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SAVE THE GRAMM-RUDMAN SEQUESTER

Daniel J. Mitchell
John M. Olin Fellow in Political Economy

Washington should be celebrating the Gramm-Rudman-Hollings Balanced Budget and Emergency Deficit Reduction Act of 1985, popularly known as Gramm-Rudman. Since it was enacted, inflation-adjusted federal spending has grown by only 1.4 percent annually, a dramatic reversal of the runaway federal spending increases of previous periods when it jumped 3.6 percent annually in the 1970s and 4 percent annually between 1980 and 1985. At the same time, the federal budget deficit has fallen from \$212 billion in fiscal year 1985 to an estimated \$123.8 billion this year. Adjusted for inflation, the deficit today is less than half the size it was just five years ago.

Instead of celebrating the success of Gramm-Rudman, many in Washington are claiming that it has failed. Thus, while two of the measure's principal sponsors, Republican Senators Phil Gramm of Texas and Warren Rudman of New Hampshire, still support the Act, South Carolina's Democratic Senator Ernest Hollings openly disassociates himself from it. Newspaper articles and political commentators routinely assert that Gramm-Rudman is a flop. Despite the facts that say the opposite, the sheer volume of criticism directed at Gramm-Rudman suggests that federal spending and budget deficits continue to grow uncontrollably.

Vast Improvement. Many of those who assert that Gramm-Rudman does not work are mounting a campaign to repeal the law or eliminate its enforcement mechanism, known as sequestration. If Congress fails to produce a budget that controls deficit spending, sequestration takes effect, automatically reducing spending by the amount needed to bring the deficit down to the legally-required level. This is a vast and proven improvement over earlier congressional efforts to control deficit spending. The fact that now a sequester occurs automatically if Congress fails to comply with the deficit-cutting law guarantees deficit reduction will actually happen. Without the sequester, Gramm-Rudman is almost completely emasculated.

Rather than discussing ways to weaken Gramm-Rudman, Congress should examine proposals to strengthen the law. One reform would be to introduce a second sequester, occurring in mid-year. This would help prevent Congress from increasing spending after the October 15 sequester deadline, which occurs just two weeks into the new fiscal year. Another reform, mentioned in the Bush Administration's budget this year, would require a "super-majority" vote by each House of Congress to rescind a sequester once it goes into effect; currently, a sequester can be rescinded by legislation passed by simple majority. Another reform would limit such budget gimmicks as taking programs "off budget" or moving government paydays from one fiscal year to another. These gimmicks do not cut spending but merely hide the size of the deficit.

THE GRAMM-RUDMAN APPROACH TO DEFICIT REDUCTION

In the 1970s, the proponents of higher federal government spending usually had their way. Since there were no objective limits on spending or deficits, they could enact new spending programs and increase funding for existing programs with little difficulty. Fiscally-responsible legislators then often had to raise taxes to contain deficits. This pattern of fiscal conservatives raising taxes so advocates of big government could raise spending did little to promote economic growth – or to control the federal debt.

In 1981 Ronald Reagan, with Republicans controlling the Senate, broke with tradition and pushed through comprehensive legislation to lower America's tax burden. Supporters of tax cuts hoped that reducing disincentives to work, save, and invest would lead to higher levels of economic growth. This in fact happened. A by-product of cutting tax rates and of the record 88-month economic expansion is that annual federal revenues have increased by more than \$473 billion since 1983, a jump of 79 percent. The problem was that the combination of the 1982 recession and continued congressional overspending pushed the deficit to record high levels. Some thought higher taxes were the only way to lower the deficit; this resulted in large tax increases in 1982, 1983, and 1984. As in the past, however, these tax increases were not used for deficit reduction; they simply were excuses for more government spending.

Frustrated Congress. The Gramm-Rudman-Hollings Balanced Budget and Emergency Deficit Reduction Act of 1985 changed all this. Enacted by a Congress frustrated with persistently high deficits, the Act set progressively smaller maximum budget deficits for each fiscal year. The original targets sought to balance the budget by fiscal 1991. Subsequently, Congress shifted the timetable to 1993 (see Table 1).¹

1 Note: The fiscal year begins October 1 and ends September 30 of the following year. The 1990 fiscal year, for instance, began October 1, 1989, and will end September 30, 1990.

Table 1
Gramm-Rudman Deficit Targets
(\$ billions)

Year	1990	1991	1992	1993	1994
Target	\$100*	\$64*	\$28*	-0-	?

* There is a \$10 billion margin of error for all years other than 1993, raising the effective targets by that amount.
Source: Budget of the United States Government

Gramm-Rudman requires that the Office of Management and Budget (OMB) prepare a "snapshot" estimate of the upcoming fiscal year's deficit each August based upon assumptions about economic performance and congressional actions on that year's budget. Since the August snapshot will almost certainly show that the projected deficit is higher than the Gramm-Rudman target, Congress will know how much additional deficit reduction is required before the new budget takes effect on October 1.

Automatic Reductions. OMB takes a final deficit snapshot on October 15. If the projected deficit on that day is more than \$10 billion over the Gramm-Rudman target, spending for federal programs subject to sequestration is automatically reduced by the percentage necessary to lower the deficit to the required level. Under Gramm-Rudman, 50 percent of the sequester comes from defense and 50 percent from domestic spending. Most entitlement programs are exempt from sequestration.

Should a sequester occur, Congress can simply accept the results, or it may choose to substitute an alternative deficit reduction package. A full sequester has never happened, although partial year sequesters did occur in fiscal 1986 and 1990.

DYNAMICS OF THE GRAMM-RUDMAN PROCESS

Gramm-Rudman sharply curtails Congress's ability to increase spending. Under Gramm-Rudman, total spending in any year cannot exceed the sum of anticipated tax revenues plus the maximum allowable deficit. To introduce new programs or to increase spending for existing ones, legislators must either raise taxes or cut spending elsewhere in the budget. This deficit-neutral requirement forces policy makers to make trade offs. This, more than anything else, fundamentally has altered the dynamics of the budget process.

In the case of catastrophic care, for example, Congress had to include a large tax increase as part of the legislation to "pay" for the spending provisions of the bill. This sparked a revolt by the elderly asked to pay the higher taxes, leading Congress last year to repeal the catastrophic care program. The lesson: beneficiaries of spending are much less enthusiastic about big government if they have to pay for the programs.

Congress, of course, could trim some existing programs to free up money for new programs. This is a commendable process, for it would require lawmakers to set priorities. Politically, however, it has been difficult to find off-

setting spending reductions. An attempt to comply with Gramm-Rudman's deficit neutrality requirement, for example, resulted in bitter warfare in the Senate last year over legislation to fund anti-drug programs.

GRAMM-RUDMAN SUCCESS IN CONTROLLING SPENDING

As shown in Table 2, federal spending in current dollars increased by an average of more than 9.9 percent annually between 1980 and 1985. Since Gramm-Rudman was adopted, however, annual spending increases have averaged about 4.8 percent. If federal spending had continued to grow at the 9.9 percent annual rate, both the budget and the deficit for 1990 would be more than \$300 billion higher than currently projected.

Table 3 shows that after adjusting for inflation, the impact of Gramm-Rudman is even more striking. Federal spending in real terms grew almost three times faster before Gramm-Rudman than it has since Gramm-Rudman.

More important, Gramm-Rudman has helped reduce the size of government relative to the size of the productive sector of the

economy. In every year but one between 1980 and 1985, government spending as a percentage of Gross National Product (GNP) was higher than the previous year, with annual increases averaging 0.36 percentage points. Yet as Table 4 shows, government spending as a percentage of GNP has fallen or remained stable every year since Gramm-Rudman was adopted, declining by an average of more than 0.4 percentage points each year.

Table 2
Annual Spending Increase During the 1980s

Year	Spending (\$ billions)	Annual Growth Percent	
1980	590.9	—	
1981	678.2	14.8	Five Year Average Growth = 9.9 %
1982	745.7	10.0	
1983	808.3	8.4	
1984	851.8	5.4	
1985	946.3	11.1	
1986	990.3	4.6	Five Year Average Growth = 4.8 %
1987	1003.8	1.4	
1988	1064.0	6.0	
1989	1142.6	7.4	
1990*	1197.2	4.8	

*Estimate

Source: Budget of the United States Government

GRAMM-RUDMAN'S SUCCESS IN SLASHING THE DEFICIT

Gramm-Rudman also has reduced the budget deficit. In four of the five years before Gramm-Rudman, the deficit increased. As Table 5 shows, of the five years since Gramm-Rudman was enacted, the deficit has fallen three years. As a percent of GNP, the budget deficit increased in three of the five years before Gramm-Rudman; since enactment, the deficit as a percent of GNP has fallen every year. According to current projections, the deficit as a percent of GNP will be at its lowest level in more than a decade. As recently

Table 3
Annual Spending Increases During the 1980s
(1982 dollars)

Year	Spending (\$billions)	Annual Growth Percent	
1980	699.1	—	
1981	726.5	3.9	Five Year Average Growth = 4.0 percent
1982	745.7	2.6	
1983	775.0	3.9	
1984	788.1	1.7	
1985	849.6	7.8	
1986	867.5	2.1	Five Year Average Growth = 1.4 percent
1987	857.8	-1.1	
1988	879.6	2.5	
1989	907.1	3.1	
1990	912.2	0.6	

*Estimate

Source: Budget of the United States Government

Table 4
Federal Government Spending as a Percent of GNP

Year	Spending Percent of GNP	Change	
1980	22.1	—	
1981	22.7	+0.6	Five Year Average Growth = +0.36%
1982	23.8	+0.9	
1983	24.3	+0.5	
1984	23.1	-1.2	
1985	23.9	+0.8	
1986	23.7	-0.2	Five Year Average Shrinkage = -0.42%
1987	22.7	-1.0	
1988	22.2	-0.5	
1989	22.2	—	
1990	21.8	-0.4	

Source: Budget of the United States Government

as 1988, total government deficits in the U.S. as a percent of GNP were the same as West Germany's (though West Germany was in better shape than the U.S. last year), and for at least the past half-dozen years, the annual U.S. government deficit as a percent of GNP was below the average for all West European countries.

Another way to illustrate how Gramm-Rudman has reduced the budget deficit is to compare what the Congressional Budget Office (CBO) projected the deficit would be in 1989 and 1990 before Gramm-Rudman was enacted. In 1985, CBO es-

timated that the 1989 deficit would be \$272 billion and consume 5.2 percent of GNP. For 1990, CBO also predicted in 1985 that the 1990 deficit would climb to \$296 billion and 5.3 percent of GNP. In reality, owing largely to the Gramm-Rudman law, the 1989 deficit was \$152 billion, \$120 billion below the estimate. If the 1990 budget deficit estimate of \$123.8 billion is even close, the deficit will be less than half the amount CBO projected.

Table 5
Deficits During the 1980s

Year	Deficit (\$ billions)	Deficit as % of GNP
1980	73.8	2.8
1981	78.9	2.6
1982	127.9	4.1
1983	207.8	6.3
1984	185.3	5.0
1985	212.3	5.4
1986	221.2	5.3
1987	149.7	3.4
1988	155.1	3.2
1989	152.0	2.9
1990	123.8	2.3

Source: Budget of the United States Government, Historical Tables

THE FLAWED CASE AGAINST GRAMM-RUDMAN

Opponents raise several arguments against the Gramm-Rudman approach to fiscal policy. If the case were that Gramm-Rudman is far from perfect, then the critics would be correct. Gramm-Rudman offers considerable room for improvement. But this is not where the congressional critics focus.

Slipping Targets. Opponents point out that Gramm-Rudman originally called for a balanced budget for fiscal 1991. Now the target is fiscal 1993. Thus, it might be said the law lacks credibility. But this is an indictment not of Gramm-Rudman but of Congress, which pushed the target forward two years. Congress was unwilling to reduce the deficit as quickly as Gramm-Rudman originally demanded. The weakness of Congress in dealing with overspending underscores the importance of preserving the automatic Gramm-Rudman mechanism for meeting deficit targets.

Gramm-Rudman's critics claim that the law does not work because actual deficits at the end of each fiscal year consistently have exceeded the Gramm-Rudman target. The deficit in fiscal 1989, for instance, was \$152 billion, \$16 billion above the \$136 billion target. Furthermore, the Bush Administration

projects that the fiscal 1990 budget deficit will be \$123 billion, \$23 billion over target.

Loopholes. This overshooting of the target results from loopholes in the Gramm-Rudman law. One loophole is that Gramm-Rudman does not require that the actual deficit equal the deficit target. Instead, it mandates that the deficit projected as of October 15, two weeks into the new fiscal year, be no more than \$10 billion over the target.

If the economic assumptions underlying the deficit projection are too optimistic (for example, projecting a stronger economy and more resulting tax revenues), the actual deficit will be higher than the target. And it is Congress, not the White House, which typically usually adopts the rosier forecasts because better economic assumptions mean that less spending restraint is needed to meet projected deficit targets.

A second loophole is that once the October 15 sequester deadline passes, Congress can increase spending for that fiscal year without triggering a subsequent sequester. The only significant barrier against such midyear spending increases is the 60 votes required in the Senate to waive the budget act and consider legislation which would increase the deficit. While the 60-vote requirement makes it more difficult to increase spending, it is still possible for Congress to approve such increases. Every dollar of added spending after October 15 causes the actual deficit to be that much higher than the deficit target.

Meat-Ax Budgeting. Critics assert that Gramm-Rudman is an arbitrary meat-ax approach to budget cutting, since those programs vulnerable to sequester all are penalized, while almost all entitlement programs are exempt from automatic cuts. Indeed, there is no doubt that Gramm-Rudman discriminates. The defense budget, for instance, must account for 50 percent of the total sequester even though defense is barely one-fourth of the total budget. If Congress finds the current sequester formula unfair, however, legislators can change the law to increase the number of programs which are affected.

THE PROBLEM OF BUDGET GIMMICKS

Congress, often in cooperation with the Administration, can get around Gramm-Rudman restrictions with budgetary gimmicks and sleights of hand. Congress, for example, has shifted government paydays and Medicare and farm-price-support payment dates from one fiscal year to another. Thus, if projected spending for 1991 appears too high, Congress could move a payday from October 1, the first day of the 1991 fiscal year, back to September 30, the last day of the 1990 fiscal year. Spending will increase for the current year, but Congress will not be subject to sanctions since the sequester deadline passed nearly a year before, on October 15, 1989.

Another gimmick used by Congress to evade deficit limits is to take programs off budget. Last year, for instance, Congress took the Postal Service

off budget so that its deficit no longer is counted in the general federal deficit calculation. Congress claimed to “save” \$1.7 billion by doing this, even though the Treasury Department still must borrow just as much money to cover off-budget as on-budget debts. And once the Postal Service was off budget and its deficits no longer counted, Congress required the Postal Service to make a one-time \$400 million payment to an on-budget part of the government. This created the illusion of an additional \$400 million of deficit reduction. The Farm Credit system was also taken off budget, a move that generated another \$400 million of phony savings.

SOCIAL SECURITY AND THE BUDGET DEFICIT

The issue of deficit reduction has been confused by constant claims that the Social Security “surplus” masks the true size of the deficit. It is true that Social Security tax revenues have begun exceeding Social Security outlays. The overall federal budget deficit, however, is supposed to measure how much money the government will borrow from private credit markets. As such, all government spending and taxes, including Social Security, should be counted. Any other measurement would misrepresent the true extent of government borrowing. The Social Security system thus belongs where it is, in the unified budget.

When Social Security tax revenues exceed outlays, the Social Security system takes its excess to the Treasury and exchanges the cash for U.S. government bonds or IOUs; these are “deposited” in the Trust Fund. When Social Security outlays begin to exceed revenues, as they will early next century, the Social Security system will return to the Treasury to redeem these bonds for the cash to pay retirement benefits. At that time, to get the cash to redeem the Social Security system’s bonds, the Treasury either will have to raise taxes, or issue new debt, just as would be the case with a pay-as-you-go system. If it does not do so, then it will not be able to redeem the bonds; the Social Security system then will have to reduce benefits to retired Americans.

RECOMMENDATIONS

Gramm-Rudman has helped slow federal spending and reduce the budget deficit. Legislators concerned about its weaknesses should strengthen the law rather than repeal it. Among the changes that would bolster Gramm-Rudman’s ability to control deficit spending are:

1) Adding a second sequester. To discourage budget gimmicks and back-door spending, a second sequester should be adopted in the middle of the fiscal year. As with the present sequester, it would be triggered only if the projected deficit exceeded the target by more than \$10 billion.

2) Requiring a super-majority to rescind a sequester. Since Gramm-Rudman is a law rather than a constitutional requirement, Congress can cancel a sequester. Requiring a three-fifths or two-thirds vote to rescind sequester would make it very difficult for Congress to avoid the law’s discipline.

3) Prohibiting payday shifts and other budget gimmicks. Both Congress and the Administration often use various loopholes in the law, such as taking programs off budget or shifting paydays or days for disbursing other government payments from one year to the next. Limits should be placed on these mechanisms to force Congress to adopt measures that restrain real spending rather than create the illusion of dealing with the problem.

CONCLUSION

Even with its weaknesses, Gramm-Rudman has slowed the growth of federal spending and reduced the budget deficit. If critics complain that Gramm-Rudman is not tough enough, the answer would be to plug the loopholes. But most critics seek to repeal the Act or at least to eliminate its automatic sequester, which is the Act's most effective curb on spending.

In reality, many of Gramm-Rudman's critics object to the law because it has worked. Many legislators resent having to choose which programs will receive scarce funds. Special interest groups are having a much harder time getting access to taxpayers' wallets, forcing them to compete against one another.

Change for the Better. The passage of Gramm-Rudman thus marked a turning point in the battle of the budget. With the right strategy, refusal to capitulate on taxes and willingness to use the sequester if necessary, George Bush can assure that spending and deficits are brought under control. These benefits, however, will vanish if the Gramm-Rudman sequester is repealed. The deficit reduction law has dramatically changed the way Congress budgets — for the better.

Indeed, the only shortcoming is that Gramm-Rudman will end in 1993. There is always a possibility that politicians will "slip" the targets again and extend the balanced budget goal forward a year or two, but at some point Gramm-Rudman will accomplish its immediate goal of balancing the budget. At that point, advocates of economic growth need to be ready with tax-cut proposals, accompanied by new deficit reduction requirements. Gramm-Rudman has succeeded in reducing the relative size of government, but only constant vigilance will keep leviathan under control.

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