a long way towards fiscal transparency; further reliance on it as a gimmick to postpone hard choices would be a mistake.

9. Will specific recommendations be made on cutting "waste, fraud and abuse"?

During the primary and general election debates, Trump proposed lowering budget deficits by eliminating "waste, fraud and abuse."

The first Trump budget should make clear how much he intends to save and how those savings will be achieved. There is no line-item in the budget labeled "waste, fraud and abuse" that the president can simply cross out. And people often vehemently disagree on what belongs in this category. What some call waste may seem to others like valuable government services and initiatives.

From a fiscal standpoint, the focus should be less on small budget items than on areas where reforms would produce significant efficiencies and savings. As a simple illustration of the country's fiscal challenges, balancing the budget by 2026 would require Congress to close a gap of more than a trillion dollars in that year alone -- roughly equivalent to all projected defense and non-defense discretionary spending. So more than cutting waste will have to be done.

While improving efficiency and combating fraud would be helpful and could save some money, it would not be a sufficient strategy for fixing the long-term fiscal challenges facing the nation. Even substantial savings from cutting waste, fraud and abuse would mostly provide one-time gains that would not alter the basic structural nature of the government's projected deficits.

Trump also suggested during the campaign that -- despite warnings from the Social Security trustees of trouble ahead -- no changes would be needed to close that program's growing financing gap beyond cutting fraudulent or wasteful payments. The budget should include a specific analysis of how much could be saved in this regard.

An analysis by the Social Security Administration estimated a total share of improper payments in Fiscal 2015 of approximately $5 billion, a portion of them underpayments. In total, these improper payments represented just over half of 1 percent of the entire program. Even eliminating all of them would not come close to closing the program's total funding gap.

10. What will the budget recommend regarding the federal debt limit?

The statutory debt limit is not an effective check on the growth of government debt. It is overdue for reform. As stated by the Government Accountability Office: "While the debt limit restricts Treasury's authority to borrow, it does not restrict Congress's ability to enact spending and revenue legislation that affects the level of debt or otherwise constrains fiscal policy."

Currently, the debt limit is suspended. On March 16, however, it will return at whatever level the debt happens to be on that date.

The Treasury Department will be able to fend off immediate consequences and continue borrowing for a while by resorting to what it calls "extraordinary measures." At some point next summer or fall, though, these measures will run out, forcing the government to default on at least a portion of its obligations.

To avoid default and its harmful consequences to world financial markets, Congress will need to raise the debt limit or suspend it again. This will be true no matter what Congress or the administration might propose for the Fiscal 2018 budget; no plausible set of tax and spending proposals could prevent the debt from rising over the next few years. Even last year's House Republican budget, which took a very aggressive approach to spending reduction, would have required a debt limit increase.

If Trump's budget acknowledges the need for action on the debt limit, it would send a positive signal to financial markets that the new administration intends to uphold the full faith and credit of the United States government. Failure to request action on the debt limit would leave this commitment in doubt.

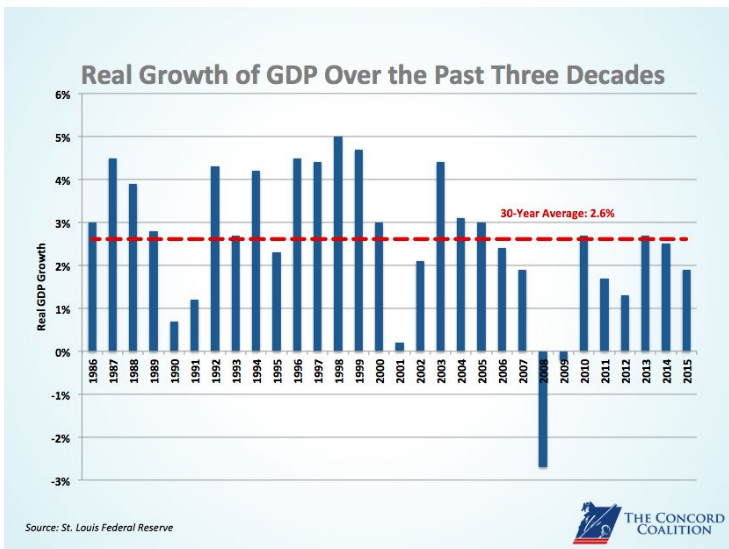
At a minimum, the Trump budget should contain a request to raise the debt limit enough to cover projected borrowing needs through 2018.

The nation's creditworthiness must not be left in doubt. As stated in the 14th Amendment to the Constitution (Section 4): "The validity of the public debt of the United States…shall not be questioned."

11. What economic growth rates will the budget assume?

On the campaign trail, Trump frequently asserted that his policies would unleash economic growth of 4, 5, or even 6 percent per year. If so, such growth would allow the federal government to run a substantially higher deficit than we have today without increasing the nation's debt-to-GDP ratio. There is, however, no evidence to suggest that such growth could be sustained, and only slight evidence it would be possible even for a very short time.

Consider that only once in the past three decades has GDP grown at 5 percent. The 30-year average GDP growth rate has been a far more modest 2.6 percent per year -- well below what would be needed to stabilize the nation's debt-to-GDP ratio if Washington enacted the policies Trump proposed on the campaign trail.



That is why the economic assumptions in Trump's first budget are so critical; artificially inflated growth assumptions can make an unsustainable budget appear sustainable. If economic assumptions prove to be unrealistic, so too will the budget's projected levels of debt-to-GDP.

12. Will scoring gimmicks be used to mask the long-term costs of new spending or tax initiatives?

Presidential and congressional budgets often use scoring gimmicks to make the bottom line look better than it really is. Overly buoyant economic assumptions are a subtle gimmick. Others are far more blatant, such as shifting costs outside the budget window to make them disappear or using one-time savings to "pay for" permanent costs.

A fiscally responsible budget must be based on realistic, attainable assumptions and refrain from the use of procedural gimmicks to hide costs or circumvent budgetary limits. Estimates of current-law deficits and the savings achievable through proposed policies should not be overly optimistic. The projected costs or revenue losses of ongoing policies, such as war spending or repeatedly renewed tax breaks, should be fully accounted for.

The same is true for new proposals in the budget. Preferably all of them will follow the pay-as-you-go principle, meaning that they will not increase cumulative deficits.

A budget should not rest on the assumption that a future Congress and a future president will enact deeper domestic spending cuts than the current Congress and president are willing to enact. The American public deserves a credible budget plan that won't simply delay difficult decisions.

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