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THE 1997 BUDGET AGREEMENT: THE RETURN OF BIG GOVERNMENT

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INTRODUCTION

The Republican leadership of Congress and President Bill Clinton have released the initial details of their plan to balance the federal budget by 2002 and provide modest tax cuts for hardworking Americans. Each new detail that comes out, however, confirms that this is a deal based on $300 billion in questionable assumptions that mask a substantial growth in the size and scope of the federal government. Moreover, while the President's agenda is revealed explicitly in the documents accompanying the agreement, the congressional agenda is left largely up to the imagination. Taxpayers are being asked to accept bigger government in exchange for the promise of a "balanced budget" and a small cut in their taxes.

The real test of a balanced budget plan is whether it actually leads to smaller, less costly government and leaves more money in the pockets of working families. The available evidence shows that this budget deal fails on nearly every count and that, in most cases, the policies it reflects may be worse than doing nothing.

Take spending. The deal will usher in a major increase in new spending, especially discretionary outlays. Some examples:

- Discretionary spending will balloon by at least $96 billion above current levels over the next five years, starting with as much as $8 billion in new spending in FY 1998.
- While the congressional leadership agreed to $30 billion in new White House initiatives, they received no commitment to eliminate any wasteful program in exchange. At a minimum, the elimination of programs such as the National Endowment for the Arts, the Legal Services Corporation, and AmeriCorps should be the price for any increased spending levels.

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- The deal also will erase all of the savings achieved in last year's landmark welfare reform legislation. The agreement includes about $22 billion in spending for new children's health care initiatives, welfare benefits for legal aliens, and food stamp recipients, in addition to a $37 billion bailout of private owners of low-income housing.
- The reported $115 billion in Medicare savings will stem the growth of these programs only modestly over the next five years while doing nothing to promote any fundamental restructuring. The Medicare deal includes a home health care accounting change that has been widely condemned as inviting a surge of new spending, in addition to which the price controls included in the plan would lead to worse care for Medicare recipients.

By contrast, taxpayers will have to settle for a tax cut that seems to move in the right direction while actually doing little to roll back government:

- The tax measures would return less than one cent of every dollar they send to Washington over the next five years.
- Taxpayers will receive just 67 cents in tax cuts for every dollar of new spending earmarked for White House and congressional priorities.

In short, based on the data released thus far, the White House and Republican leaders in Congress have negotiated a "balanced budget" plan that is not in the best interests of the American people. The only way to improve it now is by dramatically increasing the size of the tax cut package, eliminating the proposed new taxes, holding the line on new domestic spending, and including provisions that eliminate specific programs and reform entitlements. These flaws must be corrected early in the process if the agreement is to have any credibility.

Even if lawmakers took these steps, however, serious questions would remain. For instance, will the deal have any measurable impact on the FY 1998 budget, or will it simply "back-load" the hard work for future lawmakers? And since the deal is built on the shaky foundation of questionable economic assumptions, what enforcement mechanisms will lawmakers adopt to ensure that spending is controlled should the rosy claims now being made by the President and the congressional leadership fail to materialize?

FUNDAMENTAL FLAWS OF THE DEAL

Based on the details currently available, there are three fundamental flaws in the 1997 balanced budget agreement.

1. The tax cut package returns just one penny on the dollar to American families.

A credible balanced budget plan should share the benefits of a smaller, less expensive government with America's taxpayers. The current budget deal fails this test by proposing a small "net" tax cut of $85 billion (a $135 billion "gross" tax cut minus $50 billion in new tax "offsets" or increases). This modest amount—just 1 percent of the $8.5 trillion[1] in estimated tax revenues over the next five years—is supposed to fund tax relief for families with children, capital gains tax relief, death tax reform, and tax cuts for college tuition. However, this amount is only one-third of what is needed

1 This estimate does not include the CBO's latest $225 billion adjustment.

to fund all of these tax cuts fully; indeed, the full "cost" of the $500-per-child tax credit alone is $105 billion over five years.

As small as this tax cut is, its actual size may be even smaller than is being publicized. One of the key elements of this deal is the assumption that the Bureau of Labor Statistics will adjust the measurement of the consumer price index (CPI) downward by 0.25 percentage points. This adjustment will generate roughly $6 billion more in taxes over the next five years because tax brackets, personal exemptions, and the standard deduction are all indexed to the CPI.

Thus, the $85 billion "net" size of the tax package falls to just $79 billion after considering the CPI correction—amounting to a tax cut of less than one penny for every dollar taxpayers will send to Washington over the next five years. It means that taxpayers will receive only 67 cents in tax relief for every new dollar of spending allocated for government programs.

It would seem that President Clinton and congressional leaders should be able to do more for taxpayers. The Congressional Budget Office (CBO) told Congress last week that future tax collections would be $225 billion more over five years than it had projected. This $225 billion windfall—$2,250 for every household in America—should be returned to Americans in tax relief. Instead, it appears that negotiators used these projected "new" tax revenues the old-fashioned Washington way: They spent them.

Any credible tax cut package should return more than just a penny on the dollar to American families. Any credible plan also should provide more in tax cuts than it does in new spending programs.

Such a tax package should include the following elements:

- Every working family in the United States should receive a tax credit of $500 per child. This tax cut should not be phased in over the next five years; families should reap the benefits of the 1997 budget agreement immediately. Moreover, the $500 per child credit should be available to all working families regardless of income, because all families are overtaxed, and any family with a dependent child under age 18.
- The capital gains tax rate should be cut by 50 percent at a minimum. Ideally, it also should be indexed to the inflation rate.
- The death tax (estate and gift tax) should be repealed.
- The package should include both an "IRA-Plus" plan and a $2,200 spousal individual retirement account (IRA).
- The package also should include a new tax-free savings plan for higher education. Under such a plan, families would be able to put after-tax dollars into an IRA-like education savings account or a pre-paid tuition plan and withdraw those savings, while the build-up on the account would be tax-free.

The total value of these five tax cuts is about $230 billion over the next five years.

2. **The budget deal finances tax cuts with new taxes and dubious revenue assumptions instead of spending cuts or asset sale revenues.**

A good budget deal should finance tax cuts by reducing federal spending, not by increasing taxes on other Americans. A sound budget agreement should lead to a smaller government and a smaller tax burden, not a redistribution of wealth within the economy.

The budget deal fails this test by proposing to raise some $50 billion in new taxes to offset a portion of the tax cut package. The bulk of these new revenues—some $34 billion—is to be generated by extending the Airport and Airway Trust Fund tax, which expires at the end of this fiscal year. The remaining new tax revenues will likely come from eliminating various tax deductions for businesses and, perhaps, reinstating the Superfund environmental tax, raising another $6.4 billion over five years. By any measure, regardless of their motivation, these measures are tax hikes that will allow lawmakers to avoid cutting a comparable amount of wasteful spending.

If the White House and Congress cannot negotiate more spending cuts to finance the tax cuts, then they should look to raise an equivalent amount of revenue by selling government assets. Asset sales lawmakers should consider for quick liquidation include:

- Selling portions of the government's $165 billion direct loan portfolio, which could raise over $50 billion;
- Selling the government-owned utilities operated by the Power Marketing Administrations, which could raise another $10.8 billion; and
- Selling oil from the Strategic Petroleum Reserve, which could raise another $11.7 billion.

A sound budget deal should ensure that tax cuts are paid for by smaller government, not by other taxpayers.

3. **The budget deal opens the floodgates to new government spending.**

A credible balanced budget plan should reduce the size and scope of government and result in fundamental changes in federal programs. Both Congress and the White House are claiming that the budget deal will deliver $115 billion in Medicare savings, $8 billion in Medicaid savings, $61 billion in non-defense discretionary savings, and $78 billion in defense savings. In reality, however, lawmakers have used the 1997 budget deal to open the floodgates to as much as $118 billion in new spending, at least $96 billion of which is higher discretionary spending.

All of the so-called spending cuts in the plan are reductions from a "baseline" projection of government spending in which programs are assumed to grow according to such factors as the rate of inflation, population growth, and formulas written into law. If the budget deal's proposals are measured against how much actually was spent in FY 1997, non-defense discretionary spending will grow by a cumulative $73 billion over the next five years, and defense spending will receive about $23 billion in new funding over the same time period.

Although year-by-year figures are not available, estimates based on the available data indicate that discretionary spending will be $7 billion to $8 billion higher in FY

1998 than in FY 1997. As much as $6 billion of this increase is likely to occur in domestic programs. Moreover, FY 1998 discretionary spending is likely to be $11 billion greater than the legal "cap" prescribed by the 1993 budget deal.

As part of these discretionary increases, the Republican leadership agreed to at least $30 billion in new funding for President Clinton's education priorities but extracted no concessions to eliminate wasteful programs in return. At a minimum, congressional negotiators should have pressed for the elimination of such unnecessary programs as the National Endowments for the Arts and Humanities, the Legal Services Corporation, the AmeriCorps program, and the Corporation for Public Broadcasting. Eliminating these programs alone would have freed up $5.5 billion for the President's education priorities or $5.5 billion more for tax cuts.

Congressional leaders should have demanded that dozens of other redundant, outmoded, or useless programs be eliminated in order to redirect the savings to the President's new initiatives. For example, the following proposals would save an additional $26 billion to pay for the President's priorities without increasing overall spending:

- $13.75 billion could be saved over five years by consolidating and block granting most of the more than 160 job training programs (which cost more than $20 billion per year) and cutting their overall funding by 50 percent;
- $8.3 billion could be saved over five years by eliminating the Department of Energy's Energy Supply Research and Development programs, which largely benefit wealthy businesses and industries;
- $2.3 billion could be saved over five years by eliminating the Technology Administration, which has become a "corporate welfare" program for large firms; and
- $1.8 billion could be saved over five years by eliminating the Economic Development Administration, the Appalachian Regional Commission, and the Tennessee Valley Authority's non-power functions—just three of at least 62 federally funded economic development programs.

If Congress and the President feel strongly enough about these new spending initiatives, they should be willing to fund them by eliminating programs that have become outmoded, redundant, or simply unworkable.

In addition, based on the best available information, the budget deal erases all of the savings lawmakers achieved last year in the landmark welfare reform bill. At least $22 billion in new spending will be pumped into welfare programs such as aid for legal aliens, increased food stamp payments, and health care for children. Moreover, $37 billion in new discretionary spending is to be dedicated to bailing out landlords and developers participating in the Section 8 low-income housing program. Not only is this bailout bad policy, but it amounts to $37 billion in corporate welfare disguised as aid to the poor.

As a consequence of this new spending, negotiators were left with two choices: Extract deeper savings from entitlement programs such as Medicare or skimp on the size of the tax cuts.

REMAINING QUESTIONS

Even if lawmakers renegotiated the deal to increase the value of the tax cuts and reduce the amount of spending increases, however, other serious problems remain. For instance, White House and congressional negotiators have yet to indicate whether spending next year (FY 1998) will be substantively different from this year, or whether the hard work of cutting spending and delivering tax cuts has been put off for later years. If the spending cuts and full value of the tax cuts are put off until later years, taxpayers have no choice but to conclude that this deal, like earlier ones, is not in their best interest.

The experience of the last six budget deals (1982, 1984, 1987, 1989, 1990, and 1993) clearly indicates that future year promises never materialize. That is why tough enforcement mechanisms are needed to ensure that lawmakers honor whatever fiscal discipline is agreed to in the deal, and that its promises are met.

1. **The budget deal must show results in FY 1998 and not "back-load" deficit reduction.**

   A sound balanced budget plan must show immediate results in the next fiscal year (FY 1998) and not delay the hard work until after 2000 (known as "back-loading"). For example, the CBO found that Clinton's FY 1998 budget pushed 98.5 percent of its deficit reduction measures into fiscal years 2001 and 2002—after the President leaves office.

   While there are many details yet to be released regarding the current budget deal, two factors will determine its credibility:

   - Are the tax cuts phased in over many years?
   - Does the new spending begin immediately?

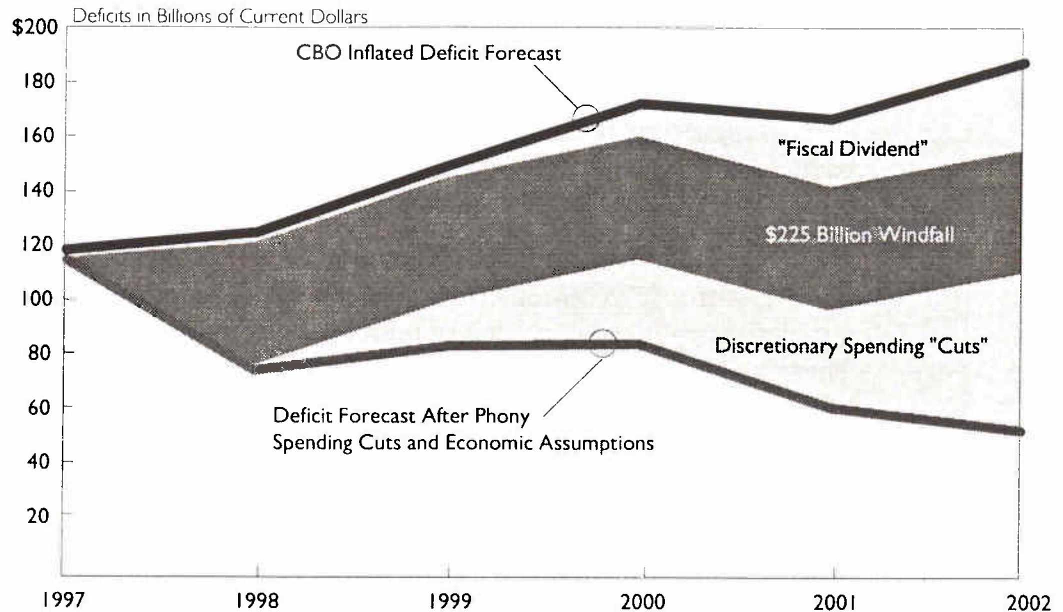
   If the answer to both of these questions is yes, then taxpayers are getting a raw deal. Once again, it will prove that lawmakers place a higher priority on their new spending than they do on delivering tax cuts for ordinary Americans.

   A serious balanced budget plan should begin cutting both taxes and spending, without delay, in FY 1998.

2. **Congressional committees must be given flexibility in meeting the plan's savings targets.**

   The budget deal should not tie the hands of congressional committees, such as the House Ways and Means Committee and the Senate Finance Committee, with respect to how they achieve the plan's savings goals. This is especially true when it comes to Medicare reform. There are two very different ways to achieve $115 billion in savings from Medicare. One way is to repeat the mistakes of past budget deals by enacting price controls on hospitals and reducing payments to doctors. Not only will this method fail, but it also will ensure a lower standard of care for seniors because doctors will have even less incentive to accept new Medicare patients.

   The second way to achieve $115 billion in Medicare savings is to alter the fundamental nature of Medicare by changing it from a defined benefit program to a defined contributions program. This change would deliver the following benefits, both to seniors and to Medicare itself:



- Seniors would be able to choose from a wide range of competing health plans.
- Seniors' access to quality care would be increased, not decreased.
- Such a system would rely on consumer choice and competition—not price controls and reduced payments—to bring Medicare costs into line. The Federal Employees Health Benefits Program (FEHBP), which operates on similar principles, has seen its costs moderate and premiums hold steady in recent years.
- The result of such a fundamental change in the system would be lower costs, greater choice, and better care for seniors.

It appears that negotiators may be able to dictate many of the terms for these key committees. Indeed, the deal assumes that the Home Health Care portion of Medicare will be transferred from Part A, the near-bankrupt Health Insurance (HI) Trust Fund, to Part B, the part in which some 75 percent of the costs are paid from general tax receipts. This gimmick merely shifts funding within Medicare accounts without fundamentally restructuring the nature of the program.

3. **Because the plan is built on shaky assumptions, it must be enforced with tough measures such as overall spending caps.**

A credible five-year plan to balance the budget must be enforced by more than a handshake and back-room agreement between congressional and White House negotiators. This is especially true since at least 72 percent of the deficit reduction promised

by this deal comes from two debatable economic assumptions—the so-called fiscal dividend and the $225 billion in new tax revenues the CBO assumes will flow into the Treasury over the next five years—and from the phony spending cuts claimed because of baseline budgeting.

Chart 1 shows that lawmakers began the negotiating process with the CBO's estimate of a $188 billion deficit in FY 2002 (the year in which the budget is to be balanced). As daunting as this deficit seems, the CBO lowered this figure by $34 billion because of the "fiscal dividend" which it estimates will accrue to government—in the form of higher tax revenues and lower spending—as a result of enacting a balanced budget plan.[2] Thus, the deficit forecast negotiators began with actually was $154 billion in FY 2002, not the higher $188 billion.

Even this starting point was lowered, however, thanks to the CBO's eleventh-hour discovery of a $225 billion error: Its estimates of federal tax revenues, and the resulting interest savings, would lower future deficits by $45 billion per year through 2002. Thus, the negotiators' starting point fell again to an estimated FY 2002 deficit of $109 billion—two-thirds of the level the CBO had forecast originally for that year.

Yet another 30 percent of the projected FY 2002 deficit melts away because of the so-called discretionary spending "cuts" which actually lead to higher spending. In 2002 alone, these discretionary spending "cuts" are likely to total about $56 billion. They also lower the projected 2002 deficit to just $53 billion even before a single dollar is "saved" from entitlement programs such as Medicare and Medicaid.

Because any economic downturn could render these assumptions meaningless, tough enforcement mechanisms are the only way to ensure that today's promises become tomorrow's reality. Previous budget deals have achieved only modest success in controlling spending through such mechanisms as the sequester (automatic spending cuts required by the Gramm–Rudman–Hollings Act) and discretionary spending caps (first instituted in the 1990 budget agreement and extended in 1993).

The discretionary spending caps will expire after FY 1998. Lawmakers may be tempted to extend them through 2002, except at the higher spending levels assumed in the deal. If lawmakers cap discretionary spending at these higher levels, such a rule will make a mockery of the concept of spending caps. It would amount to placing a 95 miles-per-hour speed limit in a school zone.

There are two sensible ways to enforce this balanced budget deal. One is the legislation sponsored by Representative George Gekas (R–PA) and Senator John McCain (R–AZ). This legislation would ensure that the government will not shut down in the event of a stalemate between the White House and Congress over appropriations bills. If such a stalemate occurs, the legislation would require that spending for programs continue automatically into the next fiscal year, but at 98 percent of the previous year's funding. The Gekas–McCain proposal would force fiscal discipline on lawmakers while avoiding the calamity of a government shutdown.

Second, Congress should fix into law the overall federal spending levels prescribed for fiscal years 1998 through 2002 in the budget resolution. There are many benefits to enacting enforceable caps over total federal spending:

2 The CBO estimates that this fiscal dividend totals $77 billion over five years, with $34 billion of this in FY 2002.

- An overall spending cap would control the root cause of deficits—overspending. In effect, a cap on total federal spending would put Washington on a fixed budget for the next five years.
- A cap would control all federal spending, not just the one-third of the budget that currently is enforced under the discretionary spending caps.
- An overall spending cap would force lawmakers to review annually the growth of major entitlement programs to prevent their growth from crowding out discretionary programs. As a consequence, lawmakers would have to monitor the effectiveness of the entitlement reforms enacted in the 1998 balanced budget deal.
- An overall spending cap would prevent new tax revenues—such as the $225 billion windfall discovered by the CBO—from being turned into new spending, and ensure that such windfalls immediately reduced the deficit.

CONCLUSION

A credible plan to balance the federal budget must result in a smaller government that costs less and leaves much more money in the pockets of working Americans. The current budget deal not only fails these important tests, but in many cases would implement policies that are worse than taking no action at all.

The plan increases, not decreases, federal spending by at least $118 billion, with $96 billion of this in the form of new discretionary spending. The plan also fails to give Americans sufficient tax relief. Indeed, its net tax cut of $79 billion amounts to returning to taxpayers less than one penny of every dollar they will send Washington over the next five years. Worse, the deal affords taxpayers only 67 cents of every dollar of new spending given to government programs.

As if these flaws were not enough, there remain the serious questions of whether the deal will have any impact on FY 1998 spending and how much work it has put off on the next President and Congress. Given the deal's questionable economic assumptions, lawmakers should be under even greater pressure to develop enforcement mechanisms that deliver today's rosy promises.

The 1997 budget agreement is a bad deal for Americans, but lawmakers still have time to renegotiate it. The real question is: Will they simply push a bad deal through the process for short-term political gain, or will they do what is right to balance the budget, cut the size of government, and allow Americans to keep more of their own hard-earned money?

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