The Heritage Foundation Issue Bulletin

No. 177 | The Heritage Foundation · 214 Massachusetts Avenue, N.E. · Washington, D.C. 20002-4999 · (202)546-4400 · Telex:440235

September 28, 1992

THE TEN PERCENT TAXPAYER CHECKOFF: BREAKING SPECIAL INTEREST BUDGET GRIDLOCK

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INTRODUCTION

In this election year, voters understandably are voicing their frustration at the inability of Washington politicians to put America's economic house in order. The 1990 budget deal was supposed to balance the federal budget. But legislation implementing the deal gutted the enforcement mechanisms of the 1985 Gramm-Rudman-Hollings Deficit Reduction Act, and the deficit widened in the past two years. Instead of the promised era of fiscal restraint, record tax and spending increases are consuming larger and larger amounts of national income.

While it is difficult to be optimistic about Congress imposing real controls on spending and the deficit, one idea could well force Congress to do so. Representative Robert Walker, the Pennsylvania Republican, has introduced legislation in the House that will put into the hands of each taxpayer power to determine directly how fast the federal budget grows. Walker's plan (H.R. 5773) is co-sponsored in the Senate by Robert Smith, the New Hampshire Republican (S. 3158), and was given an important boost in August when George Bush endorsed it in his convention acceptance speech.

Taxpayer Antidote. The Walker-Smith proposal allows taxpayers, through a checkoff on their tax form, to dedicate up to 10 percent of their personal income tax liability to a fund to retire the national debt. Further, it prohibits politicians from simply replacing the old debt with new borrowing by mandating that federal spending be reduced by the same amount as the total taxpayer checkoff. If approved, the plan could balance the budget in as little as four years.

An attractive feature of the Walker-Smith plan is that it gives taxpayers the power to act as an antidote to the disproportionate influence now exercised over the budget by interest groups. Beneficiaries of federal largesse closely monitor budget developments, lobby policy makers, and devote considerable resources to maintain or increase their slice of an ever-growing budget pie. Ordinary taxpayers, on the other hand, usually lack the time, detailed knowledge, and resources to counter the organized efforts of special interest groups. And while many members of Congress portray themselves as fiscal conservatives when campaigning in their home states and districts, in Washington they often yield to the pressure of interest groups demanding higher spending.

By giving each taxpayer the direct power to limit the growth of federal spending, the Walker-Smith checkoff plan would allow families to challenge and defeat the spending coalitions without having to organize themselves into a political constituency. As such, the plan profoundly would change the dynamics of spending, and could at last force fiscal discipline on Washington.

HOW THE TAXPAYER CHECKOFF WOULD WORK

The taxpayer checkoff is a technically simple method of allowing individual taxpayers to make modest changes in the total level of federal spending. Under the plan, all taxpayers will have the option, when filing their annual tax returns, of dedicating up to 10 percent of their personal income tax liability to a debt retirement trust fund. Lawmakers then will have to reduce federal spending by the total amount dedicated to the fund.[1] Should lawmakers fail to reduce total spending as required, budget cuts would occur automatically in a process known as sequestration.

To understand exactly how this would work, consider an example. Let us say that after all the tax return checkoffs were tallied when Americans filed their 1992 returns next April, taxpayers had dedicated $40 billion of their personal income tax liability to the trust fund. Total federal spending for the 1994 fiscal year, beginning in October 1993, would have to be reduced by the same amount—$40 billion—below projected 1994 baseline spending levels. This process would repeat every year. If, in early 1994, taxpayers dedicated $45 billion of their 1993 tax liability to the trust fund, fiscal 1995 federal spending would have to be reduced by that amount.[2]

Slowing Spending Growth. The taxpayer checkoff could have a significant impact on the deficit. The actual level of savings would depend on the level of taxpayer participation, which in turn would reflect the importance placed by individual taxpayers on deficit control. It is also difficult to estimate precisely how fast government spending would grow if the taxpayer checkoff were enacted since the cuts would be made from whatever spending level lawmakers approved for that year. The growth of spending, however, certainly would be slowed. For instance, assume the current services baseline projected that spending would have to grow

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1 The spending "cut" mandated by the Walker-Smith plan is a reduction from the upcoming fiscal year's current services baseline. Since the current services baseline projects higher spending, due to inflation, demographic shifts, and program expansions, the actual effect of the checkoff would be to reduce the size of the budget's increase.

2 Tax returns for any particular calendar year are due by April 15 of the following year. It would be shortly after this date that the government would tabulate the total amount dedicated to the trust fund. This amount then would be sequestered from the upcoming fiscal year's budget, which would begin October 1.

by $65 billion. If, then, taxpayers selected $40 billion on their tax returns, lawmakers would be allowed to spend only $25 billion above the previous year's level. Failure to comply would trigger a sequester, which would bring spending down to the legally required level.

Nor would politicians be able to evade this fiscal discipline by simply increasing spending by an extra $40 billion above the baseline. The current rules governing the budget, while considerably weakened in 1990, still impose some limit on the overall level of spending. Discretionary spending growth is limited by a spending cap.[3] Entitlement spending, meanwhile, is subject to pay-as-you-go rules originally implemented by Gramm-Rudman back in 1985. These rules prohibit the creation of new entitlement programs, or expansion of existing ones, unless that spending is paid for by higher taxes or cuts in other entitlements. The discretionary and entitlement budget rules do allow spending to grow by more than twice the rate of inflation, but they place an upper limit on how much Congress can spend in any given fiscal year.[4]

THE POTENTIAL SAVINGS

The following table, prepared by the Congressional Budget Office (CBO), illustrates the maximum potential savings the checkoff plan could achieve when compared with current projections of how federal spending will grow. If all taxpayers were to choose the maximum checkoff, today's record deficits would fall quickly and a budget surplus of $26 billion would occur as early as 1997, according to the CBO. And even if currently projected spending levels grow because of the "economic" and "technical" re-estimates allowed under the 1990 Budget Enforcement Act, worst-case scenarios indicate that these re-estimates would delay a balanced budget only by one year.

One reason why the savings become so large in future years is that the sequester is designed to reduce permanently the federal spending baseline. This is a crucial feature of the legislation because the federal budget is prepared each year using baseline projections as the benchmark or starting point. If, for instance, the baseline projects that spending should rise by $75 billion because of inflation, demographic shifts, and program expansions already built into the law, reducing that $75 billion increase to a $50 billion increase is counted as a $25 billion budget "cut." This process, known as current services budgeting, biases budgetary choices by allowing interest groups to portray even modest program reforms as deep cuts, since both the general public and the media tend to assume that govern-

3 While discretionary spending has been subject to three separate caps, one each for domestic, defense, and international, these firewalls disappear beginning in fiscal 1994 when a single unified cap for all discretionary spending takes effect.

4 The budget rules do allow for emergency spending which is exempt from the budget caps. It is this loophole, for instance, which will allow politicians to approve hurricane relief spending. While this provision theoretically could be used to remove any and all fiscal discipline imposed by a taxpayer checkoff, it is more likely that politicians would just repeal the law if they ever reached that stage.

ment budget numbers refer to nominal year-to-year changes. The taxpayer checkoff will not repeal current services budgeting, but the multi-year impact of sequesters on the spending baseline will reduce the problem.

Taxpayer Checkoff Deficit Savings
(in $ billions)

	1994	1995	1996	1997	1998	1999
Current Spending Estimates*	1,529	1,543	1,602	1,726	1,843	1,962
Current Deficit Estimates	267	203	189	236	265	296
Maximum Checkoff Savings	49	107	178	263	360	474
Resulting Outlay Levels	1,479	1,435	1,424	1,464	1,482	1,487
Resulting Deficit Levels	218	96	11	(26)	(96)	(178)

*These baseline spending estimates incorporate spending caps and pay-as-you-go-rules.
Source: Congressional Budget Office

Another reason why the taxpayer checkoff saves so much money over time is that the federal government will not need to pay interest on borrowed money. Every dollar saved by the checkoff means one less dollar that the federal government borrows from private credit markets. Not only does this mean more funds for consumers seeking car loans and mortgages, and more money for businesses attempting to build new factories and create jobs, it also means that taxpayers will be paying less interest since the national debt will have grown at a slower rate.

WHY THE TAXPAYER CHECKOFF IS NECESSARY

The fiscal picture has deteriorated at an alarming pace in recent years. Moreover, there is little reason to believe that the situation will improve without a major change in the budget process. Allowing taxpayers to "vote" on federal spending would be such a change because it would empower taxpayers at the expense of the special interest groups that currently wield so much power in Washington. Decisive action of this kind is necessary. Consider:

✗ Federal spending is projected at $1.407 trillion for fiscal 1992, some $262.9 billion higher than it was when George 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 Gross Domestic Product (GDP), up from 22.1 percent in 1989. Next year, federal spending is projected to consume 24.3 percent of GDP.

- ✗ Over the eight years of his presidency, Ronald Reagan reduced domestic spending from 14.83 percent of GDP to 12.24 percent of GDP. In just three years, George Bush and Congress have permitted domestic spending to climb to 14.92 percent of GDP, 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, is expected to reach $333.5 billion this fiscal year and 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.

- ✗ 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 be triggered 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 1990 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. Inflation-adjusted domestic discretionary spending under the BEA 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.

- ✗ 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.

As these figures demonstrate, America's federal spending crisis is real and must be addressed urgently. The taxpayer checkoff is not the only way to achieve meaningful deficit reduction, but it may be the only realistic way to break the special interest control of the budget process. Failure to act will burden future generations with even higher levels of debt.

CRITICISMS OF THE CHECKOFF PLAN

Interest groups already have mobilized against the taxpayer checkoff. They recognize that the plan's sequester provision would put an end to the record spending increases of recent years. In order to fight the taxpayer checkoff, opponents have marshalled several arguments. These are either wrong or misleading.

Among the objections:

Claim #1: The taxpayer checkoff is a budget gimmick that will not work.

The Congressional Budget Office (CBO) rarely acknowledges the effectiveness of fiscal policies that reduce or restrain government spending and taxes. Yet even the CBO has stated that the taxpayer checkoff would work. Indeed, the savings estimates outlined above come directly from CBO estimates.

The sequestration provision is the key to the legislation's workability. Should Congress fail to act voluntarily to reduce spending by the amount of the checkoff, spending cuts would occur automatically, reducing by equal percentages all programs other than Social Security, deposit insurance, and net interest. And Congress could not avoid the automatic cuts by raising taxes; the only way to cancel the sequester is through a package of spending cuts of equal magnitude. This insures that the deficit will be reduced in a way that does not undermine economic growth.

Claim #2: The taxpayer checkoff will cause draconian budget cuts.

In direct contradiction to the charge that the proposal is an ineffective gimmick, opponents also argue that the cuts forced by the taxpayer checkoff would be too severe. Under the Walker-Smith legislation, full participation in the checkoff would limit fiscal 1997 federal spending to $1.464 trillion. While still 4.5 percent greater than the $1.407 trillion projected for the 1993 fiscal year, a $1.464 trillion budget is more than 13 percent below the baseline fiscal 1997 projection made by the CBO in February 1992.

By Washington standards, these "cuts" might seem harsh, but by real world measurements they represent modest and long overdue steps to control federal spending. Moreover, if the Walker-Smith legislation were enacted, not all taxpayers would choose to check off, and many of those that did would not choose the full 10 percent. So, the actual amount of spending discipline mandated by the Walker-Smith legislation would be less than critics claim.

Claim #3: Excessive spending cuts will hinder economic recovery.

Another line of attack comes from Keynesian economists who argue that increased federal spending is needed to lift the economy out of the doldrums. According to the Keynesians, legislation which mandates less spending will weaken the economy by reducing aggregate demand.

But years of experience demonstrates the hollow ring of the Keynesian argument. Record spending increases and record deficits in the last few years have been associated with slow economic growth, not a boom. Keynesian policies produced the stagflation of the 1970s—theoretically impossible in the Keynesian model. Keynesians also predicted that the Reagan tax cuts would lead to more inflation. In fact, inflation dropped from 13 percent to 4 percent following the Reagan tax cuts, and the tax cuts triggered the longest peacetime economic expansion in America's history.

Claim #4: The taxpayer checkoff will undermine Congress's ability to allocate funds.

Opponents assert that an across-the-board sequester treats all programs as if they had equal value, subjecting monies for AIDS research to the same percentage cut as subsidies for honey production and spending for pork-barrel mass transit projects. A "meat-ax" approach to the budget, critics say, denies lawmakers the power to channel federal funds to where they are needed most.

Not true. Politicians concerned about the wise use of federal money can comply with the law by enacting their own package of spending cuts. And even if Congress fails to produce an alternative package, sequestration does not eliminate congressional discretion. When preparing a budget for an upcoming fiscal year, lawmakers will be free to increase or decrease funding for any program as long as they keep spending levels within already existing budget constraints such as the overall cap on discretionary spending and the pay-as-you-go rules for expanding entitlement programs. Lawmakers simply would have to choose priorities, to spend less on one program to spend more on another.

Nothing in the Walker-Smith legislation would prevent Congress from appropriating more money to politically popular programs. Indeed, even if taxpayers checked off enough money to force a 5 percent reduction, Congress could guarantee the level of funding for any particular program by appropriating 5 percent more than they really wanted to spend. They would just have to find the money from other programs.

Rather than putting the budget on autopilot, the Walker-Smith legislation thus would force lawmakers to set priorities by shrinking the overall federal spending pie and making interest groups compete for fewer federal dollars. This discipline would put an end to the current practice of giving all programs big increases, regardless of how poorly the money is being spent.

Claim #5: The taxpayer checkoff is a one-way street, allowing taxpayers to cut projected spending levels but not permitting taxpayers to choose to increase spending.

If there was any evidence that federal spending was too low, this criticism might have some merit. But spending is growing so rapidly that the budget deficit now exceeds $300 billion. The economy is suffering because government spends too much, not too little. Even so, the legislation could be modified to give taxpayers the option of increasing spending.

As the law currently stands, there is nothing that prevents taxpayers from making contributions to the federal government. Indeed, tax forms already include a procedure encouraging individuals to pay additional taxes to help reduce the national debt. In fact, the taxpayer checkoff could be amended to allow taxpayers to increase their tax liability and dedicate the extra money to whatever program they preferred.

There would be several advantages to this modification. First, allowing taxpayers to choose higher spending would give voters who want higher spending on specific programs the chance to achieve this goal. Second, the fact that almost no taxpayers would voluntarily choose to pay more taxes for higher spending would dispel the myth, disseminated by the media and some politicians, that the American people want taxes to increase to fund more domestic spending.

Claim #6: The taxpayer checkoff gives those with high tax liabilities greater influence over the budget than those with low tax liabilities.

It is true that those who finance a higher percentage of the federal budget would be able to trigger more budget cuts than those who pay fewer taxes. But rather than a shortcoming of the legislation, this is a powerful argument on behalf of the taxpayer checkoff. For too long, the federal budget has been used as a mechanism to redistribute income. Some of this redistribution is designed to transfer income from rich to poor, a policy which reduces incentives to work, save, and invest for all parties involved. A surprisingly large portion of the redistribution, however, is from taxpayers in general to well-organized interest groups, many of which already have high incomes.

The taxpayer checkoff begins to redress this problem. While it does not directly reduce the tax liability of any taxpayer, it does give taxpayers some authority over how their income is spent.

CONCLUSION

Just as interest groups condemned the Gramm-Rudman Act for reducing the growth of federal spending, the intensity of the criticism levelled at the Walker-Smith legislation is a sign that the legislation would be effective. The real question is not whether it will work, it is whether Congress voluntarily would enact legislation that so clearly would curtail lawmakers' ability to funnel resources to favored constituencies. As important, a checkoff system would place in the hand of frustrated taxpayers the power to deal directly with the plague of excessive government spending.

This is why the President's endorsement of the checkoff in his acceptance speech at the Republican convention is so important. It raises the stakes, forcing public consideration of a plan that really would bring deficit spending under control.