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THE SENATE RECONCILIATION BILL: REPEATING THE MISTAKES OF THE 1990 BUDGET DEAL

(Updating *Backgrounder Update* No. 193, "How Clinton's Budget Plan Taxes the Elderly," June 4, 1993; *Backgrounder Update* No. 192, "The House Budget Reconciliation Bill: Making a Bad Budget Even Worse," May 25, 1993; *Backgrounder* No. 942, "Why Higher Tax Rates on Income Will Slow Growth, Cost Jobs," May 25, 1993; *Backgrounder* No. 932, "Taxes, Spending, Gimmicks, and Snake Oil: Why Bill Clinton's Budget Is Bad for America," March 16, 1993.)

The so-called deficit reduction legislation—or reconciliation bill—which will be considered by the Senate this week represents yet another lurch in the wrong direction for fiscal policy. The bill would impose the largest tax increase in world history while doing almost nothing to rein in the rapidly increasing burden of domestic spending programs. If enacted, the Clinton tax package will weaken the economy and reduce America's international competitiveness.

Moreover, the Clinton Administration and Democratic congressional leaders are misrepresenting the level of taxes and spending cuts in the bill. The Administration, for instance, argues that the package will reduce deficits by about $500 billion over the next five years, even though the Congressional Budget Office (CBO) estimates that the reconciliation bill contains less than $350 billion worth of savings. The Administration claims that future spending cuts will bring the total up to $500 billion, but the CBO estimate makes such a promise ring hollow.

The Administration also is straining credibility by arguing that the package is evenly balanced between revenue increases and spending cuts. Even if the dishonest Washington definition of a spending cut is used —increasing spending by less than previously planned—this is completely false. According to CBO's accounting, nearly 72 percent of the reconciliation bill comes from higher revenues, a revenue increase to spending "cut" ratio of $2.53 to $1.

Yet the CBO number understates the level of revenue increases in the bill by counting so-called user fees and other revenue-raising provisions as spending cuts. Adding in these user fees, as Republican Senators have done in their estimates, brings the ratio of revenue increases to spending cuts up to $3.15 to $1. But even this figure understates the severity of the tax hike by failing to count such provisions as the $7.2 billion in revenue generated by selling portions of the radio spectrum. This is sound policy, but it is not a spending cut.

THE UNLEARNED LESSONS OF 1990

If the Senate approves the tax bill, it will be yet another illustration of the sad fact that lawmakers have learned nothing from the disastrous 1990 budget deal. In particular, lawmakers have forgotten the following lessons of that deal:

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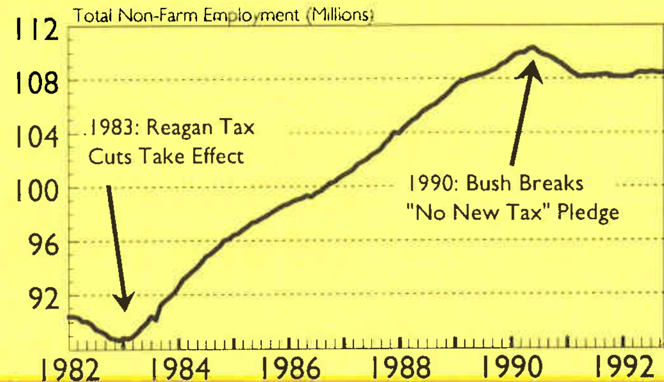
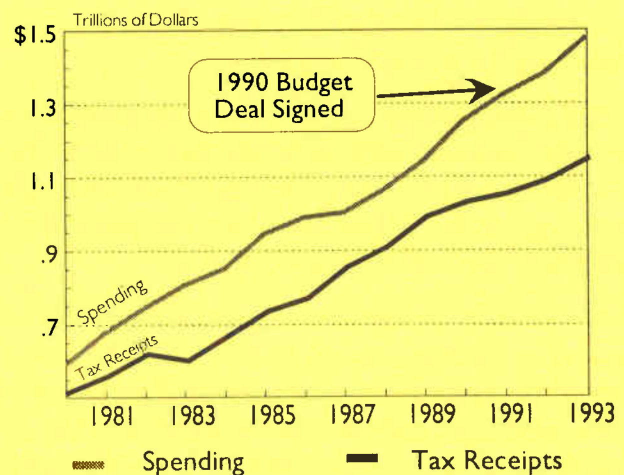
LESSON #1: Higher taxes destroy jobs. As the chart below illustrates, the record job growth during the Reagan boom came crashing to a halt in 1990. While other anti-growth policies of the Bush Administration, such as the huge growth in the regulatory burden, doubtless played a role, there is no question that both the prospect of higher taxes and the eventual imposition of the largest single-year tax increase in history derailed the American jobs machine.



Just as in 1990, the current threat of higher taxes this year has had an effect on the economy—even before the law goes into effect. Jobs have been hit. Businesses understandably are reluctant to increase employment, knowing that government policies soon will make it less desirable to hire new workers. This is especially true since businesses also expect a massive new payroll tax, either explicitly or in the form of a mandate, to finance the Administration's health plan.

LESSON #2: Higher taxes encourage more federal spending. After the 1990 budget deal, the growth rate of federal spending increased substantially. As the chart below shows, inflation-adjusted federal spending grew much faster after the 1990 budget deal than it did in the five previous years when the Gramm-Rudman Deficit Reduction Act was in effect. Unfortunately, the spending surge after 1990 was not surprising. A 1991 Joint Economic Committee study found that every $1 of higher taxes between 1947 and 1990 was associated with $1.59 of new spending.

While it is impossible to predict exactly how much new spending will be triggered by Clinton's record tax hike, the Administration's own numbers suggest that the increase will be substantial. According to the Office of Management and Budget, as well as the Congressional Budget Office, federal spending will be more than $300 billion higher in 1998 than it is today. Moreover, because of falling defense and deposit insurance outlays, the increase is concentrated among domestic programs. All told, domestic spending is projected to rise more than twice as fast as inflation according to the White House's own estimates. These numbers, incidentally, do not count the new spending which undoubtedly will follow enactment of the tax increase.



LESSON #3: Higher tax rates on income are particularly damaging to economic growth. By radically increasing tax rates on income, the Senate tax bill repeats the failed class warfare policy of the 1990 budget deal. Indeed, lawmakers have plenty of examples from which they should have learned that higher tax rates on income backfire on the economy. Presidents Herbert Hoover, Lyndon Johnson, Jimmy Carter, and George Bush all signed legislation increasing tax rates and in every single case an economic downturn followed. By contrast, tax rate reductions under Presidents John F. Kennedy and Ronald Reagan were followed by record economic expansions.

As bad as the 1990 tax hike was, the Senate tax bill is far worse. The 1990 legislation raised the top tax rate on regular income from 28 percent to "only" 31 percent, more than doubled the amount of income subject to Medicare taxes, and reduced the value of itemized deductions for upper-income taxpayers. The bill currently before the Senate creates two new higher tax rates. A family or small business with more than $140,000 of income will be subject to a new 36 percent tax, while families or small businesses with $250,000 of income will face a 39.6 percent tax. The legislation also would subject all income to the Medicare payroll tax, thus increasing the real top tax rate to 42.5 percent. The Senate bill even raises the top rate of taxation on capital gains from 28 percent to 30.8 percent, thus exceeding the House tax bill in terms of provisions that will harm new investment. The Senate bill also increases income taxes on the elderly and raises the top corporate income tax rate from 34 percent to 35 percent. If approved, these tax increases will slow savings and investment.

LESSON #4: Higher taxes lead to higher budget deficits. When President Bush acquiesced to tax increase negotiations with Congress in 1990, budget deficits were projected to be under $150 billion and falling over the next several years. Since the 1990 tax increases were approved, however, budget deficits have more than doubled. Again, the 1990 budget deal is not the only evidence that higher taxes lead to higher deficits. Major tax increases were enacted in 1982, 1984, and 1987, for the alleged purpose of deficit reduction. In every case, however, the deficit rose the following year.

There is no reason to think the Clinton tax hike will lead to a different result. Higher taxes hinder economic growth and job creation, thus shrinking the tax base. Combined with the new spending which always follows adoption of a tax increase, it is not surprising that the deficit climbs. The White House effectively admits that this will occur, since their own estimates show that adoption of the Administration's budget will cause the deficit to balloon to $431 billion by 2003.

PLAYING WITH NUMBERS

In their effort to sell the Clinton package, supporters of the Clinton budget have stretched the truth beyond its breaking point. In particular, the White House and Democrat congressional leaders claim that the package is evenly balanced between spending cuts and tax increases. Using honest accounting, however, the bill is overwhelmingly comprised of higher taxes.

The Administration's numbers have several shortcomings:

1) Many revenue increases are counted as spending cuts. For instance, increasing the monthly Medicare tax paid by senior citizens is counted as a $6.6 billion spending cut. The legislation would raise $7.2 billion by auctioning a portion of the radio spectrum and count the revenue as a spending cut. A few examples of other revenues being counted as spending cuts include $205 million in tonnage fees, $633 million in veterans home loan fees, a $1.041 billion transfer from the Postal Service, and $2.4 billion in customs taxes. All told, there are more than $20 billion of revenues in the Senate bill that are falsely counted as spending cuts.

2) Budget gimmicks are used to artificially inflate the reported spending cuts. In particular, the legislation claims $4.295 billion from a provision nationalizing a portion of the guaranteed student loan program. These savings, however, will materialize only if the federal government turns out to be more efficient than the private sector. As any comparison of the Postal Service and Federal Express will demonstrate, this

is a very dubious proposition. The reconciliation bill also counts $8.616 billion in savings from eliminating the lump sum option for federal retirees. This provision, however, simply shifts spending into future years, leaving the government's liabilities unchanged.

Counting hidden revenues and budget gimmicks, the ratio of revenue increases to spending "cuts" in the Senate bill is almost five to one. And if provisions that merely extend current law are not counted, because they do nothing to change existing levels of government spending, then the ratio of revenue increases to spending cuts jumps to more than six to one. This may be a considerable improvement over the fifteen-to-one ratio in the House bill, but it is still a disaster in the making for the U.S. economy.

CONCLUSION

The Senate tax bill is a surefire recipe for continued economic stagnation. Policies which have not worked in the past are not going to work today or in the future. By failing to learn the lessons of history—even history that occurred just three years ago—lawmakers are condemning the American people to lower living standards, less opportunity, and an economy that will perform well below its potential.

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