

No Escaping the Red Ink as Bush Pens '04 Agenda

By **RICHARD W. STEVENSON** and **EDMUND L. ANDREWS**

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WASHINGTON, Nov. 28 — President Bush is heading into 2004 facing a growing budget deficit, frustration among some Republicans about what they see as a lack of fiscal discipline and a challenge in putting together an election-year agenda that will not plunge the government all the deeper into debt, lawmakers, analysts and administration officials say.

The legislative victories chalked up by the White House and the Republican-controlled Congress this year, including a new round of tax cuts and the final approval this week of a Medicare prescription drug benefit, came with a price tag that further weighed down a budget already saddled with the costs of fighting terrorism and stabilizing Iraq.

The deficit, projected a few months ago to be around \$475 billion for the fiscal year that started on Oct. 1, now seems likely to hit \$500 billion, up from \$374 billion last year. The White House's goal of cutting it at least in half within a few years will be hard to achieve despite the economic rebound and the growth in tax revenue it is expected to generate, budget analysts in the government and on Wall Street say.

Douglas Holtz-Eakin, a former Bush administration official who is now director of the Congressional Budget Office, said bringing the deficit down to some \$250 billion in the next five years "is going to be very hard to do" even if the economic recovery remains strong and unemployment falls sharply.

"The thing I would caution is that economic growth is not going to be enough" to solve the fiscal problem, Mr. Holtz-Eakin said in an interview.

It is not clear whether the deficit will be enough of an issue next year to hurt Mr. Bush's chances of re-election. But at a minimum it is limiting the White House's options as the administration looks at new policy proposals, from further tax cuts to new spending.

To avoid criticism that it is making the deficit even worse, the administration is focusing attention primarily on initiatives that would have little or no budgetary cost in the next few years, officials said. These include new tax-free savings accounts, which could be set up in a way that would actually generate additional tax revenue for several years before creating

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substantial revenue losses down the road. They also include very long-term proposals like an overhaul of Social Security.

With the economy growing again at a robust pace and starting to generate new jobs, Democrats, despite their own advocacy of increased spending on many programs, see the deficit as the most politically compelling evidence of economic mismanagement by Mr. Bush.

Saying the economic rebound had been "built on a foundation of reckless and irresponsible tax cuts and record-setting levels of debt," one Democratic presidential candidate, Howard Dean, issued a statement this week asserting that the White House's fiscal policy would ultimately come back to haunt the country.

"This president's approach," Dr. Dean said, "is the equivalent of mortgaging your house to get spending money for the weekend."

At the same time, Mr. Bush is coming under intensifying pressure from conservatives in the Republican ranks who want him to do more to choke off what they see as an orgy of spending since he took office.

Although Mr. Bush has had some success at slowing growth in spending on programs that receive annual appropriations, overall government spending — including money for the war in Iraq, farm subsidies, medical research and other undertakings — has grown at rates that have given some Republicans heartburn.

"I would be in favor of the administration being much tougher, taking the toughest possible stance on fiscal discipline," said the chairman of the House Budget Committee, Representative Jim Nussle of Iowa.

Brian M. Riedl, a budget analyst at the conservative Heritage Foundation, said government spending per household in the fiscal year that ended Sept. 30 was \$20,301 — the highest level since World War II, he said, even after adjustment for inflation. (His analysis showed that the figure peaked in 1944 at \$26,445, as measured in current dollars.)

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Though the administration has said the spending increases are largely a result of a need to strengthen the military and protect against terrorism at home, most of the new spending since 2001, 55 percent, has gone to programs with no link to national security, Mr. Riedl said.

"The Republican Party," he said, "has grown addicted to federal spending as a means to re-election."

Administration officials said they still expected to be able to reduce the deficit through a combination of spending restraint and increased revenue flowing from a healthier economy. "There's no doubt that both features will be important to getting the deficit down," said N. Gregory Mankiw, the chairman of the White House's Council of Economic Advisers.

But White House officials said the fiscal pressure would restrict them somewhat over the next month as they make final a budget proposal for next year, an exercise that will yield what amounts to Mr. Bush's election-year agenda.

"To some extent," Mr. Mankiw said, "the goal of spending restraint puts a constraint on policy proposals."

Despite the shadow of the deficit, Mr. Bush is likely to set out plans for further tax cuts and other new programs, even if he has to rely on budget sleight of hand. One of the biggest ideas under consideration is a big expansion of tax-free savings and investment accounts.

Such a plan could reduce federal revenue by billions or even tens of billions of dollars a year in the long run. But it might actually bring in additional revenue for a few years, as taxpayers sold stocks and other financial assets, incurring capital gains in the process, to raise cash to deposit in the accounts.

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Mr. Bush is also maintaining pressure on Congress to extend or make permanent the many elements of his previous tax cuts that will otherwise expire at various points over the next decade. Compliance by Congress, the Congressional Budget Office estimates, would reduce revenue by nearly \$1.4 trillion in the next 10 years.

In addition, Congress has deficit-increasing ideas of its own that the White House has supported or at least not opposed. The energy bill that stalled in the Senate before lawmakers recessed provides tax cuts totaling \$24 billion over the next decade. And House Republicans, pushing for an overhaul of taxes on international corporations, want legislation that would grant them \$60 billion more of tax breaks in that period.

In the long run, the government faces rising interest costs from the increasing level of debt it is amassing. (Debt held by the public, the portion of the total national debt generated by year-to-year budget deficits, currently stands at around \$4 trillion.) Only a few years ago, when the nation was awash in budget surpluses, both parties pledged to pay off the debt held by the public. Such a step would have made it easier for the government to address a problem now just over the horizon: the prospect that Social Security and Medicare will not be able to pay full benefits to the baby boomers as they retire.

Mr. Bush is considering a new push next year on behalf of his plan to overhaul Social Security through the creation of private investment accounts, a change that would require large though temporary infusions of cash. But any effort to promote his approach will run into questions about whether it is fiscally feasible given the likelihood of large long-term budget deficits.

Both the White House and the Congressional Budget Office are updating their deficit projections and will make them public in January or February, just when the presidential campaign is getting under way in earnest.

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