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How Obama Should Shrink His Deficit

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For one thing, cut the remaining 'stimulus' spending.

President Obama declared in his budget message last month that "it's time to live within our means" and to stop "borrowing against our children's future." Unfortunately, his budget would move us away from that goal by adding trillions of dollars to our national debt over the next decade.

The administration's projected $18.5 trillion debt in 2020 would be more than double the size of the debt when Mr. Obama took office. The annual interest on that debt would exceed $800 billion, requiring a 36% rise in the personal income tax just to pay that interest.

Mr. Obama complains about the problems he "inherited." But the key to shrinking the nearer term deficits is to avoid his costly new initiatives. The most expensive of these is the tax cuts and income transfers to low- and middle-income households that would cost some $3.1 trillion over the next decade.

The proposed tax cuts include the Making Work Pay plan, a refundable tax credit targeted at individuals earning less than $13,000 a year. Since many of those individuals owe no tax, this "tax cut" just becomes a new government transfer.

Also hidden in the vast budget document is a repeat of the president's plan to spend a trillion dollars over the next decade to expand Medicaid and provide subsidies for health insurance. It doesn't reach the bottom line because equally well hidden is the trillion dollars of tax increases and Medicare cuts to finance the extra spending. Dropping that spending would cut the national debt by a trillion dollars.

The president has emphasized his proposal to freeze for three years the current $437 billion of spending on discretionary nondefense programs. The administration's budget indicates that this would reduce outlays by a total of $49 billion over three years. This is a trivial cut relative to this year's $3.7 trillion projected outlays.

But even the small projected three-year saving may never occur, since the proposed freeze would apply only to the total of the nondefense programs and not to each program separately. Because Congress does not legislate all of that spending in a single bill, it would be virtually impossible to control the total even if the president is prepared to use his veto authority.

Mr. Obama's proposed freeze does not apply to the big backdoor spending routes: increases in "mandatory" spending programs and new tax rules that substitute for increased government spending. The president's proposal to increase the Medicare drug benefit would therefore not be part of the freeze because Medicare is a "mandatory" program. Similarly, the president's plan to increase funds for child care wouldn't be covered by the freeze because it would be done by changing tax rules. If the president tries to revive his trillion-dollar health plan, that would no doubt be done as a new "mandatory" entitlement.

Future deficits could be reduced not only by rejecting the Obama plans for new transfers and low-income "tax cuts," but also by canceling some of the future transfer payments that were enacted in last year's "stimulus" plan. Despite the hype about shovel-ready projects and new green energy initiatives, the Congressional Budget Office (CBO) reports that the stimulus bill paid for only $5 billion of Transportation and Energy Department spending in fiscal year 2009 and will now pay for only $20 billion in 2010. Most of the stimulus spending is just transfers to state governments and to individuals.

Moreover, the CBO projects that $289 billion of the "stimulus" money will be spent in 2011 through 2019, years when the administration projects the economy will be growing at an above-trend rate. Much of that spending will be on health care, food stamps and other transfer programs that have nothing to do with stimulating a growing economy. The out-year fiscal deficits could be cut by $100 billion or more by repealing some of the $289 billion of future outlays.

But the biggest potential for reducing the out-year deficits without raising marginal tax rates or taxes on business is to limit the growth of the special tax provisions that substitute for spending programs. The recent Senate debate about the exclusion from taxable income of employer-provided health insurance showed the potential importance of such "tax expenditures." That exclusion reduces income and payroll tax revenue this year by more than $200 billion. Just stopping the projected rise in that tax expenditure could reduce the 2020 national debt by more than $1 trillion. Limiting other tax expenditures could cut the 2020 debt by additional hundreds of billions of dollars.

Unfortunately, the Obama administration has focused its deficit reduction measures on raising tax rates on businesses and high-income individuals. The proposed tax hike of more than $1 trillion over the next decade would hurt incentives, hurt the recovery, and hurt the economy's long-term growth.

Fortunately, the Obama budget is not the law. It's up to Congress now to slow the growth of the nation's debt and to do so without the damaging effects of higher marginal tax rates.

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