

Tax & Budget

BULLETIN

No. 42 • February 2007

Improving on the President's 2008 Budget

by Chris Edwards, Director of Tax Policy Studies, Cato Institute

President Bush has introduced his federal budget for 2008.¹ The budget would extend the president's income tax cuts and modestly restrain spending on nondefense programs. However, it does not include a repeal of the damaging alternative minimum tax (AMT), and it offers too few spending cuts and reforms, given the huge problem of rising entitlement costs.

Recent Spending Growth and the Fiscal Outlook

Table 1 shows that federal outlays, aside from interest, have risen 54 percent since 2001 under President Bush. By contrast, the consumer price index has risen just 16 percent since 2001. There have been large increases for the Departments of Defense, Education, Health and Human Services, Homeland Security, State, and Veterans Affairs.

The new budget proposes to roughly freeze domestic, nonentitlement outlays over coming years, and it includes Medicare reforms to reduce unfunded costs over 75 years by 25 percent. But the budget will fund further large increases in the enormous Pentagon budget. In 2008, outlays on defense will be double the level of 2001.

The president plans to extend partial relief from the AMT for only one year, but most tax experts support full repeal of this tax. If the AMT is not repealed, it will be costing taxpayers \$140 billion annually by 2012.² Thus the president's promise of a balanced budget in 2012 is illusory unless he is seeking a huge AMT tax increase on American families.

Figure 1 shows three spending scenarios and a projection of revenues assuming full AMT repeal and extension of the Bush tax cuts. Spending under the Bush budget would be substantially less than under a business-as-usual scenario whereby discretionary spending grows as fast as gross domestic product. Most of Bush's proposed spending restraint is supposed to occur after he has left office. It would be much better if Bush took a hard line right now and made credible veto threats to obtain the elimination of wasteful programs this year. Nonetheless, if

Table 1. Federal Outlays (billions of dollars)

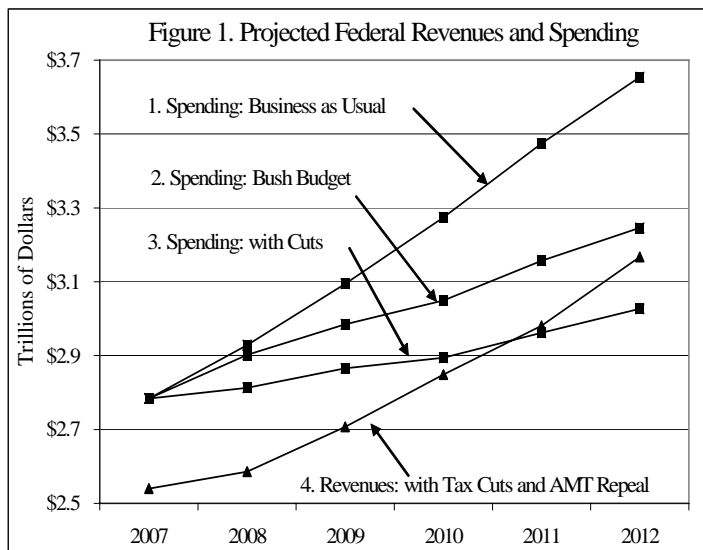
Department or Agency	2001	2007	Increase
Agriculture	68.1	88.8	30%
Commerce	5.0	6.2	24%
Defense	290.2	548.9	89%
Education	35.5	68.0	92%
Energy	16.3	22.0	35%
Health and Human Services	425.9	671.3	58%
Homeland Security	15.0	50.4	236%
Housing and Urban Dev.	33.9	42.8	26%
Interior	7.8	10.9	40%
Justice	18.4	23.0	25%
Labor	39.7	47.4	19%
State	7.5	16.3	117%
Transportation	49.2	63.8	30%
Veterans Affairs	45.0	72.3	61%
Federal employee retirement	85.1	106.4	25%
Corps of Engineers	4.6	7.6	65%
EPA	7.4	8.0	8%
International Aid	11.8	17.1	45%
Judicial Branch	4.4	5.8	32%
Legislative Branch	3.0	4.3	43%
National Science Foundation	3.7	5.9	60%
NASA	14.1	16.1	14%
Social Security Admin.	461.3	622.9	35%
Other	4.0	18.9	
Total program spending	1,657.0	2,545.1	54%
Net interest	206.2	239.2	16%
Total federal spending	1,863.2	2,784.3	49%

Source: *Budget of the U.S. Government, FY2008*. Fiscal years.

policymakers stick to the Bush spending totals, federal outlays will decline from 20.2 percent of GDP this year to 18.3 percent by 2012.

A Plan to Balance the Budget and Extend the Tax Cuts

Spending should be tackled more vigorously than under the Bush budget, both to expand economic freedom and to drive the deficit down more rapidly. The problem with deficits is that they often lead to damaging tax increases, as they did during the 1980s and 1990s.



Source: Author's estimates based on *Budget of the U.S. Government, FY2008*.

To avert that outcome, policymakers should consider the spending reforms in Table 2. Line 3 in Figure 1 shows spending including these reforms, with discretionary cuts phased in over five years and entitlement reforms beginning in 2008.³ The plan would balance the budget by 2011 with the Bush tax cuts in place and the AMT repealed. It would boost economic growth by ending programs that distort markets or are wasteful.⁴

- The Corps of Engineers should be privatized, as activities such as port dredging could be done on a contract basis in the marketplace.
- NASA's manned space program has been mismanaged and serves no clear purpose, especially now that private entrepreneurs are pushing into space.
- Energy subsidies should be repealed, rather than increased as the president proposes. The dream of U.S. energy independence is both unrealistic and economically damaging.
- Pay and benefits for federal workers have been rising much faster than for private workers.⁵ Substantial savings would accrue from skipping the usual annual pay adjustments for two years.
- Foreign aid for economic development should be ended. Many studies have shown that such aid is ineffective and often prevents poor countries from making needed reforms.
- Subsidies to farmers should be terminated to improve agricultural productivity and to end an unfair giveaway to a group that enjoys high and rising incomes.

- Social Security costs should be cut by linking increases in initial benefits to prices rather than wages.
- Medicaid should be turned into a block grant and the growth in federal aid limited to inflation.
- Medicare costs should be cut by raising deductibles and raising Part B premiums to cover 50 percent of program costs. The new drug benefit ought to be repealed, or at least scaled back with cost-saving reforms such as raising deductibles.

Table 2. Proposed Spending Cuts (billions of dollars)

Program	Savings in 2012
Privatize the Army Corps of Engineers	\$6
End NASA manned space program	\$7
End energy subsidies	\$7
Forgo federal civilian pay increases for two years	\$7
End community development grants	\$8
End foreign aid for economic development	\$9
End farm subsidies	\$15
Social Security: Index initial benefits to inflation	\$5
Medicaid: Block grant and grow with inflation	\$44
Medicare: Cut drug bill costs in half	\$37
Medicare: Increase deductibles and premiums	\$62
Total spending cuts	\$207

Source: Author's estimates based on *Budget of the U.S. Government, FY2008*.

Conclusion

If enacted, these proposals would be saving taxpayers \$207 billion annually by 2012. There are many other activities that should be cut, including the massive and poorly managed defense budget. But these cuts would make room for AMT repeal and reduce the rising debt burden that is being imposed on future generations.

¹ *Budget of the U.S. Government, FY2008*, www.whitehouse.gov/omb/budget/fy2008.

² AMT estimate assumes the Bush tax cuts are extended, based on fiscal year data from the Urban-Brookings Tax Policy Center.

³ Outlays for spending with cuts (line 3) are calculated by applying Table 2 cuts to proposed Bush spending (line 2). Interest savings from reduced deficits is taken into account.

⁴ For details on proposed cuts, see Chris Edwards, *Downsizing the Federal Government* (Washington: Cato Institute, 2005).

⁵ Chris Edwards, "Federal Pay: Myth and Realities," *Washington Post*, August 13, 2006, p. B7.