No. 1515 January 30, 2002

What Really Is Turning the Budget Surpluses into Deficits

Brian M. Riedl

As the annual budget debate begins on Capitol Hill, policymakers are no doubt surprised to find themselves in a difficult position. Just a year ago, forecasters were predicting steady economic growth, and annual budget surpluses over $300 billion. Since then, the economy has fallen into recession, and the budget now appears headed for deficits.

Some policymakers have concluded from these twin problems that the federal budget drives the economy and that the projected deficits have caused or exacerbated the recession. Because they believe the 2001 tax cuts are responsible for the projected deficits, they propose repealing the tax relief measures in order to balance the budget and thereby spur the economy.

This misguided view is based on a misunderstanding of the relationship between the federal budget and the U.S. economy. Budget surpluses do not *cause* economic growth; they are a *consequence* of economic growth. Balancing the budget alone will not lower interest rates noticeably or increase the productive capacity of the economy, which would stimulate growth. However, policies that remove barriers to economic growth, such as cutting marginal tax rates, would stimulate the economy and in turn increase tax revenue and balance the budget as long as spending is kept in check.

Over the long run, federal budget deficits have resulted from overspending. Had the federal government simply held spending increases to the rate of inflation, it would have run budget surpluses in 28 of the 32 fiscal years since 1970. Instead, it increased annual spending by 852 percent—120 percent above the rate of the inflation.

Lessons can be learned from past experience with recessions and deficits. For example,

- In the early 1930s, President Herbert Hoover was faced with a severe recession that depleted tax revenues and threw the budget into deficit. Based on the mistaken view that the budget drove the economy, Hoover raised income tax

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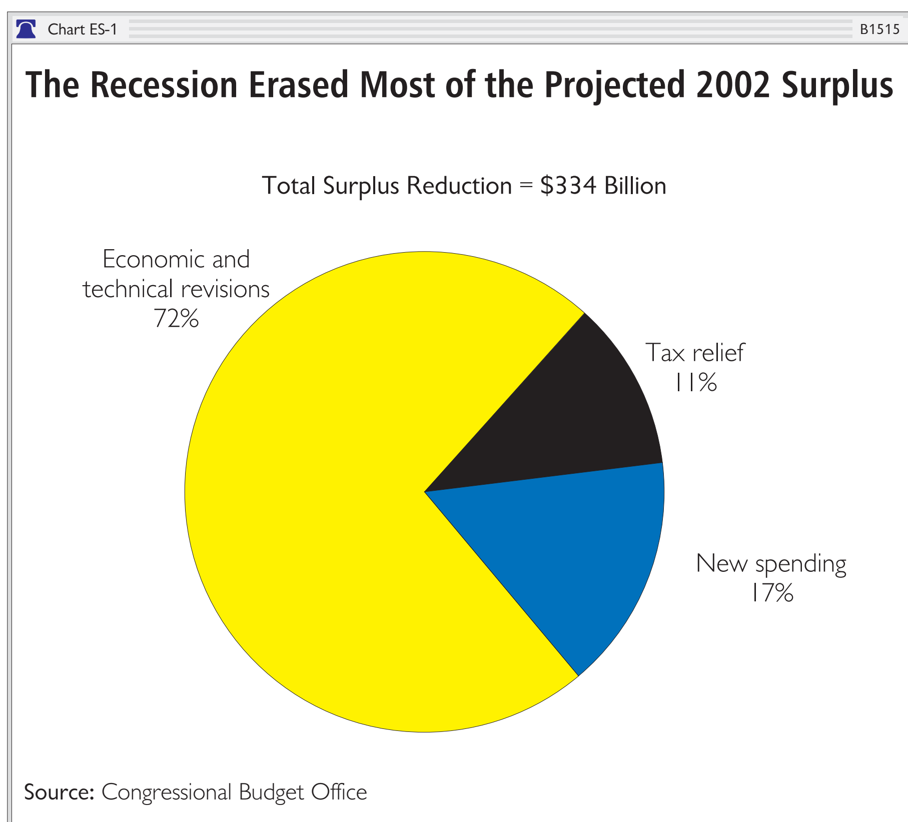
rates and tariffs (import taxes) in an attempt to balance the budget. Instead, the taxes and tariffs reduced economic opportunity and undermined incentives to work, save, and invest; the economy collapsed; and the recession turned into the Great Depression.

- In the 1980s, President Ronald Reagan was also faced with a severe recession and increasing deficits. He responded by passing tax rate cuts designed to remove barriers to economic growth and end the recession. His approach proved the wiser course. These tax reductions began the longest peacetime economic expansion in American history up to that time—an expansion that increased tax revenues and eventually balanced the budget. Only runaway spending prevented it from happening sooner.



In the current recession, policymakers would be wise to avoid a Hoover-style reaction to the recession. Instead of repealing President George W. Bush's tax cuts and sacrificing the economy for their budget priorities, they should follow the Reagan model of focusing policy on family budgets and business growth by cutting tax rates further, ending the recession, and allowing the growing economy to provide the tax revenue needed to balance the budget.

—Brian M. Riedl is Grover M. Hermann Fellow in Federal Budgetary Affairs in the Thomas A. Roe Institute for Economic Policy Studies at The Heritage Foundation.

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.

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As Congress prepares to begin the next annual budget debate, policymakers such as Senators Thomas A. Daschle (D–SD) and Edward M. Kennedy (D–MA), as well as Representative Ellen Tauscher (D–CA), have suggested that the 10-year tax reduction package signed last year (1) caused the recession, (2) was chiefly responsible for the dwindling of the budget surplus, and (3) should be delayed or repealed if the economy does not recover soon. At the base of these assertions is a fundamental misunderstanding of the interaction between the federal budget and the economy.

In reality, the budget does not drive the economy; rather, economic growth drives the budget. In recessions, Presidents like Herbert Hoover who sacrificed economic growth for balanced budgets ended up with neither, while Presidents like Ronald Reagan who sought to implement policies that promote economic growth, like tax rate cuts, not only ended recessions and created jobs, but also saw incomes rise and tax revenues grow.

In the current recession, those who favor repealing the Bush tax cuts are ignoring the lessons of history, and the consequences of their proposals could be as calamitous as those that resulted in the Great Depression. The right approach is the Reagan model of improving family budgets and business growth by cutting tax rates further, ending the recession, and allowing the growing economy to provide the tax revenues to balance the budget.

WHY HAS A DEFICIT REAPPEARED?

In January 2001, the Congressional Budget Office (CBO) forecast that the gross domestic product (GDP) would grow by 2.4 percent in 2001 and 3.4 percent in 2002.[1] Much to the surprise of forecasters, however, the economy fell into recession last March. For the 2001 fiscal year, revenues were $145 billion below target, while spending was $10 billion above target—results that caused the 2001 budget surplus to fall from the forecast level of $281 billion to $127 billion. Recent estimates conclude that the $313

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1. Congressional Budget Office, "Budget and Economic Outlook: Fiscal Years 2002–2011," January 2001, p. 28.

cit,[2] with revenue $280 billion lower than previously forecast and spending $53 billion higher.

The link between the current recession and declining surpluses—and more broadly, between economic growth and budget surpluses and deficits—is central to explaining why the budget surplus is disappearing and what should be done.

Economic Growth and the Budget: Fact and Fiction

Over the long run, federal budget deficits have resulted from overspending. Had the federal government simply held spending increases to the rate of inflation, it would have run budget surpluses in 28 of the 32 fiscal years since 1970.[3] Instead, it increased annual spending by 852 percent—120 percent above the rate of the inflation. Consequently, the federal government ran just four budget surpluses and 28 budget deficits. Clearly, budget surpluses require spending restraint, and Presidents and Congresses since 1970 have lacked the discipline necessary to keep the federal government's books out of the red.

While burgeoning federal spending has made long-term deficits the norm since 1970, revenues best explain the year-to-year fluctuations in the budget balance. Although spending has increased at a rapid but persistent rate, revenues have fluctuated wildly from year to year, and these fluctuations have determined whether the budget has been in surplus or deficit.

Since 1970, inflation-adjusted spending has grown between 0 percent and 4 percent annually in 25 of 32 years. Revenue, on the other hand, has not been so steady: It has grown within the steady 0 percent to 4 percent annual range in only six of the past 32 years; the rest of the time, it has fluctuated between declines that are as large as 9 percent and increases as large as 10 percent.[4] These large swings in revenue explain the annual shifts in the budget balance. With just one exception, every year since 1970, when revenue grew by more than 4 percent, the budget balance has improved. Conversely, every year that revenue decreased, the budget balance got worse. This connection leads to two important conclusions:

1. Persistent spending increases set a very high bar for federal revenues to clear in order to maintain balanced budgets.
2. Since revenues can fluctuate rapidly from one year to the next, the budget can be expected to be in balance only in years with very high revenue increases.

The important question, then, is what explains the fluctuations in revenue? The answer: economic growth. Chart 1 shows that tax revenue is closely correlated with economic growth. When the economy is growing, more people are working, salaries are increasing, and businesses are making more profits. With more income, there are more tax revenues even if tax policy is unchanged.[5] On the other hand, with economic stagnation, fewer people are working and paying taxes, and there is less business income to tax. Economic growth is required to increase tax revenue. Therefore, economic growth is the main determinant of whether the federal budget is in surplus or deficit, particularly since the federal government has not shown the ability to limit spending.[6]

Lower Tax Rates Lead to More Revenue. Critics assert that government revenue depends mostly on tax rates. Therefore, they simplistically believe that raising tax rates will transfer more money to the government and ultimately balance the budget. Although raising tax rates increases government's slice of the pie, however, it does not always increase tax revenues because raising taxes also shrinks the

2. Congressional Budget Office, "Budget and Economic Outlook: Fiscal Years 2003–2012," testimony before the Committee on the Budget, U.S. Senate, January 23, 2002.
3. Unless otherwise noted, all budget statistics throughout this paper are taken from Office of Management and Budget, *Budget of the United States Government, Fiscal Year 2002, Historical Tables*.
4. These percentages are adjusted for inflation.
5. However, if tax revenues grow faster than the economy, their increasing size relative to the economy will eventually drag down economic growth, which will in turn curb revenue growth.
6. Although their main budgetary effect is to decrease revenue, recessions to a lesser extent also increase spending on mandatory programs like unemployment insurance and food stamps, a consequence that further reduces budget surpluses in recessions.

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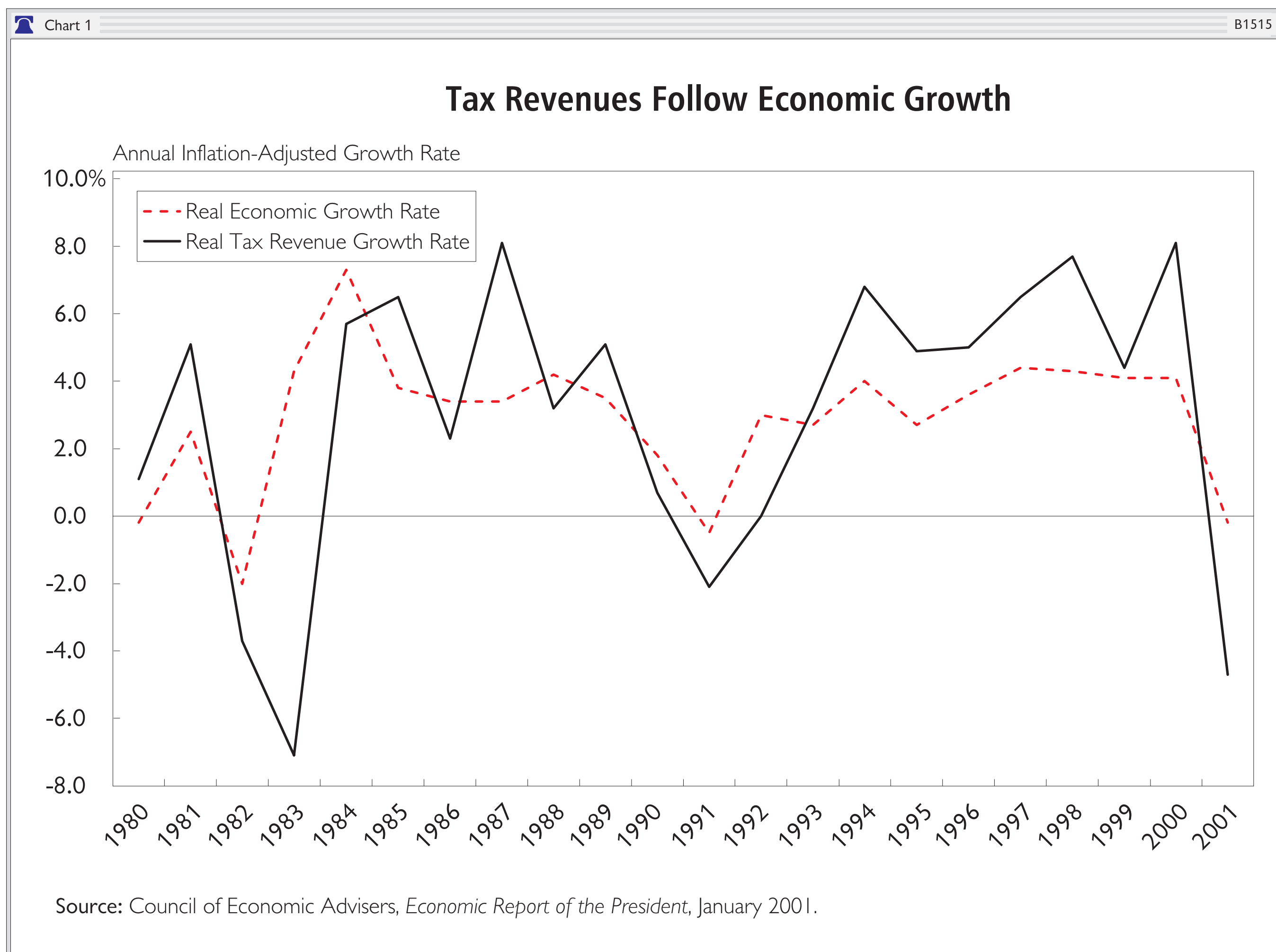


Source: Council of Economic Advisers, *Economic Report of the President*, January 2001.

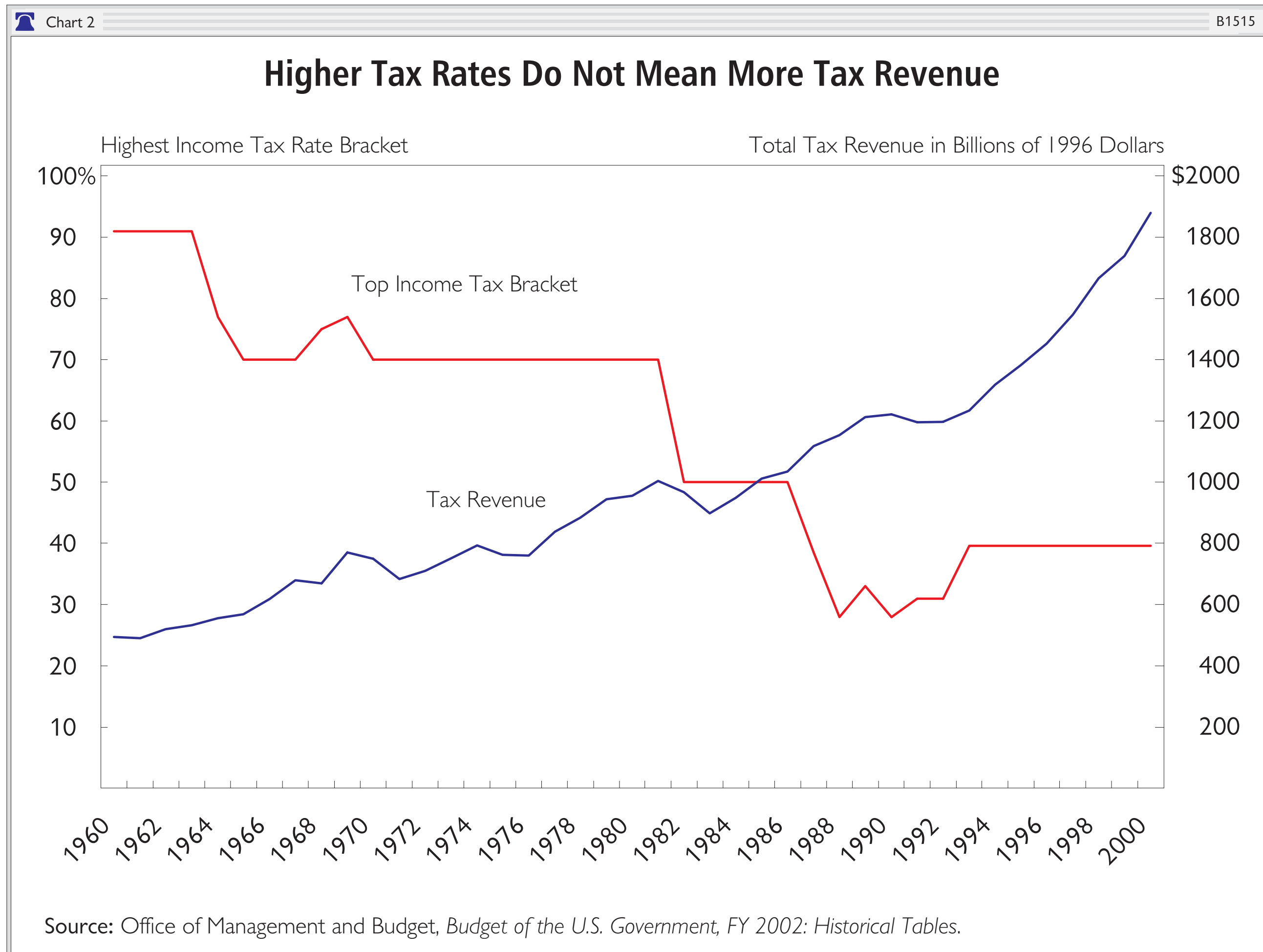
size of the pie itself. When government raises taxes, it raises the price of working, investing, and saving. It becomes harder to start, continue, or expand a business (e.g., by hiring more workers), and incentives to be productive shrink. As the tax burden grows, economic activity declines, and the anticipated surge in government revenue does not materialize.

Chart 1 and Chart 2 together show that economic growth is a much better determinant of tax revenue than tax rates. Tax rates influence tax revenue because lower tax rates stimulate the economy, which in turn brings in more tax revenue.

The simple lesson is that economic growth drives the federal budget. If the federal government seeks a balanced budget, it must pursue pro-growth policies such as tax rate cuts to remove barriers to working, saving, investing, and entrepreneurship.

Balanced Budgets Do Not Create Economic Growth. Economic growth is defined statistically as an increase in the total dollar amount of goods and services produced in an economy, after adjusting for inflation. Government spending hinders economic growth through direct purchasing from the private sector, where government acts as a disproportionately large consumer, or through subsidies that alter the behavior and spending decisions of individuals, organizations, and businesses—effectively misallocating resources. Productivity and output also are affected by tax policy because, as described above, taxes reduce the amount of money people have to spend and decrease incentives to work, save, and invest, and to start or expand a business.

But while both government spending and revenues are extremely important, the difference between the two numbers—the budget balance—



Source: Office of Management and Budget, *Budget of the U.S. Government, FY 2002: Historical Tables.*

does not affect the incentives or bottom line of consumers or producers. Thus, budget deficits and surpluses have little effect on economic growth.

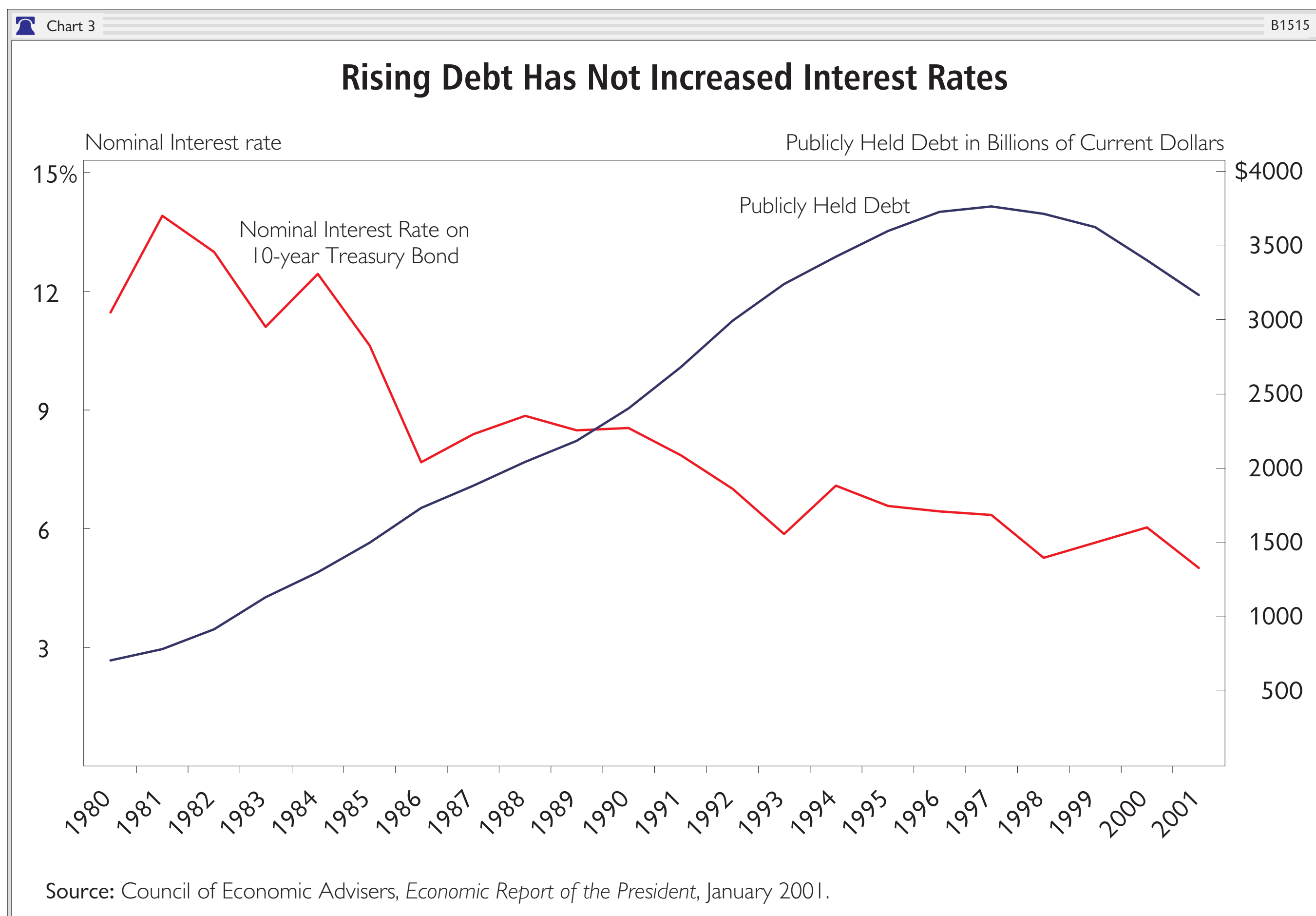
Some mistakenly believe that deficits harm the economy, asserting that when the federal government borrows money to finance its debt, this borrowing substantially increases interest rates, a result that makes it more expensive for households and businesses to borrow and make investments that would expand the economy.

Despite the theoretical simplicity of this "crowding out" theory, Chart 3 shows no discernible link between publicly held federal debt and interest rates. Since 1980, the national debt (the accumulation of each annual deficit) held by the public has grown from $712 billion to $3.4 trillion, but the 10-year Treasury bond's interest rate has decreased from a high of 14 percent to only 5.5 percent.

Throughout the 1980s, when deficits were as high as 6 percent of GDP and the national debt tripled, interest rates on the 10-year Treasury bond decreased from 14 percent to less than 8 percent. Decades of deficits were followed by $431 billion in surpluses between 1998 and 2000, but over those three years the interest rate on the 10-year Treasury bond actually increased from 5.5 percent to a high of 6.7 percent.[7]

This analysis of stated interest rates does not include the effects of inflation. However, a more sophisticated analysis favored by many economists would use "real" interest rates—i.e., interest rates after inflation. Chart 4 depicts no significant relationship between debt and "real" interest rates. In fact, the Treasury Department examined trends between 1965 and 1983 and concluded that "high deficits have virtually no relationship with high

7. The 10-year Treasury bond, whose interest rate is provided by the U.S. Treasury Department, is a good benchmark interest rate because many corporate and personal interest rates—including some mortgage rates—follow this interest rate.

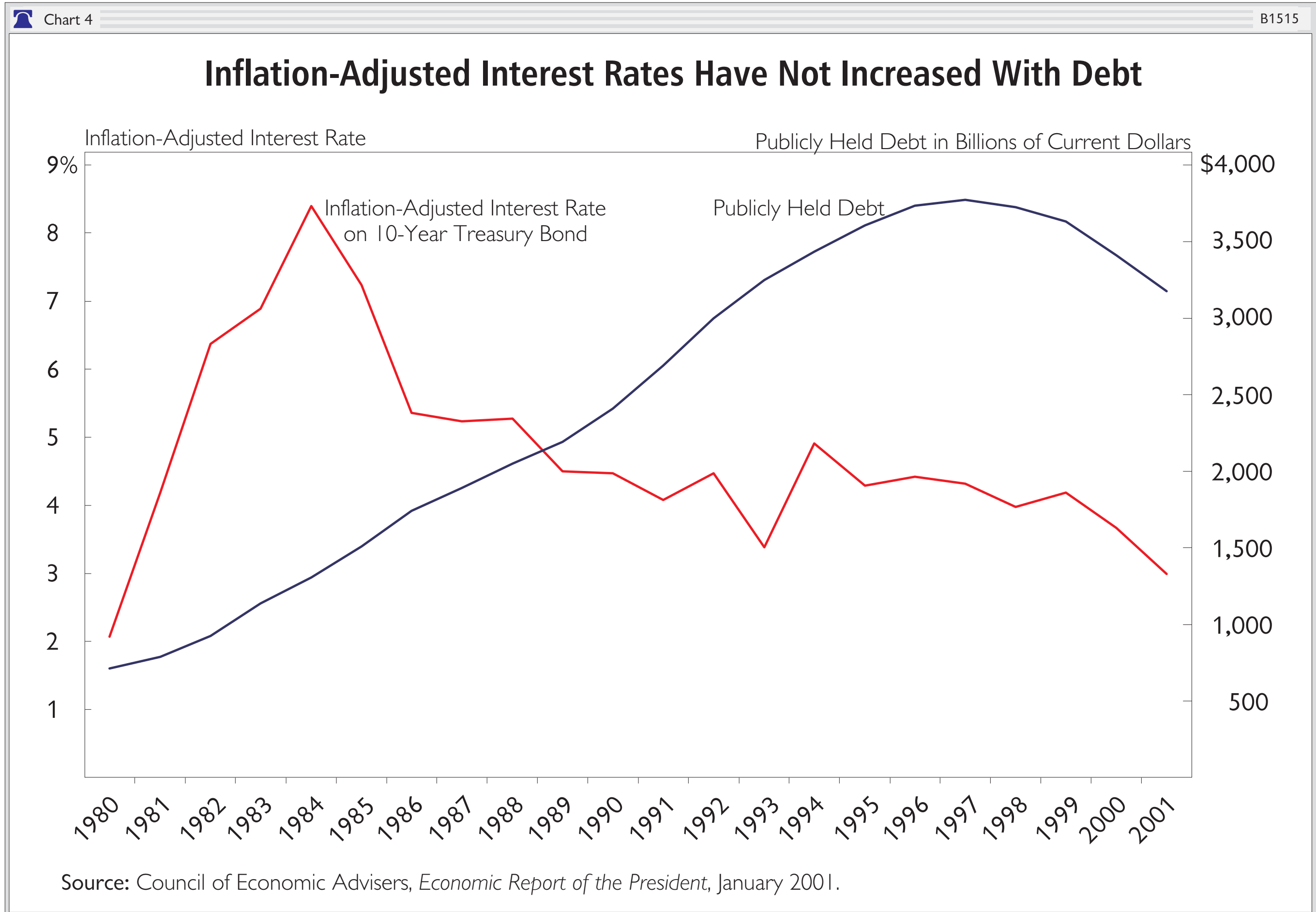


interest rates in this time period."[8] A series of university and government studies of other nations and time periods yielded the same results.[9]

Furthermore, as Chart 5 illustrates, some sectors sensitive to interest rates, and therefore supposedly sensitive to deficits and debt, have not been noticeably hurt by the quintupling of the national debt since 1980:

- **Housing starts**. While government borrowing has increased, new housing starts have fluctuated more with the economic cycle than with the budget balance. In fact, the largest single increase in housing starts (60 percent) occurred in 1983, when the budget deficit was at its highest level relative to the size of the economy since 1980.
- **Auto sales**. Like housing starts, auto sales since 1980 correlate more with economic growth than with budget trends. Domestic auto sales peaked from 1984–1986, a period of rapid economic growth but relatively high deficits. The balanced budgets of the late 1990s had no noticeable effect on auto sales.
- **Business investment**. Even with the quintupling of publicly held debt between 1980 and 2000, annual business investment in equipment and software grew by an inflation-adjusted 315 percent. Investment increased steadily throughout the period, slowing only during the first half of the 1980–1982 and 1991 recessions.

8. U.S. Department of the Treasury, *The Effects of Deficits on Prices of Financial Assets: Theory and Evidence* (Washington D.C.: U.S. Government Printing Office, March 1984).
9. See Charles I. Plosser, "Government Financing Decisions and Asset Returns," *Journal of Monetary Economics*, Vol. 9 (1982), pp. 325–382, and Paul Evans, "Do Large Deficits Produce High Interest Rates?" *American Economic Review*, Vol. 75 (March 1985), pp. 68–87.



Source: Council of Economic Advisers, *Economic Report of the President*, January 2001.

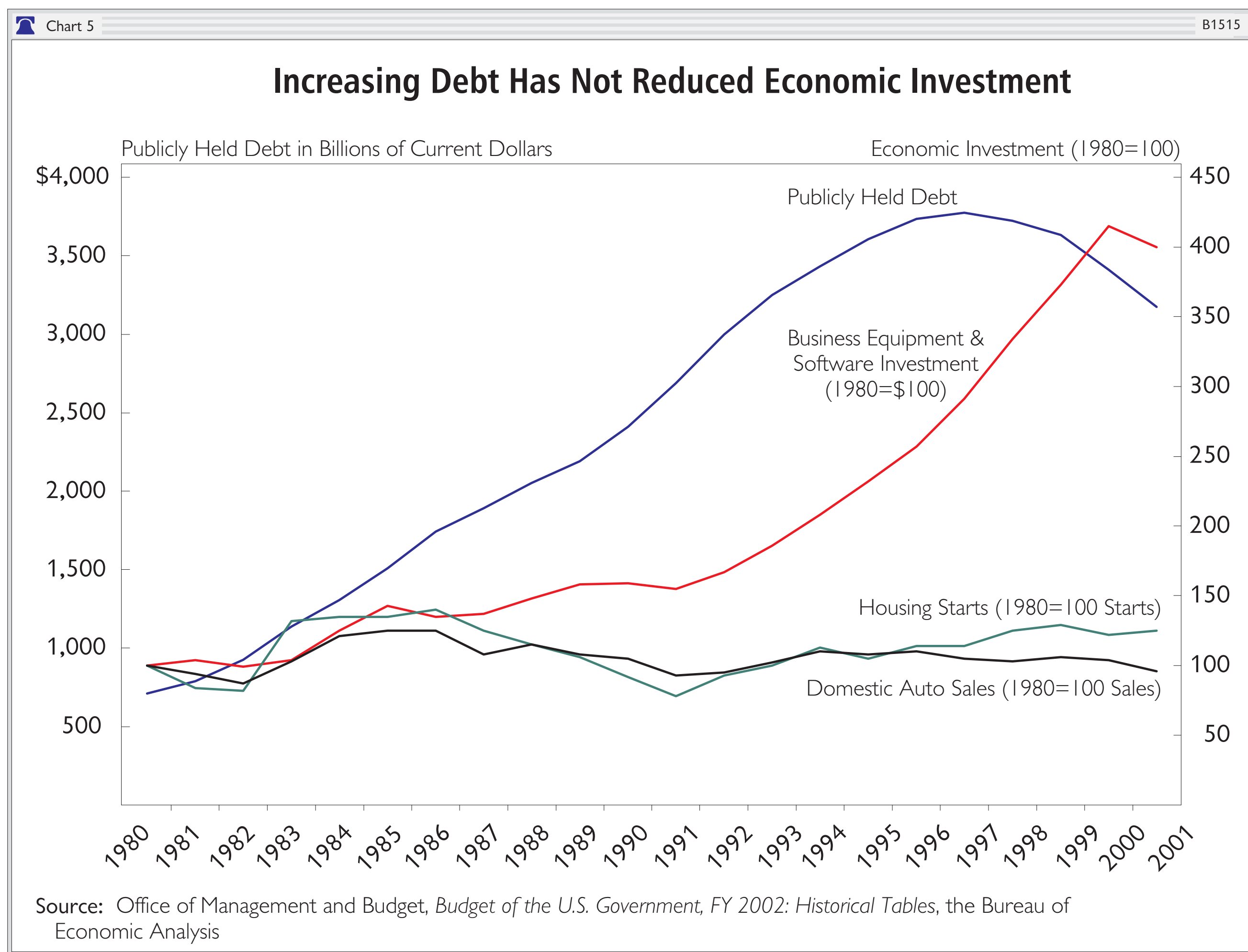
Twenty years of deficits and debt did not noticeably raise interest rates and devastate these industries because the federal government does not dominate capital markets. As a result of economic growth, low tax rates, and the explosion of employee retirement plans and individual investors, trillions of dollars are still invested in stocks, bonds, real estate, and other wealth-producing assets. Moreover, international capital markets see trillions of dollars flowing among nations and picking up the slack whenever a shortage of investment capital threatens to increase interest rates.[10] Consequently, federal deficits of $100 billion to $200 billion constitute less than one-three hundredth of the $60 trillion global debt market—an amount too small to make a significant difference.[11]

The effect of the global economy is also seen in Japan, whose debt has increased from 50 percent of GDP in 1990 to 140 percent of GDP today (equivalent to a debt of $15 trillion in the United States). Yet long-term interest rates in Japan have decreased from 7 percent to under 2 percent.[12] There will always be investors who are willing to purchase federal debt at low interest rates, and interest rates will continue to fluctuate based more on expected future inflation, government spending, tax policy, and economic performance than on federal borrowing patterns.[13]

10. This is dependent on the free and open flow of capital between markets, which some nations and organizations have attacked recently. Barriers to international capital flows would upset this ability of the global economy to pick up the slack when capital shortages threaten to increase interest rates, thereby decreasing investment and economic growth.

11. Joint Economic Committee, *Fiscal Policy Choices: Examining the Empirical Evidence*, November 2001.

12. For a survey of current studies examining links between interest rates and deficits, see *ibid*.



Source: Office of Management and Budget, *Budget of the U.S. Government, FY 2002: Historical Tables*, the Bureau of Economic Analysis

HOW TO FOCUS ON ECONOMIC GROWTH

While a balanced budget does not substantially affect interest rates or economic growth, policies intended to balance the budget do. If Congress were to raise tax rates during a recession in hopes of replenishing declining tax revenues, the higher taxes would significantly harm the economy. Not only would the budget not balance, but the economy also would become even worse off.

The simple lesson is for Congress and the President to focus on family budgets instead of the federal budget. That is, they should focus on economic growth and assure that families and businesses are not burdened by an overtaxed and over-regulated system that erects barriers to working, saving, investing, and business development. As long as the economy grows and Congress holds the line on spending, budget deficits will disappear. One has to look no further than the two worst economic crises of the past 75 years, and how Presidents Herbert Hoover and Ronald Reagan dealt with their respective twin problems of deep recession and deficits, to see the importance of putting the economy before the deficit.

President Hoover's Response to a Recession

As President during and after the stock market crash of 1929, Herbert Hoover faced a panicked population suffering the effects of severe recession.

13. The most direct ways that debt could harm the economy would be for the federal government to borrow so much that debt payments substantially increase future taxes, or for the Federal Reserve to increase the money supply to pay the national debt, thereby raising inflation and interest rates. With the national debt less than one-third of GDP and annual debt service payments only 3 percent of GDP, the United States is in no real danger of either occurrence.

Although GDP was decreasing and unemployment increasing, President Hoover preferred policies aimed at alleviating the budget deficit to policies that would stimulate the economy.

In an attempt to increase tax revenue and balance the budget, he signed into law the 1930 Smoot–Hawley Tariff Act, imposing tariffs (import taxes) of up to 50 percent on a wide range of goods. This policy resulted in decreased imports, triggering trade protectionism in other countries and making it more difficult for struggling businesses and families to make ends meet.

The bitter medicine of the tariff did not cure the deficit, as trade decreased 67 percent and caused tariff revenues to drop from $602 million in 1929 to $328 million in 1933.[14] GDP dropped another 15 percent over 1930 and 1931, and the federal budget went from a $738 million surplus in 1930 to a $2.735 billion deficit in 1932 (the equivalent of a $410 billion deficit in today's economy). With the President raising taxes and the Federal Reserve also tightening the money supply, a nation in recession plunged into the Great Depression.

Tragically, President Hoover did not learn from this mistake. Although the Smoot–Hawley tariff showed that raising taxes during a recession damages the economy without balancing the budget, he once again put the budgetary cart before the economic horse and implemented another round of tax increases that proved devastating.

The Revenue Act of 1932 represented the largest peacetime tax increase in American history, increasing marginal income tax rates across the board, including the lowest tax bracket from 1.5 percent to 4 percent and the highest bracket from 24 percent to 63 percent.[15] The tripling of marginal tax rates contributed to the economic freefall, as the GDP decreased an unprecedented 13 percent in 1932 and individual income tax revenues plummeted 64 percent between 1928 and 1934. When President Hoover left office in March 1933, he left the economy in the worst depression in its history and with deficits likely even larger than they would have been without his tax policies.

President Reagan's Response to a Recession

The situation President Ronald Reagan faced in 1981 was not markedly different from that faced by President Hoover in 1930. The economy was in its worst recession since the Great Depression, and like Hoover, Reagan was faced with the task of preventing the recession from becoming a depression.

Rather than follow Hoover's decision to raise taxes and tariffs in order to balance the budget—a decision that wound up crashing the economy—President Reagan employed the strategy of cutting tax rates and removing barriers to economic growth. With GDP falling by 0.2 percent in 1980 and 2 percent more in 1982,[16] President Reagan relentlessly cut marginal income tax rates to reduce barriers to working, saving, and investing. Overall, the Reagan tax cuts reduced the top income tax rate from 70 percent in 1980 to 28 percent in 1988.[17]

Chart 6 shows that while Hoover's "budget balancing" approach to recessionary fiscal policy drenched the nation in depression, Reagan's emphasis on economic growth unleashed what became at the time the longest peacetime economic expansion in American history. Real economic growth surged by over 7 percent in 1984 and continued at a 4 percent annual clip throughout Reagan's second term; and 18 million new jobs were created between 1982 and 1989—the most in any 7-year span in U.S. history.[18]

Though the Reagan tax cuts were not intended specifically to erase the deficits the President faced upon taking office, they did not markedly worsen the deficit. In any recession, tax revenues would fall, and the deficit would increase. Instead of futilely focusing on the budget, President Reagan pushed policies to achieve long-term economic growth, and Chart 7 shows that these policies

14. Layth Matthews, "What Caused the Great Depression of the 1930s?" *Gold Ocean Online Journal*, at *http://www.shambhala.org/business/goldocean/causdep.html*.

15. *Ibid*.

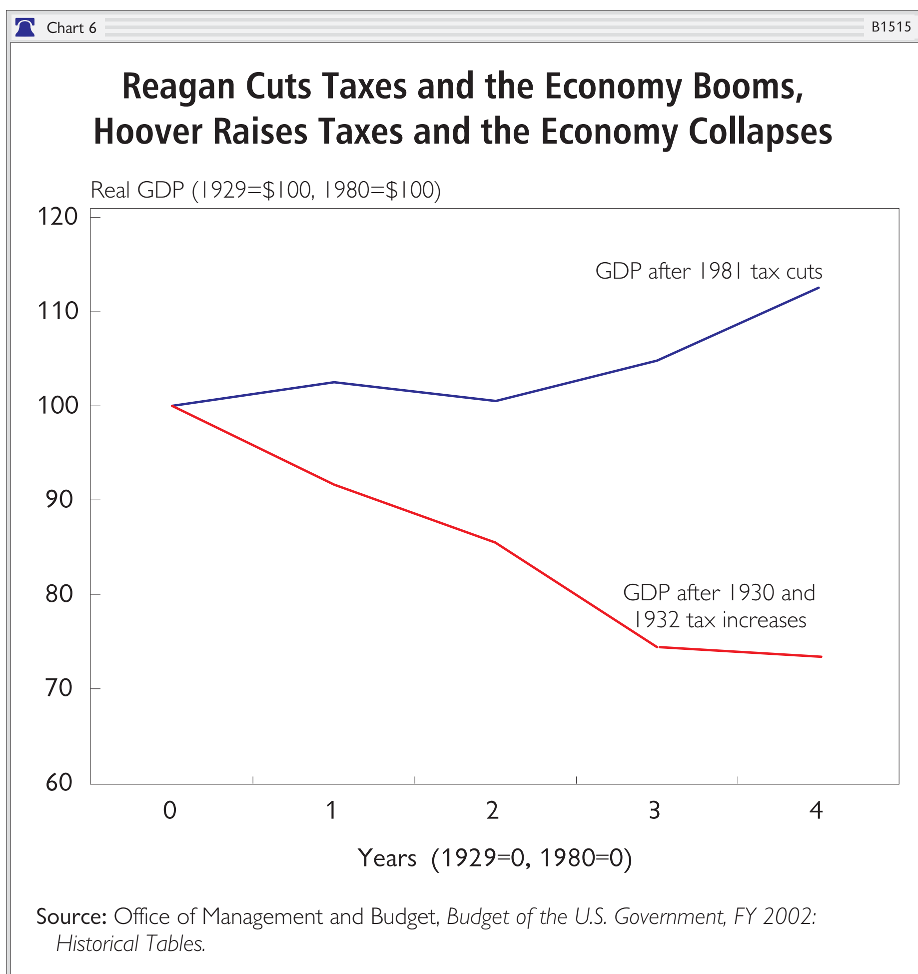
16. Council of Economic Advisers, *Economic Report of the President*, January 2001, Table B–4.

17. Joint Committee on Taxation, as cited at *www.taxplanet.com/library/oldtaxrates/oldtaxrates.html*.

18. Council of Economic Advisers, *Economic Report of the President*, January 2001, Table B–35.

allowed tax revenues to hold steady instead of plummeting as they had after the tax increases of the 1930s. By 1987, inflation-adjusted tax revenues were growing by over 8 percent annually. Even with major tax reductions between 1982 and 1987, inflation-adjusted tax revenues were 25 percent higher in 1989 than they were in 1982. The deficits of the late 1980s, therefore, were a consequence of a rash of new spending that even rapidly increasing revenues could not overcome.

In the end, by triggering strong economic growth, Reagan's policies substantially contributed to a balanced budget. The income tax increases of President George H. W. Bush and President Bill Clinton were associated with slowing federal revenue growth between 1991 and 1994. The beginning of a return to Reagan-style tax policies in the late 1990s, including capital gains tax cuts, helped spur stronger economic growth and kept federal revenues increasing rapidly until they finally caught up to the government's high spending rate and balanced the budget.



POLICY LESSONS FOR TODAY'S RECESSION

The 2001–2002 recession has created an economic and budgetary situation that is certainly less severe than, but in many respects similar to, what President Hoover and President Reagan faced.

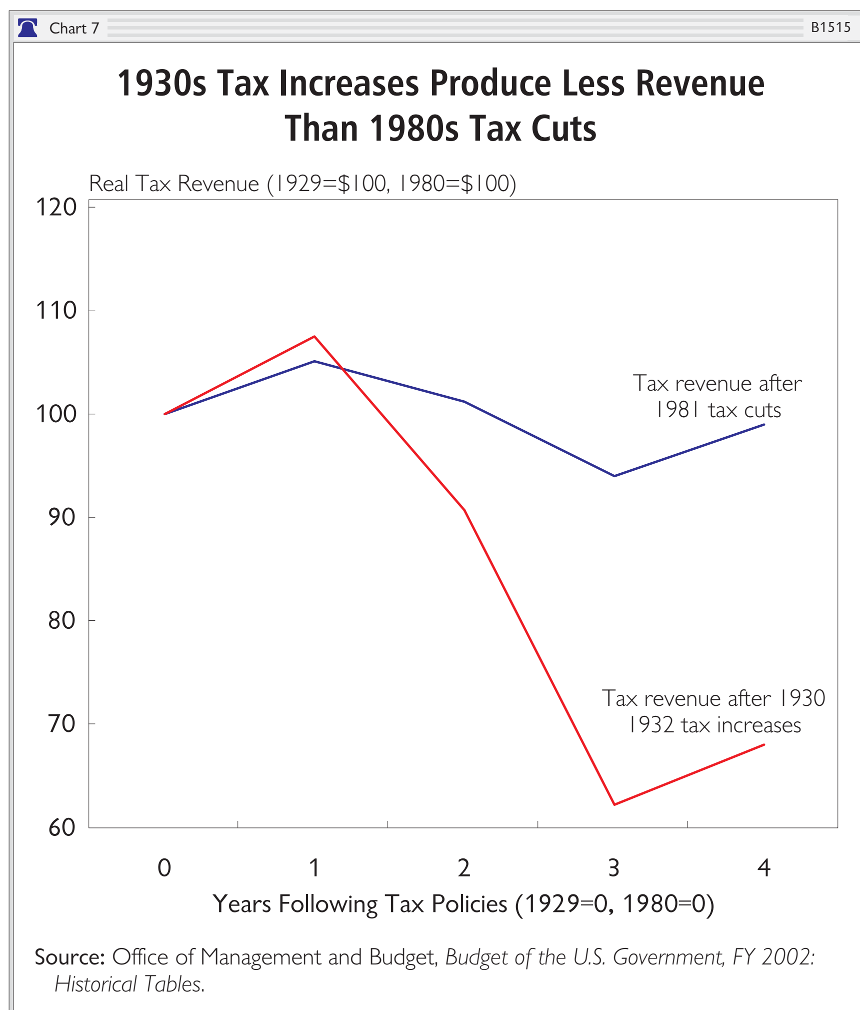
As stated above, GDP, which had been expected to grow by 2.4 percent in 2001 and 3.4 percent in 2002, instead decreased slightly in 2001, and growth now looks to remain flat in 2002.[19] Accordingly, the budget surplus for fiscal year 2002, which had been forecast at $313 billion, could now be replaced with a $21 billion deficit.[20]

President George W. Bush has properly focused more on alleviating the recession than replenishing the declining surplus. In 2001, he proposed and Congress enacted a 10-year package of tax reductions that included individual tax rebates in 2001 (which did not markedly alter tax rates and therefore will not substantially help the economy) and will include future reductions in marginal income tax rates over the next decade to lower barriers to working, saving, investing, and business development.

As President Bush follows the proven strategy of focusing on economic growth through tax cuts, however, Senate Majority Leader Thomas Daschle is taking a page from another historical model. His misguided assertions in a recent speech include the following myths.

19. Congressional Budget Office, "Budget and Economic Outlook: Fiscal Years 2002–2011," January 2001, p. 28.

20. Congressional Budget Office, "Budget and Economic Outlook: Fiscal Years 2003–2012."



Source: Office of Management and Budget, *Budget of the U.S. Government, FY 2002: Historical Tables*.

Misguided Assertion #1: Tax cuts failed to prevent, and probably worsened, the recession. This assertion is simply wrong. As countless economists and analysts have reported, the tax cuts did not cause the recession; Congress did not even enact them until two months after the recession had begun. Certainly, no economic school of thought—whether Keynesian, neoclassical, supply-side, or monetarist—teaches that tax cuts cause recessions.

Critics of the Bush tax cuts reason that they worsened the recession because they kept interest rates too high, but the evidence proves otherwise. On January 1, 2001, when it appeared the nation was headed for 10-year surpluses of $5.6 trillion, the interest rate on the 30-year Treasury bond was 5.46 percent. One year later, projections of immediate $300 billion annual surpluses were replaced with deficit projections, yet the interest rate on the 30-year Treasury bond on January 1, 2002, was 5.45 percent—0.01 percent lower.

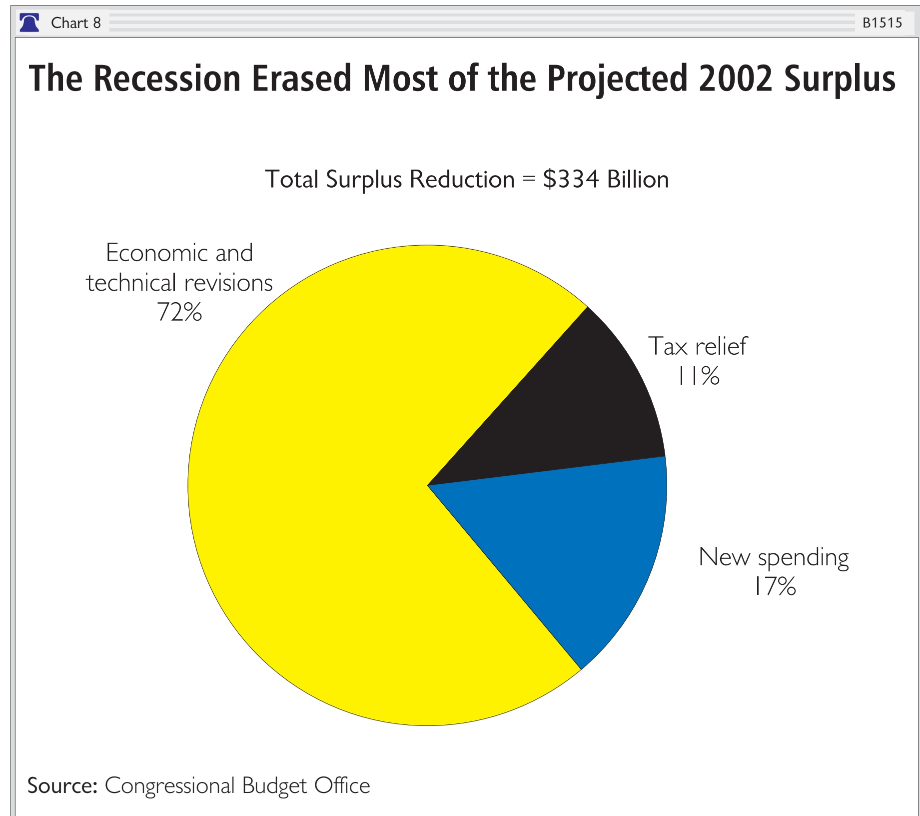
These interest rates remained low not because investors do not know about the projected deficits, but because, in a global economy, the effect of additional U.S. government borrowing of $50 billion or so a year (one-half of 1 percent of GDP) on interest rates is inconsequential. The projected deficits have not increased interest rates and have not caused or worsened the recession, and the tax cuts in all probability will help shorten the recession.[21]

Misguided Assertion #2: Tax cuts are chiefly responsible for the declining surplus. This claim also is simply untrue. As the economy has dipped into recession, tax revenues have predictably declined as well. Chart 8 shows that 72 percent of the declining surplus estimated for fiscal year 2002 is a result of decreasing tax revenues in the recession (and to a lesser extent, the increasing spending on entitlement programs like unemployment insurance, which automatically increases during recessions). The Bush tax cuts, in contrast, are responsible for only 11 percent of the decreasing surplus, and combined new spending programs from both before and after the terrorist attacks comprise the final 17 percent.[22]

21. Critics would argue that the Federal Reserve's 11 interest rate cuts in 2001 should have lowered long-term interest rates, and their stickiness is evidence that some policy (i.e., the deficit) was preventing interest rates from falling. However, long-term interest rates, such as the 30-year Treasury bond, are not historically sensitive to most short-term interest rate changes, except to the extent that dramatic short-term interest rate reductions by the Federal Reserve could increase long-term interest rates due to fears of future inflation. Substantial evidence of these fears has not been present over the past year, so recent Federal Reserve rate cuts have not noticeably affected long-term interest rates. Therefore, if the deficit projections did substantially increase interest rates, that should have been reflected in interest rates increasing steadily over the year—which they did not.

Of course, this static model probably overstates the revenue loss of the Bush tax cut, which through lower tax rates likely will prevent the economy from going into a deeper recession and therefore make declines in revenue smaller than they otherwise would be. There is simply no way tax cuts that totaled $38 billion in 2002 could be chiefly responsible for a projected $334 billion decline in the budget surplus.

Implication of These Assertions: Raise Taxes. Although Senator Daschle stopped short of proposing higher taxes, Senator Kennedy recently called for postponing future tax cuts, and Representative Tauscher proposed delaying the scheduled upcoming income tax rate reductions if the federal budget falls into deficit.[23]



There are two principal scenarios by which the economy would continue to stay in deficit: either the economy stays in recession, or Congress continues to increase spending at rates faster than the economy can pay for it. Certainly, delaying tax cuts that individuals and businesses have come to expect and plan for would amount to a tax increase, and increasing tax rates in a recession would be taking a page from Herbert Hoover's policy book. The policy likely would not increase revenues, but it would deepen the recession and harm family income and business prospects.

Under this approach, Congress would not even need the recession to delay the tax cut, because increasing spending until the economy falls into deficit would also trigger calls for tax increases. That outcome is a clear possibility, as evidenced by the fact that Congress increased discretionary spending by 8 percent last year even without the emergency spending related to the September 11 attacks.

In the speech in which he denounced the tax cuts, Senator Daschle also proposed major new expenditures in unemployment insurance, health care, research and development, job training energy, and farm subsidies in the most expensive farm bill in U.S. history.[24] If one believes tax cuts are not fiscally responsible because they could drain the surplus, these proposed spending increases—which also would drain the surplus—are equally fiscally irresponsible. And although delaying or repealing the tax cuts would not end the recession, it could serve as a scheme to fund these new long-term and expensive government spending commitments.

22. Congressional Budget Office, "The Budget and Economic Outlook: Fiscal Years 2003–2012."

23. Ellen Tauscher, "Tax Cuts Only When We Can Afford Them," *The Washington Post*, January 9, 2002, p. A19; see also remarks of Senator Edward M. Kennedy at the National Press Club, January 16, 2002.

24. Remarks by Senate Majority Leader Thomas A. Daschle, "America's Economy: Rising to our New Challenges," January 4, 2002.

AVOIDING A RETURN TO DEPRESSION ECONOMICS

With the economy in recession and the surplus dwindling, there are two diametrically opposed approaches to fiscal policy. The first—raising taxes and contracting the economy to balance the budget—turned a recession in 1930 into the Great Depression. The second—reducing tax rates and removing barriers to economic growth—turned a recession in 1980 into what became at the time the longest continuous peacetime economic expansion in American history.

Cutting taxes in a recession has not always been such a partisan issue. During the 1981 tax debate, Democrat Speaker of the House Thomas P. O'Neill (D–MA) proposed his own five-year tax cut of $627 billion ($1.2 trillion in current dollars), and Senator Russell Long (D–LA) stated that tax cuts would "directly increase investment and savings to improve productivity and to create more jobs."[25]

Thus far, President Bush has sided with the Reagan–O'Neill–Long approach of cutting tax rates and focusing on unleashing economic growth. The past century provides rich lessons in economic policy during recessions. Policymakers should heed those lessons and reduce the burden on American families and businesses by cutting tax rates further and allowing the growing economy to provide the tax revenue to balance the budget.

—Brian M. Riedl is Grover M. Hermann Fellow in Federal Budgetary Affairs in The Thomas A. Roe Institute for Economic Policy Studies at The Heritage Foundation.

25. "Democratic Senators Ask for More Investment Incentives," Dow Jones News Service, April 8, 1981.