MAPI Policy Review

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THE OMNIBUS BUDGET RECONCILIATION ACT OF 1993:

WILL IT REDUCE THE DEFICIT?

MAPI's 60th YEAR

. . . of Contribution to U.S. Economic Progress

The Omnibus Budget Reconciliation Act of 1993: Will It Reduce the Deficit?

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Initial distribution of ***The Omnibus Budget Reconciliation Act of 1993: Will It Reduce the Deficit?*** (PR-125) is being made to presidents, economists, and public affairs officials of MAPI member companies and to members of MAPI's Board of Trustees and to Financial Councils I, II, and III and the Strategic Planning and Development Council.

The Omnibus Budget Reconciliation Act of 1993: Will It Reduce the Deficit?

Budget Reconciliation Act Contains Large Tax Increases, Mostly "Phoney" Expenditure Cuts, and Is Unlikely To Reduce Budget Deficit

Introduction

On August 10, 1993, President Clinton signed into law the Omnibus Budget Reconciliation Act of 1993 (OBRA), P.L. 103-66. From the moment President Clinton outlined his proposal for the 1994 fiscal year (FY) budget in his speech to the Congress on February 17, OBRA became ***the*** major legislative priority of his Administration, temporarily displacing other initiatives, including health reform. Its final passage marks a major success for the Administration and the Democratic leadership in the Congress.[1] Over the longer run, however, OBRA is unlikely to make a major contribution to the dual goals of deficit reduction and economic recovery.

Rather than providing a comprehensive, long-run solution to the deficit, OBRA is merely the latest in a series of attempts by the Congress and the executive branch to control the federal budget deficit through tax increases and marginal spending cuts. It does not place the deficit on a sustainable downward course because it avoids dealing with the structural forces that drive the deficit.[2] More than previous budget agreements, OBRA relies heavily on tax increases to achieve its deficit reduction targets. On the outlay side, OBRA makes only marginal changes in spending programs, leaving their basic structure intact. Total government spending will still increase in each of the next five years. Even if its revenue and spending predictions prove accurate, OBRA will only cut the deficit to just over $200 billion in 1997 before it begins to rise again (Chart 1). In recent times, however, even the most accurate forecasts have consistently underestimated structural deficits. The salient point for the business community is that the deficit will remain a huge problem and that, in order to deal with it, the Administration is almost certain to recommend additional taxes in future years.

The Omnibus Budget Reconciliation Act of 1993

Table 1 shows the major categories of deficit reduction over the next five years. OBRA raises total revenues by $241 billion. Mandatory programs are reduced by an estimated $99 billion, with most of the cuts coming in the government's Medicare and Medicaid programs. In addition, OBRA contains provisions to freeze discretionary programs at FY 1993 levels, saving another $102 billion according to the Administration's estimates. Finally, if these revenues and spending cuts are made, another $54 billion in savings is expected from lower interest payments on the federal debt.

Table 1

Omnibus Budget Reconciliation Act of 1993

(Selected Major Categories of Deficit Reduction)

(Billions of Dollars)

	1994	1995	1996	1997	1998	Total
Revenues	29	44	48	61	59	241
Mandatory Cuts	11	12	21	25	30	99
Discretionary Cuts	9	15	17	25	36	102
Interest Savings	1	4	9	16	24	54
Total	50	75	95	127	149	496

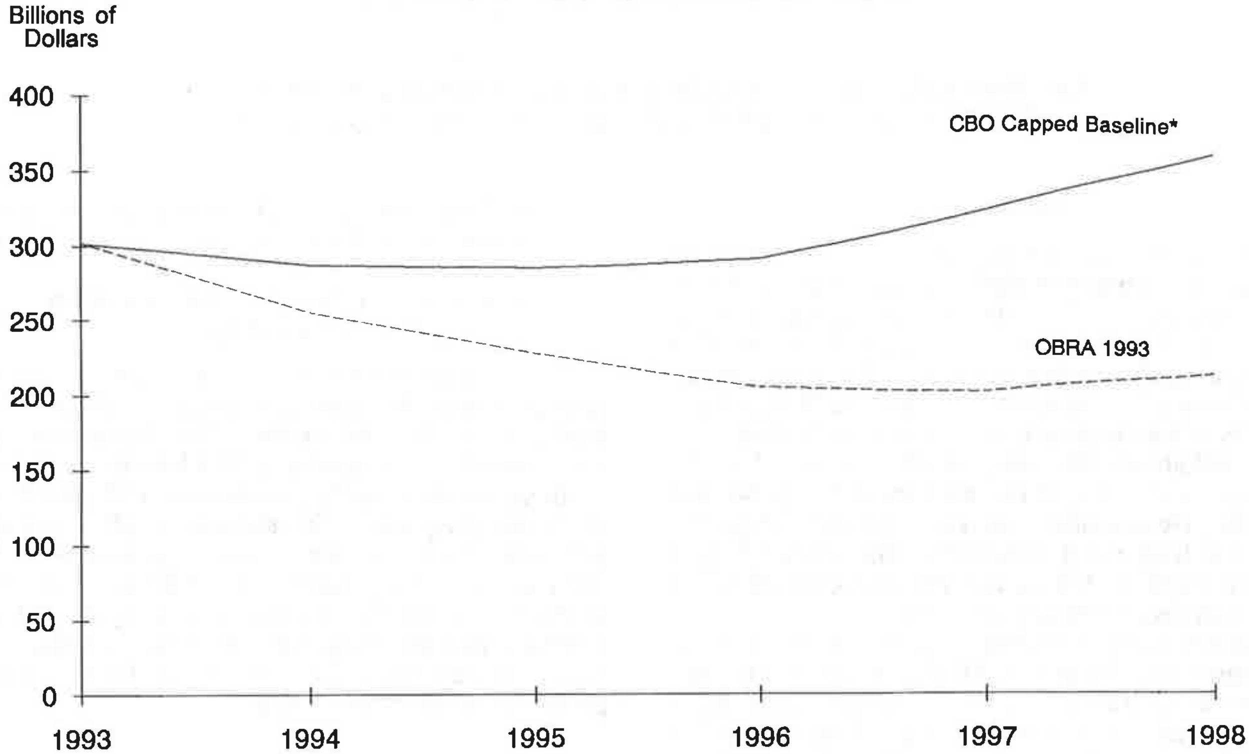
Source: Congressional Budget Office; Senate Budget Committee.

There has been a vigorous debate over how to measure the ratio of tax increases to spending cuts contained in OBRA. Its supporters argue that it contains a 1-1 ratio. If one excludes interest savings and the double counting of discretionary savings required by the 1990 budget agreement, the ratio is substantially less. Whatever method is used, the balance in the first two years is heavily weighted in favor of taxes. Table 1 shows that of the total savings in both discretionary and mandatory spending programs, over 51 percent is delayed until 1997 and 1998, after the Administration's term has ended. In contrast, 30 percent of the tax revenue is received in the first two years.

[1]For previous MAPI analyses of the Clinton economic package, see ER-258 and ER-265.

[2]The structural or standardized employment deficit is the deficit that would exist if the economy were performing at its full potential. It removes the effect that cyclical economic behavior has on the annual deficit. Certain fundamental forces, such as legislation, public attempts to qualify for government programs, and the degree to which people avoid taxes, play a large role in determining the size of the structural deficit.

Chart 1
Annual Deficit Projections Under OBRA



* The capped baseline assumes that no changes are made to tax law or to mandatory spending programs. It also assumes that total discretionary spending is held to the levels required by the 1990 budget agreement in 1994 and 1995 and increases with the rate of inflation in later years.

Source: Congressional Budget Office; Senate Budget Committee.

Discretionary Spending

Discretionary programs are those programs that require annual congressional appropriations. Unless the Congress specifically appropriates money in advance, no spending occurs. Several points are important regarding OBRA's approach to these programs.

Freezing spending.—OBRA promises to freeze total discretionary spending for five years. This is expected to result in $102 billion less spending than if these programs were to increase according to the Administration's baseline. The act does not specify which particular programs will be cut, however. Since the Administration also wants to increase spending for some domestic discretionary spending, some programs will have to be reduced, not just frozen. Tough decisions remain about where to cut.

Double counting.—In claiming savings of $102 billion, OBRA takes credit for $44 billion in savings that were originally promised as part of the 1990 budget agreement. The Congress and the President are already required to hold total discretionary spending to $36 billion below the spending assumptions used by the Administration. When indirect interest savings are added to this amount, a total of $44 billion in savings is already required under existing law. The ***incremental*** savings beyond existing law from the budget agreement are only $66 billion. In the first two years, all of the savings in discretionary programs claimed by the Administration are already required by the 1990 budget agreement (Table 2).

Emergency provisions.—The act also retains provisions allowing the Congress and the President to undo the spending ceilings if they declare certain spending to be an emergency. The Congress has recently approved $5.7 billion under this emergency exception to aid flood victims in the Midwest. Some Senators have suggested that the aid package will ultimately be as high as $10 billion. Since the Congress does not have to pay for this spending with cuts in other discretionary programs, it adds directly to the deficit. As Table 2 shows, a package of this size would erase all of the discretionary savings for the first three years. This escape valve for higher spending is likely to be used in future years.

Table 2

Discretionary Savings in OBRA
(Billions of Dollars)

	1994	1995	1996	1997	1998	Total
Administration Baseline	548	556	564	572	584	
Baseline Under 1990 Agreement	539	540	555	569	585	
Savings From 1990 Agreement	9	16	9	3	-2	36
Baseline Under 1990 Agreement						
Defense (Bush Recommendation)	275	268	276	283	291	
Nondefense	264	272	279	286	294	
Total	539	540	555	569	585	
OBRA 1990						
Defense (1993 Budget Resolution)	279	273	266	250	253	
Nondefense	260	268	281	297	295	
Total	539	541	547	547	548	
OBRA 1993 Savings						
Defense	-4	-5	10	33	38	72
Nondefense	4	4	-2	-11	-1	-6
Total	0	-1	8	22	37	66
Savings Claimed by Administration						102

Source: Congressional Budget Office; Senate Budget Committee.

Domestic vs. defense.—The cap on ***total*** discretionary spending covers both domestic and defense expenditures. Defense projections contained in the President's original submission to the Congress account for over 100 percent of the reductions in discretionary spending needed to stay within the freeze (Table 2).[3] The Administration can adhere to the caps on discretionary spending only if it achieves its projected savings in defense. Although the Administration has projected substantial reductions early in the budget process, it has not specified where the cuts will come from. This detail is expected to emerge from the bottom-up review of defense requirements which Defense Secretary Les Aspin currently is conducting. In the absence of information on such a review, it is unclear whether the Administration's projected defense budgets will be consistent with its own foreign policy goals. And the Congress is likely to find that the political and economic pain from rapid downsizing is more intense than expected. If these cuts are not made, the savings expected from discretionary programs will not materialize.[4]

User fees.—Much of the other deficit reduction in discretionary programs will result from ***fee increases*** rather than ***spending cuts***. This also is true of $15 billion of the "cuts" in mandatory programs. Increasing the fees for government services may reduce demand for them. Increased fees also reduce the government subsidy implicit in the delivery of free services. Moreover, relying on fee increases to offset government spending does not reduce the government's role in the economy. This approach to deficit reduction also does not address the problem of government preemption of markets that could be served more efficiently by the private sector.

Mandatory Spending Programs

Mandatory spending includes all programs in which spending occurs automatically in the absence of further congressional action. Typically, the Congress enacts eligibility requirements and payment amounts and then lets the programs operate on their own. Although the Congress bases its decision on estimates of the cost of these programs, unlike discretionary programs, actual spending is not limited to annual appropriations. As a result, the Congress is not forced to budget explicitly for their cost. Over the past five years, mandatory programs have accounted for most of the increases in federal spending. This trend is expected to accelerate over the next decade as expenditures on mandated health programs experience double-digit rates of growth.

Significant portion of spending cuts are "phoney."—Although the Clinton budget began with relatively honest numbers, by the time the conference

[3] The defense numbers in Table 2 are somewhat misleading since they show actual outlays rather than budget authority. Outlays in defense programs often lag behind budget authority by several years. Although Table 2 indicates that defense spending will rise during the next two years, the Administration's budget proposed to cut budget authority by $12.2 billion in 1994 and $11.3 billion in 1995 from the levels requested by President Bush. If enacted, these cuts will reduce outlays in later years.

[4] For recent MAPI analyses of the economic effect of defense reductions, see PR-116 and ER-264.

committee finished with it almost all of the spending cuts were questionable in one sense or another. In addition to the $44 billion savings already required by the 1990 agreement, many other savings, especially in agriculture, have already been achieved either through administrative action or appropriations bills. They did not require further action by the Congress. Other provisions, such as improved management of the public debt and the shift to direct student loans, are unlikely to produce anywhere near the savings the Administration claims for them. Over $4 billion in savings comes from correcting a drafting error in the 1990 agreement which mistakenly extended medicaid coverage to personal services. Finally, it should be kept in mind that many of the other cuts are actually reductions in inflation adjustments. While these "cuts" reduce the amount of money the government would otherwise pay out, they are actually reductions in the rate of increased spending rather than absolute cuts.

Almost $25 billion of the changes in mandatory spending are merely extensions of changes that were originally enacted in the 1990 budget agreement, but were scheduled to expire in 1995. This process reflects another way in which congressional budgeting practice is biased in favor of higher taxes. Although the tax increases contained in OBRA are permanent, almost all of the spending cuts will expire in 1998, just after the five-year budget window closes. The next time a budget agreement is enacted, the Congress can claim credit for extending these savings, while balancing them with additional permanent tax increases.

Subsidy programs.—OBRA's approach to mandatory spending can best be described as trimming around the edges. ***It does not eliminate a single major government program***. Even perennial subjects of criticism such as the honey and mohair programs retain their basic shape. Instead, OBRA makes marginal changes in eligibility rules and subsidy amounts. In taking this approach OBRA repeats previous, and unsuccessful, efforts to eliminate the persistent imbalance between government spending and revenues. It does not affect the basic trends causing the imbalance.

Government health care programs.—Most of the cuts in entitlement programs come from medicare ($56 billion in cuts) and medicaid ($7 billion). While many of the changes in these programs may be beneficial, they do not fundamentally alter the government's role in health care markets. (This is not unexpected since the Administration will be putting forward a comprehensive health care proposal later this year.) OBRA does impact health care reform in one significant way, however. Many of the cost savings included in OBRA also have been discussed as ways to pay for the costs of health care reform. The fact that these savings have already been claimed for deficit reduction means that the Administration's health care proposal probably will be forced to rely even more heavily on new taxes to raise the necessary funding.[5]

Spending increases.—OBRA also contains major increases in spending programs. The largest of these is an increase of $21 billion over five years in the earned income tax credit which supplements the income of working families with children. Other increases include $2.5 billion in enhanced eligibility for food stamps, $1 billion in direct grants to inner cities, and $600 million for child immunization.

Revenues

At its heart, OBRA is really a tax bill. Revenues account for almost all of the deficit reduction actually enacted into law. While the cuts in discretionary spending, if adhered to, will change the balance, OBRA is heavily weighted in favor of tax increases in the early years.

A detailed analysis of the tax portion of OBRA will be provided in a forthcoming MAPI publication.[6] Highlights of the major tax provisions follow:

- **Energy Tax**. OBRA increases the federal excise tax on fuel products by 4.3 cents per gallon. This is the level originally enacted by the Senate.
- **Corporate Tax**. The corporate tax is raised to 35 percent for taxable incomes over $10 million. The benefits of the lower 34 percent level are phased out beginning with taxable incomes over $15 million. OBRA eliminates the current deductions for lobbying expenses and executive income over $1 million unless the income is based on performance goals approved by shareholders.
- **Individual Income Taxes**. The act raises the top marginal tax rate to 36 percent, effective January 1, 1993, on individuals with taxable income of over $115,000 and couples with income over $140,000. It imposes a 10 percent surtax on taxable incomes over $250,000. OBRA also eliminates the current wage cap on health insurance premiums. The act reduces the portion of meals and business expenses that can be deducted from 85 percent to 50 percent and eliminates business deductions for club dues and memberships.
- **Social Security**. OBRA increases from 50 percent to 85 percent the portion of social security benefits subject to taxation for individuals earning over $34,000 a year ($44,000 for couples).
- **Investment Incentives**. The act contains the following tax reductions:

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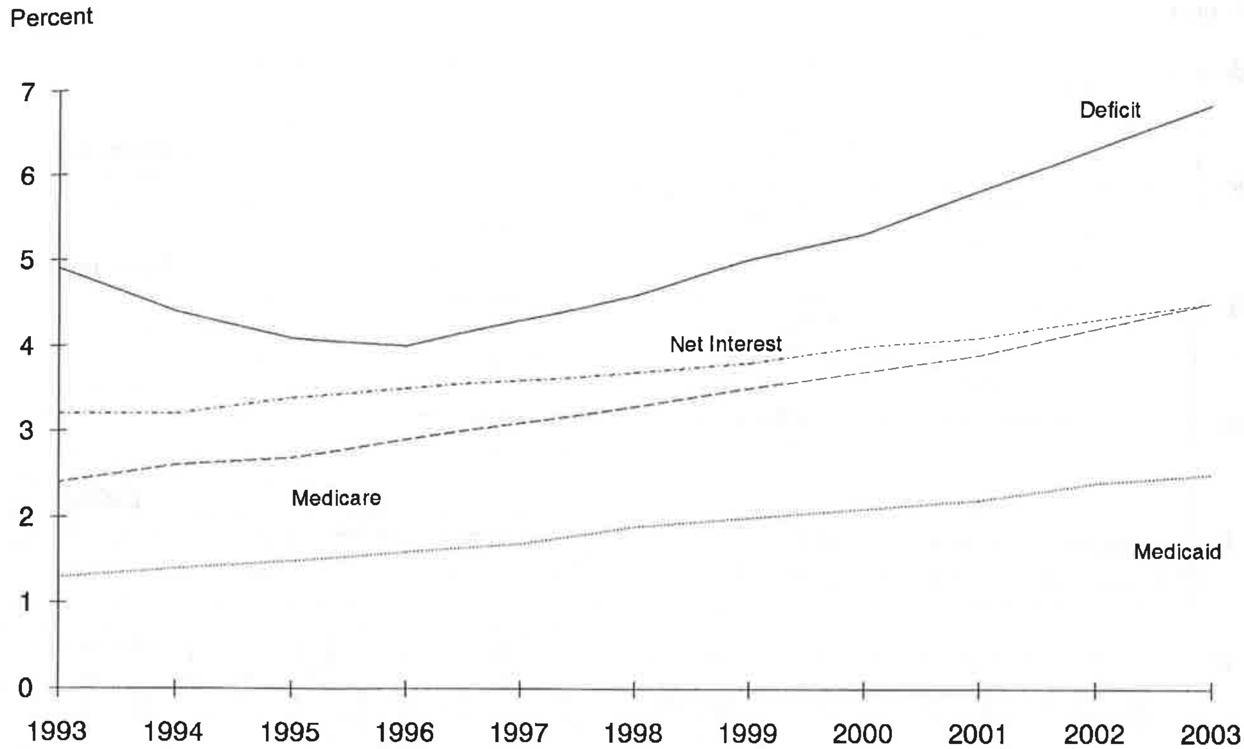
[5]For MAPI analysis previewing health care reform, see PR-123.

[6]For MAPI analyses of the tax provisions contained in the House and Senate bills, see LAR-266 and LAR-270.

Chart 2

Deficit as a Percentage of GDP



Source: Congressional Budget Office, *Economic and Budget Outlook: Fiscal Years 1994-1998.*

— A permanent extension of the low-income housing credit;
— A 50 percent reduction in the capital gains tax for profits on the sale of newly issued stock in a small business if held for over five years;
— $3.5 billion to fund empowerment zones to stimulate investment in inner cities and rural areas; and
— An increase to $17,500 in the annual limit on deductions small businesses can take for equipment purchases.

Analysis of OBRA

Political Strategy and Deficit Reduction

MAPI believes that OBRA is unlikely to succeed in substantially reducing structural deficits over the next five years. Part of this is due to the fact that OBRA repeats a pattern of attempting to manage the deficit problem rather than solving it. Even under its own projections, OBRA will reduce the deficit only to $201 billion in 1997 before it starts to grow again. Another deficit reduction package of at least the size of OBRA will be needed to bring down the deficit. In addition, the government must deal with future increases in federal health care costs. Chart 2 shows that rising costs in medicare and medicaid, together with increased interest payments, are expected to exceed the increases in the deficit. Controlling these increases will be one of the major tasks of the Administration's health care plan to be announced later this year.

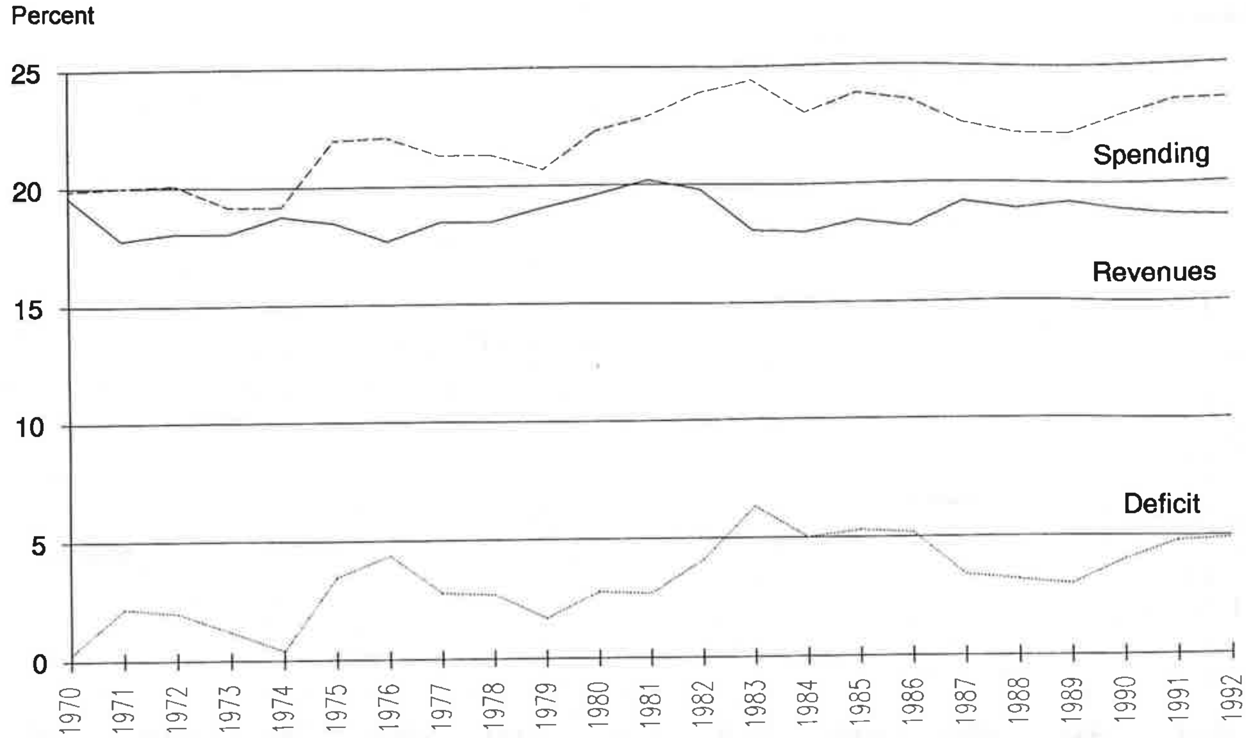
OBRA represents no more than one-third of the effort needed to bring the budget into long-term balance. A sound health care plan which reduces health care cost escalation may represent a second third. Further deficit reduction also will be needed within the next few years. Given the Administration's priorities, it is likely that both these latter bills will involve additional tax increases. Yet even if enacted, these future bills will not solve the deficit unless they fundamentally change the structure of government policies affecting taxes and spending.

The Administration's approach to deficit reduction, as reflected in OBRA, is unlikely to reduce the structural deficit significantly over the medium term. This is because it avoids the difficult task of restructuring government programs to deal with the incentives that are the cause of growing deficits.

Previous attempts.—OBRA marks the sixth time since 1981 that the Congress and the President have

Chart 3

Government Spending and Revenues as a Percentage of GDP



Source: Congressional Budget Office, *Economic and Budget Outlook: Fiscal Years 1994-1998.*

developed an economic package designed to control rising federal deficits.[7] All but one of these previous attempts relied at least in part on large tax increases to bring revenues and spending into balance. Although each plan also enacted spending cuts, the cuts tended to hit at the margins of the federal programs and did not address the structural reasons why spending continues to grow. Chart 3 shows that, in spite of these attempts, since 1970 total revenue has remained relatively constant as a percentage of gross domestic product (GDP), while government spending has increased. The previous budget agreement, the Omnibus Budget Reconciliation Act of 1990 (OBRA 1990), differs most from the current version primarily in the latter's increased emphasis on taxes versus spending cuts. Like the current act, OBRA 1990 claimed to achieve almost $500 billion in deficit reduction, and like its predecessors, it was followed by higher deficits.

[7]The Congress passed major deficit reduction packages in 1981, 1982, 1984, 1987, and 1990.

Obstacles to Deficit Reduction

In theory, balancing the federal budget is not difficult. The need to estimate income and fit expenditures within it defines the economics of every household and business. Although federal revenues may be more difficult to predict than those of entities in the private sector, the basic principle is still the same. Then why is it so difficult for the federal government to accomplish a balanced budget? There are at least three reasons.

Existing programs.—First, there is the legacy of existing programs. Were the Congress to start from scratch, it presumably would have an easier time matching spending with revenues. Many existing spending programs and tax breaks would never be enacted if the Congress was considering them for the first time today. However, the constituencies benefiting from them are willing to work hard to keep them, irrespective of whether they accomplish any longer a public purpose to justify their cost. Faced with these pressures, the Congress has difficulty eliminating even the most marginal government programs. The Congress tends to consider spending cuts only in a crisis atmosphere and then almost invariably opts to make the minimum changes necessary to dissipate the crisis rather than to use the opportunity to conduct a thorough review of the way government spends tax revenues.

Lack of accountability.—Second, unlike almost every private sector entity, the federal government lacks any single institution with the responsibility and authority to balance the budget. The closest the government comes to this is the President, who is responsible for submitting an annual budget for the entire federal government to the Congress. However, the President's budget does not have the force of law. Instead, all spending and revenue decisions must be enacted by the Congress.

Within the Congress, decentralization is pervasive. Although the House and Senate Budget Committees have the nominal task of developing an annual budget, they lack the institutional power to compel action by other committees without the support of the party leadership. Jurisdiction over revenue and, especially, spending decisions is spread among dozens of subcommittees, each representing only a piece of the total. Decisions on new spending programs are seldom linked to decisions on the revenues needed to finance them. As a result, every legislator can press for changes in spending and tax policy, but none is charged with the responsibility of ensuring that these changes are in the public interest or that spending is matched with revenues. Finally, actual spending on mandatory programs is determined by actions the Congress took years ago, and not by current decisions. This separation of power from responsibility makes it almost impossible to enforce balanced budgets.

Although the changes enacted as part of OBRA 1990 provided some linkage between spending decisions and the need to pay for them, the fact remains that there is no committee in either house of the Congress with the undisputed power to match revenues to spending or to plan and enforce a long-term strategy for achieving a balanced budget. Because it is so decentralized, the Congress finds it very difficult to accomplish serious deficit reduction without strong leadership from the President.

Political pressure.—Perhaps most important, however, are the political and economic forces which continually push government spending up and leave revenues stable even after tax increases. Political scientists have argued that the imbalance in power between narrow special interests that stand to benefit a great deal from increased spending on their programs and the more generalized public interest in spending restraint continually pushes spending up. The same principle applies to the pressure to enact changes in tax law which benefit narrow interests. The imbalance in these pressures is already known. What is less well understood is the reason why the cost of ***existing*** government policies has exceeded expectations.

Table 3 shows the structural deficit as estimated by the Congressional Budget Office (CBO) immediately after the 1990 budget agreement and again last winter. These estimates show what the deficit was expected to be if the economy was stable and unemployment was at its normal levels. Over the past two years the estimated deficit for 1996 alone has increased by $175 billion. Of this amount, $131 billion is due to "technical" changes. These technical changes do not include reestimates caused by new legislation, changed economic conditions such as the recession, the cost of deposit insurance, or Desert Storm. Instead, they reflect changes which CBO could not have predicted even if it had correctly anticipated future economic conditions. Almost invariably, the technical reestimates increase the deficit (Chart 4). These reestimates reflect a combination of revenues being lower and outlays being higher than expected.

Table 3

CBO Estimates of Annual Standardized Employment Deficits
(Billions of Dollars)

	1991	1992	1993	1994	1995	1996
Estimate in January 1991	127	122	116	94	73	81
Estimate in January 1993	180	201	228	222	230	256
Increase	53	79	112	128	157	175
Technical Reestimates*						
Revenues	20	24	36	37	40	43
Outlays	-5	5	45	56	75	88
Total	15	29	81	93	115	131

* Does not include the cost of deposit insurance or Desert Storm.

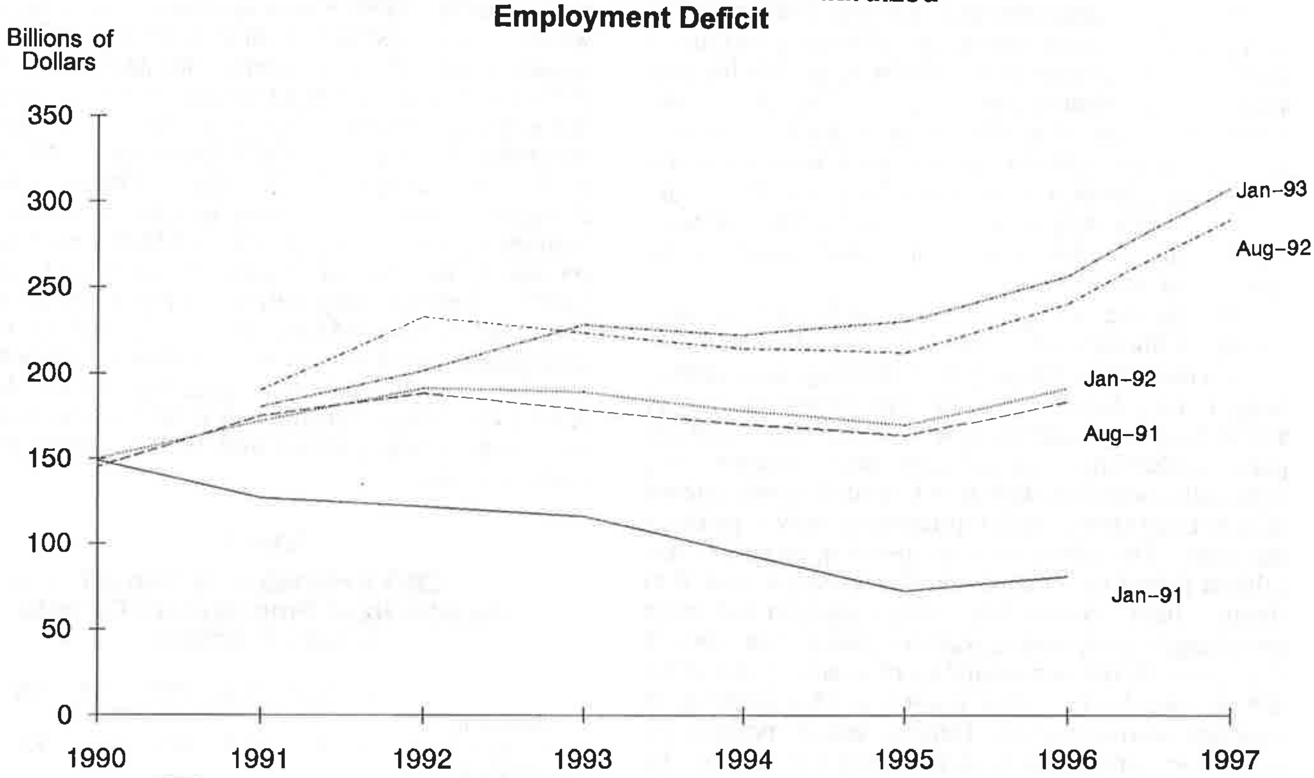
Source: Congressional Budget Office, *Annual Economic and Budget Outlooks* and *Midyear Updates*, various years.

Behavioral Changes

It is probable that, if nothing further is done with regard to government policy, the federal budget deficit will continue to grow over the next decade, not just in real terms, but also when measured against existing forecasts which already assume rapid growth. This is because the cost of existing mandatory spending programs is almost always higher than expected. Once a standard for qualifying for government payments is enacted, incentives exist for more and more people to change their behavior in order to become eligible for more and more benefits. Over time, this increases the number of people receiving benefits and, hence, the cost of the programs. Similarly, once a revenue provision is enacted into law, those affected have a strong incentive to change their behavior to reduce their tax exposure. While this may

Chart 4

CBO Estimates of the Annual Standardized Employment Deficit



Source: Congressional Budget Office, *Annual Economic and Budget Outlooks* and *Midyear Updates*, various years.

be difficult in the near term, over the medium term significant behavior modification can take place. As long as the government fails to recognize and deal with these behavioral forces driving deficit reduction, its attempts to make marginal changes every two to three years are unlikely to solve the problem.

Setting Priorities

Chart 3 shows that government spending has increased relative to GDP. A strong reason behind this growth is the government's inability to separate needs from wants and to assess reasonable priorities for both. It is perhaps an innate human characteristic that wants are infinite. Needs, however, are more limited. Households and businesses find it necessary to pay for their needs with existing resources and to impose priorities on their wants, affording some and postponing others, possibly indefinitely. The government, however, has lost this ability because the public consensus on what the government should do has broken down. There is something anomalous about the implicit claim by some politicians that, even when it is taking in 20 percent of the income of the richest nation on earth, the federal government still is unable to meet even the basic needs of its citizens with regard to poverty, malnutrition, homelessness, and drug abuse. This inability can be attributed only to structural failures in existing programs and to a failure to set priorities for government spending. Additional tax revenues may relieve these problems, but they will not solve them. OBRA addresses neither of them.

A government that can neither distinguish between priorities nor spend efficiently is unlikely to resist calls for more and better programs or to restrain the cost of those that already exist. Where markets reflect the worth of the goods they sell, every good that government can buy is worth its price. This does not mean that government can afford them all, however. The private sector's ability to change its behavior to take advantage of existing government programs and avoid taxes and the continuing pressure on government to expand are likely to erode the deficit reduction expected from the revenue increases contained in OBRA. Although continued economic recovery may cause the actual deficit to fall, the structural deficit is likely to continue rising above expectations, necessitating another round of deficit reduction in two or three years.

Recommended Strategy for Deficit Reduction

MAPI believes that any deficit reduction plan which fails to establish a firm link between spending and revenues and between both and the nation's ability to pay for them, is unlikely to succeed. In the current context, this requires a fundamental re-thinking of how the federal government spends its resources.

The Need To Reduce Spending

The focus of future budget deficit reduction efforts should be on cutting spending rather than on raising taxes. Several practical arguments support this proposal. As Chart 3 shows, over the past decade, total revenues have averaged 18.7 percent of GDP. In spite of repeated changes in tax laws, this ratio has been remarkably constant over the past three decades. Although the percentage varies from year to year, only once in the past 25 years has it exceeded 20 percent of income. Since any law that seeks to raise future revenues rapidly may reduce GDP growth, there are reasons to think that this ratio should be raised slowly and carefully, if at all. This is not an argument against revenue-neutral attempts to make the tax system fairer and more conducive to growth. For example, the composition of government revenues has changed due to an increased emphasis on payroll taxes (a less progressive form of taxation) and a fall in both individual and corporate income taxes. If additional revenues are required, the Congress should first direct its attention to reducing tax expenditures rather than increases in the marginal rates. These subsidies, given in the form of tax breaks rather than direct government outlays, often distort private markets rather than stimulate economic growth.

The present drive to focus budget deficit reduction efforts on revenues ignores the government's responsibility to spend these resources wisely. Discussion of the wisdom of raising taxes should not be divorced from an examination both of what those taxes would be spent on and what the government is already spending money on. Although the Congress usually ignores this fact in budget debates, every dollar given to the public sector in the form of taxes imposes a cost on the private sector. Higher government revenues mean that taxpayers in the private sector have less money to purchase homes, to send their children to college, to save for their retirement, and to invest in new businesses.

Linking spending to GDP growth.—A government which cannot distinguish between programs that serve important public needs and meet their purpose efficiently and those that do not is unlikely to spend additional taxes wisely. Instead, it is likely to find that even with additional revenue it faces the same problems. Unless the government intervenes in the economy only when the market system fails to produce an efficient outcome or to respond to a widely supported social goal, no amount of additional revenues is likely to satisfy all of the pressures to fund new programs. In the absence of such a rationale for the government's role in the economy, it makes more sense to limit spending to a fixed percentage of GDP than to let it continually grow in order to fund rising program costs which exceed any possible benefits.

Selecting the appropriate revenue as a share of GDP is, of course, difficult to determine. Limiting spending to a fixed percentage of GDP would, however, place a ceiling on government spending within which the Congress would face pressure to set priorities. This in itself would be a beneficial change. A fixed cap on spending would, however, leave open the possibility that the Congress would increasingly seek to expand its power through off-budget activities or through the increased use of unfunded mandates to state and local governments or the private sector.

Linking total government spending to a fixed percentage of GDP would give everyone, including those who see government programs primarily as a tool for redistribution of income, an incentive to enact policies which foster economic growth. It also would link the size of the government to the country's ability to pay for it. Finally, linking spending to the prior year's GDP would provide a fixed budget for legislators to spend while permitting some countercyclical policy to operate, since changes in spending would lag behind changes in GDP growth rates. Allowing the government to build up a surplus which could be spent during recessionary times would make room for even greater countercyclical policy. While linking government spending to the prior year's GDP would constrain countercyclical policy, it would not eliminate it, especially if the Congress ran surpluses in years of strong GDP growth. Monetary policy also could be used to moderate cyclical fluctuations. Although the percentage chosen is arbitrary, the historic stability of revenues and the fact that spending has risen rapidly argue for choosing a level that is close to the current ratio of revenues to GDP. A government that limited spending to, say, 19 percent of GDP could not afford to satisfy all of the pressures for federal spending. It should, however, be able to address the most important concerns. A budget which cuts spending to this level over five years would still allow for a nominal increase in spending over the next five years. It also would reduce the deficit to zero.[8]

Control spending growth.—Eventually, the Congress must match outlays to revenues. Even without the additional taxes contained in OBRA, holding spending in 1998 to the level of revenues currently expected in that year still would allow spending to increase slightly over the next five years. Some have argued that a five-year time frame is too short. Yet

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[8]Holding government expenditures to a fixed percentage of the prior year's GDP would require new budget procedures. While a discussion of these procedures is beyond the scope of this paper, a number of rules could be drafted to make the Congress respect the limits.

CBO found that most of the effects of such an effort could be offset by an expansionary monetary policy. Even if monetary policy is not accommodating, the net effect of a five-year plan would be to reduce annual GDP growth by 0.5 percent.[9] This still would allow for some positive growth. The benefits from deficit reduction would soon exceed its costs. CBO also estimated that balancing the budget would increase both national saving and personal consumption by 5 percent by the end of the century.[10]

There are reasons to doubt the viability of any effort to balance the budget that takes longer, especially if most of the spending cuts are delayed until later years. An eight-year plan would span at least four Congresses and two Administrations. No government can credibly commit the willingness of future lawmakers to abide by the plan. Moreover, since many benefits of deficit reduction depend on convincing private markets that lower deficits will actually occur, serious and credible deficit reduction in the near term is likely to boost public confidence sooner and with greater results than plans which promise action later.

Forcing the Congress to budget for programs.— Any plan to control spending must place caps on individual programs to ensure that the forces discussed above do not continue to expand them without limit. This would in effect transform all programs into discretionary accounts. Such a transformation need not seriously hamper the government's ability to run effective programs. Important programs such as Head Start and the Women, Infant, and Children programs already are subject to spending caps. It, however, would force the Congress to rewrite these programs to specify what happens when the spending cap is reached. In the past, the Congress has chosen to implement cuts by not making payments to all those eligible and/or reducing the payments to each eligible person by a pro rata amount. Similar policies could be used for existing entitlements.

Capping spending would restore congressional control over spending in each program and would link debate on its merits with a meaningful discussion of its cost. The Congress could always increase or decrease funding for specific programs. It could not, however, ignore program increases or fund programs with no regard for their cost.

Capping spending would not, however, ensure that the government spends its revenues wisely or directs their benefits to those who are in greatest need. Nor would it ensure that a determined Congress could not find ways around the new budget procedure by placing programs off budget or creating large contingent liabilities. Capping spending would, however, focus the debate more squarely on where it should be: on whether the benefit of these programs exceeds the cost they impose both on other programs that are truly important and on the rest of the economy which must pay for them.

Conclusion

OBRA is the Democratic party's answer to what it views as systematic mismanagement of the nation's finances over the past 12 years. The basic view driving the act is that the federal government needs to become more involved in addressing social problems and that the American public needs to start paying more for the services government delivers to them. Although Democrats have frequently lamented the lack of Republican support for the act, this support was never seriously sought nor expected. From the moment the President put forward his original budget proposal last February, the Democratic party committed itself to finding the majority needed to pass it within its own ranks. Especially in the House, the Democratic leadership frequently used its majority to minimize any Republican role in legislative policy and to reserve for closed party caucuses the substantive discussions on changes to the President's proposal.

OBRA's success or failure in meeting its goals of deficit reduction and economic stability will be attributable to the Democratic leadership which enacted it. By the 1994 elections the Congress is likely to have passed two major rounds of tax increases with almost no Republican support. The wisdom of this strategy will depend largely upon whether the American people believe that the cost of these additional taxes is worth the benefits they receive in the form of better health care and lower deficits.

This report has argued that OBRA is unlikely to accomplish significant deficit reduction over the next five years. It has explained some of the reasons why this is so and has suggested changes in budgeting procedure that would allow the Congress and the President to regain control over government spending. While it may be possible to design procedures which hold spending growth down, it is more difficult to force the Congress to spend the taxpayers' money wisely. To achieve better policy, citizens will ultimately have to use their electoral power to impose better fiscal discipline on their representatives and themselves.

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9 Congressional Budget Office, *Economic and Budget Outlook: Fiscal Years 1994-98*, p. 79.

10 *Ibid.*, pp. 74-75. For an argument that the deficit represents a more serious threat to the economy, see Harry E. Figgie Jr. and Gerald J. Swanson, *Bankruptcy 1995: The Coming Collapse of America and How To Stop It*, (Little, Brown and Company, 1992).