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WASHINGTON'S BUDGET BINGE: GETTING EVEN WORSE

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INTRODUCTION

Statistics recently released from the Office of Management and Budget (OMB) confirm that the tax and spending increases concocted by the White House and Congress have been an unmitigated disaster. Rather than control spending, cut the deficit, and reignite the economy, the 1990 budget agreement has led to accelerating spending, a surge in red ink, and economic stagnation.

According to the *Mid-Session Review of the Budget*, issued July 24, federal spending has climbed to $1.407 trillion for fiscal 1992, an increase of $262.9 billion in just three years. To make matters worse, spending now is projected to climb by another $96.8 billion in fiscal 1993, bringing federal spending over the $1.5 trillion mark. The *Mid-Session Review* also reveals that the budget deficit for the year will reach an all-time high of $333.5 billion in fiscal 1992, a staggering $180 billion higher than the figure three years ago.

The dismal fiscal policy record of the last three years largely is the result of the 1990 budget deal. That ill-fated agreement between Congress and the White House was supposed to reduce budget deficits by a total of almost $500 billion over the 1991-1995 period. In every possible way, however, the deal failed. According to the *Mid-Session Review*:

- The cumulative budget deficit for the 1991-1995 period now is expected to be $707.8 billion higher than the figure projected in the 1990 *Mid-Session Review* —made before the "deficit reduction" deal was consummated. The budget agreement was supposed to cut the deficit $500 billion.
  THE BOTTOM LINE: an "error" of $1.2 trillion.

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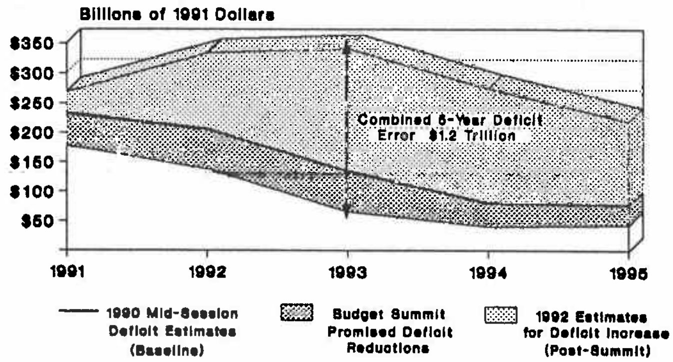
The Budget Summit: Promising $500 Billion Reduction in Federal Deficit, Delivering $708 Billion Increase



Source: *Mid-Session Review of the Budget*, July 1990 and July 1992. Heritage DataChart

- Projected spending levels, instead of falling by $325 billion between 1991 and 1995, as negotiators in 1990 predicted, will be $179.8 billion above the 1990 *Mid-Session Review* projections, according to this summer's *Review*.
  THE BOTTOM LINE: a $500 billion "error" by the budget deal supporters.

- The tax hikes in the budget deal were supposed to generate $175 billion of additional revenue between 1991 and 1995. But this summer's *Review* predicts that revenue during this period will be $528.5 billion below 1990 *Mid-Session Review* projections.
  THE BOTTOM LINE: an "error" of over $700 billion.

- The budget deal gutted the 1985 Gramm-Rudman-Hollings Deficit Reduction Act, the law which successfully lowered the growth of federal spending and reduced the federal budget deficit when it was enforced. The 1990 agreement replaced Gramm-Rudman with a law, the so-called Budget Enforcement Act, that permits spending to increase at much faster rates.
  THE BOTTOM LINE: Inflation-adjusted domestic spending is growing more than seven and one-half times faster now than it was under Gramm-Rudman.

Despite the budget deal's clear failure, as evident from the government's own statistics, Congress and the Administration seem determined to stick to the terms of their budget fiasco. But to those lawmakers and policy makers concerned about today's stagnant economy and about America's future prosperity, the policy lessons of the latest budget figures are clear: If the United States economy is to avoid being bankrupted by Washington, Congress and the White House must agree to urgent steps to control spending, preferably by returning to the budget discipline of Gramm-Rudman. And as the sorry experience of the 1990 agreement shows, any agreement to control spending must not, under any circumstances, contain an increase in taxes.

AMERICA'S FEDERAL SPENDING CRISIS

The economic crisis now afflicting America never should have happened. When Ronald Reagan left office in January 1989, the economy was expanding, setting records for job creation and peacetime economic growth. Thanks in large part to Gramm-Rudman, the federal budget deficit had fallen to 3.0 percent of gross domestic product (GDP) in 1989, down from a peak of 6.3 percent in 1983. The falling deficit was not just the result of spending restraint. The job creation and economic growth during the 1980s resulted in record tax revenues flowing into the federal Treasury, even though critics had charged that reductions in marginal tax rates in the early 1980s would leave the federal government "revenue-starved."

Unfortunately, the Bush Administration and Congress were not content to leave well enough alone. In 1989, the White House and Congress used budget gimmicks and accounting tricks to evade Gramm-Rudman's fiscal discipline and thus to permit a substantial rise in fiscal 1990 federal spending. This reckless policy increased the gap between the projected deficit and the legally mandated Gramm-Rudman deficit target for the following fiscal year. As a result, when faced in 1990 with the prospect of having to reduce projected fiscal 1991 spending increases by large amounts to comply with Gramm-Rudman, Congress and the White House decided instead to negotiate a new budget plan rather than make long-overdue cuts in the bloated federal budget. Ironically, although supporters of the budget deal claimed the agreement was to reduce budget deficits, the budget summit actually was convened to avoid the genuine deficit reduction which would have occurred automatically had Gramm-Rudman been enforced.

The results of this irresponsible budget policy are now evident. The *Mid-Session Review* issued by OMB this July 24 reveals just how much the country's fiscal situation has deteriorated since Reagan left office.

✘ **Federal spending is projected at $1.407 trillion for fiscal 1992,** some $262.9 billion higher than it was when Bush took office. By next year, it is projected to be $1.504 trillion, or $359.7 billion higher.

✘ **Federal spending now consumes 24.0 percent of GDP,** up from 22.1 percent in 1989. By next year, federal spending is projected to consume 24.3 percent of GDP.

✘ Over eight years, Ronald Reagan reduced domestic spending from 14.83 percent of GDP down to 12.24 percent of GDP. In just three years, **George Bush and Congress have permitted domestic spending to climb to 14.92 percent,** wiping out all the gains achieved during the Reagan years.

✘ **In inflation-adjusted 1987 dollars, domestic spending has increased by a total of $134.1 billion from fiscal 1989 to fiscal 1992,** an average annual increase of $44.7 billion during the Bush Administration. This compares with a total increase between fiscal 1981 and fiscal 1989 of $22.54 billion, averaging $2.82 billion annually under Reagan, and a total increase between fiscal 1977 and fiscal 1981 of $61.24 billion, or $15.31 billion annually, during the Carter Administration.

✘ **Inflation-adjusted domestic spending has climbed by an average of 7.14 percent annually under Bush,** or more than thirteen times faster than the 0.53 percent average annual growth under Reagan and nearly two and one-half times faster than the 2.95 percent average annual domestic spending growth under Carter.

- ✘ **The budget deficit, which was $153.5 billion in fiscal 1989, when Bush became President, will be $333.5 billion this fiscal year** and is expected to reach an all-time record of $341.0 billion next fiscal year. This $187.5 billion jump represents an increase of 122 percent in just four years.

- ✘ In the summer of 1990, before taxes were raised, **the projected budget deficit for 1993 was $135.2 billion. The current estimate for that year is $341.0 billion.** This represents a $205.8 billion increase in the projected deficit since the "deficit reduction" tax increase was signed into law.

- ✘ **The cumulative budget deficit for the 1991-1995 period now is expected to be $707.8 billion higher than that projected just two years ago.** Advocates of the budget summit argued that this agreement would *reduce* the 1991-1995 cumulative deficit by $500 billion. Supporters of the budget agreement erred, in other words, by approximately $1.2 trillion in the budget impact of their actions (see Table 1).

- ✘ **Spending for the 1991-1995 period is expected to be $179 billion higher than projected in the summer of 1990**—not $325 billion lower as the budget summit advocates estimated their agreement would achieve. This represents an error of approximately $500 billion (see Table 2).

- ✘ **On the revenue side, budget summit defenders were off by $700 billion,** losing $3 of previously projected revenue for every $1 of additional revenue the ill-fated deal was supposed to generate. Rather than raising $175 billion of new tax revenue during 1991-1995 when compared with baseline forecasts, as the budget agreement assumed, total revenues now are projected to be $528.5 billion lower than they were estimated to be in the summer of 1990—before the tax hike (see Table 3).

- ✘ **The 1990 budget agreement included provisions which eliminated the fixed annual deficit targets that were the key feature of the 1985 Gramm-Rudman-Hollings Deficit Reduction Act.** These fixed deficit targets effectively capped the growth of federal spending since automatic budget cuts, known as "sequestration," would occur if lawmakers attempted to increase spending by more than the sum of projected revenues plus the allowable deficit for each year. The Budget Enforcement Act (BEA), which replaced Gramm-Rudman after the budget agreement, does not cap the total growth of federal spending.

- ✘ Supporters claimed that the BEA was an improvement over Gramm-Rudman, but **inflation-adjusted domestic spending has grown at an 8.38 percent annual average rate under the new budget law,** or more than seven and one-half times faster than the growth rate under Gramm-Rudman.

- ✘ **The BEA's "caps" on domestic discretionary spending have failed to curtail spending.** Inflation-adjusted domestic discretionary spending under the BEA, for example, is climbing at a 5.4 percent annual clip, or more than five times the 1.01 percent average annual growth rate under Gramm-Rudman.

Table 1

The Budget Summit's Dismal Failure, Part I
Deficit Estimates

($billions)

	1991	1992	1993	1994	1995
1990 Mid-Session (pre-budget deal)	*231.4*	*205.0*	*135.2*	*79.6*	*76.8*
1992 Mid-Session	*268.7*	*333.5*	*341.0*	*274.2*	*218.4*
Difference	*+37.3*	*+128.5*	*+205.8*	*+194.6*	*+141.6*

Source: *Mid-Session Review of the Budget*, Office of Management and Budget, Washington, D.C., July 1990. *Mid-Session Review of the Budget*, Office of Management and Budget, Washington, D.C., July 1992.

Table 2

The Budget Summit's Dismal Failure, Part II
Spending Estimates

($billions)

	1991	1992	1993	1994	1995
1990 Mid-Session (pre-budget deal)	*1353.1*	*1399.5*	*1413.9*	*1442.7*	*1517.9*
1992 Mid-Session	*1323.0*	*1407.1*	*1503.9*	*1527.3*	*1544.8*
Difference	*-30.1*	*+7.6*	*+90.0*	*+84.6*	*+26.9*

Note: Spending in 1991 and 1992 actually was, and is, higher than listed because allied contributions for the Gulf War are counted as "negative spending" rather than revenue. While the spending numbers should be adjusted to increase 1991 and 1992 spending by those amounts, official Administration figures are used here.

Source: *Mid-Session Review of the Budget*, Office of Management and Budget, Washington, D.C., July 1990. *Mid-Session Review of the Budget*, Office of Management and Budget, Washington, D.C., July 1992.

Table 3

The Budget Summit's Dismal Failure, Part III
Revenue Estimates

($billions)

	1991	1992	1993	1994	1995
1990 Mid-Session (pre-budget deal)	*1121.7*	*1194.5*	*1278.7*	*1363.*	*1 1441.1*
1992 Mid-Session	*1054.3*	*1073.6*	*1162.9*	*1253.1*	*1326.4*
Difference	*-67.4*	*-120.9*	*-115.8*	*-110.0*	*-114.7*

Source: *Mid-Session Review of the Budget*, Office of Management and Budget, Washington, D.C., July 1990. *Mid-Session Review of the Budget*, Office of Management and Budget, Washington, D.C., July 1992.

✘ With Gramm-Rudman's cap on overall spending gone, **Congress and the Administration have allowed entitlement spending to grow unchecked.** Under the BEA, inflation-adjusted entitlement spending is growing at an annual average rate of 9.43 percent, or more than eight times faster than the 1.13 percent annual growth rate under Gramm-Rudman.

PHONEY EXCUSES FOR THE FISCAL CRISIS

Some supporters of the budget deal still maintain that the agreement was sound fiscal policy. They have even gone so far as to develop theories explaining why fiscal policy would be in even worse shape if the 1990 package had not been enacted. Upon closer examination, however, these excuses are shown to be phoney.

Phoney Excuse #1: The spending rise is due to the savings and loan bailout.

Some critics blame the deposit insurance bailout for the deteriorating budget estimates. But Table 4 indicates that deposit insurance spending is no excuse for the spending and deficit picture. Inflation-adjusted domestic spending—which excludes defense, international spending, net interest on the debt, as well as deposit insurance outlays—is growing nearly 16 times more each year under Bush than it did under Reagan. Of the $1.2 trillion deficit error revealed by the *Mid-Session Review*, less than $100 billion can be attributed to bailing out the deposit insurance system.

Table 4
Average Annual Domestic Spending Growth
(billions $1987)

	Annual Dollar Increase	Annual Percent Change
Carter	*$15.31*	*2.95%*
Reagan	*$2.82*	*0.53%*
Bush	*$44.70*	*7.14%*

Source: *Budget of the United States Government, FY1993; Historical Tables*, Office of Management and Budget, Washington, D.C., February 1992. *Mid-Session Review of the Budget*, Office of Management and Budget, Washington, D.C., July 1992.

More detailed budget figures show that both domestic discretionary spending and entitlement outlays have climbed rapidly. As Table 5 illustrates, Bush clearly reversed Reagan's policies and easily has outspent Carter.

Phoney Excuse #2: The recession caused deficits to climb.

Some supporters of the budget deal concede that budget deficits have increased, but nonetheless argue that deficits would have increased even more in the absence of a budget deal. According to this novel theory, the recession caused tax revenues to fall and led to higher outlays for safety-net programs, the combination of which increased deficits by amounts that were not expected when the agreement was hatched in 1990. Following this line of reasoning, deficits over the 1991-1995 time period would be almost $500 billion higher were it not for the budget deal.

This argument puts the cart before the horse. It makes sense only if one believes that the recession was completely unrelated to the record tax increase. While it is certainly true that the recession had many causes, including other policy mistakes such as the increase in regulation since 1989,[1] it is patently absurd to claim that the record tax increase imposed by the 1990 budget deal had no impact on the economy. Opponents of the 1990 deal were right when they warned, as they did over and over again, that the tax increases would hinder economic growth by reducing incentives to work, save, and invest. The opponents pointed out that a tax increase would slow growth and that a smaller than expected tax base would produce less tax revenue than summiteers projected. Critics of the budget deal did warn that high taxes might cause the deficit to rise.[2]

Table 5
Average Annual Domestic Spending Growth
(billions $1987)

	Discretionary		Entitlements	
	Annual Dollar Increase	Annual Percent Change	Annual Dollar Increase	Annual Percent Change
Carter	*$2.24*	*1.41%*	*$13.07*	*3.72%*
Reagan	*-$2.30*	*-1.24%*	*$5.11*	*1.32%*
Bush	*$7.77*	*4.7%*	*$36.93*	*8.00%*

Source: *Budget of the United States Government, FY1993; Historical Tables*, Office of Management and Budget, Washington, D.C., February 1992. *Mid-Session Review of the Budget*, Office of Management and Budget, Washington, D.C., July 1992.

PHONEY EXCUSE #3: Short-term hikes in taxes and spending were the price for getting Congress to go along with tight spending controls in the future.

Gramm-Rudman, defenders of the agreement assert, was not working and needed to be replaced by more effective budget rules. Supporters argue that the Budget Enforcement Act imposes strict controls on federal spending in the future, and that these controls will reduce future deficits.

The evidence clearly shows, however, that federal spending is growing much faster under the BEA than it did under Gramm-Rudman. Indeed, one of the biggest mistakes of the budget summit was the elimination of the fixed annual deficit targets mandated by the Gramm-Rudman Act.[3]

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1 William G. Laffer, III and Nancy Bord, "George Bush's Hidden Tax: The Explosion in Regulation," Heritage Foundation *Backgrounder* No. 905, July 10, 1992.

2 Daniel J. Mitchell, "Mr. President Keep Your Promise: No New Taxes," Heritage Foundation *Backgrounder* No. 769, May 18, 1990.

3 Gramm-Rudman imposed maximum annual deficits designed to balance the budget by fiscal 1993. If policy makers did not bring the deficit for the next year's budget within $10 billion of the mandated deficit target, automatic spending cuts, known as sequestration, would occur to bring the deficit down to the legally required level. The key feature of Gramm-Rudman was the creation of a limit on total federal spending since lawmakers could spend no more than the sum of projected revenues plus the maximum allowable deficit. If projected spending did exceed that level, sequestration occurred.

To be sure, Gramm-Rudman itself was far from perfect. When the law was in force, lawmakers resorted to overly optimistic economic assumptions to evade the law's intent. Budget gimmicks and accounting tricks often were utilized to delay long-overdue spending cuts and program reforms. But for all the law's shortcomings, it worked tolerably well, and spending grew at a slower rate under Gramm-Rudman than it did before the law's enactment.[4] Moreover, spending under Gramm-Rudman grew much slower than it has since the 1990 budget deal replaced it with the supposedly tougher Budget Enforcement Act.

The problem with the new budget law is the absence of fixed deficit targets. Instead, the BEA's deficit targets are adjusted each year automatically on the basis of "economic" and "technical" re-estimates. This means that, instead of a schedule of deficit targets forcing Congress to achieve a balanced budget in a specific future year, the BEA allows budget deficits to increase without any corrective action being required to bring about deficit reduction. Critics of the budget deal argued in 1990 that the BEA thus would permit spending increases that would have been impossible under Gramm-Rudman. That is in fact what happened. Table 6 compares spending growth under Gramm-Rudman and the BEA.

Table 6
Spending growth under Gramm-Rudman and BEA
(billions $1987)

	Total Domestic		Discretionary		Entitlements	
	Annual Dollar Increase	Annual Percent Change	Annual Dollar Increase	Annual Percent Change	Annual Dollar Increase	Annual Percent Change
G-R	$6.34	1.09%	$1.52	1.01%	$4.82	1.13%
BEA	$53.35	8.38%	$8.91	5.40%	$44.44	9.43%

Source: *Budget of the United States Government, FY1993; Historical Tables*, Office of Management and Budget, Washington, D.C., February 1992. *Mid-Session Review of the Budget*, Office of Management and Budget, Washington, D.C., July 1992.

The provision in the BEA which allows deficit targets to be revised for economic and technical re-estimates can be suspended, at the discretion of the President, on January 21, 1993. As a result, whoever wins the presidential election this November could, if he so chooses, restore some of the budget discipline imposed by Gramm-Rudman. Whether or not this leads to improved fiscal performance, of course, will depend on the President's budget strategy.

4 Daniel J. Mitchell, "Save the Gramm-Rudman Sequester," Heritage Foundation *Backgrounder* No. 763, April 3, 1990.

CONCLUSION

The runaway deficits and sluggish economic performance of recent years demonstrate that raising taxes and weakening spending controls does nothing to balance budgets and speed economic growth.

The lesson found in this year's *Mid-Session Review of the Budget* is clear. Raising taxes to reduce the budget deficit only makes fiscal matters worse and undermines the economy. If similar policies are pursued in the future, the U.S. economy will continue to deteriorate. If, however, policy makers in the executive and legislative branches of the federal government recognize the lessons of the 1990 budget agreement, they will work together to reduce both taxes and spending. Then the economy will prosper and the budget deficit will shrink.