economic perspective

by Gene Steuerle

From Taxes to Health Care: Inconsistent Rhetoric Is Bipartisan

In recent years, the largest budgetary decisions of the Congress have been concentrated in two areas: tax cuts and expansions in health care, particularly Medicare. This year is no different. The 2003 tax cut follows those of 1997, 2001, and 2002, among others, while the new drug benefit for the elderly was preceded recently by decisions to expand Medicaid and to relax a set of Medicare cost constraints already far from adequate.

Given all the rhetoric that surfaced during the tax cut debate, and the extent to which arguments on both sides were put forward as almost immutable principles that only fools could fail to follow, it might be worthwhile to see how consistently these arguments have been carried forth from that bill to the new Medicare bill. To be balanced, let us take from each side, Democratic and Republican alike, the arguments that were made about the effect of the legislation on, first, growth, and, second, the poor or at least those too poor to pay any income tax.

The opponents of the tax cut, you may remember, argued that it would be bad for growth because of its effect on the deficit. The proponents of the tax cuts, in turn, argued that Congress should engage in dynamic scoring of its actions so as to better record their ultimate effect on economic growth (and, through additional growth, the positive feedback effects on revenues). When it came to the poor, the opponents suggested that policy changes put forward by Republicans consistently shortchanged the lower-income people, while the proponents stated that there was little reason to give benefits, or at least very many benefits, to those who didn't pay taxes. Did anyone really expect these arguments to be consistently applied over time? Is anyone surprised how quickly they were forgotten when the next major piece of legislation, the new drug benefit for the elderly, came to the fore?

Projections of growth as a result of legislative action are usually made out of elaborate black box economic models, but in point of fact the models are driven by quite simple assumptions. In particular, if government expenditures do little to enhance growth (and most of these dynamic models treat government expenditures as neutral, if not negative), then higher taxes by themselves are likely to encourage people to work less and save less. (I use the term "likely" since work and saving become less profitable, so taxpayers may naturally favor leisure and consumption more . . . but government actions, which do redistribute income, could provide some offsetting effects). But the opponents of the tax cuts didn't disagree that higher taxes considered by themselves — ignoring any expenditures they might finance — were bad. They simply argued another growth effect had to be taken into account. Increases in the deficit draw on private saving, and this may reduce the amount of money available for private investment.

It doesn't take a degree in economics or political science to figure out how much stress the two sides would put on these two effects: lower tax penalties on work and saving and a higher deficit. The proponents stressed the effect of lower tax rates on economic growth and tried to ignore the impact on the deficit, while the opponents gave much attention to the deficit.

How about the Medicare expansion? Following their previous debate over the growth effects of legislation, you might think that they would give as much if not more attention to this enactment, which, once fully phased in, is likely to be more expensive and more permanent than the tax cut. Instead, we have been offered utter silence by both sides. Here we have an expenditure increase leading to larger deficits. Take any of the models applied to the tax cut. Without exception, it would show a decline in long-term growth and, as a consequence, deficits even larger than implied by the "static" estimate of the cost of the bill.

Why didn't either side want to apply to the Medicare bill the logic it used about growth effects of the tax bill? For the tax cut proponents, it would mean that the simplistic dynamic scoring they so advocated would show negative economic effects from their own bill. For that matter, it would show a negative effect from many other pieces of legislation they favored, ranging from the farm bill to a variety of tax cuts, such as child credits (their pro-family policy). For the tax cut opponents, deficits all of a sudden don't seem to matter because expenditures are being increased. Since most spending bills are enacted without any corresponding increase in revenues, these tax cut opponents would have to argue that spending increases add to the deficit, hurt long-term growth, and raise long-term costs through a variety of compound effects including interest costs. Moreover, unlike tax rate cuts, there often is not even a partial growth offset to the negative impact of the increase in the deficit.

How about the poor? Are they constantly losing out under Republican policy, as argued by the Democrats? Well, yes, those who pay no income taxes did not yet get much of anything out of the 2003 tax bill, although some recent bills would add to the 2003 legislation by getting some refundable child credits to those with fairly moderate incomes. Of course, those paying no income taxes did gain an additional refundable credit in the 2001 legislation. But all of this is small potatoes compared to the Medicare legislation. Here, many of the benefits go to those who pay no income taxes since so many of the elderly get tax-free Social Security benefits. True, some of them may have paid some health insurance (the HI portion of Social Security) taxes along the way, but these are small relative to benefits being received already. Moreover, the drug benefit is approximately the same for the poor as for the rich, implying a substantial redistribution since the rich will pay a far more than proportionate share of taxes.

Some Republicans argued that those who paid no income taxes didn't deserve any help in the tax bill. Why have they now become so deserving in the drug bill? It really can't be that tax bills are inappropriate places to increase expenditures. After all, one could easily have separated the tax bill into two pieces and passed both of them, one with a refundable credit and the other with everything else. No, the real answer must be that it depends on who is the nonincome taxpayer in question. Those who retire for approximately one-third of their adult lives are considered more worthy than many of the working "poor" with even less income on which to live.

It is hard to come to any conclusion other than that Democrats and Republicans alike choose their arguments selectively depending on the bill in question. Neither party has developed a consistent set of principles that it will apply to domestic policy. Logic is not going to get in the way of politics. There is one element in common between the tax cut and the Medicare expansion. They both were in the form of giveaways. As long as we, the public, want to be served treats, and want the payment for those treats to be hidden from us or passed onto future generations, maybe logic and consistency are about the last things that we can demand.