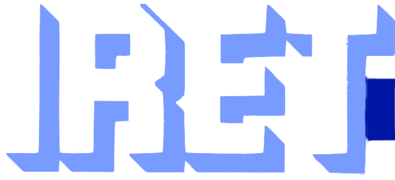
POLICY BULLETIN

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THE PRESIDENT'S FISCAL YEAR 1992 BUDGET

Introduction

The complexities of federal budget concepts and accounting make it difficult to determine the effects of the President's fiscal 1992 budget proposals on federal outlays, receipts, and deficits over the next several fiscal years. After sorting through the ambiguities created by alternative budget concepts and presentations, it appears that following the spending excesses of the current fiscal year, spending growth would very substantially moderate over the fiscal years 1992-1996. With a reasonable economic recovery, the increase in revenues, with no further tax hikes, would bring the budget into near balance at the end of the 5-year projection period.

Overview

There are many ways to look at a federal budget. It is like a glass that is half full or half empty, depending on one's viewpoint. The view of the budget shifts depending on the measures chosen and the time frame selected.

Two key measures of the budget are the "baseline budget" and the "consolidated policy budget". Figures based on both measures are presented in the budget submission (and throughout this paper) inclusive of off-budget items, including Social Security. The off-budget accounts are as important in judging the economic consequences of the budget for the economy as the on-budget accounts, and should be included in any budget analysis.

Baseline budget. The baseline budget presents estimates of government outlays and receipts for the current fiscal year (FY1991), and for the succeeding five fiscal years (FY1992-FY1996) that make up the budget period, assuming no change in current law. The outlays in the baseline budget are those established by the budget process enacted in the Omnibus Budget Reconciliation Act of 1990 (OBRA90). If the spending targets envisioned in OBRA90 are met, total baseline spending (current law spending on all items, including off-budget items such as Social Security) would fall sharply as a share of GNP and baseline budget deficits, while very high near term, would turn into

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a small surplus of $14.4 billion by FY1996. These improvements are projected to occur as a result of economic growth and budget actions taken to date.

Consolidated policy budget. The outlook is even better on the basis of the "consolidated policy budget", which consists of total baseline budget figures (including off-budget items such as Social Security) plus the budget effects of the Administration's policy proposals. The policy changes are of modest magnitude. Spending as a share of GNP would fall by a bit more than in the baseline budget, and the FY1996 surplus would be $19.9 billion. However, a portion of the projected FY1996 surplus is due to a net gain on the sale of assets acquired in the S&L rescue effort and other deposit insurance activities. Excluding these extraordinary items, the budget would be in deficit by $10 billion in FY1996. The remainder of this paper is based on the consolidated policy budget, with or without adjustments for deposit insurance activities, as noted.

There is some bad news in the budget in FY1991 and FY1992. The consolidated policy budget deficit will average about $300 billion for the two years. Outlays will hit 25 percent of GNP in FY1991. The spending caps in OBRA90 allow discretionary outlays to soar in FY1991, and to a lesser extent in FY1992, before significantly limiting spending increases in the later part of the budget period. The near-term deficit is further increased by the temporary effects of the weak economy on receipts and entitlement outlays, and by initial outlays for the savings and loan and banking industry bailout. Fortunately, these temporary elements do not represent a fundamental imbalance between the revenues projected under the current tax laws and the projected levels of government spending.

Indeed, with a good economic recovery, the projected longer-term budget outlook is quite favorable. The consolidated policy budget shows that with restrained growth of government spending it is possible to produce a modest budget surplus by FY1996 without further tax increases, and that there is room in the budget for serious tax reform designed to ensure that the strong economic growth forecast in the budget actually occurs. The budget contains policy recommendations aimed at promoting economic growth. These are a good beginning, but more will need to be done if the forecast growth is to be assured.

The economy will be struggling under the burden of the sharp tax increases included in OBRA90, which are projected to increase revenues by $192.8 billion over the FY1991-FY1996 period. The consolidated policy budget for FY1992 contains only a few proposals for limited tax increases, and several to reduce taxes to promote economic growth. The net revenue effect of these new proposals is projected at a loss of $2.2 billion total for the FY1991-FY1996 period.

After a sharp jump in outlays in FY1991, the rate of growth of total government spending in the consolidated policy budget falls sharply, to well below the rate of inflation, in FY1992-FY1996, although some categories of spending are allowed to rise rapidly. This projection of over-all restraint is achieved with only modest additional policy changes to restrain spending. It assumes that the caps on discretionary spending and the pay-as-you-go (paygo) provisions of OBRA90 are retained intact over the projection period. Paygo requires a proposal to reduce taxes or raise

entitlement spending in one area to contain an offsetting tax increase or entitlement cut in another area.

With the spending caps and tax increases in OBRA90 and an optimistic economic forecast, it was not hard to project a budget surplus in FY1996. The prospect of a surplus under reasonable growth and spending assumptions dampens the panic that might otherwise have been generated by the high deficit projections of FY1991 and FY1992, and blunts the drive for another large tax increase. Economic forecasts in past budgets have often been too optimistic, but even somewhat slower rates of economic growth and somewhat higher rates of interest than those projected in this budget would still show a rapidly improving budget outlook if the OBRA90 spending caps are met. With a basically healthy economy, the budget is not out of control. However, a sharply lower growth rate would make the picture much darker.

Near Term Budget Concerns and Risks for the Future

There are three unsettling concerns that cast a cloud over the sunny budget outlook.

The first cloud is that the future restraints on outlay growth in OBRA90 came at a high price. OBRA90 provides for a huge tax increase, and permits outlays to zoom 12.6% between FY1990 and FY1991. Even excluding higher outlays for thrift and bank bailouts, outlays rose 8.8% in FY1991. In short, the Administration bought Congress off. The tax increase and higher outlays up front were given in exchange for Congress's pledge of future spending restraint, as embodied in OBRA90's spending cap and paygo provisions.

There is no guarantee that Congress will honor the bargain struck in OBRA90 and live within the spending ceilings for the next five years.

The second cloud is that the spending caps negotiated in OBRA90 and reflected in the budget may be breached. There is no guarantee that Congress will honor the bargain struck in OBRA90 and live within the spending ceilings for the next five years. Congress won't stay bought off very long, if history is any guide. This deal is reminiscent of the 1982 budget accord, in which Congress promised three dollars in outlay reductions for every dollar of tax increases, and then reversed all the spending reductions in the 1983 budget process.

Indeed, the very fact that outlays will reach new heights in many programs in FY1991 bodes ill for the future of the spending caps. Higher spending levels tend to become built into the baseline for future budget planning, and lead to further outlay growth. Programs are seldom reconsidered on a "zero-budget basis", where the question is one of whether the program is needed at all. Rather, the previous year's level is taken as a given, and the question becomes one of how large an increase to permit, or even how large a real increase in addition to an adjustment for inflation to allow. The

spending caps promised in OBRA90 require a cut in real or even nominal terms for many budget categories. It is not clear that the caps will be able to stand the heat.

In fact, OBRA90 allows the spending caps to be adjusted or breached under several circumstances. OBRA90 requires that the discretionary spending caps be revised annually to allow for emergency outlays and to take account of changes in inflation and other economic assumptions and changes in budget concepts and definitions. It is possible that these revisions will allow spending to grow more rapidly than intended, and constitute a loophole in the caps.

The emergency spending loophole is even now being exercised, and could become a major problem. As of early March, the Administration and the House had agreed to just over $4 billion in an emergency supplemental spending bill aimed chiefly at domestic programs. It provides for drought relief in California, clean-up at a nuclear weapons plant, increased infant-mortality prevention, and additional poultry inspection in Maryland, among other things. If the definition of "emergency" becomes looser over time, the emergency spending provision in OBRA90 will permit outlays well in excess of the spending caps.

The revisions for economic and conceptual changes appear less of a threat to the caps. Revisions on economic and conceptual grounds in the FY1992 Budget have generally been in line with a limited set of adjustments anticipated in OBRA90. Some factors have tended to reduce the caps, others to increase them. (See appendix.)

The third cloud on the horizon is that the economic forecast which underlies the budget may prove to be far too optimistic. The forecast is unlikely to come true in the absence of vigorous policy initiatives for growth. For starters, the growth incentives in the budget would have to be enacted in their entirety. In addition, stronger medicine in the form of a payroll or income tax rate reduction would be needed to lower the cost of labor to stimulate new hiring, and some form of accelerated depreciation would be needed to further improve the outlook for investment. It is not that the growth targets are unattainable. A pro-growth tax package could make them happen. Unfortunately, the paygo provisions of OBRA will make it very difficult to enact a pro-growth tax package. Getting rid of paygo to permit a tax reduction will not be easy, given the absolute preference in Washington for faster growth of revenue and bigger government over faster growth of jobs and GNP.

Budget Time Frame and Concepts

Time frame

The Administration FY1992 budget focuses on the FY1992-FY1996 five year period. However, it is also advisable to take a close look at the current fiscal year, FY1991, and review the effect of the tax increases and spending rules imposed by OBRA90 for the six year period FY1991-FY1996.

Consolidated policy budget

The budget presentation is based on the consolidated policy budget concept, which incorporates the Administration's policy initiatives for revenues and outlays. "Consolidated" means that it covers the total federal budget, including both on-budget and off-budget accounts. The latter consist chiefly of Social Security's retirement and disability programs. Covering the total budget provides a more informative picture of the government's impact on the economy than the on-budget accounts alone. While policy makers may like to pretend that Social Security can be set aside and ignored, its impact is felt throughout the economy.

Excluding deposit insurance

Table II-1 of the Budget helpfully presents deficit estimates on the basis of several budget concepts in addition to the consolidated policy outlook. The most important alternative is "policy excluding deposit insurance", which subtracts the outlays in budget function 373, Deposit Insurance.

Normally, the total budget picture would be the one to look at in determining the magnitude of budgeted government activities and its command over resources. However, the large near-term outlays and long-term asset sales relating to the rescue of the thrift and banking industries distort the budget picture.

In the near term, the government will be spending substantial sums to shut down or merge failed S&Ls and banks. These sums are recorded in the "deposit insurance" category in the budget. There are two points to note.

First, there will be heavy outlays in the near term to shut down institutions with negative net worth. These outlays involve the spending of appropriated funds and deposit insurance premiums to cover the losses of these thrifts (including funds spent to facilitate mergers, advances to thrifts operating in conservatorship that may not be repaid, and payments to depositors of closed institutions). These outlays will not be recovered, but spending for this purpose will abate in future years after the sick thrifts and banks are eliminated. Large outlays for thrift and bank rescues are not expected to become a permanent feature of the budget.

Second, in addition to the losses described above, the Resolution Trust Corporation (RTC) will borrow and spend heavily near term to acquire and temporarily carry the assets of failed institutions. Over time, the assets will be sold, recouping most of the initial outlays on their acquisition. There may be some further losses (or even some gains) on these assets. It is the net loss on this portfolio over time that matters, not the annual pattern of outlays and sales.

This process is reflected in the recently enacted legislation providing additional funds for the clean-up of the S&L industry. The new law provides spending authority of $78 billion. It would allow the RTC to spend $30 billion (in addition to sums already appropriated) to cover losses at insolvent thrifts. The RTC would also be allowed to borrow $48 billion (in addition to borrowing

already authorized) to purchase and hold assets from the affected institutions. It is expected that the $48 billion will be recovered when these assets are sold.

The asset purchases will be recorded as outlays in the deposit insurance category in the budget, and the subsequent asset sales will be recorded in that same category as "negative outlays" rather than as revenues. This budget treatment swells outlays early in the budget period and shrinks them toward the end of the period, making the rate of growth of outlays within the budget period look slower than otherwise. Near-term deficits are exaggerated, and long-term deficits slightly understated.

The thrift crisis is supposed to be a one-time event. It is important to look past the bailout and to keep in mind the underlying trend of ongoing federal spending programs. A better measure of the underlying effect of the budget on the economy is to be had by excluding the deposit insurance figures. Most certainly, the transitory thrift crisis should not be used as an excuse for a permanent tax increase.

Consolidated Policy Budget Numbers

Deficit outlook

On the face of it, the consolidated policy budget deficit looks very bad near term, and very good later on. It shows record deficits near term, but projects a budget surplus by FY1996.

The FY1991 consolidated policy budget deficit will be $318.1 billion, equal to 5.7% of GNP. The deficit will still be $280.9 billion in FY1992. However, some perspective is in order. While the FY1991 consolidated budget deficit is a record in dollar terms, it is less than the 6.3% of GNP reached in FY1983 following the 1981-82 recession. Furthermore, the budget on this basis shows a surplus of nearly $20 billion, or 0.3% of GNP, by FY1996.

If the distorting effects of spending for the thrift and bank bailouts are removed, the deficit looks a lot better near term and a bit worse long term. Excluding deposit insurance outlays, the FY1991 deficit will be $206.6 billion, or 3.7% of GNP. In dollar terms, excluding deposit insurance, it is the fourth largest deficit, exceeded in FY1983, FY1985, and FY1986 (also adjusted for thrift spending). As a percent of GNP, it is the seventh largest deficit since FY1950. Excluding the outyear asset sales, the FY1996 budget shows a deficit of $10 billion, or 0.1% of GNP instead of a surplus of 0.3%.

The public and the financial markets have greeted the consolidated policy deficit outlook with yawns. This reaction indicates that the public and the Administration understand the special circumstances that generated the deficit forecast, and suggests that the consolidated deficit including Social Security but excluding deposit insurance may be the focus of public attention. Had the Administration been fixated on the consolidated budget deficit including deposit insurance, it would probably have made more effort to tighten outyear spending, or to raise taxes substantially.

CONSOLIDATED POLICY BUDGET*
RECEIPTS, OUTLAYS, AND DEFICITS
WITH AND WITHOUT DEPOSIT INSURANCE**
FISCAL YEARS 1990-1996
(Dollar amounts in billions)

fiscal year	1990	1991	1992	1993	1994	1995	1996
receipts	$1031.3	$1091.4	$1165.0	$1252.7	$1365.3	$1467.3	$1560.7
outlays							
with deposit insurance	$1251.7	$1409.6	$1445.9	$1454.2	$1427.1	$1470.3	$1540.8
without deposit insurance	$1193.6	$1298.1	$1357.8	$1410.0	$1465.2	$1512.6	$1570.7
deficit							
with deposit insurance	$ 220.4	$ 318.1	$ 280.9	$ 201.5	$ 61.8	$ 2.9	$ -19.9
without deposit insurance	$ 162.3	$ 206.6	$ 192.8	$ 157.3	$ 99.9	$ 45.2	$ 10.0
deposit insurance	$ 58.1	$ 111.5	$ 88.1	$ 44.2	$ -38.1	$ -42.3	$ -29.9
receipts as % of GNP	19.1%	19.4%	19.5%	19.5%	19.9%	20.0%	20.0%
outlays as % of GNP							
with deposit insurance	23.2%	25.1%	24.2%	22.6%	20.8%	20.0%	19.7%
without deposit insurance	22.1%	23.1%	22.7%	21.9%	21.3%	20.6%	20.1%
deficit as % of GNP							
with deposit insurance	4.1%	5.7%	4.7%	3.1%	0.9%	0.0%	-0.3%
without deposit insurance	3.0%	3.7%	3.2%	2.4%	1.5%	0.6%	0.1%

* Federal budget, including off-budget items such as Social Security, adjusted for Administration's policy proposals.

**Budget function 373: bank and thrift insurance funds, Resolution Trust Corp., FSLIC Resolution Fund, National Credit Union Administration. An excess of asset sales, earnings on assets, and deposit insurance premiums over asset purchases and expenditures on liquidation or merger of, and asset acquisition from failed banks and thrifts may result in net "negative outlays".

Outlay growth

The Administration stresses that its FY1992 Budget outlook and spending proposals would hold the increase in total outlays – on and off-budget – to just over 9%, or less than 2% per year, in FY1992-FY1996, substantially less than projected inflation. In real terms, outlays will fall by more than 8% over the period.

The FY1992-FY1996 outlay figures are not so reassuring after adjusting for deposit insurance purchases and sales. Outlays excluding deposit insurance will rise 21% between FY1991 and FY1996, which is about 1.2% greater than projected inflation for the period.

The spending picture is worse after factoring in the 12.6% jump in outlays between FY1990 and FY1991, an 8.8% real increase. Including deposit insurance, FY1991 outlays will hit 25% of GNP, a post-1946 record which has alarmed many observers. FY1996 outlays will exceed FY1990 outlays by over 23% in nominal terms, a drop in real dollars of only a bit more than 1% when adjusted for projected inflation of over 24% for the period.

Excluding the deposit insurance category improves the near-term spending outlook, but it somewhat worsens the longer view by omitting the projected "negative outlays" from sales of assets of defunct thrifts in FY1994-FY1996. Excluding spending for deposit insurance, total outlays will rise in FY1991 by a sharp 8.8% in nominal terms, a real increase of about 4.2%. FY1991 outlays excluding deposit insurance will hit 23.1% of GNP. This figure is substantially less than the 25% share on a consolidated budget basis. While not a calamity, it is not much improved relative to outlays excluding deposit insurance in the FY1982-FY1986 period, when they averaged 23.7% of GNP. Furthermore, the FY1991 figure is well above the FY1950-FY1979 average outlay share of 19.2% of GNP.

Over the whole FY1991-FY1996 period, outlays excluding deposit insurance purchases and sales will increase by 31.6% in nominal terms, or 5.5% in real terms, over FY1990 levels. While spending growth measured on this basis is notably higher than on a total budget basis and excluding FY1991, the growth rate is still a significant improvement over the growth rates of previous budget periods.

Revenues

OBRA90 included major tax changes projected to increase revenues by $192.8 billion in the FY1991-FY1996 period, or about $32 billion a year. Baseline revenues are projected to rise by nearly 7.2 percent per year, and to be over 51% higher in nominal terms in FY1996 than in FY1990. In real terms, revenues are projected to rise about 3.2 percent per year, and to be over 21% higher in real terms in FY1996 than in FY1990. The policy proposals in the FY1992 budget leave these figures virtually unchanged.

OUTLAY AND REVENUE GROWTH*
IN THE
FY1992 CONSOLIDATED POLICY BUDGET**
WITH AND WITHOUT DEPOSIT INSURANCE***

	FY1991 over FY1990	FY1996 over FY1991	FY1996 over FY1990
Outlay growth			
Nominal	+12.6%	+ 9.3%	+23.1%
Real	+ 7.9%	- 8.6%	- 1.3%
Outlay growth without deposit insurance			
Nominal	+ 8.8%	+21.0%	+31.6%
Real	+ 4.2%	+ 1.2%	+ 5.5%
Revenue growth			
Nominal	+ 5.8%	+43.0%	+51.3%
Real	+ 1.4%	+19.6%	+21.3%

* Total percentage increase over the indicated period.

** Federal budget, including off-budget items such as Social Security, adjusted for Administration's policy proposals.

*** Budget function 373: bank and thrift insurance funds, Resolution Trust Corp., FSLIC Resolution Fund, National Credit Union Administration.

The consolidated policy budget for FY1992 contains only a few proposals for further tax hikes, and several to reduce taxes. The only major tax increase in the budget is to extend the Medicare portion of the payroll tax to state and local government workers hired before April 1, 1986. (Workers hired after that date were covered by the 1986 Tax Reform Act.) It will raise the combined employer and employee tax rate on the affected wages by 2.9 percentage points. This tax will raise about $7.1 billion over the budget period. The Budget's rationale for the extension of the tax to this

group is that as many as four out of five untaxed workers may be eligible for Medicare coverage on the basis of other employment, or through spouses, without paying the tax on their current state and local government earnings. The minority that are not eligible for coverage will now become eligible as a result of paying the tax.

The budget proposals to reduce taxes to promote economic growth include a capital gains tax rate reduction, creation of a Family Saving Plan in the form of a new type of non-deductible IRA in which the withdrawals would be tax exempt, and extension of the R&D tax credit. As conventionally estimated, the net revenue effect of the proposed tax increases and decreases is projected at a loss of $2.2 billion total for the FY1991-FY1996 period. In fact, there would be no revenue loss from these proposals if they were scored realistically for budget purposes. The capital gains cut would likely bring in more revenue near-term than the Administration is showing in the budget. The Family Savings Plan would not lose $6.5 billion as shown in the budget. Insofar as deposits in FSP accounts were new saving by families, there would be no revenue loss, as there would have been no interest earned to be taxed in the absence of the incentive. To project a revenue loss of this magnitude, revenue estimators must have assumed, contrary to research on past saving behavior, that the deposits would consist almost entirely of saving that would have been done anyway.

Although the proposed tax changes would be scored as trimming only $2.2 billion from revenues over the FY1992-FY1996 period, even these modest revenue losses could bring the tax proposals afoul of the paygo provisions of OBRA90. Paygo requires a proposal to reduce taxes in one area to contain either an offsetting tax increase in another area or to obtain a 60-vote margin in the Senate. If it passes, it will then trigger automatic reductions in selected "non-exempt" areas of entitlement spending.

Hybrids: de facto tax increases scored as spending cuts

Outlays on Medicare, Part B (physicians and outpatient services) are to be curbed by what amounts to a tax on upper-income elderly. Currently, the general fund of the Treasury pays for roughly 75% of the cost of Medicare, Part B. The remaining 25% is covered by premiums paid by the enrollees. The budget proposes to reduce this subsidy for upper-income taxpayers from 75% to about 25% by tripling the monthly premium for those with adjusted gross incomes above $125,000. Because the higher payment is related to the level of income, it amounts to an income tax increase. Furthermore, the premium increase merely shifts the funding of the program from the Treasury to the well-to-do elderly; it does not directly affect total Medicare outlays. Although Federal budget outlays will be reduced, there will be no actual reduction in the scope of the Medicare program or the economic resources it influences.

The Budget also proposes a reduction in Commodity Credit Corporation subsidies to those with off-farm income over $125,000. Since the cut in the subsidy is means-tested, it constitutes a de facto income tax increase on the outside earnings. Unlike the Medicare case, however, it does represent a contraction in the scope of the federal program.

Size of Government More Important Than Deficits

The consolidated policy budget is forecast to achieve a tiny surplus of 0.3% of GNP in FY1996, and a deficit of 0.1% of GNP excluding the sales of the thrift assets. Either number is far better than the current situation. Unfortunately, this near balance is achieved with revenues of 20% of GNP and outlays of 19.7% (total) or 20.1% (excluding asset sales). That is, the budget will be roughly balanced with revenues and outlays of about 20% of GNP. This would leave revenues well above their 1950-1979 historical average of 18.0%, prior to the sharp increase in taxes during the inflation and bracket creep of the 1979-1981 period. Outlays would remain well above their historical average of 19.2%. In terms of the projected FY1996 GNP, these increases relative to the historical averages represent excess revenues of $156 billion, and excess outlays (excluding deposit insurance) of $70 billion. These increases are not only large, they threaten to continue year after year, and stand in the way of important reforms of the tax code to promote economic growth and higher living standards. Thus, in spite of efforts by the Reagan and Bush Administrations to reduce the role of government, both revenues and outlays will be well above their long-term levels, even if the laudable outlay restraint in the FY1992 budget materializes.

Not Too Tight a Budget

There is little doubt that some in the Congress will complain that the FY1992-FY1996 spending pause is a sign of great fiscal austerity, and proclaim this budget to be too restrictive. The rise in revenues and outlays in real terms over the full OBRA90 era give the lie to such claims, and justify the Administration's efforts to ensure that, following the revenue and spending increases of FY1991, future deficit reduction will come from spending restraint rather than tax increases. The Administration would be completely justified in standing firm on this issue. Though there would still be a need for further restraint in the growth of government in the post-FY1996 period, achievement of the budget targets would be a major step forward in restoring a better balance between the public and private sector.

Many spending categories in the budget are to receive large increases in both nominal and real terms between FY1990 and FY1996. Defense is the big loser.

- Defense faces a real cut of 23% in the Department of Defense military accounts (excluding outlays on Operations Desert Shield and Desert Storm). It remains to be seen if the long term situation in the Middle East and the Soviet Union will permit this massive cut in defense outlays.

- General Science, Space, and Technology will receive a 33% real increase. Among the eminently deferrable big ticket items here are the superconductor supercollider; work on the space station; and a new, heavy-lift, unmanned launch vehicle to replace the more dangerous and unreliable Space Shuttle on many missions.

- Health spending – federally-provided health care services, research, and education – will rise 74% in real terms.

- Medicare, in spite of cutbacks in allowable physician and hospital fees and reductions in teaching subsidies, will receive a nearly 43% real increase.

- Administration of Justice will receive a real increase of 37%.

- General Government will receive a real increase of less than 7%. However, two areas within that budget category grow very smartly. There is a real increase of 35% between FY1990 and FY1992, and nearly 15% for the full period, for legislative functions – paying for the Congress. There is a real increase of nearly 49% between FY1990 and FY1992, and 57% for the full period, for executive direction and management – controlling the Executive Branch and dealing with the Congress.

In Summary, a Mixed Bag

Excluding the deposit insurance category and including FY1991 in the time frame of the analysis makes several points clear regarding the budget. The deficit is large, but not so large as to justify either panic or a tax increase, and it will be heading in the right direction if the OBRA90 spending targets are honored. Outlay growth, while not so restrictive as may appear on a total budget basis between FY1991 and FY1996, would be slowed significantly, again assuming that the OBRA90 spending targets are honored. Outlays would be off their recent highs as a share of GNP, though still in need of further careful control in the post-FY1996 period. Finally, there remains the need for a vigorous tax reduction program to promote growth, especially after the damaging tax increase enacted in 1990. The budget proposals for FY1992-FY1996 are best described as a first step in the right direction.

Achieving the Promise of the Budget Outlook

Tax reduction needed

If the OBRA90 spending targets are met and the economy grows at the healthy pace assumed in the budget, the budget will move into rough balance by FY1996. It is not clear that the economic growth forecast can be realized without the adoption of a growth agenda, which means a carefully designed package of tax reductions to lower the cost of capital and labor.

Enactment of a sound tax reform program for economic growth would enable the economy to achieve the Administration growth targets and fight inflation with a burst of output, as in the mid-1980s. The real growth rates forecast in the Administration budget are not excessive. To shave the unemployment rate back down to nearly full employment levels, while at the same time boosting productivity and real wage growth at rates approaching the post-World War II average, would take about four years of real growth of close to 3.5 percent. The Administration forecast does not come

close to that, and may in fact not be optimistic enough about real growth to justify the projected drop in unemployment contained in its forecast.

A pro-growth tax reduction package would require some reduction in revenue, but would still permit rapid reduction in the deficit, though perhaps not to zero by FY1996 without additional spending restraint. The added economic growth would be well worth the effort. Unfortunately, enactment of a pro-growth tax package is made very difficult by the paygo provisions of OBRA90.

It is not clear that the economic growth forecast can be realized without the adoption of a growth agenda, which means a carefully designed package of tax reductions to lower the cost of capital and labor.

Under those restrictions, current law revenue projections become built into the budget resolutions for the upcoming fiscal years. Consequently, any revenue bill that cuts revenues will be subject to a point of order against its consideration. To overcome that point of order in the Senate requires a super-majority vote of 60 Senators (in the House, a mere majority).

If the bill gets by the point of order, it must overcome other obstacles. Under paygo, if it cuts revenues in one area it must raise them in another, or provide for matching reductions in non-exempt entitlements. If it does not, and is enacted anyway, a sequester of non-exempt entitlements will be triggered, increasing the political baggage a tax cut must carry.

If we are to achieve the economic growth promised in the budget, we must get rid of the restriction on reducing revenue, and enact a tax agenda for growth. Senator McCain has introduced a bill that would eliminate the paygo bias against a tax cut and create a barrier to a tax increase. The bill would make it possible to enact a tax reduction by simple majority vote, and would require a super-majority vote of 60 Senators and three-fifths of the House to raise taxes.

Wanted: serious budget reform

The budget guidelines in OBRA90 constitute an awkward, ad hoc, and temporary patch on the budget process that prevents sensible consideration of either outlays or a sound tax policy. On no account can they be considered meaningful budget process reform. Meaningful budget process reform is urgently needed.

Congressman Christopher Cox has introduced a bill, H.R. 298, to reform the budget process in more fundamental and more significant ways than those contained in OBRA90. The Cox proposal would require Congress to enact a binding budget law by May 15 of each year. This law would be a Joint Budget Resolution, subject to Presidential signature or veto, unlike the Concurrent

Resolutions required under present law. The Joint Resolution would set binding ceilings on 19 categories of federal spending, including most types of entitlements, covering everything except Social Security and interest on the debt. Unlike current Budget Resolutions, there would be no minimum revenue floor.

The Cox plan would give Congress every incentive to pass the Joint Resolution and subsequent appropriation bills on time, for if Congress did not, a pre-arranged, perpetual continuing resolution would maintain outlays at the previous year's levels. The plan would permit the President to enforce these levels with enhanced rescission authority, and they could be increased only by a two-thirds vote in both Houses of Congress. The automatic continuing resolution would thereby prevent a recurrence of last-minute, 1,000-page emergency spending bills such as the President has been forced to sign in recent years to avoid shutting down the government.

If a Joint Budget Resolution were passed on time, the proposal would require a two-thirds super-majority vote to breach the spending ceilings in the Resolution, and give the President enhanced rescission powers to counter such excesses when they occur.

Under this proposal, it would be easier for Congress to pass a tax cut, and harder to raise spending, than under the current Budget Act. A tax cut could be passed by majority vote of both Houses of Congress. Excessive spending would be forced to garner a two-thirds vote in one of three ways. The President could veto the Joint Resolution if it contained excessive spending ceilings. It would take a two-thirds vote to override his veto. If a Joint Resolution were not passed on time, it would take a two-thirds vote to increase spending above the previous year's levels contained in the automatic continuing resolution. Finally, if a Resolution were passed, it would take a two-thirds vote to breach its spending ceilings in any category. These categories would cover almost all Federal spending. Even entitlements, other than Social Security, that now escape Budget Resolution discipline would be subject to a ceiling. If entitlement spending were projected to exceed the ceilings, Congress would have to revise by majority vote the relevant entitlement statutes' benefit formulas and eligibility requirements to enable the programs to meet the spending targets. To raise the outlay ceiling instead would require a two-thirds vote.

Conclusion

It is possible that the spending caps imposed by OBRA90 and a robust economy will sharply reduce or eliminate the deficit by FY1996. However, a strong economy would be much more certain if the Congress and the Administration were to enact a pro-growth tax reform program. In addition, a more permanent and more meaningful reform of the budget process is needed to keep outlays and deficits from rising ever again to such heights as a share of GNP as were reached in recent years and as are projected for the near future.

Appendix A: Revisions of the Caps

Many critics of OBRA90 were concerned by the provision that requires that the discretionary spending caps be revised annually to allow for emergency outlays and to take account of changes in inflation and other economic assumptions and changes in budget concepts and definitions. It was feared that these revisions would allow spending to grow more rapidly than intended, and constitute a loophole in the caps.

The dollar values for the caps set in OBRA90 were only meant to be preliminary, covering a portion of discretionary spending on programs already part of the budget. The caps were meant to be revised to accommodate other changes in spending that were being enacted in other parts of the bill or in other bills that were in the works and considered worthy of additional outlays. At the same time, OBRA90 was making changes in the way the budget categories were to be defined, bringing parts of formerly uncovered programs under the umbrella of the spending caps. Consequently, OBRA90 set tentative caps to cover existing elements of discretionary spending and listed a set of programs and category shifts that were to be accommodated by adjusting the caps at a later date.

Inflation in 1990 was 0.1 percentage point below the assumption in OBRA90, and outlays have been slightly revised down accordingly.

Budget caps have been raised according to conceptual changes in budget definitions. For example, the Federal Credit Reform Act of 1990, enacted as part of OBRA90, provides that credit programs must count as outlays the increases in the expected levels of defaults they face as lending expands, thus bringing the credit programs under the restraining influence of the spending caps. The one-time adjustment to include current levels of expected defaults causes a jump in the cap. Changes in the statutory treatment of budget authority of specified trust funds and new scoring guidelines for leases and lease-purchases also affected the caps, as did transfers of some programs from one budget category to another. These adjustments do not represent increases in total outlays.

OBRA90 also listed a set of outlays not then approved by the Congress which were to be accommodated in the budget caps once appropriations for the outlays were enacted. These include funding for an expansion of the IRS, forgiveness of Egyptian and Polish debt to the U.S., the increase in the U.S. quota to the International Monetary Fund, and funding for accounts designated by the President as emergency spending, including Operation Desert Shield.

OBRA90 also specifies a set of "special allowances" to account for estimating differences between OMB and CBO. It may be assumed that Congressional estimates will trigger the use of these added funds. The allowances are limited in FY1991 through FY1993 to $2.5 billion for defense, $1.5 billion for international, and $2.5 billion for domestic; in FY1994 and FY1995, the total discretionary allowance is $6.5 billion.

The effect of these adjustments of the caps on the various categories of discretionary spending is as follows:

- The Budget shows an increase in the defense cap of $1.2 billion in FY 1991 for Desert Shield outlays, but has revised the cap down by about $700 million over the subsequent four years to reflect lower inflation since OBRA90 was enacted. Further adjustments for Desert Storm are not yet calculated, but are expected to be anywhere from zero to $15 billion after receipt of contributions by allies.

- The Budget shows an increase in the international cap of between $500 million and $1.2 billion annually over the budget period. These increases include the use of a portion of the special allowances, assumption of passage of loan forgiveness and International Monetary Fund funding, and compliance with credit reform adjustments.

- The Budget shows a net increase in the domestic cap of $1.6 billion to $3 billion per year over the budget period, with increases due to assumed use of allowances and definition changes partly offset by the effect of lower inflation.

- Total discretionary outlay caps have been marked up by between $2.4 billion and $3.7 billion each fiscal year of the budget period, in line with expectations on the use of the authorities in OBRA90.

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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.