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IS A LARGE TAX CUT NEEDED TO FORESTALL AN EXPLOSION IN SPENDING?

Some supporters of a large tax cut this year, such as the tax cut the Bush Administration has proposed, argue that a large tax cut is needed to prevent an explosion of federal spending. They state that the Congressional Budget Office has determined that action by Congress and the last Administration in the final half of 2000 increased federal spending by $561 billion over the next ten years. A $1.6 trillion tax cut is needed, this argument goes, or else further spending explosions will occur. There are several problems, however, with the use of these figures to make the case that a spending explosion has begun.

How Much Did Spending Increase Last Year?

CBO has reported that actions taken in the last session of Congress increased CBO's estimate of baseline spending on government programs by $434 billion over the next ten years. Since this $434 billion will be used for program expenditures rather than for paying down debt, CBO has estimated that interest payments on the debt will be $118 billion higher. The figure of "$600 billion in new spending" that some policymakers have cited as a reason for a large tax cut is reached by adding the $118 billion in interest payments to the $434 billion in projected increased spending, also adding (inappropriately) $9 billion in increased interest costs that CBO says will result from some modest tax cuts enacted last year, and rounding the resulting $561 billion figure up to $600 billion.

It may be noted that $368 billion of the $434 billion in projected increases in program spending — or 85 percent of the increases in program spending — consist of increases in discretionary spending. The remaining $66 billion includes $28 billion in increased entitlement spending for health care for military retirees, a net of $20 billion in increased Medicare spending as a result of scaling back some Medicare savings provisions enacted in 1997,[1] and $18 billion in increases in spending for other entitlement programs.

Should All of These Costs be Considered as Spending Increases?

Upon closer examination, a question arises as to whether this $368 billion in discretionary spending should all be regarded as a spending increase. Whether, and to what extent, it

[1] Legislation enacted last year increased projected Medicare outlays by $84 billion over 10 years but offset all but $20 billion of this amount through savings in Medicaid. The Medicaid savings were achieved by narrowing a loophole in Medicaid financing that had enabled some states to secure additional federal Medicaid dollars.

constitutes a spending increase depends on the baseline against which the new discretionary spending levels are measured.

No adjustment for population growth

The baseline that CBO employs assumes the maintenance of discretionary spending at its level for the preceding fiscal year, adjusted only for inflation. Since the U.S. population increases each year but the CBO baseline contains no adjustment for population growth, the CBO baseline essentially assumes a decline each year in the purchasing power of discretionary programs on a per-person basis. Under the CBO baseline, simply keeping discretionary spending constant in real per capita terms (i.e., keeping it at the same level in its ability to provide goods and services per U.S. resident) is counted as a significant spending increase.

A number of analysts have argued over the years that a more appropriate baseline for discretionary spending would be one that adjusted for *both* inflation and population growth. Robert Reischauer, the former CBO director who now heads the Urban Institute, argued (unsuccessfully) when CBO was first established that the discretionary spending baseline should account for population growth as well as inflation. In addition, President Bush himself stated on a number of occasions during the presidential campaign that the right way to measure changes in spending in Texas during his tenure as governor was by comparing the actual spending that occurred to what spending would have been if it had kept pace with both inflation and population growth. Were the same approach used here, the magnitude of the increase in discretionary spending that policymakers approved last year would be significantly smaller.

Spending as a share of the economy to hit half-century low

Furthermore, when measured as a share of the Gross Domestic Product, federal spending *declined* this year, despite the spending actions the last session of Congress took. The new CBO report on the budget shows that between fiscal year 2000 and fiscal year 2001, federal spending will drop from 18.2 percent of GDP to 18.0 percent. The 18.0 percent level for fiscal year 2001 is *the lowest level since 1966.* The CBO report also projects that federal spending will decline further to 15.1 percent of GDP by 2011, which would be the lowest level since 1951.

George W. Bush on Adjusting for Inflation and Population Growth

As a presidential candidate, George W. Bush used inflation plus population growth as the benchmark for measuring changes in spending in Texas during his tenure as governor. For example, the *Dallas Morning News* quoted Bush as saying “an ‘honest comparison’ of spending growth should take inflation and the state’s increasing population into account.” (October 28, 1999.)

Similarly, on his campaign website, Bush presented his record in Texas by noting: “When adjusted for inflation and population, state spending will increase by only 3.6 percent between 1994-1995 and the end of the 2000-2001 biennium.” (See www.georgewbush.com/issues/budget.html.)

In addition , CBO projects that discretionary spending will remain constant at 6.3 percent of GDP between 2000 and 2001, which is the lowest level ever recorded. (These data go back to 1962.) Under the CBO projections — which include the much-touted "explosion" of spending — discretionary spending will *decline* to 5.1 percent of GDP by 2011, a level that would be the lowest by far in at least half a century.

One wouldn't know from the claims of a spending explosion that federal spending is at its lowest level as a share of GDP in 35 years or that by 2011, it would — under the baseline that includes the $561 billion in added spending — reach its lowest share as a percentage of GDP since 1951.

Defense Constituted Nearly One-Third of Spending Increase

A fact not often mentioned by those decrying the "spending explosion" is that the spending added in the last session of Congress was disproportionately directed toward defense spending. Defense spending increases accounted for nearly one-third — 31 percent — of the $434 billion in spending increases over ten years. Defense spending accounts for 18 percent of the federal budget, exclusive of interest payments, so defense's share of the spending increase was nearly twice its share of the budget.

CBO has estimated that as a result of action in the last session of Congress, defense discretionary spending in the baseline will be $106 billion higher over the next 10 years, while entitlement spending for military health will be $28 billion higher. This $134 billion total accounts for 31 percent of the $434 billion projected increase in program spending before the increased interest payments are added.

Double Standards Used in Counting the Cost of Interest Payments

Counting the cost of higher interest payments on the debt is an appropriate step to take in determining how much of the projected surplus will be consumed by increases in spending for federal programs. Unfortunately, some of the same policymakers who cite the $600 billion figure (or in some cases, the $561 billion figure) — a figure that includes the additional interest costs that result from last year's spending decisions — continue to cite $1.6 trillion as the cost of the Bush tax cut. The $1.6 trillion does *not* include the added interest costs that the tax cut would entail; revenue collections would be reduced by $1.6 trillion (before taking into account the additional costs the Bush tax cut is expected to generate when problems in the Alternative Minimum Tax are fixed), but the cost to the government would be about $2 trillion when the additional interest costs are included. Counting the cost of higher interest payments when citing the cost of actions Congress has taken to expand government programs while failing to count the interest costs when citing the cost of a tax cut entails use of a double standard and is not defensible.

Conclusion

Proponents of a large tax cut frequently speak of revenues as being at or near their highest level as a share of GDP since World War II.[2] In discussing trends in federal expenditures, however, tax-cut proponents typically eschew use of a standard that measures federal spending as a share of GDP. They measure trends in discretionary spending against a baseline that assumes reductions in such spending on a real per-capita basis and counts spending levels that keep discretionary spending constant in purchasing power per person as constituting spending increases. These definitions of what constitutes a spending increase underlie arguments that a spending explosion has taken place, arguments that overlook the reality that federal spending is at its lowest level in decades as a share of the economy.

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[2] The trend in revenues as a share of GDP is sometimes misused to imply or claim that the typical family is paying a higher percentage of its income in taxes than at any time in recent decades. That is not the case. See Iris J. Lav "Taxes on Middle Income Families Are Declining," Center on Budget and Policy Priorities, January 10, 2001.