

## **ROSTENKOWSKI'S BUDGET PROPOSAL: THE GOOD, THE BAD, AND THE UGLY**

**In election after election and poll after poll, Americans have made it clear that they do not want to pay more taxes. Despite public opinion, the Chairman of the House Ways and Means Committee, Illinois Democrat Dan Rostenkowski, has proposed a budget plan raising taxes. On the positive side, the package does correctly call for some long-overdue limits on the growth of federal spending. But its proposed repeal of the Gramm-Rudman-Hollings deficit reduction law could mean that the deficit will rise rather than fall.**

**Curiously, rather than denouncing this plan, the White House welcomes it as a positive contribution to the budget debate. Further, Office of Management and Budget Director Richard Darman told a congressional committee that some new taxes, those that allegedly contribute to economic growth, are good. Like the unicorn, however, pro-growth taxes are more imaginary than real. Giving Congress more money to spend would inhibit economic growth by taking resources out of the productive sector of the economy. George Bush therefore should announce quickly that he has no intention of agreeing to a tax increase.**

**The Good: The Rostenkowski plan addresses in part the true source of the budget deficit: excessive government spending. The plan calls for a one-year across-the-board freeze on domestic discretionary spending. It also would freeze for one year such non-means tested entitlement programs as Social Security. It would require a 3 percent annual cut in defense spending. And the plan would require that any new spending must be "paid for" by reductions in existing programs.**

**This approach probably is not as effective as the current Gramm-Rudman-Hollings system, which puts a cap on the total spending and leaves to legislators the responsibility of dividing that fixed amount of money between various programs. It is, nonetheless, a step in the right direction.**

**The Bad: The centerpiece of Rostenkowski's proposal is higher taxes. His plan would tamper with the 1986 Tax Reform Act and ignore the world-wide revolution toward lower tax rates by increasing the top personal income tax rate from 28 percent to 33 percent. One of the major achievements of the past decade was to protect citizens from having their taxes raised because the government inflates the currency. This was done in 1985 by indexing tax brackets and the personal exemption to inflation. Rostenkowski's plan would restore the inflation tax for one year. Finally, the Rostenkowski proposal would mean higher taxes on oil, alcohol, and tobacco. Besides taking more money out of the pockets of American consumers and giving it**

to the government, taxes on energy in particular will raise costs for American industry, making it less competitive in world markets.

A tax increase would almost certainly result in a higher budget deficit if it leads to a recession. Even if higher taxes have only a mild impact on the economy, the deficit could rise. The Congressional Budget Office estimates that the taxes proposed by Rostenkowski would raise \$29 billion in revenue next year. The same group points out, however, that a one percentage point decline in annual gross national product growth would increase the deficit by \$26 billion in 1991 while a one percentage point rise in unemployment would boost the deficit by \$52 billion that year.

**The Ugly:** A particularly grotesque aspect of the Rostenkowski plan is its call for the repeal of the Gramm-Rudman-Hollings (GRH) "sequester" mechanism, which requires automatic budget cuts if Congress fails to meet deficit reduction targets. While GRH has by no means been perfect, it has led to substantial reductions in the deficit. The growth of federal spending, in both nominal and inflation-adjusted dollars, has fallen by more than 50 percent since GRH was enacted in 1985. The budget deficit as a percent of gross national product, after peaking at 6.3 percent in 1983, is projected to fall this year to only 2.3 percent, its lowest level in more than a decade.

Rostenkowski's call for repeal of the automatic sequester is especially strange since he claims that his approach to deficit reduction will more than match the GRH requirements. If he is correct, there is little urgency to repeal the deficit reduction law. It makes more sense to leave the sequester as a back-up mechanism, just in case Congress decides to use the higher taxes for additional spending rather than deficit reduction. Indeed, Rostenkowski is just one of several prominent legislators to propose the end of Gramm-Rudman, suggesting that Congress is unhappy with the degree of fiscal responsibility the law requires.

More important, undermining Gramm-Rudman-Hollings would send dangerous signals to financial markets, suggesting that Congress is giving up on deficit reduction. Indeed, rather than weakening the deficit reduction law, Congress should strengthen it. For example, the adoption of a second sequester, to occur in the middle of the fiscal year if the projected deficit exceeded the target, would help control the kinds of budget gimmicks and back door spending that Congress uses to evade GRH strictures.

**Gramm-Rudman Alternative.** The reaction to Rostenkowski's proposal has been mixed. While few have endorsed the specifics of the package, many commentators and policy makers have expressed general support for Rostenkowski because they feel that no acceptable alternative has been offered. Yet Gramm-Rudman-Hollings is an alternative. Under it, real deficit reduction will occur automatically if Congress fails to produce an acceptable budget. The Congressional Budget Office projects that a \$37 billion sequester this year, the amount necessary to reach the \$64 billion target for 1991, would lower projected deficits by \$311 billion over the next five years.

The Bush Administration's initial positive reaction to the Rostenkowski plan sends the wrong signal to Congress and the nation. George Bush was right to promise never to raise taxes. He should loudly reaffirm this promise with respect to Rostenkowski's plan. Whether by sequester or regular budget, the deficit can and should be reduced without a tax increase. The Rostenkowski plan fails this test.

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