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TAXES, SPENDING, GIMMICKS, AND SNAKE OIL: WHY BILL CLINTON'S BUDGET IS BAD FOR AMERICA

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INTRODUCTION

President Bill Clinton's proposed budget would, among other things, impose on the economy a record $316 billion tax increase over the next five years. His aim, he says, is to stimulate economic growth and to cut the deficit. But if history is any guide, these higher taxes will undermine the economy's performance, trigger an orgy of new federal spending, and result in a larger rather than smaller budget deficit. While the Administration asserts that its new budget marks a bold change in policy, the package relies on the same dubious logic and assumptions that were used to justify the deeply flawed 1990 budget deal. And there is every reason to think that the Clinton tax hike, which is nearly twice as large as the one imposed in 1990, will be just as much of a disaster if enacted.

The Clinton budget, which is poised to receive preliminary approval in both Houses of Congress, contains no provisions to prevent higher tax revenues from being used for additional spending.[1] Nor does the budget propose long overdue process reforms, such as the line-item veto which candidate Clinton vocally endorsed last year. Further, the Clinton budget is littered with new spending proposals designed to reward political supporters and key constituencies. The President calls these programs "stimulus" and "investment," yet offers no explanation why programs which have failed in the past will work today.

1 As this study went to press, it appeared that Congress was going to approve a Budget Resolution that closely matched Clinton's proposal. A Budget Resolution, however, does not actually make changes in tax and spending laws; it simply instructs congressional committees to make those changes. The actual budget, if it is approved, will be contained in what is known as a Reconciliation Bill, and probably will be debated this summer.

Among the more disturbing elements of the Clinton package:

- ✘ **Bigger Government.** Even if all Clinton's gimmicks and accounting sleights-of-hand are accepted, federal spending will be $301 billion higher in 1998 than it is today.

- ✘ **More Debt.** The Clinton budget will, by its own admission, add nearly $1.2 trillion to the national debt over the next five years.

- ✘ **Less Growth, Fewer Jobs.** Adoption of the Clinton package would destroy 3.2 million jobs by 1996 and reduce real economic output by $450 billion.[2]

- ✘ **No Domestic Spending Cuts.** Clinton's budget increases total federal spending in 1993 and 1994. To the extent there are any spending cuts, they occur only in defense and are concentrated in future years, making their eventual implementation highly unlikely. Under the plan, domestic spending will increase at nearly twice the rate of inflation over the next five years.

- ✘ **Heavy on Taxes, Light on Spending.** As a candidate, Clinton promised $3 of spending cuts for every $1 of taxes. After the election, that ratio dropped to $2 of spending cuts for every $1 of taxes. By the time the budget was submitted, the Administration was claiming $1 of spending cuts for every $1 of taxes. In reality, however, the proposed budget contains $3.90 of taxes for every $1 of spending cuts (even these cuts are only reductions in previously planned increases).

- ✘ **Dishonest Numbers.** Clinton claims that 70 percent of the tax hike will be paid by Americans earning more than $100,000 per year. The Administration, however, can only make this claim by artificially inflating incomes by including such things as the value of fringe benefits and the rental value of owner-occupied housing.

- ✘ **Budget Gimmicks.** Many of the spending cuts in the Clinton plan, such as $12.1 billion from "streamlining government" and $11.2 billion from "other administrative savings," are no more than accounting tricks and phantom savings.

- ✘ **Hidden Tax Hikes.** The Clinton plan misleadingly classifies many tax increases as spending cuts, including the increased tax on Social Security benefits. Other hidden taxes include levies on mining, financial markets, ranchers, and pharmaceutical companies.

Large tax increases are a recipe for economic stagnation. Higher taxes on investment will not increase investment, as the Clinton plan assumes. Higher taxes on worker income will not boost job creation, as the Clinton plan asserts. New taxes on energy will

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2 Lawrence Kudlow, "Wrong Diagnosis—Wrong Medicine," forthcoming in *Global Spectator*, Bear, Stearns & Co, Inc., New York, New York.

not stimulate greater production of goods and services, as the Clinton plan claims. Higher taxes will destroy jobs, slow economic growth, fuel more spending, and increase the budget deficit.

CARTERNOMICS, PART II

President Clinton refers to his budget plan as a balanced and serious effort to reduce the federal budget deficit. Upon closer inspection, however, it is neither balanced nor serious, and it certainly will not lead to a lower budget deficit. As the following table illustrates, the package is overwhelmingly comprised of higher taxes. There are some domestic spending "cuts" (by the Washington definition, an increase in spending by an amount less than previously planned is a cut), but they are more than completely offset by proposed increases for other domestic programs. The only genuine spending cuts come from the defense budget.

THE CLINTON DEFICIT REDUCTION PLAN

In $billions		1993	1994	1995	1996	1997	1998	TOTAL
Spending Reductions	Defense	0	-7	-12	-20	-37	-36	-112
	Non-Defense	1	-8	-18	-32	-45	-54	-156
	Total	—	-14	-30	-52	-83	-90	-268
Spending Increases	Defense	0	0	0	0	0	0	0
	Non-Defense	8	15	28	38	46	51	186
	Total	8	15	28	38	46	51	186
Net Spending Change	Defense	0	-7	-12	-20	-37	-36	-112
	Non-Defense	9	7	10	6	1	-3	31
Total Spending Change		9	1	-2	-13	-36	-39	-80
Revenue Increases	Social Security	0	3	6	6	7	8	29
	User Fees	0	1	2	5	6	4	18
	New Taxes	3	46	51	66	82	81	328
	Total	3	50	58	77	95	93	375
Revenue Decrease		-6	-12	-11	-9	-9	-11	-59
Total Revenue Change		-4	37	47	68	85	82	316
Debt Service (including financing change)		—	-2	-6	-10	-18	-27	62
Net Deficit Reduction		(13)[1]	38	54	92	140	148	460

1. Represents deficit increase caused by Clinton "stimulus" plan.
Note: Figures may not add due to rounding.
Source: *A Vision of Change for America*, Office Management and Budget, Washington, D.C.

There are several important numbers in the table above which do not match the rhetoric Clinton employs as he campaigns for his budget. Most notable:

✔ **The biggest and fastest growing part of the budget, domestic spending, receives a net spending increase of $31 billion over the 1993-1998 period.** Only in the last year of the package is there a net decrease in domestic spending.

The odds of Congress following through on promised future spending reductions, of course, are slim at best.

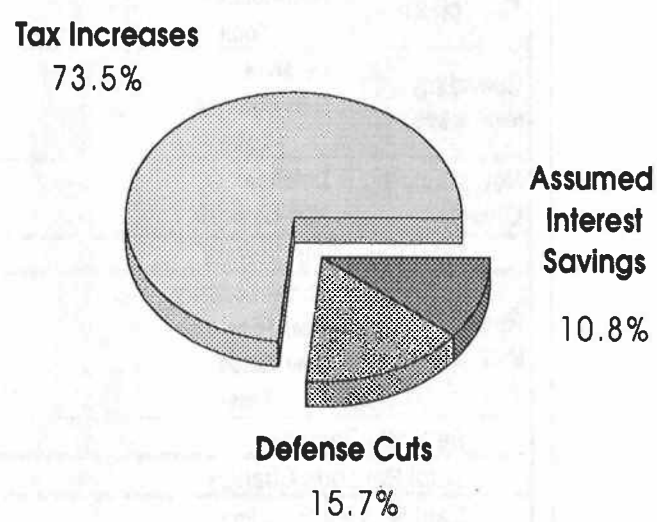
✔ **The ratio of tax increases to spending cuts cannot be calculated in 1993 and 1994 because there are no net reductions in spending.** In 1995, there are $24.40 of tax increases for every $1 of spending cuts. Assuming Congress can be trusted to deliver promised spending cuts in 1996 and beyond, the ratio eventually drops to $3.90 of higher taxes for every $1 of defense cuts.

THE DISHONEST NUMBERS

Despite Administration claims of "a new era of integrity...in the budget process," the Clinton budget makes widespread use of dishonest and misleading numbers. For example, the Administration talking points released prior to the State of the Union address asserted that the White House was proposing a $493 billion four-year deficit reduction package. Only after journalists and analysts examined the fine print, however, did it became clear that proposed new spending wiped out much of the deficit reduction; the actual level of planned deficit reduction between 1994 and 1997 is only $325 billion.

Similarly, the Clinton Administration continues a long Washington tradition of dishonesty by claiming to cut spending any time they increase spending at a slower rate than previously planned. As stated earlier, actual spending will climb by more than $300 billion between now and 1998. Yet the White House asserts that the Clinton budget cuts spending because outlays are not expected to rise even faster.

Big Tax Hikes, Deep Defense Cuts, But No Reductions in Domestic Spending



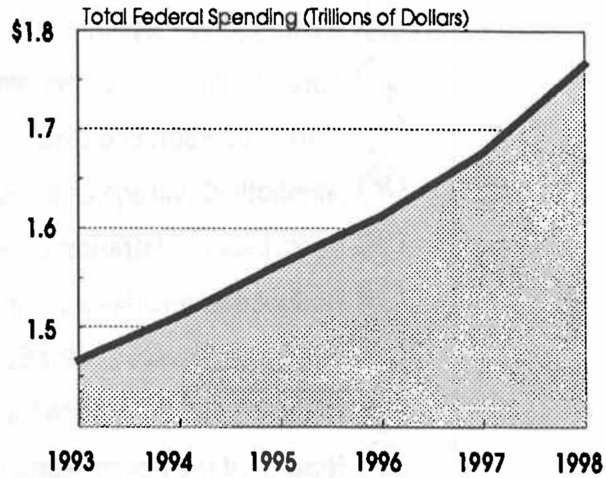
Impact of Clinton's Programs: 1994-1997

Taxpayers Pay Twice for Same Spending Cuts

Perhaps the most dishonest element of the Clinton budget, however, is the decision to take credit for savings which were mandated by the 1990 budget deal. Under the 1990 agreement, taxpayers were subjected to a then-record tax increase in exchange for the promise that Congress would cut spending in future years. The future is now. Under the terms of the 1990 deal, Congress is supposed to cut (actually reduce the growth of) discretionary spending by $13 billion next year and $25 billion in 1995. By including these "cuts" in his budget, Clinton is taking credit for cuts that already have been agreed to and were included in the final Bush Administration spending projections released in January.

Clinton's behavior is typical of politicians. Ronald Reagan agreed to raise taxes in 1982 with the understanding that Congress would cut spending by $3 for every $1 of higher taxes. Congress, of course, raised spending rather than follow through on the deal. Ironically, this inability on the part of politicians to deliver on promised spending cuts is one of the reasons why many budget experts harshly criticized the 1990 tax increase. The failure to deliver on promised cuts "tomorrow" is also one of the many reasons why it would be a mistake for Congress to approve Clinton's proposed tax increase today.

The Clinton Plan: Annual Federal Spending to Grow Over $300 Billion



Source: *A Vision of Change for America*, Office of Management and Budget.

Heritage DataChart

The Hidden Tax Hikes

President Clinton claims that his budget contains 151 separate spending cuts. Upon closer scrutiny, however, many of these so-called cuts are really proposals to increase revenues. Some of these revenues represent genuine user fees, in the sense that a beneficiary of a government service will be required to pay for that service. This is sound public policy, among other reasons because it forces the beneficiary to consider whether the service is worth the cost—and so would curb demand for some services that are now "free" to the user. Many of the proposals, however, are nothing more than tax increases. Included in this category are the Social Security benefits tax, as well as taxes on importers, pharmaceutical companies, stockbrokers, and farmers.

Even in the cases where proposed user fees and other revenues are legitimate and desirable,[3] however, the Clinton budget should be condemned as resorting to smoke and mirrors for categorizing these higher revenues as spending cuts. These increased revenues do not reduce the size and scope of government spending. Among the revenue increases that Clinton counts as "spending cuts":

3 The Clinton budget also proposes to increase revenue by auctioning a portion of the radio spectrum and insisting on greater repayment of U.S. debts by foreign nations. These proposals increase government revenue without harming the economy.

- Federal Grain Inspection Service User Fee
- Agricultural Marketing Service User Fee
- Agricultural Cooperative Service User Fee
- Meat/Poultry Inspection Overtime User Fee
- Foreign Customers Decommissioning/Decontamination User Fee
- Increased Food and Drug Administration User Fees
- Alcoholic Beverage User Fee
- Securities Registration User Fees
- Reduced Enterprise for the Americas Debt Forgiveness
- Increased Private Sector Superfund Financing
- Reduced AID Enterprise for the Americas Debt Forgiveness
- Reform of the Power Marketing Administration
- Increased Inland Waterway User Fees
- Increased Agriculture Department Grazing Fees
- Increased Interior Department Grazing Fees
- Federal Irrigation Water Surcharge
- Increased Corps of Engineers Recreation Fees
- Increased Interior Department Recreation Fees
- Increased Agriculture Department Recreation Fees
- Extension of Hardrock Mining Holding Fees
- Hardrock Mining Royalties
- Increased Enforcement of Harbor Maintenance Fees
- Permanent Extension of 50% Net Receipt Sharing
- Increased Assessments on "non-program" Crops
- Examination Fees for State-Chartered Insured Banks
- Commodity Futures Trading Commission Processing Fees
- Increased Securities and Exchange Commission Registration Fees
- Extension of Patent and Trademark Fees
- Increased Registration Fee on General Aviation Aircraft
- Permanent Extension of Tonnage Fees
- Payment of Outstanding Postal Health Insurance Liabilities
- Fees for State SSI Administration

- **Extension of Customs Merchandise and Passenger Fees**
- **Auction of Federal Communications Commission Spectrum**
- **Payment of Outstanding Postal Cost of Living Liabilities**
- **Improved IRS Tax Compliance**
- **Increased Part B Medicare Premiums**
- **Tax 85 percent of Social Security Benefits**

All told, the Administration's five-year "deficit reduction" package contains at least $60.9 billion of higher taxes and revenue increases that the White House dishonestly classifies as spending cuts.

THE BUDGET GIMMICKS

In addition to hidden tax hikes, the Clinton budget contains numerous "spending cuts" that are more truthfully characterized as budget gimmicks and accounting sleights-of-hand. Needless to say, phony savings and proposals that simply shift spending into future years do not reduce the size and scope of the federal government. Clinton's gimmicks include:

1) **Stretch out spending for the Superconducting Super Collider.** Slowing down construction on this multi-billion dollar project may generate $108 million in savings over the next four years, as the Administration claims, but only by increasing spending in future years.

2) **Reduce the Strategic Petroleum Reserve fill rate.** Clinton wants to fill the reserve at a rate which is one-third slower than the current rate. Slowing down the rate at which oil is added to the reserve, which is in any case of questionable value, simply delays $59 million of expenses to future years.

3) **Improve the management of Veterans Administration Hospitals.** This $1.5 billion "savings" is supposed to come from assumed "improvements" and "efficiencies" in ongoing operations.

4) **Cut 100,000 federal employees.** This $10.5 billion budget item was included in two Reagan budgets, but never materialized. The only way to cut employees is to reduce the size and scope of the government. Since Clinton proposes to increase total spending, the 100,000 work force reduction almost certainly will not materialize.

5) **Other administrative savings.** This $11.3 billion claimed savings is dubious for the same reasons. To be sure, the federal government wastes at least $11.3 billion in administrative costs. But in reality the only way to end the waste is to eliminate or reduce programs.

6) **Streamlining government.** The budget assumes $12.1 billion from streamlining government. But again, experience shows that these savings will not materialize unless Clinton reduces the size and scope of government, which he is not proposing.

7) **Shorten the maturity of debt securities.** The Administration assumes $16.4 billion in savings from shifting government debt to short-term Treasury Bills to take advantage of current lower interest rates. In effect, the White House is gambling that today's interest rates, which currently are at 25-year lows, will not rise. This is probably wishful thinking. If short-term interest rates do rise, the proposal actually will increase spending.

8) **Put hospitals on a calendar year basis.** This proposal saves $6.0 billion in Medicare spending only by shifting the outlays into future years.

9) **End lump sum benefits for federal retirees.** This proposal purports to save $8.3 billion. But all it does is shift spending on federal retirees into future years.

10) **Reform the student loan program.** Using the assumption that the Department of Education is more efficient than private banks, the Clinton budget assumes $3.2 billion of savings from switching the guaranteed student loan program to a direct loan program. Because government bureaucracy is less efficient than the private sector, however, actual costs almost certainly will increase.

The budget includes many more examples of such questionable budget savings. Just these ten items, however, account for $69.5 billion of claimed budget cuts. If these doubtful cuts and accounting tricks were subtracted from the proposal, the net effect of the Clinton budget would be to *increase* total spending—even after factoring in the defense cuts.

THE LARGEST TAX INCREASE IN HISTORY

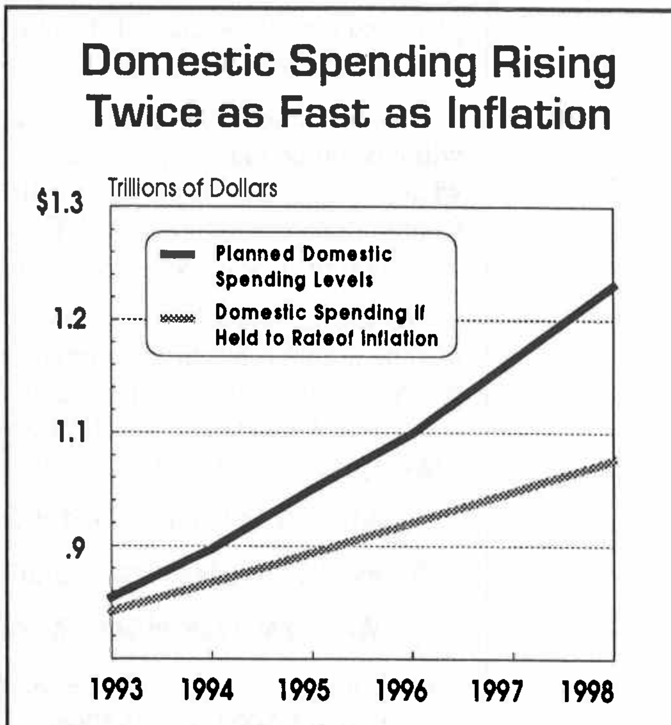
Clinton's budget cuts many be phony, but the same cannot be said on the tax side of the equation. In addition to the hidden tax increases listed above, the Administration's budget includes explicit hikes in personal income tax rates, corporate income tax rates, Medicare payroll taxes, and estate taxes. The Clinton plan creates a new broad-based energy tax, as well as higher gas taxes beginning in 1996. Combined with nearly two dozen other explicit tax increases, as well as the hidden tax hikes discussed above, the Clinton budget purports to generate an additional $316 billion of revenue by 1998.

If history is any guide, however, the tax increase will not reduce the deficit. Instead, the higher taxes are likely to trigger the following effects:

Effect #1: Federal spending will grow. History shows that raising taxes unleashes a torrent of new spending. In the 1970s, every dollar of higher taxes was matched by $1.22 of new spending. In the 1980s, each dollar of additional tax revenue was matched by $1.29 of new spending. In the 1990s, the ratio has grown even worse; each $1 of new revenue has been accompanied by $1.91 of higher spending.[4] In fact, according to the Joint Economic Committee, each dollar of higher taxes since 1947 has been associated with $1.59 of new spending. And there is nothing in the Clinton budget to prevent

4 Office of Management and Budget, *Budget Baselines, Historical Data, and Alternatives For the Future* (Washington, D.C.: U.S. Government Printing Office, January 1993).

Congress from boosting spending in anticipation of more money flowing into federal coffers.



Source: *A Vision of Change for America*, Office of Management and Budget.

Effect #2: Tax revenues will stagnate. Tax revenues are very dependent on the economy's performance. A strong economy, with rapid job creation, higher incomes, and increased business profits, generates substantial new revenue for the government. Conversely, a weak economy results in declining or stagnant revenues. It is also clear that tax policy affects the economy's performance. Higher taxes, such as those imposed by Herbert Hoover, Jimmy Carter, and George Bush, reduced incentives to work, save, and invest and slowed economic growth, leading to a slowdown in tax revenues and *higher* budget deficits.

Oddly, the Clinton Administration predicts that the economy actually will grow stronger following the imposition of the record tax hike. But in reality, individuals and businesses will tend to change their behavior to protect their earnings as far as possible from government. Some production and investment will cease completely, as higher taxes will wipe out already thin profit margins and decisively change the tradeoff between work and leisure. Other taxpayers will resort to tax shelters and other lightly taxed—but less productive—forms of economic activity to shield their earnings from tax. All told, it is safe to say that the federal government will not collect anywhere near the $316 billion of higher tax revenue the White House estimates.

Effect #3: The budget deficit will rise. The combination of increased spending and less-than-predicted tax revenues means that the budget deficit almost certainly will rise if the Clinton tax hike is enacted. Budget deficits rose following tax hikes in 1982, 1984, 1987, and 1990; there is no reason to believe that fiscal policy will behave differently today.

REINVENTING INCOME

The Clinton Administration has resorted to the ugly politics of class warfare to sell its flawed budget plan. White House officials believe that lower- and middle-income taxpayers will accept a major tax hike as long as they believe that the "rich" are paying a disproportionate share of the new taxes. With this strategy in mind, President Clinton maintains that taxpayers earning less than $30,000 will not pay higher taxes under his plan, and that 70 percent of the new taxes will be paid by those Americans making more than $100,000 annually.

But an examination of the tax proposal shows that middle-income Americans in fact will pay a much larger percentage of the tax increase than the Administration claims. In what can only be interpreted as a deliberate attempt to keep middle-income taxpayers from understanding how much their taxes would go up, the White House uses a definition of income which artificially inflates taxpayers' earnings by 30 to 40 percent.

The Clinton plan does not propose to tax people on the basis of this artificially high income number, but the Administration is using this figure in a misleading campaign to convince lower- and middle-income voters that they will be spared the brunt of higher taxes. The White House's definition, known as Family Economic Income, includes what a taxpayer would consider his or her income, plus:

1) **An estimate of unreported and underreported income.**
2) **Individual Retirement Account (IRA) and Keogh deductions.**
3) **Welfare and Social Security payments.**
4) **Employer-provided fringe benefits, such as health insurance, pension contributions, parking, and life insurance.**
5) **The increased value of life insurance, pensions, IRAs, and similar assets.**
6) **Interest on tax-exempt bonds.**
7) **Imputed rent on owner-occupied housing (as if a homeowner pays himself rent).**
8) **Unrealized capital gains.**
9) **The decline in the inflation-adjusted value of debts.**
10) **The income of other family members.**

Using this definition of Family Economic Income, many families who would not consider themselves rich, and whose traditionally defined incomes may be as low as $60,000 per year, suddenly make over $100,000 per year in the eyes of Bill Clinton.[5] As Robert Reichauer, Director of the Congressional Budget Office, explained in testimony to the House Budget Committee, in a classic example of understatement, Clinton's "definition of family economic income is broad and probably not recognizable to the average person."[6] The White House, moreover, has refused so far to release figures that would allow taxpayers to compare their gross incomes with their Family Economic Incomes, but experts estimate that households with income of $60,000-$70,000 under today's definition of income would become part of the "rich" $100,000-and-above income class that Clinton intends to carry the lion's share of new taxes.

5 This is not to say that Family Economic Income is a concept that lacks validity. It is quite valuable for determining the extent to which statistics such as the poverty rate overstate economic problems among the less fortunate in society.

6 "Details, Details," *The Wall Street Journal*, February 26, 1993, p. A15.

CONCLUSION

By repeating the failed tax-and-spend policies of Jimmy Carter and George Bush, Bill Clinton is endangering the economy's recent resurgence. Higher taxes will not encourage businesses to create jobs; higher taxes will not encourage individuals to save and invest more; higher taxes will not promote fiscal restraint on Capitol Hill; and higher taxes will not increase America's international competitiveness.

If the Clinton plan is approved, federal spending will climb, the deficit will increase, and private incomes will stagnate. By simultaneously raising taxes and expanding domestic spending, the White House's budget will undermine private opportunities and make Americans even more dependent on government.