

by Gene Steuerle

Reversal in Budget Policy: Bush's First vs. Proposed Second Term

Much of the discussion over President Bush's 2004 submission of a proposed budget for fiscal year 2005 and beyond has focused on what it is not. It is not an agenda for major reform. It is not a budget that Congress appears to take seriously, especially given the number of days it is scheduled to be in session for 2004. It is not likely to achieve stated deficit goals, since many items such as the cost of the war in Iraq are not accounted for. It is not complete, since it leaves open major questions such as what the administration proposes to do about the alternative minimum tax and subsidies to replace those formerly provided for exporting companies.

Here, however, I wish to take the budget at face value and to see what preferences are revealed in it. The one outstanding conclusion is that the budget proposes a dramatic reversal of expenditure and tax policy in almost every single budget category other than health care.

The figure below shows the change, as a percentage of gross domestic product, in the amount of revenues and expenditures between fiscal 2001 and 2005, and then the proposed change between fiscal 2005 and 2009. As can be seen, the president wants to project a decline in the deficit as a percentage of GDP. To achieve this, he suggests that revenues be allowed to rise and that expenditures be allowed to fall relative to the size of the economy — in many ways the types of changes that prevailed in the deficit-reduction years of the 1990s.

Revenues increase? Yes. Basically, people will experience significant "bracket creep" onto the alternative minimum tax. This was scheduled by the way that 2001 and 2003 legislation was passed without adjustment in AMT rates when ordinary rates were reduced. Other real bracket creep will continue in the regular income tax, while items like the child credit were deliberately scheduled to fall in value by not being adjusted for inflation. Thus, despite proposals for some

further tax cuts in a few areas like energy and charitable incentives, the budget counts on tax increases to help reduce deficits.

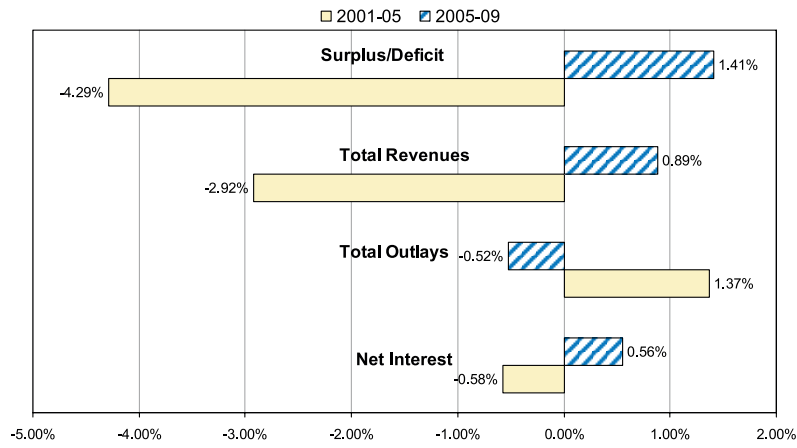
When it comes to expenditures, as noted, almost every major category in the budget was on an upswing in the 2001 to 2005 period. Now they are proposed for reduction. Defense, all of a sudden, is projected to be less necessary. International affairs are no longer a priority. Science, energy, natural resources, transportation, community and regional development, veterans, justice, general government — you name it — went up in the first term but are proposed for reduction in a second term. Income security is scheduled for a big hit. As for education and training, it is scheduled for about as big a decline as a percent of GDP as the entire increase from 2001 to 2005.

In terms of continuity, the major item proposed to move in the same direction is health care, which in the budget is divided into Medicare and health other than Medicare. Here entitlement reform is needed but so far has been dodged (by both political parties) in favor of a variety of add-ons — including a drug benefit for the elderly and higher payments to a variety of health providers. The Social Security numbers are misleading, since the retirement of baby boomers will soon take place, and the saving occurring while these boomers are in the labor market is relatively trivial. I suppose one could say here that policy is consistent in the sense of the administration wanting reform but failing so far to be able to produce it. The agriculture and commerce and housing numbers are more complicated, and driven significantly by prices and interest rates, although here, too, an agriculture bill in the first term involved a number of subsidies that reflected the spending tendency of the first term.

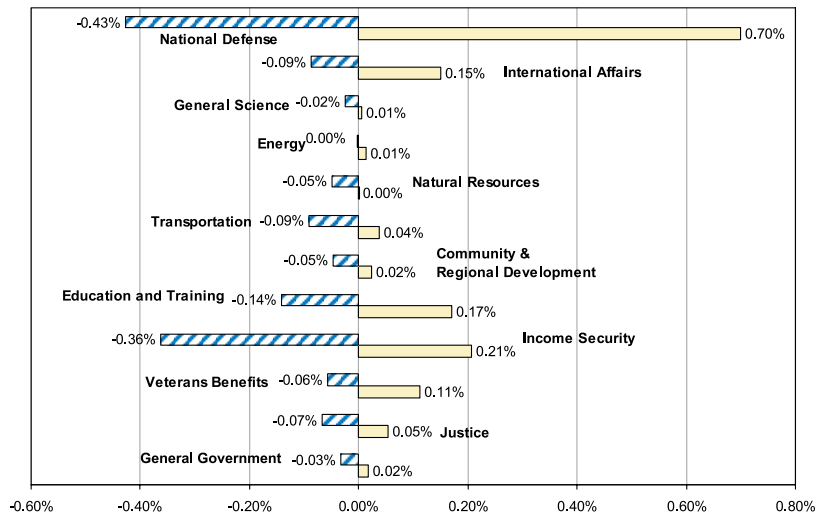
However one interprets the numbers politically, economically the message is clear: The profligacy of the past few years, stretching back to the late 1990s, is over. Revenue increases and spending cuts are on the way — no matter who wins the next election and whether they derive from automatic policy, legislative action, or legislative inaction that allows revenues to grow faster and expenditures slower than the economy.

Comparing Budget Policy From First Term With Policy for a Second Term

Reversals . . .

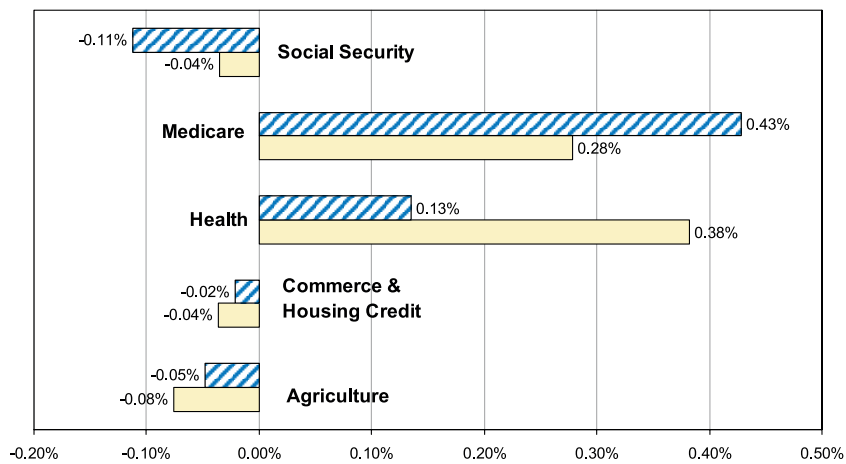


2001-05 2005-09



Continuity . . .

2001-05 2005-09



Source: C. Eugene Steuerle and Adam Carasso, The Urban Institute: 2004. Data based on the U.S. Budget FY 2005, historical tables, table 3.1. Excludes allowances and undistributed offsetting receipts.