Backgrounder UPDATE

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THE BUDGET SUMMIT AGREEMENT: PART III NO NEW TAXES NEEDED

(Updating *Backgrounder Update* No. 141, "The Budget Summit Agreement: Serious Damage to the Economy, Part II," October 2, 1990; *Backgrounder Update* No. 141, "The Budget Summit Agreement: Serious Damage to the Economy, Part I," October 1, 1990; and *Backgrounder* 787, "Rx for the Federal Deficit: The Four Percent Solution," September 4, 1990.)

George Bush and congressional budget negotiators are telling the American people that the only way to deal with the budget deficit is to raise taxes by $134 billion over the next five years. Yet their own calculations show just the opposite – that deficit reduction can be achieved with no new taxes simply by a reasonable slowdown in the overall growth of federal spending. If the aggregate outlay targets agreed to by the summit negotiators are enforced, the budget deficit will be reduced significantly without the new taxes which threaten to send the economy into a recession.

Even greater deficit reduction could be achieved with a "Four Percent Solution," which would limit to four percent the annual increases in non-defense spending. The Four Percent Solution in fact would result in a large budget surplus by 1994.

Bush and the negotiators claim that they have instituted real spending cuts as well as long-term spending restraint in exchange for the $134 billion in new taxes. Yet the dirty little secret of the agreement is that domestic discretionary spending and domestic entitlement spending still will increase by an average of 6.5 percent per year – not even including the Savings and Loan (S&L) bailout. Thus, the cumulative spending increases in non-defense spending accounts will total $724.6 billion over the five years of the agreement. What this means is that the agreement increases non-defense spending by $5.40 for every new dollar of tax revenues.

So-called cuts in non-defense spending, moreover, are largely illusory. Example: the agreement does not cut Medicare spending, despite the protests from lobbyists for the elderly, but merely reduces the annual rate of increase from 12.6 percent to 11.0 percent. In fact, non-defense spending will increase under the agreement during the first three years at the same rate as that projected under current law.

Only the large real cuts in defense spending made in the budget agreement allow the summiteers to claim a reduced rate of annual spending growth. This would help achieve a spending growth rate significantly below the 6.6 percent annual growth rate of tax revenues projected under current law without any new tax increases. Indeed, under current law, total tax revenues are projected to increase by $397 billion over the next five years.

The lesson of the budget summiteers' own calculations: No new taxes are needed.

THE OLD DEFICIT CALCULATION METHOD

The budget summiteers' own data show that with continued modest economic growth, in addition to the freeze in defense spending outlined in the budget agreement, the deficit will be cut to $8.4 billion without any increases in taxes. Table 1 shows the pre-budget summit method for calculating the Gramm-Rudman deficit targets: the cost of the savings and loan (S&L) bailout is excluded from the spending levels, and the surpluses generated in the Social Security accounts are included in the revenue levels.

TABLE I
DEFICIT REDUCTION WITHOUT TAX INCREASES
(OLD GRAMM-RUDMAN CALCULATION METHOD)

(Outlays in billions)	1991	1992	1993	1994	1995
Agreed Summit Outlay Levels: S&L Costs Excluded	1263.5	1312.2	1359.6	1396.3	1430.2
Tax Revenues Without A Tax Increase	1121.4	1194.2	1278.6	1363.0	1441.1
Summiteers' Economic Assumptions	30.4	58.4	54.4	35.8	19.3

Lawmakers should note that the budget summiteers show a higher deficit than their calculations might otherwise indicate by including figures in a category labeled "Revised Economic Assumptions." These numbers reflect assumptions about spending growth higher than indicated in initial outlay predictions and lower revenue receipts than is assumed in initial revenue predictions. Policy makers are not told what these numbers represent – they seem little more than a stealth spending agenda hidden in the agreement.

DEFICIT DOWN WITHOUT TAXES

The budget negotiators have added another twist on deficit calculation. The "consolidated" deficit includes the cost of the S&L bailout in total federal spending and the surpluses generated in the Social Security trust funds in total federal revenues (See Table 2).

Using this method to calculate the deficit, the summiteers' own data show that a tax increase is not needed. The deficit can be reduced, without introducing new taxes, to only $15.5 billion by fiscal 1994. A $36.4 billion surplus will be generated by 1995.

TABLE II DEFICIT REDUCTION WITHOUT TAX INCREASES (CONSOLIDATED DEFICIT CALCULATION METHOD)					
(Outlays in billions)	1991	1992	1993	1994	1995
Agreed Summit Outlays: S&L Costs Included	1360.8	1391.8	1380.6	1342.7	1385.4
Tax Revenues	1121.4	1194.2	1278.6	1363.0	1441.1
Summiteers' Adjusted Economic Assumptions	30.4	58.4	54.4	35.8	19.3
Consolidated Deficit	-269.8	-256.0	-156.4	-15.5	+36.4

Table 2 indicates the outlay levels agreed to by the summiteers. These levels reflect the defense spending freeze and the alleged savings in other programs, and they include the cost of the S&L bailout. The revenues cited are the projected revenues before the addition of any new taxes.

NON-DEFENSE SPENDING SOARS

Under the agreement, defense spending is practically frozen at nominal 1990 levels. It is this freeze that slows down the aggregate growth of spending. However, non-defense spending continues to increase rapidly. During the five-year period of the agreement, domestic spending will rise on average by 6.5 percent per year (See Table 3). Despite the so-called spending cuts, non-defense spending actually matches the pre-summit projected spending rates during the first three years of the agreement. There are no cuts in this segment of the budget.

The budget summit agreement also contains a hidden time bomb in the form of the "enforcement provisions," which could lead to even higher spending than the given 6.5 percent annual growth in the non-defense-domestic category. Although the enforcement mechanism "caps" spending increases in these categories at 6.5 percent per annum, these caps effectively could become null and void if the economic assumptions – primarily projected interest and inflation rates and entitlement spending – prove to be inaccurate.

This is likely to be the case. The tax increases in the budget summit plan will trigger a deep economic recession. This means that revenues will drop drastically, and the government will have to pay out more benefits such as unemployment insurance and food stamps. The spending caps will be adjusted upward automatically to absorb the extra spending. Thus with a tax increase stalling the economy, the real rate of growth of non-defense spending under the summit plan will exceed 6.5 percent and probably be closer to 8.5 percent.

TABLE III SUMMIT AGREEMENT: GROWTH IN NON-DEFENSE SPENDING							
(Outlays in Billions)	1990	1991	1992	1993	1994	1995	Total Spending Increase
Discretionary Non-Defense Spending	185.3	198.1	2120.1	221.7	*	*	$80**
Growth Rate	–	6.9%	6.1%	5.5%	–	–	–
Mandatory Non-DefenseSpending Excluding Interest and S&L Costs	523.2	555.4	592.2	633.6	675.9	715.3	$557.4
Growth Rate	–	6.2%	6.6%	7.0%	6.7%	5.8%	–

*Spending Levels Unresolved by Budget Summit

**Three-Year Total

THE FOUR PERCENT SOLUTION

Congress and the Administration must deal with the budget deficit in a way that does not plunge the country into a recession. If the budget summit agreement outlay targets are enforced, the deficit can and should be reduced without new taxes.

Yet even greater deficit reduction than the summiteers envision can be achieved by controlling spending, without raising taxes, with a so-called Four Percent Solution. This approach would accomplish the goals of the budget negotiators, and would do so with a more even-handed approach to spending control. The three key elements in the solution are:

1) No new taxes;

2) A freeze on defense spending at the levels approved by the budget summiteers;

3) A four percent per year cap on the growth in non-defense spending.

By rejecting tax increases, the Four Percent Solution would avoid both the direct burden to individuals forced to shoulder the taxes and the tax-induced recession that would cause the budget deficit to balloon. The Four Percent Solution would reduce the deficit more rapidly than envisioned under the summit plan by bringing the non-defense spending under control. The Four Percent Solution, however, would not require any cuts in non-defense spending; instead it would allow this spending to increase at roughly the general rate of inflation.

TABLE IV DEFICIT REDUCTION UNDER THE FOUR PERCENT SOLUTION						
(Outlays in Billions)	1990	1991	1992	1993	1994	1995
Defense Spending/Nunn Levels	318.40	315.00	313.40	310.90	310.90	310.90
Discretionary Domestic Spending	185.30	192.71	200.42	208.44	216.77	225.45
Mandatory Spending	523.20	544.13	565.89	588.53	612.07	636.55
Interest	181.40	195.00	196.50	193.40	185.60	174.10
Total Outlays	1208.30	1246.84	1276.21	1301.27	1325.34	1347.00
Baseline Taxes		1121.40	1194.20	1278.60	1363.00	1441.10
Savings And Loan Costs	54.00	97.30	79.60	21.00	-53.60	-44.80
Summit Economic Assumptions		30.40	58.40	54.40	35.80	19.30
4 Percent Solution Consolidated Deficit		-253.14	-220.01	-98.07	+55.46	+119.60
Summit Consolidated Deficit		-253.60	-229.40	-129.40	+16.70	+68.30

Table 4 shows the impact of the Four Percent Solution on the budget deficit. By the third year of this plan, in 1993, total outlays would be $1,301 billion, while revenues – without any tax increase – would be at $1,278 billion. The cost of the S&L bailout and the summiteers' adjusted economic assumptions would bring the total deficit to $98 billion. This compares with a fiscal 1993 deficit of $129 billion under the summit budget plan.

In 1991, 1992, and 1993, the deficit would be lower with the Four Percent Solution than with the summit budget agreement. Thus, given the economic assumptions of the summiteers themselves, by 1994 the Four Percent Solution would produce a robust budget surplus of $55 billion compared to $16.7 billion under the summit budget agreement.

INCREASED ENFORCEMENT

The key to any successful budget agreement is the enforcement mechanism. If Congress can simply ignore its own agreement, then the budget will be out of control. The Four Percent Solution, however, would amend the Gramm-Rudman Deficit Reduction Act to provide a formidable barrier against runaway spending. Among the safeguards:

1) Spending targets would be incorporated into the Gramm-Rudman Act. The outlay targets established in the bill are four percent above the previous year's total outlays, starting with fiscal 1990 as the base year. If Congress exceeds the outlay target, then a sequester would be triggered to bring spending back in line. A sequester would continue to be triggered if the deficit target is not met.

2) A mid-year sequester would be added. The Four Percent Solution establishes a mid-year sequester on April 15, following a March 15 evaluation of the federal government's success or failure in meeting its spending targets. This guards against the introduction of new spending after the current October 15 sequester deadline and the "fudging" of expected revenues.

3) Current services budgeting would be eliminated. Under the four percent proposal, Congress will start the budget process using the last year's spending as the basis for deciding next year's spending. This will bring honesty to the budget process by defining spending increases as increases above the previous year's level, and spending decreases as reductions below the previous years's level.

4) A pay-as-you-go clause in the budget process would be established. Simply stated, this provision ensures that any spending increase is offset by a corresponding spending decrease. And any revenue cuts are offset by spending cuts or revenue increases.

CONCLUSION

The budget summit agreement offers the same old "business as usual" on non-defense spending which increases at a minimum of 6.5 percent per annum. If the growth in non-defense spending were limited to four percent per year and no new taxes were imposed on the economy, the deficit would be reduced even more rapidly and a large budget surplus would be generated by 1994.

The budget summiteers' own data show that a tax increase is not needed to produce deficit reduction. If the budget summit outlay targets were actively enforced without a tax increase, the result would be significant deficit reduction in future years. A tax increase would not lead to further deficit reduction but simply finance higher entitlement spending and, by slowing growth and tax revenue increases, would raise the deficit.

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