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214 Massachusetts Avenue N.E. Washington, D.C. 20002 (202)546-4400

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THE BUDGET SUMMIT AGREEMENT: PART VIII HIDDEN TIME BOMBS

(Updating *Executive Memorandum* No. 286, "The Budget Summit Agreement: Part VII, Economists Speak Out," October 3, 1990; *Backgrounder Update* No. 145, "The Budget Summit Agreement: Part VI, No Real Budget Process Reform," October 3, 1990; *Backgrounder Update* No. 144, "The Budget Summit Agreement: Part V, Faulty Economic Assumptions, " October 3, 1990; *Backgrounder Update* No. 143, "The Budget Summit Agreement: Part IV, The Myth of Entitlement Reform," October 3, 1990; *Backgrounder Update* No. 142, "The Budget Summit Agreement: Part III, No New Taxes Needed" October 3, 1990; *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.)

Budget summiteers claim that the $134 billion tax hike included in their agreement, the largest first-year tax increase in America's history, was a one-time necessity. In the long run, they say, the agreement will limit the growth of government spending and thus eliminate the need for higher taxes in the future. Yet the budget agreement actually includes several provisions which would reshape fundamentally the nation's tax and spending policies. Far from reducing the likelihood of future tax increases, these provisions would open the door to higher taxes and bigger government. Thus, not only does the budget package propose recessionary policies for today, it also virtually guarantees a huge increase in spending and taxation in the future.

Among the many fiscal time bombs hidden in the budget agreement:

- **A National Sales Tax.** Many liberals in Congress have long wanted a value-added tax or some similar national sales tax, knowing that such a national tax would be a cash cow to finance future pet programs. The agreement opens the door to such a tax. The imposition of a ten percent tax on so-called luxury items can easily be expanded to include other products and services. Indeed, because the overall package is sure to fail in its goal of deficit reduction, pressure will be created for more tax increases in future years. Legislators then will be tempted to define more and more goods as "luxury" items. Eventually this revenue-raising "luxury" tax will become the full blown national sales tax that the big spenders have always wanted.

- **Effective Prohibition of Future Tax Cuts.** Many policy makers, concerned that the budget summit agreement may be enacted into law, are developing tax-cut proposals to pull the economy out of the recession which almost certainly will follow the enactment of the budget summit package. But the agreement blocks virtually any future legislation that would reduce the tax burden on the American people. The reason is that the agreement requires any tax cut to be accompanied by a provision raising taxes by an equal amount. Furthermore, if higher taxes are not included in the tax cut legislation, the budget agreement requires the appropriate congressional committees to produce legislation raising taxes by the same amount as the tax cut provision.

- **Reduction of Itemized Deductions.** The budget agreement would reduce the value of itemized tax deductions for higher income Americans, opening the door to the gradual erosion of many deductions now available to middle-income Americans. This sets the stage for the elimination of such deductions as home mortgage interest, state and local income and property taxes, and charitable contributions. If the Federal Reserve Board follows an inflationary monetary policy, as advocated currently by the Bush Administration, middle-class taxpayers who receive wage increases just to offset inflation soon will find their deductions are reduced.

- **Gutting the Gramm-Rudman Deficit Reduction Act.** Supporters of the agreement claim that the package strengthens Gramm-Rudman by adding spending caps for domestic, international, and defense discretionary spending. This marginal improvement is overshadowed, however, by the creation of a number of loopholes. Under the proposed agreement, for instance, Gramm-Rudman's fiscal discipline does not apply if the excessive spending is caused by faulty "technical" and "economic" assumptions. Given legislators' proclivity to use inaccurate assumptions and faulty estimates under current law, this provision enables lawmakers to evade the Gramm-Rudman targets simply by adopting phony economic projections. It does not take much imagination to see how this loophole will emasculate Gramm-Rudman.

- **The Raid on Special Funds.** The budget summit agreement raises revenues by misusing taxing authority meant to deal with specific national problems. Example: Revenues from the gasoline tax normally go into a trust fund meant to finance improvements in America's highways. But half of the new money raised by the proposed 12 cent increase in gasoline taxes will go to general revenues, not into the highway fund. Example: The amount of an individual's income subject to the Medicare tax is raised from $51,300 to $73,000, not to help elderly Americans who become sick but to give Congress more money to spend on other programs. With the major trust funds raided in this way, the door is open to future abuses of taxing authority and raids by a spendthrift government on funds set aside in special accounts.

The budget summit agreement, contrary to the claims of its supporters, not only fails to reduce spending but makes it easier in the future for the government to extort further revenues from an already overtaxed American public. Far from being stop-gap measures to reduce the deficit, they are major changes in policy, overturning some of the most basic principles of U.S. tax policy.

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