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THE RESULTS ARE IN ON THE 1990 BUDGET AGREEMENT

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INTRODUCTION

The American public last year witnessed a monumental battle over federal budget policy. Lawmakers, from the beginning of summit negotiations in early May until the final budget was adopted in late October, heatedly debated issues such as taxes, spending, budget process reform, and economic growth. In the end, the White House and congressional liberals triumphed, enacting a "balanced" package of tax increases and alleged spending cuts that they claimed would strengthen the economy and reduce the budget deficit.

Opponents, including a majority of Republicans in both the House of Representatives and the Senate, argued that the final budget deal merely raised taxes to avoid the genuine budget cuts and deficit reduction which were scheduled to occur automatically as part of a sequester under the Gramm-Rudman-Hollings Deficit Reduction Act of 1985. Opponents also charged the record $175 billion tax increase would dampen economic growth and fuel additional government spending, which together would increase rather than reduce the budget deficit.

Broken Promises. The opponents pointed to the history of budget summits. Invariably, when the books were closed on the fiscal year, it was found that despite promises, spending was not cut and deficits were not cut. Budget summits, warned the critics of last year's deal, ended up raising taxes, raising spending, and raising the deficit.

Note: Nothing written here is to be construed as necessarily reflecting the views of The Heritage Foundation or as an attempt to aid or hinder the passage of any bill before Congress.

The results of the 1990 budget summit are:

- The tax burden has reached 19.4 percent of the gross national product (GNP) this year and is expected to climb to 20 percent of GNP by 1995, far exceeding the 19.2 percent average tax burden as a percent of GNP during the Carter Administration. The tax increase was supposed to generate approximately $175 billion of additional tax revenue over five years. Because the tax increase has lowered economic growth, however, as supply-side economists warned, actual tax revenue collections have increased only 2.9 percent so far in 1991, far below the 8.1 percent average annual revenue growth between 1983 and 1990.

- Federal spending is projected to climb by a record $158 billion this fiscal year, easily exceeding the previous record, a $107.6 billion spending increase in 1990. The Administration estimates 1991 federal spending will consume a peacetime record 25.1 percent of GNP, up sharply from 22.3 percent when Ronald Reagan left office. Domestic spending is driving the 1991 budget higher, with agriculture spending up 20 percent over last year's levels, health spending up 20.7 percent compared to 1990, general government outlays 18.6 percent above last year, and income security spending 17.4 percent over 1990 levels.

- The deficit will be a record $318 billion this year according to the Office of Management and Budget (OMB), up almost $100 billion over the 1990 deficit. The deficit, which had fallen to 3 percent of GNP when Ronald Reagan left office in 1989, will consume 5.7 percent of GNP in 1991. Delays in the S&L deposit insurance bailout may result in the actual deficit being below the Administration's $318 billion projection, but this simply means future years' deficits will be even higher.

- Process reforms in the budget agreement actually undermine the fiscal discipline imposed by Gramm-Rudman-Hollings. As a result, more spending and higher deficits will be permitted than would have occurred had policy makers complied with Gramm-Rudman-Hollings.

With the 1991 fiscal year nearly complete, the American people now see clearly that opponents of the budget deal were right. Administration and Congressional Budget Office (CBO) figures show record high spending and deficit levels, just as foes of the budget deal predicted. In addition, the tax increase is a major cause of the prolonged and painful economic recession, which has thrown approximately two million Americans out of work and abruptly ended the longest period of peacetime economic expansion in American history.

Defenders of the package argue that last year's budget process reforms will hold down future spending and thus offset the damage caused by the tax increases and sharply higher spending levels enacted last year. Yet while the spending caps covering appropriations spending and pay-as-you-go provisions doubtlessly will deter some additional spending, the reforms turn out to be weaker than the spending restrictions imposed by the old Gramm-Rudman-

Hollings deficit reduction law. Federal spending will increase faster under the budget deal than it did when Gramm-Rudman-Hollings was in force.

No Surprise. The failure of last year's package to control spending or reduce the budget deficit should come as no surprise. Budget summits in 1982, 1984, 1987, and 1989 saddled the American economy with higher taxes. Yet in every case the deficit rose the following year as policy makers, anticipating higher revenues, increased spending. Last year's budget agreement perpetuated this miserable record; the massive tax increase led to the largest single-year federal spending increase in America's history. As a result, a record budget deficit of approximately $300 billion is projected for this fiscal year.

Because last year's budget agreement increased rather than reduced long-term deficit spending, pressure soon may mount for another budget summit to "solve" the problem yet again. Ironically, even though calls for a new summit prove the old summit agreement failed, some politicians and policy makers claim the 1990 budget deal is working and presumably will argue that a new summit should follow the same approach. Unfortunately, to the extent politicians get away with untruths about last year's budget catastrophe, there is every reason to suspect a new budget summit will produce the same failed tax-and-spend policies.

Another budget catastrophe, however, need not occur. The last ten years provide powerful evidence that deficit reduction is best achieved by placing restrictions on the growth of federal spending. Budget summits, on the other hand, consistently have worsened America's fiscal health.

THE BUDGET SUMMIT: EXERCISE IN FISCAL DISINFORMATION

In the first half of 1990, the American people had little reason to suspect that the year would end in a recession with 700,000 workers losing their jobs. Annual economic growth as of last May had slipped to less than 2 percent, but few forecasters saw a recession was on the horizon. Although not performing as well as it did during the middle 1980s, the economy was still growing, continuing the record expansion that began after the 1981 Economic Recovery Tax Act tax cut took effect.

Further, as of last May, the estimated budget deficit for fiscal 1991 was projected to be about $150 billion, the level it had been hovering around since 1987. While nothing to cheer about, that deficit would have consumed less than 3 percent of gross national product (GNP), a significant improvement compared to $200 billion-plus deficits totalling more than 5 percent of GNP in 1985 and 1986. So long as federal spending growth was restrained, it was almost certain that the deficit gradually would continue to shrink as a share of national output, which is the best measure of the deficit's burden on the productive sector of the economy.

Fear of Sequester. Still, some Washington policy makers proclaimed a crisis and called for a budget summit to reduce the deficit and "save" the economy. Many observers were properly skeptical. With the economy still growing and the deficit slowly shrinking, why the sudden desire for government action? In retrospect, it is clear that what spurred the budget summit was fear on Capitol Hill and in the White House of genuine budget cuts which were scheduled to occur automatically in accordance with Gramm-Rudman-Hollings. Under the 1985 law, if the projected deficit for a new fiscal year was more than $10 billion above the legally mandated maximum deficit amount as of October 15, automatic spending reductions were triggered, a process known as sequestration, reducing the projected deficit to the Gramm-Rudman-Hollings target.[1]

With a projected 1991 deficit at the time exceeding $150 billion, and a deficit target of $64 billion, Gramm-Rudman-Hollings would have required a sequester in the $100 billion range. A $100 billion sequester seemed like a large cut, but to achieve it would have required trimming spending only between 5 percent and 10 percent below 1990 levels. As it turns out, this was too much to swallow for those lawmakers accustomed to annual spending increases. Even modest cuts would threaten the jobs of some government bureaucrats and the programs of special interest groups. Many politicians feared that such cuts would limit their own pork barrel spending.

Accounting Gimmicks. While politicians predicted a $100 billion sequester would have catastrophic consequences, they overlooked their own role in creating the "crisis." The gap between the projected deficit and the Gramm-Rudman-Hollings target was largely a result of the previous year's budget package. That budget relied heavily on accounting gimmicks to make 1990 spending appear lower than it really was. For instance, the phony savings included moving the Postal Service and Farm Credit expenses off budget and delaying federal employee retirement spending to future years. The 1990 budget also included more than $5 billion in tax increases, which slowed economic growth and lowered tax collections. By resorting to budget gimmicks and higher taxes instead of real spending restraint, the White House and Congress simply postponed the day of reckoning and therefore created a much larger budget problem the next fiscal year.

While shady tactics helped policy makers evade Gramm-Rudman-Hollings's fiscal discipline for 1990, they would not work for the 1991 budget because of the magnitude of deficit reduction required. To comply with Gramm-Rudman-Hollings, lawmakers either had to enact a 1991 budget with a projected deficit of no more than $74 billion or endure a $100 billion sequester.

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1 Fiscal years for the federal government begin on October 1 and run through September 30 of the following year. The 1991 fiscal year, for example, began October 1, 1990. Unless otherwise stated, all years cited in this study are fiscal years.

Budget summit supporters say that the matter involved tough choices, that all sides in the debate put everything "on the table," and that tremendous sacrifices were made to end the deficit crisis threatening America's economy. Yet, if the real goal had been deficit reduction, policy makers could have accepted sequestration. Both the Congressional Budget Office and the Office of Management and Budget had estimated that sequestration would generate the maximum short- and long-term deficit reduction. But a desire to avoid Gramm-Rudman-Hollings sequestration, rather than to reduce the deficit, seemed to be the real aim of the budget summit.

THE SUMMIT AGREEMENT: RETURN OF CARTERNOMICS

The actual summit package put together by the budget negotiators was a throwback to the tax-and-spend policies of the 1970s. The budget agreement repealed key features of Gramm-Rudman-Hollings. Most important, the fixed deficit targets requiring a balanced budget by 1993 were jettisoned, permanently freeing policy makers from the law's discipline.

The agreement allegedly reduced combined 1991-1995 budget deficits by a total of nearly $500 billion. At least $175 billion of the "savings" came from higher taxes. These included tax increases that were disguised as spending cuts or "user fees." For example, raising monthly Medicare taxes on senior citizens was considered a spending cut, while higher taxes on bank deposits were defined as user fees. A virtual freeze on defense spending saved more than $180 billion compared to what policy makers projected would be spent. And approximately $65 billion in deficit reduction would come from interest savings resulting from reductions in projected government debt levels. Out of the entire package, less than $100 billion was to come from reductions in domestic spending.

On close inspection, the promised savings are largely fictional. Projected revenue from tax increases were based on a Congressional Budget Office model that assumes that changes in the tax code will have no effect on individual behavior or the overall economy. Yet, as the current recession proves, taxes do have supply-side effects in the real world. When individuals and businesses are taxed at a higher rate, they spend less and produce less. With less economic activity, the government collects less revenue, even though the actual burden of taxation is higher.

Phony Savings. The projected savings in the budget package from spending cuts were phony. Other than a minor portion of the defense savings, all the spending "cuts" contained in the agreement were no more than reductions in projected spending increases. Further, the assumed interest savings are not likely to occur. This reduction is dependent entirely on the integrity of the rest of the package. If the deficit does not decline as promised, interest payments will not fall.

False and misleading claims about the contents of the budget package were only part of the problem. To maintain the fiction that the agreement would balance the budget, the White House and Congress used economic assumptions which had little chance of materializing.

Assumption #1: Adoption of the largest single-year tax increase in history was supposed to double annual economic growth in 1991 and triple it in 1992.

The Facts: After growing approximately 1 percent in the first nine months of 1990, the economy fell into recession. On an annualized basis, the economy contracted 1.6 percent in the fourth quarter and 2.8 percent in the first three months of 1991.

Assumption #2: Long-term interest rates are supposed to fall to 5.3 percent by 1995.

The Facts: Long-term interest rates are currently 8.3 percent and have not been as low as 5.3 percent since 1967.

Assumption #3: Inflation is supposed to drop to less than 3 percent by 1995.

The Facts: Inflation has climbed 5 percent in the last twelve months and rose 6.1 percent in 1990.

Assumption #4: Unemployment is projected to drop to 5.1 percent by 1995.

The Facts: Unemployment is currently 7 percent and has not been at or below 5.1 percent since 1973.

Supporters of the budget summit agreement apparently were not bothered by the fact that reputable economists almost universally rejected these assumptions. Nor did supporters seem bothered by the fact that similar tax-and-spend policies in the 1970s caused the economy to deteriorate rather than expand. Despite the many objections, however, the agreement was enacted in late October and enthusiastically signed into law by George Bush in early November.

WHAT HIGHER TAXES HAVE DONE TO THE ECONOMY AND REVENUE COLLECTIONS

It did not take long for the budget agreement to affect the economy. The uncertainty created by months of tax negotiations and the eventual imposition of a record tax increase, compounded by the imposition of costly new regulatory burdens, needlessly halted America's longest-ever period of peacetime economic growth. The economic stagnation caused by last year's budget package is not surprising. The federal government has reduced significantly incentives for Americans to work, save, and invest, dampening the entrepreneurship so critical to economic expansion.

Ronald Reagan's Economic Recovery Tax Act of 1981 reduced the tax burden to 18.1 percent of gross national product in 1983 and 1984. But subsequent tax increases have eroded the beneficial effects of that tax cut. By the time Reagan left office, taxes were consuming more than 19 percent of GNP. Thanks to the budget summit agreement, the average tax burden under Bush is 19.4 percent and climbing, higher than it was under Jimmy Carter.

Chart 1

Average Federal Tax Burden as a Percent of GNP

NIXON/FORD	CARTER	REAGAN	BUSH
18.3	19.2	18.8	19.4

Source: Office of Management and Budget, *Budget of the United States Government, FY 1992, Historical Tables.*

Almost no sector of the economy is spared by last year's tax hike. Income taxes are higher, gasoline taxes are higher, excise taxes on alcohol products and tobacco are higher, airline ticket taxes are higher, new taxes are imposed on "luxuries"; and insurance companies, telephone users, state and local government workers, and small businesses all pay higher taxes. The elderly are burdened with higher monthly Medicare taxes, and Medicare payroll taxes for many workers also are up. Others paying higher tax burdens include the banking industry, boaters, pension funds, tourists, inventors, and importers.

Supporters of the budget package asserted that these tax increases would raise nearly at least $175 billion of new revenue for the government over the next five years.[2] Opponents of the budget agreement, however, noted that these new taxes would probably not generate the revenue claimed because higher taxes would slow the economy and therefore depress revenue collections. According to figures published last month by the Financial Management Service (FMS) in the Treasury Department, the critics were correct. The FMS's *Monthly Treasury Statement of Receipts and Outlays of the United States Government* shows that tax collections through this May are running only 2.9 percent ahead of 1990 levels, a sharp dropoff compared to the 8.1 percent average annual revenue growth between 1983 and 1990.

Despite, or perhaps because of, increases in the top personal income tax rate, limits on itemized deductions, and the phase out of the personal exemption, 1991 personal income tax collections are only 0.4 percent above comparable 1990 levels. By contrast, in previous years, personal income tax collections grew by more than 7 percent annually. Payroll taxes such as Social Security and Medicare are growing somewhat faster, but still are just 4.9 above 1990 levels.

Chart 2

Federal Budget Receipts by Category

(in $ billions)

Category	FY 1991	FY 1990	Change
Individual Income Tax	302.2	300.8	0.4%
Social Insurance Taxes	265.3	253.1	4.9%
Corporate Income Tax	59.9	53.9	11.1%
Excise Taxes	26.1	23.2	12.6%
Customs Duties	10.4	10.9	-4.4%
Estate and Gift Taxes	7.6	8.0	-4.9%
Miscellaneous Receipts	14.9	17.1	-12.6%

Source: Department of the Treasury, Financial Management Service, May 1991.

Reality has forced the Congressional Budget Office to revise its revenue projections. In July 1990, before the tax increase was enacted, the Congressional Budget Office projected that total tax collections for 1991-1995 would be $6.325 trillion. In January 1991, after the tax increase was signed into law, the Congressional Budget Office estimated that total tax collections for the

2 Proponents actually attempted to underestimate the tax portion of the package by re-defining tax hikes on the elderly, banks, and others as spending cuts. While supporters came up with tax figures as low as $137 billion, reliable independent estimates prove the tax portion of the package totalled between $175 billion and $190 billion. All these revenue estimates, however, are based on Congressional Budget Office's deeply suspect revenue model.

same time period would be $6.263 trillion, a reduction of $62 billion. Even though the tax increase was supposed to generate a minimum of $175 billion in new revenue, projected revenue fell because of deteriorating economic conditions. In other words, "supply side" economists who warned that higher taxes would reduce government revenues were correct.

"Soak the rich" taxes provide the most graphic example of how the budget summit's tax increases backfired. The share of total taxes paid by wealthier Americans rose throughout the 1980s. Still, backers of the budget deal felt that wealthier Americans were not paying their "fair share" and thus supported higher personal income taxes. Instead of generating more tax revenue, however, personal income tax collections are only 0.4 percent above last year's levels after growing by an average annual rate of 7.2 percent between 1983 and 1990. If the economy begins to climb out of the recession, this figure could improve somewhat, but personal income tax revenue growth for the year will not come close to the Administration's optimistic 5.5 percent estimate.

Huge Job Losses. Even more disastrous is the effect the budget agreement's luxury taxes are having on affected industries. In a move motivated almost exclusively by politics of envy, a 10 percent excise tax was slapped on furs, jewelry, yachts, private airplanes, and luxury automobiles. Rather than getting more money from "rich" taxpayers, the luxury tax is wreaking havoc in the shipbuilding and imported automobile businesses. Early estimates already show job losses of more than 3,000 in the auto industry and 19,000 in the boating industry.

Beyond the personal tragedies of so many Americans losing jobs, the luxury tax is increasing the deficit. Workers without jobs do not pay income and payroll taxes. Bankrupt companies do not pay corporate income taxes. Jobless workers collect unemployment benefits and become eligible for other government spending programs. These revenue losses and spending increases probably will completely offset what little revenue is being collected as a result of the new taxes on "luxury" goods.

There is a possible silver lining to the dark tax cloud blanketing America. Taxpayers can hope that if policy makers begin to understand the serious consequences of higher taxes, the likelihood of similar budget summit catastrophes in the future will be reduced. The last ten years offer strong proof that taxes do have real effects and that the economy performs better when the tax burden is low or is being reduced.

MORE TAXES CAUSE MORE SPENDING

Despite the adverse economic effects of higher taxes, it is not difficult to understand why elected officials so frequently increase taxes. While tax hikes entail some political risk, they also generate political rewards. Projected increases in tax revenues make possible actual increases in federal spending. In-

terest groups that benefit from higher spending repay the politicians with electoral support. Every time taxes are raised, the perceived political benefits of directing more funds to favored interest groups exceed, in the near term, the potential risks of a taxpayer revolt.

These political dynamics help explain why the 1990 budget summit agreement, with its record tax increase, ignited the largest spending burst in America's history. The Bush Administration estimates that federal spending will jump by a record $158 billion this year, easily breaking the $107.6 billion single-year spending increase mark set in the first year of the Bush Administration. By contrast, average annual spending increases during the Reagan Administration were "only" $58.2 billion.

Many federal departments and agencies received substantial budget in-

Chart 3

Federal Outlays by Category

(in $ billions, through May of each fiscal year)

Category	FY 1991	FY 1990	Change
National Defense	176.8	198.6	-11.0%
Social Security	175.2	162.0	8.2%
Interest	129.8	121.1	10.7%
Income Security	119.4	101.7	17.4%
Medicare	68.7	63.5	8.3%
Health	44.6	37.0	20.7%
Education/Social Services	28.7	26.0	10.2%
Commerce/Housing Credit	28.1	29.4	-4.2%
Veterans	22.5	19.3	16.9%
Transportation	20.4	19.0	7.0%
Agriculture	13.2	11.0	20.0%
International Affairs	12.7	10.2	25.2%
Natural Resources/Environment	12.6	11.7	7.6%
Science/Space/Technology	10.6	9.4	12.9%
Justice Administration	8.2	6.7	22.3%
General Government	7.6	6.4	18.6%
Community/Regional Development	5.2	6.2	-16.4%
Energy	1.6	2.3	-30.0%
Offsets*	-24.5	-22.9	6.9%
Total	861.5	818.5	5.3

* Note: Revenue collected by the government that is subtracted from spending totals rather than counted as receipts.

Source: Department of the Treasury, Financial Management Service, May 1991.

creases for 1991. The Treasury Department's Financial Management Service reports significantly higher spending in the international affairs budget and in almost all areas of domestic spending. Looking at the first eight months of fiscal 1991, from last October 1 through May 31, agriculture spending is 20 percent above comparable 1990 levels, health spending is running 20.7 percent over 1990, general government expenses are up 18.6 percent for the year, and income security spending has jumped 17.4 percent. By comparison, the Bush Administration estimates inflation will be 4.3 percent in 1991.

Distorted Defense Figures. Among major spending categories, only defense outlays and commerce and housing credit expenditures are running below last year's levels. While reduced expenditures in these categories offset some of the enormous increases in other areas of the government, this small glimmer of fiscal restraint is largely an illusion. The defense figures are somewhat distorted by $38.1 billion of foreign contributions collected as of May to pay for Operation Desert Storm.

Commerce and housing credit numbers also are artificially deflated. They include the costs of the Savings & Loan deposit insurance bailout. But this bailout is proceeding at a far slower rate than earlier projected. Even if this delay causes S&L spending for the full fiscal year to be lower than first forecast, taxpayers will not benefit since the cost is simply shifted to next year. Actual housing spending is spiralling upwards as measured by 13.6 percent annual growth in the Department of Housing and Urban Development budget. While total federal government spending is up "only" 5.3 percent for the year to date, expected revisions to both the defense figures and the deposit insurance bailout cost will push the annual increase closer to the Administration's original estimate of 12.6 percent annual growth.

With spending growing at such a rapid pace, it is not surprising that government is consuming an ever larger percentage of the nation's gross national product. Federal spending jumped from 22.3 percent of GNP in 1989 to more than 25 percent of GNP today. This unprecedented burden on the private sector is a peacetime record, exceeded only during World War II.

Some proponents of the budget deal concede that spending is increasing rapidly, but contend this spurt will end after the first year of the budget agreement. Yet, even the Administration's budget estimates contradict this claim. As the following tables indicate, both entitlement spending and domestic discretionary spending will grow faster than inflation while the budget summit agreement is in place.

THE BUDGET SUMMIT LEGACY: HIGHER DEFICITS

While politicians claimed last year's budget summit was convened to reduce the deficit, the real motive was find a way of averting Gramm-Rudman-Hollings automatic budget cuts. Automatic cuts of $100 billion out of a $1.4 trillion budget would have meant real deficit reduction. The same cannot

be said for the budget package lawmakers adopted. With tax revenues stagnant because of the recession and federal spending rising much faster than inflation, the deficit exploded. The Congressional Budget Office estimates the 1991 deficit will reach $298 billion, while the Bush Administration projects the deficit will top $318 billion. Considering the deficit was $153.4 billion in 1989 and $220.4 billion in 1990, taxpayers should be thankful "deficit reduction" deals do not occur every year.

There is nothing mysterious about higher deficits; they are a direct consequence of the unwarranted increases in domestic spending. According to the Congressional Budget Office, domestic discretionary spending will climb by 9.1 percent in fiscal 1991 and entitlement spending, excluding the deposit insurance bailout, will grow by 12.5 percent. Even if the

Chart 4

The Bite of Federal Spending

Fiscal Year	$ billions	as a % of GNP
1980	590.9	22.1
1981	678.2	22.7
1982	745.7	23.8
1983	808.3	24.3
1984	851.8	23.1
1985	946.3	23.9
1986	990.3	23.7
1987	1003.8	22.7
1988	1064.1	22.3
1989	1144.1	22.3
1990	1251.7	23.3
1991	1409.6	25.1

Source: Office of Management and Budget, *Budget of the United States Government, FY 1991, Historical Tables*.

Chart 5

Domestic Discretionary Spending

Fiscal Year	1989	1990	1991	1992	1993
Total (billions of current $)	$169.00	$182.50	$199.80	$212.00	$223.20
Annual Change	–	7.99%	9.48%	6.11%	5.28%
Projected Inflation Rate*	–	4.15%	5.37%	4.31%	3.96%
Percentage Point Change Above Inflation	–	3.19	3.78	2.01	1.48

Note: The Budget Summit set spending caps for the Domestic Discretionary category only for fiscal years 1991 to 1993. After 1993, Congress will be able to once again fund additional domestic discretionary spending by taking funds out of the defense budget, making 1994 and 1995 projections impractical.
Source: Budget of the United States Government 1992.
* Based upon the Composite Deflator.

Chart 6
Entitlement Spending

Fiscal Year	1989	1990	1991	1992	1993	1993	1995
Total (billions of current $)	$459.3	$510.3	$574.8	$626.3	$671.0	$718.3	$765.1
Annual Change	–	11.1%	12.66%	8.96%	7.14%	7.05%	6.52%
Projected Inflation Rate *	–	4.15%	5.37%	4.31%	3.96%	3.70%	3.71%
Percentage Point Change Above Inflation	–	6.95	7.3	4.65	3.18	3.35	2.81

Note: Totals exclude net interest on the national debt and S&L bailout costs.
Source: Budget of the United States Government 1992.
* Based upon the Composit Deflator.t

economy were booming, the deficit would have increased with spending growing so rapidly.

Defenders of the budget deal argue that 1991 figures are not representative of the total package because most of the deficit reduction will occur in future years. It is true that spending growth is projected to slow down in future years. But any claims of serious deficit reduction depend on politicians practicing long-term fiscal restraint. In the past, however, every time Congress has promised future spending restraint in exchange for more taxes, the higher taxes go into effect while the spending cuts are forgotten.

Under the flawed assumptions of the original budget agreement last fall, the deficit was supposed to disappear by 1994. By January 1991, however, the Congressional Budget Office increased its estimate of the 1994 budget deficit to $211 billion. Under the budget agreement, Congress still is supposed to trim 1994 spending by $51 billion. If policy makers follow through on this commitment, the 1994 deficit will "only" be $160 billion. There are reasons to doubt whether these future spending cuts will be forthcoming; Ronald Reagan still is waiting for the $3 of spending cuts he was promised by Congress for every $1 of tax increases he agreed to back in 1982.

Unrealistic Assumptions. To make matters worse, the $211 billion 1994 deficit estimate is based on economic assumptions that are unlikely to be met under current government policies. The Congressional Budget Office assumes the economy will grow 3.3 percent in 1992, and at least 2.7 percent annually thereafter. Inflation is supposed to drop to less than 4 percent and unemployment is projected to fall under 6 percent. The Congressional Budget Office also assumes significant drops in both short- and long-term interest rates. The Administration's estimates are even more optimistic. If the economy does not perform as well as assumed, however, the deficit will be considerably higher.

There is little reason to believe the economy's performance will match either Congressional Budget Office or Office of Management and Budget projections. With the burden of federal spending and taxes at all-time highs, even modest economic growth will be an achievement. Indeed, under current policies, the economy of the 1990s is more likely to resemble the stagnant economy of the 1970s. The economic prosperity of the 1980s is not likely to return unless policy makers return to the pro-growth policies of the 1980s, including, first and foremost, lower taxes. And without strong growth, deficits are likely to remain over $200 billion, and could climb substantially higher.

PROCESS REFORM: ONE STEP FORWARD, TWO STEPS BACKWARDS

Some supporters of the budget deal argue that reforms in the budget process balance out the damaging effects of higher spending and taxes by imposing binding restraints on future congressional spending. The Budget Enforcement Act (BEA), passed last year as part of the budget deal, might block some spending compared to what would happen if no spending restrictions existed. In the real world, however, the relevant comparison is how much spending the BEA will allow compared to how much spending would have grown under the Gramm-Rudman-Hollings law which was in effect prior to the BEA's enactment.

Using this criterion, the BEA portion of the budget summit agreement was yet another step in the wrong direction. Summit supporters assert the pay-as-you-go provision, which requires a 60 percent vote of the Senate to enact legislation that could increase the deficit, will block new congressional spending proposals. But pay-as-you-go has existed since the Gramm-Rudman-Hollings law was enacted in 1985. The only difference between the two laws is when a sequester takes place if spending limits are exceeded. There thus was no need to accept higher taxes to get pay-as-you-go, as defenders of the package misleadingly contend.

Further, the effectiveness of the pay-as-you-go provision depends on the Congressional Budget Office's estimates of the impact proposed legislation will have on the deficit. These estimates often are influenced by partisan politics and ideology. On tax matters, for instance, the Congressional Budget Office uses the revenue estimates of Congress's Joint Tax Committee; these consistently have been found to be slanted because the Committee model assumes taxes have no effect on economic behavior. As a result, the revenue gains from all tax increases are vastly overstated, as last year's tax package poignantly demonstrates.

Skewed Projections. Tax cut estimates are similarly flawed. Skewed projections, for example, have been used to derail the capital gains tax cut. The Congressional Budget Office argues that such a cut would reduce tax revenues. Independent economists, however, estimate a capital gains tax cut would increase government revenue by billions of dollars annually. The Congressional Budget Office's track record on capital gains has been extremely poor. For ex-

ample, it overestimated annual capital gains realizations by a shocking $75 billion annually beginning in 1989 because it failed to take into account the effect of the higher tax rate on capital gains imposed by the 1986 Tax Reform Act.

Supporters of the budget deal maintain that the BEA's spending caps also will limit federal spending. The caps impose ceilings on appropriated defense, domestic, and international affairs spending each year through 1993. If spending exceeds the cap in any category, a sequester automatically will reduce spending in that category to the legally mandated level. In 1994 and 1995, the "firewalls" between the three categories will disappear, leaving a single cap on combined appropriations. Like the pay-as-you-go provision, the spending caps will block some spending which would occur if no restrictions existed.

Technical Spending Cuts. The truth is, however, that these caps will allow spending to increase much faster than the old Gramm-Rudman-Hollings law permitted. The spending caps are similar to imposing a 150 mile-per-hour speed limit on America's highways. With the limit set so high, there would be few violators. Authorities, technically, could boast of almost universal compliance to the speeding laws. But almost any reasonable observer would argue the speed limit was set too high to protect lives. Compliance would be up, but safe driving would be down. Similarly, spending caps which allow domestic discretionary spending to grow more than 50 percent faster than the rate of inflation hardly can be said to promote fiscal responsibility.

While better than nothing, the caps are inferior to the old Gramm-Rudman-Hollings restrictions. The spending caps do not apply to entitlement spending, leaving the fastest growing part of the budget completely unchecked. Gramm-Rudman-Hollings placed restrictions on the entire budget, limiting total spending to the sum of projected tax revenues plus the allowable deficit amount. The cap on domestic discretionary spending allows outlays to increase above the rate of inflation. Gramm-Rudman-Hollings held domestic discretionary spending constant in real dollars. The BEA spending caps are riddled with loopholes, allowing spending to increase if economic assumptions change, if technical estimates are revised, and if spending is declared an "emergency." The old Gramm-Rudman-Hollings, while far from perfect, imposed rigid deficit targets that were much less subject to budget gimmickry.

Failing the Test. The crucial issue, however, is whether adoption of the BEA permits higher levels of federal spending compared to what would have happened under Gramm-Rudman-Hollings. The BEA fails this test. Even if politicians had permitted only a partial sequester last year, below the $100 billion level originally required, federal spending this year would be far below the levels imposed by the budget summit. Exact comparisons are difficult, since the difference would have depended on the size of the sequester and estimates of how much stronger the economy would be today if taxes had not been raised last year. Under the BEA, taxpayers already have been burdened with the largest single-year spending increase in history, more than $150 billion. By contrast, while Gramm-Rudman-Hollings was in effect between 1985

and 1990, the growth of federal spending fell by 50 percent compared to the previous five-year period.

VICTORY FOR THE WASHINGTON ESTABLISHMENT

Establishment politicians from both parties were uncomfortable with the fiscal discipline of Gramm-Rudman-Hollings. Unlike the current BEA, Gramm-Rudman-Hollings forced lawmakers to choose between different deficit reduction strategies and take responsibility for those choices. This meant either proposing higher taxes or proposing to limit federal spending growth to comply with the deficit reduction law. Even worse for policy makers on a spending binge but better for the taxpayer, Gramm-Rudman-Hollings's fixed deficit targets gave voters a yardstick to measure politicians' performance.

The budget summit "solved" the problems, at least temporarily. Record tax and spending increases, combined with emasculation of Gramm-Rudman-Hollings, gave career politicians from both parties the best of all worlds. Special interest groups received a windfall of new spending. And since the BEA's new deficit targets are "adjusted" each year to reflect new economic and technical assumptions, politicians will be able to claim that they are complying with the budget summit agreement even as the deficit climbs ever higher.

CONCLUSION

The losers, of course, are American taxpayers, workers, and consumers. While politicians pat themselves on the back for making "tough" choices that, in retrospect, were not tough at all, ordinary Americans must raise their families with less income. While George Bush's 1988 opponents praise him for "courageously" breaking his no tax increase promise, lower- and middle-income workers struggle to keep their jobs. While government bureaucrats dream up more ways to spend the new money their programs have received, Americans in the productive sector of the economy must deal with high unemployment and the myriad problems brought on by recession.

And the worst may yet come. Since the budget summit increased rather than reduced deficit spending, politicians eventually may decide another budget summit is needed. If this time comes, as it may come right after the 1992 election to minimize the role of public outrage, taxpayers likely will face an even greater hardship. Further increases in income tax rates, imposition of a national sales tax, and another unwarranted increase in federal spending are all likely consequences of another budget summit. The only way to stop such economically damaging policies, however, is for the American people to remember the failures of the past and let elected officials know that they will not accept a repeat performance.