NEW YORK TIMES - February 7, 2005
NEWS ANALYSIS

Trim Deficit? Only if Bush Uses Magic

By EDMUND L. ANDREWS

WASHINGTON, Feb. 6 - The economy is growing. Tax revenues are climbing. But can these factors rescue President Bush from a federal deficit that seems stuck above $ 400 billion?

The answer, unfortunately, is almost certainly no, analysts say.

For all the programs that Mr. Bush is expected to slash in his budget proposal on Monday - from health care and housing aid to Amtrak - the cuts would total less than $15 billion next year and barely dent the deficit.

By far the biggest parts of the budget - Medicare, Social Security and military spending - would be immune from cuts and are expected to grow rapidly for years to come.

On top of that, Mr. Bush's plan to replace part of Social Security with private savings accounts could require additional trillions of dollars in borrowing over the next several decades.

The cornerstone of Mr. Bush's budget strategy is a belief that vigorous economic growth, spurred by supply-side tax cuts that were designed to provide incentives for upper-income Americans to produce more wealth, will generate big jumps in tax revenue that gradually reduce the deficit.

At first glance, he would seem to have grounds for optimism. After all, surging tax revenue did come to Washington's rescue during the economic boom of the 1990's, pushing the budget from the red to the black. Republican and Democratic budget analysts, however, say that such an event is much less likely this time around. The contrasts are stark:

¶Through most of the 1990's, government spending grew at a snail's pace. But government spending soared during President Bush's first term and is expected to keep growing rapidly as the nation's baby boomers start to claim old-age benefits.

¶In the 1990's, the biggest jump in revenues came from high-income taxpayers who made enormous profits in the stock market bubble that ended in 2000. But Mr. Bush's tax cuts of 2001 and 2003 reduced rates on the wealthiest taxpayers and cut in half the taxes on dividends and capital gains, making it all but impossible for revenues to rise at a substantially faster pace than economic growth.

¶Mr. Bush's own projections leave out the cost of rolling back the alternative minimum tax, a parallel tax that is expected to ensnare tens of millions of middle-income households as incomes rise with inflation. Republicans and Democrats both want to prevent such a trap, but a fix would cost roughly $500 billion over the next 10 years.

"I don't think we are likely to see a repeat of the 1990's," said Douglas Holtz-Eakin, the Republican-appointed director of the Congressional Budget Office. "We can't grow our way out of this."

When Mr. Bush unveils his budget plan on Monday, White House officials hope to focus public attention on his proposals to cut scores of domestic programs: Medicaid, housing programs and Amtrak subsidies, among others. But while many of those cuts would be severe, their impact on the deficit would be small.

Administration officials have proposed changes they say would reduce Medicaid spending by $60 billion over 10 years, or about $6 billion a year. Mr. Bush would cut spending on community development programs, consolidating 18 programs into 2 and reducing annual outlays from $5.6 billion to $3.7 billion.

Eliminating operating subsidies for Amtrak, which would face intense opposition in Congress, would save about $1.2 billion a year.

In all, Mr. Bush has vowed to cut or eliminate 150 government programs. But Republican Congressional analysts predicted on Friday that those cuts would be unlikely to save more than $15 billion. And even those savings may not materialize.

Last year, Mr. Bush called for cutting or eliminating 65 programs, for a total projected saving of $4.8 billion. But Congress agreed to eliminate only four of those programs, for a savings of less than $200 million.

The other side of Mr. Bush's equation - higher tax revenues that result from faster growth - is unlikely to fill the gap. Despite strong economic growth and soaring corporate profits last year, federal tax revenues amounted to only 16.3 percent of the total economy, comparable with levels in the 1950's and far below the level of 21 percent reached during the stock market bubble in 2000.

"What's unrealistic is that they are trying to fund a government with today's demands on a 1950's stream of revenue," said Robert Bixby, executive director of the Concord Coalition, a research group that advocates fiscal discipline by the government.

Tax revenues soared far beyond expectations during the economic boom and stock market bubble of the late 1990's, but budget analysts say there is little likelihood of repeating that feat in this decade.

One reason is that Mr. Bush's tax cuts of 2001 and 2003 went largely to the nation's wealthiest taxpayers, the same people who accounted for the unexpected flood of tax revenue last time around. White House officials are already counting on tax revenues to surge by at least $200 billion this year, an increase of about 10 percent, and to climb more gradually after that.

But even Mr. Bush's conservative allies have warned that those inflows will not be enough to cover the continued growth in overall government spending. Brian Riedl, budget analyst at the Heritage Foundation, a conservative research group here, estimated that deficits would remain around $400 billion through 2009 if current spending trends on Iraq and major benefit programs continued.

For Mr. Bush to fulfill his promise of cutting the deficit in half by 2009, Mr. Riedl said, the president would have to cut $200 billion from domestic programs that now cost less than $500 billion a year.

"There is no way you can reach that goal by cutting only discretionary spending," Mr. Riedl said. "You have to go after entitlements as well."

About two-thirds of the $2.3 trillion federal budget now goes to entitlement programs. The Congressional Budget Office estimates that costs for Medicare will rise $55 billion in 2005, to $380 billion. Social Security outlays are expected to rise to $540 billion, from $517 billion.

But Mr. Bush has focused almost all of his budget cuts on discretionary domestic programs costing a total of $466 billion last year. Freezing spending at current levels on the vast array of programs Washington supports - thus allowing them to grow simply at the rate of inflation - would save about $10 billion next year, according to the Congressional Budget Office; a politically difficult reduction of 1 percent would save about $15 billion.

Senator Judd Gregg, Republican of New Hampshire and chairman of the Senate Budget Committee, said neither Mr. Bush's spending cuts nor his hope of strong economic growth would be enough to close the gap.

"You can't get there from here unless you look at entitlements," Mr. Gregg said last Thursday. "It's for the same reason that Willy Sutton said he robbed banks: Because that's where the money is."

Chad Kolton, a spokesman for the White House Office of Management and Budget, said Mr. Bush was on track to cut the deficit by half over the next five years. "We have a two-pillar approach for getting the budget deficit down by half," Mr. Kolton said, "by restraining the growth in government spending and encouraging greater economic growth that leads to higher tax revenues."

But even if rising tax revenues do help reduce the deficit over the next five years, the subsequent five years are likely to be far more difficult.

For starters, Mr. Bush wants to permanently extend his tax cuts rather than allow them to expire by 2011. That would cost about $1.8 trillion over the next decade, and most of the cost would occur after 2009.

If Congress prevents an expansion of the alternative minimum tax, which Mr. Bush has said he wants, the cost would be $500 billion over the next decade and well over half of those costs would in the second five years.

Those blows would be hitting the budget at the same time that the costs of the new Medicare prescription drug programs approach $100 billion a year and as the flood of baby boomers start to claim Social Security and Medicare entitlements.

By that time, however, Mr. Bush will no longer be in office.