The Heritage Foundation
Backgrounder UPDATE
214 Massachusetts Avenue N.E. Washington, D.C. 20002 (202)546-4400

10/18/90 Number 150

THE FOUR BIG LIES OF THE "NEW" BUDGET AGREEMENT

(Updating *Backgrounder Update* No. 148, "The 'New' Budget Agreement: Part III, The Fairness Issue - Trojan Horse for Taxing the Middle Class, October 18, 1990; *Backgrounder Update* No. 147, "The 'New' Budget Agreement: Part II, Back to Carternomics," October 12, 1990; and *Executive Memorandum* No. 289, "The 'New' Budget Agreement: Part I, From Bad to Worse," October 9, 1990.)

The House of Representatives enacted the largest tax increase in America's history October 16, raising taxes by at least $170 billion over five years. The Senate is poised to follow suit today with a tax hike of equivalent proportions. Neither bill cuts one cent of spending except for defense. The two bills will then go to a House-Senate conference committee to iron out differences. If the conference commettee's changes are approved by each chamber, the legislation goes to the White House for the President's signature or veto.

While the House and Senate bills differ to some degree, both are based on lies repeated apparently unashamedly by the White House and top Republican and Democratic congressional leaders. Both bills return to the tax-and-spend policies of the 1970s. Higher taxes would be used to finance more than $245 billion of additional federal spending. If either bill, or any possible combination of the two, is signed into law by the President, the economy almost certainly will fall into a recession.

Administration officials consistently have claimed that the President must capitulate since failure to sign a tax bill results in a stalemate with Congress. The deficit, this argument goes, then would remain unacceptably large, and the Federal Reserve Board would not adopt an easy money policy to lower interest rates. The White House, led by Office of Management and Budget Director Richard Darman, is deliberately misleading America when it puts the choices this way. George Bush need not choose between higher taxes and higher deficits. The President instead can achieve the largest deficit reduction in history without one penny of new taxes by using the automatic Gramm-Rudman-Hollings spending restraint mechanism known as sequestration.

The first step is a veto of the tax increase being prepared by Congress. The President should then demand, and responsible lawmakers should then produce, a full year spending bill, or Continuing Resolution, that funds the government at a level consistent with a partial $40.1 billion sequester. While politicians in Congress would not be inclined to support this request, their other alternatives

This is Part 4 in a series of Heritage Foundation studies on the "new" budget agreement. Parts I, II, and II are listed at the beginning of this study.

would be either to shut the government by failing to pass any spending bill or to allow a current law sequestration to go into effect, automatically reducing fiscal year 1991 spending – and the deficit – by an estimated $85.3 billion.

The choice is therefore not between higher taxes and higher deficits, each of which drains resources out of the economy's productive sector. The honest choice is between the record-high tax increases proposed in Congress, all the revenues from which are used to fund higher spending, and a partial sequester, which reduces the deficit by addressing the true problem – excessive federal spending.

Many politicians would characterize a $40.1 billion partial sequester as an excessive "cut" in government spending, even though total federal spending in 1991 after sequestration would still be more than $30 billion higher than 1990 spending, even if the costs of the Deposit Insurance Bailout are not counted. An attempt to repeal, waive, or suspend Gramm-Rudman-Hollings would certainly be forthcoming if the White House adopted a pro-growth partial sequester strategy. The President, however, can veto any legislation attempting to gut the deficit reduction law. Congress would have trouble overriding this veto. An amendment to fund a temporary spending bill at a level consistent with a $40.1 billion sequester received 186 votes in the House of Representatives, well beyond the 145 votes needed to sustain a veto.

With the economy facing a possible recession, one of the major advantages of a sequester is that taxes are not raised. Instead of taking money out of the hands of consumers, workers, investors, savers, farmers, the elderly, the poor, and others who would see their tax burdens increase, a sequester makes across-the-board cuts in projected spending levels for affected programs. An equally important benefit of sequestration is deficit reduction. As the following table demonstrates, not only does a sequester produce real savings in the first year, it also generates considerable savings over five years. And unlike the supposed $500 billion of deficit reduction in the tax bills before Congress, the sequester savings are real. With a sequester, there are no budget gimmicks, no "user fees" masquerading as spending cuts, and no phantom savings that never materialize.

FIVE-YEAR SAVINGS FROM $40.1 BILLION SEQUESTER
($ billions)

Year	1991	1992	1993	1994	1995
Savings	$40.1	$58	$70	$79	$88

Source: Congressional Budget Office.

Administration advisors continuously have rejected a sequester strategy without ever explaining why it would not work. Along with most of the leadership in Congress, the Bush White House and Treasury continue to lie to the nation. They know the truth, yet they continue to insist that: 1) a budget agreement will lower the deficit; 2) the pending budget agreement includes substantial cuts in spending on federal programs; 3) no agreement means the deficit will not be reduced; and 4) the Federal Reserve Board can reduce interest rates and will only do so if taxes are raised. These are all lies that would embarrass even a big-city machine ward-heeler.

LIE # 1: A budget deal with Congress will reduce the deficit.

TRUTH: Bipartisan budget agreements containing significant tax increases were enacted in 1982, 1984, 1987, and 1989. In each case, promises were made to restrain spending growth and assurances were given that the new revenues would be used to reduce the deficit. In every single case, Congress simply spent the additional money and the deficit was higher the following year. There is no eveidence that this year would be any different. Based on how many of the spending "cuts" in the original agreement have already disappeared or been exposed as budget gimmicks, it is almost certain that the deficit will rise next year if any of the packages under consideration become law.

LIE # 2: A budget deal balances tax increases with courageous spending cuts.

TRUTH: Politicians from both Congress and the White House are telling the American public that the budget agreement cuts spending by more than $300 billion. In reality, however, spending will rise by a minimum of $245 billion over the next five years. The only part of the budget which

1991 Budget Proposed Spending Levels Compared to 1990 Levels

	Fiscal 1990	Fiscal 1991	Change 1990-1991 (billions)	
(050) National Defense	$299.9	$297.0	- $2.9	-0.96%
(150) International Affairs	$15.5	$17.4	$1.9	12.3%
(250) General Science, Space and Technology	$14.2	$15.2	$1.0	7.0%
(270) Energy	$3.3	$4.0	$0.7	21.2%
(300) Natural Resources and Environment	$17.8	$18.9	$1.1	6.2%
(350) Agriculture	$12.5	$14.1	$1.6	12.8%
(370) Commerce and Housing Credit	$75.7	$87.0	$11.3	15.0%
(400) Transportation	$29.5	$30.7	$1.2	4.1%
(450) Community and Regional Development	$8.3	$8.6	$0.3	3.6%
(500) Education	$38.3	$41.8	$3.5	9.1%
(550) Health	$58.2	$65.5	$7.3	12.5%
(570) Medicare	$96.9	$104.9	$8.0	8.3%
(600) Income Security	$148.5	$160.5	$12.0	8.1%
(650) Social Security	$248.7	$266.3	$17.6	7.1%
(700) Veterans Benefits and Services	$29.4	$31.7	$2.3	7.8%
(750) Administration of Justice	$10.5	$12.3	$1.8	17.1%
(800) General Government	$10.6	$11.7	$1.1	10.4%

Note: Numbers are known as budget subfunction numbers and indicate the order in which programs appear in the President's budget.

will have less money to spend in future years than today is defense. Pentagon spending will decline from $300 billion in 1990 to $291 billion in 1993, a reduction of $9 billion. Domestic discretionary spending, by contrast, will rise by at least $36 billion in the next three years, and domestic entitlement spending will jump by nearly $200 billion by 1995.

Politicians are able to mislead the American people on the issue of spending cuts because they have redefined the meaning of the word "cut." In the real world, a spending cut means spending less next year than this year. In Washington, however, the process has been rigged to ensure more spending. A spending cut in the Washington vernacular, therefore, occurs when spending does not increase as fast as politicians had previously planned. When OMB Director Darman says the budget agreement contains genuine spending cuts, he is not telling the truth. When Senate Majority Leader George Mitchell say the budget package makes significant budget cuts, he is not telling the truth. The chart on the preceding page demonstrates this.

LIE # 3: Failure to enact a bipartisan agreement will leave the deficit at unbearable levels.

TRUTH: Proponents of the budget agreement privately admit that neither the House nor Senate bills will reduce the deficit nearly as much as is publicly claimed. They say, however, that this approach is the only alternative to no deficit reduction at all. They ignore the obvious fact that the Gramm-Rudman-Hollings Deficit Reduction Act is still the law of the land. As such, failure to approve a budget agreement will trigger a sequester that cuts the deficit more than twice as much as does the budget agreement. Defeat of tax increase legislation puts the President in an enviable position. He can demand that Congress either enact a full year spending bill containing a $40.1 billion sequester or let lawmakers endure the political fallout of the $85.3 billion sequester which would automatically occur.

The choice thus is not between accepting taxes or doing nothing about the budget deficit. The honest choice is between a record tax increase which will not reduce the deficit and could trigger a recession or a sequester that unambiguously extinguishes government spending authority and permanently lowers the trend line of future outlays.

LIE # 4: The Federal Reserve Board will not lower interest rates in the absence of an agreement.

TRUTH: The Administration's argument for higher taxes quickly boils down to the belief that the nation's central bank will respond by engineering a drop in interest rates which will head off a recession. This argument assumes that the Fed controls credit markets sufficiently to lower interest rates significantly. The Fed's primary tool for lowering interest rates is injecting money into the banking system, thus creating the illusion of more savings. Financial markets, however, have become increasingly sensitive to Fed policies that put upward pressure on prices. At best, an inflationary monetary policy can lead to a temporary drop in short-term interest rates. The more enduring effect of an easy money policy would be higher interest rates since investors would demand a greater "inflation premium" because of rising prices, much as occurred in the late 1970s following the Carter Administration's easy money policy. Advocates of higher taxes portray Federal Reserve Board Chairman Alan Greenspan's tepid endorsement of the budget agreement as "proof" that higher taxes will lower interest rates. Not only does this assertion misinterpret the Chairman's comments, it also overlooks Greenspan's endorsement of sequestration over higher taxes when he testified before the Senate Budget Committee last year.

Senate and House Tax Bills: Two Sides of the Same Coin.

Much attention has been given to the minor differences between the two tax bills in Congress, leading some to assert that the Senate legislation is somehow preferable to the House version. The House bill does contain several provisions which will depress economic growth and reduce incentives to work, save, and invest. Income tax rates are explicitly raised, violating the promise of the 1986 Tax Reform Act. As bad, the House bill also raises income taxes on low - and middle-income individuals by suspending the indexing provision which protects taxpayers from "bracket creep." This allows a return to the 1970s policy of hidden tax hikes every year as inflation pushes taxpayers into higher tax brackets even though they experience no increase in their inflation-adjusted income.

The Senate bill is no better. Instead of raising income tax rates openly, it boosts them by reducing the value of deductions. The Senate bill also doubles the gas tax, adding a special burden to America's working men and women and legislating an across-the-board increase in the cost of all products and services that require energy to produce and transport.

Tax theorists can debate which bill, the House or Senate version, damages the economy the most. Either bill, however, or any combination of the two that might emerge from a conference committee, will take America in the wrong direction. Sucking $170 billion out of the economy while growth is faltering is irresponsible. Choosing between two record tax hikes guarantees economic decline. The only responsible alternative at this point is a sequester.

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George Bush has an opportunity to rescue the economy from the tax increase juggernaut moving through Congress. It is completely within his power to stop recession-inducing tax hikes and instead to choose the honest deficit reduction which is generated by a partial sequester. The President has to choose which is more important, the federal budget or the family budget.

The consequences are enormous. Higher taxes would bring back the economic stagnation and declining living standards of the 1970s. And whenever the economy weakens, the most vulnerable in society are the first ones to suffer. As the U.S. Civil Rights Commission stated October 16, "In bad economic times, black and Hispanic unemployment rates rise the fastest. In good times, a tight labor market encourages employers to cast a wider net when hiring, thus breaking barriers that have traditionally prevented minorities, women, and persons with disabilities from gaining better paying jobs.... We therefore call on the President and Congress to adopt only those deficit-reducing proposals consistent with economic growth. Specifically, we recommend freezing real total government expenditure at the fiscal 1990 level."

The President and other policy makers should heed those words. The White House and Senate and House leaders should stop lying to the nation. What America needs is a budget that really cuts spending and that measures its effect in terms of jobs preserved and created, the businesses that do not fail, and the families that do not suffer.

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