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Obama's Budget Proposals

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On February 13 President Obama presented his proposed budget for fiscal year 2013, which begins on October 1, 2012, just seven months from now. Government expenditures, along with the revenues to support them, are at the heart of politics in all countries. They influence both the level and the distribution of "public goods" and, perhaps more important in most countries, the distribution of income, including of course favors to particular interests or individuals through government expenditures and through tax privileges.

The United States differs from most countries in that the president does not determine the government's budget. He only proposes a budget that he would like to see. Congress (both of its two houses) must actually decide what the President will be allowed to spend ("appropriations" in formal terms) and what tax rates will be on what objects or entities. Typically Congress reduces the totals that have been proposed by presidents, and also alters the proposed allocations. In contrast, in a parliamentary system the Prime Minister or the Cabinet proposes a budget and has the votes in parliament to carry its proposals, unless there are unusually controversial items, in which case the prime minister can be sacked and a new election called if he does not agree to proposed changes.

The main features of Obama's budget involve substantial increases in taxes, especially on rich families, amounting net of some tax reductions to over $400 billion in 2013, over two percent of GDP; while holding total expenditures constant in nominal terms, which implies cuts in expenditures in real terms after allowing for inflation of nearly two percent. Within the proposed budget there are some increases in expenditures, especially on infrastructure and education, and many proposed declines. There are significant proposed cuts both in military and in medical expenditures, two of the largest budget items. Taken altogether, expenditures are expected to decline by about one percent of GDP between 2012 and 2013, and along with the proposed tax increases (some of which are already embodied in law) the budget deficit is expected to decline by three percentage points of GDP, from 8.5 percent to 5.5 percent, and further to 2.8 percent by 2020. Reckoning the budget in terms of GDP of course involves a forecast of GDP in the coming year, which the President's budget assumes to grow by three percent in real terms. This is rather higher than the growth foreseen by most forecasters, which averages around 2.6 percent. GDP growth buoys up revenue (due to growth in income and consumption) and also implies a larger denominator in the ratio. But the main effects are due to the proposed actions on taxes and expenditures, not on the assumption regarding growth in GDP.

A reduction in the Federal budget deficit of three percent of GDP would normally have a strong negative effect on the economy. The budget assumes that increased taxes on the rich and on some corporations will not reduce private expenditures nearly as much as the job-creating programs will raise them. Indeed, GDP is projected to grow by 3.6 percent in 2014.

No one expects the budget as proposed to be passed by Congress. Indeed, the United States will be lucky to have a new budget at all. The budget for fiscal year 2011 was not passed until April 2011, seven months into the fiscal year. The budget for fiscal year 2012 was passed in December, three months into the fiscal year. The government continued to function on the basis of "continuing resolutions," which allow agencies to spend at the rate they spent last year, but not to inaugurate new programs. Presidential and Congressional elections will take place in November 2012 – the new government will start two month later, in January – and the Republican-dominated House of Representatives (the lower house of Congress) will not want to give Obama any "victories" before the election. Nor will Obama want to make any undue concessions to right-wing Republicans before the election. So it is possible, indeed likely, that a budget for fiscal year 2013 will not pass before the election, or indeed until early 2013, after the newly-elected Congress has been formed. And its size and composition will reflect the outcome of the election.

That does not mean that Obama's proposed budget is irrelevant. It is a political document, reflecting the spending and revenue priorities of the President, or at least those priorities he would like to emphasize in an election year. As noted, some of the tax proposals are already in law, to take effect in January 2013. At that time tax reductions passed in 2001 and 2003, at the urging of President George W. Bush, will expire. This will automatically raise the top rates of personal income tax (to 39.6 percent) and will increase the taxes to be paid on stock dividends, on capital gains on real estate or financial assets, and on estates above a certain size. It would be desirable to modify the details in certain respects, but that would require new legislation, hence agreement between the Congress and the President (since the President must sign legislation before it becomes law). Absent such agreement, the tax increases will go into effect. That likelihood, over strong objections of many Republicans, will encourage some of them to compromise to get the desired changes. But the disagreements between the current House Republicans and the President are so fundamental that a sensible compromise, one that still results in a substantial increase in taxes on rich families, is unlikely before the election.