

Tax & Budget

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Improving on the President's 2007 Budget

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President Bush has introduced his federal budget for 2007.¹ The budget would extend the president's income tax cuts and continue his policies of excess spending and large deficits. The budget proposes to trim some programs, but much larger spending reforms are needed if the tax cuts are to be preserved and the budget balanced. This bulletin examines recent budget trends and outlines a plan to cut spending and eliminate the deficit.

The Fiscal Outlook and the 2007 Budget

With the president's income tax cuts extended and permanent relief provided from the rising burden of the alternative minimum tax, federal tax revenues will be just short of 18 percent of gross domestic product, which is about the average tax-to-GDP ratio since 1960.

The deficit problem is caused, not by a shortage of revenues, but by an excess of spending. Table 1 shows that federal outlays, aside from interest, have risen 50 percent during the past five years under President Bush. By contrast, the consumer price index, which measures inflation, rose just 13 percent in the same period. There have been very large spending increases for the Departments of Defense, Education, Health and Human Services, Homeland Security, State, and Veterans Affairs.²

The president's budget proposes to slow spending growth in 2007, and it includes some cuts to Medicare and domestic discretionary programs. Those would be good first steps, but Figure 1 shows that there would continue to be a large gap between spending under the president's plan (line 2) and revenues with the tax cuts and AMT relief extended (line 4). The deficit would be even larger with a business-as-usual policy under which discretionary spending grows as fast as GDP (line 1). One problem with large deficits is that they often lead to damaging tax hikes, as they did in the 1980s and 1990s. To reduce the chance of tax increases and to preserve the Bush tax cuts, spending should be cut sharply and deficits reduced to zero in coming years.

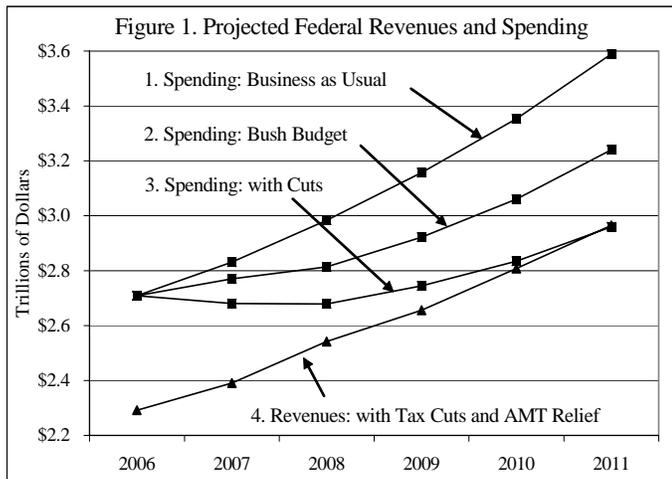
Table 1. Federal Outlays (billions of dollars)

Department or Agency	2001	2006	Increase
Agriculture	68.0	95.7	41%
Commerce	5.0	6.5	29%
Defense	290.3	512.1	76%
Education (w/o student aid)	27.9	46.9	68%
Education (student aid)	7.8	37.1	376%
Energy	16.3	21.7	33%
Health and Human Services	426.3	641.5	50%
Homeland Security (w/o FEMA)	10.6	27.9	163%
Homeland Security (FEMA)	4.4	38.9	784%
Housing and Urban Dev.	33.9	46.8	38%
Interior	7.9	9.1	16%
Justice	18.7	22.3	19%
Labor	39.8	51.4	29%
State	7.4	13.6	83%
Transportation	49.3	61.3	24%
Veterans Affairs	45.1	70.4	56%
Civilian and military retirement	85.1	109.2	28%
Corps of Engineers	4.7	7.4	57%
EPA	7.4	7.9	7%
International Assistance	11.8	16.3	38%
Judicial Branch	4.4	6.1	38%
Legislative Branch	3.0	4.4	46%
National Science Foundation	3.7	5.8	56%
NASA	14.1	15.6	10%
Social Security Administration	461.3	592.5	28%
Other	2.8	20.4	
Total program spending	1,657.0	2,488.6	50%
Net interest	206.2	220.1	7%
Total federal spending	1,863.2	2,708.7	45%

Source: *Budget of the U.S. Government, FY2007*. Fiscal years.

A Plan to Balance the Budget and Extend the Tax Cuts

There are many programs that could be cut to save money, while also boosting growth and expanding freedom. Table 2 summarizes a set of reforms that would be enough to balance the budget by 2011 with the Bush tax cuts and AMT relief in place. Line 3 in Figure 1 shows spending under this plan assuming that discretionary cuts are phased in over five years and that entitlement reforms begin in 2007.³



Source: Author, based on *Budget of the U.S. Government, FY2007*.

Business Subsidies. Federal payments to farming businesses should be terminated to improve agricultural productivity and to end an unfair giveaway to a group that is generally well-off. Federal energy subsidies should be repealed. Decades of federal interventions in energy markets have proven to be either damaging or wasteful, as have subsidies for clean coal projects.

Defense. Annual savings of about \$10 billion could be realized by eliminating a few low-priority weapon systems and reducing purchases of others. Permanently reducing the number of U.S. troops stationed abroad (mainly in Europe and Asia) by one-quarter would save roughly \$10 billion per year, including personnel and operations costs.

State, Local, and Private Activities. Table 2 lists some of the vast array of federal activities that should be left to the states and the private sector. The nation's schools were traditionally a local and private concern, and large increases in federal spending in recent decades do not seem to have improved school quality. Cutting federal education grants in half would save \$21 billion per year. Foreign aid for economic development should be ended. Many studies have shown that such aid is ineffective and can prevent poor countries from taking needed reform actions. NASA's manned space program, which has been mismanaged and serves no clear purpose, should be terminated. Federal programs for employment and training are ineffective and are properly the responsibility of individuals and businesses. The Corps of Engineers should be privatized, as its activities such as port dredging could be done on contract to businesses and state governments.

Entitlement Programs. Large cuts should be made to entitlement programs. Table 2 shows projected annual savings in 2011 from selected cuts. A simple way to cut

Social Security would be to slow the rise in initial benefits by linking them to increases in prices rather than wages. Medicaid should be turned into a block grant and the growth in state payments limited to inflation. Medicare costs should be cut by raising deductibles and raising Part B premiums to cover 50 percent of program costs. The Medicare prescription drug plan should be repealed as an unaffordable fiscal disaster. But even cutting drug benefits in half would save \$44 billion annually by 2011.

Table 2. Proposed Spending Cuts (billions of dollars)

Program	Annual Savings
Business Subsidies	
End farm subsidies	\$23
End energy subsidies	\$6
Defense	
Cut low-priority weapons	\$10
Reduce troops in Europe and Asia by 1/4	\$10
State, Local, and Private Activities	
Cut education grants to states by 1/2	\$21
End foreign aid for economic development	\$7
End community development block grants	\$7
End NASA manned space program	\$6
End employment and training programs	\$5
Privatize Army Corps of Engineers	\$5
Entitlement Programs	
Social Security: Index initial benefits to inflation	\$5
Medicaid: Block grant and grow with inflation	\$48
Medicare: Increase deductibles and premiums	\$57
Medicare: Cut drug bill costs in half	\$44
Total spending cuts	\$254

Source: Author, based on *Budget of the U.S. Government, FY2007*. For entitlements, the dollar figures are projected savings in 2011. For other programs, the figures are 2006 outlays.

Conclusion

If enacted, these proposals would be saving \$254 billion annually by 2011—enough with related interest savings to balance the budget in that year and subsequent years. There are many other programs that should be cut, but these cuts would make room for continued taxpayer relief and would halt the rising debt burden that current policymakers are imposing on future generations.

¹ *Budget of the United States Government, Fiscal Year 2007*.

² Note that outlays for student loans, the Corps of Engineers, and the Federal Emergency Management Agency had one-time spikes in 2006.

³ Outlays for spending with cuts (line 3) are calculated by applying Table 2 cuts to proposed Bush spending (line 2). Interest savings from a reduced deficit are taken into account. For details on all proposed spending cuts, see Chris Edwards, *Downsizing the Federal Government* (Washington: Cato Institute, 2005).