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Why Clinton Should Not Get Credit for Reducing the Deficit

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The Office of Management and Budget last week announced that the FY 1996 deficit is forecast to be $145.6 billion, or one-half of the FY 1992 level of $290.4 billion.[1] Although the Clinton Administration claims credit for this significant deficit reduction, in fact it has had very little to do with it.

Before President Clinton took office, three factors already were beginning to bring down the deficit:

❶ **Reductions in defense spending.** A significant part of the decrease in the deficit is the result of much lower defense spending. Defense spending in FY 1996 will be $266.3 billion, which is $36.3 billion less than in FY 1992. In real, inflation-adjusted terms, defense spending is the lowest since the Carter years, and as a percentage of GDP it is lower than before World War II. The Chairman of the Joint Chiefs of Staff has testified to Congress about the dangerous neglect of military procurement, which is now at the lowest level since the Korean War. Since FY 1992, military procurement has been reduced by 44 percent.

❷ **The reform of deposit insurance.** The most deceptive part of the "deficit reduction" between FY 1992 and FY 1996 is simply the way in which the budget accounts for federal deposit insurance for banks and thrift institutions. During the Bush Administration, the S&L bailout made the budget deficit much greater, requiring $57.9 billion in FY 1990 and $66.2 billion in FY 1991. But in FY 1993, before Clinton's economic policies were enacted, the fed-

1 *Budget of the United States Government, Fiscal Year 1995: Historical Tables* (Washington: U.S. Government Printing Office, 1996), p. 20, Table 1-1.

eral government actually began to make a profit of $28 billion from selling assets. In FY 1996, the deposit insurance funds will bring in $13.5 billion to make the deficit appear even smaller. The Clinton Administration has enjoyed a large windfall.

Defense spending cuts and the distorting effects of deposit insurance account for 36 percent of the change in the deficit between FY 1992 and FY 1996. While the Administration claims credit for deficit reduction, its domestic spending has surged 23 percent since FY 1992, from $857.1 billion in FY 1992 to $1,058.4 billion in FY 1996. Domestic spending now is equal to 14.5 percent of GDP, the highest proportion since the 1980 and 1982 recessions, which pushed up the ratio because the economy slumped.

❸ **Economic growth and tax revenues.** As the economy grew out of the 1990-1991 recession, federal tax revenues began to increase significantly. Indeed, one of the largest contributing factors to the huge deficits during the Bush years was the drop in revenue growth during the recession. Historically, tax revenues have grown at about 7.9 percent per year, but during 1990-1992, government revenues grew at half that rate. When the economy recovered from the Bush recession in FY 1993, revenue growth rebounded strongly to 9 percent, and FY 1994 saw a 7.8 percent growth. Government revenues have grown from $1,090.5 billion to $1,426.8 billion, or 31 percent, since FY 1992.

This significant growth in taxes, combined with the cut in defense spending and the shift of deposit insurance from a net cost to a profit center in the budget, accounts for all of Clinton's deficit reduction. Not a dime of this deficit reduction is from controlling spending. The "era of big government" is not over; it is just hiding behind the business cycle and post-Cold War defense policy.

Just as incoming Presidents are unfairly blamed for economic slowdowns, they also receive unwarranted credit for economic growth even when it is more sluggish than it should be. A look at what has happened to federal tax revenues collected since the first Clinton budget suggests that the deficit should have been falling faster. The Clinton Administration's 1993 tax increase has been followed by a significant slowdown in the rate of growth in tax revenues. In FY 1996, federal revenue is projected to be only $71.6 billion greater than it was in FY 1995, while in FY 1995 it was $97.5 billion higher than FY 1994, and in FY 1994 it was $104.2 billion greater than in FY 1993.

Clinton's Tax Increase Slows Revenue Growth

	Total Increase In Revenues (billions)	Revenue from 1993 Tax Increase (billions)	Revenue from Economic Growth (billions)
FY 1994	$104.2	$26.4	$77.8
FY 1995	$ 97.5	$43.5	$54.0
FY 1996	$ 71.6	$51.5	$20.1

According to the Congressional Budget Office, tax revenues from the Clinton 1993 tax hike increased from $26.4 billion to $51.5 billion between FY 1994 and FY 1996.[2] But the total increase in tax revenues from all sources decreased from $104.2 billion to $71.6 billion. Most of the drop in the deficit from new revenues occurred before the new 1993 tax increases could be collected. The tax data suggest that Clinton's economic policies actually may have sapped the economic recovery and produced a deficit larger than it otherwise could have been.

2 *The Economic and Budget Outlook, Update* (Washington: U.S. Government Printing Office, 1993), p. 29, Table 2-2.

CBO's September 1993 estimate of new tax revenues from Clinton's economic program might have been too large, but such an error would hardly be to the credit of the political leadership that pushed through the largest tax increase in history on a strictly party-line vote.

The Heritage Foundation will soon release a report analyzing the impact of the Clinton Administration's tax and spending policies from the Omnibus Budget Reconciliation Act of 1993 (OBRA-93) on the nation's economic performance. Using one of the nation's leading models of the U.S. economy, this study will examine how the economy would be performing today had the Clinton Administration and Congress not raised taxes as the U.S. was coming out of the 1990-1991 recession. This analysis will show that President Clinton's 1993 economic plan actually has deprived Americans of a higher standard of living by cutting the economy's growth potential.