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The Fiscal Cliff and the Perils of Grand Budget Deals

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One of the major complications in the current fiscal cliff debate is that both sides are overreaching, trying to tie a near-term resolution to a sweeping deficit reduction plan that would address the longer-term budgetary crisis looming in the years ahead. They see the cliff negotiations as a stage for a "grand bargain" on the budget between the President and Congress.

The tight time frame of the cliff's approach makes such an aim increasingly impractical. Furthermore, history shows that broad bipartisan compromises between the White House and Congress have typically just yielded higher taxes, while the promised spending restraint (except in national defense) and deficit reduction have failed to materialize. Given the current state of divided government, these risks prevail today. More broadly, they also offer a warning to budget process reformers who seek to institutionalize regular budget negotiations between Capitol Hill and the President.

Experience of the Reagan Administration. After his inauguration in January 1981, President Ronald Reagan moved assertively to enact his budget plan, cutting taxes, boosting defense spending, and seeking to gain control of entitlements. With the economy still reeling from the prior years' stagflation, however, deficits widened initially, leading Congress to push for a series of budget "summits," as they were called then, to close the gap.

First came the 1982 Tax Equity and Fiscal Responsibility Act, "a $98 billion tax increase which supporters claimed would reduce the deficit from $128 billion in 1982 to $104 billion in 1983." It did not. "Spending restraints never materialized…and the actual deficit jumped to $208 billion."[1] (In today's dollars, that tax hike would have totaled $204 billion and the deficit $432 billion—roughly a third of this year's red ink.)

In 1984, the President agreed to yet another tax hike totaling $49 billion, which was supposed to reduce the deficit from $185 billion to $181 billion. Once again, however, the deficit *increased—to $212 billion.*[2]

The 1987 budget summit repeated the pattern. President Reagan swallowed a tax hike of $28 billion, but the result was the same: "The deficit, which was supposed to remain at $150 billion, jumped to $155 billion in 1988."[3]

The 1990 Budget Agreement. Despite these failures, 1990 produced another major exercise in budget summitry. With deficits having swollen well beyond target amounts written in law at the time, the government by mid-year faced automatic spending cuts (called "sequestration") that would slash defense spending by 42 percent and non-defense spending by 38 percent.[4] So President George H. W. Bush and the Democratic Congress agreed to a plan that was estimated to reduce deficits by $482 billion over five years.

Though the President had famously pledged never to raise taxes, his Administration by mid-1990 conceded to adding "revenue" as part of the deficit reduction plan. Predictably, this crack in the door widened during the arduous negotiations at Andrews Air Force Base. In the end, fully one-third of the package—$158 billion—consisted of tax hikes. The next largest savings came from cutting national defense by $91

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billion over five years, which proponents rationalized by arguing that the Cold War had ended. Meanwhile, non-defense discretionary spending in the plan actually increased by $45 billion, offset by an empty promise of $144 billion in additional, unspecified discretionary cuts.[5]

The plan's outcomes were no more satisfying. Even after the defense cuts, total outlays (excluding interest payments) increased by 13 percent from 1990 through 1993, and even with the tax hikes, the deficit worsened by 17 percent in the first two years of the plan.[6] When President Bill Clinton took office in January 1993, he promptly called for another deficit reduction plan, this one with $241 billion in tax increases over five years.[7]

The 1997 Balanced Budget Agreement. Even genuinely successful deficit reduction can lead to expanded government, allowing both parties to declare victory. Such was the case with the 1997 balanced budget agreement between a Republican Congress and President Clinton.

Although it cut taxes by $80 billion over five years—or perhaps because it did—the plan produced surpluses within a year of enactment. This was largely due to real growth in gross domestic product (GDP) that was greater than 4 percent per year from 1997 through 2000, which boosted tax revenue to 20.6 percent of GDP.

The problem was that the plan also increased spending. Though officially estimated to reduce outlays by $198 billion over five years,[8] the legislation contained a number of entitlement spending increases sought by President Clinton, including the creation of the State Children's Health Insurance Program and expansions of food stamps, Supplemental Security Income, and welfare. Consequently, total "programmatic" spending (excluding interest) grew by nearly 3 percent to 4 percent per year faster than inflation and exploded by a total of nearly 14 percent from 1997 through 2001.[9] The effect was hidden because with the government running budget surpluses, interest payments declined, reducing the total spending increases.

Learn from History. The background outlined above should give pause to advocates of a grand budget deal between the President and Congress—especially those who are seeking to limit the size and scope of government. Such agreements tend to produce higher taxes and higher spending with little or no deficit reduction. Congress and the President should dispel any visions of a "grand bargain" and focus on the task at hand: avoiding the fiscal cliff.

This history also warns against budget process reforms that would institutionalize summitry by requiring the President to sign or veto the congressional budget resolution. Advocates argue that this change would create a forum for regular, early White House–congressional negotiations on broad budget levels, presumably making it easier to settle on specific spending and tax legislation later.

Some analysts, however, doubt whether the practice would actually produce agreements as often as its advocates think.[10] Equally important, the process could produce higher spending and higher taxes even more often. Thus, a reform aimed at budgeting more "efficiently" might only be more efficient at expanding government.

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3. Ibid.
4. Congressional Budget Office, *Initial Sequestration Report for Fiscal Year 1991*, August 20, 1990, http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/77xx/doc7772/90-cbo-040.pdf (accessed December 7, 2012).
5. Congressional Budget Office, *The Economic and Budget Outlook: Fiscal Years 1992–1996*, January 1991, http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/76xx/doc7664/91-cbo-002.pdf (accessed December 7, 2012).
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7. Congressional Budget Office, *The Economic and Budget Outlook: An Update*, September 1993, http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/76xx/doc7670/09-1993-outlookentirerpt.pdf (accessed December 7, 2012).
8. Congressional Budget Office, *The Economic and Budget Outlook: An Update*, September 1997, http://www.cbo.gov/sites/default/files/cbofiles/attachments/Eb09-97.pdf (accessed December 7, 2012).
9. Office of Management and Budget, *Budget of the U.S. Government, Fiscal Year 2013: Historical Tables.*
10. See Paul L. Posner, George Mason University, testimony before the Committee on the Budget, U.S. Senate, October 12, 2011; and Rudolph G. Penner, testimony before the Committee on the Budget, U.S. House of Representatives, September 21, 2011.

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