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CLINTON'S BUDGET: HIGHER TAXES AND MORE SPENDING

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INTRODUCTION

President Bill Clinton last night proposed the biggest tax increase in American history as part of what he claimed is a balanced $493 billion deficit reduction package. Stripped of rhetoric, however, the package is neither balanced nor would it generate the level of budget savings Clinton implied. Once proposed spending increases are included, the actual level of deficit reduction falls to $339 billion over four years.

Most disappointing, not one penny of the proposed deficit savings comes from net reductions in the most rapidly growing portion of the budget—domestic spending. Indeed, the Clinton proposal calls for domestic spending programs to receive a net increase of $10 billion over the next four years. That increase, incidentally, would be above the $245.5 billion of additional domestic spending already included in the baseline budget projections against which the Clinton budget measures its tax increases and spending "cuts."

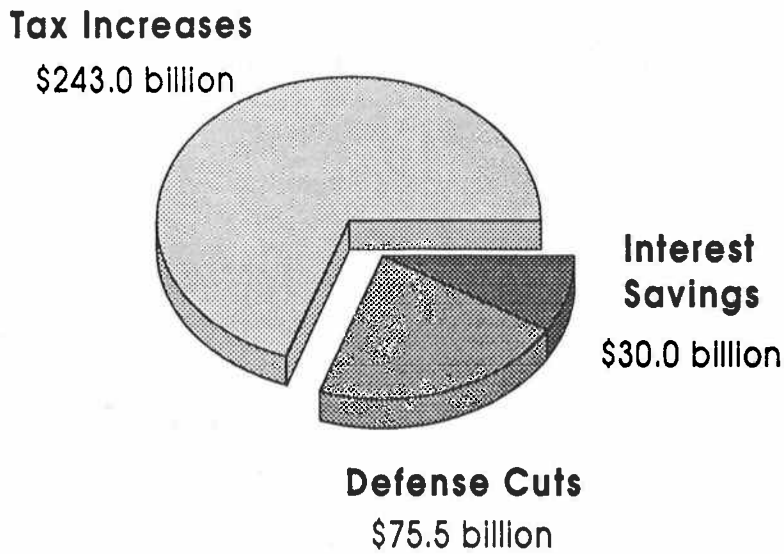
Clinton's package relies almost completely on tax increases. New taxes and increases in existing taxes account for 72 percent of the total package, a net increase of $243 billion over the next four years. Projected defense cuts generate 22 percent of the savings, $75.5 billion over four years. Assumed reductions in federal interest payments, meanwhile, are projected to equal about $30 billion, or 9 percent of the total. (The percentages total 103 percent due to the fact that higher domestic spending lowers the aggregate level of deficit reduction by 3 percent.)

CARTERNOMICS, PART II

The Clinton package marks a stark return to the failed tax-and-spend policies of the Carter Administration. The revenue portion of the package includes at least 53 separate tax increases, 27 of which the Administration dishonestly counts as spending cuts. The tax increases include a new 36 percent tax rate which would be imposed on families making more than $140,000, rather than on those at the $200,000 level, as Clinton promised during the campaign. The Clinton plan further unravels the 1986 Tax Reform Act by creating an additional "millionaires'" surtax that would impose a 40 percent marginal tax rate on income over $250,000.

Incentives to work, save, and invest will be further diminished by proposals to impose a 2.9 percent Medicare tax on incomes above $135,000 and to increase the corporate tax rate from 34 percent to 36 percent. The middle class would be particularly hard hit by a proposed tax on the heat content of energy sources. This tax, estimated to raise more than $71 billion over the next five years, will add 7.5 cents to the cost of a gallon of gasoline, boost home heating oil prices by 8.25 cents per gallon, and increase the average consumer's electric bill by $27 per year. The $71 billion cost to consumers does not count, moreover, the unavoidable increase in the price of every good and service produced in the American economy.

Where Will Clinton's $339 Billion in Deficit Reduction Come From?



Note: Net domestic spending will increase $10 billion, shrinking the overall deficit reduction from the planned $349 billion in "sacrifices."

Hidden Tax Hikes. Notwithstanding Administration talking points heralding "a new era of integrity...in the budget process," the Clinton budget deliberately attempted to understate the size of the proposed tax increase by falsely classifying at least 27 tax increases as spending cuts. Among these tax increases were the proposed increase, from 50 percent to 85 percent, in the share of Social Security benefits subjected to taxation. This proposal, which is projected to raise $21.4 billion of new revenue over the next four years, will discourage senior citizens from continuing to engage in productive economic activity after retirement. Other tax increases Clinton counts as spending cuts include the monthly Medicare tax paid by senior citizens, as well as taxes on banks, pharmaceutical companies, importers, and stockbrokers.

Budget Gimmicks. The Clinton plan also contains a startling number of accounting tricks and phony assumptions to generate savings. The budget magically assumes $1 billion of savings through better management of Veterans Administration hospitals. "Other administrative savings" supposedly will generate $7.7 billion of deficit reduction, while "Streamlining Government" allegedly will reduce spending by $7.9 billion. The Administration proposes to save $11.5 billion by exchanging longer-term government debt for shorter-term debt. If, however, interest rates happen to rise—they are now at twenty-year lows—this proposal will increase spending. Improved IRS tax compliance efforts (needed to guarantee more of what the President euphemistically calls "contributions") are somehow assumed to raise almost $1 billion.

These gimmicks are joined by proposals which save money, but only by pushing the spending into future years. Included in this category are proposals to move Medicare payments to hospitals onto a calendar year basis. This proposal, which does not change the federal government's liabilities, is counted as a $4.6 billion spending cut. Another $5.1 billion is "saved" by ending the lump-sum benefit for federal retirees. Once again, however, the proposal simply shifts spending into future years. All told, at least $38.7 billion of Clinton's budget package comes from budget gimmicks which are counted as reductions in domestic spending.

More Domestic Spending. In an effort to portray the package as balanced, Clinton referred to 150 "specific" spending cuts. He did not tell the American people, however, that many of these "cuts" were really tax increases and budget gimmicks. Even more troubling, Clinton did not point out that his supposed domestic cuts are offset by more than 131 proposals to increase domestic spending by a total of $123.7 billion.

All told, proposed increases in domestic spending outweigh the proposed "cuts" by about $10 billion over the next four years. If the $38.7 billion of budget gimmicks and phony cuts are excluded from the calculation, however, the net increase in domestic spending climbs to almost $50 billion (Reminder: baseline projections already include $245.5 billion of higher domestic spending between 1993 and 1997).

Bigger Deficits Predicted. Even if all of the White House's assumptions are accurate, the Clinton budget signifies a significant increase in the size and cost of the federal government. If a dose of reality is allowed, however, a terrible package becomes even more frightening. A Joint Economic Committee report found that every dollar of higher taxes since 1947 has resulted in $1.59 of higher spending. This statistical survey is supported by recent history. Tax increases in 1982, 1984, 1987, and 1990 all were enacted for the alleged purpose of deficit reduction. In every case, however, the deficit rose the following year because lawmakers could not resist the temptation to spend the expected new revenues. Nowhere in the Clinton plan are there any proposals or mechanisms to counter this propensity of higher taxes to trigger more spending and higher deficits.

The Clinton plan also relies on static models to generate revenue estimates. All of the tax increases, including the increases in marginal income tax rates, are assumed to have no impact on the behavior of taxpayers. In the real world, however, individuals and businesses already have been adjusting their behavior to protect their earnings and lighten the expected burden of higher taxes. As a result, even though the Clinton proposal contains a very steep increase in the nation's tax burden, the actual amount of money the government collects may fall if enough workers lose their jobs and the taxable incomes of individuals and businesses decline. One does not have to travel very far back in time to find an example of a tax increase that lost money. The 1990 budget deal was supposed to raise about $175 billion of new revenue over the 1991-1995 period. Instead, tax revenues fell by more than $3 for every $1 the ill-fated deal was supposed to raise.

CONCLUSION

Higher taxes did not work for Herbert Hoover, Lyndon Johnson, Jimmy Carter, or George Bush, and there is no reason to think that they will work for Bill Clinton. If enacted, the Clinton tax hike will fuel more federal spending, destroy jobs, undermine America's international competitiveness, reduce economic growth, and increase the budget deficit.