UPDATE

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THE BUDGET AND THE ECONOMY: A FIRST YEAR ASSESSMENT OF THE CLINTON PRESIDENCY

(Updating *Backgrounder* No. 932, "Taxes, Spending, Gimmicks, and Snake Oil: Why Bill Clinton's Budget is Bad for America," March 16, 1993.)

The Clinton Administration's 1995 budget, to be released today, cites reports of falling budget deficits and evidence of stronger-than-expected economic growth as proof that the Administration's economic policies have been successful. In reality, however, President Clinton's decision to continue Bush Administration policies of more spending and higher taxes is imposing a heavy cost on the economy. While White House spin doctors cheer recent growth numbers, they overlook the fact that the economy is growing at only 50 percent of levels it traditionally reaches when coming out of recession. The President also claims credit for job creation last year, but he neglects to mention that job creation, like growth, is far weaker than normal.

In addition, much has been made of Administration and Congressional Budget Office (CBO) projections that the budget deficit may fall to less than $200 billion in fiscal year 1995. Unfortunately, this may be a case of counting the chickens before they hatch. During debate on the 1990 budget deal, for instance, the Administration and CBO projected that there would be a $16.7 billion surplus in 1994 if Bush's tax hike was approved. Needless to say, with this year's budget deficit expected to easily exceed $200 billion, promises of future deficit reduction never materialized.

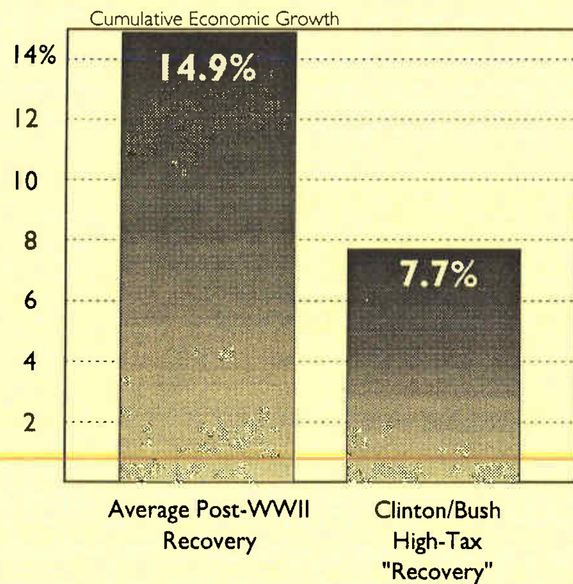
Rather than stimulate the economy, it is far more likely that Clinton's record $262 billion tax hike last year has kept the economy from rebounding as strongly as it typically does following a period of stagnation. Part of the blame for the sub-par growth, to be sure, rests with the Bush Administration, which caused the recession in the first place by reversing most of the pro-growth policies set in place in the 1980s. Nonetheless, by continuing the failed policies of the Bush Administration—after campaigning as the candidate of "change"—President Clinton now must be held accountable.

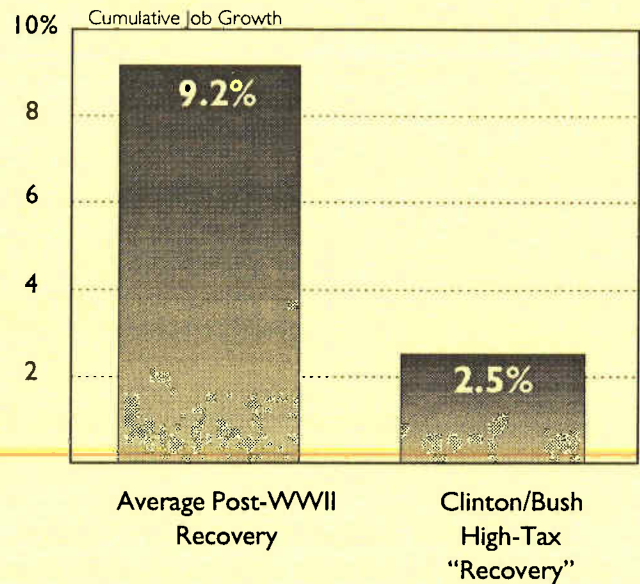
Weakest Recovery in Decades. In a welcome development, the preliminary numbers for the fourth quarter of 1993 show that the economy grew at an annual rate of 5.9 percent. Even with this late surge, however, the economy grew by only 2.8 percent over the full year, considerably less than the 3.7 percent rate of growth in the last year of the Bush Administration. The Clinton Administration, predictably, prefers to use a different measure of gross domestic product growth (average for the year rather than end-of-year total) since the alternative measure reduces growth in Bush's last year to 2.6 percent.

Partisan bickering notwithstanding, the level of growth in both 1992 and 1993 was far from robust. Only when compared to the economy's performance in 1990 and 1991 do the recent numbers look good. Bush's last year and Clinton's first year do not look impressive, however, when compared to historical averages.

Note: Nothing written here is to be construed as necessarily reflecting the views of The Heritage Foundation or as an attempt to aid or hinder the passage of any bill before Congress.

Economic Growth After a Recession: Clinton/Bush "Recovery" Significantly Less Robust than the Average





Note: Total growth 2.75 years after trough.
Source: Bureau of Economic Analysis.

Note: Total employment increase 33 months after trough.
Source: Bureau of Labor Statistics.

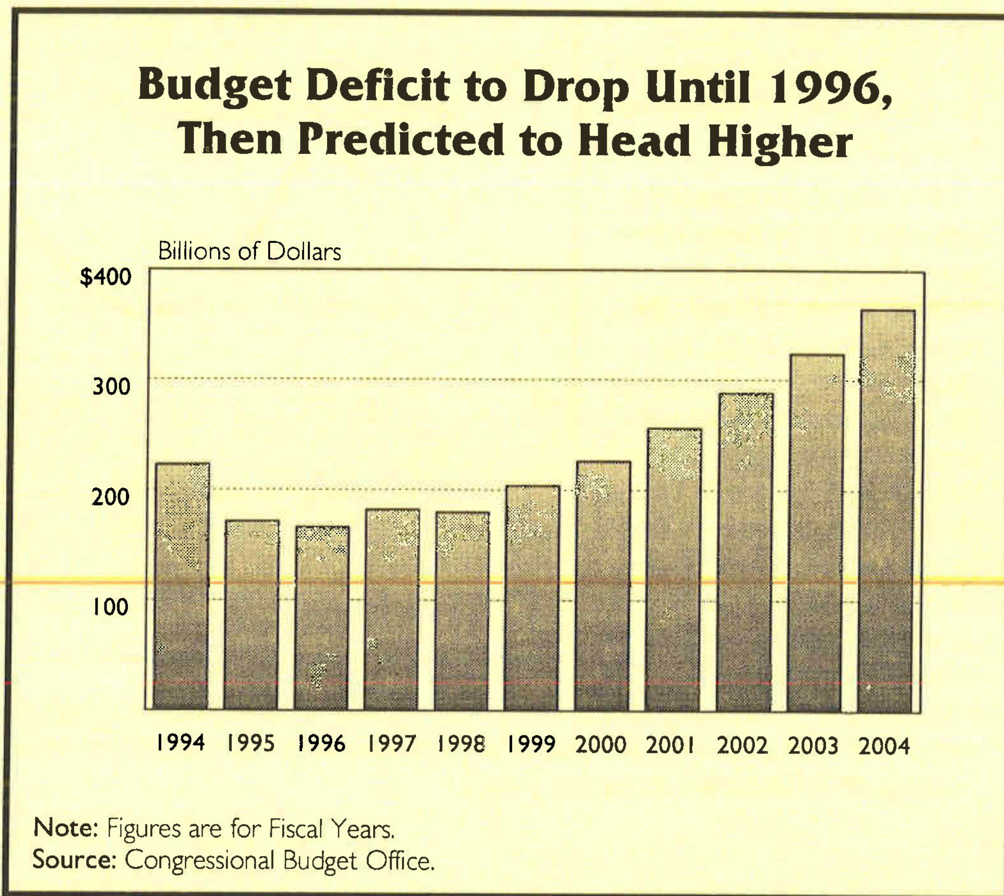
Consider that during the post-World War II era, including recession years, the economy has grown by an average of more than 3 percent annually. The economy's performance under Clinton, in other words, is below average by any measure.

Even more discouraging, the economy's growth rate normally is well above the historical average following a period of recession. Annual growth rates averaging more than 5 percent are the norm following an economic downturn, yet growth in Bush's last year and Clinton's first year failed to reach even the long-term average. Indeed, an analysis of economic growth rates eleven quarters into a recovery (eleven quarters have elapsed since the 1990-1991 recession ended) shows that growth has been barely half the level experienced during past expansions. Why has growth been so anemic during this expansion? The most likely reason: the large tax increases adopted in 1990 and 1993.

The Jobless Recovery. In his State of the Union address, President Clinton boasted about the creation of 1.6 million new jobs during his first year in office. While this figure is better than no job creation, it represents a much smaller increase than usually experienced. At this stage in an economic expansion, 33 months after the low point of the recession, total employment traditionally has increased by an average of 9.2 percent.

With higher payroll and income taxes, new mandated benefits, added regulatory burdens, and the threat of the President's health care plan looming on the horizon, employers today have been much more cautious. Even including the 1.6 million jobs created last year, total employment has climbed by just 2.5 percent since the bottom of the recession—far below the average. Because the 1990-1991 recession was relatively mild, it would be unfair to expect job creation to match the levels reached coming out of prior recessions, but the job market's lackluster performance indicates government policy is inhibiting job creation.

Pollyanna Deficit Numbers. The Administration is trying to justify last year's tax increase by trumpeting projections showing that the budget deficit may fall to under $200 billion in 1995. More sober analysis suggests the outlook may not be so rosy. A lot of time remains before the next fiscal year is over, and history clearly indicates that promises of future deficit reduction are nebulous at best. As mentioned previously, supporters of the 1990 budget deal falsely alleged that the budget would have a surplus of more than $16 billion this year. The 1982 tax hike was supposed to require $3 of spending cuts for every $1 of new revenue. Instead, spending went up and the deficit rose.



With any luck, history will not repeat itself this time and the deficit will fall. Considering that the budget deficit was $150 billion and falling when President Reagan left office more than five years ago, any progress will be welcome news to long-suffering taxpayers. It may be too soon, however, to celebrate. Even if the deficit does fall in 1995 and 1996 as the Administration and CBO estimate, the good news is only temporary.

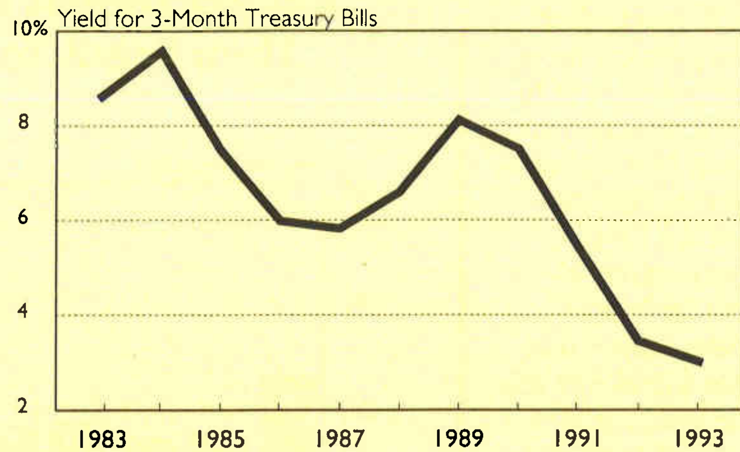
According to CBO, the deficit will climb rapidly after 1996. By the year 2003, the budget deficit more than doubles, climbing to an all-time record of $324 billion. And with unpublished Administration figures showing that the Clinton health care plan could boost annual budget deficits by nearly $200 billion by the turn of the century, the fiscal situation could deteriorate rapidly.

Exploding Domestic Spending. The major reason why deficits are expected to explode is the unconstrained growth of domestic spending. According to CBO, total government spending will increase by $328 billion in five years as a result of last year's "deficit reduction" legislation. An astounding 97.3 percent of that increase is due to higher domestic spending. Indeed, CBO projects that domestic spending will grow more than 91 percent faster than needed to keep pace with inflation.

This continuing surge of domestic spending, which includes both entitlement and discretionary programs, more than wipes out the fiscal benefits that should exist thanks to falling defense spending, reduced deposit insurance outlays, and declining interest payments. And because domestic spending climbs so rapidly, total federal spending is projected to grow 48 percent faster than needed to keep pace with inflation.

Lower Interest Rates: Thank the Fed. The Administration also is trying to take credit for low interest rates. According to the White House, last year's record tax hike convinced financial markets that Washington was finally serious about deficit reduction. While the Administration's political strategy is

sound, its economic analysis is not. Interest rates have been falling steadily since 1989. Moreover, interest rates during that time fell even though the budget deficit was nearly doubling.



Note: Yields are for newly issued T-Bills.
Source: Council of Economic Advisers.

Why did interest rates fall and why do they remain low now? Simply stated, the Federal Reserve Board (the nation's central bank) has done a stellar job of bringing the inflation rate down and convincing financial markets that the Fed intends to keep a close eye on the money supply. As a result, financial institutions and other lenders have significantly reduced the inflation premium on interest rates. This progress has nothing to do with Clinton's tax increase (though the White House should be commended for not following the example of the previous Administration, which constantly pressured the Fed to adopt an inflationary monetary policy).

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The economic and budget outlook after President Clinton's first year in office is not positive. Not only did the President fail to reverse Bush's disastrous tax-and-spend policies, he compounded the damage by imposing a record tax increase of his own. The economy's continued slow growth and anemic levels of job creation are a direct result.

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