Taxes, Deficits and the Current Recession

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Executive Summary

Despite claims of "deficit reduction," the recent budget summit agreement between President Bush and Congress will produce record deficits over the next five years.

- The previous Gramm-Rudman law would have allowed deficits of $64 billion in 1991, $28 billion in 1992 and zero thereafter.

- The new budget agreement will allow $546.5 billion in federal borrowing through 1995.

The goal of the summiteers will not be met, however. Realistic forecasts predict that the actual deficits will be much higher.

- An anticipated recession, the negative impact of new taxes on the economy and the cost of Desert Shield will add at least $258 billion to federal borrowing over the next five years.

- As a result, the five-year cumulative deficit will be at least $804.5 billion.

- Other unforeseen developments, such as a banking bailout or a more severe recession will push federal borrowing closer to $1 trillion.

- In apparent anticipation of these events, the budget summit bill raised the federal debt ceiling by $1 trillion over the next five years.

The budget summit agreement, including the largest tax increase in history, was rushed through Congress in the final moments of the last session. Even now — long after passage of the act and the 1990 elections — many specifics of the agreement have not been made public. We know enough to compare overall promises with reality, however. For example, although the conferees promised to cut spending in return for higher taxes, precisely the opposite result occurred: while taxpayers pay more, the federal government will also borrow and spend more.

- As part of the formal agreement, there will be about $2.74 of new deficit spending for each $1 of new taxes.

- Based on a more realistic forecast, there will be about $6.65 of new deficit spending for each $1 of actual new taxes and user fees collected.

The budget summit agreement has effectively reversed the late 1980s trend toward lower deficits.

- Total real borrowing during the first four years of the Bush Administration will be considerably higher (in real terms) than during the Carter or Reagan administrations.

- In fact, real federal borrowing will be higher than at any time since the end of World War II.

Almost everyone agrees that the official forecasts of future deficits are unrealistically low. The budget summiteers anticipated this fact, and provided for "automatic" increases in the deficit ceiling in response to very predictable problems. For example,

- Deficit ceilings will be automatically increased in response to lower federal revenues caused by a recession or by the negative impact on the economy caused by new taxes.
- Deficit ceilings will be automatically increased by the cost of Operation Desert Shield.
- Deficit ceilings will be automatically increased if the bill's unrealistically low estimates of inflation or unrealistically high estimates of economic growth turn out to be off the mark.
- Deficit ceilings will be automatically increased if taxpayer money is needed for a banking bailout or if government sales of S&L assets bring in less revenue than expected.
- Deficit ceilings can be increased for *any* reason provided the President and Congress agree that there is an "emergency" need to do so.

During the negotiations, much was heard about "painful spending cuts." Yet far from budget restraint, federal spending over the next five years will soar.

- The bill provides for double-digit spending increases averaging about 13 percent per year.
- To the degree that there is any spending restraint at all, it will come in 1994 and 1995 — far enough into the future to be avoided by a new Congress or a new President.

The major reason given for the budget agreement was the health of the U.S. economy. Yet far from creating beneficial effects for the economy, the new taxes imposed will dampen economic activity — roughly doubling the negative effects of a mild recession.

- While the recession will cost the economy about $254.6 billion in lost output, the negative impact of new taxes will cost $242.6 billion in lower GNP.
- While a recession will increase the federal deficit by $75.5 billion (excluding additional interest on the debt), the negative impact of new taxes will increase the deficit by $71.9 billion.
- The combined effects of a recession and new taxes will cause a $597 billion loss in GNP — about $2,000 for every man, woman and child in the country.

Five More Years of Deficits

"The new budget agreement increases federal borrowing by $546.5 billion over the next five years."

After negotiations between the Bush Administration and congressional leaders, Congress passed the Omnibus Budget Reconciliation Act of 1990. Although advertised as a deficit reduction measure, it features $147 billion in new taxes and $18.6 billion in new "user fees" over the next five years, double-digit increases in spending over the next three years and bigger deficits for at least five more years.

Had Congress and the President failed to reach an agreement, spending would have been automatically constrained, producing deficits of $64 billion in 1991, $28 billion in 1992 and zero thereafter. The new agreement, however, sanctions $546.5 billion in new federal borrowing through 1995. Moreover, because of "loopholes" in the agreement, actual federal deficits will be much larger.

- An additional $100 billion in deficits will result from the current recession, and the total will be much higher if the recession turns out to be severe.

- The bill's negative effects on the economy will produce additional deficits of $80 billion.

"Actual borrowing will increase by at least $804.5 billion, however."

- Operation Desert Shield will add about $77.5 billion.

- Over the next five years, federal spending and the deficit are on virtual automatic pilot in a steady climb, increasing federal borrowing by at least $804.5 billion by 1995.

FIGURE I

Cumulative Deficit Ceilings

($ Billions)

"The official forecasts underestimate actual deficits by at least $258 billion."

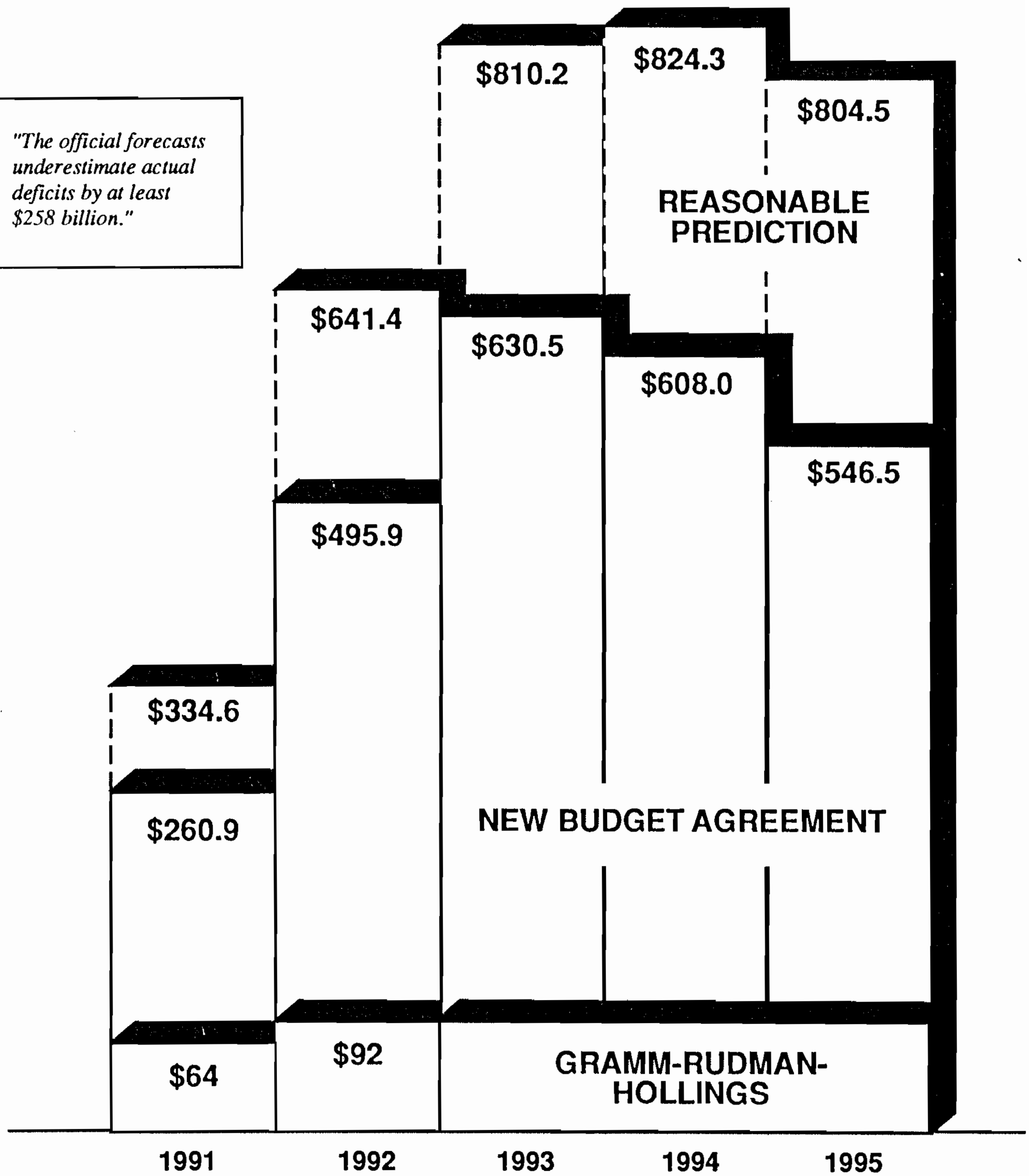
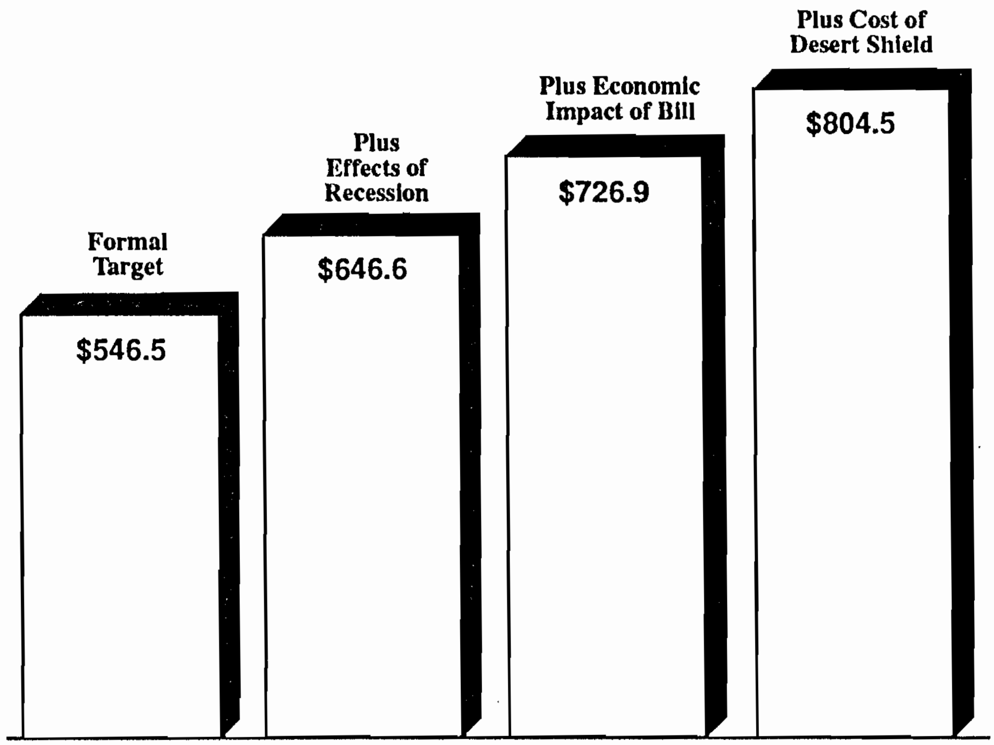


FIGURE II

Addition to the Cumulative Deficit Above and Beyond Official Forecasts 1991-1995



"The official deficit target does not include the effects of a recession, the negative economic impact of new taxes or the cost of Desert Shield."

Record Deficits Despite "Deficit Reduction"

The budget agreement was supposed to help cure the high deficits of the Reagan years. As Figures III and IV illustrate, however, it will have the opposite effect.

- Total real borrowing during the four-year Bush term will be considerably higher than that during the Carter or Reagan administrations.[1]

"Projected borrowing will be higher than at any time since World War II."

- In fact, real borrowing will be higher than at any time since the end of World War II.
- The trend of shrinking deficits which began as the U.S. economy recovered from the 1981-1982 recession will be reversed.

"Gramm-Rudman deficit targets have been tossed aside."

TABLE 1

Evolution of Deficit Ceilings

($ billions)

Fiscal Year	Gramm-Rudman 1985	Gramm-Rudman 1987	Budget Agreement 1991	NCPA Forecast 1991
1986	$171.9			
1987	144.0			
1988	108.0	$144.0		
1989	72.0	136.0		
1990	36.0	100.0		
1991	0.0	64.0	$260.9	$334.6
1992		28.0	235.0	306.8
1993		0.0	134.6	168.8
1994			-22.5	14.0
1995			-61.5	- 19.8
Total			546.5	804.5

[1]Social Security surpluses are included in the deficit ceiling calculations for the purpose of comparison with prior years. The 1990 bill officially removes the Social Security surplus from the deficit ceiling calculation.

The Rising Deficit Ceiling. Table 1 shows the ever-increasing level of deficit forgiveness on the part of Congress and the President since passage of the Gramm-Rudman-Hollings bill in 1985. Instead of a balanced budget in 1991, as called for by the original act, the recent deficit reduction bill accepts a 1991 deficit of $260.9 billion (including the Social Security surplus). When the effects of the recession, the negative economic impact of new taxes and the cost of Operation Desert Shield are added, the 1991 deficit will actually total about $334.6 billion by year end.

"The deficit for 1991 will be about $334.6 billion — the largest deficit in U.S. history."

Increased Spending Limits. As Table 2 shows, the budget agreement permits generous deficit spending increases during the first three years. Note: These are spending increases above and beyond the projected increases in federal revenues. So-called painful cuts occur only in years four and five — far enough into the future to give Congress plenty of opportunities to avoid them.

"The agreement allows double-digit deficit spending increases for the next three years."

TABLE 2

Increases in Deficit Spending[1]

Fiscal Year	Formal Increase[1]	Predicted Increase[2]
1991	9.9%	15.3%
1992	11.9%	17.1%
1993	10.1%	12.6%
1994	1.4%	4.2%
1995	-3.0%	0.0%
Average	6.1%	9.8%

[1]Net of RTC spending for the "S&L bailout."
[2]Includes the recession, economic effects of the bill and Desert Shield.

Why Were New Taxes Needed?

Far from reducing the deficit, the $166 billion in new taxes and user fees will finance higher spending and tax breaks for special interests.

Special Tax Breaks. Warren Brookes has reported that the new legislation provides for at least $27.4 billion in new tax subsidies for special interests, thus undermining the spirit of tax reform.[2]

"The bill calls for $27.4 billion in special-interest tax breaks."

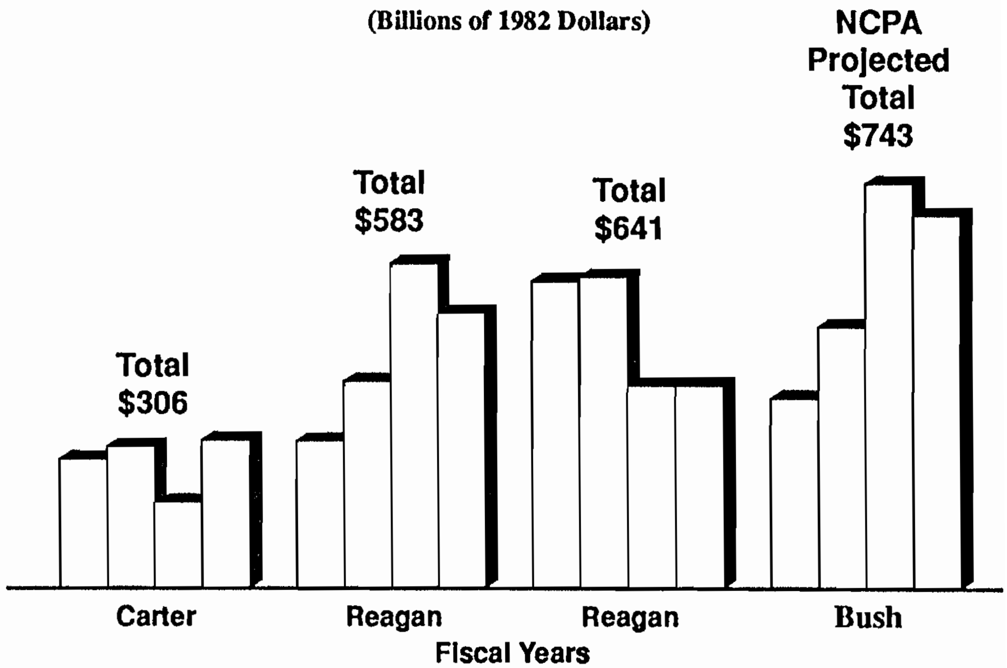
- $2 billion worth of new research-and-development credits scheduled to expire this year have been extended.
- $2.1 billion in housing credits and mortgage revenue bonds have been restored to the housing developer lobby.
- $2.5 billion in new energy incentives for oil and gas drilling and ethanol research have been extended to the oil and gas people.
- $1.6 billion in new small business tax breaks have been allowed as a gift to small business PACs.
- $5.3 billion in new child health insurance credits have been added.
- $13 billion in expanded Earned Income Tax Credits and a special deduction for children under age one are supposed to compensate parents unable to use the new federally funded day-care centers.

These graphs compare administrations in constant 1982 dollars.

FIGURE III

Federal Deficits

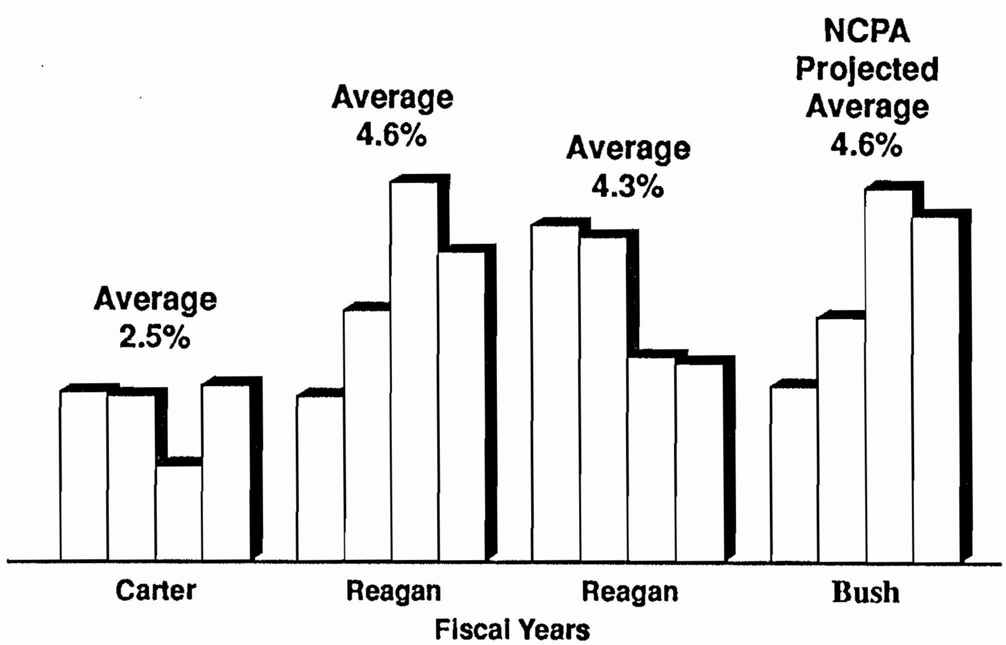
(Billions of 1982 Dollars)



The graphs show total federal borrowing and ignore the artificial separation between on-budget and off-budget items.

FIGURE IV

Federal Deficits as a Percent of GNP



"New spending includes $500,000 for a Lawrence Welk museum and $5 million for new parliament buildings in the Solomon Islands."

New Spending. In the strange language of budget negotiations, a "spending cut" is not actually a reduction in spending. Instead, it is a lower level of spending than the projected trend of past spending increases. Actual spending under the budget agreement will be higher than ever. New spending will include $500,000 for a Lawrence Welk Museum in Strasburg, North Dakota, and $5 million for new parliament buildings in the Solomon Islands. The first year's cost of the new child care program will be $3 billion. In addition, Scott Hodge of the Heritage Foundation observes that 1991 spending increases will include the following:[3]

- Agriculture, rural development and related agencies, up $7 billion.
- Energy and water development, up $1.7 billion.
- Labor, health and human services, education and related agencies, up $17 billion.
- Transportation and related agencies, up $2.8 billion.
- Treasury, U. S. Postal Service, president's office, certain independent agencies, up $2.5 billion.
- Veterans affairs, housing and urban development and related agencies, up $11.7 billion.

The "Trade-off." Voters were told that in return for tax increases, there would be reductions in spending. In fact, the opposite will occur. In return for new taxes, voters will get even more new spending.

"Deficit spending will increase $6.65 for every $1 of new taxes and user fees."

- Under the formal agreement, we can expect $454.4 billion in new deficits in return for $165.6 billion in new revenue — about $2.74 of new deficit spending for each $1 of new taxes.[3A]
- Based on a more realistic forecast, there will be $712.5 billion in new deficits and $107.2 billion in new revenue[3B] — about $6.65 of new deficit spending for each $1 of actual new taxes and user fees collected.

Why the Goals of the Agreement Will Not Be Met

The goals of the budget agreement will not be met because: 1) new taxes in the bill will have a depressing effect on the economy, causing revenues to be lower than projected, 2) official forecasts ignored the fact that a mild recession was inevitable and 3) official forecasts ignored the costs of Desert Shield.

Economic Effects of the Bill. The bill will depress the economy because of higher taxes and the way in which they are imposed.[4] In addition to payroll and excise tax hikes, the bill increases personal income taxes by:

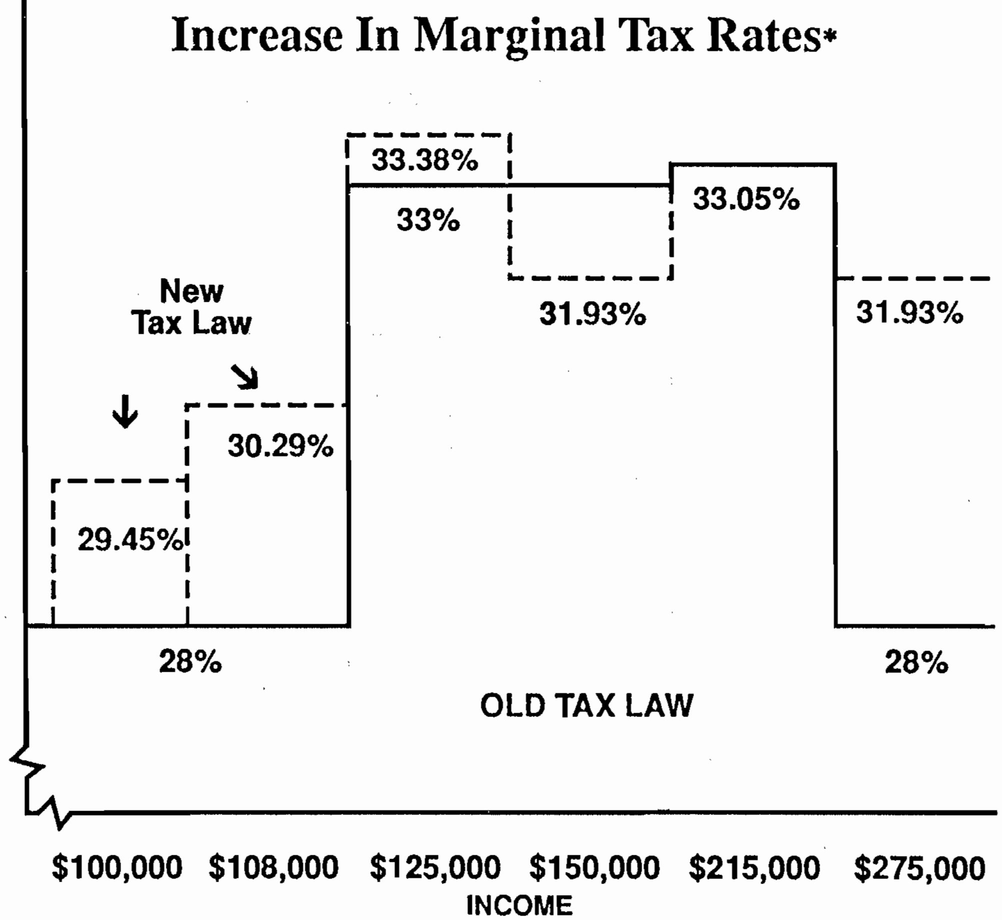
"The conferees ignored the damaging effects of higher marginal tax rates."

- Raising the income tax rate on the highest income earners from 28 percent to 31 percent — a 4 percentage point increase in the marginal tax rate;
- Disallowing $300 in deductions for every $10,000 in income above $100,000 (thereby increasing the marginal tax rate by almost 1 percentage point); and
- Phasing out personal exemptions for couples with an income above $150,000 and for individuals with an income above $100,000 (thereby increasing marginal tax rates by 1/2 percent per exemption).

"The federal government will actually collect only 6 percent of the predicted increase in income tax revenues."

By assuming no economic impact of these tax measures, government static forecasts predict these personal income tax measures will raise $40.2 billion in revenue over the next five years. Because higher income taxpayers derive a larger share of their earnings from capital, raising income tax rates will actually discourage saving and capital formation. Taking into account the economic effects of all the changes, the income tax revenues will actually be only $2.5 billion above what they would have been absent the bill. Lost economic growth will lead to an overall $37.7 billion loss in personal income tax revenue or 94 percent of the revenue goal for new personal income taxes.

FIGURE V



*Tax rates on a one-earner joint return with no children and deductions equal to 20 percent of income. Includes the new extension of the Medicare payroll tax.

"The 'bubble' has been replaced with two bubbles — producing a camel-like appearance."

The Effects of Recession. The economic harm caused by the bill will come on top of the recession which is currently just beginning. Assuming a modest downturn, the economic effects of the bill will dampen the economy's output and widen the government deficit by as much as the recession will.[5]

"New taxes will depress the economy, leading to 512 thousand fewer jobs by 1995."

Table 3 shows the loss of jobs due to the recession and the negative economic impact of the bill. Defense cuts will exacerbate the normal recession pattern. Overall, more than 1.5 million jobs will be temporarily lost as the economy adjusts and displaced defense workers are absorbed into the private sector. Even after the economy recovers from recession, however, the deficit reduction package will result in 512,000 fewer jobs by 1995.

Table 4 compares the effects of the recession alone with the economic effects of the bill.

"The recession and the bill will cost $2,000 for every man, woman and child in the country."

- The recession will result in a GNP loss of nearly $255 billion over the next three years.

- This translates into a loss of more than $1,000 in goods and services for every man, woman and child in the U.S., or $4,000 for a family of four.

- The new taxes in the bill will lead to an additional $243 billion loss in GNP, further reducing living standards but over a longer period of time.

- The combined loss from the recession and the bill will be about $2,000 per person.

Table 5 shows the combined losses in GNP and federal revenues over the next five years. Even with the modest recession assumed in this study, the federal government will be $150 billion short of its deficit reduction target. Interest payments on the additional debt will add another $33 billion.

"A reasonable prediction: Desert Shield will add another $77.5 billion to the projected deficit."

Effects of Desert Shield. The bill allows the President to exempt certain military activities from the new budget rules. President Bush has invoked this privilege for Operation Desert Shield.[6] Original estimates that the operation would cost about $1 billion per month have already increased to a total of $30 billion for fiscal 1991.[7] A shooting war or long-term U.S. troop occupation will cost even more.[8]

"Almost 2 million jobs will be lost by 1992."

TABLE 3

Job Losses

(in thousands)

Fiscal Year	Due to Recession	Due to Bill	Combined
1991	1,536	126	1,662
1992	1,615	324	1,939
1993	97	381	477
1994	0	467	467
1995	0	512	512

"The economic impact of the agreement will double the negative effects of a mild recession."

TABLE 4

Loss of GNP and Increase in the Deficit

($ billions)

	Recession		Effect of Bill	
Fiscal Year	GNP Loss	Deficit Increase*	GNP Loss	Deficit Increase*
1991	$117.2	$34.7	$9.6	$5.5
1992	126.3	37.5	25.4	10.6
1993	11.1	3.3	43.8	14.3
1994	0.0	0.0	68.9	19.0
1995	0.0	0.0	94.9	22.5
TOTAL	$254.6	$75.5	$242.6	$71.9

*The estimated amount by which the official static estimates will understate the actual deficit due to predictable consequences of lower growth resulting from the recession and economic behavioral adjustments to the bill itself.

"The economic damage created by the agreement will be almost twice as large as the new taxes people will have to pay."

TABLE 5

Combined Effects of Recession and The Economic Impact of the Bill

($ billions)

Fiscal Year	Increased Deficit	Increased Borrowing Costs	Total Addition to Deficit
1991	$40.2	$2.0	$42.2
1992	48.1	5.4	53.4
1993	17.6	7.5	25.1
1994	19.0	8.4	27.4
1995	22.5	9.8	32.3
TOTAL	$147.4	$33.0	$180.5

How Will Government React to the Shortfalls?

When the actual deficits turn out to be larger than the official projections, one might suppose that Congress and the Bush Administration will be required to do something about it — especially in light of the publicized "enforcement" mechanisms in the act. In fact, neither will be required to do anything. Spending caps and the deficit ceiling will be adjusted through "technical and economic revisions" to the underlying budget forecast. These technical revisions can camouflage myriad problems.[9]

"The deficit will rise automatically through 'technical' adjustments."

- If inflation turns out to be greater than anticipated, the spending limits will be adjusted upward to allow higher spending — an extremely likely event because the official forecast used near-historic low rates of inflation.[10]
- Because "mandatory" spending has no imposed limit, it can grow to whatever limit is necessary to fulfill currently promised benefits.[11]
- The deficit ceiling will be automatically increased to incorporate the revenue losses attributable to the recession.
- Funding for Desert Shield will require a "technical increase" in the ceilings.
- Economic effects of the bill itself will also require an economic revision — the government's forecasting agencies will never concede that economic output was reduced by the bill's economic effects but will treat it as an unrelated event.

Spending Limits

Budget resolutions enacted for fiscal years 1992 through 1995 will be subject to: (1) spending limits, (2) pay-as-you-go limits and (3) deficit targets.[12] Spending programs are divided into the following four categories:

"So-called painful spending cuts do not appear until after the 1992 elections."

- Mandatory spending (with no limits), such as Social Security Retirement and Disability payments and other protected transfer programs; salaries for the federal judiciary system, the President, Congress and other special pay categories; and payments for federal retirement and disability programs.

- Discretionary defense spending, including national defense, civil defense, certain drug interdiction activities and nuclear weapons production.

"No spending limits are applied to congressional salaries."

- Discretionary international spending, including military and general foreign aid, international finance and exchange rate stabilization and most of the State Department's foreign operations.

- Discretionary domestic spending, including most general domestic government programs, with some overhead and administrative expenses imputed back to other relevant categories such as the administrative expenses of operating the Social Security system.

The limits are shown in Table 6. Limits in the final two years are deliberately not allocated into spending categories and could be dramatically rearranged to reflect congressional preferences at the time. In general, this special treatment of fiscal years 1994 and 1995 is continued throughout the bill, presumably to recognize the possibility of a new administration or a dramatic shift of political power as a result of the 1992 elections. The 1994 Budget will be the first to reflect completely the political changes resulting from the election.

"Spending limits can be easily increased if the President and Congress agree there is an 'emergency' need."

TABLE 6

Spending Limits

($ billions)

Fiscal Year	Mandatory	Defense	International	Domestic	Total Discretionary
1991	None	$297.7	$18.6	$198.1	$514.4
1992	None	295.7	19.1	210.1	524.9
1993	None	292.7	19.6	221.7	534.0
1994[1]	None				534.8
1995	None				540.8

[1]Excludes "technical adjustments" and exempt categories described above. Limits for 1994 and 1995 are specifically not allocated to separate categories.

"The agreement calls for higher taxes now, spending cuts later."

Enforcement of the spending limits is to be accomplished through a sequester mechanism similar to Gramm-Rudman law.[13] As under previous law, the President is allowed to enforce the spending limits after having made appropriate "economic and technical adjustments." Only new legislation can cause a sequester, however. If the growth in existing programs increases the deficit, this increase will be permitted under the revision process. As a result, existing programs are virtually unbounded through 1993.

New Legislation: Pay-As-You-Go Limits

Under the bill, any new legislation must be "deficit neutral." That is, any deficit-increasing proposal must be coupled with an offsetting, deficit-reducing proposal. This constraint pertains to both mandatory and discretionary categories and prevents the expansion of mandatory programs by adding new provisions. The impact of new legislation is calculated by adding the "pluses and minuses" to assure that no net costs are added. A specific legislative breach of this requirement will trigger a sequester.

"If Congress raises its salaries, the President must cut other spending to pay for the increase."

How Sequester Works. The cuts ordered are not solely against the new program, however. Rather, cuts are placed against the discretionary spending categories. Thus, this mechanism can result in an expansion of mandatory spending programs at the expense of discretionary spending. For example, suppose that Congress authorizes a congressional pay raise with no offsetting increase in taxes or reduction in spending. Congress would keep its salary increase, and the President would have to order across-the-board reductions in discretionary spending to pay for it.

Static Forecasting Techniques Required. How do we determine whether a piece of legislation is revenue neutral? All spending and revenue provisions will be assumed to have no behavioral effects. This static forecasting assumption is actually required by the bill. Any increase in the deficit which occurs because programs do not hit their targets will be assumed to be the result of extraneous influences, and the errors will become part of automatic deficit ceiling adjustments.

"Static forecasting techniques guarantee that future deficits will be underestimated."

For instance, a new tax, estimated to raise $100 billion on a static basis but causing economic activity to contract so that total federal revenue increases by only $80 billion, will be credited with raising the full $100 billion. The lost $20 billion will later be added to the deficit as an "economic revision." Suppose the tax is designed to fund a $100 billion spending program which will actually cost $120 billion because of the public's dynamic response. The program will be credited with only $100 billion in new spending. Thus, these two tax and spending measures combined will be permitted to add $40 billion per year to the annual federal deficit, indefinitely into the future.[14]

"The Bush Administration and Congress are already fighting over who gets to 'keep score.'"

The Conflict Over Official Scorekeeping. Who determines whether a piece of legislation is revenue neutral? Under the agreement, the official "scorekeeping" task has been transferred to the Office of Management and Budget (OMB), headed by the Bush Administration's chief negotiator, Richard Darman. Previously, that task was under the control of Congressional Democrats through the Joint Committee on Taxation. Already disputes are arising, however, on what constitutes a "technical adjustment." Congressional Democrats are signalling that if the OMB does not give way to the congressional penchant for higher spending, Congress will simply ignore the OMB and usurp the scorekeeping function for itself.

Other Exceptions to the Ceilings

The requirement of sequester can be bypassed if the President and Congress agree that the new legislation is based on an "emergency." In other words, the President can propose an emergency program outside the budget ceilings which can be enacted without triggering the enforcement provisions if the Congress also approves the program. S&L bailout costs are specifically prohibited from triggering a sequester under the pay-as-you-go provisions.

"Spending restraints are automatically suspended if we enter a recession."

A bailout of the nation's banking system, for example, could be required if the current recession turns out to be severe. The staff of the House Banking Committee estimates that insurance fund losses could be as high as $63 billion over the next three years. Additional spending to respond to a banking crisis would surely be treated as an emergency not subject to the spending limits.[15]

Congress can pass new spending programs above the ceilings if a "super-majority" of 60 percent of the members of the Senate vote to consider and pass the program. The President can veto the new program, but the mere fact of the extraordinary congressional support would make an override of the veto very likely.

"With the current economic downturn, the enforcement provisions will be suspended before they become effective."

The bill also provides that the sequester process can be halted in the case of a recession — technically defined as two successive quarters of actual zero or negative real economic growth measured by the Commerce Department or a forecast by OMB or CBO of two quarters of less than 1 percent growth. There is little doubt that this condition will soon be met. Under these circumstances, the Speaker of the House is required to offer a resolution to "shut down" the effects of the bill. Given the supposed need for immediate action argued by the bill's proponents, it is especially ironic that the spending constraints in the bill could be suspended before it even becomes effective. The tax increases, however, are permanent.

A $14.9 billion cut in farm supports is also subject to an exception. The bill requires that agricultural subsidies be restored if the U.S. fails to ratify the current General Agreement on Tariffs and Trade (GATT) trade negotiations.[16] We have not included this potential deficit increase despite the apparent failure of current trade talks.

The Bottom Line

Even if Congress and the administration stick to the agreement, the likely impact of the deficit reduction bill is as follows:

- Despite much rhetoric to the contrary, the bill permits the federal deficit to increase by $546.5 billion over the next five years — a $454.5 billion increase over the previous (Gramm-Rudman-Hollings) law.
- A relatively moderate recession will increase that amount by $100 billion.
- The negative economic effects of the bill itself will add another $80.4 billion to the five-year deficit.
- Taking into account current estimates of Operation Desert Shield without hostilities, the deficit will increase another $77.5 billion.
- As a result, the federal government will need to raise an additional $805 billion in private credit markets over the next five years.

"The agreement raises the debt limit — allowing $1 trillion in new borrowing over the next five years."

- This is in addition to $519 billion in borrowing from the Social Security trust funds.

- Other unforeseen adjustments such as a major banking bailout, a loss of agriculture subsidy cutbacks or other technical revisions will push deficit borrowing from the public toward the $1 trillion mark.

- Fortuitously, the deficit reduction bill provided for this possibility by increasing the debt limit by $1 trillion.[17]

If the only problem with the new budget bill were its inability to reduce the deficit as promised, it would be merely another in a long line of faulty deficit agreements between the Congress and the President.[18] The most recent bill does much more damage, however. While claiming to reduce the pressure of federal borrowing on credit markets, the bill will actually accelerate the ballooning national debt.

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NOTE: Nothing written here should be construed as necessarily reflecting the views of the National Center for Policy Analysis or as an attempt to aid or hinder the passage of any bill before Congress.

Footnotes

[1]Borrowing is defined as the general fund deficit less the Social Security trust fund surpluses. It therefore measures the amount the federal government must raise in private credit markets.

[2]Warren Brookes, "Budget Tricks and Treats," *Washington Times*, Oct. 31, 1990.

[3]Scott A. Hodge, "Your New Taxes Working for You," Backgrounder No. 795, The Heritage Foundation, Nov. 2, 1990.

[3A]The total deficit is $546.5 billion, but $92 billion was already permitted by Gramm-Rudman-Hollings.

[3B]This equals $165.6 billion in the official forecast minus $58.4 billion because of lower growth brought about by the legislation and the effects of the recession.

[4]See Gary and Aldona Robbins, "Will the New Budget Package Create A Recession?," NCPA Policy Backgrounder No. 108, October 16, 1990.

[5]We limited the contraction to one-half the depth and to a slightly shorter duration than the 1982 recession. Specifically, the 1982 contraction dropped to 6 percent below the trend growth line at its trough and lasted from the second quarter of 1981 to the first quarter of 1983, or 6 quarters. We limited the estimated recession to 5 quarters, peak to trough, beginning the third quarter of 1990 and ending by leveling off in the last quarter of 1991. GNP reaches a maximum loss of 3 percent relative to the baseline growth.

[6]"The funds for Operation Desert Shield are to be treated as emergency funding requirements not subject to the defense spending limits." Omnibus Budget Reconciliation Act of 1990, Sec. 251 (b)(2)(D)(ii).

[7]Contributions by U.S. allies have yielded only $4 billion so far.

[8]A conservative estimate of the costs of Desert Shield assumes no shooting war and a gradual troop withdrawal to one-sixth current levels. The estimated costs used are $30 billion for this fiscal year, followed by $15 billion for 1992, and $5 billion per year thereafter. If a war does occur, current estimates place the cost at $2 billion a day.

[9]The first budget "crisis" of the new process will occur due to one of these technical adjustments. Apparently as the Congress was adding new spending to Fiscal Year 1991, the baseline spending levels for 1992 were not adjusted appropriately to include the new spending. As a result, OMB has informed executive agencies that they will have to absorb the shortfall. Congressional budget staffs have already indicated that they consider this to be an oversight requiring an "automatic" adjustment. The staff comments in the Conference Report on the bill notes that the members of the House and Senate conferees:

> "...are concerned that the Office of Management and Budget has not always shown complete objectivity in its estimates. The conferees urge the Congress to scrutinize the scorekeeping of the Office of Management and Budget as that Office implements the procedures under this conference agreement. The conferees considered procedures under which Congress would enact into law Congressional Budget Office cost estimates as part of any spending legislation. Should the Office of Management and Budget abuse its scorekeeping power, the conferees believe that the Congress should adopt such procedures at that time."

[10]The estimates assume inflation rates of 3.2 percent for 1993, 3 percent for 1994 and 2.8 percent for 1995. In the 39 years since 1950, inflation has been less than 2.8 percent only 13 times, less than 3 percent only 14 times, and less than 3.2 percent only 16 times.

[11]This is a continuation of Gramm-Rudman-Hollings practice.

[12]The bill specifies: "... Enforcement, as necessary, is to be implemented through sequestration (1) to enforce discretionary spending levels assumed in that resolution (with adjustments as provided ...); (2) to enforce the requirement that any legislation increasing direct spending or decreasing revenues be on a pay-as-you-go basis; and (3) to enforce the deficit targets specifically set forth in the Congressional Budget and Impoundment Control Act of 1974 (with adjustments as provided ...); applied in the order set forth above."

[13]This is a continuation of Gramm-Rudman-Hollings practice.

[14]For instance, the Congressional Budget Office (CBO) technical revisions added 50 percent to the CBO's original cost estimates of the short-lived Medicare Catastrophic Coverage Act within the first six months of enactment. The primary reason for the cost

Footnotes (continued)

overrun was the failure of estimators to forecast the rapid expansion in use of the law's new benefits.

[15]John M. Berry, "FDIC Chief Warns of Low Fund Reserve," *Washington Post*, December 17, 1990, p. A1.

[16]Omnibus Budget Reconciliation Act of 1990, Sec. 1302 (a).

[17]Under the Omnibus Budget Reconciliation Act of 1990, Sec. 11901: "Subsection (b) of section 3101 of title 31, United States Code, is amended by striking the dollar limitation contained in such subsection and inserting '$4,145,000,000,000'." The permanent limit public limit under previous law was $3,122.7 billion. A temporary limit through October 24, 1990 of $3,195 billion was passed as part of the Continuing Resolutions needed to fund the government during the budget debate.

[18]Each of the five previous summit agreements led to an increase, not a decrease, in the federal deficit. See Merski, Paul G., "A Decade of Budget Summitry," *Tax Foundation Issue Brief*, Washington, DC, June 1990.

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