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OMB TRASHES TAX CUT ON TECHNICALITY, NOT REALITY

The Office of Management and Budget (OMB) has issued some numbers on the spending "sequestration" that would occur under the budget rules if the recently-passed Congressional tax bill became law. The report is being "spun" by the White House to claim that the $792 billion ten year tax cut is too large, and would result in across-the-board spending cuts in popular programs such as Medicare. This "spin" is untrue.

The tax cuts would only trigger spending cuts because of the PAYGO (pay-as-you-go) budget rules, not because the cuts are too large relative to the projected budget surplus, and the PAYGO rules would be waived if an agreement were reached by the Congress and the White House on a tax plan.

OMB is setting up a straw man. The tax cuts would only trigger spending cuts because of the PAYGO (pay-as-you-go) budget rules, not because the cuts are too large relative to the projected budget surplus, and the PAYGO rules would be waived if an agreement were reached by the Congress and the White House on a tax plan. In fact, the same objection, and the same rebuttal, would apply to the $300 billion tax cut that President Clinton and Congressional Democrats are offering.

The tax cut just passed by the Congress shows the public what Congress hopes to do with the budget surplus. The bill does not, however, contain a waiver of the old budget rules that were adopted when the government was running a deficit, and which outlaw any net tax reduction unless offset by cuts in entitlements. Such a waiver would have required a 60 vote margin in the Senate, under the budget rules. There was no point in struggling to insert such a section in the tax bill, since the President made it quite clear that he would veto the bill. If by some fluke he were to sign it, or if by some miracle the Congress were able to muster the margin to override the veto, the Congress would quickly pass the necessary waiver to make the spending cuts that OMB is threatening unnecessary.

The budget rules enacted as part of the 1990 budget agreement were bad policy. They created an artificial distinction between discretionary spending on one side, and mandatory spending and tax changes on the other, and tied each category up in knots with silly restrictions. They imposed caps (since revised) on discretionary spending. If discretionary spending exceeds the caps without being classified as "emergency spending", the President must "sequester" discretionary outlays across-the-board to offset the excess spending. Congress could avoid that sequester by not overspending the caps, by setting specific cuts to offset program increases, or by raising the caps. This threat-ened sequester is due to the caps and additional spending just voted by Congress, and would occur with or without a tax bill.

The PAYGO budget rules also state that, if Congress either increases mandatory spending or cuts taxes, there must be either offsetting cuts in other mandatory spending or offsetting tax hikes to compensate; for no sane reason, the rules do not allow cuts in discretionary spending to be used to make room for a tax reduction. If Congress does not choose what mandatory spending to trim to pay for a tax cut, there must be a "sequester" of outlays

Institute for Research on the Economics of Taxation

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by formula across most "non-exempt" entitlement programs, including Medicare. Social Security retirement and disability benefits are "exempt" from this sequestration.

The OMB numbers that the White House has released project the "sequester' situation under the budget rules assuming the tax cut were to become law. But the rules will not apply if a tax bill is actually signed into law; Congress and the President would not permit it.

The budget rules were based on the assumption of deficits as far as the eye could see. The caps and offsets were designed to prevent any changes to current law that would increase the projected deficit. Now that the budget is projecting a large surplus, it is foolish to require a tax increase to offset a tax reduction, or to force a reduction in mandatory spending to compensate. In fact, is it not clear that the rules were intended to apply in a situation of surplus, but OMB and the White House are interpreting them that way. One of the first orders of business of the next Congress and the next President should be to repeal the PAYGO budget rules outright.

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The spin being put on the OMB sequestration report can best be described as scare tactics. They are deflecting the debate from two important real issues. The first is whether it is better for people and the economy to use the budget surpluses for tax reduction or to pay down debt. In fact, the tax cuts would foster more growth, and are the superior choice. The second, longer term question is whether future deficits projected for Social Security and Medicare should be covered by higher income taxes or avoided through serious reform of both programs that would trim their rising outlays and encourage private saving to enable individuals to take control of their own retirement and health care decisions. The latter would provide higher income and better health care for the population.

The Congress-passed tax cut is less than the projected on-budget surplus, even on a static revenue basis, even after factoring in the interest that would otherwise have been saved by added debt reduction (and even if Congress "busts the caps" with a little added spending). It would permit a paydown of over $2 trillion of the national debt held by the public because it does not touch the Social Security surpluses. In fact, the tax bill would be less costly than the static revenue estimate makes it appear, because it would trigger additional growth that would return 25% to 30% of the projected revenue loss. Several provisions of the tax cut would spur growth by lowering taxes on saving and working. These include the reduction in tax rates and indexing for capital gains, expansion of IRAs, phase-outs of the individual and corporate minimum taxes and the estate and gift tax, and a small cut in marginal tax rates.

If anything, the tax cuts should be larger, not smaller; they should be phased in sooner, not later; they should not be "sunsetted" nor subject to a "trigger".

The tax cuts are needed to offset recent tax increases due to rising real incomes, which are not sheltered by the inflation indexing provision in current law. If anything, the tax cuts should be larger, not smaller; they should be phased in sooner, not later; they should not be "sunsetted" nor subject to a "trigger". Taxpayers deserve a tax cut. The economy needs this growth-friendly tax cut to permit the non-inflationary expansion to continue. Just do it!

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