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How Bush ruined a decade's good work

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Jeffrey D Sachs, director of the Earth Institute at Columbia University, predicts a U-turn on tax cuts as George W Bush's fiscal policy goes belly-up.



President George W Bush has run the most reckless fiscal policy in the history of the US – so reckless that we can be sure that the policies will be reversed. The only questions are when and how. Will voters repudiate Bush's irresponsibility this autumn? Will Bush be forced to reverse himself in a second term? Or will the US suffer a long bout of political strife and economic malaise as long-term budget constraints catch up with a political system that is wedded to fiscal fantasies?

The fiscal realities are clear, even if the political projections are not. Bush inherited a modest budget surplus, of 2.4% of GNP in fiscal year 2000 and 1.3% of GNP in fiscal year 2001. The appearance of fiscal health was a bit of fiction, because already the long-term projections of the main entitlements programmes for health and pensions showed a massive uncovered liability of tens of trillions of dollars in future decades. Still, Bush proceeded to grab the surplus, and much more, to justify tax cuts directed overwhelmingly at the top 20% of the taxpayers.

Economic shocks

He continued to press for, and achieve, further rounds of tax cuts despite three huge subsequent shocks: the end of the stock market bubble, which led to much lower tax

collections than expected as of January 2001; the post-September 11 surge of more than 1% of GNP in military, security, and Iraqi reconstruction outlays; and a string of new spending initiatives for education, prescription drug coverage, and in the coming years for space exploration.

As a result of both the legislative and economic shocks, federal tax revenues have declined from a little above 20% of GNP when Bush entered office, to a little above 16% of GNP projected for fiscal year 2004.

As a president elected by less than half the voters in 2000, with a radical foreign policy and an expensive tax-cut policy directed at the rich, Bush has studiously avoided asking for any financial sacrifice from the voters. The message has relentlessly been pure populism – that the tax cuts, the war in Iraq, the prescription drugs and the new mission to The Moon and Mars are all free.

In fact, of course, their costs are very real, but the bills have simply been pushed to the future via rising public debt. Thus, within four short years, the budget swing is around \$700bn a year, or 7% of GNP – from a surplus of \$236bn in fiscal year 2000 to a deficit of \$480bn in fiscal year 2004 as projected by the Congressional Budget Office (CBO). The government debt held by the public has gone up from around 35% of GNP at the end of fiscal year 2000 to around 40% of GNP projected at the end of fiscal year 2004.

Today's massive deficits are just the beginning of the bad news. As Bush peddles budgetary fiscal illusions to the electorate, the ageing of the US population, the retirement of the baby boomers, and the continuing steep rise in healthcare costs will lead to a fiscal explosion. Last December, the CBO issued a new report, The Long-Term Budget Outlook. With a moderate (or 'intermediate') forecast of future entitlements outlays, spending on health and pensions is projected to rise another 6% of GNP by 2030. Public debt would soar, interest servicing on the debt would soar in tandem, and the budget deficit including interest costs would grow explosively.

This, of course, will not happen. Conservatives harbour the not-so-secret hope that government spending will be the first to give, with the entitlements programmes dismantled to make way for a small, tax-free paradise. This too is fantasy, as US recent history and public opinion surveys make amply clear. Americans like their entitlements programmes at least as much as they like their tax cuts. When not forced to choose, they are happy to take both. But there is not the slightest shred of evidence that they will endorse tax cuts for the rich that are financed via spending cuts on broad-based retirement and health programmes. Even if the Bush administration's vainglorious aspirations to manage a new American empire are abandoned, so that US military outlays are cut back, the saving of a couple of per cent of GNP in military spending would not begin to make up the difference. Bush's tax cuts are a goner in the long term, and perhaps much sooner.

History repeating

Bush's fiscal tactics mimic the first famous experiment in 'supply-side economics' under Ronald Reagan. President Reagan came to power in 1981, also on a programme of tax cuts and military spending increases. The budget deficit similarly increased, from 2.7% of GNP in 1980 to 5.1% of GNP in 1985. Government revenues fell by about 1.5% of GNP while outlays, mainly on the military, rose by around 1% of GNP. The result was a long, drawn-out and politically painful process of restoring fiscal sanity that stretched out over a decade.

That process involved painstaking budgetary compromises, several tax increases staggered over the Reagan, Bush Sr, and Clinton administrations, and a final showdown in 1995 between right-wing budget-cutters and moderates, in which Newt Gingrich and his conservative colleagues temporarily shut down the government at enormous political cost. The US was rewarded for its decade of hard-fought fiscal responsibility, not only by the end result of a budget surplus, but through many years of robust macro-economic conditions in the 1990s. All of that work George W Bush has squandered in a couple of years.

Reagan's legacy

When the dust had settled, here was the legacy of the Reagan experiment. Taxes as a percentage of GNP as of fiscal year 2001 were about 1% of GNP higher than in fiscal year 1981, while total spending was about 3.6% of GNP lower. Military spending had declined by 2.1% of GNP, and non-military spending by another 1.5% of GNP. The non-military cuts were not in entitlements programmes – those went up modestly – but in less politically protected programmes, such as housing and foreign assistance.

Bush's tax cuts will similarly be reversed, but with an important difference this time around. The balance between tax increases and spending cuts is likely to be weighted more heavily toward the tax increases. There is simply very little to cut in the non-military, non-entitlements budget. Those who hanker after cutting 'waste' from government bureaucracy or from non-entitlements programmes will surely be disappointed to learn that the total federal outlays on non-defence discretionary spending is just 3.5% of GNP, to cover functions such as science and technology, agriculture, energy, conservation, transport, education, disaster relief, law enforcement, the judiciary, Congress and so on. All of these could be cut to zero without eliminating today's budget deficit, not to mention the increased outlays on entitlements and debt servicing in the future. The military too will bear some cuts, and with them the neo-conservatives' dreams of US empire, but at roughly 4% of GNP, the military too can only provide a modicum of the fiscal tightening that lies ahead.

On the horizon

There are three scenarios for the tax increases that lie ahead. The first is Bush's defeat in November. Despite appearances, it certainly cannot be ruled out. While an incumbent is probably odds-on to win re-election, the public is at least getting a whiff of the economic mischief afoot. While the public does not properly appreciate that the tax cuts for the rich, made permanent, will have to be paid for by spending cuts for everybody, they do already feel that they didn't get very much in tax cuts in any event. When asked recently whether Bush

administration policies 'have made your taxes go up, go down, or not affected your taxes?', 32% said 'up', another 44% said 'no effect', with only 19% answering 'down'. This is not surprising, given that the bottom 60% of households got only around 15% of the 2001 Bush Tax cut. These households would, on the other hand, suffer 60% or more of cuts in entitlements programmes to make the cuts permanent.

A second scenario is that Bush wins re-election, but reverses himself, as his father eventually did, and accepts the inevitability of a tax increase. A third scenario is more likely, however, if Bush wins re-election. A re-elected Bush would put forward plans to privatise Social Security and Medicare, at which point the real fireworks would begin. The odds are strong that the public would recoil, as they did in the aftermath of the Reagan era.

The odds are also strong that consensus would be hard to find for years to come, just as was true after Reagan's re-election in 1984. In an unstable world, we would add increasingly bitter US politics and a US macro-economic stalemate to a growing international inquietude. The financing of the large US current account deficit, itself largely a reflection of the budget deficit, would become much harder too. Interest rates would rise, stock market prices fall. In case of a long-drawn out fiscal slugfest, as they say in show business, you ain't seen nothing yet.

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