IRET Congressional Advisory

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THE BREAUX BUDGET PROPOSAL: A SMALLER DOSE OF POISON

Senator John Breaux has proposed an alternative to the deficit reduction proposals in the Clinton budget plan. Senator Breaux would replace the Btu energy tax ($71.4 billion over 5 years) with a more narrowly-based tax on transportation fuels ($40.2 billion over 5 years), and make up the revenue difference by trimming federal outlays on Medicare ($31.6 billion over 5 years). He would charge upper income Medicare subscribers higher premiums for Part B coverage, collect a 10% copayment on home health services, and reduce annual inflation increases in payments to hospitals. The higher premiums and copayments, though entailing higher payments to the government or providers by the affected citizens, would be classified as a spending reduction because they would reduce the general revenue outlays to health care providers that constitute a subsidy of the health care costs of the elderly. In that narrow sense, the Breaux proposal may be described as consisting of smaller tax increases and more spending cuts than the Clinton plan. In the sense that it is better to be shot four times in the foot than five times, the Breaux proposal is a marginal improvement.

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The Medicare proposals

At present, just over 75% of Part B of Medicare (doctors fees and outpatient services) is paid for by the federal government. Just under 25% is paid for through monthly premiums collected from enrollees. (The basic premium is currently $36.60 per month, more for those who enrolled after age 65.) Thus, the government is paying for almost 75% of the cost of the coverage.

Senator Breaux would limit the federal payment to 50% (and double the premium to 50% of costs) for single enrollees with adjusted gross incomes of $75,000 per year, $100,000 for couples. The payment would be cut to 25% (and the premium tripled to 75% of costs) for single enrollees with adjusted gross incomes of $100,000 per year, $125,000 for couples. The payment would be cut to 10% (premium raised to 90% of costs) for single enrollees with adjusted gross incomes of $125,000 per year, $150,000 for couples. There would be no federal payment (premium would be quadrupled to 100% of costs) for single enrollees with adjusted gross incomes of $150,000 per year, $175,000 for couples.

It is perfectly proper for the government to give welfare assistance to the poor, either in cash, food stamps, or free medical care, as in the Medicaid program. It makes no sense, however, for the government to subsidize the consumption of health care for people merely because they have reached the age of 65. Ideally, they should pay for their own insurance from private issuers. The government has in place a program — Medicaid — to pay health insurance costs for the poor; people aged 65 or over who are poor should be covered by that program.

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The Breaux proposal, however, would continue federal insurance payments for most non-poor persons over 65, graduated by income, and charge the full cost of the Part B coverage to only a few wealthy individuals. Earning an additional $25,000 would boost one's Medicare Part B premium by about $439 per year, equivalent to a tax rate increase of about 1.8 percentage points. This is a back-door income tax rate hike of about the same magnitude as that imposed by the phase-out of itemized deductions and personal exemptions for an upper-income couple over 65.

Under the Breaux plan, the government would be charging people of different income levels different prices for the same service. This is sharply at odds with rational economic practice. When two people buy identical loaves of bread at a supermarket, they are charged the same price, no matter how different their incomes may be. That price reflects the cost of the resources that went into the production and distribution of the bread. Charging people for their consumption according to their income makes no sense.

The transportation fuels tax

Senator Breaux would impose a 7.3 cents per gallon tax on all transportation fuels, including those used in road, water, rail, and air transportation. The tax per gallon would be marginally less than the 7.5 cent per gallon tax that would have been imposed by the fully phased in Btu tax. The proposal would not impose taxes on electricity, heat, and the energy used in the production of consumer goods that would have been imposed by the Btu tax, and would raise only 60% of the revenue of the Btu proposal.

There would be less damage done to the economy by the transportation fuels tax because it is smaller than the Btu tax, and less damage done to highly energy-intensive industries because it would not tax energy used as feedstocks or for processing materials. Indeed, a vocal part of the opposition to the Btu tax came from energy-intensive businesses. They pointed out, correctly, that the tax would raise their costs of production, reduce their competitiveness in the world economy, and cost jobs.

However, it would be a great mistake to think that the transportation fuels tax would do no economic damage, or at least none to businesses, simply because it would not be imposed directly on energy-intensive industries. There would still be considerable loss of production and jobs.

The tax would initially affect the fuel refining and distribution industries and the transportation industries (air, rail, water, and highway). However, it would ultimately affect all industries using transportation — which is to say, all industries — and raise the price of every raw material, semi-finished product, or final product moved anywhere within, into, or out of the country — that is, virtually all products. Even the imposition of the tax on the individual consumers would have consequences for U.S. businesses. The tax would raise the cost of commuting to work, driving to the supermarket, or travelling to a vacation spot. It would raise prices and reduce the value of the after-tax wage, affecting the supply of and cost of labor nationwide. It would reduce the competitiveness of U.S. labor and U.S. industries. It would cost jobs.

Last year, IRET estimated the economic impact of a 10 cent increase in the federal gasoline tax. (See *The Impact, Shifting, and Incidence of an Increase in the Gasoline Excise Tax* by Norman B. Ture, Carlos Bonilla, and Stephen J. Entin, IRET, Washington, DC, 1992.) The transportation fuels tax proposed by Senator Breaux is a slightly broader tax, with gasoline for cars and trucks comprising about 80% of the fuel covered, imposed at a lower rate of 7.3 cents per gallon. The transportation fuels tax would do about 90% (i.e., 7.3/0.8=0.9) of the damage to jobs and economic output as IRET estimated for the gasoline tax hike. Consequently, the transportation fuels tax would reduce annual GNP by about $25 billion to $26 billion in the 1990s (in 1993 dollars) and cost roughly 200,000 to 225,000 jobs, compared to the levels that otherwise would be achieved.

Cut spending first

The Clinton plan raises taxes to reduce the deficit. The Breaux plan mostly raises taxes to cut the deficit, and creates disincentives where it does cut spending. A pro-growth deficit reduction program would cut spending in a straightforward manner and raise no taxes. Until Washington learns this lesson, and stops trying to hang onto every possible dollar for itself, we shall see proposals that are simply economic poison served up in different colored pills.

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Note: Nothing written here is to be construed as necessarily reflecting the views of IRET or as an attempt to aid or hinder the passage of any bill before Congress.