IRET Institute For Research On The Economics Of Taxation

IRET is a non-profit 501(c)(3) economic policy research and educational organization devoted to informing the public about policies that will promote growth and efficient operation of the market economy.

H.R. 429: ENHANCING FISCAL EFFICIENCY

Summary of Statement by
Norman B. Ture, President
Institute for Research on the Economics of Taxation
to
Subcommittee on Select Revenue Measures
Committee on Ways and Means
U.S. House of Representatives
November 16, 1993

- H.R. 429 would improve the federal budget making process by allowing individual income taxpayers to mandate reductions in total budget outlays from projected baseline levels. Enactment of the bill would establish more effective communication between taxpayers and policy makers concerning budget policy.

- H.R. 429 would slow the growth of federal spending and lead to smaller budget deficits. If all individual income taxpayers chose to allocate the maximum amount — 10 percent — of their tax liabilities to the proposed debt buy-down trust fund, federal budget surpluses would replace deficits beginning in fiscal year 2000, based on CBO baseline projections.

- Federal spending and budget deficits continue to expand despite the broad consensus in favor of less government spending and lower deficits because policy makers are buffered from the preferences of the public as a whole while accessible and responsive to the demands of interest groups.

- Budget policy making in any years is the captive of policy decisions in the past. Baseline budget projections dominate budget decision making, exerting strong upward pressure on total outlays.

- Budget deficits reflect a fundamental failure of the fiscal system. An efficient fiscal system would limit total outlays to the amount the public as a whole is willing to pay for in taxes. Borrowing to pay for government outlays hides the cost of government services from the public and results in more of them than the public would be willing to pay for.

- H.R. 429 would break the hold of baseline projection on budget decision making. It would require policymakers to conform decisions about budget aggregates more closely with the preferences of the public as a whole. It would impose greater pressure on budget policy makers to set more carefully determined priorities among competing programs, given the constraints imposed by the public on total spending.

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I am Norman B. Ture, president of the Institute for Research on the Economics of Taxation (IRET). My testimony presents my views, not necessarily those of IRET, about H.R. 429, the Taxpayer Debt Buy-Down Act.

I want to commend the Chairman and the Subcommittee for providing this opportunity to address H.R. 429. The bill, I believe, represents an impressive and constructive effort to improve the existing federal budget process. Its enactment and implementation would very likely result in a material slowdown in the growth of federal spending and in more constructive federal programs. Just as important, it would create an effective nexus between policy makers in the Congress and in the Executive Branch, on the one hand, and the entire population of individual federal income taxpayers, on the other. In both respects, enactment of H.R. 429 would substantially improve the federal budget process and lead to a level and composition of federal activities conforming more closely with the preferences of the public as a whole.

It is the lack of close connection between taxpayers and policymakers that, I believe, is a major reason why avoiding federal budget deficits, or at the least reducing them, has proved to be so elusive a fiscal policy objective. By tying budget policy making more closely to the expressed preferences of individual taxpayers, H.R. 429 would increase the efficiency of the fiscal system. It is on this point, generally overlooked but critically important, in my judgment, that I wish to concentrate my testimony.

Every member of the Congress must be aware of the anomaly posed by year-in, year-out federal budget deficits in the face of a virtually universal preference throughout the body politic for balanced budgets. Congressmen and Senators and their constituents alike deplore federal spending in excess of federal revenues and the resulting requirement for the federal government to borrow some of the saving of households and businesses. Notwithstanding this unanimity, federal budget deficits are the rule, rather than the exception. In large part, this anomaly results from the fact that policy makers are to all intents and purposes buffered from the preferences of the body politic as a whole with respect to how much government they are willing to pay for. As a group, individual income taxpayers have no way to communicate their wishes in this regard to the executive branch and the Congress. On the other hand, policymakers are quite accessible and responsive to the urging and demands of organized groups of individuals for specific government programs and services of benefit to the groups. The result is continuing pressure to add to the inventory of government programs and no effective means for curbing spending growth. Not surprisingly, the outcome is what we have witnessed for far too long, i.e., increases in government activities and outlays in excess of the taxes we are prepared to pay to finance them.

To be sure, budget policy making for any given fiscal year is very much the prisoner of policy decisions in the past and of the aversion to cutting back on future spending for programs with established beneficiary constituencies. Baseline projections of existing budget program outlays, not the worthiness of those programs, have for the most part dominated budget decisions making. As such, the tyrannical grip of the past both impels excessive expansion of federal spending and impedes adjusting spending priorities to the changes in demands for government services that necessarily occur in a dynamic and progressive society. This grip of baseline projections on budget making must be broken if the fiscal system is to be responsive to those changes in priorities and accurate to reflect the public's preferences and willingness to pay for government.

Something must be done to overcome these impairments of the fiscal system that exert pressures for untoward growth in outlays in excess of tax revenues. H.R. 429, I believe, would go far to meet this requirement for a more efficient fiscal system.

Fiscal Efficiency

In a free society, government budget deficits, whatever their other faults and adverse consequences, should be seen as reflecting a fundamental failure of the fiscal system. An efficient fiscal system would provide a volume and composition of government spending programs and activities that conform closely with the public's preferences for the services it wants from its government and the cost it is willing to bear to obtain those services. To achieve that result, government activity must be financed by taxes that are as broadly based and as visible to taxpayers as possible. The core function of taxes, after all, is to price out government activity — to inform the body politic about the cost they must incur, by way of forgone alternative products and services, for what they want government to do. Insofar as the financing of government activity doesn't rely on highly visible taxes paid by the largest possible number of people, this function can't be performed. The result almost certainly will be more, less valuable government activity than the public would be willing to pay for. Government borrowing to finance the excess of outlays over tax revenues conceals the cost of those extra outlays from the public. Government borrowing, in short, muffles the public's voice regarding the worthiness of the debt-financed government activity.

Achieving a more efficient fiscal system, one that confines government spending to the amount the public is willing to pay for in taxes, obviously requires effective communication between taxpayers and public policymakers. This communication clearly has been largely lacking. The American public disapproves of budget deficits, believes government is too large and too intrusive, and isn't willing to pay additional taxes to reduce, let alone eliminate, the huge deficits in prospect for the indefinite future. There are few, if any, policymakers or people seeking policy making positions who proclaim a preference for more government and government borrowing to finance the increased spending. Surely, one must wonder why the preferences of both taxpayers and policymakers in this respect are not reflected — indeed, are flagrantly denied — in actual budget results. The election process itself obviously doesn't effectively convey the electorate's mandate, which lacks specific instruction, to the people who are elected. This isn't because, once elected, policymakers disregard their constituents' views or really have no desire to curb deficit spending and excessive government spending. It is, instead, that their constituents' preferences are not effectively communicated and that there is no effective means for implementing those preferences.

The existing fiscal system, therefore, operates contrary to the preferences of policymakers and the body politic as a whole for getting from rapidly expanding budget outlays and deficits to slower growth, if not actual reduction, in the amount of government spending and much smaller deficits. It favors specific groups, some small, some large, at the expense of the public as a whole.

Past efforts to curb spending growth and to reduce budget deficits clearly have not succeeded. The closest approach to achieving these results was the Gramm-Rudman-Hollings provision, but G-R-H foundered when its implementation called for drastic outlay sequester. The important lesson to be learned from this experience is that achieving an efficient fiscal system can't be achieved by draconian measures that call for huge spending cuts or very large tax increases in a single or few fiscal years. This is the reason why balanced budget amendments, however desirable their objective, are not realistic approaches to solving the deficit problem. What is needed, instead, is a system that (1) allows policymakers to heed the demands of the constituency as a whole for less government spending and smaller deficits, and (2) would be effective in satisfying these demands.

H.R. 429: Increasing Fiscal Efficiency

For this purpose, there is needed (1) better communication between taxpayers — those who write the checks to pay for government — and policymakers and (2) an effective device for implementing taxpayers' preferences. H.R. 429, The Taxpayer Debt Buy-Down Act, satisfies both of these requirements.

H.R. 429 puts in the hands of every individual income taxpayer the means for communicating explicit instructions to the executive branch and to the Congress to reduce aggregate budget outlays by as much as 10 percent of individual income tax liabilities. In essence, the bill provides for setting up an annual taxpayer referendum concerning the extent to which federal government spending should be reduced below the baseline levels for each fiscal year. More than a mere expression of preference, moreover, the referendum would mandate the Congress to enact reductions in aggregate spending equal to the aggregate amount of debt buy-down that taxpayers specified.

The bill would not impose on taxpayers the impossible task of specifying which government programs are to be cut back by how much from the spending levels they would otherwise reach. Instead, the Congress would confront the requirement for ordering the priorities of existing and new spending programs subject to the overall outlay constraint specified by individual income taxpayers. Congress would have the opportunity to enact differential cuts in spending, provided that the total of such cuts from the year's baseline at least equalled the taxpayer-specified buy-down amount. Only if the Congress failed to bring aggregate spending authorizations within the limits set by the buy-down would an across-the-board sequestration take effect.

One of the great virtues of H.R. 429 is its incremental approach to deficit reduction. It combines certainty of spending and deficit reduction with gradualism, avoiding the wrenching fiscal strains that would be entailed by legislation or constitutional amendment requiring balanced budgets immediately or in the span of a very few fiscal years. Moreover, it would provide individual taxpayers the opportunity to slow or to accelerate the spending and deficit reduction process.

Expected Results of Implementing H.R. 429

H.R. 429 has two closely related objectives — to give individual income taxpayers an opportunity to communicate their preferences regarding the amount and growth of federal spending and to reduce federal budget deficits. What are the prospects for its success in achieving these objectives?

There is little reason to doubt that the enactment of H.R. 429 would very effectively open the lines of communication between taxpayers and policymakers. No complicated instructions or calculations would be required for informing taxpayers how to indicate on their tax returns how much of the tax liabilities they are reporting for the preceding year they wish to be allocated to the debt buy-down trust fund, hence to inform budget makers by how much spending for the coming fiscal year is to be reduced from the projected baseline amount. Whether taxpayers chose to take little or maximum advantage of this opportunity, the aggregate results would far more accurately than any other poll convey to policymakers the public's views about the level and growth of total federal spending.

There is little information on which to base confident estimates of the magnitude of the spending and deficit reductions that would result under H.R. 429. The Congressional Budget Office has provided estimates of the budget effects assuming that all individual income taxpayers would assign the maximum amount — 10 percent — of their tax liabilities to the debt buy-down trust fund, hence require equal spending reductions from the fiscal year base line amount. On these assumptions, as the attached table shows, budget outlays would peak in the year 2000 and begin to decline slowly in the year 2002. The budget deficit, on the other hand, would begin to decline substantially from projected baseline levels beginning in fiscal year 1995; surpluses would replace deficits beginning in the year 2000 and would increase substantially thereafter. The debt held by the public would peak in the fiscal year 1999 and fall rapidly thereafter. Of course, these results would be altered if the baseline projections were revised, particularly if there were changes in tax revenues because of changes in the tax laws or changes in underlying economic conditions. Nonetheless, the CBO projections are useful as indicators of the potential of H.R. 429 for imposing an effective discipline on policymakers' decisions about aggregate federal spending.

The CBO estimates are outside estimates. In all probability, the actual outcomes would be somewhat smaller cuts in spending and in budget deficits. But the specific magnitudes of these results, in one sense, would be less consequential than what the results would reflect — an accurate portrayal of what taxpayers generally wish in terms of aggregate levels of government services. As such, these results would also depict a major achievement in enhancing fiscal efficiency. Allow me to commend H.R. 429 to the Subcommittee on this basis as well as its potential for improving budget outcomes.